

COMMUNITY HEALTH SYSTEMS INC

Form 10-Q

August 01, 2011

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

**Form 10-Q
QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2011

Commission file number 001-15925

COMMUNITY HEALTH SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

Delaware

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

13-3893191

*(I.R.S. Employer
Identification Number)*

4000 Meridian Boulevard

Franklin, Tennessee

(Address of principal executive offices)

37067

(Zip Code)

(Registrant's telephone number)

615-465-7000

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 web site, 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. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting
company

(Do not check if a 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

As of July 22, 2011, there were outstanding 93,212,756 shares of the Registrant's Common Stock, \$0.01 par value.

Community Health Systems, Inc.
Form 10-Q
For the Three and Six Months Ended June 30, 2011

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Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements****COMMUNITY HEALTH SYSTEMS, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS***(In thousands, except share data)**(Unaudited)*

	June 30, 2011	December 31, 2010
ASSETS		
<i>Current assets</i>		
Cash and cash equivalents	\$ 191,432	\$ 299,169
Patient accounts receivable, net of allowance for doubtful accounts of \$1,793,404 and \$1,639,198 at June 30, 2011 and December 31, 2010, respectively	1,792,404	1,714,542
Supplies	342,268	329,114
Prepaid income taxes		118,464
Deferred income taxes	115,819	115,819
Prepaid expenses and taxes	117,458	100,754
Other current assets	175,109	193,331
Total current assets	2,734,490	2,871,193
<i>Property and equipment</i>		
Less accumulated depreciation and amortization	(2,291,842)	(2,058,685)
Property and equipment, net	6,506,424	6,324,437
<i>Goodwill</i>	4,227,970	4,150,247
<i>Other assets, net</i>	1,356,531	1,352,246
Total assets	\$ 14,825,415	\$ 14,698,123
LIABILITIES AND EQUITY		
<i>Current liabilities</i>		
Current maturities of long-term debt	\$ 70,112	\$ 63,139
Accounts payable	583,924	526,338
Current income tax payable	349	
Deferred income taxes	8,882	8,882
Accrued interest	145,146	146,415
Accrued liabilities	854,329	897,266
Total current liabilities	1,662,742	1,642,040
<i>Long-term debt</i>	8,781,443	8,808,382
<i>Deferred income taxes</i>	608,177	608,177

<i>Other long-term liabilities</i>	1,026,069	1,001,675
<i>Total liabilities</i>	12,078,431	12,060,274
<i>Redeemable noncontrolling interests in equity of consolidated subsidiaries</i>	376,658	387,472
<i>EQUITY</i>		
<i>Community Health Systems, Inc. stockholders' equity</i>		
Preferred stock, \$.01 par value per share, 100,000,000 shares authorized; none issued		
Common stock, \$.01 par value per share, 300,000,000 shares authorized; 93,210,424 shares issued and 92,234,875 shares outstanding at June 30, 2011, and 93,644,862 shares issued and 92,669,313 shares outstanding at December 31, 2010	932	936
Additional paid-in capital	1,119,205	1,126,751
Treasury stock, at cost, 975,549 shares at June 30, 2011 and December 31, 2010	(6,678)	(6,678)
Accumulated other comprehensive loss	(200,533)	(230,927)
Retained earnings	1,396,095	1,299,382
<i>Total Community Health Systems, Inc. stockholders' equity</i>	2,309,021	2,189,464
<i>Noncontrolling interests in equity of consolidated subsidiaries</i>	61,305	60,913
<i>Total equity</i>	2,370,326	2,250,377
<i>Total liabilities and equity</i>	\$ 14,825,415	\$ 14,698,123

See accompanying notes to the condensed consolidated financial statements.

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CONDENSED CONSOLIDATED STATEMENTS OF INCOME***(In thousands, except share and per share data)**(Unaudited)*

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2011	2010	2011	2010
<i>Net operating revenues</i>	\$ 3,433,829	\$ 3,080,646	\$ 6,787,881	\$ 6,149,258
<i>Operating costs and expenses:</i>				
Salaries and benefits	1,384,096	1,231,559	2,763,463	2,478,240
Provision for bad debts	433,002	367,002	832,971	733,503
Supplies	449,279	430,574	907,096	852,686
Other operating expenses	654,737	559,962	1,269,530	1,116,581
Rent	62,431	60,851	125,601	122,908
Depreciation and amortization	161,376	149,779	319,531	293,682
Total operating costs and expenses	3,144,921	2,799,727	6,218,192	5,597,600
<i>Income from operations</i>	288,908	280,919	569,689	551,658
<i>Interest expense, net</i>	163,230	160,759	326,448	320,182
<i>Equity in earnings of unconsolidated affiliates</i>	(12,017)	(10,980)	(30,151)	(23,570)
<i>Income from continuing operations before income taxes</i>	137,695	131,140	273,392	255,046
<i>Provision for income taxes</i>	44,821	42,761	88,913	82,310
<i>Income from continuing operations</i>	92,874	88,379	184,479	172,736
<i>Discontinued operations, net of taxes:</i>				
Income (loss) from operations of entities sold and held for sale	235	(2,037)	(1,443)	(1,398)
Impairment of hospitals held for sale	(39,562)		(47,930)	
Loss on sale			(3,234)	
<i>Loss from discontinued operations, net of taxes</i>	(39,327)	(2,037)	(52,607)	(1,398)
<i>Net income</i>	53,547	86,342	131,872	171,338
Less: Net income attributable to noncontrolling interests	18,158	16,277	35,159	31,266
Net income attributable to Community Health Systems, Inc.	\$ 35,389	\$ 70,065	\$ 96,713	\$ 140,072

Basic earnings (loss) per share attributable to Community Health Systems, Inc. common stockholders (1):

Continuing operations	\$ 0.82	\$ 0.77	\$ 1.64	\$ 1.53
Discontinued operations	(0.43)	(0.02)	(0.58)	(0.01)
Net income	\$ 0.39	\$ 0.75	\$ 1.06	\$ 1.51

Diluted earnings (loss) per share attributable to Community Health Systems, Inc. common stockholders (1):

Continuing operations	\$ 0.81	\$ 0.76	\$ 1.62	\$ 1.51
Discontinued operations	(0.43)	(0.02)	(0.57)	(0.01)
Net income	\$ 0.39	\$ 0.74	\$ 1.05	\$ 1.49

Weighted-average number of shares outstanding:

Basic	91,130,672	93,358,771	91,069,876	92,491,839
Diluted	91,783,725	94,711,919	91,960,610	93,779,001

(1) Total per share amounts may not add due to rounding.
See accompanying notes to the condensed consolidated financial statements.

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COMMUNITY HEALTH SYSTEMS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Six Months Ended	
	June 30,	
	2011	2010
<i>Cash flows from operating activities</i>		
Net income	\$ 131,872	\$ 171,338
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	324,367	301,060
Stock-based compensation expense	20,732	20,418
Loss on sale	3,234	
Impairment of hospitals held for sale	47,930	
Excess tax benefit relating to stock-based compensation	(4,659)	(10,104)
Other non-cash expenses, net	4,313	(2,342)
Changes in operating assets and liabilities, net of effects of acquisitions and divestitures:		
Patient accounts receivable	(83,082)	(63,896)
Supplies, prepaid expenses and other current assets	9,374	(1,147)
Accounts payable, accrued liabilities and income taxes	129,518	114,100
Other	1,086	12,365
Net cash provided by operating activities	584,685	541,792
<i>Cash flows from investing activities</i>		
Acquisitions of facilities and other related equipment	(204,264)	(2,413)
Purchases of property and equipment	(351,383)	(263,924)
Proceeds from disposition of ancillary operations	18,464	
Proceeds from sale of property and equipment	8,034	2,307
Increase in other non-operating assets	(75,211)	(64,258)
Net cash used in investing activities	(604,360)	(328,288)
<i>Cash flows from financing activities</i>		
Proceeds from exercise of stock options	18,831	53,615
Deferred financing costs	(234)	
Excess tax benefit relating to stock-based compensation	4,659	10,104
Stock buy-back	(50,002)	(12,242)
Proceeds from noncontrolling investors in joint ventures	863	5,155
Redemption of noncontrolling investments in joint ventures	(3,303)	(2,395)
Distributions to noncontrolling investors in joint ventures	(30,078)	(29,371)
Repayments of long-term indebtedness	(28,798)	(34,157)
Net cash used in financing activities	(88,062)	(9,291)

<i>Net change in cash and cash equivalents</i>	(107,737)	204,213
<i>Cash and cash equivalents at beginning of period</i>	299,169	344,541
<i>Cash and cash equivalents at end of period</i>	\$ 191,432	\$ 548,754
<i>Supplemental disclosure of cash flow information:</i>		
Interest payments	\$ 327,717	\$ 320,150
Income tax (refunds received) paid, net	\$ (25,697)	\$ 79,711

See accompanying notes to the condensed consolidated financial statements.

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COMMUNITY HEALTH SYSTEMS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. BASIS OF PRESENTATION

The unaudited condensed consolidated financial statements of Community Health Systems, Inc. and its subsidiaries (the Company) as of June 30, 2011 and December 31, 2010 and for the three-month and six-month periods ended June 30, 2011 and June 30, 2010, have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP). In the opinion of management, such information contains all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the results for such periods. All intercompany transactions and balances have been eliminated. The results of operations for the three and six months ended June 30, 2011, are not necessarily indicative of the results to be expected for the full fiscal year ending December 31, 2011. Certain information and disclosures normally included in the notes to consolidated financial statements have been condensed or omitted as permitted by the rules and regulations of the Securities and Exchange Commission (the SEC). The Company believes the disclosures are adequate to make the information presented not misleading. The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto for the year ended December 31, 2010, contained in the Company's Annual Report on Form 10-K.

Noncontrolling interests in less-than-wholly-owned consolidated subsidiaries of the parent are presented as a component of total equity on the condensed consolidated balance sheets to distinguish between the interests of the parent company and the interests of the noncontrolling owners. Noncontrolling interests that are redeemable or may become redeemable at a fixed or determinable price at the option of the holder or upon the occurrence of an event outside of the control of the Company are presented in mezzanine equity on the condensed consolidated balance sheets.

During the three months ended March 31, 2011, the Company sold a multi-specialty physician clinic and made the decision to sell a hospital. In June 2011, the Company entered into a definitive agreement to sell two of its hospitals in Oklahoma. As of June 30, 2011, the Company has three hospitals held for sale. The condensed consolidated statement of income for the three and six months ended June 30, 2010 has been restated to reclassify the results of operations for these entities to discontinued operations. The condensed consolidated balance sheet as of December 31, 2010 has been restated to present the long-lived assets of the disposal group as held for sale in other assets, net for comparative purposes with the June 30, 2011 presentation.

Throughout these notes to the condensed consolidated financial statements, Community Health Systems, Inc. (the Parent), and its consolidated subsidiaries are referred to on a collective basis as the Company. This drafting style is not meant to indicate that the publicly-traded Parent or any subsidiary of the Parent owns or operates any asset, business, or property. The hospitals, operations and businesses described in this filing are owned and operated, and management services provided, by distinct and indirect subsidiaries of Community Health Systems, Inc.

2. ACCOUNTING FOR STOCK-BASED COMPENSATION

Stock-based compensation awards are granted under the Community Health Systems, Inc. 2000 Stock Option and Award Plan, amended and restated as of March 24, 2009 (the 2000 Plan), and the Community Health Systems, Inc. 2009 Stock Option and Award Plan, amended and restated as of March 18, 2011 (the 2009 Plan).

The 2000 Plan allows for the grant of incentive stock options intended to qualify under Section 422 of the Internal Revenue Code (IRC), as well as stock options which do not so qualify, stock appreciation rights, restricted stock, restricted stock units, performance-based shares or units and other share awards. Prior to being amended in 2009, the 2000 Plan also allowed for the grant of phantom stock. Persons eligible to receive grants under the 2000 Plan include the Company's directors, officers, employees and consultants. To date, all options granted under the 2000 Plan have been nonqualified stock options for tax purposes. Generally, vesting of these granted options occurs in one-third increments on each of the first three anniversaries of the award date. Options granted prior to 2005 have a 10-year contractual term, options granted in 2005 through 2007 have an eight-year contractual term and options granted in 2008 or later have a 10-year contractual term. As of June 30, 2011, 127,250 shares of unissued common stock were reserved for future grants under the 2000 Plan.

Table of Contents**COMMUNITY HEALTH SYSTEMS, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

The 2009 Plan provides for the grant of incentive stock options intended to qualify under Section 422 of the IRC and for the grant of stock options which do not so qualify, stock appreciation rights, restricted stock, restricted stock units, performance-based shares or units and other share awards. Persons eligible to receive grants under the 2009 Plan include the Company's directors, officers, employees and consultants. Options granted in 2011 have a 10-year contractual term. As of June 30, 2011, 2,897,129 shares of unissued common stock were reserved for future grants under the 2009 Plan.

The exercise price of all options granted is equal to the fair value of the Company's common stock on the option grant date.

The following table reflects the impact of total compensation expense related to stock-based equity plans on the reported operating results for the respective periods (in thousands):

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2011	2010	2011	2010
Effect on income from continuing operations before income taxes	\$ (10,814)	\$ (10,655)	\$ (20,732)	\$ (20,418)
Effect on net income	\$ (6,867)	\$ (6,473)	\$ (13,165)	\$ (12,404)

At June 30, 2011, \$79.5 million of unrecognized stock-based compensation expense was expected to be recognized over a weighted-average period of 26 months. Of that amount, \$17.2 million related to outstanding unvested stock options was expected to be recognized over a weighted-average period of 26 months and \$62.3 million related to outstanding unvested restricted stock, restricted stock units and phantom shares was expected to be recognized over a weighted-average period of 26 months. There were no modifications to awards during the three and six months ended June 30, 2011.

The fair value of stock options was estimated using the Black Scholes option pricing model with the following assumptions and weighted-average fair values during the three and six months ended June 30, 2011 and 2010:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2011	2010	2011	2010
Expected volatility	38.1%	35.3%	31.5%	33.6%
Expected dividends				3.1
Expected term	4 years	3 years	4 years	years
Risk-free interest rate	1.35%	1.20%	1.73%	1.47%

In determining expected term, the Company examined concentrations of option holdings and historical patterns of option exercises and forfeitures, as well as forward-looking factors, in an effort to determine if there were any discernable employee populations. From this analysis, the Company identified two primary employee populations, one consisting of certain senior executives and the other consisting of substantially all other recipients.

The expected volatility rate was estimated based on historical volatility. In determining expected volatility, the Company also reviewed the market-based implied volatility of actively traded options of its common stock and determined that historical volatility utilized to estimate the expected volatility did not differ significantly from the implied volatility.

The expected term computation is based on historical exercise and cancellation patterns and forward-looking factors, where present, for each population identified. The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of the grant. The pre-vesting forfeiture rate is based on historical rates and forward-looking

factors for each population identified. The Company adjusts the estimated forfeiture rate to its actual experience.

Table of Contents**COMMUNITY HEALTH SYSTEMS, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

Options outstanding and exercisable under the 2000 Plan and the 2009 Plan as of June 30, 2011, and changes during each of the three-month periods following December 31, 2010, were as follows (in thousands, except share and per share data):

		Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value as of June 30, 2011
	Shares	Price	Term	
Outstanding at December 31, 2010	7,834,332	\$ 32.08	-	
Granted	1,329,000	37.96		
Exercised	(595,431)	30.44		
Forfeited and cancelled	(64,508)	34.84		
Outstanding at March 31, 2011	8,503,393	33.10		
Granted	45,000	28.12		
Exercised	(23,579)	29.98		
Forfeited and cancelled	(50,342)	32.70		
Outstanding at June 30, 2011	8,474,472	\$ 33.08	5.8 years	\$ 9,910
Exercisable at June 30, 2011	5,804,556	\$ 32.78	4.3 years	\$ 7,468

The weighted-average grant date fair value of stock options granted during the three months ended June 30, 2011 and 2010 was \$8.89 and \$10.07, respectively, and \$10.29 and \$8.54 during the six months ended June 30, 2011 and 2010, respectively. The aggregate intrinsic value (the number of in-the-money stock options multiplied by the difference between the Company's closing stock price on the last trading day of the reporting period (\$25.68) and the exercise price of the respective stock options) in the table above represents the amount that would have been received by the option holders had all option holders exercised their options on June 30, 2011. This amount changes based on the market value of the Company's common stock. The aggregate intrinsic value of options exercised during the three months ended June 30, 2011 and 2010 was \$0.2 million and \$18.6 million, respectively. The aggregate intrinsic value of options exercised during the six months ended June 30, 2011 and 2010 was \$6.1 million and \$28.2 million, respectively. The aggregate intrinsic value of options vested and expected to vest approximates that of the outstanding options.

The Company has also awarded restricted stock under the 2000 Plan and the 2009 Plan to its directors and employees of certain subsidiaries. The restrictions on these shares generally lapse in one-third increments on each of the first three anniversaries of the award date. Certain of the restricted stock awards granted to the Company's senior executives contain a performance objective that must be met in addition to any vesting requirements. If the performance objective is not attained, the awards will be forfeited in their entirety. Once the performance objective has been attained, restrictions will lapse in one-third increments on each of the first three anniversaries of the award date. Notwithstanding the above-mentioned performance objectives and vesting requirements, the restrictions will lapse earlier in the event of death, disability or termination of employment by the Company for any reason other than

for cause of the holder of the restricted stock, or change in control of the Company. Restricted stock awards subject to performance standards are not considered outstanding for purposes of determining earnings per share until the performance objectives have been satisfied.

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COMMUNITY HEALTH SYSTEMS, INC. AND SUBSIDIARIES

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

Restricted stock outstanding under the 2000 Plan and the 2009 Plan as of June 30, 2011, and changes during each of the three-month periods following December 31, 2010, were as follows: