

Edgar Filing: TRIAD HOSPITALS INC - Form 10-Q

TRIAD HOSPITALS INC
Form 10-Q
November 14, 2001

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

FORM 10-Q

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

For the quarterly period ended September 30, 2001

OR

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

For the transition period from _____ to _____

Commission file number 0-29816

Triad Hospitals, Inc.
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| Delaware | 75-2816101 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

| | |
|--|------------|
| 13455 Noel Road, Suite 2000 | |
| Dallas, Texas | 75240 |
| (Address of principal executive offices) | (Zip Code) |

(972) 789-2700
(Registrant's telephone number, including area code)

Not Applicable
(Former name, former address and former fiscal year,
if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports
required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of
1934 during the preceding 12 months, and (2) has been subject to such filing
requirements for the past 90 days.

YES X

NO

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

As of October 31, 2001, the number of shares of common stock of Triad Hospitals, Inc. outstanding was 72,044,520.

Part I: Financial Information
Item 1: Financial Statements

TRIAD HOSPITALS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
For the periods ended September 30, 2001 and 2000
Unaudited
(Dollars in millions, except per share amounts)

| | For the three months ended | | For the nine months ended | |
|---|-------------------------------|---------|------------------------------|---------|
| | 2001 | 2000 | 2001 | 2000 |
| | ----- | ----- | ----- | ----- |
| Revenues..... | \$829.5 | \$301.3 | \$1,838.5 | \$915.4 |
| Salaries and benefits..... | 369.4 | 125.4 | 802.0 | 376.2 |
| Supplies..... | 127.3 | 44.7 | 285.3 | 136.9 |
| Other operating expenses..... | 155.1 | 63.4 | 348.2 | 192.7 |
| Provision for doubtful accounts..... | 66.3 | 28.4 | 171.7 | 78.1 |
| Depreciation..... | 44.8 | 19.2 | 102.6 | 57.0 |
| Amortization..... | 10.5 | 1.7 | 19.8 | 5.1 |
| Interest expense..... | 39.9 | 16.0 | 89.8 | 47.4 |
| Interest income..... | (0.4) | (1.6) | (1.1) | (4.5) |
| ESOP expense..... | 2.5 | 2.0 | 6.9 | 4.7 |
| Gain on sale of assets..... | (0.7) | (0.2) | (1.1) | (4.6) |
| Impairment of long-lived assets..... | -- | -- | -- | 0.9 |
| | ----- | ----- | ----- | ----- |
| Total operating expenses..... | 814.7 | 299.0 | 1,824.1 | 889.9 |
| | ----- | ----- | ----- | ----- |
| Income from continuing operations before minority interests, equity in earnings and income tax provision..... | 14.8 | 2.3 | 14.4 | 25.5 |
| Minority interests in earnings of consolidated entities..... | (2.5) | (1.9) | (6.5) | (6.3) |
| Equity in earnings (loss) of affiliates..... | 4.7 | (0.2) | 8.1 | (0.6) |
| | ----- | ----- | ----- | ----- |
| Income from continuing operations before income tax provision..... | 17.0 | 0.2 | 16.0 | 18.6 |
| Income tax provision..... | (10.5) | (1.2) | (20.6) | (10.5) |
| | ----- | ----- | ----- | ----- |
| Income (loss) from continuing operations..... | 6.5 | (1.0) | (4.6) | 8.1 |
| Extraordinary loss on retirement of debt, net of | | | | |

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| | | | | |
|---|---------|-----------|-----------|---------|
| income tax benefit of \$1.5 million..... | -- | -- | (2.4) | -- |
| | ----- | ----- | ----- | ----- |
| Net income (loss)..... | \$ 6.5 | \$ (1.0) | \$ (7.0) | \$ 8.1 |
| | ===== | ===== | ===== | ===== |
| Income (loss) per common share: | | | | |
| Basic | | | | |
| Continuing operations..... | \$ 0.09 | \$ (0.03) | \$ (0.09) | \$ 0.26 |
| Extraordinary loss on retirement of debt..... | \$ -- | \$ -- | \$ (0.04) | \$ -- |
| | ----- | ----- | ----- | ----- |
| Net..... | \$ 0.09 | \$ (0.03) | \$ (0.13) | \$ 0.26 |
| | ===== | ===== | ===== | ===== |
| Diluted | | | | |
| Continuing operations..... | \$ 0.09 | \$ (0.03) | \$ (0.09) | \$ 0.24 |
| Extraordinary loss on retirement of debt..... | \$ -- | \$ -- | \$ (0.04) | \$ -- |
| | ----- | ----- | ----- | ----- |
| Net..... | \$ 0.09 | \$ (0.03) | \$ (0.13) | \$ 0.24 |
| | ===== | ===== | ===== | ===== |

See notes to the condensed consolidated financial statements.

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TRIAD HOSPITALS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
Unaudited
(Dollars in millions)

ASSETS

Current assets:

| | |
|--|--|
| Cash and cash equivalents..... | |
| Restricted cash..... | |
| Accounts receivable, less allowances for doubtful accounts of \$213.9 at September 30, 2001 and \$122.9 at December 31, 2000..... | |
| Inventories..... | |
| Deferred income taxes..... | |
| Prepaid expenses..... | |
| Other..... | |

Property and equipment, at cost:

| | |
|---------------------------------|--|
| Land..... | |
| Buildings and improvements..... | |
| Equipment..... | |
| Construction in progress..... | |

Accumulated depreciation

| | |
|--|--|
| Intangible assets, net of accumulated amortization of \$76.9 million at September 30, 2001 and \$61.1 million at December 31, 2000..... | |
| Investment in and advances to affiliates | |
| Other..... | |

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Total assets.....

LIABILITIES AND EQUITY

Current liabilities:

Accounts payable.....
 Accrued salaries
 Current portion of long-term debt.....
 Other current liabilities

Long-term debt

Other liabilities.....

Deferred taxes

Minority interests in equity of consolidated entities

Stockholders' equity:

Common stock .01 par value: 120,000,000 shares authorized, 71,973,303 and
 34,783,816 shares issued and outstanding at September 30, 2001 and December 31,
 2000, respectively.....
 Additional paid-in capital.....
 Unearned ESOP compensation and stockholder notes receivable.....
 Accumulated deficit.....

Total stockholders' equity.....

Total liabilities and stockholders' equity.....

See notes to the condensed consolidated financial statements.

TRIAD HOSPITALS, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
 For the periods ended September 30, 2001 and 2000
 Unaudited
 (Dollars in millions)

| | |
|--|------|
| Cash flows from operating activities | |
| Net income (loss)..... | \$ (|
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | |
| Provision for doubtful accounts..... | 17 |
| Depreciation and amortization..... | 12 |
| ESOP expense..... | |
| Minority interests..... | |
| Equity in (earnings) loss of affiliates..... | (|
| Debt issue cost amortization..... | |
| Non-cash stock option expense..... | |
| Deferred income taxes..... | 2 |
| Gain on sale of assets..... | (|
| Impairment of long-lived assets..... | |

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| | |
|---|--------|
| Extraordinary loss, net of tax benefit..... | |
| Increase (decrease) in cash from operating assets and liabilities | |
| Accounts receivable..... | (13) |
| Inventories and other assets..... | |
| Accounts payable and other current liabilities..... | 4 |
| Other..... | |
| | ----- |
| Net cash provided by operating activities..... | 24 |
| Cash flows from investing activities | |
| Purchases of property and equipment..... | (11) |
| Payments for acquisitions, net of cash acquired..... | (1,37) |
| Proceeds received on sale of assets..... | 7 |
| Investment in and advances to affiliates..... | |
| Investment in restricted cash..... | (|
| Other..... | |
| | ----- |
| Net cash used in investing activities..... | (1,41 |
| Cash flows from financing activities | |
| Payments of long-term debt..... | (47 |
| Proceeds from long-term debt..... | 1,69 |
| Payment of debt issue cost..... | (4 |
| Proceeds from issuance of common stock..... | 2 |
| Distributions to minority partners..... | (|
| | ----- |
| Net cash provided by (used in) financing activities..... | 1,18 |
| | ----- |
| Change in cash and cash equivalents..... | 1 |
| Cash and cash equivalents at beginning of period..... | |
| | ----- |
| Cash and cash equivalents at end of period..... | \$ 2 |
| | ===== |
| Interest payments..... | \$ 5 |
| Income tax payments..... | \$ |

See notes to the condensed consolidated financial statements.

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TRIAD HOSPITALS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Unaudited

NOTE 1--BASIS OF PRESENTATION

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

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thereto for the year ended December 31, 2000 included in Triad's Form 10-K.

The balance sheet at December 31, 2000 has been derived from the audited financial statements at that date but does not include all of the information and notes required by generally accepted accounting principles for complete financial statements.

NOTE 2--ACQUISITIONS

On April 27, 2001, Triad completed the previously announced merger of Quorum Health Group, Inc. ("Quorum") with and into Triad with Triad being the surviving corporation. Triad is the acquiror for accounting purposes based on several considerations, including, in particular, that the former Quorum shareholders are not able to replace a majority of Triad's board of directors until at least the 2003 annual meeting of shareholders. Under the terms of the merger agreement, Quorum shareholders received \$3.50 in cash and 0.4107 shares of Triad common stock for each outstanding share of Quorum stock, plus cash in lieu of fractional shares of Triad common stock. In addition, each outstanding option to purchase shares of Quorum common stock, whether or not vested or exercisable, was converted at the holder's election into either a fully vested and exercisable option to purchase shares of Triad common stock or cash and shares of Triad common stock. Triad issued 35,786,380 shares, paid \$305.0 million in cash and issued 1,638,479 options to Quorum option holders in connection with the merger. The preliminary purchase price for the merger was determined using the average stock price at the time the merger was announced, cash paid, fair value of options converted and direct costs associated with the merger. The preliminary purchase price calculation is summarized below (in millions, except for share amounts):

| | |
|--|-----|
| Shares issued..... | 3 |
| Average stock price..... | \$ |
| | --- |
| | \$ |
| | --- |
| Cash paid to Quorum shareholders..... | |
| Fair value of converted options..... | |
| Quorum indebtedness paid at closing..... | |
| Direct merger costs and other..... | |
| Quorum government investigation settlement paid..... | |
| | --- |
| | \$ |
| | == |

The merger was accounted for under the purchase method of accounting and the results of operations for Quorum are included in Triad's results of operations beginning May 1, 2001. The purchase price will be allocated to assets acquired and liabilities assumed based on estimated fair values. Triad is in the process of obtaining independent appraisals of acquired property and equipment and identifiable intangible assets and their remaining useful lives. Triad is also reviewing and determining the fair value of other assets and liabilities assumed. Therefore, the allocation of the purchase price is subject to revision based on the final determination of the appraisals and other fair value determinations. The preliminary estimated fair values of the assets acquired and liabilities assumed relating to the acquisition are summarized below (in millions):

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Unaudited

NOTE 2--ACQUISITIONS (continued)

| | |
|--|--|
| Working capital..... | |
| Property and equipment..... | |
| Other assets..... | |
| Net investment in held for sale assets..... | |
| Long-term debt..... | |
| Other non-current liabilities..... | |
| Minority interests..... | |
| Preliminary purchase price in excess of net assets acquired..... | |

The preliminary purchase price in excess of net assets acquired (included in "Intangible assets" on the Condensed Consolidated Balance Sheets) is being amortized on a straight-line basis over 30 years. Amortization of the preliminary purchase price in excess of net assets acquired was \$13.0 million in the nine months ended September 30, 2001.

On May 2, 2001, Triad sold two acute care hospitals in Minot, North Dakota acquired in the merger with Quorum for \$38.0 million plus \$8.2 million for working capital. Additionally, two hospitals acquired in the merger with Quorum were designated as held for sale prior to the completion of the merger. The preliminary purchase price allocated to these assets is equal to the estimated sales prices of the hospitals plus the anticipated cash flows for the estimated holding period and the estimated interest expense on the incremental debt incurred for the purchase of the hospitals. On August 7, 2001, Triad sold to an affiliate of one member of Triad's board of directors its hospital in Baton Rouge, Louisiana for \$19.0 million plus assumption of liabilities of \$2.3 million. The results of operations of this entity are not included in Triad's results of operations. The pre-tax loss from continuing operations for this hospital and the associated interest expense excluded was \$0.4 million and \$0.5 million, respectively, during the nine months ended September 30, 2001. Triad has decided not to sell the remaining hospital that was originally designated as held for sale. The assets of this hospital have been reallocated as if the hospital had never been designated as held for sale. The cumulative effect of this hospital's results of operations from May 1, 2001 through June 30, 2001 are included in Triad's results of operations in the three months ended September 30, 2001. The cumulative effect was not significant to pre-tax income from continuing operations.

Subsequent to the merger, Triad recorded charges of approximately \$31.8 million associated with coordinating Quorum's accounting policies, practices and estimation processes with those of Triad. These charges included an \$8.3 million pre-tax reduction to revenue, \$18.5 million pre-tax increase in provision for doubtful accounts and \$5.0 million additional income tax provision.

In connection with the merger, Triad's board of directors was increased by the addition of two former members of Quorum's board.

On February 5, 2001, Triad acquired the remaining 50% interest in the entity that owns SouthCrest Hospital in Tulsa, Oklahoma from its not-for-profit partner, Hillcrest Healthcare System ("Hillcrest"), for \$44.6 million, the

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amount of Hillcrest's investment in the entity. The acquisition consolidated 100% ownership and control of the hospital in Triad effective January 1, 2001. Triad has an option to acquire an adjacent 26-acre parcel of land from Hillcrest for future expansion. SouthCrest Hospital will continue to participate in Hillcrest's joint contracting network that includes other Hillcrest hospitals in Tulsa. Under certain conditions and for a limited time, Hillcrest will have an option to repurchase a 49% interest in SouthCrest Hospital at the then fair market value, subject to minimum valuations and minimum returns on investment to Triad; if Hillcrest were to exercise the option, Triad would retain governance of the facility and continue consolidating the facility for financial reporting.

The acquisition of SouthCrest Hospital was recorded under the purchase method of accounting and, therefore, the purchase price has been allocated to assets acquired and liabilities assumed based on estimated fair values. The results of operations have been included in Triad's consolidated results of operations since January 1, 2001. The estimated fair values of the assets acquired and liabilities assumed relating to the acquisition are summarized below (in millions):

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TRIAD HOSPITALS, INC.
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
 Unaudited

NOTE 2--ACQUISITIONS (continued)

| | |
|-----------------------------|--------|
| Working capital..... | \$ 5.5 |
| Property and equipment..... | 86.4 |
| Minority interests..... | (0.9) |
| | ----- |
| Purchase price allocation.. | \$91.0 |
| | ===== |

The purchase price consists of the \$44.6 million in cash paid plus \$46.4 million equity investment Triad had recorded prior to the acquisition.

The following unaudited pro forma data summarizes the results of operations of the periods indicated as if the acquisitions discussed previously had been completed as of the beginning of the periods presented. The pro forma results of operations gives effect to actual operating results prior to the acquisitions, adjusted to include the pro forma effect of the acquisitions. The pro forma results do not purport to be indicative of the results that would have actually been obtained if the acquisitions occurred as of the beginning of the periods presented or that may be obtained in the future.

| | For the ended S |
|---------------------|------------------------|
| | ----- 2001 ----- |
| Revenues..... | \$2,470.1 |
| Net loss..... | \$ (15.9) |
| Net loss per share: | |
| Basic..... | \$ (0.23) |

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Diluted.....

\$ (0.23)

NOTE 3--SALES AND CLOSURES

On November 1, 2001, Triad sold its acute care hospital in Phoenix, Arizona for \$55.3 million, including working capital. As of September 30, 2001, the book value of this facility was \$33.2 million. This facility had revenues of \$16.9 million and \$15.9 million for the three months ended September 30, 2001 and 2000, respectively, and \$52.9 million and \$48.3 million for the nine months ended September 30, 2001 and 2000, respectively. This facility had pre-tax income (losses) before income tax benefit of \$0.0 million and \$(1.0) million for the three months ended September 30, 2001 and 2000, respectively, and \$1.0 million and \$(1.0) million for the nine months ended September 30, 2001 and 2000, respectively.

Triad closed its acute care hospital in San Diego, California on November 30, 2000. On June 29, 2001, Triad sold the remaining assets of this facility for a net sales price of \$6.6 million and recognized a minimal gain on the sale.

As discussed in NOTE 2, Triad sold two acute care hospitals in Minot, North Dakota and one acute care hospital in Baton Rouge, Louisiana.

On February 11, 2000, Triad closed its acute care hospital in Roseburg, Oregon, which was designated as held for sale. As of September 30, 2001, the carrying value of this facility was \$5.2 million. For the three and nine months ended September 30, 2000, this facility had revenues of \$0.3 million, and \$2.2 million, respectively, and pre-tax losses before impairment charges and income tax benefit of \$0.2 million, and \$4.0 million, respectively.

On March 31, 2000, Triad sold its limited partnership interest in a rehabilitation hospital located in Tucson, Arizona for \$4.0 million. A gain of \$4.2 million was recognized on the sale.

NOTE 4 - IMPAIRMENT OF LONG-LIVED ASSETS

During the quarter ended March 31, 2000, Triad entered into negotiations, which were subsequently completed, to cancel one of its physician management contracts. Accordingly, the carrying value of the long-lived assets related to this entity of approximately \$1.0 million was reduced to fair value, based on estimated disposal value, resulting in a non-cash charge of \$0.9 million. For the three and nine months ended September 30, 2000, this

TRIAD HOSPITALS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Unaudited

NOTE 4 - IMPAIRMENT OF LONG-LIVED ASSETS (continued)

entity contributed revenues of \$1.0 million and \$2.7 million, respectively, and losses before impairment charges and income taxes of \$0.7 million and \$2.3 million, respectively.

NOTE 5--LONG-TERM DEBT

As part of the merger with Quorum (See NOTE 2), Triad refinanced its Tranche A term loan, Tranche B term loan, Delay Draw term loan, and Quorum's indebtedness with new indebtedness totaling \$1.8 billion. This indebtedness

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consisted of a Tranche A term loan of \$250 million presently bearing interest at LIBOR plus 3.0% (6.53% at September 30, 2001) with principal amounts due beginning 2001 through 2007, a Tranche B term loan of \$550 million presently bearing interest at LIBOR plus 3.0% (6.53% at September 30, 2001) with principal amounts due beginning 2001 through 2008, an Asset Sale term loan of \$150 million presently bearing interest at LIBOR plus 3.0% (6.53% at September 30, 2001) with principal amounts due in 2003 and \$600 million of senior notes bearing interest at 8.75% with principal amounts due in 2009. Triad also obtained a \$250 million revolving credit line, of which \$10 million was outstanding at September 30, 2001, that presently bears interest at LIBOR plus 3.0% (5.67% at September 30, 2001). The revolving credit line reduces to \$225 million in 2004, \$200 million in 2005 and matures in 2007. As of September 30, 2001, Triad had \$2.5 million in letters of credit outstanding which reduce the amount available under the revolving credit line.

Triad repaid \$71.0 million on the Asset Sale term loan from the proceeds received on the facility sales described in NOTE 2 and NOTE 3. On November 1, 2001, Triad repaid an additional \$56.3 million on the Asset Sale term loan primarily from proceeds received on the sale of the acute care hospital in Phoenix, Arizona described in NOTE 3.

Triad's term loans and revolving lines of credit are collateralized by a pledge of substantially all of its assets other than real estate associated with the Quorum facilities. The debt agreements require that Triad comply with various financial ratios and tests and have restrictions including, but not limited to, new indebtedness, asset sales and use of proceeds therefrom, capital expenditures and dividends.

In connection with the debt financing, Triad incurred \$47.4 million in debt issue costs, which will be amortized over the period the indebtedness is outstanding.

As a result of the debt refinancing, an extraordinary loss of \$2.4 million was incurred during the second quarter of 2001 from the write-off of \$3.9 million of associated debt issue costs, net of a tax benefit of \$1.5 million.

Triad's senior subordinated notes and senior notes are guaranteed by all wholly owned operating subsidiaries of Triad (the "Subsidiary Guarantors"). Triad Hospitals Holdings, Inc. was the primary obligor on the senior subordinated notes until the merger with Quorum. As part of the merger (see NOTE 2) and related financing transactions, Triad Hospitals Holdings, Inc. was merged into Triad and all of its existing debt was assumed by Triad. The guarantee obligations of the Subsidiary Guarantors are full, unconditional and joint and several. Triad's non-wholly owned operating subsidiaries do not guarantee the notes (the "Non-Guarantor Subsidiaries").

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

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TRIAD HOSPITALS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Unaudited

NOTE 5--LONG-TERM DEBT (continued)

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Condensed Consolidating Statements of Operations
 For the three months ended September 30, 2001
 Unaudited
 (dollars in millions)

| | Triad Hospitals, Inc. | Guarantor Subsidiaries | No Guar Subsid |
|--|--------------------------|---------------------------|----------------------|
| | ----- | ----- | ----- |
| Revenues..... | \$ -- | \$686.5 | \$ |
| Salaries and benefits..... | -- | 298.2 | |
| Supplies..... | -- | 107.0 | |
| Other operating expenses..... | -- | 128.4 | |
| Provision for doubtful accounts..... | -- | 56.2 | |
| Depreciation..... | -- | 38.2 | |
| Amortization..... | -- | 8.8 | |
| Interest expense allocated..... | -- | -- | |
| Interest expense, net..... | 36.3 | 3.2 | |
| ESOP expense..... | 2.5 | -- | |
| Management fees..... | -- | -- | |
| Gain on sale of assets..... | -- | (0.7) | |
| | ----- | ----- | |
| Total operating expenses..... | 38.8 | 639.3 | |
| | ----- | ----- | |
| Income (loss) from continuing operations before minority interest, equity in earnings and income tax provision... | (38.8) | 47.2 | |
| Minority interests..... | -- | (3.6) | |
| Equity in earnings of affiliates..... | 55.8 | 12.2 | |
| | ----- | ----- | |
| Income from continuing operations before income tax provision..... | 17.0 | 55.8 | |
| Income tax provision..... | (10.5) | -- | |
| | ----- | ----- | |
| Net income..... | \$ 6.5 | \$ 55.8 | \$ |
| | ===== | ===== | = |

TRIAD HOSPITALS, INC.
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
 Unaudited

NOTE 5--LONG-TERM DEBT (continued)

Condensed Consolidating Statements of Operations
 For the three months ended September 30, 2000
 Unaudited
 (dollars in millions)

Triad Guarantor Gu

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| | Hospitals, Inc. | Subsidiaries | Subs |
|--|-----------------|--------------|-------|
| | ----- | ----- | ----- |
| Revenues..... | \$ -- | \$286.8 | \$ |
| Salaries and benefits..... | 0.3 | 121.3 | |
| Supplies..... | -- | 41.1 | |
| Other operating expenses..... | -- | 61.5 | |
| Provision for doubtful accounts..... | -- | 28.1 | |
| Depreciation..... | -- | 18.4 | |
| Amortization..... | -- | 1.6 | |
| Interest expense allocated..... | -- | -- | |
| Interest expense, net..... | 15.7 | (1.3) | |
| ESOP expense..... | 2.0 | -- | |
| Management fees..... | -- | -- | |
| Gain on sale of assets..... | -- | (0.2) | |
| Impairment of long-lived assets..... | -- | -- | |
| | ----- | ----- | |
| Total operating expenses..... | 18.0 | 270.5 | |
| | ----- | ----- | |
| Income (loss) from continuing operations before minority interest, equity in earnings and income tax provision..... | (18.0) | 16.3 | |
| Minority interests..... | -- | (1.9) | |
| Equity in earnings (loss) of affiliates..... | 18.2 | 3.8 | |
| | ----- | ----- | |
| Income from continuing operations before income tax provision..... | 0.2 | 18.2 | |
| Income tax provision..... | (1.2) | -- | |
| | ----- | ----- | |
| Net income (loss)..... | \$ (1.0) | \$ 18.2 | \$ |
| | ===== | ===== | |

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TRIAD HOSPITALS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Unaudited

NOTE 5--LONG-TERM DEBT (continued)

Condensed Consolidating Statements of Operations
For the nine months ended September 30, 2001
Unaudited
(dollars in millions)

| | Triad Hospitals, Inc. | Guarantor Subsidiaries | Guar Subsi |
|----------------------------|--------------------------|---------------------------|---------------|
| | ----- | ----- | ----- |
| Revenues..... | \$ -- | \$1,593.3 | \$2 |
| Salaries and benefits..... | 5.6 | 678.8 | 1 |

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| | | | |
|---|----------|----------|-------|
| Supplies..... | -- | 247.9 | |
| Other operating expenses..... | -- | 303.2 | |
| Provision for doubtful accounts..... | -- | 155.6 | |
| Depreciation..... | -- | 91.2 | |
| Amortization..... | -- | 17.6 | |
| Interest expense allocated..... | -- | -- | |
| Interest expense, net..... | 88.2 | 0.5 | |
| ESOP expense..... | 6.9 | -- | |
| Management fees..... | -- | -- | |
| Gain on sale of assets..... | -- | (1.1) | |
| | ----- | ----- | ----- |
| Total operating expenses..... | 100.7 | 1,493.7 | 2 |
| | ----- | ----- | ----- |
| Income (loss) from continuing operations before minority interest, equity in earnings and income tax provision..... | (100.7) | 99.6 | |
| Minority interests..... | -- | (8.3) | |
| Equity in earnings of affiliates..... | 116.7 | 25.4 | |
| | ----- | ----- | ----- |
| Income from continuing operations before income tax provision..... | 16.0 | 116.7 | |
| Income tax provision..... | (20.6) | -- | |
| | ----- | ----- | ----- |
| Income (loss) from continuing operations..... | (4.6) | 116.7 | |
| Extraordinary loss on retirement of debt, net of tax... | (2.4) | -- | |
| | ----- | ----- | ----- |
| Net income (loss)..... | \$ (7.0) | \$ 116.7 | \$ |
| | ===== | ===== | ===== |

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TRIAD HOSPITALS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Unaudited

NOTE 5--LONG-TERM DEBT (continued)

Condensed Consolidating Statements of Operations
For the nine months ended September 30, 2000
Unaudited
(dollars in millions)

| | Triad Hospitals, Inc. | Guarantor Subsidiaries | No Guar Subsid |
|--------------------------------------|--------------------------|---------------------------|----------------------|
| | ----- | ----- | ----- |
| Revenues..... | \$ -- | \$871.9 | \$ |
| Salaries and benefits..... | 0.6 | 364.6 | |
| Supplies..... | -- | 126.6 | |
| Other operating expenses..... | -- | 186.4 | |
| Provision for doubtful accounts..... | -- | 77.2 | |

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| | | |
|---|--------|---------|
| Depreciation..... | -- | 54.9 |
| Amortization..... | -- | 4.7 |
| Interest expense allocated..... | -- | 0.1 |
| Interest expense, net..... | 46.6 | (3.7) |
| ESOP expense..... | 4.7 | -- |
| Management fees..... | -- | -- |
| Gain on sale of assets..... | -- | (4.6) |
| Impairment of long-lived assets..... | -- | 0.9 |
| | ----- | ----- |
| Total operating expenses..... | 51.9 | 807.1 |
| | ----- | ----- |
| Income (loss) from continuing operations before minority interest, equity in earnings and income tax provision..... | (51.9) | 64.8 |
| Minority interests..... | -- | (6.2) |
| Equity in earnings (loss) of affiliates..... | 70.5 | 11.9 |
| | ----- | ----- |
| Income from continuing operations before income tax provision..... | 18.6 | 70.5 |
| Income tax provision..... | (10.5) | -- |
| | ----- | ----- |
| Net income..... | \$ 8.1 | \$ 70.5 |
| | ===== | ===== |

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TRIAD HOSPITALS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Unaudited

NOTE 5 - LONG-TERM DEBT (continued)

Condensed Consolidating Balance Sheets
September 30, 2001
Unaudited
(dollars in millions)

| | Triad Hospitals, Inc. | Guarantor Subsidiaries | Non- Guarantor Subsidiari |
|--|--------------------------|---------------------------|---------------------------------|
| | ----- | ----- | ----- |
| Assets | | | |
| Current assets | | | |
| Cash and cash equivalents..... | \$ -- | \$ 21.0 | \$ -- |
| Restricted cash..... | 5.7 | -- | -- |
| Accounts receivable, net..... | -- | 380.6 | -- |
| Other current assets..... | 36.7 | 195.1 | -- |
| | ----- | ----- | ----- |
| Total current assets..... | 42.4 | 596.7 | 1 |
| Net property and equipment, at cost..... | -- | 1,545.8 | 2 |

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| | | | |
|---|-----------|-----------|-----|
| Due from affiliates..... | 455.6 | -- | |
| Intangible assets..... | -- | 1,221.9 | |
| Investments in subsidiaries..... | 3,092.3 | 482.0 | |
| Other assets..... | 44.8 | 42.7 | |
| | ----- | ----- | |
| | | | |
| Total assets..... | \$3,635.1 | \$3,889.1 | \$4 |
| | ===== | ===== | == |
| Liabilities and Equity | | | |
| Current liabilities..... | \$ 56.8 | \$ 275.0 | \$ |
| Due to affiliates..... | -- | 395.8 | |
| Long-term debt..... | 1,790.6 | 5.4 | |
| Deferred taxes and other liabilities..... | 84.6 | 59.6 | |
| Minority interests in equity of consolidated entities..... | -- | 61.0 | |
| Equity..... | 1,703.1 | 3,092.3 | 2 |
| | ----- | ----- | -- |
| Total liabilities and equity..... | \$3,635.1 | \$3,889.1 | \$4 |
| | ===== | ===== | == |

Condensed Consolidating Balance Sheets
December 31, 2000
Unaudited
(dollars in millions)

| | Triad Hospitals, Inc. | Guarantor Subsidiaries | Non Guara Subsid |
|---|--------------------------|---------------------------|------------------------|
| | ----- | ----- | ----- |
| Assets | | | |
| Current assets | | | |
| Cash and cash equivalents..... | \$ -- | \$ 6.4 | |
| Accounts receivable, net..... | -- | 162.5 | |
| Other current assets..... | 41.9 | 106.9 | |
| | ----- | ----- | |
| Total current assets..... | 41.9 | 275.8 | |
| Net property and equipment, at cost..... | -- | 738.3 | |
| Investments in subsidiaries..... | 1,326.7 | 136.2 | |
| Due from affiliates..... | -- | 137.1 | |
| Intangible assets..... | -- | 215.6 | |
| Other assets..... | 4.7 | 7.4 | |
| | ----- | ----- | |
| Total assets..... | \$1,373.3 | \$1,510.4 | |
| | ===== | ===== | |
| Liabilities and Equity | | | |
| Current liabilities..... | \$ 13.4 | \$ 121.3 | |
| Due to affiliates..... | 160.3 | -- | |
| Long-term debt..... | 576.7 | 5.0 | |
| Deferred taxes and other liabilities..... | 49.2 | 7.4 | |
| Minority interests in equity of consolidated entities..... | -- | 50.0 | |
| Equity..... | 573.7 | 1,326.7 | |
| | ----- | ----- | |

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| | | |
|-----------------------------------|--------------------|--------------------|
| Total liabilities and equity..... | \$1,373.3 ===== | \$1,510.4 ===== |
|-----------------------------------|--------------------|--------------------|

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TRIAD HOSPITALS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Unaudited

NOTE 5 - LONG-TERM DEBT (continued)

Condensed Consolidating Statements of Cash Flows
For the nine months ended September 30, 2001
Unaudited
(dollars in millions)

| | Triad Hospitals, Inc. | Guarantor Subsidiaries | Non Guara Subsid |
|--|--------------------------|---------------------------|------------------------|
| | ----- | ----- | ----- |
| Net cash provided by (used in) operating activities..... | \$ (42.1) | \$ 264.5 | |
| Cash flows from investing activities | | | |
| Purchases of property and equipment..... | -- | (82.5) | |
| Payments for acquisitions..... | (1,336.0) | (43.9) | |
| Proceeds received on sale of assets..... | -- | 72.0 | |
| Investment in and advances to affiliates..... | 59.1 | (47.8) | |
| Investment in restricted cash..... | (5.7) | -- | |
| Other..... | -- | 3.7 | |
| | ----- | ----- | |
| Net cash used in investing activities..... | (1,282.6) | (98.5) | |
| Cash flows from financing activities | | | |
| Payments of long-term debt..... | (468.4) | (2.4) | |
| Proceeds from issuance of long-term debt..... | 1,690.0 | -- | |
| Payment of debt issue costs..... | (47.4) | -- | |
| Proceeds from issuance of common stock..... | 22.6 | -- | |
| Distributions to minority partners..... | -- | (6.1) | |
| Net change in due to (from) affiliate..... | 127.9 | (142.9) | |
| | ----- | ----- | |
| Net cash provided by (used in) financing activities..... | 1,324.7 | (151.4) | |
| | ----- | ----- | |
| Change in cash and cash equivalents..... | -- | 14.6 | |
| Cash and cash equivalents at beginning of period..... | -- | 6.4 | |
| | ----- | ----- | |
| Cash and cash equivalents at end of period..... | \$ -- | \$ 21.0 | |
| | ===== | ===== | |

Condensed Consolidating Statements of Cash Flows
For the nine months ended September 30, 2000
Unaudited
(dollars in millions)

| | | |
|-------|-----------|------|
| Triad | Guarantor | N |
| | | Guar |

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| | Hospitals, Inc. | Subsidiaries | Subsi |
|--|-----------------|--------------|-------|
| | ----- | ----- | ----- |
| Net cash provided by (used in) operating activities..... | \$ (41.0) | \$ 88.9 | |
| Cash flows from investing activities | | | |
| Purchases of property and equipment..... | -- | (57.2) | |
| Payments for acquisitions..... | -- | (70.1) | |
| Proceeds received on sale of assets..... | -- | 4.4 | |
| Investment in and advances to affiliates..... | 3.5 | 35.2 | |
| Other..... | (0.8) | (1.4) | |
| | ----- | ----- | |
| Net cash provided by (used in) investing activities..... | 2.7 | (89.1) | |
| Cash flows from financing activities | | | |
| Payments of long-term debt..... | (14.0) | (0.7) | |
| Proceeds from issuance of common stock..... | 7.9 | -- | |
| Distributions to minority partners..... | -- | (6.7) | |
| Net change in due to (from) affiliate..... | 44.4 | (45.4) | |
| | ----- | ----- | |
| Net cash provided by (used in) financing activities..... | 38.3 | (52.8) | |
| | ----- | ----- | |
| Change in cash and cash equivalents..... | -- | (53.0) | |
| Cash and cash equivalents at beginning of period..... | -- | 70.8 | |
| | ----- | ----- | |
| Cash and cash equivalents at end of period..... | \$ -- | \$ 17.8 | |
| | ===== | ===== | |

NOTE 6--STOCK BENEFIT PLANS

During the nine months ended September 30, 2001, 107,173 shares of common stock, net of cancellations, were issued through the Management Stock Purchase Plan and the Employee Stock Purchase Plan. Triad received proceeds of \$2.2 million on these issuances. Additionally during the nine months ended September 30, 2001, 1,295,934 stock options were exercised for proceeds of \$20.4 million.

The merger of Triad and Quorum (See NOTE 2) constituted a "change of control" under the terms of the Triad 1999 Long-Term Incentive Plan, the Triad Management Stock Purchase Plan, the Triad Executive Stock Purchase Plan and all other similar plans. All of the outstanding, unvested stock options became vested and exercisable at the effective time of the merger; however, certain executive officers of Triad waived the vesting of

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TRIAD HOSPITALS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Unaudited

NOTE 6--STOCK BENEFIT PLANS (continued)

certain stock options in connection with the merger. The waivers ended June 29, 2001. In addition, restrictions lapsed on shares of Triad restricted common stock held by Triad executive officers and these shares became fully vested and transferable and no longer are subject to forfeiture. As a result of the above referenced vesting, Triad recorded non-cash stock option expense of \$3.8 million during the three months ended June 30, 2001. On September 26, 2001, one participant in the Executive Stock Purchase Plan repaid his \$0.4 million loan under the plan.

On April 26, 2001, shareholders approved an amendment to the 1999 Long-Term Incentive Plan increasing the number of shares available to 14,000,000. On

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April 27, 2001, 2,713,000 stock options were granted under the 1999 Long-Term Incentive Plan with an exercise price equal to the market price at the date of grant. On June 21, 2001, 102,000 stock options were granted under the 1999 Long-Term Incentive Plan with an exercise price equal to the market price at the date of grant. On September 14, 2001, 100,000 stock options were granted under the 1999 Long-Term Incentive Plan with an exercise price equal to the market price at the date of grant. All options become exercisable over a four-year period and expire ten years from date of grant.

On May 29, 2001, shareholders approved an amendment to the Outside Directors Stock and Incentive Compensation Plan increasing the numbers of shares available to 400,000. On May 29, 2001, 220,000 stock options were granted under this plan with an exercise price equal to the market price at the date of grant. The options become exercisable over a four-year period and expire ten years from date of grant.

As anticipated at the time of the spin-off from HCA, Inc. ("HCA") on May 11, 1999, Triad entered into a stock option pledge agreement with a charitable corporation granting 100,000 stock options on July 11, 2000 subject to approval by the Internal Revenue Service (the "IRS"). The exercise price of these stock options is equal to the market price on the grant date. The stock options become immediately exercisable upon receipt of the IRS approval and expire 10 years from that date. Triad waived the IRS approval provision on June 27, 2001 and the options are now exercisable. Non-cash stock option expense of \$1.4 million was recorded under Statement of Financial Accounting Standards No. 123 "Accounting for Stock Based Compensation" using the fair value of these options. Since the options are immediately exercisable, no additional non-cash stock option expense will be recorded.

NOTE 7--INCOME (LOSS) PER SHARE

Basic weighted average shares outstanding is based on the weighted average number of shares outstanding adjusted for the shares issued to Triad's Employee Stock Ownership Plan ("ESOP"). Diluted weighted average shares outstanding is calculated by adjusting basic weighted average shares outstanding by all potentially dilutive stock options. Stock options outstanding of 8,952,822 as of September 30, 2001 were not included for diluted loss per share calculations in the nine months ended September 30, 2001 since the impact was antidilutive. Stock options outstanding of 5,794,358 as of September 30, 2000 were not included for diluted loss per share calculations in the three months ended September 30, 2000 since the impact was antidilutive. Weighted average shares for the three and nine months ended September 30, 2001 and 2000 are as follows:

| | For the three months ended | |
|---|----------------------------|------------|
| | 2001 | 2000 |
| Weighted average shares exclusive of unreleased ESOP shares..... | 69,218,457 | 31,696,120 |
| Weighted average of ESOP shares committed to be released..... | 187,500 | 187,500 |
| Basic weighted average shares outstanding..... | 69,405,957 | 31,883,620 |
| Effect of dilutive securities - employee stock options..... | 3,598,490 | -- |
| Diluted weighted average shares outstanding..... | 73,004,447 | 31,883,620 |

TRIAD HOSPITALS, INC.
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
 Unaudited

NOTE 8 - SEGMENT AND GEOGRAPHIC INFORMATION

In connection with the merger with Quorum (See NOTE 2), Triad reorganized its segment information into four segments. The segment information for the prior periods has been restated to conform to the current segment structure. The hospital operations segment includes Triad's acute care hospitals that it intends to operate on an ongoing basis. The management services segment includes the newly acquired management services business, which provides executive management services to smaller not-for-profit acute care hospitals. The ambulatory surgery center segment includes Triad's freestanding ambulatory surgery centers. The sold and held for sale segment is comprised of acute care hospitals that Triad has sold or has designated as held for sale. During the three months ended September 30, 2001, Triad decided not to sell one hospital that was acquired in the merger with Quorum (see NOTE 2) that was designated as held for sale. This hospital is now in the hospital operations segment. On November 1, 2001, Triad sold its hospital in Phoenix, Arizona (see NOTE 3). This hospital has been reclassified to the sold and held for sale segment from the hospital operations segment. Prior periods have been restated to reflect this change.

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

| | For th ended 2001 ----- |
|---------------------------------|----------------------------------|
| Revenues: | |
| Hospital operations..... | \$756.0 |
| Management services..... | 36.0 |
| Ambulatory surgery centers..... | 15.1 |
| Sold and held for sale..... | 16.9 |
| Corporate and other..... | 5.5 |
| | ----- |
| | \$829.5 |
| | ===== |
| EBITDA (a): | |
| Hospital operations..... | \$115.6 |
| Management services..... | 6.1 |
| Ambulatory surgery centers..... | 3.7 |
| Sold and held for sale..... | -- |
| Corporate and other..... | (9.3) |
| | ----- |
| | \$116.1 |
| | ===== |

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| | For the ended S 2001 ----- |
|---------------------------------|-------------------------------------|
| Revenues: | |
| Hospital operations..... | \$1,664.1 |
| Management services..... | 60.9 |
| Ambulatory surgery centers..... | 45.4 |
| Sold and held for sale..... | 53.9 |
| Corporate and other..... | 14.2 |
| | ----- |
| | \$1,838.5 |
| | ===== |
| EBITDA (a): | |
| Hospital operations..... | \$ 239.5 |
| Management services..... | 11.5 |
| Ambulatory surgery centers..... | 11.9 |
| Sold and held for sale..... | 3.0 |
| Corporate and other..... | (26.5) |
| | ----- |
| | \$239.4 |
| | ===== |

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TRIAD HOSPITALS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Unaudited

NOTE 8 - SEGMENT AND GEOGRAPHIC INFORMATION (continued)

| | September 2001 ----- |
|---------------------------------|----------------------------|
| Assets: | |
| Hospital operations..... | \$3,631.4 |
| Management services..... | 150.0 |
| Ambulatory surgery centers..... | 67.2 |
| Sold and held for sale..... | 45.5 |
| Corporate and other..... | 236.2 |
| | ----- |
| | \$4,130.3 |
| | ===== |

EBITDA for hospital operations includes equity in earnings (loss) of affiliates of \$4.7 million and \$(0.2) million in the three months ended September 30, 2001 and 2000, respectively, and \$8.1 million and \$(0.6) million in the nine months ended September 30, 2001 and 2000, respectively.

The following tables restate the annual segment disclosures to incorporate the changes discussed above:

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| | For the year ended | |
|---------------------------------|--------------------|---------|
| | 2000 | 1999 |
| Revenues: | | |
| Hospital operations..... | \$1,044.4 | \$ 967 |
| Management services..... | -- | |
| Ambulatory surgery centers..... | 52.4 | 49 |
| Sold and held for sale..... | 121.4 | 298 |
| Corporate and other..... | 17.2 | 14 |
| | ----- | ----- |
| | \$1,235.5 | \$1,329 |
| | ===== | ===== |

| | 2000 | 1999 |
|---------------------------------|---------|-------|
| | ----- | ----- |
| EBITDA (a): | | |
| Hospital operations..... | \$164.0 | \$15 |
| Management services..... | -- | |
| Ambulatory surgery centers..... | 16.1 | 1 |
| Sold and held for sale..... | (9.3) | (2) |
| Corporate and other..... | 3.2 | (1) |
| | ----- | ----- |
| | \$174.0 | \$12 |
| | ===== | ===== |

| | 2000 | De |
|---------------------------------|-----------|-------|
| | ----- | ----- |
| Assets: | | |
| Hospital operations..... | \$1,178.8 | |
| Management services..... | -- | |
| Ambulatory surgery centers..... | 53.6 | |
| Sold and held for sale..... | 31.3 | |
| Corporate and other..... | 136.8 | |
| | ----- | |
| | \$1,400.5 | |
| | ===== | |

(a) EBITDA is defined as income (loss) from continuing operations before depreciation, amortization, interest expense, interest income, ESOP expense, gain on sale of assets, impairment of long-lived assets, minority interests in earnings of consolidated entities, and income taxes. EBITDA is commonly used as an analytical indicator within the health care industry, and also serves as a measure of leverage capacity and debt service ability. EBITDA should not be considered as a measure of financial performance under generally accepted accounting principles, and the items excluded from EBITDA are significant components in understanding and assessing financial performance. EBITDA should not be considered in isolation or as an alternative to net income (loss), cash flows generated by operating, investing or financing activities or financial statement data presented in the condensed consolidated financial statements as an indicator of financial performance or

TRIAD HOSPITALS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Unaudited

NOTE 8 - SEGMENT AND GEOGRAPHIC INFORMATION (continued)

liquidity. Because EBITDA is not a measurement determined in accordance with generally accepted accounting principles and is thus susceptible to varying calculations, EBITDA as presented may not be comparable to other similarly titled measures of other companies.

NOTE 9 -- CONTINGENCIES

Merger Litigation

On October 20, 2000, a purported class action, Samuel Brand v. Colleen Conway Welch, et al., Case No.: OCC-3066, was filed against Triad and members of the board of directors of Quorum in the Circuit Court of Davidson County, Tennessee, on behalf of all public stockholders of Quorum. The complaint alleged, among other things, that Quorum's directors breached their fiduciary duties to Quorum and its stockholders in agreeing to the merger at an unfair price.

In April 2001, the parties negotiated a settlement that would result in the dismissal of the action. The settlement was subject to a number of conditions, including Court approval. Court approval was obtained, and on October 22, 2001 the court dismissed the action pursuant to the terms of the agreed upon settlement which was not material to Triad's financial position or results of operations.

False Claims Act Litigation

At a meeting in September 1998, Quorum learned from the government that the government would likely join in a lawsuit filed against Quorum under the False Claims Act. The suit was filed in January 1993 by a former employee of a hospital managed by a Quorum subsidiary. These lawsuits, commonly known as qui tam actions, are filed "under seal." That means that the claims are kept secret until the government decides whether to join the case. The person who files the lawsuit is called a "relator." The government joined the case against Quorum in October 1998. The relator's lawsuit named Quorum, Quorum Health Resources, Inc. ("QHR") a subsidiary of Quorum, HCA and all hospitals that Quorum or HCA owned, operated or managed from 1984 through 1997, as defendants. The unsealed complaint, prepared by the relator, alleged that Quorum knowingly prepared and caused to be filed cost reports which claimed payments from Medicare and other government payment programs greater than the amounts due.

The United States government elected to intervene in, or join, the lawsuit; on February 24, 1999, the government filed its own complaint in the case. The new complaint alleged that Quorum, on behalf of hospitals it managed between 1985 and 1995 and hospitals it owned from 1990 to the date of the complaint, violated the False Claims Act by knowingly submitting or causing to be submitted false Medicare cost reports, resulting in the submission of false claims to Federal health care programs.

The government asserted that the false claims in cost reports were reflected, in part, in "reserve analyses" created by Quorum. The complaint also alleged that these cost report filings were prepared as a result of company policy.

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On April 23, 2001, a settlement agreement was signed and a stipulation of dismissal was filed with the court dismissing all claims against Quorum, QHR and the other Quorum subsidiaries named in the lawsuit. The settlement provided for a payment of \$82.5 million to the government, plus interest accruing on \$77.5 million at 7.25% per annum from October 2, 2000 (the date on which an understanding with the government to settle this lawsuit was reached) to the payment date. The settlement was paid in April 2001. The settlement agreement also provides, on certain conditions, for a release of all hospitals currently or formerly managed by QHR electing to participate in the settlement.

In connection with the settlement, Quorum entered into a corporate integrity agreement with the Office of Inspector General containing, among other things, an affirmative obligation to report certain violations of applicable laws and regulations. This obligation could result in greater scrutiny by regulatory authorities. Complying with the corporate integrity agreement may impose expensive and burdensome requirements on certain of Triad's operations which could have a material adverse impact on Triad. Failure to comply with the terms of the corporate integrity

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TRIAD HOSPITALS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Unaudited

NOTE 9 -- CONTINGENCIES (continued)

agreement could subject the Quorum hospitals to significant monetary penalties and/or exclusion from Medicare, Medicaid and other governmental reimbursement programs.

On August 10, 2001, the Office of Inspector General agreed to suspend Quorum's obligations under this corporate integrity agreement until November 1, 2001, in exchange for Triad's agreement to negotiate a corporate integrity agreement that would also include the hospitals owned by Triad at the time of its merger with Quorum, as well as hospitals Triad might subsequently acquire. (In the distribution agreement with HCA at the time of its spin-off, Triad agreed to participate in the negotiation of a corporate integrity agreement with the Office of Inspector General.) These negotiations of a "combined" corporate integrity agreement were concluded and the agreement became effective on November 1, 2001.

Other Qui Tam Actions and Related Investigations

In May 1998, Quorum was informed that it was a defendant in another qui tam action involving home health services provided by two of its owned hospitals and alleging that Quorum had violated Medicare laws. This action was filed under seal in June 1996 by a former employee, whom Quorum fired in April 1996. The United States Attorney's Office allowed Quorum an opportunity to review the results of the government's investigations and discuss the allegations made in the action prior to the government making a decision to intervene as a plaintiff. Quorum cooperated fully with the United States Attorney's Office and provided additional information and made employees available for interviews.

On October 26, 2000, Quorum completed settlement of a qui tam lawsuit which primarily involved allegedly improper allocation of costs at Flowers Hospital, Dothan, Alabama, to its home health agency. Quorum paid to the government on October 26, 2000 approximately \$18 million in connection with this settlement. In addition to the settlement agreement, Quorum entered into a five-year

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corporate integrity agreement covering Flowers Hospital with the Office of the Inspector General, which was terminated upon the effective date of the corporate integrity agreement entered into in connection with the False Claims Act litigation discussed above. The government always reserves the right to investigate and pursue other allegations made by a relator under a complaint. However, under the settlement agreement, the relator is prohibited from pursuing these additional allegations.

As a result of its ongoing discussions with the government, prior to the merger, Quorum learned that there are two additional unrelated qui tam complaints against it alleging violations of the False Claims Act for claims allegedly submitted to the government involving one owned and two managed hospitals. Quorum accrued \$3.5 million on these items prior to the merger. Both matters remain under seal. With respect to the matter involving the two managed hospitals, the government has requested that Quorum conduct a self-audit with respect to one Medicare cost report for one managed hospital and three other specific issues. The government could undertake additional investigative efforts. The government has stated that it intends to investigate certain other allegations. As Quorum's successor, Triad is also a defendant in certain other qui tam complaints, in which the government has declined to intervene. At this time Triad cannot take a position on how it will respond on these matters.

Stockholder Class Action Regarding the Securities Exchange Act of 1934

In October and November 1998, some of Quorum's stockholders filed lawsuits against Quorum in the U.S. District Court for the Middle District of Tennessee. In January 1999, the court consolidated these cases into a

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TRIAD HOSPITALS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
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NOTE 9 -- CONTINGENCIES (continued)

single lawsuit (M.D. Tenn. No. 3-98-1004). The plaintiffs filed an amended complaint in March 1999. The plaintiffs seek to represent a class of plaintiffs who purchased Quorum's common stock from October 25, 1995 through October 21, 1998, except for Quorum's insiders and their immediate families. The consolidated complaint names Quorum, several of Quorum's former officers, and one of Quorum's former outside directors, as defendants.

The complaint alleges that defendants violated the Securities Exchange Act of 1934. The plaintiffs claim that Quorum materially inflated Quorum's net revenues during the class period by including in those net revenues amounts received from the settlement of cost reports that had allegedly been filed in violation of applicable Medicare regulations years earlier and that, because of this practice, this statement, which first appeared in Quorum's Form 10-K filed in September 1996, was false: "The Company believes that its owned hospitals are in substantial compliance with current federal, state, local, and independent review body regulations and standards." In May 1999, Quorum filed a motion to dismiss the complaint. On November 13, 2000, the judge denied Quorum's motion to dismiss the complaint against Quorum and James E. Dalton, Jr., Quorum's former President/CEO. The judge granted Quorum's motion to dismiss as to all other defendants. The judge has heard oral argument on Mr. Dalton's motion to reconsider the judge's denial of Mr. Dalton's motion to dismiss and on April 19, 2001 granted Mr. Dalton's motion to dismiss. As Quorum's successor, Triad intends to vigorously defend the claims and allegations in this action.

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

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

Income Taxes

The IRS is in the process of conducting an examination of the federal income tax return of Triad for the calendar year ended December 31, 1999, the federal income tax returns of Quorum for the fiscal years ended June 30, 1996 through 2000 and the partnership returns of income for certain joint ventures where Quorum owns a majority interest for the fiscal years ended June 30, 1997 and 1998. The IRS has proposed adjustments with respect to the fiscal years ended June 30, 1996 through 1998 but, to date, has not proposed adjustments with respect to any other years. The most significant adjustments proposed involve the tax accounting methods adopted for computing bad debt expense, the valuation of purchased hospital property and equipment and related depreciable lives, income recognition related to estimated cost report settlements and the loss calculation on a taxable liquidation of a subsidiary. The IRS has recently proposed a settlement with respect to the examination of the federal income tax returns of Quorum for the fiscal years ended June 30, 1996 through June 30, 1998, which Triad is currently considering. Triad will protest substantially all of the proposed adjustments that are not settled both on behalf of itself and as successor-in-interest to Quorum and on behalf of the joint ventures through the appeals process of the IRS.

In the opinion of management, the ultimate outcome of the IRS examinations currently under way will not have a material effect on Triad's results of operations or financial position.

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TRIAD HOSPITALS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Unaudited

NOTE 9 -- CONTINGENCIES (continued)

HCA Litigation and Investigations

In connection with the spin-off, Triad entered into a distribution

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agreement with HCA. The terms of the distribution agreement provide that HCA will indemnify Triad for any losses (other than consequential damages) which it may incur as a result of proceedings described below. HCA has also agreed to indemnify Triad for any losses (other than consequential damages) which it may incur as a result of proceedings which may be commenced by government authorities or by private parties in the future that arise from acts, practices or omissions engaged in prior to the date of the spin-off and that relate to the proceedings described below.

HCA is currently the subject of several Federal investigations into certain of its business practices, as well as governmental investigations by various states. HCA is cooperating in these investigations and understands, through written notice and other means, that it is a target in these investigations. Given the breadth of the ongoing investigations, HCA expects additional subpoenas and other investigative and prosecutorial activity to occur in these and other jurisdictions in the future. HCA is the subject of a formal order of investigation by the SEC. HCA understands that the SEC's investigation includes the anti-fraud, insider trading, periodic reporting and internal accounting control provisions of the Federal securities laws.

HCA is a defendant in several qui tam actions on behalf of the United States of America, which have been unsealed and served on HCA. The actions allege, in general, that HCA and certain subsidiaries and/or affiliated partnerships violated the False Claims Act, 31 U.S.C. (S) 3729 et seq., by submitting improper claims to the government for reimbursement. The lawsuits seek three times the amount of damages caused to the United States by the submission of any Medicare or Medicaid false claims presented by the defendants to the Federal government, civil penalties of not less than \$5,000 nor more than \$10,000 for each such Medicare or Medicaid claim, attorneys' fees and costs. HCA has disclosed that on March 15, 2001, the Department of Justice filed a status report setting forth the government's decisions regarding intervention in existing qui tam actions against HCA and filed formal complaints in those suits in which the government has intervened. Of the original 30 qui tam actions, the Department of Justice remains active in and has elected to intervene in 8 actions. HCA has also disclosed that it is aware of additional qui tam actions that remain under seal and believes that there may be other sealed qui tam cases of which it is unaware.

The investigations, actions and claims affecting HCA relate to HCA and its subsidiaries, including subsidiaries that, prior to the spin-off, owned facilities now owned by Triad. On May 5, 2000, Triad was advised that one of the qui tam cases which had been unsealed listed three of Triad's hospitals as defendants. This qui tam action alleges various violations arising out of the relationship between Curative Health Services and the other defendants, including allegations of false claims relating to contracts with Curative Health Services for the management of certain wound care centers and excessive and unreasonable management fees paid to Curative Health Services and submitted for reimbursement. Two of the three Triad hospitals named as defendants terminated their relationship with Curative Health Services prior to the spin-off and the third hospital terminated its contract thereafter.

In July 1999, Olsten Corporation and its subsidiary, Kimberly Home Health (neither of which is affiliated with HCA), announced that they would pay \$61 million to settle allegations that both companies defrauded the Medicare program. Kimberly pled guilty to three separate felony charges (conspiracy, mail fraud and violating the Medicare Anti-Kickback statute) filed by the U.S. Attorneys in the Middle and Southern Districts of Florida and the Northern District of Georgia. While HCA was not specifically named in these guilty pleas, the guilty pleas refer to the involvement of a "Company A" or a "company not named as a defendant." HCA has disclosed that it believes these references refer to HCA or its subsidiaries.

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HCA is a defendant in a number of other suits, which allege, in general, improper and fraudulent billing, overcharging, coding and physician referrals, as well as other violations of law. Certain of the suits have been conditionally certified as class actions. Since April 1997, numerous securities class action and derivative lawsuits have been filed in the United States District Court for the Middle District of Tennessee against HCA and a number of its current and former directors, officers and/or employees. Several derivative actions have been filed in state court by certain purported stockholders of HCA against certain of its current and former officers and directors

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TRIAD HOSPITALS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Unaudited

NOTE 9 -- CONTINGENCIES (continued)

alleging breach of fiduciary duty, and failure to take reasonable steps to ensure that HCA did not engage in illegal practices thereby exposing it to significant damages.

On May 18, 2000, HCA announced that it had reached an understanding with attorneys of the Civil Division of the Department of Justice to recommend an agreement to settle, subject to certain conditions, the civil claims actions against HCA relating to diagnosis related group coding, outpatient laboratory billing and home health issues. The understanding with the Department of Justice attorneys would require HCA to pay \$745 million in compensation to the government, with interest accruing at a fixed rate of 6.5% per annum (beginning May 18, 2000), and would reduce HCA's existing letter of credit agreement with the government from \$1 billion to \$250 million at the time of the payment of the settlement. On December 14, 2000, HCA announced that it had entered into a settlement agreement with the Civil Division of the Department of Justice and that payment of the amounts required by the settlement agreement would be made upon court approval of the settlement. On July 31, 2001, the government filed a motion to order payment of the settlement amount by HCA. On August 7, 2001, an order was entered approving the settlement and directing the payment. On August 10, 2001, the payment was made by HCA. HCA also entered into a corporate integrity agreement with the Health and Human Services Office of the Inspector General. HCA is in continuing discussions with the government regarding civil issues relating to cost reporting and physician relations.

On December 14, 2000, HCA also announced that it had signed an agreement with the Criminal Division of the Department of Justice to resolve pending Federal criminal actions against HCA. HCA received a full release from criminal liability for conduct arising from or relating to billing and reimbursement for services provided pursuant to Federal health care benefit programs regarding: Medicare cost reports; violations of the anti-kickback statute or prohibitions against physician self-referrals, and any other conduct involving relations with referral sources and those in a position to influence referral sources; diagnosis related group billing; laboratory billing; the acquisition of home health agencies; and the provision of services by home health agencies. In addition, the government agreed not to prosecute HCA for other possible criminal offenses which are or have been under investigation by the Department of Justice arising from or relating to billing and reimbursement for services provided pursuant to Federal health care benefit programs. As part of the criminal agreement, HCA paid the government \$95 million and two non-operating subsidiaries of HCA entered certain pleas in respect of the criminal actions. HCA also stated that representatives of state attorneys general have agreed to recommend to state officials that HCA be released from corresponding criminal

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liability in all states in which it conducts business.

The agreements announced on December 14, 2000 relate only to conduct that was the subject of the Federal investigations resolved in the agreements, and HCA has stated publicly that it continues to discuss civil claims relating to cost reporting and physician relations with the government. These agreements with the government do not resolve various qui tam actions filed by private parties against HCA, or any pending state actions. In addition to other claims not covered by these agreements, the government also reserved its rights under these agreements to pursue any claims it may have for:

- . any civil, criminal or administrative liability under the Internal Revenue Code;
- . any other criminal liability;
- . any administrative liability, including mandatory exclusion from Federal health care programs;
- . any liability to the United States (or its agencies) for any conduct other than the conduct covered in the government's investigation;
- . any express or implied warranty claims or other claims for defective or deficient products or services, including quality of goods and services, provided by HCA;
- . any claims for personal injury or property damage or for other similar consequential damages arising from the conduct subject to the investigation; and
- . any civil or administrative claims of the United States against individuals.

In addition, 14 of Triad's current and former hospitals received notices in early 2001 from the Centers for Medicare and Medicaid Services (formerly known as the Health Care Financing Administration), a United States

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TRIAD HOSPITALS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
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NOTE 9 -- CONTINGENCIES (continued)

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

HCA has agreed that, in the event that any hospital owned by Triad at the time of the spin-off is permanently excluded from participation in the Medicare and Medicaid programs as a result of the proceedings described above, then HCA will make a cash payment to Triad, in an amount (if positive) equal to five times the excluded hospital's 1998 income from continuing operations before depreciation and amortization, interest expense, management fees, impairment of

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long-lived assets, minority interests and income taxes, as set forth on a schedule to the distribution agreement, less the net proceeds of the sale or other disposition of the excluded hospital.

Triad has agreed that, in connection with the government investigations described above, it will participate with HCA in negotiating one or more compliance agreements setting forth each of HCA's and Triad's agreements to comply with applicable laws and regulations.

HCA will not indemnify Triad under the distribution agreement for losses relating to any acts, practices or omissions engaged in by Triad after the spin-off, whether or not Triad is indemnified for similar acts, practices and omissions occurring prior to the spin-off. HCA also will not indemnify Triad under the distribution agreement for similar qui tam litigation, governmental investigations and other actions to which Quorum was subject, some of which are described above. If indemnified matters were asserted successfully against Triad or any of its facilities, and HCA failed to meet its indemnification obligations, then this event could have a material adverse effect on Triad's business, financial condition, and results of operations or prospects.

Triad is unable to predict the effect or outcome of any of the ongoing investigations or qui tam and other actions, or whether any additional investigations or litigation will be commenced. The extent to which Triad may or may not continue to be affected by the ongoing investigations of HCA and the initiation of additional investigations, if any, cannot be predicted. These matters could have a material adverse effect on Triad's business, financial condition, and results of operations or prospects in future periods.

General Liability Claims

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

NOTE 10 - RECENT ACCOUNTING PRONOUNCEMENTS

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133 "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133"), which was required to be adopted in years beginning after June 15, 1999. In May 1999, the effective date of SFAS 133 was deferred until years beginning after June 15, 2000. Because of Triad's minimal use of derivatives, the adoption of SFAS 133 did not have a significant effect on the results of operations or the financial position of Triad.

On July 20, 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 141 "Business Combinations" ("SFAS 141") and Statement of Financial Accounting Standards No. 142 "Goodwill and Other Intangible Assets" ("SFAS 142"), which are required to be adopted in fiscal years beginning after December 15, 2001. SFAS 141 supersedes Accounting Principles Board Opinion No. 16 "Business Combinations" and Statement of Financial Accounting Standards No. 28 "Accounting for Preacquisition Contingencies of Purchased Enterprises" and eliminates pooling of interests accounting for business combinations for transactions entered into after July 1, 2001. The adoption of SFAS 141 will not have a significant impact on the results of operations or the financial condition of Triad. SFAS 142 supersedes Accounting Principles Board Opinion

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TRIAD HOSPITALS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
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NOTE 10 - RECENT ACCOUNTING PRONOUNCEMENTS (continued)

No. 17 "Intangible Assets" which changes the accounting for goodwill. The adoption of SFAS 142 will eliminate the periodic amortization of goodwill and institute an annual review of the fair value of goodwill. Impairment of goodwill would be recorded if the fair value of the goodwill is less than the book value. Goodwill amortization was \$10.5 million and \$1.7 million for the three months ended September 30, 2001 and 2000, respectively, and \$19.8 million and \$5.1 million for the nine months ended September 30, 2001 and 2000, respectively.

In October 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS 144"), which is required to be adopted in fiscal years beginning after December 15, 2001 with early application encouraged. SFAS 144 supercedes Financial Accounting Standards No. 121 "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of" ("SFAS 121") and the accounting and reporting provisions of Accounting Principles Board Opinion No. 30 "Reporting the Results of Operations-Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions" for the disposal of a segment of a business. SFAS 144 establishes a single accounting model, based on the framework established in SFAS 121, for long-lived assets to be disposed of by sale and resolves implementation issues related to SFAS 121 by removing goodwill from its scope. Triad has not yet determined the effect on results of operations or the financial condition of adoption of SFAS 144.

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Part I: Financial Information
ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND
RESULTS OF OPERATIONS

OVERVIEW

On April 27, 2001, Triad completed the previously announced merger of Quorum Health Group, Inc. ("Quorum") with and into Triad with Triad being the surviving corporation. Triad is the acquiror for accounting purposes based on several considerations including, in particular, that the former Quorum shareholders are not able to replace a majority of Triad's board of directors until at least the 2003 annual meeting of shareholders. Under the terms of the merger agreement, Quorum shareholders received \$3.50 in cash and 0.4107 shares of Triad common stock for each outstanding share of Quorum stock, plus cash in lieu of fractional shares of Triad common stock. In addition, each outstanding option to purchase shares of Quorum common stock, whether or not vested or exercisable, was converted at the holder's election into either a fully vested and exercisable option to purchase shares of Triad common stock or cash and shares of Triad common stock. Triad issued 35,786,380 shares, paid \$305.0 million in cash and issued 1,638,479 options to Quorum option holders in connection with the merger. The preliminary purchase price for the merger was determined using the average stock price at the time the merger was announced, cash paid, fair value of options converted and direct costs associated with the merger. The preliminary purchase price was approximately \$2.4 billion.

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On May 2, 2001, Triad sold two of the acute care hospitals acquired in the merger with Quorum for \$38.0 million plus \$8.2 million for working capital. Additionally, two hospitals acquired in the merger with Quorum were designated as held for sale prior to the completion of the merger. The preliminary purchase price allocation of these assets is equal to the estimated sales prices of the hospitals plus the anticipated cash flows for their estimated holding period and the estimated interest expense on the incremental debt incurred for the purchase of the hospitals. On August 7, 2001, Triad sold one of the two hospitals. The results of operations of this entity are not included in Triad's results of operations. Triad has decided not to sell the remaining hospital that was originally designated as held for sale. The assets of this hospital have been reallocated as if the hospital had never been designated as held for sale. The cumulative effect of this hospital's results of operations from May 1, 2001 through June 30, 2001 are included in Triad's results of operations in the three months ended September 30, 2001. The cumulative effect was not significant to pre-tax income from continuing operations.

Subsequent to the merger, Triad recorded charges of approximately \$31.8 million associated with coordinating Quorum's accounting policies, practices and estimation processes with those of Triad. These charges included an \$8.3 million pre-tax reduction to revenue, \$18.5 million pre-tax increase in provision for doubtful accounts and \$5.0 million additional income tax provision.

Prior to the merger, Quorum provided health care services through 21 general acute care hospitals located in 9 states. The merger creates the third-largest publicly owned hospital company in the United States, with 47 hospitals (after the sale of three Quorum hospitals subsequent to the acquisition) and 14 ambulatory surgery centers in 17 states.

During 2000, Triad sold one hospital, ceased operations of two hospitals and purchased two hospitals. Triad sold its partnership interest in a rehabilitation hospital on March 31, 2000. On February 5, 2001, Triad acquired the remaining 50% interest in one of its joint ventures effective January 1, 2001.

The above described events significantly affect the comparability of the results of operations for the three and nine months ended September 30, 2001 to the three and nine months ended September 30, 2000.

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

FORWARD LOOKING STATEMENTS

This "Management's Discussion and Analysis of Financial Condition and Results of Operations" contains disclosures which are "forward-looking statements." Forward-looking statements include all statements that do not relate solely to historical or current facts, and can be identified by the use of words such as "may", "believe", "will", "expect", "project", "estimate", "anticipate", "plan" or "continue". These forward-looking statements are based on the current plans and expectations of Triad and are subject to a number of uncertainties and risks that could significantly affect current plans and expectations and the future financial condition and results of Triad. These factors include, but are not limited to,

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

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

RESULTS OF OPERATIONS

Revenue/Volume Trends

As discussed previously, Triad completed the merger with Quorum on April 27, 2001. The effective date of the transaction for accounting purposes was May 1, 2001. Triad also acquired the remaining 50% interest in one of its joint ventures effective January 1, 2001 and two hospitals in the fourth quarter of 2000. The acquisitions contributed net revenue of \$510.4 million and \$882.0 million in the three and nine months ended September 30, 2001, respectively.

Triad's revenues continue to be affected by an increasing proportion of revenue being derived from fixed payment, higher discount sources, including Medicare, Medicaid and managed care plans. In addition, insurance companies, government programs (other than Medicare) and employers purchasing health care services for their employees are also negotiating discounted amounts that they will pay health care providers rather than paying standard prices. Triad expects patient volumes from Medicare and Medicaid to continue to increase due to the general aging of the population and expansion of state Medicaid programs. However, under the Federal Balanced Budget Act of 1997 (the "Balanced Budget Act"), Triad's reimbursement from Medicare and Medicaid programs has been reduced. Certain of the reductions from the Balanced Budget Act have been mitigated by the Balanced Budget Refinement Act of 1999 and were further mitigated by the Benefits Improvement Protection Act of 2000 ("BIPA"). Additional reimbursement from BIPA was approximately \$6.0 million and \$11.0 million in the three and nine months ended September 30, 2001, respectively, and

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Triad anticipates receiving approximately \$6.0 million in additional reimbursement during the remainder of 2001. The Balanced Budget Act has accelerated a shift by certain Medicare beneficiaries from traditional Medicare coverage to medical coverage that is provided under managed care plans. Triad generally receives lower payments per patient under managed care plans than under traditional indemnity insurance plans. With an increasing proportion of services being reimbursed based upon fixed payment amounts (where the payment is based upon the diagnosis, regardless of the cost incurred or level of service provided), revenues, earnings and cash flows are being impacted.

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

Triad's revenues have been affected by the trend toward certain services being performed more frequently on an outpatient basis. Growth in outpatient services is expected to continue in the health care industry as procedures performed on an inpatient basis are converted to outpatient procedures through continuing advances in pharmaceutical and medical technologies. The redirection of certain procedures to an outpatient basis is also influenced by pressures from payers to perform certain procedures as outpatient care rather than inpatient care. The Balanced Budget Act contained provisions requiring a prospective payment system (PPS) to be implemented for outpatient hospital services. Outpatient PPS was implemented on August 1, 2000, and the effect reduced reimbursement rates for outpatient services in 2001 compared to 2000. Outpatient revenues were 47.0% and 44.7% of patient revenues for the three months ended September 30, 2001 and 2000, respectively, and 45.8% and 45.3% of patient revenues for the nine months ended September 30, 2001 and 2000, respectively.

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

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

In connection with the spin-off, HCA agreed to indemnify Triad for any payments which it is required to make in respect of Medicare, Medicaid and Blue Cross cost reports relating to periods ending on or prior to the date of the spin-off, and Triad agreed to indemnify HCA for and pay to HCA any payments received by it relating to such cost reports. Triad will be responsible for the filing of these cost reports and any terminating cost reports. Triad has recorded a receivable from HCA relating to the indemnification of \$23.9 million as of September 30, 2001.

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

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RESULTS OF OPERATIONS (continued)

Operating Results Summary

The following is a summary of operating results for the three and nine months ended September 30, 2001 and 2000 (dollars in millions, except per share amounts and ratios):

| | For the three months ended | | | | |
|---|----------------------------|------------|-----------|------------|-----------|
| | 2001 | | 2000 | | Amount |
| | Amount | Percentage | Amount | Percentage | |
| Revenues..... | \$829.5 | 100.0 | \$301.3 | 100.0 | \$1,838.5 |
| Salaries and benefits..... | 369.4 | 44.5 | 125.4 | 41.6 | 802.0 |
| Supplies..... | 127.3 | 15.3 | 44.7 | 14.8 | 285.3 |
| Other operating expenses..... | 155.1 | 18.7 | 63.4 | 21.1 | 348.2 |
| Provision for doubtful accounts..... | 66.3 | 8.0 | 28.4 | 9.4 | 171.7 |
| Depreciation and amortization..... | 55.3 | 6.7 | 20.9 | 6.9 | 122.4 |
| Interest expense, net..... | 39.5 | 4.8 | 14.4 | 4.8 | 88.7 |
| ESOP expense..... | 2.5 | 0.3 | 2.0 | 0.7 | 6.9 |
| Gain on sale of assets..... | (0.7) | (0.1) | (0.2) | (0.1) | (1.1) |
| Impairment of long-lived assets..... | -- | -- | -- | -- | -- |
| | ----- | ----- | ----- | ----- | ----- |
| | 814.7 | 98.2 | 299.0 | 99.2 | 1,824.1 |
| | ----- | ----- | ----- | ----- | ----- |
| Income from continuing operations before minority interests, equity in earnings and income tax provision..... | 14.8 | 1.8 | 2.3 | 0.8 | 14.4 |
| Minority interests in earnings of consolidated entities..... | (2.5) | (0.3) | (1.9) | (0.6) | (6.5) |
| Equity in earnings (loss) of affiliates.... | 4.7 | 0.6 | (0.2) | (0.1) | 8.1 |
| | ----- | ----- | ----- | ----- | ----- |
| Income from continuing operations before income tax provision..... | 17.0 | 2.1 | 0.2 | 0.1 | 16.0 |
| Income tax provision..... | (10.5) | (1.3) | (1.2) | (0.4) | (20.6) |
| | ----- | ----- | ----- | ----- | ----- |
| Income (loss) from continuing operations... | \$ 6.5 | 0.8 | \$ (1.0) | (0.3) | \$ (4.6) |
| | ===== | ===== | ===== | ===== | ===== |
| | | | | | |
| Income (loss) from continuing operations per common share | | | | | |
| Basic..... | \$ 0.09 | | \$ (0.03) | | \$ (0.0) |
| Diluted..... | \$ 0.09 | | \$ (0.03) | | \$ (0.0) |
| EBITDA (a)..... | \$ 116.1 | | \$ 39.2 | | \$ 239. |
| Number of hospitals at end of period (b) | | | | | |
| Owned and managed..... | 44 | | 25 | | 4 |
| Joint ventures..... | 1 | | 2 | | |
| Leased to others..... | 2 | | 2 | | |
| | ----- | | ----- | | ----- |
| Total..... | 47 | | 29 | | 4 |
| Licensed beds at end of period (c)..... | 7,700 | | 3,596 | | 7,70 |

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| | | | |
|--|----------|----------|----------|
| Available beds at end of period (d)..... | 6,918 | 3,158 | 6,91 |
| Admissions (e) | | | |
| Owned and managed..... | 70,312 | 30,924 | 166,07 |
| Joint ventures..... | 1,448 | 2,917 | 4,38 |
| | ----- | ----- | ----- |
| Total..... | 71,760 | 33,841 | 170,45 |
| Adjusted admissions (f)..... | 120,066 | 54,199 | 280,49 |
| Outpatient visits..... | 852,268 | 322,466 | 1,903,37 |
| Inpatient surgeries..... | 26,901 | 11,249 | 61,27 |
| Outpatient surgeries..... | 72,284 | 39,960 | 176,22 |
| Total surgeries..... | 99,185 | 51,209 | 237,50 |
| Average length of stay (g)..... | 4.9 | 4.3 | 4. |
| Outpatient revenue percentage..... | 47.0% | 44.7% | 45. |
| Inpatient revenue per admission..... | \$ 5,809 | \$ 5,220 | \$ 5,62 |
| Outpatient revenue per outpatient visit... | \$ 454 | \$ 405 | \$ 41 |
| Patient revenue per adjusted admission.... | \$ 6,419 | \$ 5,387 | \$ 6,14 |

- (a) EBITDA is defined as income (loss) from continuing operations before depreciation and amortization, interest expense, ESOP expense, gain on sale of assets, impairment of long-lived assets, minority interests in earnings of consolidated entities, and income taxes. EBITDA is commonly used as an analytical indicator within the health care industry, and also serves as a measure of leverage capacity and debt service ability. EBITDA should not be considered as a measure of financial performance under generally accepted accounting principles, and the items excluded from EBITDA are significant components in understanding and assessing financial performance. EBITDA should not be considered in isolation or as an alternative to net income, cash flows generated by operating, investing or financing activities or other financial statement data presented in the condensed consolidated financial statements as an indicator of financial performance or liquidity. Because EBITDA is not

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

- a measurement determined in accordance with generally accepted accounting principles and is thus susceptible to varying calculations, EBITDA as presented may not be comparable to other similarly titled measures of other companies.
- (b) This table does not include any operating statistics for the joint ventures and facilities leased to others, except for admissions.
- (c) Licensed beds are those beds for which a facility has been granted approval to operate from the applicable state-licensing agency.
- (d) Available beds are those beds a facility actually has in use.
- (e) Represents the total number of patients admitted (in the facility for a period in excess of 23 hours) to Triad's facilities and is used by management and certain investors as a general measure of inpatient volume.
- (f) Adjusted admissions are used by management and certain investors as a general measure of combined inpatient and outpatient volume. Adjusted admissions are computed by multiplying admissions (inpatient volume) by the sum of gross inpatient revenue and gross outpatient revenue and then dividing the resulting amount by gross inpatient revenue. The adjusted admissions computation "equates" outpatient revenue to the volume measure (admissions) used to measure inpatient volume resulting in a general measure of combined inpatient and outpatient volume.
- (g) Represents the average number of days an admitted patient stays in Triad's hospitals.

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Three Months Ended September 30, 2001 and 2000

Income from continuing operations before income taxes increased to \$17.0 million in the three months ended September 30, 2001 from \$0.2 million in the three months ended September 30, 2000. The acquisitions increased pre-tax income approximately \$39.8 million. Pre-tax income from same facility operations increased \$10.0 million. Same facility is defined as facilities that were owned and consolidated in both periods. The increases were offset by an increase in interest expense of \$25.1 million primarily related to the additional indebtedness incurred in the acquisition of Quorum. Also, corporate overhead increased \$8.4 million in the three months ended September 30, 2001 compared to the three months ended September 30, 2000 due primarily to additional staffing and other costs due to the merger.

Revenues increased to \$829.5 million in the three months ended September 30, 2001 from \$301.3 million in the three months ended September 30, 2000. Same facility revenues increased \$32.0 million or 11.1% in the three months ended September 30, 2001 compared to September 30, 2000. For the three months ended September 30, 2001 compared to the three months ended September 30, 2000, same facility admissions increased 4.8%, adjusted admissions increased 3.0%, and revenue per adjusted admissions increased 7.3%. Same facility outpatient visits increased 1.0%, outpatient revenue per visit increased 12.9% and surgeries increased 4.0%. Revenues for facilities acquired were \$510.4 million in the three months ended September 30, 2001. The acquired facilities had admissions of 39,578, adjusted admissions of 67,282, outpatient visits of 490,287 and surgeries of 48,066. The increase in revenues was partially offset by the facilities that were sold or closed. In the three months ended September 30, 2000, the sold or closed facilities had revenues of \$14.2 million. The facilities that were sold or closed had admissions of 1,596, adjusted admissions of 2,941, outpatient visits of 17,737 and surgeries of 2,077 in the three months ended September 30, 2000.

Salaries and benefits (which includes contract nursing), as a percentage of revenues, increased to 44.5% in the three months ended September 30, 2001 from 41.6% in the three months ended September 30, 2000. Same facility salaries and benefits increased 0.9% as a percentage of revenue in the three months ended September 30, 2001 compared to the three months ended September 30, 2000. This was due primarily to an increase in the number of full time equivalent employees primarily at the corporate office. This was partially offset by productivity increases. Salaries and benefits for the acquired facilities, as a percentage of revenue, were 45.9% in the three months ended September 30, 2001. This includes approximately \$1.4 million in duplicate overhead cost and stay-on bonuses at the former Quorum corporate office. For the three months ended September 30, 2000, salaries and benefits for the facilities sold or closed were \$6.8 million.

Supplies increased as a percentage of revenues to 15.3% in the three months ended September 30, 2001 from 14.8% in the three months ended September 30, 2000. Same facility supplies increased 0.7% as a percentage of revenue in the three months ended September 30, 2001 compared to the three months ended September 30, 2000. This was due primarily to higher patient acuity and supply cost increases. Supplies for the acquired facilities, as a percentage of revenue, were 15.3% in the three months ended September 30, 2001. For the three months ended September 30, 2000, supplies for the facilities sold or closed were \$2.1 million.

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Other operating expenses (primarily consisting of contract services, professional fees, repairs and maintenance, rents and leases, utilities, insurance and non-income taxes) decreased as a percentage of revenues to 18.7% in the three months ended September 30, 2001 compared to 21.1% in the three months ended September 30, 2000. Same facility other operating expenses increased 0.4% as a percentage of revenue in the three months ended September 30, 2001 compared to the three months ended September 30, 2000 due primarily to an increase in professional fees at the corporate office. Other operating expenses for the acquired facilities, as a percentage of revenue, were 17.2% in the three months ended September 30, 2001. For the three months ended September 30, 2000, other operating expenses for the facilities sold or closed were \$4.7 million.

Provision for doubtful accounts, as a percentage of revenues, decreased to 8.0% in the three months ended September 30, 2001 compared to 9.4% in the three months ended September 30, 2000. Same facility provision for doubtful accounts decreased 1.0% as a percentage of revenue in the three months ended September 30, 2001 compared to the three months ended September 30, 2000. This was due primarily to adjustments in estimates at three facilities in the three months ended September 30, 2000. Provision for doubtful accounts for the acquired facilities, as a percentage of revenue, was 7.6% in the three months ended September 30, 2001. For the three months ended September 30, 2000, provision for doubtful accounts for the facilities sold or closed was \$0.6 million.

Depreciation and amortization as a percentage of revenues decreased to 6.7% in the three months ended September 30, 2001 compared to 6.9% in the three months ended September 30, 2000, due primarily to increased revenues.

Interest expense, which was offset by \$0.4 million and \$1.6 million of interest income in the three months ended September 30, 2001 and 2000, respectively, increased to \$39.5 million in the three months ended September 30, 2001 from \$14.4 million in the three months ended September 30, 2000, due to a decrease in interest income and additional debt outstanding primarily from indebtedness incurred to finance the Quorum acquisition.

Gain on sale of assets was \$0.7 million in the three months ended September 30, 2001 as a result of the sale of undeveloped land in Arizona.

Minority interests increased to \$2.5 million in the three months ended September 30, 2001 compared to \$1.9 million in the three months ended September 30, 2000, due primarily to the Quorum acquisition.

Equity in earnings (loss) of affiliates increased to \$4.7 million in the three months ended September 30, 2001 from \$(0.2) million in the three months ended September 30, 2000. This was due primarily to the Quorum acquisitions.

Income tax provision was \$10.5 million in the three months ended September 30, 2001 compared to \$1.2 million in the three months ended September 30, 2000. Triad's effective tax rate is impacted by the effect of nondeductible goodwill amortization and ESOP expense.

Nine Months Ended September 30, 2001 and 2000

Income from continuing operations decreased to \$16.0 million in the nine months ended September 30, 2001 from \$18.6 million in the nine months ended September 30, 2000. The change in pre-tax income was attributable primarily to \$26.3 million of charges associated with coordinating Quorum's accounting policies, practices and estimation processes with those of Triad discussed previously and an increase in interest expense of \$45.8 million primarily related to the additional indebtedness incurred in the acquisition of Quorum.

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Triad incurred \$3.8 million of non-cash stock compensation expense relating to stock option vesting acceleration that was incurred due to the acquisition of Quorum and \$1.4 million of non-cash stock compensation from options granted to a charitable foundation. Corporate overhead increased \$11.8 million in the nine months ended September 30, 2001 compared to the nine months ended September 30, 2000 due primarily to additional staffing and other costs due to the merger. Additionally, Triad recognized a \$4.2 million gain on sale of a joint venture interest during the nine months ended September 30, 2000. The decreases were offset by \$69.9 million of pre-tax income from acquisitions, excluding the charges discussed above from the acquisition of Quorum. Pre-tax income from same facility operations increased \$20.1 million which included \$1.5 million of unfavorable adjustments at one facility from write-offs of certain expenditures that were previously capitalized in the nine months ended September 30, 2000. Same facility equity in earnings increased \$0.7 million due primarily to \$1.1 million of unfavorable adjustments from various changes of estimates and other adjustments during the nine months ended September 30, 2000.

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

Revenues increased to \$1,838.5 million in the nine months ended September 30, 2001 from \$915.4 million in the nine months ended September 30, 2000. Same facility revenues increased \$86.0 million or 9.9% in the nine months ended September 30, 2001 compared to September 30, 2000. For the nine months ended September 30, 2001 compared to the nine months ended September 30, 2000, same facility admissions increased 5.5%, adjusted admissions increased 4.0% and revenues per adjusted admissions increased 5.5%. Outpatient visits increased 3.9%, outpatient revenue per visit increased 4.2% and surgeries increased 3.8%. Another factor in the increase in revenues was \$4.2 million in favorable prior year cost report settlements during 2001. Revenues for the nine months ended September 30, 2000 included \$4.7 million in favorable prior year cost report settlements and contractual estimate adjustments and \$5.2 million in unfavorable changes of estimate for contractual discounts at one facility. Revenues for facilities acquired were \$882.0 million in the nine months ended September 30, 2001. Revenues for facilities acquired were reduced by \$8.3 million associated with coordinating Quorum's accounting policies, practices and estimation processes with those of Triad as discussed previously. The acquired facilities had admissions of 70,913, adjusted admissions of 119,805, outpatient visits of 962,005 and surgeries of 81,941. The increase in revenues was partially offset by the facilities that were sold or closed. In the nine months ended September 30, 2000, the sold or closed facilities had revenues of \$46.0 million, which included \$3.1 million in favorable prior year cost report settlements and contractual estimates. The facilities that were sold or closed had admissions of 5,164, adjusted admissions of 9,124, outpatient visits of 56,987 and surgeries of 6,282, in the nine months ended September 30, 2000.

Salaries and benefits (which include contract nursing), as a percentage of revenues, increased to 43.6% in the nine months ended September 30, 2001 from 41.1% in the nine months ended September 30, 2000. Same facility salaries and benefits increased 0.8% as a percentage of revenue in the nine months ended September 30, 2001 compared to the nine months ended September 30, 2000. This was due primarily to \$5.5 million in non-cash stock option expense in 2001, an increase in the number of full time equivalent employees primarily at the corporate office and a smaller favorable adjustment relating to Triad's retirement plan contributions of \$1.3 million in 2001 compared to \$2.8 million in 2000. This was partially offset by productivity increases. Salaries and benefits for the acquired facilities, as a percentage of revenue, were 46.1% in the nine months ended September 30, 2001. This includes approximately \$2.0

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million in duplicate overhead costs and stay-on bonuses at the former Quorum corporate office. For the nine months ended September 30, 2000, salaries and benefits for the facilities sold or closed were \$23.2 million, which included approximately \$1.0 million of severance costs for one facility closed in February 2000.

Supplies increased as a percentage of revenues to 15.5% in the nine months ended September 30, 2001 from 14.9% in the nine months ended September 30, 2000. Same facility supplies increased 0.3% as a percentage of revenue in the nine months ended September 30, 2001 compared to the nine months ended September 30, 2000. This was due primarily to higher patient acuity and supply cost increases. Additionally, Triad had unfavorable adjustments of \$1.1 million at one facility from write-off of certain expenditures that were previously capitalized in the nine months ended September 30, 2000. Supplies for the acquired facilities, as a percentage of revenue, were 15.7% in the nine months ended September 30, 2001. For the nine months ended September 30, 2000, supplies for the facilities sold or closed were \$6.0 million.

Other operating expenses (primarily consisting of contract services, professional fees, repairs and maintenance, rents and leases, utilities, insurance and non-income taxes) decreased as a percentage of revenues to 18.9% in the nine months ended September 30, 2001 compared to 21.1% in the nine months ended September 30, 2000. Same facility other operating expenses decreased 0.4% as a percentage of revenue in the nine months ended September 30, 2001 compared to the nine months ended September 30, 2000. This decrease was due primarily to the increase in revenues. This was partially offset by an increase in professional fees at the corporate office. Other operating expenses for the acquired facilities, as a percentage of revenue, were 17.4% in the nine months ended September 30, 2001. For the nine months ended September 30, 2000, other operating expenses for the facilities sold or closed were \$12.4 million.

Provision for doubtful accounts, as a percentage of revenues, increased to 9.3% in the nine months ended September 30, 2001 compared to 8.5% in the nine months ended September 30, 2000. Same facility provision for doubtful accounts increased 0.4% as a percentage of revenue in the nine months ended September 30, 2001 compared to the nine months ended September 30, 2000. This was due, in part, to an increase in emergency room visits, primarily in Texas, which typically have a higher incidence of uninsured accounts. Provision for doubtful accounts for the acquired facilities, as a percentage of revenue, was 9.7% in the nine months ended September 30, 2001. As discussed previously, included in the provision for doubtful accounts were \$18.5 million in charges associated with coordinating Quorum's accounting policies, practices and estimation process with those of Triad.

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

For the nine months ended September 30, 2000, provision for doubtful accounts for the facilities sold or closed was \$2.4 million.

Depreciation and amortization remained relatively constant as a percentage of revenues in the nine months ended September 30, 2001 compared to the nine months ended September 30, 2000.

Interest expense, which was offset by \$1.1 million and \$4.5 million of interest income in the nine months ended September 30, 2001 and 2000, respectively, increased to \$88.7 million in the nine months ended September 30, 2001 from \$42.9 million in the nine months ended September 30, 2000, due to a

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decrease in interest income and additional debt outstanding primarily from indebtedness incurred to finance the Quorum acquisition.

Gain on sale of assets was \$4.6 million during the nine months ended September 30, 2000, due primarily to the sale of Triad's partnership interest in a rehabilitation hospital.

Impairments on long-lived assets were \$0.9 million during the nine months ended September 30, 2000. The impairments during 2000 were due to the carrying value of the long-lived assets related to one physician management contract which was reduced to fair value, based on estimated disposal value.

Minority interests remained relatively constant in the nine months ended September 30, 2001 compared to the nine months ended September 30, 2000.

Equity in earnings (loss) of affiliates increased to \$8.1 million in the nine months ended September 30, 2001 from \$(0.6) million in the nine months ended September 30, 2000, primarily due to the Quorum acquisition and \$1.1 million of unfavorable adjustments from various changes of estimates and other adjustments during the nine months ended September 30, 2000.

Income tax provision was \$20.6 million in the nine months ended September 30, 2001 compared to \$10.5 million in the nine months ended September 30, 2000. As discussed previously, included in the income tax provision for the nine months ended September 30, 2001 was \$5.0 million in charges associated with coordinating Quorum's accounting policies, practices and estimation processes. Triad's effective tax rate is impacted by the effect of nondeductible goodwill amortization and ESOP expense.

LIQUIDITY AND CAPITAL RESOURCES

Cash provided by operating activities was \$241.4 million in the nine months ended September 30, 2001 compared to \$62.4 million in the nine months ended September 30, 2000. The increase was due to the acquisition of Quorum, improved same facility operations in 2001 compared to 2000 and a decrease in accounts payable and other current liabilities during the nine months ended September 30, 2000 from payments made to HCA for capital expenditures funded by HCA in 1999.

Cash used in investing activities was \$1,415.1 million in the nine months ended September 30, 2001 compared to \$101.7 million in the nine months ended September 30, 2000. This was due to \$1,379.9 million, net of cash acquired, paid for the acquisitions of Quorum and SouthCrest Hospital, which are discussed elsewhere. This was offset by a \$37.0 million loan repayment from the co-venturer in SouthCrest Hospital during the nine months ended September 30, 2000. Also, Triad received \$71.8 million in proceeds on the sale of three hospitals acquired from Quorum and one hospital closed during 2000 in the nine months ended September 30, 2001 compared to \$4.0 million in proceeds on the sale of its partnership interest in a rehabilitation hospital during the nine months ended September 30, 2000. Triad may expend up to \$130 million (\$100 million for expansion) in capital expenditures for the remainder of 2001.

Cash provided by financing activities was \$1,188.0 million in the nine months ended September 30, 2001 compared to cash used in financing activities of \$13.5 million in the nine months ended September 30, 2000. This was due to the financing activity as part of the Quorum acquisition.

As part of the merger with Quorum, Triad refinanced its Tranche A term loan, Tranche B term loan, Delay Draw term loan, and Quorum's indebtedness with new indebtedness totaling \$1.8 billion. This indebtedness consisted of a Tranche A term loan of \$250 million presently bearing interest at LIBOR plus 3.0% (6.53% at September 30, 2001) with principal amounts due beginning 2001 through 2007, a Tranche B term loan of \$550 million presently bearing interest at LIBOR plus

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3.0% (6.53% at September 30, 2001) with principal amounts due

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

beginning 2001 through 2008, an Asset Sale term loan of \$150 million presently bearing interest at LIBOR plus 3.0% (6.53% at September 30, 2001) with principal amounts due in 2003 and \$600 million of senior notes bearing interest at 8.75% with principal amounts due in 2009. Triad also obtained a \$250 million revolving credit line, of which \$10.0 million was outstanding at September 30, 2001, that presently bears interest at LIBOR plus 3.0% (5.67% at September 30, 2001). The revolving credit line reduces to \$225 million in 2004, \$200 million in 2005 and matures in 2007. As of September 30, 2001, Triad had \$2.5 million in letters of credit outstanding which reduce the amount available under the revolving credit line. The revolving credit line was repaid in October 2001.

Triad has repaid \$71.0 million on the Asset Sale term loan through September 30, 2001 from the proceeds received on the facility sales described previously. On November 1, 2001, Triad repaid an additional \$56.3 million on the Asset Sale term loan primarily from the sales proceeds discussed below.

Triad's term loans and revolving lines of credit are collateralized by a pledge of substantially all of its assets other than real estate associated with the Quorum facilities. The debt agreements require that Triad comply with various financial ratios and tests and have restrictions, including but not limited to, new indebtedness, asset sales and use of proceeds therefrom, capital expenditures and dividends.

In connection with the debt financing, Triad incurred \$47.4 million in debt issue costs, which will be amortized over the period the indebtedness is outstanding.

At September 30, 2001, Triad had working capital of \$379.8 million. Management expects that operations and working capital facilities will provide sufficient liquidity for the remainder of fiscal 2001.

On November 1, 2001, Triad sold its hospital in Phoenix, Arizona for \$55.3 million including working capital. The proceeds from the sale were used to reduce the Asset Sale term loan. The book value of the facility at September 30, 2001 was \$33.2 million. This facility had revenues of \$16.9 million and \$15.9 million in the three months ended September 30, 2001 and 2000, respectively, and \$52.9 million and \$48.3 million in the nine months ended September 30, 2001 and 2000, respectively. This facility had pre-tax income (loss) of \$0.0 million and \$(1.0) million in the three months ended September 30, 2001 and 2000, respectively, and \$1.0 million and \$(1.0) million in the nine months ended September 30, 2001 and 2000, respectively.

On August 7, 2001, Triad sold its hospital in Baton Rouge, Louisiana, that it acquired in the Quorum transaction and was designated as held for sale, for \$19.0 million plus assumed liabilities of \$2.3 million. The purchaser is affiliated with one member of Triad's board of directors. The sales price was the amount of the purchase price allocated to the hospital and, therefore, no gain or loss was recorded.

Triad closed its acute care hospital in San Diego, California on November 30, 2000. On June 29, 2001, Triad sold the remaining assets of this facility for a net sales price of \$6.6 million and recognized a minimal gain on the sale.

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As discussed previously, Triad sold two hospitals in Minot, North Dakota that it acquired from Quorum on May 2, 2001 for \$38.0 million plus \$8.2 million in working capital. The sales price was the amount of the purchase price allocated to the hospitals and, therefore, no gain or loss on the sale was recorded.

Triad had engaged a financial advisor to assist it in exploring strategic alternatives with respect to the management services business it acquired in the Quorum transaction, including a possible sale. After evaluating whether to sell or continue operating the management service business, Triad determined that the business is more valuable to Triad than to potential buyers and it will continue to operate the business.

On February 5, 2001, Triad acquired the remaining 50% interest in the entity that owns SouthCrest Hospital in Tulsa, Oklahoma which opened in May 1999, from its not-for-profit partner, Hillcrest Healthcare System ("Hillcrest"), for \$44.6 million, the amount of Hillcrest's investment in the entity. The acquisition consolidated 100% ownership and control of the hospital in Triad effective January 1, 2001. Triad has an option to acquire an adjacent 26-acre parcel of land from Hillcrest for future expansion and a right of first refusal on certain other real estate. SouthCrest Hospital will continue to participate in Hillcrest's joint contracting network that includes other Hillcrest hospitals in Tulsa. Under certain conditions and for a limited time, Hillcrest will have an option to repurchase a 49% interest in SouthCrest Hospital at the then fair market value, subject to minimum valuations and minimum returns on investment to Triad; if Hillcrest were to exercise the option, Triad would retain governance of

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

the facility and continue consolidating it for financial reporting. The purchase was funded with a draw on Triad's delay draw loan.

Triad has commenced development of a new hospital in Las Cruces, New Mexico. The projected cost of this development is approximately \$67 million and is expected to be completed by the third quarter of 2002. As of September 30, 2001, approximately \$8.5 million had been spent for this project.

Triad is continuing to build a replacement hospital that was initiated by Quorum in Vicksburg, Mississippi. The total project cost of this facility is approximately \$108 million and the facility is scheduled to be completed in the first quarter of 2002. As of September 30, 2001, approximately \$33 million of expenditures remain to be made on the project.

Subsequent to September 30, 2001, Triad commenced development of a replacement hospital in Bentonville, Arkansas, which is expected to be completed in third quarter of 2003. The anticipated cost of the replacement facility is approximately \$63 million.

The above referenced projects will be funded with either operating cash flows or existing credit facilities.

RECENT ACCOUNTING PRONOUNCEMENTS

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133 "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133"), which was required to be adopted in years

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beginning after June 15, 1999. In May 1999, the effective date of SFAS 133 was deferred until years beginning after June 15, 2000. Because of Triad's minimal use of derivatives, the adoption of SFAS 133 did not have a significant effect on the results of operations or the financial position of Triad.

On July 20, 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 141 "Business Combinations" ("SFAS 141") and Statement of Financial Accounting Standards No. 142 "Goodwill and Other Intangible Assets" ("SFAS 142"), which are required to be adopted in fiscal years beginning after December 15, 2001. SFAS 141 supersedes Accounting Principles Board Opinion No. 16 "Business Combinations" and Statement of Financial Accounting Standards No. 28 "Accounting for Preacquisition Contingencies of Purchased Enterprises" and eliminates pooling of interests accounting for business combinations for transactions entered into after July 1, 2001. The adoption of SFAS 141 will not have a significant impact on the results of operations or the financial condition of Triad. SFAS 142 supersedes Accounting Principles Board Opinion No. 17 "Intangible Assets" which changes the accounting for goodwill. The adoption of SFAS 142 will eliminate the periodic amortization of goodwill and institute an annual review of the fair value of goodwill. Impairment of goodwill would be recorded if the fair value of the goodwill is less than the book value. Goodwill amortization was \$10.5 million and \$1.7 million for the three months ended September 30, 2001 and 2000, respectively, and \$19.8 million and \$5.1 million for the nine months ended September 30, 2001 and 2000, respectively.

In October 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS 144"), which is required to be adopted in fiscal years beginning after December 15, 2001 with early application encouraged. SFAS 144 supercedes Financial Accounting Standards No. 121 "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of" ("SFAS 121") and the accounting and reporting provisions of Accounting Principles Board Opinion No. 30 "Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions" for the disposal of a segment of a business. SFAS 144 establishes a single accounting model, based on the framework established in SFAS 121, for long-lived assets to be disposed of by sale and resolves implementation issues related to SFAS 121 by removing goodwill from its scope. Triad has not yet determined the effect on results of operations or the financial condition of adoption of SFAS 144.

CONTINGENCIES

Merger Litigation

On October 20, 2000, a purported class action, Samuel Brand v. Colleen Conway Welch, et al., Case No.: OCC-3066, was filed against Triad and members of the board of directors of Quorum in the Circuit Court of

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

Davidson County, Tennessee, on behalf of all public stockholders of Quorum. The complaint alleged, among other things, that Quorum's directors breached their fiduciary duties to Quorum and its stockholders in agreeing to the merger at an unfair price.

In April 2001, the parties negotiated a settlement that would result in the

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dismissal of the action. The settlement was subject to a number of conditions, including Court approval. Court approval was obtained, and on October 22, 2001 the court dismissed the action pursuant to the terms of the agreed upon settlement.

False Claims Act Litigation

At a meeting in September 1998, Quorum learned from the government that the government would likely join in a lawsuit filed against Quorum under the False Claims Act. The suit was filed in January 1993 by a former employee of a hospital managed by a Quorum subsidiary. These lawsuits, commonly known as qui tam actions, are filed "under seal." That means that the claims are kept secret until the government decides whether to join the case. The person who files the lawsuit is called a "relator." The government joined the case against Quorum in October 1998. The relator's lawsuit named Quorum, QHR, HCA and all hospitals that Quorum or HCA owned, operated or managed from 1984 through 1997, as defendants. The unsealed complaint, prepared by the relator, alleged that Quorum knowingly prepared and caused to be filed cost reports which claimed payments from Medicare and other government payment programs greater than the amounts due.

The United States government elected to intervene in, or join, the lawsuit; on February 24, 1999, the government filed its own complaint in the case. The new complaint alleged that Quorum, on behalf of hospitals it managed between 1985 and 1995 and hospitals it owned from 1990 to the date of the complaint, violated the False Claims Act by knowingly submitting or causing to be submitted false Medicare cost reports, resulting in the submission of false claims to Federal health care programs.

The government asserted that the false claims in cost reports were reflected, in part, in "reserve analyses" created by Quorum. The complaint also alleged that these cost report filings were prepared as a result of company policy.

On April 23, 2001, a settlement agreement was signed and a stipulation of dismissal was filed with the court dismissing all claims against Quorum, QHR and the other Quorum subsidiaries named in the lawsuit. The settlement provided for a payment of \$82.5 million to the government, plus interest accruing on \$77.5 million at 7.25% per annum from October 2, 2000 (the date on which an understanding with the government to settle this lawsuit was reached) to the payment date. The settlement was paid in April 2001. The settlement agreement also provides, on certain conditions, for a release of all hospitals currently or formerly managed by QHR electing to participate in the settlement.

In connection with the settlement, Quorum entered into a corporate integrity agreement with the Office of Inspector General containing, among other things, an affirmative obligation to report certain violations of applicable laws and regulations. This obligation could result in greater scrutiny by regulatory authorities. Complying with the corporate integrity agreement may impose expensive and burdensome requirements on certain of Triad's operations which could have a material adverse impact on Triad. Failure to comply with the terms of the corporate integrity agreement could subject the Quorum hospitals to significant monetary penalties and/or exclusion from Medicare, Medicaid and other governmental reimbursement programs.

On August 10, 2001, the Office of Inspector General agreed to suspend Quorum's obligations under this corporate integrity agreement until November 1, 2001, in exchange for Triad's agreement to negotiate a corporate integrity agreement that would also include the hospitals owned by Triad at the time of its merger with Quorum, as well as hospitals Triad might subsequently acquire. (In the distribution agreement with HCA at the time of its spin-off, Triad agreed to participate in the negotiation of a corporate integrity agreement with

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the Office of Inspector General.) These negotiations of a "combined" corporate integrity agreement were concluded and the agreement became effective on November 1, 2001.

Other Qui Tam Actions and Related Investigations

In May 1998, Quorum was informed that it was a defendant in another qui tam action involving home health services provided by two of its owned hospitals and alleging that Quorum had violated Medicare laws. This

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

action was filed under seal in June 1996 by a former employee whom Quorum fired in April 1996. The United States Attorney's Office allowed Quorum an opportunity to review the results of the government's investigations and discuss the allegations made in the action prior to the government making a decision to intervene as a plaintiff. Quorum cooperated fully with the United States Attorney's Office and provided additional information and made employees available for interviews.

On October 26, 2000, Quorum completed settlement of a qui tam lawsuit which primarily involved allegedly improper allocation of costs at Flowers Hospital, Dothan, Alabama, to its home health agency. Quorum paid to the government on October 26, 2000 approximately \$18 million in connection with this settlement. In addition to the settlement agreement, Quorum entered into a five-year corporate integrity agreement covering Flowers Hospital with the Office of the Inspector General, which was terminated upon the effective date of the corporate integrity agreement entered into in connection with the False Claims Act litigation discussed above. The government always reserves the right to investigate and pursue other allegations made by a relator under a complaint. However, under the settlement agreement, the relator is prohibited from pursuing these additional allegations.

As a result of its ongoing discussions with the government, prior to the merger Quorum learned that there are two additional unrelated qui tam complaints against it alleging violations of the False Claims Act for claims allegedly submitted to the government involving one owned and two managed hospitals. Quorum accrued \$3.5 million on these items prior to the merger. Both matters remain under seal. With respect to the matter involving the two managed hospitals, the government has requested that Quorum conduct a self audit with respect to one Medicare cost report for one managed hospital and three other specific issues. The government could undertake additional investigative efforts. The government has stated that it intends to investigate certain other allegations. As Quorum's successor, Triad is also a defendant in certain other qui tam complaints, in which the government has declined to intervene. At this time Triad cannot take a position on how it will respond on these matters.

Stockholder Class Action Regarding the Securities Exchange Act of 1934

In October and November 1998, some of Quorum's stockholders filed lawsuits against Quorum in the U.S. District Court for the Middle District of Tennessee. In January 1999, the court consolidated these cases into a single lawsuit (M.D. Tenn. No. 3-98-1004). The plaintiffs filed an amended complaint in March 1999. The plaintiffs seek to represent a class of plaintiffs who purchased Quorum's common stock from October 25, 1995 through October 21, 1998, except for Quorum's insiders and their immediate families. The consolidated complaint names Quorum, several of Quorum's former officers, and one of Quorum's former outside

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directors, as defendants.

The complaint alleges that defendants violated the Securities Exchange Act of 1934. The plaintiffs claim that Quorum materially inflated Quorum's net revenues during the class period by including in those net revenues amounts received from the settlement of cost reports that had allegedly been filed in violation of applicable Medicare regulations years earlier and that, because of this practice, this statement, which first appeared in Quorum's Form 10-K filed in September 1996, was false: "The Company believes that its owned hospitals are in substantial compliance with current federal, state, local, and independent review body regulations and standards." In May 1999, Quorum filed a motion to dismiss the complaint. On November 13, 2000, the judge denied Quorum's motion to dismiss the complaint against Quorum and James E. Dalton, Jr., Quorum's former President/CEO. The judge granted Quorum's motion to dismiss as to all other defendants. The judge has heard oral argument on Mr. Dalton's motion to reconsider the judge's denial of Mr. Dalton's motion to dismiss and on April 19, 2001 granted Mr. Dalton's motion to dismiss. As Quorum's successor, Triad intends to vigorously defend the claims and allegations in this action.

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

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

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

Income Taxes

The IRS is in the process of conducting an examination of the federal income tax return of Triad for the calendar year ended December 31, 1999, the federal income tax returns of Quorum for the fiscal years ended June 30, 1996 through 2000 and the partnership returns of income for certain joint ventures where Quorum owns a majority interest for the fiscal years ended June 30, 1997 and 1998. The IRS has proposed adjustments with respect to the fiscal years ended June 30, 1996 through 1998 but, to date, has not proposed adjustments with respect to any other years. The most significant adjustments proposed involve the tax accounting methods adopted for computing bad debt expense, the valuation of purchased hospital property and equipment and related depreciable lives,

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income recognition related to estimated cost report settlements and the loss calculation on a taxable liquidation of a subsidiary. The IRS has recently proposed a settlement with respect to the examination of the federal income tax returns of Quorum for the fiscal years ended June 30, 1996 through June 30, 1998, which Triad is currently considering. Triad will protest substantially all of the proposed adjustments that are not settled both on behalf of itself and as successor-in-interest to Quorum and on behalf of the joint ventures through the appeals process of the IRS.

In the opinion of management, the ultimate outcome of the IRS examinations currently under way will not have a material effect on Triad's results of operations or financial position.

HCA Litigation and Investigations

In connection with the spin-off, Triad entered into a distribution agreement with HCA. The terms of the distribution agreement provide that HCA will indemnify Triad for any losses (other than consequential damages) which it may incur as a result of proceedings described below. HCA has also agreed to indemnify Triad for any losses (other than consequential damages) which it may incur as a result of proceedings which may be commenced by government authorities or by private parties in the future that arise from acts, practices or omissions engaged in prior to the date of the spin-off and that relate to the proceedings described below.

HCA is currently the subject of several Federal investigations into certain of its business practices, as well as governmental investigations by various states. HCA is cooperating in these investigations and understands, through written notice and other means, that it is a target in these investigations. Given the breadth of the ongoing investigations, HCA expects additional subpoenas and other investigative and prosecutorial activity to occur in these and other jurisdictions in the future. HCA is the subject of a formal order of investigation by the SEC. HCA understands that the SEC's investigation includes the anti-fraud, insider trading, periodic reporting and internal accounting control provisions of the Federal securities laws.

HCA is a defendant in several qui tam actions on behalf of the United States of America, which have been unsealed and served on HCA. The actions allege, in general, that HCA and certain subsidiaries and/or affiliated partnerships violated the False Claims Act, 31 U.S.C. (S) 3729 et seq., by submitting improper claims to the government for reimbursement. The lawsuits seek three times the amount of damages caused to the United States by the submission of any Medicare or Medicaid false claims presented by the defendants to the Federal government,

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

civil penalties of not less than \$5,000 nor more than \$10,000 for each such Medicare or Medicaid claim, attorneys' fees and costs. HCA has disclosed that on March 15, 2001, the Department of Justice filed a status report setting forth the government's decisions regarding intervention in existing qui tam actions against HCA and filed formal complaints in those suits in which the government has intervened. Of the original 30 qui tam actions, the Department of Justice remains active in and has elected to intervene in 8 actions. HCA has also disclosed that it is aware of additional qui tam actions that remain under seal and believes that there may be other sealed qui tam cases of which it is unaware.

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The investigations, actions and claims affecting HCA relate to HCA and its subsidiaries, including subsidiaries that, prior to the spin-off, owned facilities now owned by Triad. On May 5, 2000, Triad was advised that one of the qui tam cases which had been unsealed listed three of Triad's hospitals as defendants. This qui tam action alleges various violations arising out of the relationship between Curative Health Services and the other defendants, including allegations of false claims relating to contracts with Curative Health Services for the management of certain wound care centers and excessive and unreasonable management fees paid to Curative Health Services and submitted for reimbursement. Two of the three Triad hospitals named as defendants terminated their relationship with Curative Health Services prior to the spin-off and the third hospital terminated its contract thereafter.

In July 1999, Olsten Corporation and its subsidiary, Kimberly Home Health (neither of which is affiliated with HCA), announced that they would pay \$61 million to settle allegations that both companies defrauded the Medicare program. Kimberly pled guilty to three separate felony charges (conspiracy, mail fraud and violating the Medicare Anti-Kickback statute) filed by the U.S. Attorneys in the Middle and Southern Districts of Florida and the Northern District of Georgia. While HCA was not specifically named in these guilty pleas, the guilty pleas refer to the involvement of a "Company A" or a "company not named as a defendant." HCA has disclosed that it believes these references refer to HCA or its subsidiaries.

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

On May 18, 2000, HCA announced that it had reached an understanding with attorneys of the Civil Division of the Department of Justice to recommend an agreement to settle, subject to certain conditions, the civil claims actions against HCA relating to diagnosis related group coding, outpatient laboratory billing and home health issues. The understanding with the Department of Justice attorneys would require HCA to pay \$745 million in compensation to the government, with interest accruing at a fixed rate of 6.5% per annum (beginning May 18, 2000), and would reduce HCA's existing letter of credit agreement with the government from \$1 billion to \$250 million at the time of the payment of the settlement. On December 14, 2000, HCA announced that it had entered into a settlement agreement with the Civil Division of the Department of Justice and that payment of the amounts required by the settlement agreement would be made upon court approval of the settlement. On July 31, 2001, the government filed a motion to order payment of the settlement amount by the HCA. On August 7, 2001, an order was entered approving the settlement and directing the payment. On August 10, 2001, the payment was made by HCA. HCA also entered into a corporate integrity agreement with the Health and Human Services Office of the Inspector General. HCA is in continuing discussions with the government regarding civil issues relating to cost reporting and physician relations.

On December 14, 2000, HCA also announced that it had signed an agreement with the Criminal Division of the Department of Justice to resolve pending Federal criminal actions against HCA. HCA received a full release from criminal liability for conduct arising from or relating to billing and reimbursement for services provided pursuant to Federal health care benefit programs regarding:

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Medicare cost reports; violations of the anti-kickback statute or prohibitions against physician self-referrals, and any other conduct involving relations with referral sources and those in a position to influence referral sources; diagnosis related group billing; laboratory billing; the acquisition of home health agencies; and the provision of services by home health agencies. In addition, the government agreed not to prosecute HCA for other possible criminal offenses which are or have been under

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

investigation by the Department of Justice arising from or relating to billing and reimbursement for services provided pursuant to Federal health care benefit programs. As part of the criminal agreement, HCA paid the government \$95 million and two non-operating subsidiaries of HCA entered certain pleas in respect of the criminal actions. HCA also stated that representatives of state attorneys general have agreed to recommend to state officials that HCA be released from corresponding criminal liability in all states in which it conducts business.

The agreements announced on December 14, 2000 relate only to conduct that was the subject of the Federal investigations resolved in the agreements, and HCA has stated publicly that it continues to discuss civil claims relating to cost reporting and physician relations with the government. These agreements with the government do not resolve various qui tam actions filed by private parties against HCA, or any pending state actions. In addition to other claims not covered by these agreements, the government also reserved its rights under these agreements to pursue any claims it may have for:

- . any civil, criminal or administrative liability under the Internal Revenue Code;
- . any other criminal liability;
- . any administrative liability, including mandatory exclusion from Federal health care programs;
- . any liability to the United States (or its agencies) for any conduct other than the conduct covered in the government's investigation;
- . any express or implied warranty claims or other claims for defective or deficient products or services, including quality of goods and services, provided by HCA;
- . any claims for personal injury or property damage or for other similar consequential damages arising from the conduct subject to the investigation; and
- . any civil or administrative claims of the United States against individuals.

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

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liabilities arising out of cost reports filed during these periods.

HCA has agreed that, in the event that any hospital owned by Triad at the time of the spin-off is permanently excluded from participation in the Medicare and Medicaid programs as a result of the proceedings described above, then HCA will make a cash payment to Triad, in an amount (if positive) equal to five times the excluded hospital's 1998 income from continuing operations before depreciation and amortization, interest expense, management fees, impairment of long-lived assets, minority interests and income taxes, as set forth on a schedule to the distribution agreement, less the net proceeds of the sale or other disposition of the excluded hospital. Triad has agreed that, in connection with the government investigations described above, it will participate with HCA in negotiating one or more compliance agreements setting forth each of HCA's and Triad's agreements to comply with applicable laws and regulations.

HCA will not indemnify Triad under the distribution agreement for losses relating to any acts, practices or omissions engaged in by Triad after the spin-off, whether or not Triad is indemnified for similar acts, practices and omissions occurring prior to the spin-off. HCA also will not indemnify Triad under the distribution agreement for similar qui tam litigation, governmental investigations and other actions to which Quorum was subject, some of which are described above. If indemnified matters were asserted successfully against Triad or any of its facilities, and HCA failed to meet its indemnification obligations, then this event could have a material adverse effect on Triad's business, financial condition, and results of operations or prospects.

Triad is unable to predict the effect or outcome of any of the ongoing investigations or qui tam and other actions, or whether any additional investigations or litigation will be commenced. The extent to which Triad may or may not continue to be affected by the ongoing investigations of HCA and the initiation of additional investigations,

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

if any, cannot be predicted. These matters could have a material adverse effect on Triad's business, financial condition, and results of operations or prospects in future periods.

General Liability Claims

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

HEALTH CARE REFORM

In recent years, an increasing number of legislative proposals have been introduced in or proposed by Congress and some state legislatures that would significantly affect health care systems in Triad's markets. The cost of certain proposals would be funded, in significant part, by a reduction in payments by government programs, including Medicare and Medicaid, to health care providers (similar to the reductions incurred as part of the Balanced Budget Act as

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previously discussed). While Triad is unable to predict whether any proposals for health care reform will be adopted, there can be no assurance that proposals adverse to the business of Triad will not be adopted.

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

Item 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Triad is exposed to market risk related to changes in interest rates. No derivatives are currently used to alter the interest rate characteristics of Triad's debt instruments.

With respect to Triad's interest-bearing liabilities, approximately \$889.0 million of long-term debt at September 30, 2001 was subject to variable rates of interest, while the remaining balance in long-term debt of \$925.2 million at September 30, 2001 was subject to fixed rates of interest. The estimated fair value of Triad's total long-term debt was \$1,866.0 million at September 30, 2001. The estimates of fair value are based upon the quoted market prices for the same or similar issues of long-term debt with the same maturities. Based on a hypothetical 1% increase in interest rates, the potential annualized decrease in future pre-tax earnings would be approximately \$8.9 million. The impact of such a change in interest rates on the carrying value of long-term debt would not be significant. The estimated changes to interest expense and the fair value of long-term debt are determined considering the impact of hypothetical interest rates on Triad's borrowing cost and long-term debt balances. These analyses do not consider the effects, if any, of the potential changes in Triad's credit ratings or the overall level of economic activity. Further, in the event of a change of significant magnitude, management would expect to take actions intended to further mitigate its exposure to such change.

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Part II: Other Information

Item 1: LEGAL PROCEEDINGS

Incorporated by reference from NOTE 9 to the Condensed Consolidated Financial Statements contained in Part I, Item 1.

Item 6: Exhibits and Reports on Form 8-K.

- (a) List of Exhibits:
None

- (b) Reports on Form 8-K filed during the quarter ended September 30, 2001:

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On July 31, 2001, Triad reported that it had issued a press release announcing their consolidated financial results for the three months ended June 30, 2001.

On August 30, 2001, Triad reported that it had issued a press release announcing that it would extend its offer to exchange its outstanding unregistered 8 3/4 % Senior Notes for new 8 3/4 % Series B Senior Notes that have registered under the Securities Act of 1933, as amended.

SIGNATURES

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

Date: November 14, 2001

Triad Hospitals, Inc.

By: /s/BURKE W. WHITMAN

Burke W. Whitman

Executive Vice President and

Chief Financial Officer

(Principal Financial Officer)

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INDEX TO EXHIBITS

None

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