

TRIAD HOSPITALS INC
Form 10-Q
November 07, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2006

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
(State or other jurisdiction of
incorporation or organization)

75-2816101
(I.R.S. Employer
Identification No.)

5800 Tennyson Parkway
Plano, Texas
(Address of principal executive offices)

75024
(Zip Code)

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(214) 473-7000

(Registrant's telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

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

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

Large accelerated filer Accelerated filer Non-accelerated filer

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

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

As of October 31, 2006, the number of shares of common stock of Triad Hospitals, Inc. outstanding was 88,020,293.

Part I: Financial Information**Item 1: Financial Statements****TRIAD HOSPITALS, INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

For the periods ended September 30, 2006 and 2005

Unaudited

(Dollars in millions, except per share amounts)

	For the three		For the nine	
	months ended 2006	2005	months ended 2006	2005
Revenues	\$ 1,373.1	\$ 1,160.9	\$ 4,120.4	\$ 3,481.3
Salaries and benefits, including share-based compensation expense of \$7.1 and \$20.8 for the three and nine months ended September 30, 2006, respectively	555.4	494.1	1,666.8	1,436.3
Reimbursable expenses	12.1	12.2	38.1	38.8
Supplies	238.0	198.0	709.7	584.1
Other operating expenses	270.7	208.9	796.1	633.7
Provision for doubtful accounts	152.0	84.6	400.9	280.5
Depreciation	55.9	49.5	164.7	148.6
Amortization	1.4	1.8	5.0	4.8
Interest expense	29.1	27.6	86.7	82.7
Interest income	(4.7)	(3.4)	(14.9)	(5.0)
Refinancing transaction costs				8.4
ESOP expense	3.1	3.7	9.2	10.9
Gain on sales of assets	(5.3)	(0.3)	(5.9)	(0.8)
Total operating expenses	1,307.7	1,076.7	3,856.4	3,223.0
Income from continuing operations before minority interests, equity in earnings and income tax provision	65.4	84.2	264.0	258.3
Minority interests in earnings of consolidated entities	(7.1)	(1.8)	(17.1)	(8.1)
Equity in earnings of unconsolidated affiliates	11.3	8.1	31.1	27.8
Income from continuing operations before income tax provision	69.6	90.5	278.0	278.0
Income tax provision	(28.9)	(35.2)	(109.4)	(107.6)
Income from continuing operations	40.7	55.3	168.6	170.4
Income (loss) from discontinued operations, net of tax	(0.9)	(9.0)	14.4	1.0
Net income	\$ 39.8	\$ 46.3	\$ 183.0	\$ 171.4
Income per common share:				
Basic:				
Continuing operations	\$ 0.47	\$ 0.65	\$ 1.96	\$ 2.11
Discontinued operations	\$ (0.01)	\$ (0.11)	\$ 0.17	\$ 0.01

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Net	\$ 0.46	\$ 0.54	\$ 2.13	\$ 2.12
Diluted:				
Continuing operations	\$ 0.47	\$ 0.64	\$ 1.94	\$ 2.06
Discontinued operations	\$ (0.01)	\$ (0.11)	\$ 0.17	\$ 0.01
Net	\$ 0.46	\$ 0.53	\$ 2.11	\$ 2.07

See notes to the condensed consolidated financial statements.

TRIAD HOSPITALS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

Unaudited

(Dollars in millions)

	September 30, 2006	December 31, 2005
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 262.4	\$ 310.2
Accounts receivable, less allowances for doubtful accounts of \$376.9 at September 30, 2006 and \$292.8 at December 31, 2005	932.4	800.2
Inventories	142.2	130.0
Deferred income taxes	40.0	31.8
Prepaid expenses	57.1	41.1
Discontinued operations assets		67.6
Other	100.8	93.0
	1,534.9	1,473.9
Property and equipment, at cost:		
Land	207.0	182.3
Buildings and improvements	1,930.0	1,739.3
Equipment	1,634.3	1,449.1
Construction in progress	215.1	226.3
	3,986.4	3,597.0
Accumulated depreciation	(1,160.6)	(1,012.8)
	2,825.8	2,584.2
Goodwill	1,333.9	1,301.6
Intangible assets, net of accumulated amortization	72.1	71.7
Investment in and advances to unconsolidated affiliates	241.6	204.8
Other	115.7	100.7
Total assets	\$ 6,124.0	\$ 5,736.9
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable	\$ 214.7	\$ 197.5
Accrued salaries	132.1	126.8
Current portion of long-term debt	16.9	7.7
Current income taxes payable		17.1
Discontinued operations liabilities		3.1
Other current liabilities	225.9	163.1
	589.6	515.3
Long-term debt	1,687.3	1,695.8
Other liabilities	187.1	167.8
Deferred taxes	193.6	201.9
Minority interests in equity of consolidated entities	294.5	228.4
Stockholders' equity:		
Common stock \$0.01 par value: 120,000,000 shares authorized, 88,000,930 and 86,373,170 shares issued and outstanding at September 30, 2006 and December 31, 2005, respectively	0.9	0.9

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Additional paid-in capital	2,390.2	2,331.6
Unearned ESOP compensation	(7.8)	(10.4)
Accumulated other comprehensive loss	(1.6)	(1.6)
Accumulated earnings	790.2	607.2
Total stockholders' equity	3,171.9	2,927.7
Total liabilities and stockholders' equity	\$ 6,124.0	\$ 5,736.9

See notes to the condensed consolidated financial statements.

TRIAD HOSPITALS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

For the periods ended September 30, 2006 and 2005

Unaudited

(Dollars in millions)

	For the nine	
	months ended	
	2006	2005
Cash flows from operating activities:		
Net income	\$ 183.0	\$ 171.4
Adjustments to reconcile net income to net cash provided by operating activities:		
Income from discontinued operations, net of tax	(14.4)	(1.0)
Provision for doubtful accounts	400.9	280.5
Depreciation and amortization	169.7	153.4
ESOP expense	9.2	10.9
Minority interests	17.1	8.1
Equity in earnings of unconsolidated affiliates	(31.1)	(27.8)
Gain on sales of assets	(5.9)	(0.8)
Deferred income tax provision (benefit)	(10.1)	25.3
Non-cash interest expense	2.5	3.2
Refinancing transaction costs		8.4
Non-cash share-based compensation expense	20.8	1.4
Excess tax benefits on share-based compensation	(1.4)	
Increase (decrease) in cash from operating assets and liabilities:		
Accounts receivable	(518.0)	(370.9)
Inventories and other assets	(30.5)	(2.8)
Accounts payable and other current liabilities	(15.3)	73.0
Other	34.6	18.9
Net cash provided by operating activities	211.1	351.2
Cash flows from investing activities:		
Purchases of property and equipment	(338.9)	(279.4)
Distributions and advances (to) from unconsolidated affiliates, net	(4.5)	21.6
Proceeds received on disposals of assets	116.5	35.9
Acquisitions, net of cash acquired	(55.6)	(161.3)
Other	(0.3)	(0.2)
Net cash used in investing activities	(282.8)	(383.4)
Cash flows from financing activities:		
Payments of long-term debt	(4.3)	(484.0)
Proceeds from issuance of long-term debt		520.0
Payment of debt issue costs		(6.4)
Proceeds from issuance of common stock	27.1	310.2
Excess tax benefits on share-based compensation	1.4	
Contributions from (distributions to) minority partners, net	(0.3)	9.5
Net cash provided by financing activities	23.9	349.3
Change in cash and cash equivalents	(47.8)	317.1

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Cash and cash equivalents at beginning of period	310.2	56.6
Cash and cash equivalents at end of period	\$ 262.4	\$ 373.7
Cash paid for:		
Interest	\$ 66.5	\$ 62.6
Income taxes, net of refunds	\$ 153.7	\$ 76.8

See notes to the condensed consolidated financial statements.

TRIAD HOSPITALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Unaudited

NOTE 1 BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U.S. 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 U.S. 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 thereto for the year ended December 31, 2005 included in Triad s Annual Report on Form 10-K.

In the third quarter of 2006, Triad revised its estimate of uncollectible accounts which increased the allowance for doubtful accounts to approximately 65.9% of discounted uninsured receivables from approximately 62.5%, resulting in an increase in the provision for doubtful accounts of approximately \$15 million. This change in estimate resulted in a reduction to income from continuing operations and net income of approximately \$9.5 million. Basic earnings per share and diluted earnings per share both were decreased by \$0.11 for both the three and nine months ended September 30, 2006 as a result of the change in estimate.

During the second quarter of 2006, Triad recorded an increase of approximately \$10.3 million to its estimated liabilities for general and professional insurance due to a reduction of the discount rate to 5.5% from 6.0% and changes in actuarial assumptions to accelerate claim payment patterns. The increase in the estimated liabilities for general and professional insurance decreased income from continuing operations and net income by approximately \$6.5 million. Basic earnings per share and diluted earnings per share were decreased by \$0.08 and \$0.07, respectively, for the three and six months ended June 30, 2006, as a result of the increase.

The condensed consolidated balance sheet at December 31, 2005 has been derived from the audited consolidated financial statements at that date but does not include all of the information and notes required by U.S. Generally Accepted Accounting Principles for complete financial statements.

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

NOTE 2 STOCK BENEFIT PLANS

At September 30, 2006, Triad had share-based compensation plans that, prior to January 1, 2006, were accounted for under the recognition and measurement principles of APB Opinion No. 25, Accounting for Stock Issued to Employees (APB 25) and related interpretations, as permitted by Statement of Financial Accounting Standards No. 123 (SFAS 123), Accounting for Stock-Based Compensation . APB 25 used the intrinsic value method to account for options granted to employees. Share-based compensation expense of \$0.6 million and \$0.8 million was recognized in the condensed consolidated statement of operations for restricted stock issued to non-employee members of the Board of Directors and an executive officer during the three and nine months ended September 30, 2005, respectively. No share-based compensation expense was recognized on options awarded to employees, as all unvested options were granted at exercise prices equal to the market value of the underlying common stock on the date of grant. Triad recorded \$0.2 million and \$0.6 million in share-based compensation expense during the three and nine months ended September 30, 2005, respectively, relating to stock options granted to non-employees, deferred stock units (DSUs) granted to non-employee members of the Board of Directors and shares issued under Triad s Amended and Restated Management Stock Purchase Plan (MSPP).

Effective January 1, 2006, Triad adopted the fair value recognition provisions of Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment (SFAS 123R), using the modified prospective transition method. Under this method, share-based compensation expense is recognized beginning January 1, 2006 for all share-based payments granted prior to, but not yet vested at, January 1, 2006 based on the grant date fair value estimated in accordance with the original provisions of SFAS 123, and for all share-based payments granted subsequent to January 1, 2006 at the grant date fair value, using estimated forfeitures. Prior periods have not been restated.

TRIAD HOSPITALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Unaudited

NOTE 2 STOCK BENEFIT PLANS (continued)

The following table illustrates the impact of adopting SFAS 123R on the condensed consolidated statements of operations for the three and nine months ended September 30, 2006 (amounts in millions, except per share information):

	For the three months ended September 30, 2006	For the nine months ended September 30, 2006
Income from continuing operations before income tax provision	\$ (7.1)	\$ (20.8)
Income from continuing operations	\$ (4.8)	\$ (13.9)
Net income	\$ (4.8)	\$ (13.9)
Basic income from continuing operations per share	\$ (0.06)	\$ (0.16)
Basic net income per share	\$ (0.06)	\$ (0.16)
Diluted income from continuing operations per share	\$ (0.05)	\$ (0.16)
Diluted net income per share	\$ (0.05)	\$ (0.16)

Prior to adopting SFAS 123R, Triad presented all benefits of tax deductions for share-based compensation as operating cash flows in the condensed consolidated statements of cash flows. SFAS 123R requires that the tax benefit in excess of compensation costs be classified as financing cash flows. As a result of adopting SFAS 123R, Triad reported a reduction of cash flows from operating activities and a corresponding increase to cash flows from financing activities of \$1.4 million in the nine months ended September 30, 2006.

Triad's Amended and Restated Long-Term Incentive Plan (LTIP) has 20,500,000 shares of Triad's common stock reserved for issuance. The LTIP provides for grants of stock options, restricted stock and other equity-based awards to officers, employees and directors of Triad. Awards of stock options granted under the LTIP are generally at an exercise price equal to the market value of Triad's common stock at the date of grant, become exercisable over a four-year period and expire 10 years from the date of grant. The fair value of stock options granted under the LTIP is estimated on the date of grant using the Black-Scholes option pricing model. Expected volatility is based on the historical volatility of Triad's common stock. The expected term is based on the historical exercise patterns of Triad's stock options. Awards of restricted stock granted under the LTIP have a fair value equal to the market value of Triad's common stock on the date of grant and generally vest over a four-year period except for awards of restricted stock granted to non-employee directors, which generally vest one year from the date of grant. Triad recorded \$6.0 million and \$17.6 million in share-based compensation expense in the three and nine months ended September 30, 2006, respectively, for awards granted under the LTIP.

Triad's Outside Directors Stock and Incentive Compensation Plan (Outside Directors Plan) has 750,000 shares of Triad's common stock reserved for issuance. The Outside Directors Plan provides for grants of stock options and DSUs to non-employee members of the Board of Directors. Awards of stock options granted under the Outside Directors Plan are generally at an exercise price equal to the market value of Triad's common stock at the date of grant, become exercisable over a four-year period and expire 10 years from the date of grant. The fair value of stock options granted under the Outside Directors Plan is estimated on the grant date using the Black-Scholes option pricing model. The Outside Directors Plan provides outside directors the option to elect to receive all or a portion (in 25% increments) of their annual retainer (excluding the annual stipend for the committee chairpersons) in DSUs that settle in shares of Triad common stock at the earlier of the fifth anniversary of the date of grant or the end of the director's service on the Board of Directors, at the director's election. If a director elects to receive DSUs, the number of DSUs granted in payment of all or a portion of the annual retainer is calculated based on the market value of Triad's common stock on the date of grant. Triad recorded \$0.2 million and \$0.5 million in share-based compensation expense in the three and nine months ended September 30, 2006, respectively, for awards granted under the Outside Directors Plan.

Triad's MSPP provides certain members of management an opportunity to purchase restricted shares of its common stock at a discount through payroll deductions over six month intervals. The restricted shares are granted at a 25% discount from the six-month average market price of the common stock on the date of grant. The vesting period is three years from the date of grant, and subject to certain exceptions, an employee forfeits the value of the discount and any appreciation in the stock if employment is terminated during the vesting period. The fair value of shares issued under the MSPP is estimated on the date of grant using the Black-Scholes option pricing model. Triad

TRIAD HOSPITALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Unaudited

NOTE 2 STOCK BENEFIT PLANS (continued)

recorded \$0.1 million and \$0.2 million in share-based compensation expense in the three and nine months ended September 30, 2006, respectively, for shares issued under the MSPP.

Triad has an Employee Stock Purchase Plan (ESPP) which provides an opportunity to purchase shares of its common stock to all eligible employees at a discount through payroll deductions over six month intervals. The shares are issued at a 15% discount from the lower of the market price of Triad s common stock at the beginning date of the plan period or the market price at the ending date of the plan period. The fair value of shares issued under the ESPP is estimated at the beginning of the plan period using the Black-Scholes option pricing model. Triad recorded \$0.8 million and \$2.5 million in share-based compensation expense in the three and nine months ended September 30, 2006, respectively, for shares issued under the ESPP. Triad issued 190,985 shares under the ESPP during the nine months ended September 30, 2006.

The following weighted average assumptions were used in the Black-Scholes option pricing model for stock options granted for all plans during the nine months ended September 30, 2006 and 2005.

	2006	2005
Risk free interest rate	4.88%	3.51%
Expected life	5 years	5 years
Expected volatility	19.6%	26.4%
Expected dividend yield		

The following table illustrates the effect on income from continuing operations, net income and earnings per share if Triad had applied the fair value recognition provisions of SFAS 123 to its share-based compensation plans prior to adoption of SFAS 123R:

	For the three months ended	For the nine months ended
	September 30, 2005	
Income from continuing operations, as reported	\$ 55.3	\$ 170.4
Add: Share-based compensation expense recorded	0.5	0.9
Less: Fair value share-based compensation expense	(4.7)	(16.7)
Pro forma	\$ 51.1	\$ 154.6
Net income, as reported	\$ 46.3	\$ 171.4
Add: Share-based compensation expense recorded	0.5	0.9
Less: Fair value share-based compensation expense	(4.7)	(16.7)
Pro forma	\$ 42.1	\$ 155.6
Basic income per share		
Income from continuing operations, as reported	\$ 0.65	\$ 2.11
Add: Share-based compensation expense recorded	0.01	0.01
Less: Fair value share-based compensation expense	(0.05)	(0.21)
Pro forma	\$ 0.61	\$ 1.91

TRIAD HOSPITALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Unaudited

NOTE 2 STOCK BENEFIT PLANS (continued)

	For the three months ended	For the nine months ended
	September 30, 2005	
Net income, as reported	\$ 0.54	\$ 2.12
Add: Share-based compensation expense recorded	0.01	0.01
Less: Fair value share-based compensation expense	(0.05)	(0.21)
Pro forma	\$ 0.50	\$ 1.92
Diluted income per share		
Income from continuing operations, as reported	\$ 0.64	\$ 2.06
Add: Share-based compensation expense recorded		0.01
Less: Fair value share-based compensation expense	(0.04)	(0.19)
Pro forma	\$ 0.60	\$ 1.88
Net income, as reported	\$ 0.53	\$ 2.07
Add: Share-based compensation expense recorded		0.01
Less: Fair value share-based compensation expense	(0.04)	(0.19)
Pro forma	\$ 0.49	\$ 1.89

A summary of stock option activity under Triad's share-based compensation plans at September 30, 2006 is presented below:

	Shares	Weighted average exercise price	Weighted average remaining contractual term (in years)	Aggregate intrinsic value
Outstanding at January 1, 2006	8,001,692	\$ 33.04		
Granted	20,000	\$ 41.12		
Exercised	(758,637)	\$ 26.82		
Cancelled	(229,714)	\$ 38.51		
Outstanding at September 30, 2006	7,033,341	\$ 33.64	7.1	\$ 73,268,892
Exercisable at September 30, 2006	4,446,503	\$ 31.07	6.3	\$ 57,658,011

The weighted average grant-date fair value of options granted was \$11.63 and \$12.88 during the nine months ended September 30, 2006 and 2005, respectively. The total intrinsic value of options exercised was \$11.2 million and \$62.7 million during the nine months ended September 30, 2006 and 2005, respectively.

A summary of Triad's non-vested shares at September 30, 2006 is presented below:

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	Restricted Stock		MSPP Shares		DSUs	
	Shares	Weighted average grant-date fair value	Shares	Weighted average grant-date fair value	Shares	Weighted average grant-date fair value
Non-vested at January 1, 2006	120,000	\$ 49.42	85,086	\$ 10.68	23,488	\$ 33.03
Granted	686,100	\$ 40.77	11,049	\$ 11.84	6,199	\$ 41.12
Vested	(20,000)	\$ 49.42	(15,091)	\$ 9.43	(4,804)	\$ 24.98
Cancelled	(18,250)	\$ 40.83	(5,565)	\$ 10.58		\$
Non-vested at September 30, 2006	767,850	\$ 41.90	75,479	\$ 11.09	24,883	\$ 36.60

The total fair value of shares vested was \$26.1 million and \$31.8 million during the nine months ended September 30, 2006 and 2005, respectively.

TRIAD HOSPITALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Unaudited

NOTE 2 STOCK BENEFIT PLANS (continued)

At September 30, 2006, there was \$52.1 million of total unrecognized share-based compensation expense related to Triad's non-vested share-based compensation plans that is expected to be recognized over a weighted average period of 2.4 years.

Cash received from option exercises under share-based payment arrangements during the nine months ended September 30, 2006 was \$27.1 million. The actual tax benefit realized for the tax deductions of the share-based payment arrangements totaled \$4.8 million for the nine months ended September 30, 2006.

NOTE 3 ACQUISITIONS

Effective February 1, 2006, Triad closed under a definitive agreement to form a venture with a non-profit entity in Clarksville, Tennessee. Triad contributed approximately \$25.6 million in cash for an 80% interest in the venture and the non-profit contributed the hospital's current operations, including real estate and equipment, and received a 20% interest in the venture. The venture has begun building a replacement facility for which Triad would contribute an additional \$125 million.

Effective February 1, 2006, Triad closed under a definitive agreement to form a venture with a non-profit entity in Massillon, Ohio. Triad contributed its current hospital in Massillon and approximately \$11.4 million in cash for approximately a 59% interest in the venture and the non-profit entity contributed its hospital for approximately a 41% interest in the venture. In the second quarter of 2006, the non-profit entity exercised its option to sell a portion of its interest in the venture to Triad. Triad paid approximately \$12.2 million and obtained an additional interest in the venture of approximately 21%, increasing its total interest to approximately 80%.

In the third quarter of 2006, Triad acquired certain non-hospital healthcare entities for approximately \$6.4 million.

The operations of the acquired entities are included in Triad's operations from the effective dates of the transactions.

Triad has obtained appraisals and valuations on the assets and liabilities acquired and, based on these valuations, intangible assets of \$2.7 million were recorded, of which \$1.8 million was assigned to a trade name that is not subject to amortization and \$0.9 million was assigned to non-compete agreements that are being amortized over a five-year period. The acquired goodwill, based on the appraisals, totaled \$41.8 million and has been assigned to the owned operations segment. Approximately \$8.9 million of the acquired goodwill is anticipated to be deductible for tax purposes.

In 2006, Triad obtained an appraisal for a joint venture formed in the fourth quarter of 2005 in Birmingham, Alabama. Acquired intangible assets of \$2.4 million were recorded in 2006, which were assigned to non-compete agreements that are being amortized over a five-year period. The acquired goodwill, which was assigned to the owned operations segment, was reduced in 2006 by \$10.2 million.

NOTE 4 DISCONTINUED OPERATIONS

Effective January 1, 2006, Triad closed on a definitive agreement to sell its hospitals in Wharton, Texas, Pampa, Texas and Hope, Arkansas for \$75 million plus \$15.1 million for working capital. These facilities were reclassified to discontinued operations in the fourth quarter of 2005. Triad recognized a pre-tax gain on the sale in discontinued operations of \$26.9 million for the nine months ended September 30, 2006. The condensed consolidated statement of operations for the three and nine months ended September 30, 2005 was restated to reflect the reclassification to discontinued operations. These facilities were a component of the owned operations segment.

On November 1, 2005, Triad closed on an agreement to sell its hospital in Searcy, Arkansas. At the time of disposal, Triad recorded a contingent liability relating to the sale of the facility. Management determined that the contingency was resolved and reversed the liability in the second quarter of 2006. A pre-tax gain of approximately \$0.3 million was recognized in discontinued operations in the second quarter of 2006.

TRIAD HOSPITALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Unaudited

NOTE 4 DISCONTINUED OPERATIONS (continued)

Triad closed under an agreement in May 2004 to sell certain assets related to its leased acute care hospital in Terrell, Texas. At the time of the disposal, Triad recorded \$3.4 million in notes receivable. During the third quarter of 2006, the borrower defaulted on the first payment due under the notes. A reserve on the notes for the amount in excess of the estimated value of the collateral of approximately \$1.4 million was recorded in discontinued operations.

The assets and liabilities of entities included in discontinued operations are presented in the condensed consolidated balance sheets under the captions Discontinued operations assets and Discontinued operations liabilities. At September 30, 2006, all assets and liabilities included in discontinued operations were sold. The carrying amounts of the major classes of these assets and liabilities are as follows (in millions):

	December 31,
	2005
Assets	
Accounts receivable, net	\$ 17.6
Inventories	2.2
Other current assets	3.9
Property and equipment, net	40.5
Goodwill	3.3
Other	0.1
 Total discontinued operations assets	 \$ 67.6
Liabilities	
Accounts payable	\$ 1.3
Accrued salaries	1.8
 Total discontinued operations liabilities	 \$ 3.1

Revenues and income for these entities are included in the condensed consolidated statements of operations as Income (loss) from discontinued operations, net of tax for all periods presented. The amounts are as follows (in millions):

	For the three months		For the nine months	
	ended September 30,	ended September 30,	ended September 30,	ended September 30,
	2006	2005	2006	2005
Revenues	\$ (0.1)	\$ 36.9	\$ 0.9	\$ 141.2
Pre-tax loss from operations	(0.5)	(5.3)	(1.4)	(0.5)
Income tax benefit	0.2	2.0	0.5	0.1
	(0.3)	(3.3)	(0.9)	(0.4)
Impairment charge, net of tax benefit of \$2.8 million for the three and nine months ended September 30, 2005		(4.7)		(4.7)
Gain (loss) on disposal, net of tax (provision) benefit of \$0.8 million and \$0.5 million for the three months ended September 30, 2006 and 2005, respectively, and \$(10.5) million and \$(2.0) million	(0.6)	(1.0)	15.3	6.1

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for the nine months ended September 30, 2006 and 2005, respectively.

\$ (0.9) \$ (9.0) \$ 14.4 \$ 1.0

NOTE 5 GUARANTEES

Triad has entered into physician recruiting agreements under which it supplements physician income to a minimum amount over a period of time while the physicians establish themselves in the community. As part of the agreements, the physicians are required to stay in the community for a period of time after the payments have ended or the payments are required to be returned to Triad. The payments under these agreements are forgiven ratably if the physicians stay in the community through the end of the agreement. Triad adopted Financial Accounting

TRIAD HOSPITALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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NOTE 5 GUARANTEES (continued)

Standards Board Staff Position No. FIN 45-3, Application of FASB Interpretation No. 45 to Minimum Revenue Guarantees Granted to a Business or Its Owners (FIN 45-3), on January 1, 2006. FIN 45-3 requires that a liability for the estimated fair value of minimum revenue guarantees be recorded on new agreements entered into on or after January 1, 2006 and requires disclosure of the maximum amount that could be paid on all minimum revenue guarantees. Triad records an asset for the estimated fair value of the minimum revenue guarantees and amortizes the asset from the beginning of the guarantee payment period through the end of the agreement. At September 30, 2006, Triad had liabilities for the minimum revenue guarantees entered into on or after January 1, 2006 of \$14.1 million. At September 30, 2006, the maximum amount of all unpaid minimum revenue guarantees was \$66.9 million.

Triad has entered into agreements whereby it has guaranteed certain loans entered into by patients for whom services were performed at Triad's facilities. All uninsured patients are eligible to apply for these loans. These loans are provided by various financial institutions who determine whether the loans are made. The terms of the loans range from 1 to 5 years. Triad would be obligated to repay the financial institutions if a patient fails to repay his or her loan. Triad could then pursue collections from the patient. Triad records a reserve for the estimated defaults on these loans at the historical default rate, which was approximately 29.9% at September 30, 2006 and 29.1% at December 31, 2005. At September 30, 2006 and December 31, 2005, the amounts subject to the guarantees were \$24.3 million and \$23.6 million, respectively. Triad had accrued liabilities of \$7.2 million and \$6.8 million at September 30, 2006 and December 31, 2005, respectively, for the estimated loan defaults that would be covered under the guarantees.

FASB Interpretation No. 45, Guarantors Accounting on Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others requires recognition of a liability for the estimated fair value of guarantee obligations entered into after January 1, 2003 and disclosure of the maximum amount that could be paid under all guarantee obligations. Prior to January 1, 2003, Triad entered into agreements to guarantee the indebtedness of certain joint ventures that are accounted for by the equity method. The maximum amount of the guarantees entered into prior to January 1, 2003 was \$2.0 million at September 30, 2006. Subsequent to January 1, 2003, Triad entered into agreements to guarantee the indebtedness of joint ventures accounted for by the equity method. A minimal amount was recorded for the fair value of the guarantees. The maximum amount of the guarantees entered into after January 1, 2003 was \$1.8 million at September 30, 2006.

NOTE 6 INCOME PER SHARE

Income per common share is based on the weighted average number of shares outstanding adjusted for the shares issued to Triad's Employee Stock Ownership Plan (ESOP) and unvested restricted shares issued under Triad's share-based compensation plans. Diluted weighted average shares outstanding is calculated by adjusting basic weighted average shares outstanding by all potentially dilutive stock options and unvested restricted stock. Stock options outstanding of 1,655,250 for the three and nine months ended September 30, 2006 and stock options outstanding of 40,000 for the three and nine months ended September 30, 2005 were not included in the computation of diluted earnings per share because the exercise prices of the options were greater than the average market price of Triad's common stock and thus the inclusion would have been antidilutive. Weighted average shares are as follows:

	For the three months		For the nine months	
	ended September 30,		ended	
	2006	2005	September 30,	2005
Weighted average shares exclusive of unreleased ESOP shares and unvested restricted shares	86,333,965	84,635,308	86,035,126	80,797,070
Average of ESOP shares committed to be released	187,500	187,500	112,500	112,500
Basic weighted average shares outstanding	86,521,465	84,822,808	86,147,626	80,909,570
Effect of dilutive securities - share-based compensation plans	939,586	1,766,049	784,491	1,767,842
Diluted weighted average shares outstanding	87,461,051	86,588,857	86,932,117	82,677,412

TRIAD HOSPITALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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NOTE 7 SEGMENT INFORMATION

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

	For the three months		For the nine months	
	ended September 30, 2006	2005	ended September 30, 2006	2005
Revenues:				
Owened operations	\$ 1,344.7	\$ 1,132.5	\$ 4,034.9	\$ 3,394.9
Management services	28.1	28.2	84.8	86.0
Corporate and other	0.3	0.2	0.7	0.4
	\$ 1,373.1	\$ 1,160.9	\$ 4,120.4	\$ 3,481.3

	For the three months		For the nine months	
	ended September 30, 2006	2005	ended September 30, 2006	2005
Adjusted EBITDA (a):				
Owened operations	\$ 174.7	\$ 185.1	\$ 609.7	\$ 580.8
Management services	2.0	5.7	10.0	14.6
Corporate and other	(20.5)	(19.6)	(79.8)	(59.7)
	\$ 156.2	\$ 171.2	\$ 539.9	\$ 535.7

Adjusted EBITDA for owned operations includes equity in earnings of unconsolidated affiliates of \$11.3 million and \$8.1 million for the three months ended September 30, 2006 and 2005, respectively, and \$31.1 million and \$27.8 million for the nine months ended September 30, 2006 and 2005, respectively.

Prior periods have been restated for the reclassification of discontinued operations (see NOTE 4).

A reconciliation of Adjusted EBITDA to income from continuing operations before income tax provision follows (in millions):

	For the three months		For the nine months	
	ended September 30, 2006	2005	ended September 30, 2006	2005
Total Adjusted EBITDA for reportable segments	\$ 156.2	\$ 171.2	\$ 539.9	\$ 535.7
Depreciation	55.9	49.5	164.7	148.6
Amortization	1.4	1.8	5.0	4.8
Interest expense	29.1	27.6	86.7	82.7
Interest income	(4.7)	(3.4)	(14.9)	(5.0)
Refinancing transaction costs				8.4
ESOP expense	3.1	3.7	9.2	10.9

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Gain on sales of assets	(5.3)	(0.3)	(5.9)	(0.8)
Minority interests in earnings of consolidated entities	7.1	1.8	17.1	8.1
Income from continuing operations before income tax provision	\$ 69.6	\$ 90.5	\$ 278.0	\$ 278.0

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- (a) Adjusted EBITDA is defined as earnings before depreciation, amortization, interest expense, interest income, refinancing transaction costs, ESOP expense, gain on sales of assets, minority interests in earnings of consolidated entities, income tax provision and discontinued operations. Adjusted EBITDA is commonly used by lenders and investors to assess leverage capacity, debt service ability and liquidity. Many of Triad's debt covenants use Adjusted EBITDA, or a modification of Adjusted EBITDA, in financial covenant calculations. Adjusted EBITDA is used by management to evaluate financial performance and resource allocation for each facility and for Triad as a whole. Adjusted EBITDA should not be considered as a measure of financial performance under U.S. Generally Accepted Accounting Principles, and the items excluded from Adjusted EBITDA are significant components in understanding and assessing financial performance. Adjusted EBITDA should not be considered in isolation or as an alternative to net income, 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 liquidity. Because Adjusted EBITDA is not a measurement determined in accordance with U.S. Generally Accepted Accounting Principles and is thus susceptible to varying calculations, Adjusted EBITDA as presented may not be comparable to other similarly titled measures of other companies.

TRIAD HOSPITALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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NOTE 8 COMPREHENSIVE INCOME

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

The component of comprehensive income, net of income tax, is as follows (in millions):

	For the three months		For the nine months	
	ended September 30, 2006	2005	ended September 30, 2006	2005
Net income	\$ 39.8	\$ 46.3	\$ 183.0	\$ 171.4
Other comprehensive income, net of income tax:				
Net change in fair value of interest rate swaps				0.3
Comprehensive income	\$ 39.8	\$ 46.3	\$ 183.0	\$ 171.7

Accumulated other comprehensive loss, net of tax, is related to a minimum pension liability of \$1.6 million at September 30, 2006 and December 31, 2005.

NOTE 9 CONTINGENCIES

False Claims Act Litigation

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

On September 9, 2003, Triad was served with a *qui tam* complaint alleging, among other things, the submission of false claims for reimbursement and improper allocation of costs at a hospital in Mississippi managed by Quorum Health Resources, LLC (QHR), which is named as an additional defendant. The Federal government has apparently elected not to intervene in the case and the complaint was unsealed. Triad is vigorously defending this matter and has filed a motion to dismiss, which is pending before the court. While Triad currently believes that it has no liability for any of the claims alleged in the complaint, discovery has not been completed and at this time Triad cannot predict the final effect or outcome of the complaint.

On May 18, 2004, Triad was served with a *qui tam* complaint alleging, among other things, the submission of false claims for reimbursement at two hospitals in Georgia formerly managed by QHR. This case was dismissed on October 27, 2005. The plaintiff appealed the dismissal, and Triad is vigorously contesting the appeal.

On April 26, 2005, Triad received a copy of a *qui tam* complaint alleging, among other things, the submission of false claims for reimbursement at a hospital in Pennsylvania managed by QHR. The Federal government elected not to intervene in this case and the complaint was recently unsealed. While Triad intends to vigorously defend this matter, it is not yet able to form a view as to the probable liability for any of the claims alleged in the complaint.

Triad's merger agreement with Quorum will not provide indemnification to Triad in respect of the *qui tam* complaints and investigations described above. If Triad incurs material liabilities as a result of *qui tam* litigation or governmental investigation, these matters could have a

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material adverse effect on Triad's business, financial condition, results of operations or prospects.

At this time Triad cannot predict the final effect or outcome of the ongoing investigations or *qui tam* actions. If violations of Federal or state laws relating to Medicare, Medicaid or other government programs are found, then Triad may be required to pay substantial fines and civil and criminal damages and also may be excluded from participation in the Medicare and Medicaid programs and other government programs. Similarly, the amount of

TRIAD HOSPITALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Unaudited

NOTE 9 CONTINGENCIES (continued)

damages sought in these *qui tam* actions 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, including *qui tam* actions, alleging violations of law. Triad may not know about those investigations or about *qui tam* actions filed against it unless and to the extent such matters are unsealed. If any of those matters were successfully asserted against Triad, there could be a material adverse effect on Triad's business, financial position, results of operations or prospects.

Income Taxes

The Internal Revenue Service (IRS) is currently conducting an examination of the Federal income tax returns for Triad's short taxable years ended April 27, 2001, September 30, 2001 and December 31, 2001, and the taxable years ended December 31, 2002 and 2003. On May 10, 2006, the IRS issued an examination report (30 Day Letter) with proposed adjustments disallowing deductions for portions of the payments made to the Federal government in settlement of certain *qui tam* complaints that had been brought against Quorum. The total proposed adjustments with respect to the settlement payment deductions, if sustained, would increase taxable income in the amount of approximately \$67.3 million and result in the payment by Triad of additional cash taxes of approximately \$24.9 million. Any cash taxes paid resulting from the proposed adjustments in excess of the tax reserve previously established would increase goodwill from the acquisition of Quorum.

Triad believes its reporting of the deductions with respect to the settlement of the *qui tam* cases was appropriate. Accordingly, on June 9, 2006, Triad filed a protest to the 30 Day Letter to contest the proposed adjustments, and the matter has since been referred to the IRS Appeals Office. In the opinion of management, even if the IRS proposed adjustments were sustained, the adjustments would not have a material effect on Triad's results of operations or financial position.

General Liability Claims

Triad, QHR, and The Intensive Resource Group, LLC (IRG), a subsidiary of QHR, are defendants against claims for breach of an employment contract filed in a lawsuit involving a former employee of Cambio Health Solutions, a former subsidiary of IRG. Triad, QHR and IRG have been vigorously defending the claim. On May 13, 2004, a jury returned a verdict against Triad, QHR and IRG, and on June 8, 2004, the court entered a judgment on such verdict in the aggregate amount of approximately \$5.9 million. Triad, QHR and IRG have appealed such judgment. Triad has reserved \$5.9 million in respect of this judgment.

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.

TRIAD HOSPITALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Unaudited

NOTE 10 COSTS OF SALES

The following tables show the line items in the condensed consolidated statements of operations that are considered costs of sales (dollars in millions):

	For the three months ended September 30, 2006		
	Total Expenses	General and Administrative Expenses	Costs of Sales
Salaries and benefits	\$ 555.4	\$ 13.2	\$ 542.2
Reimbursable expenses	12.1		12.1
Supplies	238.0	0.1	237.9
Other operating expenses	270.7	8.1	262.6
Provision for doubtful accounts	152.0		152.0
Depreciation	55.9	0.8	55.1
Amortization	1.4		1.4
Total	\$ 1,285.5	\$ 22.2	\$ 1,263.3

	For the three months ended September 30, 2005		
	Total Expenses	General and Administrative Expenses	Costs of Sales
Salaries and benefits	\$ 494.1	\$ 10.9	\$ 483.2
Reimbursable expenses	12.2		12.2
Supplies	198.0		198.0
Other operating expenses	208.9	8.6	200.3
Provision for doubtful accounts	84.6		84.6
Depreciation	49.5	0.9	48.6
Amortization	1.8		1.8
Total	\$ 1,049.1	\$ 20.4	\$ 1,028.7

	For the nine months ended September 30, 2006		
	Total Expenses	General and Administrative Expenses	Costs of Sales
Salaries and benefits	\$ 1,666.8	\$ 51.5	\$ 1,615.3
Reimbursable expenses	38.1		38.1
Supplies	709.7	0.3	709.4
Other operating expenses	796.1	29.5	766.6
Provision for doubtful accounts	400.9		400.9
Depreciation	164.7	2.3	162.4
Amortization	5.0		5.0
Total	\$ 3,781.3	\$ 83.6	\$ 3,697.7

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	For the nine months ended September 30, 2005		
	Total	General and	Costs of
	Expenses	Administrative	Sales
		Expenses	
Salaries and benefits	\$ 1,436.3	\$ 33.3	\$ 1,403.0
Reimbursable expenses	38.8		38.8
Supplies	584.1	0.3	583.8
Other operating expenses	633.7	26.0	607.7
Provision for doubtful accounts	280.5		280.5
Depreciation	148.6	2.1	146.5
Amortization	4.8		4.8
Total	\$ 3,126.8	\$ 61.7	\$ 3,065.1

TRIAD HOSPITALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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NOTE 11 RECENT ACCOUNTING PRONOUNCEMENTS

In June 2006, the Financial Accounting Standards Board issued FASB Interpretation No. 48 Accounting for Uncertainty in Income Taxes (FIN 48), which clarifies the accounting for uncertainty in income taxes recognized in accordance with FASB Statement No. 109 Accounting for Income Taxes . FIN 48 is effective for fiscal years beginning after December 15, 2006, with early adoption permitted. The cumulative effect of applying the provisions of FIN 48 would be reported as an adjustment to the opening balance of retained earnings in the year of adoption. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosures, and transition. Triad will adopt FIN 48 on January 1, 2007, but it has not yet determined the full impact of the adoption. Triad anticipates that it will reclassify amounts recorded in its deferred tax liabilities for uncertain tax positions to other liabilities. FIN 48 may also require additional disclosures with respect to valuation allowances and reserves related to tax uncertainties.

In September 2006, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 157 Fair Value Measurements (SFAS 157), which is effective for fiscal years beginning after November 15, 2007, with early adoption encouraged. This statement provides a single definition of fair value, establishes a framework for measuring fair value, and expanded disclosures concerning fair value measurements. Triad does not anticipate a material impact on its results of operations or financial position from the adoption of SFAS 157.

In September 2006, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 158 Employer s Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R) (SFAS 158), which is effective for fiscal years ending after December 15, 2006. SFAS 158 requires recognition of defined benefit plan funding status, including gains or losses on plan assets, prior service costs and transition assets or obligations, and recognizes changes in the funding status of those plans in the plan sponsors financial statements. Changes in the funding status will be reported in comprehensive income. Additional footnote disclosures about certain effects on net periodic benefit costs for the next fiscal year that arise from delayed recognition of gains or losses on plan assets, prior service costs and transition assets or obligations will also be required. SFAS 158 also requires the measurement of plan assets and obligations as of the date of the plan sponsors fiscal year end. This provision of SFAS 158 is effective for fiscal years ending after December 15, 2008. Triad has not yet determined the full impact from the adoption of SFAS 158 but does not anticipate a material impact on its results of operations or financial position.

In September 2006, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements (SAB 108), which is effective for fiscal years ending after November 15, 2006. SAB 108 provides guidance on the consideration of the effects of prior year immaterial misstatements in quantifying current year misstatements for the purpose of a materiality assessment on both the balance sheet and income statement. SAB 108 would require restatement of prior year financial statements for current year misstatements even if the revisions are immaterial to those prior years, if the correction would be material to the current year. SAB 108 allows for the cumulative effect of the initial application to be made to beginning retained earnings. Triad has not yet determined the impact of the adoption of SAB 108.

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

OVERVIEW

Triad is one of the largest publicly owned hospital companies in the United States and provides healthcare services through hospitals and ambulatory surgery centers that it owns and operates in small cities and selected urban markets primarily in the southern, midwestern and western United States. At November 1, 2006 Triad's hospital facilities include 53 general acute care hospitals and 12 ambulatory surgery centers located in the states of Alabama, Alaska, Arizona, Arkansas, Georgia, Indiana, Louisiana, Mississippi, Nevada, New Mexico, Ohio, Oklahoma, Oregon, South Carolina, Tennessee, Texas and West Virginia. Included among these facilities is one hospital under construction and one hospital operated through a 50/50 joint venture that is not consolidated for financial reporting purposes. Triad is also a minority investor in three joint ventures that own seven general acute care hospitals in Georgia and Nevada. Through its wholly-owned subsidiary, QHR, Triad also provides management and consulting services to independent general acute care hospitals located throughout the United States.

Triad's general acute care hospitals typically provide a full range of services commonly available in hospitals, such as internal medicine, general surgery, cardiology, oncology, neurosurgery, orthopedics, obstetrics, diagnostic and emergency services. These hospitals also generally provide outpatient and ancillary healthcare services such as outpatient surgery, laboratory, radiology, respiratory therapy, cardiology and physical therapy. Outpatient services also are provided by ambulatory surgery centers operated by Triad. In addition, some of Triad's general acute care hospitals have a limited number of licensed psychiatric beds and provide psychiatric skilled nursing services.

In the third quarter of 2006, Triad revised its estimate of uncollectible accounts which increased the allowance for doubtful accounts to approximately 65.9% of discounted uninsured receivables from approximately 62.5%. This change in estimate resulted in a reduction to income from continuing operations of approximately \$9.5 million, or \$0.11 per diluted share, for both the three and nine months ended September 30, 2006. See Results of Operations-Other Trends-Provision for doubtful accounts for a more detailed discussion.

Triad acquired two new hospitals by entering into joint ventures with non-profit partners in the first quarter of 2006. Triad acquired two new hospitals by entering into joint ventures with non-profit partners in the second and fourth quarters of 2005. These acquisitions affect the comparability of the results of operations for the three and nine months ended September 30, 2006 and 2005.

On January 1, 2006, Triad adopted SFAS 123R. See NOTE 2 STOCK BENEFIT PLANS in the condensed consolidated financial statements for a more detailed description of SFAS 123R. As a result of the adoption of SFAS 123R, Triad recorded \$7.1 million and \$20.8 million of share-based compensation expense during the three and nine months ended September 30, 2006, respectively. This resulted in a reduction to diluted earnings per share of \$0.05 and \$0.16 during the three and nine months ended September 30, 2006, respectively. During 2006, Triad changed its share-based payment awards for employees from awards of stock options to awards of restricted stock.

In the third quarter of 2005, Triad's hospitals and ambulatory surgery centers in Hattiesburg, Mississippi, Lake Charles, Louisiana, Victoria, Texas and Wharton, Texas were directly and indirectly impacted by Hurricanes Katrina and Rita. Triad has received final reimbursement for the Hurricane Katrina claim totaling \$1.3 million. At September 30, 2006, Triad had recorded an estimated receivable for insurance reimbursement on the Hurricane Rita claim of approximately \$1.6 million.

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:

the highly competitive nature of the healthcare business,

the efforts of insurers and other payers, healthcare providers and others to contain healthcare costs,

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

possible changes in Medicare, Medicaid and other government programs that may further limit reimbursements to healthcare providers,

changes in Federal, state or local regulations affecting the healthcare industry,

the possible enactment of Federal or state healthcare reform,

the ability to attract and retain qualified management and personnel, including physicians and nurses,

the departure of key executive officers from Triad,

adverse changes in the collectibility of accounts receivable,

the successful implementation of Triad's new information technology system,

claims and legal actions relating to professional liabilities and other matters,

fluctuations in the market value of Triad's common stock,

changes in accounting standards,

changes in general economic conditions or geopolitical events,

future acquisitions, joint venture developments or divestitures which may result in additional charges,

the ability to enter into managed care provider arrangements on acceptable terms,

the availability and terms of capital to fund the expansion of Triad's business,

changes in business strategy or development plans,

the ability to obtain adequate levels of general and professional liability insurance,

the potential adverse impact of known and unknown government investigations,

timeliness of reimbursement payments received under government programs, and

other factors as may be described in Triad's filing with the SEC, including without limitation, detailed factors discussed under the heading "Item 1A. Risk Factors" in Triad's Annual Report on Form 10K for the year ended December 31, 2005.

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

RESULTS OF OPERATIONS

Revenue/Volume Trends

Triad has entered into agreements with third-party payers, including government programs and managed care health plans, under which rates are based upon established charges, the cost of providing services, predetermined rates per diagnosis, fixed per diem rates or discounts from established charges. Triad's facilities have experienced revenue rate growth from increases in managed care pricing and in reimbursement from government programs. Triad's reimbursement from government programs increased approximately 2% to 3% beginning in the fourth quarter of 2005. Triad estimates that reimbursement from government programs will increase an additional 2% to 3% beginning in the fourth quarter of 2006. Triad's managed care pricing has increased approximately 5% to 6% in 2006. There can be no assurances that Triad will continue to experience these levels of revenue rate increases in the future. Triad implemented a self-pay discount program in the second quarter of 2005 that offers discounts to all uninsured patients based on the lowest managed care discount in each hospital location. Triad's revenue rate growth was negatively affected by the self-pay discount program.

Patient volumes, on a same facility basis, increased slightly in 2006 compared to 2005. Patient volumes in 2006 have been negatively impacted by the closure of rehabilitation units at two facilities. Triad's volume growth has also been negatively impacted by increased involvement by consumers in healthcare decision making. Triad had a large volume decrease in lower acuity respiratory admissions, but experienced an increase in volumes from higher acuity procedures, such as surgeries. The lower acuity procedures did, however, increase in the third quarter of 2006 compared to the third quarter of 2005. The increase in higher acuity procedures was a result of Triad's capital expenditures to expand the types of service offered at its facilities. For fiscal year 2006, Triad anticipates that volumes, on a same facility basis, will increase approximately 1% to 2%. If Triad's volumes decrease, then its results of operations and cash flows could be adversely affected.

Triad's revenues continue to be affected by the proportion of revenue derived from fixed payment, higher discount sources, including Medicare, Medicaid and managed care plans. Triad expects patient volumes from Medicare and Medicaid to continue to increase due to the general aging of the population and expansion of state Medicaid programs. Volumes from managed care plans are expected to increase due to insurance companies, government programs (other than Medicare) and employers purchasing healthcare services for their employees by negotiating discounted amounts that they will pay healthcare providers. During the third quarter of 2006, Triad experienced a significant increase in the percentage of revenues from uninsured patients.

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

The percentages of patient revenues by provider are as follows:

	For the three months ended September 30,		For the nine months ended September 30,	
	2006	2005	2006	2005
Medicare	29.2%	31.4%	29.7%	31.4%
Medicaid	5.2	4.8	5.1	5.1
Managed care plans	46.5	44.7	45.8	44.3
Uninsured	10.6	9.5	9.8	9.3
Other sources	8.5	9.6	9.6	9.9
	100.0%	100.0%	100.0%	100.0%

The percentage of revenues from uninsured patients was affected by the implementation of the self-pay discount program discussed above. Excluding this impact, the increase in revenues from uninsured patients would have been even greater in 2006 compared to 2005. Changes in the proportion of services reimbursed based upon fixed payment amounts where the payment is based upon the diagnosis, regardless of the cost incurred or level of service provided, could impact revenues, earnings and cash flows.

On April 12, 2006, the Centers for Medicare and Medicaid Services (CMS) issued a notice of proposed rulemaking for Federal fiscal year 2007. The proposed rule affects Medicare's hospital inpatient prospective payment system (PPS) rates and policies for both inpatient acute as well as inpatient PPS exempt providers. Most of the proposed changes would become effective October 1, 2006. Comments concerning the proposed rule were due June 12, 2006, the final rule was published August 1, 2006 and the final rates were published September 29, 2006. The final rule includes updates to the base operating and capital reimbursement rates, diagnostic related group (DRG) classifications, outlier payment threshold, reporting of hospital quality data for the annual hospital payment update and changes to the area wage index, among other changes. In addition, the rule calls for the recalibration of the DRG weights using a hospital-specific relative value cost weighting methodology, which is a departure from prior years' recalibration methodology that was based primarily on hospital charges. This change will be phased in over three years beginning in Federal fiscal year 2007. Also, the rule outlines a plan to further modify the inpatient PPS by incorporating severity of illness adjusters into the systems. The severity adjustment component will begin in Federal fiscal year 2007 with 20 specific DRG changes and continue in 2008 after further analysis is completed. The hospital-specific relative value cost-based weight recalibration methodology and the severity adjustment are expected to result in a redistribution of payments among hospitals across the country. Currently, Triad does not believe that these proposed changes would have a material adverse impact on its results of operations or cash flows.

Triad's revenues have been affected by the trend toward performing certain services more frequently on an outpatient basis rather than on an inpatient basis. Growth in outpatient services is expected to continue, although possibly at a slower rate, in the healthcare industry as procedures performed on an inpatient basis are converted to outpatient procedures through continuing advances in pharmaceutical and medical technologies. The redirection of certain procedures to an outpatient basis is also influenced by pressures from payers and patients to provide certain procedures as outpatient care rather than inpatient care. Outpatient revenues were 45% of patient revenues for both the three months ended September 30, 2006 and 2005, and 45% and 46% of patient revenues for the nine months ended September 30, 2006 and 2005, respectively.

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

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

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

Triad acquired two new hospitals by entering into joint ventures with non-profit entities in the first quarter of 2006. Triad also acquired two new hospitals by entering into joint ventures with non-profit entities in the second quarter and fourth quarter of 2005. These facilities increased revenues by \$316.9 million in the nine months ended September 30, 2006 compared to the nine months ended September 30, 2005. Revenues increased by \$100.3 million in the three months ended September 30, 2006 compared to the three months ended September 30, 2005 from these acquisitions excluding the facility acquired in the second quarter of 2005.

Other Trends*Provision for doubtful accounts*

Triad estimates its allowance for doubtful accounts using analytical methods such as changes in the level of uninsured receivables, accounts receivable days, uninsured collection rates, cash collections and accounts receivable agings. Triad has multiple patient accounting systems, which could increase the time needed to analyze uninsured collection rates. In the third quarter of 2006, after reviewing these analytical methods and determining that uninsured collection rates had decreased substantially, management revised its estimate of uncollectible accounts which increased the allowance to approximately 65.9% of discounted uninsured receivables from 62.5%. This resulted in an increase to the provision for doubtful accounts of approximately \$15 million and a reduction to income from continuing operations of approximately \$9.5 million, or \$0.11 per diluted share, for the three and nine months ended September 30, 2006. Triad believes that the decrease in uninsured collection rates is due to increasing amounts of fully uninsured patient accounts which have lower collection rates than patient co-payment and deductible accounts.

Prior to the fourth quarter of 2005, Triad estimated its allowance for doubtful accounts using historical net write-offs of uncollectible accounts. Triad analyzed the ultimate collectibility of its accounts receivable after one year, using a regression analysis of the historical net write-offs to determine the amount of those accounts receivable that were ultimately not collected. The results of this analysis were then applied to the current accounts receivable to determine the allowance necessary for that period. The impact of Triad's self-pay discounts was incorporated into the historical net write-offs and accounts receivable. This process, or AR lookback, is performed each quarter. The AR lookback was augmented by the analytical methods discussed above. Triad's self-pay discount programs, which reduced the amount of receivables recorded, distorted the results of the AR lookback leading management to rely on the other analytical procedures. Although the AR lookback is not currently used as the primary estimation tool, Triad continues to use it as a part of the estimation process. Triad will continue to perform the AR lookback process quarterly, but management anticipates it will be another 9 to 15 months before the impact of the self-pay discounts will be fully reflected in the historical write-offs. The amount of historical net write-offs decreased in 2006 compared to 2005 which Triad believes is due, in part, to the self-pay discount programs. Another factor in the decrease in historical net write-offs was the change in Triad's write-off policies, as discussed below.

Triad's provision for doubtful accounts, as a percentage of revenues, was 11.1% in the third quarter of 2006 compared to 7.3% in the third quarter of 2005 and 9.7% in the first nine months of 2006 compared to 8.1% in the first nine months of 2005. The provision for doubtful accounts as a percentage of revenue increased 1.1% in the third quarter of 2006 and 0.4% in the first nine months of 2006 from the change in estimate discussed above. Triad's provision for doubtful accounts as a percentage of revenue was also impacted by the growth in fully uninsured revenue and fully uninsured receivables. The percentage of revenues from fully uninsured patients increased to 10.6% in the third quarter of 2006 from 9.1% in the second quarter of 2006, and from 9.5% in the third quarter of 2005. Fully uninsured receivables increased approximately \$25 million in the third quarter of 2006 compared to the second quarter of 2006. The provision for doubtful accounts increased approximately \$10 million in the third quarter of 2006 from the growth in fully uninsured patient revenue and fully uninsured receivables. This increase in the provision for doubtful accounts reduced income from continuing operations by approximately \$6 million, or \$0.07 per diluted share, for the three and nine months ended September 30, 2006. Triad estimates the impact of the self-pay discounts reduced the provision for doubtful accounts by approximately \$45.6 million and \$46.2 million in the third quarter of 2006 and 2005, respectively, and \$141.0 million and \$102.4 million in the first nine months of 2006 and 2005, respectively.

Triad's uninsured receivables, as a percentage of billed hospital receivables, increased to 41.5% at September 30, 2006 compared to 39.5% at December 31, 2005. During the third quarter of 2006, Medicare delayed payments to all healthcare providers in the United States. The payments were received in October 2006. Triad's receivables increased approximately \$36 million due to the Medicare payment delays. Excluding the delayed payments, uninsured receivables would have been 42.6% of billed hospital receivables at September 30, 2006. Uninsured

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

receivables increased \$112.5 million from December 31, 2005 to September 30, 2006, with the amounts relating to receivables from co-payments and deductibles increasing \$30.5 million and the amount relating to receivables from fully uninsured patients increasing \$82.0 million. A portion of the increase in uninsured receivables was due to changes at certain facilities, beginning in 2005, to conform to Triad's policies for writing off accounts during the revenue cycle process. Under current policies, accounts continue to be included in the accounts receivable agings after placement with a primary collection agency instead of being written off at that point in time. Total receivables increased \$217.6 million over the same time period. The increase in accounts receivable was also affected by the acquisition of two hospitals during 2006. The amounts of the increases in the following categories of receivables during 2006 from these facilities are as follows:

Co-payments and deductibles	\$ 8.9 million
Fully uninsured	\$ 7.0 million
Total billed	\$ 46.5 million

Days in accounts receivable increased to 69 days at September 30, 2006 compared to 66 days at December 31, 2005. Days in accounts receivable was impacted by the Medicare payment delays discussed previously, increasing days in accounts receivable by 3 days. In the fourth quarter of 2005, days in accounts receivable was impacted by an increase in managed care revenues, as a percentage of total revenue, compared to Medicare revenues. Managed care payers are typically slower payers than government payers. The trend of an increasing percentage of managed care revenue compared to Medicare revenue has continued into 2006.

The approximate percentages of billed hospital receivables (which is a component of total receivables) are summarized as follows:

	September 30, 2006	December 31, 2005
Insured receivables	58.5%	60.5%
Fully uninsured receivables	29.1%	26.7%
Co-payment and deductible receivables	12.4%	12.8%
Total	100.0%	100.0%

Included in insured receivables are accounts that are pending approval from Medicaid. These receivables were approximately 4.4% of billed hospital receivables at both September 30, 2006 and December 31, 2005. Triad maintains a contractual allowance on these receivables. The allowance was approximately 45% at September 30, 2006 and 42% at December 31, 2005. The allowances are determined using a nine-month historical conversion rate. The allowances have historically varied between 30% and 50%.

Triad's allowance for doubtful accounts and the approximate percentages of allowance for doubtful accounts to accounts receivable are summarized as follows (dollars in millions):

	September 30, 2006	December 31, 2005
Allowance for doubtful accounts	\$ 376.9	\$ 292.8
Percentage of accounts receivables	28.8%	26.8%

The approximate percentages of billed hospital receivables in summarized aging categories are as follows:

	September 30, 2006	December 31, 2005
0 to 60 days	52.6%	55.4%
61 to 150 days	21.8%	22.4%
151 to 360 days	23.2%	20.7%

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Over 360 days	2.4%	1.5%
Total	100.0%	100.0%

The increase in the older aging categories is partially due to the revenue cycle changes discussed previously.

The percentage of revenue from uninsured patients and the amount of receivables from uninsured patients increased in 2006 compared to 2005. The amount of increase in revenue from uninsured patients was substantial in the third quarter of 2006. Triad also experienced a significant reduction in uninsured collection rates in the third quarter of 2006. Triad is unable to determine if this situation will continue for the remainder of 2006 and into 2007. If the trends observed in the third quarter of 2006 relating to the increase in the percentage of revenue from uninsured patients, the increase in uninsured receivables or the decrease in uninsured collection rates were to continue, additional allowances could be required and Triad's results of operations and financial position could be materially

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

adversely affected. Triad estimates that each 1% change in uninsured collection rates impacts the allowance for doubtful accounts by approximately \$5 million, or \$0.04 per diluted share.

Impairments of long-lived assets

Two of Triad's hospitals had impairment indicators, primarily operating losses, and were evaluated for potential long-lived asset impairment in 2005. Currently, the probability weighted undiscounted future cash flows expected from the use of the assets and eventual disposition indicate that the recorded amounts are recoverable.

During the third quarter of 2006, Triad had valuations prepared for certain facilities in conjunction with proposed offerings to physicians of ownership interests in the entities that own such facilities. The valuations of three facilities contained impairment indicators and those facilities were evaluated for potential long-lived asset impairment during the third quarter of 2006. Currently, the probability weighted future cash flows expected from the use of the assets and eventual disposition indicate that the recorded amounts are recoverable.

If the probabilities assigned to the future cash flows or the projections of future cash flow deteriorate, then impairment of these assets may be required.

Information systems conversion

In January and February 2006, Triad entered into agreements to outsource its current information technology services for a ten-year period and to replace or supplement its current information systems with new clinical, revenue cycle and enterprise resource planning systems. The expected total contract value is approximately \$1.4 billion. The outsourcing component of the contracts is expected to replace approximately \$1.2 billion in current information technology services costs. The costs to replace the current information systems will be approximately \$330 million of the total contract value. Triad anticipates that the agreements will incrementally increase operating expenses over the first three to four years of their term. The costs associated with these agreements reduced Triad's diluted earnings per share by approximately \$0.02 to \$0.03 in the three months ended September 30, 2006, and approximately \$0.06 to \$0.07 in the nine months ended September 30, 2006. Triad anticipates that diluted earnings per share will be reduced by approximately \$0.02 to \$0.03 in the remainder of 2006 as a result of these agreements.

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

Operating Results Summary

The following is a summary of unaudited operating results and key operating statistics from continuing operations for the three and nine months ended September 30, 2006 and 2005 (dollars in millions, except per share amounts and statistics):

	For the three months ended				For the nine months ended			
	2006		2005		2006		2005	
	Amount	Percentage	Amount	Percentage	Amount	Percentage	Amount	Percentage
Revenues	\$ 1,373.1	100.0	\$ 1,160.9	100.0	\$ 4,120.4	100.0	\$ 3,481.3	100.0
Salaries and benefits, including share-based compensation expense (1)	555.4	40.4	494.1	42.6	1,666.8	40.5	1,436.3	41.2
Reimbursable expenses	12.1	0.9	12.2	1.0	38.1	1.0	38.8	1.1
Supplies	238.0	17.3	198.0	17.1	709.7	17.2	584.1	16.8
Other operating expenses	270.7	19.7	208.9	18.0	796.1	19.3	633.7	18.2
Provision for doubtful accounts	152.0	11.1	84.6	7.3	400.9	9.7	280.5	8.1
Depreciation and amortization	57.3	4.2	51.3	4.4	169.7	4.1	153.4	4.4
Interest expense, net	24.4	1.8	24.2	2.1	71.8	1.7	77.7	2.2
Refinancing transaction costs							8.4	0.3
ESOP expense	3.1	0.2	3.7	0.3	9.2	0.2	10.9	0.3
Gain on sales of assets	(5.3)	(0.4)	(0.3)		(5.9)	(0.1)	(0.8)	
	1,307.7	95.2	1,076.7	92.8	3,856.4	93.6	3,223.0	92.6
Income from continuing operations before minority interests, equity in earnings and income tax provision	65.4	4.8	84.2	7.2	264.0	6.4	258.3	7.4
Minority interests in earnings of consolidated entities	(7.1)	(0.5)	(1.8)	(0.1)	(17.1)	(0.4)	(8.1)	(0.2)
Equity in earnings of unconsolidated affiliates	11.3	0.8	8.1	0.7	31.1	0.8	27.8	0.8
Income from continuing operations before income tax provision	69.6	5.1	90.5	7.8	278.0	6.8	278.0	8.0
Income tax provision	(28.9)	(2.1)	(35.2)	(3.0)	(109.4)	(2.7)	(107.6)	(3.1)
Income from continuing operations	\$ 40.7	3.0	\$ 55.3	4.8	\$ 168.6	4.1	\$ 170.4	4.9
(1) Share-based compensation expense	\$ 7.1		\$ 0.8		\$ 20.8		\$ 1.4	
Income per common share from								
continuing operations								
Basic	\$ 0.47		\$ 0.65		\$ 1.96		\$ 2.11	
Diluted	\$ 0.47		\$ 0.64		\$ 1.94		\$ 2.06	
Number of hospitals at end of period (a)								
Owned	50		47		50		47	
Managed joint ventures	1		1		1		1	
Total	51		48		51		48	
Licensed beds at end of period (b)	9,316		8,144		9,316		8,144	

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Available beds at end of period (c)	8,249	7,281	8,249	7,281
Admissions (d)				
Owned	87,107	76,944	261,451	235,157
Managed joint ventures	1,368	1,485	4,137	4,377
Total	88,475	78,429	265,588	239,534
Adjusted admissions (e)	149,393	132,641	445,319	400,228
Adjusted patient days (f)	695,568	614,495	2,098,670	1,869,771
Outpatient visits excluding outpatient surgeries	1,101,705	957,415	3,275,244	2,838,883
Inpatient surgeries	35,025	30,984	104,347	91,149
Outpatient surgeries	75,623	69,438	227,628	205,496
Total surgeries	110,648	100,422	331,975	296,645