

TRIAD HOSPITALS INC
Form 10-Q/A
May 13, 2005

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

FORM 10-Q/A
Amendment No. 1

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

For the quarterly period ended March 31, 2005

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)

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| | |
|---|--|
| 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) |

(214) 473-7000

(Registrant's telephone number, including area code)

Not Applicable

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

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

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

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

As of April 29, 2005, the number of shares of common stock of Triad Hospitals, Inc. outstanding was 80,828,524.

EXPLANATORY NOTE

This Form 10-Q/A constitutes amendment no. 1 to the Triad Hospitals, Inc. quarterly report on Form 10-Q for the quarterly period ended March 31, 2005. This amendment no. 1 is being filed solely to correct a clerical error contained under the caption Results of Operations - Operating Results Summary of Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations set forth in the quarterly report on Form 10-Q. The number of Adjusted patient days for the three months ended March 31, 2005 and 2004 was reported incorrectly and should have been reported as 671,437 and 651,646, respectively. The number of Adjusted patient days has been corrected in this amendment no. 1 on Form 10-Q/A. All other information in the quarterly report on Form 10-Q remains unchanged from the original filing.

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

OVERVIEW

Triad opened one new hospital in the first quarter of 2005, acquired one hospital in the fourth quarter of 2004 and opened one hospital in the third quarter of 2004. These events affect the comparability of the results of operations for the three months ended March 31, 2005 and 2004.

In 2004, Triad sold one hospital which was reclassified to discontinued operations in the second quarter of 2004. Triad's results of operations and statistics for the first quarter of 2004 were restated to reflect this reclassification to discontinued operations.

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

FORWARD LOOKING STATEMENTS

This Management's Discussion and Analysis of Financial Condition and Results of Operations contains disclosures which are forward-looking statements. Forward-looking statements include all statements that do not relate solely to historical or current facts, and can be identified by the use of words such as may, believe, will, expect, project, estimate, anticipate, plan or continue. These forward-looking statements are 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 health care business,

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

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

changes in Federal, state or local regulations affecting the health care industry,

the possible enactment of Federal or state health care reform,

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

the departure of key executive officers from Triad,

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

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

changes in accounting standards,

changes in general economic conditions or geopolitical events,

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

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

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

changes in business strategy or development plans,

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

potential adverse impact of known and unknown government investigations, and

timeliness of reimbursement payments received under government programs.

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.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES UPDATE

Revenue Recognition

Beginning in the second quarter of 2005, Triad implemented an additional component to its self-pay discount program. This additional component offers a discount for all uninsured patients based on the lowest managed care discount in each hospital location. Currently, Triad is unable to quantify the impact of this self-pay discount component, but anticipates that there will be some reductions to revenue, but no significant impact on earnings per share. Triad anticipates that its provision for doubtful accounts will decline by an amount similar to the reduction in revenues.

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

RESULTS OF OPERATIONS (continued)

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 implemented a new self-pay discount program in the fourth quarter of 2004. The self-pay discount program offers discounts to uninsured patients based on personal financial criteria and means testing. The amount of the discount varies based on each patient's financial condition. Triad's revenue rate growth was negatively affected by the self-pay discount program. There can be no assurances that Triad will continue to receive these levels of revenue rate increases in the future.

Patient volumes, on a same facility basis, increased in 2005 compared to 2004. This was due primarily to increases in respiratory, obstetrics and open heart volumes. 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 health care services for their employees by negotiating discounted amounts that they will pay health care providers rather than by paying standard prices. Patient revenues related to Medicare and Medicaid patients were 35.8% and 36.9% of total patient revenues for the three months ended March 31, 2005 and 2004, respectively. Patient revenues related to managed care plan patients were 41.7% of total patient revenues for both the three months ended March 31, 2005 and 2004. 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.

Triad's revenues have been affected by the trend toward certain services being performed more frequently on an outpatient basis compared to inpatient admissions. Growth in outpatient services is expected to continue, although possibly at a slower rate, in the health care industry as procedures performed on an inpatient basis are converted to outpatient procedures through continuing advances in pharmaceutical and medical technologies. The redirection of certain procedures to an outpatient basis is also influenced by pressures from payers and patients to perform certain procedures as outpatient care rather than inpatient care. Outpatient revenues were 47% and 46% of patient revenues for the three months ended March 31, 2005 and 2004, respectively.

Pressures on Medicare and Medicaid reimbursement, increasing percentages of patient volume 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 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 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 will deteriorate.

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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 with the strategic support of corporate management.

Management of Triad continues to rationalize its portfolio of facilities. Triad acquired one hospital in the fourth quarter of 2004, opened a new hospital in the third quarter of 2004 and opened a new hospital in the first quarter of 2005. These facilities increased revenues by \$19.3 million in the three months ended March 31, 2005 compared to the three months ended March 31, 2004.

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

Other Trends

Provision for doubtful accounts

Triad estimates its allowance for doubtful accounts using historical net write-offs of uncollectible accounts. Triad analyzes 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 are then applied to the current accounts receivable to determine the allowance necessary for that period. The impact of Triad's self-pay discounts has been incorporated into the historical net write-offs and accounts receivable. This process, or AR lookback, is performed each quarter. This process is augmented by other analytical methods such as changes in the level of uninsured receivables, accounts receivable days, cash collections and accounts receivable agings. To reflect the potential for further deterioration in historical write-offs, Triad continues to include in its allowance for doubtful accounts approximately \$15 million beyond what the AR lookback would require and record to the upper end of its tolerance range of the AR lookback.

Triad has certain facilities that are not included in the AR lookback process due to insufficient historical data. The allowance for doubtful accounts for these facilities is estimated using a variety of other methods. When the historical data is sufficient, these facilities will be converted to the AR lookback process.

During the first quarter of 2005, the amount of adjusted historical write-offs decreased compared both to the first quarter of 2004 and the fourth quarter of 2004. Triad's provision for doubtful accounts, as a percentage of revenues, was 9.3% in the first quarter of 2005 compared to 10.2% in the first quarter of 2004. As discussed previously, Triad implemented a new self-pay discount program in the fourth quarter of 2004. The impact of the self-pay discounts reduced provision for doubtful accounts by approximately \$20.7 million in the first quarter of 2005. Excluding this impact, provision for doubtful accounts as a percentage of revenue would have been 10.8% in the first quarter of 2005. In the first quarter of 2005, Triad recorded \$4.7 million as a change in estimate to its provision for doubtful accounts at certain facilities that are not included in the AR lookback calculation due to insufficient historical data. Triad's uninsured receivables, as a percentage of billed hospital receivables, remained constant at March 31, 2005 compared to December 31, 2004. The aging percentage of uninsured receivables less than 90 days increased to 35.3% at March 31, 2005 from 33.0% at December 31, 2004, primarily from increases in revenues in the first quarter of 2005 compared to the fourth quarter of 2004. The aging percentage of uninsured receivables less than 90 days at March 31, 2004 was 40.7%. Days in accounts receivable decreased to 59 days at March 31, 2005 from 60 days at December 31, 2004. The approximate percentages of billed hospital receivables (which is a component of total receivables) is summarized as follows:

| | <u>March 31, 2005</u> | <u>December 31, 2004</u> |
|-----------------------|-----------------------|--------------------------|
| Insured receivables | 58.4% | 58.4% |
| Uninsured receivables | 41.6% | 41.6% |
| Total | 100.0% | 100.0% |

Included in insured receivables are accounts that are pending approval from Medicaid. These receivables were approximately 3.9% and 4.7% of billed hospital receivables at March 31, 2005 and December 31, 2004, respectively. Triad maintains an allowance on these receivables for

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estimated non-conversion. The allowance for non-conversion was approximately 35% at both March 31, 2005 and December 31, 2004.

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):

| | <u>March 31, 2005</u> | <u>December 31, 2004</u> |
|------------------------------------|-----------------------|--------------------------|
| Allowance for doubtful accounts | \$ 328.5 | \$ 326.5 |
| Percentage of accounts receivables | 31.6% | 33.3% |

The allowance for doubtful accounts as a percentage of accounts receivable decreased due primarily to the impact of the self-pay discount program.

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

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

| | <u>March 31, 2005</u> | <u>December 31, 2004</u> |
|-----------------|-----------------------|--------------------------|
| 0 to 60 days | 56.1% | 54.6% |
| 61 to 150 days | 22.6% | 24.9% |
| 151 to 360 days | 19.5% | 19.0% |
| Over 360 days | 1.8% | 1.5% |
| | <u>100.0%</u> | <u>100.0%</u> |

Although adjusted historical write-offs decreased in the first quarter of 2005, Triad is unable to determine if this will continue for the remainder of 2005. If uninsured receivables increase and collectibility of these receivables deteriorate in the future, then Triad's results of operations and financial position could be materially adversely affected.

Impairments of long-lived assets

Five of Triad's hospitals had impairment indicators, primarily operating losses, and were evaluated for potential long-lived asset impairment in 2004. Currently, the probability weighted undiscounted future cash flows expected from the use of the assets and eventual disposition of four of the hospitals indicate that the recorded amounts are recoverable. If the probabilities assigned to the future cash flows change or the projections of future cash flows deteriorate, then impairment of these assets may be required.

One of the hospitals evaluated for potential impairment is being operated under a lease arrangement, which expires on May 31, 2005. Triad does not intend to continue operating this facility. This facility was tested for long-lived asset impairment as if it were to be held and used. The testing indicated that no impairment was necessary, although the depreciation estimates were revised to reflect a shorter useful life. Approximately \$0.6 million of additional depreciation was recorded in the first quarter of 2005 from this change in estimate.

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

Operating Results Summary

The following is a summary of operating results from continuing operations for the three months ended March 31, 2005 and 2004 (dollars in millions, except per share amounts and ratios):

| | For the three months ended | | | |
|--|----------------------------|-------------|----------------|-------------|
| | 2005 | | 2004 | |
| | Amount | Percentage | Amount | Percentage |
| Revenues | \$ 1,212.2 | 100.0 | \$ 1,105.8 | 100.0 |
| Salaries and benefits | 483.0 | 39.9 | 446.3 | 40.4 |
| Reimbursable expenses | 13.6 | 1.1 | 13.5 | 1.2 |
| Supplies | 199.0 | 16.4 | 179.0 | 16.2 |
| Other operating expenses | 222.2 | 18.3 | 200.6 | 18.1 |
| Provision for doubtful accounts | 113.0 | 9.3 | 112.5 | 10.2 |
| Depreciation and amortization | 51.3 | 4.2 | 44.5 | 4.0 |
| Interest expense, net | 26.5 | 2.2 | 32.2 | 2.9 |
| ESOP expense | 3.3 | 0.3 | 2.4 | 0.2 |
| (Gain) loss on sales of assets | 0.3 | | (1.0) | (0.1) |
| | <u>1,112.2</u> | <u>91.7</u> | <u>1,030.0</u> | <u>93.1</u> |
| Income from continuing operations before minority interests, equity in earnings and income tax provision | 100.0 | 8.3 | 75.8 | 6.9 |
| Minority interests in earnings of consolidated entities | (4.6) | (0.4) | (1.9) | (0.2) |
| Equity in earnings of affiliates | 10.1 | 0.8 | 5.6 | 0.5 |
| Income from continuing operations before income tax provision | 105.5 | 8.7 | 79.5 | 7.2 |
| Income tax provision | (40.3) | (3.3) | (30.7) | (2.8) |
| Income from continuing operations | <u>\$ 65.2</u> | <u>5.4</u> | <u>\$ 48.8</u> | <u>4.4</u> |
| Income per common share from continuing operations | | | | |
| Basic | \$ 0.84 | | \$ 0.66 | |
| Diluted | \$ 0.82 | | \$ 0.64 | |
| Number of hospitals at end of period (a) | | | | |
| Owned | 51 | | 48 | |
| Managed joint ventures | 1 | | 1 | |
| Total | <u>52</u> | | <u>49</u> | |
| Licensed beds at end of period (b) | 8,208 | | 7,988 | |
| Available beds at end of period (c) | 7,336 | | 7,139 | |
| Admissions (d) | | | | |

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| | | |
|--|----------|----------|
| Owned | 83,965 | 80,648 |
| Managed joint ventures | 1,473 | 1,460 |
| | <hr/> | <hr/> |
| Total | 85,438 | 82,108 |
| Adjusted admissions (e) | 142,489 | 137,031 |
| Adjusted patient days (f) | 671,437 | 651,646 |
| Outpatient visits excluding outpatient surgeries | 982,636 | 912,870 |
| Inpatient surgeries | 30,227 | 29,918 |
| Outpatient surgeries | 77,773 | 77,379 |
| | <hr/> | <hr/> |
| Total surgeries | 108,000 | 107,297 |
| Average length of stay (g) | 4.7 | 4.8 |
| Outpatient revenue percentage | 47% | 46% |
| Inpatient revenue per admission | \$ 7,385 | \$ 7,044 |
| Outpatient revenue per outpatient visit | \$ 548 | \$ 534 |
| Patient revenue per adjusted admission | \$ 8,131 | \$ 7,704 |
| Patient revenue per adjusted patient day | \$ 1,726 | \$ 1,620 |

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

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

RESULTS OF OPERATIONS (continued)

- 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.
- (f) Adjusted patient days are used by management and certain investors as a general measure of combined inpatient and outpatient volume. Adjusted patient days are computed by multiplying patient days (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 patient days computation adjusts outpatient revenue to the volume measure (patient days) 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.

Three Months Ended March 31, 2005 and 2004

Income from continuing operations increased to \$65.2 million in the three months ended March 31, 2005 from \$48.8 million in the three months ended March 31, 2004. Triad's same facility revenues increased 7.9% in 2005 compared to 2004. Salaries and benefits decreased as a percentage of revenue in 2005 compared to 2004. Interest expense decreased in 2005 compared to 2004 from debt refinancing in 2004.

Revenues increased to \$1,212.2 million in the three months ended March 31, 2005 compared to \$1,105.8 million in the three months ended March 31, 2004. Same facility revenues increased 7.9% in 2005 compared to 2004, which includes \$0.7 million in unfavorable prior year governmental cost report settlements in 2005 compared to \$1.5 million in favorable prior year governmental cost report settlements in 2004. Same facility patient revenue per adjusted admission increased 5.7% in 2005 compared to 2004 due primarily to increases in managed care pricing and in reimbursement from government programs. Managed care contract pricing increased approximately 5% to 7% and reimbursement from government programs increased approximately 5% to 6% in 2005 compared to 2004. In the fourth quarter of 2004, Triad implemented a new self-pay discount program. The new self-pay discount program reduced revenues, on a same facility basis, by \$20.7 million in 2005 compared to 2004. On a same facility basis excluding the effect of the self-pay discounts, revenues increased 9.8% and patient revenue per adjusted admission increased 7.6%. Same facility admissions and adjusted admissions increased 2.5% and 2.1%, respectively, in 2005 compared to 2004. This was due primarily to increases in respiratory, obstetrics, and open heart volumes. Triad had increases in revenues of \$19.3 million, admissions of 1,277, adjusted admissions of 2,806, inpatient surgeries of 359, outpatient surgeries of 848 and outpatient visits of 21,442 from the opening of a new hospital in the first quarter of 2005, the acquisition of one hospital in the fourth quarter of 2004 and the opening of a new hospital at the beginning of the third quarter of 2004.

Salaries and benefits (which include contract nursing) as a percentage of revenues decreased to 39.9% in the three months ended March 31, 2005 from 40.4% in the three months ended March 31, 2004. Salaries decreased, as a percentage of revenues, to 31.0% in 2005 compared to 31.5% in 2004 due primarily to increased productivity.

Reimbursable expenses as a percentage of revenues decreased to 1.1% in the three months ended March 31, 2005 from 1.2% in the three months ended March 31, 2004. Reimbursable expenses relate primarily to salaries and benefits of QHR employees who serve as executives at hospitals managed by QHR. These expenses are also included as a component of revenues. The decrease was due primarily to these expenses staying relatively constant in 2005 compared to 2004, while revenues increased.

Supplies as a percentage of revenues increased to 16.4% in the three months ended March 31, 2005 from 16.2% in the three months ended March 31, 2004. This was due primarily to supplies per adjusted admission increasing 6.9% from increased usage of drug-coated stents and other implantable devices.

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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) as a percentage of revenues increased to 18.3% in the three months ended March 31, 2005 from 18.1% in the three months ended March 31, 2004 primarily from an increase in contract services from increased contract anesthesia coverage and collection service fees.

Provision for doubtful accounts as a percentage of revenues decreased to 9.3% in the three months ended March 31, 2005 compared to 10.2% in the three months ended March 31, 2004. Triad experienced a decrease in the amount of adjusted historical write-offs in the first quarter of 2005 compared to the first quarter of 2004 and the fourth quarter of 2004. As discussed previously, Triad implemented a new self-pay discount program in the fourth

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

RESULTS OF OPERATIONS (continued)

quarter of 2004. The impact of the self-pay discounts reduced provision for doubtful accounts by approximately \$20.7 million in 2005. Excluding this impact, provision for doubtful accounts as a percentage of revenue would have been 10.8% in 2005. In the first quarter of 2005, Triad recorded \$4.7 million as a change in estimate to its provision for doubtful accounts at certain facilities that are not included in the AR lookback calculation due to insufficient historical data. If uninsured receivables increase and the collectibility of these receivables deteriorate in the future, then Triad's results of operations and financial position could be materially adversely affected.

Depreciation and amortization increased to \$51.3 million in the three months ended March 31, 2005 from \$44.5 million in the three months ended March 31, 2004, primarily due to the completion of several capital projects during 2005 and 2004.

Interest expense, which was offset by \$0.9 million and \$0.5 million of interest income in the three months ended March 31, 2005 and 2004, respectively, decreased to \$26.5 million in 2005 compared to \$32.2 million in 2004. This was due primarily to the April 2004 refinancing of Triad's 8 1/4% senior notes.

Minority interests increased to \$4.6 million in the three months ended March 31, 2005 from \$1.9 million in the three months ended March 31, 2004 due to improved earnings at one of Triad's non-wholly owned facilities.

Equity in earnings of affiliates was \$10.1 million in the three months ended March 31, 2005 compared to \$5.6 million in the three months ended March 31, 2004 due primarily to improved earnings at Triad's non-consolidating jointly-owned entities in Las Vegas, Nevada.

Income tax provision was \$40.3 million in the three months ended March 31, 2005 compared to \$30.7 million in the three months ended March 31, 2004. Triad's effective tax rate was 38.2% in 2005 compared to 38.6% in 2004. In the third quarter of 2004, Triad had a reduction in its marginal tax rate to 37.0% from 37.5% from state tax rate changes. Triad's effective tax rate is also affected by nondeductible ESOP expense.

LIQUIDITY AND CAPITAL RESOURCES

Cash provided by operating activities was \$126.4 million in the three months ended March 31, 2005 compared to \$56.4 million in the three months ended March 31, 2004. Accounts receivable increased \$58.7 million in 2005 compared to a \$48.7 million increase in 2004. Accounts receivable days were relatively constant in 2005 compared to 2004. Payments for accounts payable decreased \$22.5 million in 2005 compared to 2004 due to timing of payments in 2004. Payments for salaries and payroll taxes decreased \$18.2 million in 2005 compared to 2004 due to timing of pay periods. Triad paid \$24.0 million in annual incentive payments in 2005 compared to \$21.3 million in 2004. Triad also paid \$26.3 million in annual retirement plan contributions in 2005 compared to \$24.1 million in 2004. Triad had \$19.7 million of income taxes payable at March 31, 2005. The income taxes payable from current operations was reduced by \$15.2 million of tax benefit from stock option exercises in 2005. At March 31, 2004, Triad had \$47.0 million of income taxes payable, of which approximately \$15.3 million related to one sales transaction.

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Cash used in investing activities was \$95.6 million in the three months ended March 31, 2005 compared to cash provided by investing activities of \$52.8 million in the three months ended March 31, 2004. In 2004, Triad received \$155.2 million of proceeds primarily from the sales of one hospital in Tucson, Arizona and two hospitals and three surgery centers in the Kansas City, Missouri area. Capital expenditures were \$100.3 million in 2005 compared to \$103.9 million in 2004. Approximately \$27.6 million of the 2005 capital expenditures was for maintenance capital and approximately \$72.7 million was for expansion capital. Triad currently anticipates spending approximately \$450 to \$550 million on expansion, development, acquisitions and other capital expenditures in the remainder of 2005. The amount of capital expenditures in 2005 could decrease if currently anticipated acquisitions do not occur or increase if new acquisition opportunities arise.

Cash provided by financing activities was \$37.8 million in the three months ended March 31, 2005 compared to cash used in financing activities of \$32.0 million in the three months ended March 31, 2004. Triad received \$59.7 million in proceeds from stock option exercises in 2005 compared to \$5.0 million in 2004.

At March 31, 2005, Triad's indebtedness consisted of a Tranche A term loan of \$38.4 million bearing interest at LIBOR plus 2.0% (4.85% at March 31, 2005) with principal amounts due through 2007, a Tranche B term loan of \$404.2 million bearing interest at LIBOR plus 2.25% (5.10% at March 31, 2005) with principal amounts due

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

RESULTS OF OPERATIONS (continued)

through 2008, \$600.0 million of senior notes bearing interest at 7.0% with principal amounts due in 2012 and \$600 million of senior subordinated notes bearing interest at 7.0% with principal amounts due in 2013. The senior notes are callable, at Triad's option, in May 2008, and the senior subordinated notes are callable, at Triad's option, in November 2008 and, in both cases, are callable earlier at Triad's option by paying a make-whole premium. At March 31, 2005, Triad had a \$400 million line of credit which bears interest at LIBOR plus 2.0%. At March 31, 2005, no amounts were outstanding under the line of credit although there were \$21.8 million in letters of credit outstanding which reduce the amount available under the revolving credit line. In April 2005, \$20.0 million was drawn under the revolving credit facility, which was repaid in May 2005. The LIBOR spread on the revolving credit line and the Tranche A term loan may increase or decrease depending upon the total leverage of Triad.

Triad's term loans and revolving line of credit are collateralized by a pledge of substantially all of its assets other than real estate associated with the former Quorum facilities. The debt agreements require that Triad comply with various financial ratios and tests and have restrictions on, among other things, new indebtedness, asset sales and use of proceeds therefrom, capital expenditures and dividends. The debt agreements require that Triad's total leverage ratio not exceed 3.35x as of March 31, 2005. Triad's total leverage ratio at March 31, 2005 was approximately 2.50x. The indentures governing Triad's other long-term debt also contain covenants restricting the incurrence of indebtedness, investments, dividends, asset sales and the incurrence of liens, among other things. There are no maintenance covenants under the indentures. There are no events of default under Triad's debt agreements or indentures in the event of a downgrade of its debt ratings. Triad currently is in compliance with all debt agreement covenants and restrictions. If an event of default occurs with respect to the debt agreements, then the balances of the term loans and revolving line of credit could become due and payable which could result in other debt obligations of Triad also becoming due and payable. Additionally, there would be no availability under the revolving line of credit.

Triad has entered into an interest rate swap agreement, which effectively converts a notional amount of \$100 million of floating rate borrowings to fixed rate borrowings. The term of the interest rate swap expires in June 2005. Triad pays a rate of 3.99% and receives LIBOR, which was set at 3.03% at March 31, 2005. Triad is exposed to credit losses in the event of nonperformance by the counterparty. The counterparty is a creditworthy financial institution and it is anticipated that the counterparty will be able to fully satisfy its obligation under the contract. Triad's interest rate swap agreement is designated as a cash flow hedge.

At March 31, 2005, Triad had working capital of \$591.3 million. Management expects that anticipated capital expenditures, including expansion and development projects, will be funded by operating cash flow, credit facilities or proceeds from sales of securities. Significant changes in reimbursement from government programs and managed care health plans could affect liquidity in the future.

Triad completed development and began operations of a new hospital in Tucson, Arizona in January 2005. The final cost of the development was approximately \$79.0 million.

Triad entered into a joint arrangement with a non-profit hospital organization to build a replacement hospital in Denton, Texas. The anticipated cost of the project is approximately \$100 million, of which Triad would fund approximately 80% with the non-profit organization funding the remainder. Triad would also lease its existing facility to the joint entity. This project was completed and began operations in April 2005. As of March 31, 2005, approximately \$83.2 million has been spent on this project.

Triad has commenced development of a replacement acute care hospital in Palmer, Alaska. The anticipated cost of this project is approximately \$100 million and completion is expected in the fourth quarter of 2005. As of March 31, 2005, approximately \$36.8 million has been spent on

this project.

Triad anticipates that it will construct a replacement facility in Springfield, Oregon for approximately \$100 million. Triad anticipates that construction could begin in the fourth quarter of 2005.

On April 1, 2005, Triad closed under a letter of intent to form a venture with a not-for-profit hospital in Oklahoma City, Oklahoma. Triad contributed approximately \$119 million, including approximately \$16 million for working capital, for an 80% interest in the venture and the not-for-profit hospital contributed its current operations, including real estate and equipment, and received a 20% interest in the venture.

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

In April 2005, Triad acquired HCA's 28.5% interest in its acute care hospital in Vicksburg, Mississippi for \$27.5 million. Triad now owns 99.5% of this facility.

Triad entered into a non-binding letter of intent to acquire the operations of an acute care hospital in Clarksville, Tennessee. As part of the proposed transaction, Triad would lease the existing hospital property and build a replacement facility. Triad anticipates entering into a definitive agreement during the third quarter of 2005.

Triad entered into a non-binding letter of intent to form a venture with a not-for-profit hospital in Birmingham, Alabama. Triad anticipates that it would be the majority owner in the venture. The not-for-profit hospital would contribute its current operations to the venture. The venture would build a replacement facility. Triad anticipates entering into a definitive agreement during the third quarter of 2005.

Triad has entered into a letter of intent to form a venture with a not-for-profit hospital in Massillon, Ohio. Triad would contribute its current hospital in Massillon and approximately \$11 million in cash for a 60% interest in the venture and the not-for-profit would contribute its hospital for a 40% interest in the venture. Triad anticipates that a definitive agreement could be completed in the third quarter of 2005.

Triad has entered into an agreement to lease a hospital under construction in Dublin, Ireland. Triad anticipates that the lease would commence in the third quarter of 2006.

Triad has entered into a letter of intent to acquire the operations of an acute care hospital in Erwin, North Carolina. As part of the proposed transaction, Triad would lease the operations of the existing hospital and build a replacement facility for approximately \$42 million. Triad anticipates that a definitive agreement could be completed in the fourth quarter of 2006.

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

Triad has various other existing hospital expansion projects in progress. Triad anticipates expending an aggregate of approximately \$280 million related to these projects. Of this amount, approximately \$180 million is anticipated to be expended in 2005, \$80 million in 2006 and the remainder thereafter.

On May 3, 2005, Triad completed a transaction whereby it sold its 51% interest in its freestanding ambulatory surgery centers in Phoenix, Arizona (Phoenix ASCs) and acquired its minority partner's 49% interest in its freestanding ambulatory surgery center in Tucson, Arizona (Tucson ASC). Triad received approximately \$30 million in proceeds from the sale. The net book value of the Phoenix ASCs at March 31, 2005 was approximately \$22 million. The Phoenix ASCs will be reclassified to discontinued operations in the second quarter of 2005. Triad paid approximately \$9 million for the acquisition of the Tucson ASC.

Triad is currently operating an acute care hospital under a lease arrangement in Lake City, South Carolina that expires on May 31, 2005. Triad does not intend to continue operating this facility. Triad anticipates selling the equipment at this facility for approximately book value to the lessor of the facility. Triad anticipates that this facility will be reclassified to discontinued operations in the second quarter of 2005 upon lease termination.

The facilities that Triad anticipates will be included in discontinued operations in the second quarter of 2005 had revenues of \$17.2 million and \$17.3 million in the three months ended March 31, 2005 and 2004, respectively. These facilities had pre-tax income (loss) of \$(0.1) million and \$0.7 million in the three months ended March 31, 2005 and 2004, respectively.

Off-Balance Sheet Arrangements

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 27.3% at March 31, 2005. At March 31, 2005, the amounts subject to the guarantees were \$23.6 million. Triad had \$6.5 million reserved at March 31, 2005 for the estimated loan defaults that would be covered under the guarantees.

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

RESULTS OF OPERATIONS (continued)

Prior to January 1, 2003, Triad entered into agreements to guarantee the indebtedness of certain joint ventures that are accounted for by the equity method. The ultimate amount of the guarantees was \$2.9 million at March 31, 2005. In the second quarter of 2004, Triad entered into an agreement to guarantee the indebtedness of a joint venture accounted for by the equity method. A minimal amount was recorded for the fair value of the guarantee. The ultimate amount of the guarantee was \$1.1 million at March 31, 2005.

Recent Accounting Pronouncements

In December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123 (revised 2004) Share-Based Payment (SFAS 123R), which was required to be applied as of the beginning of the first interim or annual reporting period that begins after June 15, 2005 with early adoption encouraged. In April 2005, the SEC amended the compliance date for the application of SFAS 123R to fiscal years beginning after June 15, 2005. SFAS 123R replaces Financial Accounting Standards Board Statement No. 123 Accounting for Stock-Based Compensation (SFAS 123), amends Financial Accounting Standards Board Statement No. 95, Statement of Cash Flows and supersedes APB Opinion No. 25 Accounting for Stock Issued to Employees (APB 25) and establishes standards for the accounting for transactions in which an entity obtains employee services in share-based payments. SFAS 123R will require entities to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. The cost would be recognized over the period that an employee is required to provide service in exchange for the award. SFAS 123R applies to all awards granted after the required effective date and to awards modified, repurchased, or cancelled after that date. The cumulative effect of initially applying SFAS 123R, if any, would be recognized as of the required effective date. SFAS 123R requires using a modified version of prospective application to transition to this statement. Under this transition method, compensation costs would be recognized on or after the effective date for the portion of outstanding awards for which the service has not yet been rendered, based on the grant-date fair value of those awards under SFAS 123 for either recognition or pro forma disclosures. SFAS 123R allows entities to elect to apply a modified version of retrospective application under which financial statements for prior periods are adjusted on a basis consistent with the pro forma disclosures under SFAS 123 for all periods presented. Triad will adopt SFAS 123R beginning January 1, 2006 using the prospective application transition method, but it has not determined which valuation method will be used. Triad currently anticipates that income from continuing operations will be reduced by approximately \$22 million to \$26 million on an annual basis. The amount of the impact will vary depending on many factors, including the number of awards granted and the fair value of the awards at the date of grant. SFAS 123R also requires that the benefits of tax deductions in excess of recognized compensation cost be reported as financing cash flows rather than as operating cash flows as required under current literature. This requirement could reduce net operating cash flows and increase net financing cash flows in periods after adoption. Triad cannot estimate what these amounts might be in the future because they depend on, among other things, when employees exercise stock options. The amount of benefits of tax deductions in excess of recognized compensation costs included in operating cash flows was \$15.2 million and \$2.0 million in the three months ended March 31, 2005 and 2004, respectively.

In December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 153 Exchanges of Nonmonetary Assets (SFAS 153), which is effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005 with early adoption encouraged. SFAS 153 amends APB Opinion No. 29 Accounting for Nonmonetary Transactions to eliminate the exception for the measurement of nonmonetary exchanges of similar productive assets at carrying value and replaces it with a general exception for the measurement for exchanges of nonmonetary assets that do not have commercial substance at carrying value. After adoption of SFAS 153 exchanges of nonmonetary exchanges of similar productive assets that do have commercial substance would be measured at fair value. Triad does not anticipate a material impact on the results of operations or financial position from the adoption of SFAS 153.

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

CONTINGENCIES

False Claims Act Litigation

As a result of its ongoing discussions with the government prior to the merger of Quorum with and into Triad on April 27, 2001, Quorum learned of two *qui tam* complaints against it alleging violations of the False Claims Act for claims allegedly submitted to the government involving two managed hospitals. Quorum accrued the estimated liability on these items prior to the merger and the matters remain 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 QHR, which is named as an additional defendant. The Federal government has 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 discovery has not been completed, Triad currently believes that it has no liability for any of the claims alleged in 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. The Federal government elected not to intervene in the case and the complaint was recently unsealed. While Triad is vigorously defending 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.

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 has elected not to intervene in the 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 any probable liability for any of the claims alleged in the complaint.

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

operations or prospects.

Income Taxes

The IRS is currently conducting an examination of the Federal income tax returns for Triad's short taxable years ended April 27, 2001, June 30, 2001 and December 31, 2001, and the taxable years ended December 31, 2002 and 2003. Although the examinations are ongoing, to date the IRS has not proposed any adjustments for such years.

In February 2005, Triad, on behalf of certain jointly-owned entities in which Quorum owned a majority interest, reached final settlements with the IRS with respect to the jointly-owned entities' taxable years ended June 30, 1997 and 1998, relating to adjustments to tax accounting methods adopted for computing bad debt expense, the valuation of purchased hospital property and equipment and related depreciable lives, income recognition related to cost reports and the loss calculation on a taxable liquidation of a subsidiary.

In the opinion of management, the settlement did not have a material impact on Triad's results of operations or financial position.

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

RESULTS OF OPERATIONS (continued)

HCA Investigation

HCA has been the subject of a formal order of investigation by the SEC. HCA understands that the SEC's investigation included the anti-fraud, insider trading, periodic reporting and internal accounting control provisions of the Federal securities laws. HCA has been advised by the staff of the SEC that the investigation has been closed with no action.

General Liability Claims

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

HEALTH CARE REFORM

In recent years, an increasing number of legislative proposals have been introduced or proposed to Congress and in some state legislatures that would significantly affect health care systems in Triad's markets. The cost of certain proposals would be funded, in significant part, by reduction in payments by government programs, including Medicare and Medicaid, to health care providers. Recently, the Medicare Prescription Drug, Improvement, and Modernization Act of 2003, which provides for a number of significant changes in the Medicare program, was signed into law on December 8, 2003. Triad is unable to predict whether any other proposals for health care reform will be adopted, and there can be no assurance that proposals adverse to the business of Triad will not be adopted.

In December 2000, the Centers for Medicare and Medicaid Services (CMS) acting under the Health Insurance Portability and Accountability Act of 1996 (HIPAA) released final regulations, which required compliance by April 2003, relating to adoption of standards to protect the security and privacy of health-related information. These privacy regulations extensively regulate the use and disclosure of individually identifiable health-related information. CMS has also promulgated final regulations under HIPAA establishing standards to protect the security of health-related information. These regulations were published in February 2003 and required compliance by April 2005. These regulations require health care providers to implement organizational and technical practices to protect the security of electronically maintained or transmitted health-related information. The privacy regulations and the security 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. Triad is in compliance with these regulations.

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On March 25, 2004, CMS published regulations intended to clarify parts of the Social Security Act commonly known as the Stark Law . These regulations were Phase II of a two-phase process. These regulations, referred to as interim final regulations , became effective on July 26, 2004. Phase II addresses the statutory exceptions related to ownership and investment interests, statutory exceptions for certain compensation arrangements, and reporting requirements. Phase II also creates some new regulatory exceptions and addresses public comments on Phase I. These regulations mandated certain changes to certain of Triad s practices and procedures, but Triad cannot yet predict all of the effects that the interim final regulations might have.

Part II: Other Information

ITEM 6: EXHIBITS

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

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: May 13, 2005

Triad Hospitals, Inc.

By: /s/ W. STEPHEN LOVE

W. Stephen Love
Senior Vice President, Controller and
Acting Chief Financial Officer
(Principal Financial Officer)

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