

UNIVERSAL HEALTH SERVICES INC
Form 10-Q
May 06, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(MARK ONE)

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

For the quarterly period ended March 31, 2016

OR

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

For the transition period from _____ to _____

Commission file number 1-10765

UNIVERSAL HEALTH SERVICES, INC.

(Exact name of registrant as specified in its charter)

DELAWARE 23-2077891
(State or other jurisdiction of (I.R.S. Employer

incorporation or organization) Identification No.)

UNIVERSAL CORPORATE CENTER

367 SOUTH GULPH ROAD

KING OF PRUSSIA, PENNSYLVANIA 19406

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(Address of principal executive offices) (Zip Code)

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

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

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

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

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. Common shares outstanding, as of April 30, 2016:

Class A 6,595,308
Class B 89,763,934
Class C 663,940
Class D 23,122

UNIVERSAL HEALTH SERVICES, INC.

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This Quarterly Report on Form 10-Q is for the quarter ended March 31, 2016. This Report modifies and supersedes documents filed prior to this Report. Information that we file with the Securities and Exchange Commission (the “SEC”) in the future will automatically update and supersede information contained in this Report.

In this Quarterly Report, “we,” “us,” “our” “UHS” and the “Company” refer to Universal Health Services, Inc. and its subsidiaries. UHS is a registered trademark of UHS of Delaware, Inc., the management company for, and a wholly-owned subsidiary of Universal Health Services, Inc. Universal Health Services, Inc. is a holding company and operates through its subsidiaries including its management company, UHS of Delaware, Inc. All healthcare and management operations are conducted by subsidiaries of Universal Health Services, Inc. To the extent any reference

to “UHS” or “UHS facilities” in this report including letters, narratives or other forms contained herein relates to our healthcare or management operations it is referring to Universal Health Services, Inc.’s subsidiaries including UHS of Delaware, Inc. Further, the terms “we,” “us,” “our” or the “Company” in such context similarly refer to the operations of Universal Health Services Inc.’s subsidiaries including UHS of Delaware, Inc. Any reference to employees or employment contained herein refers to employment with or employees of the subsidiaries of Universal Health Services, Inc. including UHS of Delaware, Inc.

PART I. FINANCIAL INFORMATION

UNIVERSAL HEALTH SERVICES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(amounts in thousands, except per share amounts)

(unaudited)

	Three months ended	
	March 31,	
	2016	2015
Net revenues before provision for doubtful accounts	\$2,619,593	\$2,380,101
Less: Provision for doubtful accounts	169,795	154,748
Net revenues	2,449,798	2,225,353
Operating charges:		
Salaries, wages and benefits	1,148,139	1,031,703
Other operating expenses	561,584	505,966
Supplies expense	255,250	238,741
Depreciation and amortization	104,049	98,998
Lease and rental expense	24,452	22,891
	2,093,474	1,898,299
Income from operations	356,324	327,054
Interest expense, net	29,600	30,037
Income before income taxes	326,724	297,017
Provision for income taxes	111,005	102,694
Net income	215,719	194,323
Less: Income attributable to noncontrolling interests	24,960	20,024
Net income attributable to UHS	\$190,759	\$174,299
Basic earnings per share attributable to UHS	\$1.95	\$1.76
Diluted earnings per share attributable to UHS	\$1.93	\$1.73
Weighted average number of common shares - basic	97,607	98,910
Add: Other share equivalents	1,288	1,737
Weighted average number of common shares and equivalents - diluted	98,895	100,647

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

UNIVERSAL HEALTH SERVICES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(amounts in thousands, unaudited)

	Three months ended	
	March 31,	
	2016	2015
Net income	\$215,719	\$194,323
Other comprehensive income (loss):		
Unrealized derivative gains (losses) on cash flow hedges	(14,299)	4,132
Amortization of terminated hedge	(84)	(84)
Foreign currency translation adjustment	5,986	(418)
Other comprehensive income before tax	(8,397)	3,630
Income tax expense related to items of other comprehensive		
income	(5,360)	1,497
Total other comprehensive income, net of tax	(3,037)	2,133
Comprehensive income	212,682	196,456
Less: Comprehensive income attributable to noncontrolling		
interests	24,960	20,024
Comprehensive income attributable to UHS	\$187,722	\$176,432

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

UNIVERSAL HEALTH SERVICES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(amounts in thousands, unaudited)

	March 31,	December 31,
	2016	2015
Assets		
Current assets:		
Cash and cash equivalents	\$54,590	\$ 61,228
Accounts receivable, net	1,374,737	1,302,429
Supplies	116,725	116,037
Deferred income taxes	0	135,120
Other current assets	89,386	103,490
Total current assets	1,635,438	1,718,304
Property and equipment	6,655,292	6,530,569
Less: accumulated depreciation	(2,774,740)	(2,694,591)
	3,880,552	3,835,978
Other assets:		
Goodwill	3,594,901	3,596,114
Deferred charges	16,235	16,688
Other	437,883	448,360
	\$9,565,009	\$ 9,615,444
Liabilities and Stockholders' Equity		
Current liabilities:		
Current maturities of long-term debt	\$488,262	\$ 62,722
Accounts payable and accrued liabilities	1,147,384	1,033,697
Federal and state taxes	49,794	3,987
Total current liabilities	1,685,440	1,100,406
Other noncurrent liabilities	295,684	278,834
Long-term debt	2,792,144	3,368,634
Deferred income taxes	178,947	315,900
Redeemable noncontrolling interests	261,492	242,509
Equity:		
UHS common stockholders' equity	4,289,218	4,249,647
Noncontrolling interest	62,084	59,514
Total equity	4,351,302	4,309,161
	\$9,565,009	\$ 9,615,444

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

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UNIVERSAL HEALTH SERVICES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(amounts in thousands, unaudited)

	Three months	
	ended March 31,	
	2016	2015
Cash Flows from Operating Activities:		
Net income	\$215,719	\$194,323
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation & amortization	104,049	98,998
Stock-based compensation expense	13,204	10,829
Changes in assets & liabilities, net of effects from acquisitions and dispositions:		
Accounts receivable	(79,962)	(96,972)
Accrued interest	688	1,117
Accrued and deferred income taxes	91,131	79,050
Other working capital accounts	98,972	(29,829)
Other assets and deferred charges	(5,803)	(234)
Other	20,911	17,807
Accrued insurance expense, net of commercial premiums paid	22,616	22,748
Payments made in settlement of self-insurance claims	(17,298)	(26,562)
Net cash provided by operating activities	464,227	271,275
Cash Flows from Investing Activities:		
Property and equipment additions, net of disposals	(127,214)	(89,276)
Acquisition of property and businesses	(19,543)	(34,500)
Net cash used in investing activities	(146,757)	(123,776)
Cash Flows from Financing Activities:		
Reduction of long-term debt	(166,671)	(158,871)
Additional borrowings	14,400	20,800
Financing costs	(44)	0
Repurchase of common shares	(171,042)	(28,767)
Dividends paid	(9,757)	(9,899)
Issuance of common stock	2,331	1,768
Excess income tax benefits related to stock-based compensation	11,002	20,807
Profit distributions to noncontrolling interests	(3,407)	(2,413)
Proceeds received from sale/leaseback of real property	0	12,551
Net cash used in financing activities	(323,188)	(144,024)
Effect of exchange rate changes on cash and cash equivalents	(920)	(466)
(Decrease) increase in cash and cash equivalents	(6,638)	3,009
Cash and cash equivalents, beginning of period	61,228	32,069
Cash and cash equivalents, end of period	\$54,590	\$35,078

Supplemental Disclosures of Cash Flow Information:

Interest paid	\$27,133	\$27,158
Income taxes paid, net of refunds	\$9,093	\$2,876
Noncash purchases of property and equipment	\$47,374	\$33,082

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

UNIVERSAL HEALTH SERVICES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(1) General

This Quarterly Report on Form 10-Q is for the quarterly period ended March 31, 2016. In this Quarterly Report, “we,” “us,” “our” “UHS” and the “Company” refer to Universal Health Services, Inc. and its subsidiaries.

The condensed consolidated financial statements include the accounts of our majority-owned subsidiaries and partnerships and limited liability companies controlled by us, or our subsidiaries, as managing general partner or managing member. The condensed consolidated financial statements included herein have been prepared by us, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”) and reflect all adjustments (consisting only of normal recurring adjustments) which, in our opinion, are necessary to fairly state results for the interim periods. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations, although we believe that the accompanying disclosures are adequate to make the information presented not misleading. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements, significant accounting policies and the notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2015.

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

Relationship with Universal Health Realty Income Trust:

At March 31, 2016, we held approximately 5.9% of the outstanding shares of Universal Health Realty Income Trust (the “Trust”). We serve as Advisor to the Trust under an annually renewable advisory agreement pursuant to the terms of which we conduct the Trust’s day-to-day affairs, provide administrative services and present investment opportunities. In addition, certain of our officers and directors are also officers and/or directors of the Trust. Management believes that it has the ability to exercise significant influence over the Trust, therefore we account for our investment in the Trust using the equity method of accounting. We earned an advisory fee from the Trust, which is included in net revenues in the accompanying consolidated statements of income, of approximately \$800,000 and \$700,000 during the three-month periods ended March 31, 2016 and 2015, respectively.

Our pre-tax share of income from the Trust was approximately \$250,000 and \$200,000 during the three-month periods ended March 31, 2016 and 2015, respectively. The carrying value of this investment was approximately \$8.4 million and \$8.7 million at March 31, 2016 and December 31, 2015, respectively, and is included in other assets in the accompanying consolidated balance sheets. The market value of our investment in the Trust was \$44.3 million at March 31, 2016 and \$39.4 million at December 31, 2015, based on the closing price of the Trust’s stock on the respective dates.

Total rent expense under the operating leases on these three hospital facilities was approximately \$4 million during each of the three months ended March 31, 2016 and 2015. In addition, certain of our subsidiaries are tenants in several medical office buildings and two FEDs owned by the Trust or by limited liability companies in which the Trust holds 100% of the ownership interest.

The Trust commenced operations in 1986 by purchasing certain properties from us and immediately leasing the properties back to our respective subsidiaries. Most of the leases were entered into at the time the Trust commenced operations and provided for initial terms of 13 to 15 years with up to six additional 5-year renewal terms. Each lease also provided for additional or bonus rental, as discussed below. The base rents are paid monthly and the bonus rents are computed and paid on a quarterly basis, based upon a computation that compares current quarter revenue to a corresponding quarter in the base year. The leases with our subsidiaries are unconditionally guaranteed by us and are cross-defaulted with one another.

During the first quarter of 2015, wholly-owned subsidiaries of ours sold to and leased back from the Trust, two recently constructed free-standing emergency departments (“FEDs”) located in Texas which were completed and opened during the first quarter of 2015. In conjunction with these transactions, ten-year lease agreements with six, five-year renewal options have been executed with the Trust. We have the option to purchase the properties upon the expiration of the fixed terms and each five-year renewal terms at the fair market value of the property. The aggregate construction cost/sales proceeds of these facilities was approximately \$13 million, and the aggregate rent expense paid to the Trust at the commencement of the leases will approximate \$900,000 annually.

In December, 2014, upon the expiration of the lease term, we elected to purchase from the Trust for \$17.3 million, the real property of The Bridgeway, a 103-bed behavioral health care facility located in North Little Rock, Arkansas. Pursuant to the terms of the lease, we and the Trust were both required to obtain appraisals of the property to determine its fair market value/purchase price. The rent

expense paid by us to the Trust, prior to our purchase of The Bridgeway's real property in December, 2014, was approximately \$1.1 million annually.

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

Hospital Name	Annual		Renewal
	Minimum	End of Lease Term	Term
McAllen Medical Center	Rent \$5,485,000	December, 2016	(years) 15(a)
Wellington Regional Medical Center	\$3,030,000	December, 2016	15(b)
Southwest Healthcare System, Inland Valley Campus	\$2,648,000	December, 2016	15(b)

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

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

Pursuant to the terms of the three hospital leases with the Trust, we have the option to renew the leases at the lease terms described above by providing notice to the Trust at least 90 days prior to the termination of the then current term. We also have the right to purchase the respective leased hospitals at the end of the lease terms or any renewal terms at their appraised fair market value as well as purchase any or all of the three leased hospital properties at their appraised fair market value upon one month's notice should a change of control of the Trust occur. In addition, we have rights of first refusal to: (i) purchase the respective leased facilities during and for 180 days after the lease terms at the same price, terms and conditions of any third-party offer, or; (ii) renew the lease on the respective leased facility at the end of, and for 180 days after, the lease term at the same terms and conditions pursuant to any third-party offer.

Other Related Party Transactions:

In December, 2010, our Board of Directors approved the Company's entering into supplemental life insurance plans and agreements on the lives of our chief executive officer ("CEO") and his wife. As a result of these agreements, based on actuarial tables and other assumptions, during the life expectancies of the insureds, we would pay approximately \$25 million in premiums, and certain trusts owned by our chief executive officer, would pay approximately \$8 million in premiums. Based on the projected premiums mentioned above, and assuming the policies remain in effect until the death of the insureds, we will be entitled to receive death benefit proceeds of no less than \$33 million representing the \$25 million of aggregate premiums paid by us as well as the \$8 million of aggregate premiums paid by the trusts. In connection with these policies, we paid approximately \$1.3 million in premium payments during 2015 and expect to pay similar amounts during 2016.

In August, 2015, Marc D. Miller, our President and member of our Board of Directors, was appointed to the Board of Directors of Premier, Inc. ("Premier"), a healthcare performance improvement alliance. During 2013, we entered into a new group purchasing organization agreement ("GPO") with Premier. In conjunction with the GPO agreement, we acquired a minority interest in Premier for a nominal amount. During the fourth quarter of 2013, in connection with the completion of an initial public offering of the stock of Premier, we received cash proceeds for the sale of a portion of our ownership interest in the GPO. Also in connection with this GPO agreement, we received shares of restricted stock of Premier which vest ratably over a seven-year period (2014 through 2020), contingent upon our continued participation and minority ownership interest in the GPO.

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

(3) Other Noncurrent liabilities and Redeemable/Noncontrolling Interests

Other noncurrent liabilities include the long-term portion of our professional and general liability, workers' compensation reserves, pension and deferred compensation liabilities, and liabilities incurred in connection with split-dollar life insurance agreements on the lives of our chief executive officer and his wife.

As of March 31, 2016, outside owners held noncontrolling, minority ownership interests of: (i) approximately 28% in our six acute care facilities located in Las Vegas, Nevada (including one facility currently under construction); (ii) 20% in an acute care facility located in Washington, D.C.; (iii) approximately 11% in an acute care facility located in Laredo, Texas, and; (iv) 20% in a behavioral health care facility located in Philadelphia, Pennsylvania. The redeemable noncontrolling interest balances of \$261 million as of March 31, 2016 and \$243 million as of December 31, 2015, and the noncontrolling interest balances of \$62 million as of March 31, 2016 and \$60 million as of December 31, 2015, consist primarily of the third-party ownership interests in these hospitals.

In connection with six acute care facilities located in the Las Vegas, Nevada market (including one facility currently under construction), subsequent to March 31, 2016, we agreed to purchase the minority ownership interests held by a third-party for an aggregate cash payment of \$445 million which includes both the purchase price and return of capital. The minority ownership interests related to these hospitals are reflected as redeemable noncontrolling interests on our Condensed Consolidated Balance Sheet.

In connection with a behavioral health care facility located in Philadelphia, Pennsylvania, the minority ownership interest of which is also reflected as redeemable noncontrolling interests on our Consolidated Balance Sheet, the outside owner has a “put option” to put its entire ownership interest to us at any time. If exercised, the put option requires us to purchase the minority member’s interest at fair market value.

(4) Long-term debt and cash flow hedges

Debt:

On August 7, 2014, we entered into a Fourth Amendment (the “Fourth Amendment”) to our credit agreement dated as of November 15, 2010, as amended on March 15, 2011, September 21, 2012 and May 16, 2013, among UHS, as borrower, the several banks and other financial institutions from time to time parties thereto, as lenders (“Credit Agreement”). The Credit Agreement, as amended, which is scheduled to mature in August, 2019, consists of: (i) an \$800 million revolving credit facility (\$195 million of borrowings outstanding as of March 31, 2016), and; (ii) a \$1.775 billion term loan A facility (\$1.708 billion of borrowings outstanding as of March 31, 2016) which combined our previously outstanding term loan A and term loan A2 facilities which were scheduled to mature in 2016.

Borrowings under the Credit Agreement bear interest at either (1) the ABR rate which is defined as the rate per annum equal to, at our election: the greatest of (a) the lender’s prime rate, (b) the weighted average of the federal funds rate, plus 0.5% and (c) one month LIBOR rate plus 1%, in each case, plus an applicable margin based upon our consolidated leverage ratio at the end of each quarter ranging from 0.50% to 1.25% for revolving credit and term loan-A borrowings, or (2) the one, two, three or six month LIBOR rate (at our election), plus an applicable margin based upon our consolidated leverage ratio at the end of each quarter ranging from 1.50% to 2.25% for revolving credit and term loan-A borrowings. As of March 31, 2016, the applicable margins were 0.50% for ABR-based loans and 1.50% for LIBOR-based loans under the revolving credit and term loan-A facilities.

As of March 31, 2016, we had \$195 million of borrowings outstanding pursuant to the terms of our \$800 million revolving credit facility and we had \$552 million of available borrowing capacity, net of \$19 million of outstanding borrowings pursuant to a short-term, on-demand credit facility and \$34 million of outstanding letters of credit. The revolving credit facility includes a \$125 million sub-limit for letters of credit. The Credit Agreement is secured by certain assets of the Company (which generally excludes asset classes such as substantially all of the patient-related accounts receivable of our acute care hospitals, certain real estate assets and assets held in joint-ventures with third-parties) and our material subsidiaries and guaranteed by our material subsidiaries.

Pursuant to the terms of the Credit Agreement, term loan-A quarterly installment payments of approximately: (i) \$11 million commenced during the fourth quarter of 2014 and are scheduled to continue through September, 2016, and; (ii) \$22 million are scheduled from the fourth quarter of 2016 through June, 2019.

Pursuant to the terms of our \$400 million accounts receivable securitization program with a group of conduit lenders and liquidity banks (“Securitization”), which is scheduled to mature in December, 2018, substantially all of the patient-related accounts receivable of our acute care hospitals (“Receivables”) serve as collateral for the outstanding borrowings. We have accounted for this Securitization as borrowings. We maintain effective control over the Receivables since, pursuant to the terms of the Securitization, the Receivables are sold from certain of our subsidiaries to special purpose entities that are wholly-owned by us. The Receivables, however, are owned by the special purpose entities, can be used only to satisfy the debts of the wholly-owned special purpose entities, and thus are not available to us except through our ownership interest in the special purpose entities. The wholly-owned special purpose entities use the Receivables to collateralize the loans obtained from the group of third-party conduit lenders and liquidity banks. The group of third-party conduit lenders and liquidity banks do not have recourse to us beyond the assets of the wholly-owned special purpose entities that securitize the loans. At March 31, 2016, we had \$350 million of outstanding borrowings and \$50 million of additional borrowing capacity pursuant to the terms of the Securitization.

On August 7, 2014, we issued \$300 million aggregate principal amount of 3.750% Senior Secured Notes due 2019 (the “2019 Notes”) and \$300 million aggregate principal amount of 4.750% Senior Secured Notes due 2022 (the “2022 Notes”, and together with the 2019 Notes, the “New Senior Secured Notes”). The New Senior Secured Notes were offered only to qualified institutional buyers under Rule 144A and to non-U.S. persons outside the United States in reliance on Regulation S under the Securities Act of 1933, as amended (the “Securities Act”). The New Senior Secured Notes have not been registered under the Securities Act and may not be offered or sold in the United States absent registration or an applicable exemption from registration requirements. Interest is payable

on the New Senior Secured Notes on February 1 and August 1 of each year to the holders of record at the close of business on the January 15 and July 15 immediately preceding the related interest payment dates, commencing on February 1, 2015 until the maturity date of August 1, 2019 for the 2019 Notes and August 1, 2022 for the 2022 Notes.

On June 30, 2006, we issued \$250 million of senior secured notes which have a 7.125% coupon rate and mature on June 30, 2016 (the “7.125% Notes”). Interest on the 7.125% Notes is payable semiannually in arrears on June 30th and December 30th of each year. In June, 2008, we issued an additional \$150 million of 7.125% Notes which formed a single series with the original 7.125% Notes issued in June, 2006. Other than their date of issuance and initial price to the public, the terms of the 7.125% Notes issued in June, 2008 are identical to and trade interchangeably with, the 7.125% Notes which were originally issued in June, 2006. After giving effect to the \$445 million spent in early May, 2016 in connection with the purchase of the minority ownership interests held by a third-party in six acute care hospitals located in Las Vegas, Nevada, as disclosed herein, the 7.125% Notes are classified as current maturities of long-term debt as of March 31, 2016 since we no longer have the capacity to refinance the 7.125% Notes utilizing funds borrowed pursuant to our revolving credit facility. As of December 31, 2015, the 7.125% Notes are classified as long-term on our Consolidated Balance Sheet since we previously had the ability and intent to refinance the 7.125% Notes utilizing funds borrowed pursuant to our revolving credit facility.

In connection with entering into the previous Credit Agreement on November 15, 2010, and in accordance with the Indenture dated January 20, 2000 governing the rights of our existing notes, we entered into a supplemental indenture pursuant to which our 7.125% Notes (due in 2016) were equally and ratably secured with the lenders under the Credit Agreement with respect to the collateral for so long as the lenders under the Credit Agreement are so secured.

Our Credit Agreement includes a material adverse change clause that must be represented at each draw. The Credit Agreement contains covenants that include a limitation on sales of assets, mergers, change of ownership, liens and indebtedness, transactions with affiliates, dividends and stock repurchases; and requires compliance with financial covenants including maximum leverage and minimum interest coverage ratios. We are in compliance with all required covenants as of March 31, 2016.

At March 31, 2016, the carrying value and fair value of our debt were each approximately \$3.3 billion. At December 31, 2015, the carrying value and fair value of our debt were each approximately \$3.5 billion. The fair value of our debt was computed based upon quotes received from financial institutions. We consider these to be “level 2” in the fair value hierarchy as outlined in the authoritative guidance for disclosures in connection with debt instruments.

Cash Flow Hedges:

We manage our ratio of fixed and floating rate debt with the objective of achieving a mix that management believes is appropriate. To manage this risk in a cost-effective manner, we, from time to time, enter into interest rate swap agreements in which we agree to exchange various combinations of fixed and/or variable interest rates based on agreed upon notional amounts. We account for our derivative and hedging activities using the Financial Accounting Standard Board’s (“FASB”) guidance which requires all derivative instruments, including certain derivative instruments embedded in other contracts, to be carried at fair value on the balance sheet. For derivative transactions designated as hedges, we formally document all relationships between the hedging instrument and the related hedged item, as well as its risk-management objective and strategy for undertaking each hedge transaction.

Derivative instruments designated in a hedge relationship to mitigate exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges. Cash flow hedges are accounted for by recording the fair value of the derivative instrument on the balance sheet as either an asset or liability, with a corresponding amount recorded in accumulated other comprehensive income (“AOCI”) within shareholders’ equity. Amounts are reclassified from AOCI to the income statement in the period or periods the hedged transaction affects earnings. We use interest rate derivatives in our cash flow hedge transactions. Such derivatives are designed to be highly effective in offsetting changes in the cash flows related to the hedged liability. For derivative instruments

designated as cash flow hedges, the ineffective portion of the change in expected cash flows of the hedged item are recognized currently in the income statement.

For hedge transactions that do not qualify for the short-cut method, at the hedge's inception and on a regular basis thereafter, a formal assessment is performed to determine whether changes in the fair values or cash flows of the derivative instruments have been highly effective in offsetting changes in cash flows of the hedged items and whether they are expected to be highly effective in the future.

The fair value of interest rate swap agreements approximates the amount at which they could be settled, based on estimates obtained from the counterparties. We assess the effectiveness of our hedge instruments on a quarterly basis. We performed periodic assessments of the cash flow hedge instruments during 2015 and the first three months of 2016 and determined the hedges to be highly effective. We also determined that any portion of the hedges deemed to be ineffective was de minimis and therefore there was no material effect on our consolidated financial position, operations or cash flows. The counterparties to the interest rate swap agreements

expose us to credit risk in the event of nonperformance. We do not anticipate nonperformance by our counterparties. We do not hold or issue derivative financial instruments for trading purposes.

Seven interest rate swaps on a total notional amount of \$825 million matured in May, 2015. Four of these swaps, with a total notional amount of \$600 million, became effective in December, 2011 and provided that we receive three-month LIBOR while the average fixed rate payable was 2.38%. The remaining three swaps, with a total notional amount of \$225 million, became effective in March, 2011 and provided that we receive three-month LIBOR while the average fixed rate payable was 1.91%.

During 2015, we entered into nine forward starting interest rate swaps whereby we pay a fixed rate on a total notional amount of \$1.0 billion and receive one-month LIBOR. The average fixed rate payable on these swaps, which are scheduled to mature on April 15, 2019, is 1.31%. These interest rates swaps consist of:

·Four forward starting interest rate swaps, entered into during the second quarter of 2015, whereby we pay a fixed rate on a total notional amount of \$500 million and receive one-month LIBOR. Each of the four swaps became effective on July 15, 2015 and are scheduled to mature on April 15, 2019. The average fixed rate payable on these swaps is 1.40%;

·Four forward starting interest rate swaps, entered into during the third quarter of 2015, whereby we pay a fixed rate on a total notional amount of \$400 million and receive one-month LIBOR. One swap on a notional amount of \$100 million became effective on July 15, 2015, two swaps on a total notional amount of \$200 million became effective on September 15, 2015 and another swap on a notional amount of \$100 million became effective on December 15, 2015. All of these swaps are scheduled to mature on April 15, 2019. The average fixed rate payable on these four swaps is 1.23%, and;

·One interest rate swap, entered into during the fourth quarter of 2015, whereby we pay a fixed rate on a total notional amount of \$100 million and receive one-month LIBOR. The swap became effective on December 15, 2015 and is scheduled to mature on April 15, 2019. The fixed rate payable on this swap is 1.21%.

We measure our interest rate swaps at fair value on a recurring basis. The fair value of our interest rate swaps is based on quotes from our counterparties. We consider those inputs to be “level 2” in the fair value hierarchy as outlined in the authoritative guidance for disclosures in connection with derivative instruments and hedging activities. At March 31, 2016, the fair value of our interest rate swaps was a net liability of \$16 million of which \$7 million is included in other current liabilities and \$9 million is included in other noncurrent liabilities on the accompanying balance sheet. At December 31, 2015, the fair value of our interest rate swaps was a net liability of \$1 million comprised of a \$5 million asset which is included in other assets offset by a \$6 million liability which is included in other current liabilities on the accompanying balance sheet.

(5) Commitments and Contingencies

Professional and General Liability and Workers Compensation Liability:

Effective November, 2010, the vast majority of our subsidiaries are self-insured for professional and general liability exposure up to \$10 million and \$3 million per occurrence, respectively. These subsidiaries are provided with several excess policies through commercial insurance carriers which provide for coverage in excess of the applicable per

occurrence self-insured retention (either \$3 million or \$10 million) or underlying policy limits up to \$250 million per occurrence and in the aggregate for claims incurred after 2013 and up to \$200 million per occurrence and in the aggregate for claims incurred from 2011 through 2013. We remain liable for 10% of the claims paid pursuant to the commercially insured coverage in excess of \$10 million up to \$60 million per occurrence and in the aggregate. In addition, from time to time based upon marketplace conditions, we may elect to purchase additional commercial coverage for certain of our facilities or businesses. Our behavioral health care facilities located in the U.K. have policies through a commercial insurance carrier located in the U. K. that provides for £10 million of professional liability coverage and £25 million of general liability coverage.

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

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As of March 31, 2016, the total accrual for our professional and general liability claims was \$210 million, of which \$48 million is included in current liabilities. As of December 31, 2015, the total accrual for our professional and general liability claims was \$204 million, of which \$48 million is included in current liabilities.

As of March 31, 2016, the total accrual for our workers' compensation liability claims was \$67 million, of which \$34 million is included in current liabilities. As of December 31, 2015, the total accrual for our workers' compensation liability claims was \$68 million, of which \$34 million is included in current liabilities.

Property Insurance:

We have commercial property insurance policies for our properties covering catastrophic losses, including windstorm damage, up to a \$1 billion policy limit per occurrence, subject to a deductible ranging from \$50,000 to \$250,000 per occurrence. Losses resulting from named windstorms are subject to deductibles between 3% and 5% of the declared total insurable value of the property. In addition, we have commercial property insurance policies covering catastrophic losses resulting from earthquake and flood damage, each subject to aggregated loss limits (as opposed to per occurrence losses). Our earthquake limit is \$250 million, subject to a deductible of \$250,000, except for facilities located within documented fault zones. Earthquake losses that affect facilities located in fault zones within the United States are subject to a \$100 million limit and will have applied deductibles ranging from 1% to 5% of the declared total insurable value of the property. The earthquake limit in Puerto Rico is \$25 million, subject to a \$25,000 deductible. Non-critical flood losses have either a \$250,000 or \$500,000 deductible, based upon the location of the facility. Since certain of our facilities have been designated by our insurer as flood prone, we have elected to purchase policies from The National Flood Insurance Program to cover a substantial portion of the applicable deductible. Property insurance for the facilities acquired from Cygnet Health Care Limited are provided on an all risk basis up to a £180 million limit that includes coverage for real and personal property as well as business interruption losses.

Other

Our accounts receivable as of March 31, 2016 and December 31, 2015 include amounts due from Illinois of approximately \$16 million and \$28 million, respectively. Collection of the outstanding receivables continues to be delayed due to state budgetary and funding pressures. Approximately \$6 million as of March 31, 2016 and \$12 million as of December 31, 2015, of the receivables due from Illinois were outstanding in excess of 60 days, as of each respective date. In addition, our accounts receivable as of March 31, 2016 and December 31, 2015 includes approximately \$37 million and \$80 million, respectively, due from Texas in connection with Medicaid supplemental payment programs. The \$37 million due from Texas as of March 31, 2016 consists of \$31 million related to uncompensated care program revenues and \$6 million related to disproportionate share hospital program revenues. Although the accounts receivable due from Illinois and Texas could remain outstanding for the foreseeable future, since we expect to eventually collect all amounts due to us, no related reserves have been established in our consolidated financial statements. However, we can provide no assurance that we will eventually collect all amounts due to us from Illinois and/or Texas. Failure to ultimately collect all outstanding amounts due from these states would have an adverse impact on our future consolidated results of operations and cash flows.

As of March 31, 2016 we were party to certain off balance sheet arrangements consisting of standby letters of credit and surety bonds which totaled \$129 million consisting of: (i) \$105 million related to our self-insurance programs, and; (ii) \$24 million of other debt and public utility guarantees.

Legal Proceedings

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

Office of Inspector General (“OIG”) and Government Investigations:

In February, 2013, the Office of Inspector General for the United States Department of Health and Human Services (“OIG”) served a subpoena requesting various documents from January, 2008 to the date of the subpoena directed at Universal Health Services, Inc. (“UHS”) concerning it and UHS of Delaware, Inc., and certain UHS owned behavioral health facilities including: Keys of Carolina, Old Vineyard Behavioral Health, The Meadows Psychiatric Center, Streamwood Behavioral Health, Hartgrove Hospital, Rock River Academy and Residential Treatment Center, Roxbury Treatment Center, Harbor Point Behavioral Health Center, f/k/a The Pines Residential Treatment Center, including the Crawford, Brighton and Kempsville campuses, Wekiva Springs Center and River Point Behavioral Health. Prior to receiving this subpoena: (i) the Keys of Carolina and Old Vineyard received notification during the second half of 2012 from the DOJ of its intent to proceed with an investigation following requests for documents for the period of January, 2007 to the date of the subpoenas from the North Carolina state Attorney General’s Office; (ii) Harbor Point Behavioral Health Center received a subpoena in December, 2012 from the Attorney General of the Commonwealth of Virginia requesting various documents

from July, 2006 to the date of the subpoena, and; (iii) The Meadows Psychiatric Center received a subpoena from the OIG in February, 2013 requesting certain documents from 2008 to the date of the subpoena. Unrelated to these matters, the Keys of Carolina was closed and the real property was sold in January, 2013. We were advised that a qui tam action had been filed against Roxbury Treatment Center but the government declined to intervene and the case was dismissed.

In April, 2013, the OIG served facility specific subpoenas on Wekiva Springs Center and River Point Behavioral Health requesting various documents from January, 2005 to the date of the subpoenas. In July, 2013, another subpoena was issued to Wekiva Springs Center and River Point Behavioral Health requesting additional records. In October, 2013, we were advised by the DOJ's Criminal Frauds Section that they received a referral from the DOJ Civil Division and opened an investigation of River Point Behavioral Health and Wekiva Springs Center. Subsequent subpoenas have since been issued to River Point Behavioral Health and Wekiva Springs Center requesting additional documentation. In April, 2014, the Centers for Medicare and Medicaid Services ("CMS") instituted a Medicare payment suspension at River Point Behavioral Health in accordance with federal regulations regarding suspension of payments during certain investigations. The Florida Agency for Health Care Administration subsequently issued a Medicaid payment suspension for the facility. River Point Behavioral Health submitted a rebuttal statement disputing the basis of the suspension and requesting revocation of the suspension. Notwithstanding, CMS continued the payment suspension. River Point Behavioral Health provided additional information to CMS in an effort to obtain relief from the payment suspension but the suspension remains in effect. In February, 2016, we received notification from CMS that, effective March, 2016, the payment suspension will be continued for another 180 days. We cannot predict if and/or when the facility's suspended payments will resume. Although the operating results of River Point Behavioral Health did not have a material impact on our consolidated results of operations during the three-month period ended March 31, 2016 or the year ended December 31, 2015, the payment suspension has had a material adverse effect on the facility's results of operations and financial condition.

In June, 2013, the OIG served a subpoena on Coastal Harbor Health System in Savannah, Georgia requesting documents from January, 2009 to the date of the subpoena.

In February, 2014, we were notified that the investigation conducted by the Criminal Frauds Section had been expanded to include the National Deaf Academy. In March, 2014, a Civil Investigative Demand ("CID") was served on the National Deaf Academy requesting documents and information from the facility from January 1, 2008 through the date of the CID. We have been advised by the government that the National Deaf Academy has been added to the facilities which are the subject of the coordinated investigation referenced above.

In March, 2014, CIDs were served on Hartgrove Hospital, Rock River Academy and Streamwood Behavioral Health requesting documents and information from those facilities from January, 2008 through the date of the CID.

In September, 2014, the DOJ Civil Division advised us that they were expanding their investigation to include four additional facilities and were requesting production of documents from these facilities. These facilities are Arbour-HRI Hospital, Behavioral Hospital of Belleaire, St. Simons by the Sea, and Turning Point Care Center.

In December, 2014, the DOJ Civil Division requested that Salt Lake Behavioral Health produce documents responsive to the original subpoenas issued in February, 2013.

In March, 2015, the OIG issued subpoenas to Central Florida Behavioral Hospital and University Behavioral Center requesting certain documents from January, 2008 to the date of the subpoena.

In late March, 2015, we were notified that the investigation conducted by the Criminal Frauds Section had been expanded to include UHS as a corporate entity arising out of the coordinated investigation of the facilities described above and, in particular, Hartgrove Hospital.

In December, 2015, we were notified by the DOJ Civil Division that the civil investigation also includes Arbour Hospital, Arbour-Fuller Hospital, Pembroke Hospital and Westwood Lodge located in Massachusetts. To date, these facilities have not received any requests for documentation or other information.

The DOJ has advised us that the civil aspect of the coordinated investigation referenced above is a False Claim Act investigation focused on billings submitted to government payers in relation to services provided at those facilities. At present, we are uncertain as to potential liability and/or financial exposure of the Company and/or named facilities, if any, in connection with these matters.

In December, 2015, we were advised that the DOJ opened an investigation involving the El Paso Behavioral Health System in El Paso, Texas. The DOJ is investigating potential Stark law violations relating to arrangements between the facility and physician(s) at the facility. These agreements were entered into before we acquired the facility as a part of our acquisition of Ascend Health Corporation in October, 2012. To our knowledge, this matter is not a part of the omnibus investigation referenced above. At present, we are uncertain as to potential liability and/or financial exposure, if any, which may be associated with this matter.

In January, 2016, we were notified that the Department of Justice opened an investigation of the South Texas Health System of a potential False Claim Act case regarding compensation paid to cardiologists pursuant to employment agreements entered into in 2005. At present, we are uncertain as to potential liability and/or financial exposure, if any, which may be associated with this matter.

Regulatory Matters:

On July 23, 2015, Timberlawn Mental Health System (“Timberlawn”) received notification from CMS of its intent to terminate Timberlawn’s Medicare provider agreement effective August 7, 2015. This notification resulted from surveys conducted which alleged that Timberlawn was out of compliance with conditions of participation required for participation in the Medicare/Medicaid program. We filed a request for expedited administrative appeal with the U.S. Department of Health and Human Services, Departmental Appeals Board, Civil Remedies Division, seeking review and reversal of the termination action. In conjunction with the administrative appeal, we filed litigation in the U.S. District Court for the Northern District of Texas seeking a temporary restraining order and preliminary injunction to have the termination stayed pending the conclusion of the administrative appeal. The trial court denied Timberlawn’s request for a temporary restraining order and dismissed the case. Timberlawn’s provider agreement was terminated effective August 14, 2015. In September, 2015 Timberlawn reached an agreement with CMS relative to its reapplication to the Medicare/Medicaid program. In exchange, Timberlawn agreed to dismiss its administrative appeal as well as not to pursue an appeal of the decision of the trial court. During this time, Timberlawn has remained open. In December, 2015, Timberlawn received notice from the Texas Department of State Health Services of its intent to revoke Timberlawn’s license and impose an administrative penalty. We have appealed and are contesting the proposed revocation and fine. In January, 2016, Timberlawn submitted its application for re-enrollment into the Medicare/Medicaid program. Although the operating results of Timberlawn did not have a material impact on our consolidated results of operations or financial condition for the three-month period ended March 31, 2016 or the year ended December 31, 2015, the termination of Timberlawn’s provider agreement has had a material adverse effect on the facility’s results of operations and financial condition.

During the second quarter of 2015, Texoma Medical Center (“Texoma”), which includes TMC Behavioral Health Center, entered into a Systems Improvement Agreement (“SIA”) with CMS. The SIA abated a termination action from CMS following surveys which identified alleged failures to comply with conditions of participation primarily involving Texoma’s behavioral health operations. The terms of the SIA required Texoma to engage independent consultants/experts approved by CMS to analyze and develop implementation plans at Texoma to meet Medicare conditions of participation. At the conclusion of the SIA, CMS will conduct a full certification survey to determine if Texoma is in substantial compliance with the Medicare conditions of participation. The term of agreement is set to conclude October 2, 2016 unless the terms of the agreement are fulfilled earlier. During the term of the SIA, Texoma remains eligible to receive reimbursements from Medicare and Medicaid for services rendered to Medicare and Medicaid beneficiaries.

Other Matters:

In late September, 2015, many hospitals in Pennsylvania, including seven of our behavioral health care hospitals located in the state, received letters from the Pennsylvania Department of Public Welfare (“DPW”) demanding repayment of allegedly excess Medicaid Disproportionate Share Hospital payments (“DSH”) for the federal fiscal year 2011 (“FFY2011”) amounting to approximately \$4 million in the aggregate. We have filed administrative appeals for all of our facilities contesting the recoupment efforts since we believe DPW’s calculation methodology is inaccurate and conflicts with applicable federal and state laws and regulations. DPW has agreed to postpone the recoupment of the state’s share of the DSH payments until all hospital appeals are resolved. DPW also extended the deadline to recoup the federal share (2011 federal share is 55%) until April 30, 2016. However, if DPW is ultimately successful in its demand related to FFY2011, it could take similar action with regards to FFY2012 through FFY2014. Due to a change in the Pennsylvania Medicaid State Plan and implementation of a CMS-approved Medicaid Section 1115 Waiver, we do not believe the methodology applied by DPW to FFY2011 is applicable to reimbursements received for Medicaid services provided after January 1, 2015 by our behavioral health care facilities located in Pennsylvania. We can provide no assurance that we will ultimately be successful in our legal and administrative appeals related to DPW’s repayment demands. If our legal and administrative appeals are unsuccessful, our future consolidated results of operations and financial condition could be adversely impacted by these repayments.

Matters Relating to Psychiatric Solutions, Inc. (“PSI”):

The following matters pertain to PSI or former PSI facilities (owned by subsidiaries of PSI) which were in existence prior to the acquisition of PSI and for which we have assumed the defense as a result of our acquisition which was completed in November, 2010.

Department of Justice Investigation of Friends Hospital:

In October, 2010, Friends Hospital in Philadelphia, Pennsylvania, received a subpoena from the DOJ requesting certain documents from the facility. The requested documents were collected and provided to the DOJ for review and examination. Another subpoena was issued to the facility in July, 2011 requesting additional documents, which have also been delivered to the DOJ. All documents requested and produced pertained to the operations of the facility while under PSI’s ownership prior to our acquisition. At present, we are uncertain as to the focus, scope or extent of the investigation, liability of the facility and/or potential financial exposure, if any, in connection with this matter.

Department of Justice Investigation of Riveredge Hospital:

In 2008, Riveredge Hospital in Chicago, Illinois received a subpoena from the DOJ requesting certain information from the facility. Additional requests for documents were also received from the DOJ in 2009 and 2010. The requested documents have been provided to the DOJ. All documents requested and produced pertained to the operations of the facility while under PSI’s ownership prior to our

acquisition. At present, we are uncertain as to the focus, scope or extent of the investigation, liability of the facility and/or potential financial exposure, if any, in connection with this matter.

General:

We operate in a highly regulated and litigious industry which subjects us to various claims and lawsuits in the ordinary course of business as well as regulatory proceedings and government investigations. These claims or suits include claims for damages for personal injuries, medical malpractice, commercial/contractual disputes, wrongful restriction of, or interference with, physicians' staff privileges, and employment related claims. In addition, health care companies are subject to investigations and/or actions by various state and federal governmental agencies or those bringing claims on their behalf. Government action has increased with respect to investigations and/or allegations against healthcare providers concerning possible violations of fraud and abuse and false claims statutes as well as compliance with clinical and operational regulations. Currently, and from time to time, we and some of our facilities are subjected to inquiries in the form of subpoenas, Civil Investigative Demands, audits and other document requests from various federal and state agencies. These inquiries can lead to notices and/or actions including repayment obligations from state and federal government agencies associated with potential non-compliance with laws and regulations. Further, the federal False Claim Act allows private individuals to bring lawsuits (qui tam actions) against healthcare providers that submit claims for payments to the government. Various states have also adopted similar statutes. When such a claim is filed, the government will investigate the matter and decide if they are going to intervene in the pending case. These qui tam lawsuits are placed under seal by the court to comply with the False Claims Act's requirements. If the government chooses not to intervene, the private individual(s) can proceed independently on behalf of the government. Health care providers that are found to violate the False Claims Act may be subject to substantial monetary fines/penalties as well as face potential exclusion from participating in government health care programs or be required to comply with Corporate Integrity Agreements as a condition of a settlement of a False Claim Act matter. In September 2014, the Criminal Division of the DOJ, announced that all qui tam cases will be shared with their Division to determine if a parallel criminal investigation should be opened. The DOJ has also announced an intention to pursue civil and criminal actions against individuals within a company as well as the corporate entity or entities. In addition, health care facilities are subject to monitoring by state and federal surveyors to ensure compliance with program Conditions of Participation. In the event a facility is found to be out of compliance with a Condition of Participation and unable to remedy the alleged deficiency(s), the facility faces termination from the Medicare and Medicaid programs or compliance with a System Improvement Agreement to remedy deficiencies and ensure compliance.

The laws and regulations governing the healthcare industry are complex covering, among other things, government healthcare participation requirements, licensure, certification and accreditation, privacy of patient information, reimbursement for patient services as well as fraud and abuse compliance. These laws and regulations are constantly evolving and expanding. Further, the Affordable Care Act has added additional obligations on healthcare providers to report and refund overpayments by government healthcare programs and authorizes the suspension of Medicare and Medicaid payments "pending an investigation of a credible allegation of fraud." We monitor our business and have developed an ethics and compliance program with respect to these complex laws, rules and regulations. Although we believe our policies, procedures and practices comply with government regulations, there is no assurance that we will not be faced with the sanctions referenced above which include fines, penalties and/or substantial damages, repayment obligations, payment suspensions, licensure revocation, and expulsion from government healthcare programs. Even if we were to ultimately prevail in any action brought against us or our facilities or in responding to any inquiry, such action or inquiry could have a material adverse effect on us.

The outcome of any current or future litigation or governmental or internal investigations, including the matters described above, cannot be accurately predicted, nor can we predict any resulting penalties, fines or other sanctions that may be imposed at the discretion of federal or state regulatory authorities. We record accruals for such contingencies to the extent that we conclude it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. No estimate of the possible loss or range of loss in excess of amounts accrued, if any,

can be made at this time regarding the matters specifically described above because the inherently unpredictable nature of legal proceedings may be exacerbated by various factors, including, but not limited to: (i) the damages sought in the proceedings are unsubstantiated or indeterminate; (ii) discovery is not complete; (iii) the proceeding is in its early stages; (iv) the matters present legal uncertainties; (v) there are significant facts in dispute; (vi) there are a large number of parties, or; (vii) there is a wide range of potential outcomes. It is possible that the outcome of these matters could have a material adverse impact on our future results of operations, financial position, cash flows and, potentially, our reputation.

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

(6) Segment Reporting

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Our reportable operating segments consist of acute care hospital services and behavioral health care services. The “Other” segment column below includes centralized services including information services, purchasing, reimbursement, accounting, taxation, legal, advertising, design and construction and patient accounting as well as the operating results for our other operating entities including outpatient surgery and radiation centers. The chief operating decision making group for our acute care hospital services and behavioral health care services is comprised of the Chief Executive Officer, the President and the Presidents of each operating segment. The Presidents of each operating segment also manage the profitability of each respective segment’s various facilities. The operating segments are managed separately because each operating segment represents a business unit that offers different types of healthcare services or operates in different healthcare environments. The accounting policies of the operating segments are the same as those described in the summary of significant accounting policies included in our Annual Report on Form 10-K for the year ended December 31, 2015.

Three months ended March 31, 2016

	Acute Care		Behavioral	Total
	Hospital	Health		
	Services	Services	Other	Consolidated
	(Amounts in thousands)			
Gross inpatient revenues	\$4,965,537	\$1,959,570	\$-	\$ 6,925,107
Gross outpatient revenues	\$2,767,329	\$221,643	\$-	\$ 2,988,972
Total net revenues	\$1,287,147	\$1,161,046	\$1,605	\$ 2,449,798
Income/(loss) before allocation of corporate overhead and				
income taxes	\$185,918	\$265,577	\$(124,771)	\$ 326,724
Allocation of corporate overhead	\$(42,649)	\$(38,716)	\$81,365	\$ 0
Income/(loss) after allocation of corporate overhead and				
before income taxes	\$143,269	\$226,861	\$(43,406)	\$ 326,724
Total assets as of March 31, 2016	\$3,498,240	\$5,929,802	\$136,967	\$ 9,565,009

Three months ended March 31, 2015

	Acute Care		Behavioral	Total
	Hospital	Health		
	Services	Services	Other	Consolidated
	(Amounts in thousands)			
Gross inpatient revenues	\$4,328,767	\$1,823,425	\$-	\$ 6,152,192
Gross outpatient revenues	\$2,284,712	\$204,569	\$7,827	\$ 2,497,108
Total net revenues	\$1,145,940	\$1,076,345	\$3,068	\$ 2,225,353
Income/(loss) before allocation of corporate overhead and				
income taxes	\$155,200	\$253,442	\$(111,625)	\$ 297,017
Allocation of corporate overhead	\$(49,426)	\$(29,666)	\$79,092	\$ 0
Income/(loss) after allocation of corporate overhead	\$105,774	\$223,776	\$(32,533)	\$ 297,017

and before income taxes

Total assets as of March 31, 2015	\$3,431,688	\$5,315,270	\$315,445	\$ 9,062,403
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(7) Earnings Per Share Data (“EPS”) and Stock Based Compensation

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

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The following table sets forth the computation of basic and diluted earnings per share for classes A, B, C and D common stockholders for the periods indicated (in thousands, except per share data):

	Three months ended	
	March 31, (amounts in thousands)	
	2016	2015
Basic and Diluted:		
Net income attributable to UHS	\$ 190,759	\$ 174,299
Less: Net income attributable to unvested restricted share grants	(89)	(68)
Net income attributable to UHS – basic and diluted	\$ 190,670	\$ 174,231
Weighted average number of common shares - basic	97,607	98,910
Net effect of dilutive stock options and grants based on the treasury stock method	1,288	1,737
Weighted average number of common shares and equivalents - diluted	98,895	100,647
Earnings per basic share attributable to UHS:	\$ 1.95	\$ 1.76
Earnings per diluted share attributable to UHS:	\$ 1.93	\$ 1.73

The “Net effect of dilutive stock options and grants based on the treasury stock method”, for all periods presented above, excludes certain outstanding stock options applicable to each period since the effect would have been anti-dilutive. The excluded weighted-average stock options totaled 6.0 million for the three months ended March 31, 2016 and 3.0 million for the three months ended March 31, 2015. All classes of our common stock have the same dividend rights.

Stock-Based Compensation: During the three-month periods ended March 31, 2016 and 2015, compensation cost of \$12.7 million and \$10.5 million, respectively, was recognized related to outstanding stock options. In addition, during the three-month periods ended March 31, 2016 and 2015, compensation cost of approximately \$318,000 and \$219,000, respectively, was recognized related to restricted stock. As of March 31, 2016 there was \$115.2 million of unrecognized compensation cost related to unvested options and restricted stock which is expected to be recognized over the remaining weighted average vesting period of 3.2 years. There were 2,912,050 stock options granted (net of cancellations) during the first three months of 2016 with a weighted-average grant date fair value of \$23.77 per share.

The expense associated with share-based compensation arrangements is a non-cash charge. In the Consolidated Statements of Cash Flows, share-based compensation expense is an adjustment to reconcile net income to cash provided by operating activities and aggregated to \$13.2 million and \$10.8 million during the three-month periods ended March 31, 2016 and 2015, respectively. In accordance with ASC 718, excess income tax benefits related to stock based compensation are classified as cash inflows from financing activities on the Consolidated Statement of Cash Flows. During the first three months of 2016 and 2015, we generated \$11.0 million and \$20.1 million, respectively, of excess income tax benefits related to stock based compensation which are reflected as cash inflows from financing activities in our Consolidated Statements of Cash Flows.

(8) Dispositions and acquisitions

Transaction subsequent to March 31, 2016:

Purchase of third-party ownership interests in six acute care hospitals in Las Vegas, Nevada market:

Subsequent to March 31, 2016, we agreed to purchase the minority ownership interests held by a third-party in our six acute care hospitals located in the Las Vegas, Nevada market for an aggregate cash payment of \$445 million which includes both the purchase price and return of capital. The ownership interests purchased, which range from 26.1% to 27.5%, relate to Centennial Hills Hospital Medical Center, Desert Springs Hospital, Henderson Hospital (currently under construction), Spring Valley Hospital Medical Center, Summerlin Hospital Medical Center and Valley Hospital Medical Center.

Three-month period ended March 31, 2016:

Acquisitions:

During the first quarter of 2016, we paid approximately \$20 million to acquire various businesses and property.

Three-month period ended March 31, 2015:

Acquisitions:

During the first quarter of 2015, we paid approximately \$35 million to acquire: (i) a 46-bed behavioral health care facility located in the U.K. and; (ii) various other businesses, a management contract and real property assets.

(9) Dividends

We declared and paid dividends of \$9.8 million, or \$.10 per share, during the first quarter of 2016 and \$9.9 million or \$.10 per share during the first quarter of 2015.

(10) Income Taxes

As of January 1, 2016, our unrecognized tax benefits were approximately \$2 million. The amount, if recognized, that would affect the effective tax rate is approximately \$1 million. During the quarter ended March 31, 2016, changes to the estimated liabilities for uncertain tax positions (including accrued interest) relating to tax positions taken during prior and current periods did not have a material impact on our financial statements.

We recognize accrued interest and penalties associated with uncertain tax positions as part of the tax provision. As of March 31, 2016, we have less than \$1 million of accrued interest and penalties. The U.S. federal statute of limitations remains open for the 2012 and subsequent years. Foreign and U.S. state and local jurisdictions have statutes of limitations generally ranging from 3 to 4 years. The statute of limitations on certain jurisdictions could expire within the next twelve months. It is reasonably possible that the amount of uncertain tax benefits will change during the next 12 months, however, it is anticipated that any such change, if it were to occur, would not have a material impact on our results of operations.

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

(11) Supplemental Condensed Consolidating Financial Information

Certain of our senior notes are guaranteed by a group of subsidiaries (the “Guarantors”). The Guarantors, each of which is a 100% directly owned subsidiary of Universal Health Services, Inc., fully and unconditionally guarantee the senior notes on a joint and several basis, subject to certain customary release provisions.

The following financial statements present condensed consolidating financial data for (i) Universal Health Services, Inc. (on a parent company only basis), (ii) the combined Guarantors, (iii) the combined non guarantor subsidiaries (all

other subsidiaries), (iv) an elimination column for adjustments to arrive at the information for the parent company, Guarantors, and non guarantors on a consolidated basis, and (v) the parent company and our subsidiaries on a consolidated basis.

Investments in subsidiaries are accounted for by the parent company and the Guarantors using the equity method for this presentation. Results of operations of subsidiaries are therefore classified in the parent company's and Guarantors' investment in subsidiaries accounts. The elimination entries set forth in the following condensed consolidating financial statements eliminate distributed and undistributed income of subsidiaries, investments in subsidiaries, and intercompany balances and transactions between the parent, Guarantors, and non guarantors.

UNIVERSAL HEALTH SERVICES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATING STATEMENTS OF INCOME
FOR THE THREE MONTHS ENDED MARCH 31, 2016
(amounts in thousands)

					Total
	Parent	Guarantors	Non Guarantors	Consolidating Adjustments	Consolidated Amounts
Net revenues before provision for doubtful accounts	\$0	\$1,812,098	\$815,838	\$ (8,343)	\$2,619,593
Less: Provision for doubtful accounts	0	107,680	62,115	0	169,795
Net revenues	0	1,704,418	753,723	(8,343)	2,449,798
Operating charges:					
Salaries, wages and benefits	0	824,295	323,844	0	1,148,139
Other operating expenses	0	387,677	181,980	(8,073)	561,584
Supplies expense	0	153,387	101,863	0	255,250
Depreciation and amortization	0	72,253	31,796	0	104,049
Lease and rental expense	0	15,294	9,428	(270)	24,452
	0	1,452,906	648,911	(8,343)	2,093,474
Income from operations	0	251,512	104,812	0	356,324
Interest expense	28,300	1,136	164	0	29,600
Interest (income) expense, affiliate	0	23,054	(23,054)	0	0
Equity in net income of consolidated affiliates	(208,227)	(70,175)	0	278,402	0
Income before income taxes	179,927	297,497	127,702	(278,402)	326,724
Provision for income taxes	(10,832)	97,979	23,858	0	111,005
Net income	190,759	199,518	103,844	(278,402)	215,719
Less: Income attributable to noncontrolling interests	0	0	24,960	0	24,960
Net income attributable to UHS	\$190,759	\$199,518	\$78,884	\$ (278,402)	\$190,759

UNIVERSAL HEALTH SERVICES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATING STATEMENTS OF INCOME
FOR THE THREE MONTHS ENDED MARCH 31, 2015
(amounts in thousands)

	Parent	Guarantors	Non Guarantors	Consolidating Adjustments	Total Consolidated Amounts
Net revenues before provision for doubtful accounts	\$0	\$1,661,612	\$726,080	\$ (7,591)	\$2,380,101
Less: Provision for doubtful accounts	0	106,304	48,444	0	154,748
Net revenues	0	1,555,308	677,636	(7,591)	2,225,353
Operating charges:					
Salaries, wages and benefits	0	740,554	291,149	0	1,031,703
Other operating expenses	0	351,580	161,686	(7,300)	505,966
Supplies expense	0	141,361	97,380	0	238,741
Depreciation and amortization	0	69,645	29,353	0	98,998
Lease and rental expense	0	13,755	9,427	(291)	22,891
	0	1,316,895	588,995	(7,591)	1,898,299
Income from operations	0	238,413	88,641	0	327,054
Interest expense	28,512	1,227	298	0	30,037
Interest (income) expense, affiliate	0	23,054	(23,054)	0	0
Equity in net income of consolidated affiliates	(191,898)	(59,515)	0	251,413	0
Income before income taxes	163,386	273,647	111,397	(251,413)	297,017
Provision for income taxes	(10,913)	92,130	21,477	0	102,694
Net income	174,299	181,517	89,920	(251,413)	194,323
Less: Income attributable to noncontrolling interests	0	0	20,024	0	20,024
Net income attributable to UHS	\$174,299	\$181,517	\$69,896	\$ (251,413)	\$174,299

UNIVERSAL HEALTH SERVICES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATING STATEMENTS OF COMPREHENSIVE INCOME
FOR THE THREE MONTHS ENDED MARCH 31, 2016
(amounts in thousands)

					Total
	Parent	Guarantors	Non Guarantors	Consolidating Adjustments	Consolidated Amounts
Net income	\$190,759	\$199,518	\$103,844	\$(278,402)	\$215,719
Other comprehensive income (loss):					
Unrealized derivative gains on cash flow hedges	(14,299)	0	0	0	(14,299)
Amortization of terminated hedge	(84)	0	0	0	(84)
Foreign currency translation adjustment	5,986	5,986	0	(5,986)	5,986
Other comprehensive income before tax	(8,397)	5,986	0	(5,986)	(8,397)
Income tax expense related to items of other comprehensive income	(5,360)	0	0	0	(5,360)
Total other comprehensive income, net of tax	(3,037)	5,986	0	(5,986)	(3,037)
Comprehensive income	187,722	205,504	103,844	(284,388)	212,682
Less: Comprehensive income attributable to noncontrolling interests	0	0	24,960	0	24,960
Comprehensive income attributable to UHS	\$187,722	\$205,504	\$78,884	\$(284,388)	\$187,722

UNIVERSAL HEALTH SERVICES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATING STATEMENTS OF COMPREHENSIVE INCOME
FOR THE THREE MONTHS ENDED MARCH 31, 2015
(amounts in thousands)

					Total
	Parent	Guarantors	Non Guarantors	Consolidating Adjustments	Consolidated Amounts

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Net income	\$174,299	\$181,517	\$89,920	\$(251,413)	\$194,323
Other comprehensive income (loss):					
Unrealized derivative gains on cash flow hedges	4,132	0	0	0	4,132
Amortization of terminated hedge	(84)	0	0	0	(84)
Currency translation adjustment	(418)	(418)	0	418	(418)
Other comprehensive income before tax	3,630	(418)	0	418	3,630
Income tax expense related to items of other comprehensive income	1,497	0	0	0	1,497
Total other comprehensive income, net of tax	2,133	(418)	0	418	2,133
Comprehensive income	176,432	181,099	89,920	(250,995)	196,456
Less: Comprehensive income attributable to noncontrolling interests	0	0	20,024	0	20,024
Comprehensive income attributable to UHS	\$176,432	\$181,099	\$69,896	\$(250,995)	\$176,432

UNIVERSAL HEALTH SERVICES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATING BALANCE SHEET
AS OF MARCH 31, 2016
(amounts in thousands)

	Parent	Guarantors	Non Guarantors	Consolidating Adjustments	Total Consolidated Amounts
Assets					
Current assets:					
Cash and cash equivalents	\$0	\$40,381	\$14,209	\$0	\$54,590
Accounts receivable, net	0	957,504	417,233	0	1,374,737
Supplies	0	72,559	44,166	0	116,725
Other current assets	0	67,954	21,432	0	89,386
Total current assets	0	1,138,398	497,040	0	1,635,438
Investments in subsidiaries	7,974,369	1,946,590	0	(9,920,959)	0
Intercompany receivable	0	0	801,649	(801,649)	0
Intercompany note receivable	0	0	1,242,937	(1,242,937)	0
Property and equipment	0	4,782,483	1,872,809	0	6,655,292
Less: accumulated depreciation	0	(1,897,760)	(876,980)	0	(2,774,740)
	0	2,884,723	995,829	0	3,880,552
Other assets:					
Goodwill	0	3,065,409	529,492	0	3,594,901
Deferred charges	6,708	5,586	3,941	0	16,235
Other	8,180	390,548	39,155	0	437,883
	\$7,989,257	\$9,431,254	\$4,110,043	\$(11,965,545)	\$9,565,009
Liabilities and Stockholders' Equity					
Current liabilities:					
Current maturities of long-term debt	\$485,862	\$1,241	\$1,159	\$0	\$488,262
Accounts payable and accrued liabilities	20,343	821,832	305,209	0	1,147,384
Federal and state taxes	49,794	0	0	0	49,794
Total current liabilities	555,999	823,073	306,368	0	1,685,440
Intercompany payable	186,164	615,485	0	(801,649)	0
Intercompany note payable	0	1,242,937	0	(1,242,937)	0
Other noncurrent liabilities	11,324	213,818	70,542	0	295,684
Long-term debt	2,767,605	16,468	8,071	0	2,792,144
Deferred income taxes	178,947	0	0	0	178,947
Redeemable noncontrolling interests	0	0	261,492	0	261,492
Equity:					
UHS common stockholders' equity	4,289,218	6,519,473	3,401,486	(9,920,959)	4,289,218

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Noncontrolling interest	0	0	62,084	0	62,084
Total equity	4,289,218	6,519,473	3,463,570	(9,920,959)	4,351,302
	\$7,989,257	\$9,431,254	\$4,110,043	\$(11,965,545)	\$9,565,009

UNIVERSAL HEALTH SERVICES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATING BALANCE SHEET
AS OF DECEMBER 31, 2015
(amounts in thousands)

	Parent	Guarantors	Non Guarantors	Consolidating Adjustments	Total Consolidated Amounts
Assets					
Current assets:					
Cash and cash equivalents	\$0	\$47,192	\$14,036	\$0	\$61,228
Accounts receivable, net	0	918,699	383,730	0	1,302,429
Supplies	0	72,499	43,538	0	116,037
Deferred income taxes	132,975	2,145	0		135,120
Other current assets	0	89,973	13,517	0	103,490
Total current assets	132,975	1,130,508	454,821	0	1,718,304
Investments in subsidiaries	7,760,156	1,876,415	0	(9,636,571)	0
Intercompany receivable	80,764	0	747,709	(828,473)	0
Intercompany note receivable	0	0	1,242,937	(1,242,937)	0
Property and equipment	0	4,722,050	1,808,519	0	6,530,569
Less: accumulated depreciation	0	(1,845,746)	(848,845)	0	(2,694,591)
	0	2,876,304	959,674	0	3,835,978
Other assets:					
Goodwill	0	3,070,061	526,053	0	3,596,114
Deferred charges	7,208	5,530	3,950	0	16,688
Other	14,251	394,998	39,111	0	448,360
	\$7,995,354	\$9,353,816	\$3,974,255	\$(11,707,981)	\$9,615,444
Liabilities and Stockholders' Equity					
Current liabilities:					
Current maturities of long-term debt	\$60,368	\$1,223	\$1,131	\$0	\$62,722
Accounts payable and accrued liabilities	19,996	744,137	269,564	0	1,033,697
Federal and state taxes	3,987	0	0	0	3,987
Total current liabilities	84,351	745,360	270,695	0	1,100,406
Intercompany payable	0	828,473	0	(828,473)	0
Intercompany note payable	0	1,242,937	0	(1,242,937)	0
Other noncurrent liabilities	1,982	206,287	70,565	0	278,834
Long-term debt	3,343,474	16,790	8,370	0	3,368,634
Deferred income taxes	315,900	0	0	0	315,900
Redeemable noncontrolling interests	0	0	242,509	0	242,509
Equity:					

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UHS common stockholders' equity	4,249,647	6,313,969	3,322,602	(9,636,571)	4,249,647
Noncontrolling interest	0	0	59,514	0	59,514
Total equity	4,249,647	6,313,969	3,382,116	(9,636,571)	4,309,161
	\$7,995,354	\$9,353,816	\$3,974,255	\$(11,707,981)	\$9,615,444

UNIVERSAL HEALTH SERVICES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS
FOR THE THREE MONTHS ENDED MARCH 31, 2016
(amounts in thousands)

	Total				
	Parent	Guarantors	Non Guarantors	Consolidating Adjustments	Consolidated Amounts
Net cash (used in) provided by operating activities	\$52,278	\$279,625	\$132,324	\$ 0	\$464,227
Cash Flows from Investing Activities:					
Property and equipment additions, net of disposals	0	(61,718)	(65,496)	0	(127,214)
Acquisition of property and businesses	0	(10,506)	(9,037)	0	(19,543)
Net cash used in investing activities	0	(72,224)	(74,533)	0	(146,757)
Cash Flows from Financing Activities:					
Reduction of long-term debt	(166,096)	(304)	(271)	0	(166,671)
Additional borrowings	14,400	0	0	0	14,400
Financing costs	(44)	0	0	0	(44)
Repurchase of common shares	(171,042)	0	0	0	(171,042)
Dividends paid	(9,757)	0	0	0	(9,757)
Issuance of common stock	2,331	0	0	0	2,331
Excess income tax benefits related to stock-based compensation	11,002	0	0	0	11,002
Profit distributions to noncontrolling interests	0	0	(3,407)	0	(3,407)
Changes in intercompany balances with affiliates, net	266,928	(212,988)	(53,940)	0	0
Net cash provided by (used in) financing activities	(52,278)	(213,292)	(57,618)	0	(323,188)
Effect of exchange rate changes on cash and cash equivalents	0	(920)	0	0	(920)
(Decrease) increase in cash and cash equivalents	0	(6,811)	173	0	(6,638)
Cash and cash equivalents, beginning of period	0	47,192	14,036	0	61,228
Cash and cash equivalents, end of period	\$0	\$40,381	\$14,209	\$ 0	\$54,590

UNIVERSAL HEALTH SERVICES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS
FOR THE THREE MONTHS ENDED MARCH 31, 2015
(amounts in thousands)

	Parent	Guarantors	Non Guarantors	Consolidating Adjustments	Total Consolidated Amounts
Net cash provided by operating activities	\$62,343	\$ 124,046	\$ 84,886	\$ 0	\$ 271,275
Cash Flows from Investing Activities:					
Property and equipment additions, net of disposals	0	(59,217)	(30,059)	0	(89,276)
Acquisition of property and businesses	0	(22,513)	(11,987)	0	(34,500)
Net cash used in investing activities	0	(81,730)	(42,046)	0	(123,776)
Cash Flows from Financing Activities:					
Reduction of long-term debt	(156,097)	(2,561)	(213)	0	(158,871)
Additional borrowings	20,800	0	0	0	20,800
Repurchase of common shares	(28,767)	0	0	0	(28,767)
Dividends paid	(9,899)	0	0	0	(9,899)
Issuance of common stock	1,768	0	0	0	1,768
Excess income tax benefits related to stock-based compensation	20,807	0	0	0	20,807
Profit distributions to noncontrolling interests	0	0	(2,413)	0	(2,413)
Proceeds received from sale/leaseback of real property	0	0	12,551		12,551
Changes in intercompany balances with affiliates, net	89,045	(45,555)	(43,490)	0	0
Net cash (used in) provided by financing activities	(62,343)	(48,116)	(33,565)	0	(144,024)
Effect of exchange rate changes on cash and cash equivalents	0	(466)	0	0	(466)
Increase in cash and cash equivalents	0	(6,266)	9,275	0	3,009
Cash and cash equivalents, beginning of period	0	21,784	10,285	0	32,069
Cash and cash equivalents, end of period	\$0	\$ 15,518	\$ 19,560	\$ 0	\$ 35,078

(12) Recent Accounting Standards

In November, 2015, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2015-17, “Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes”, which eliminates the guidance in Topic 740, Income Taxes, that required an entity to separate deferred tax liabilities and assets between current and noncurrent amounts in a classified balance sheet. The amendments require that all deferred tax liabilities

and assets of the same tax jurisdiction or a tax filing group, as well as any related valuation allowance, be offset and presented as a single noncurrent amount in a classified balance sheet. The amendments are effective for public business entities for annual fiscal years beginning after December 15, 2016. We early adopted this standard effective January 1, 2016, on a prospective basis and did not adjust prior periods presented. The adoption of this standard had no impact on our Condensed Consolidated Statements of Income or Condensed Consolidated Statement of Cash Flows.

In April and August 2015, the FASB issued ASU No. 2015-03 and ASU No. 2015-15, "Interest- Imputation of Interest," respectively, to simplify the presentation of debt issuance costs. The standard requires debt issuance costs be presented in the balance sheet as a direct deduction from the carrying value of the debt liability. The FASB clarified that debt issuance costs related to line-of-credit arrangements can be presented as an asset and amortized over the term of the arrangement. The guidance is effective for annual fiscal periods beginning after December 15, 2015. We adopted this standard on January 1, 2016, on a retrospective basis and adjusted prior periods presented. In connection with the adoption of this ASU, debt issuance costs of \$17 million as of March 31, 2016 and \$19 million as of December 31, 2015 were reclassified from deferred charges to long-term debt. The adoption of this standard had no impact on our financial position or overall results of operations.

In March, 2016, the FASB issued ASU 2016-09, “Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting”, which amends the accounting for employee share-based payment transactions to require recognition of the tax effects resulting from the settlement of stock-based awards as income tax expense or benefit in the income statement in the reporting period in which they occur. In addition, the ASU requires that all tax-related cash flows resulting from share-based payments, including the excess tax benefits related to the settlement of stock-based awards, be classified as cash flows from operating activities in the statement of cash flows. The ASU also requires that cash paid by directly withholding shares for tax withholding purposes be classified as a financing activity in the statement of cash flows. In addition, the ASU also allows companies to make an accounting policy election to either estimate the number of awards that are expected to vest, consistent with current U.S. GAAP, or account for forfeitures when they occur. The new standard is effective for annual reporting periods beginning after December 15, 2016 with early adoption permitted. We are currently evaluating the effect that ASU 2016-09 will have on our condensed consolidated financial statements and related disclosures.

In May 2014 and March 2016, the FASB issued ASU 2014-09 and ASU 2016-08, “Revenue from Contracts with Customers (Topic 606)” and “Revenue from Contracts with Customers: Principal versus Agent Considerations (Reporting Revenue Gross versus Net)”, respectively, which provides guidance for revenue recognition. The standard’s core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. This ASU also requires additional disclosures. The FASB updated the new revenue standard by clarifying the principal versus agent implementation guidance, but does not change the core principle of the new standard. ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2016; however, in July 2015, the FASB approved a one-year deferral of this standard, with a new effective date for fiscal years beginning after December 15, 2017. We are currently in the process of evaluating the impact of adoption of this ASU on our consolidated financial statements and related disclosures.

In February, 2016, the FASB issued ASU 2016-02, “Leases (Topic 842): Amendments to the FASB Accounting Standards Codification “ (“Update 2016-02”), which requires an entity to recognize lease assets and lease liabilities on the balance sheet and to disclose key qualitative and quantitative information about the entity’s leasing arrangements. This update is effective for annual reporting periods beginning after December 15, 2018 with early adoption permitted. A modified retrospective approach is required. We are currently evaluating the effect that ASU 2016-02 will have on our consolidated financial statements and related disclosures.

From time to time, new accounting guidance is issued by the FASB or other standard setting bodies that is adopted by the Company as of the effective date or, in some cases where early adoption is permitted, in advance of the effective date. The Company has assessed the recently issued guidance that is not yet effective and, unless otherwise indicated above, believes the new guidance will not have a material impact on our results of operations, cash flows or financial position.

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

Overview

Our principal business is owning and operating, through our subsidiaries, acute care hospitals, behavioral health centers, surgical hospitals, ambulatory surgery centers and radiation oncology centers. As of March 31, 2016, we owned and/or operated 24 inpatient acute care hospitals, 3 free-standing emergency departments and 214 inpatient and 16 outpatient behavioral health care facilities located in 37 states, Washington, D.C., the United Kingdom, Puerto Rico and the U.S. Virgin Islands. In addition, we are building a newly-constructed acute care hospital located in Henderson, Nevada, that is scheduled to be completed and opened during the fourth quarter of 2016. We also manage and/or own outright or in partnerships with physicians, 4 surgical hospitals and surgery and radiation oncology centers located in 4 states.

As a percentage of our consolidated net revenues, net revenues from our acute care hospitals, surgical hospitals, commercial health insurer, surgery centers and radiation oncology centers accounted for 53% and 52% during the three-month periods ended March 31, 2016 and 2015, respectively. Net revenues from our behavioral health care operations accounted for 47% and 48% of our consolidated net revenues during the three-month periods ended March 31, 2016 and 2015, respectively.

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

Forward-Looking Statements and Risk Factors

You should carefully review the information contained in this Quarterly Report, and should particularly consider any risk factors that we set forth in this Quarterly Report and in other reports or documents that we file from time to time with the Securities and Exchange Commission (the "SEC"). In this Quarterly Report, we state our beliefs of future events and of our future financial performance. This Quarterly Report contains "forward-looking statements" that reflect our current estimates, expectations and projections about our future results, performance, prospects and opportunities. Forward-looking statements include, among other things, the information concerning our possible future results of operations, business and growth strategies, financing plans, expectations that regulatory developments or other matters will not have a material adverse effect on our business or financial condition, our competitive position and the effects of competition, the projected growth of the industry in which we operate, and the benefits and synergies to be obtained from our completed and any future acquisitions, and statements of our goals and objectives, and other similar expressions concerning matters that are not historical facts. Words such as "may," "will," "should," "could," "would," "predict," "potential," "continue," "expects," "anticipates," "future," "intends," "plans," "believes," "estimates," "appears," "projects" and expressions, as well as statements in future tense, identify forward-looking statements. In evaluating those statements, you should specifically consider various factors, including the risks related to healthcare industry trends and those detailed in our filings with the SEC including those set forth herein and in our Annual Report on Form 10-K for the year ended December 31, 2015 in Item 1A Risk Factors and in Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations – Forward Looking Statements and Risk Factors. Those factors may cause our actual results to differ materially from any of our forward-looking statements.

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

- our ability to comply with the existing laws and government regulations, and/or changes in laws and government regulations;
- an increasing number of legislative initiatives have been passed into law that may result in major changes in the health care delivery system on a national or state level. No assurances can be given that the implementation of these laws will not have a material adverse effect on our business, financial condition or results of operations;
- possible unfavorable changes in the levels and terms of reimbursement for our charges by third party payors or government based payors, including Medicare or Medicaid in the United States, and government based payors in the United Kingdom;
- our ability to enter into managed care provider agreements on acceptable terms and the ability of our competitors to do the same, including contracts with United/Sierra Healthcare in Las Vegas, Nevada;

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- the outcome of known and unknown litigation, government investigations, false claim act allegations, and liabilities and other claims asserted against us and other matters as disclosed in Item 1. Legal Proceedings;
- the potential unfavorable impact on our business of deterioration in national, regional and local economic and business conditions, including a worsening of unfavorable credit market conditions;
- competition from other healthcare providers (including physician owned facilities) in certain markets;
- technological and pharmaceutical improvements that increase the cost of providing, or reduce the demand for healthcare;
- our ability to attract and retain qualified personnel, nurses, physicians and other healthcare professionals and the impact on our labor expenses resulting from a shortage of nurses and other healthcare professionals;
- demographic changes;
- our ability to successfully integrate and improve our recent acquisitions and the availability of suitable acquisitions and divestiture opportunities;
- as discussed below in Sources of Revenue, we receive revenues from various state and county based programs, including Medicaid in all the states in which we operate, (we receive Medicaid revenues in excess of \$90 million annually from each of Texas, Washington, D.C., California, Nevada, Illinois, Pennsylvania, Massachusetts and Virginia); CMS-approved Medicaid supplemental programs in certain states including Texas, Illinois, Oklahoma, Mississippi, California, Ohio and Arkansas, and; state Medicaid disproportionate share hospital payments in certain states including Texas and South Carolina. We are therefore particularly sensitive to potential reductions in Medicaid and other state based revenue programs as well as regulatory, economic, environmental and competitive changes in those states. We can provide no assurance that reductions to revenues earned pursuant to these programs, particularly in the above-mentioned states, will not have a material adverse effect on our future results of operations;
- our ability to continue to obtain capital on acceptable terms, including borrowed funds, to fund the future growth of our business;
- some of our acute care facilities experience decreasing inpatient admission trends;
- our financial statements reflect large amounts due from various commercial and private payors and there can be no assurance that failure of the payors to remit amounts due to us will not have a material adverse effect on our future results of operations;
- in March, 2010, the Health Care and Education Reconciliation Act of 2010 and the Patient Protection and Affordable Care Act were enacted into law and created significant changes to health insurance coverage for U.S. citizens as well as material revisions to the federal Medicare and state Medicaid programs. The two combined primary goals of these acts are to provide for increased access to coverage for healthcare and to reduce healthcare-related expenses. Medicare, Medicaid and other health care industry changes are scheduled to be implemented at various times during this decade. We cannot predict the effect, if any, these enactments will have on our future results of operations;
- the Department of Health and Human Services (“HHS”) published final regulations in July, 2010 implementing the health information technology (“HIT”) provisions of the American Recovery and Reinvestment Act (referred to as the “HITECH Act”). The final regulation defines the “meaningful use” of Electronic Health Records (“EHR”) and establishes the requirements for the Medicare and Medicaid EHR payment incentive programs. The implementation period for these new Medicare and Medicaid incentive payments started in federal fiscal year 2011 and can end as late as 2016 for Medicare and 2021 for the state Medicaid programs. Hospitals that do not qualify as a meaningful user of EHR by 2015 are subject to a reduced market basket update to the inpatient prospective payment system (“IPPS”) standardized amount in 2015 and each subsequent fiscal year. We believe that all of our acute care hospitals have met the applicable meaningful use criteria and therefore were not subject to a reduced market basket update to the IPPS standardized amount in federal fiscal year 2015. However, under the HITECH Act, hospitals must continue to meet the applicable meaningful use criteria in each fiscal year or they will be subject to a market basket update reduction in a subsequent fiscal year. Failure of our acute care hospitals to continue to meet the applicable meaningful use criteria would have an adverse effect on our future net revenues and results of operations. There will likely be timing differences in the recognition of the incentive income and expenses recorded in connection with the implementation of the EHR applications which may cause material period-to-period changes in our future results of operations;

- in August, 2011, the Budget Control Act of 2011 (the “2011 Act”) was enacted into law. The 2011 Act imposed annual spending limits for most federal agencies and programs aimed at reducing budget deficits by \$917 billion between 2012 and 2021, according to a report released by the Congressional Budget Office. Among its other provisions, the law established a bipartisan Congressional committee, known as the Joint Select Committee on Deficit Reduction (the “Joint Committee”), which was tasked with making recommendations aimed at reducing future federal budget deficits by an additional \$1.5 trillion over 10 years. The Joint Committee was unable to reach an agreement by the November 23, 2011 deadline and, as a result, across-the-board cuts to discretionary, national defense and Medicare spending were implemented on March 1, 2013 resulting in Medicare payment reductions of up to 2% per fiscal year (annual reduction of approximately \$36 million to our Medicare net revenues) with a uniform percentage reduction across all Medicare programs. The Bipartisan Budget Act of 2015, enacted on November 2, 2015, continued the 2% reductions to Medicare reimbursement imposed under the 2011 Act. We cannot predict whether Congress will restructure the implemented Medicare payment reductions or what other federal budget deficit reduction initiatives may be proposed by Congress going forward;
- our accounts receivable as of March 31, 2016 and December 31, 2015 include amounts due from Illinois of approximately \$16 million and \$28 million, respectively. Collection of the outstanding receivables continues to be delayed due to state budgetary and funding pressures. Approximately \$6 million as of March 31, 2016 and \$12 million as of December 31, 2015, of the receivables due from Illinois were outstanding in excess of 60 days, as of each respective date. In addition, our accounts receivable as of March 31, 2016 and December 31, 2015 includes approximately \$37 million and \$80 million, respectively, due from Texas in connection with Medicaid supplemental payment programs. The \$37 million due from Texas as of March 31, 2016 consists of \$31 million related to uncompensated care program revenues and \$6 million related to disproportionate share hospital program revenues. Although the accounts receivable due from Illinois and Texas could remain outstanding for the foreseeable future, since we expect to eventually collect all amounts due to us, no related reserves have been established in our consolidated financial statements. However, we can provide no assurance that we will eventually collect all amounts due to us from Illinois and/or Texas. Failure to ultimately collect all outstanding amounts due from these states would have an adverse impact on our future consolidated results of operations and cash flows;
- there have been several attempts in Congress to repeal or modify various provisions of the Patient Protection and Affordable Care Act (the “PPACA”). We cannot predict whether or not any of these proposed changes to the PPACA will become law and therefore can provide no assurance that changes to the PPACA, as currently implemented, will not have a material adverse effect on our future results of operations;
- uninsured and self-pay patients treated at our acute care facilities unfavorably impact our ability to satisfactorily and timely collect our self-pay patient accounts;
- the ability to obtain adequate levels of general and professional liability insurance on current terms;
- changes in our business strategies or development plans;
- fluctuations in the value of our common stock, and;
- other factors referenced herein or in our other filings with the Securities and Exchange Commission.

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

Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires us to make estimates and assumptions that affect the amounts reported in our consolidated financial statements and accompanying notes. We consider our critical accounting policies to be those that require us to make significant judgments and estimates when we prepare our consolidated financial statements. For a summary of our significant accounting policies, please see Note 1 to the Consolidated Financial Statements as included in our Annual Report on

Form 10-K for the year ended December 31, 2015.

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Revenue recognition: We record revenues and related receivables for health care services at the time the services are provided. Medicare and Medicaid revenues represented 33% and 36% of our net patient revenues during the three-month periods ended March 31, 2016 and 2015, respectively. Revenues from managed care entities, including health maintenance organizations and managed Medicare and Medicaid programs, accounted for 52% and 50% of our net patient revenues during the three-month periods ended March 31, 2016 and 2015, respectively.

Charity Care, Uninsured Discounts and Provision for Doubtful Accounts: See disclosure below in Results of Operations, Acute Care Hospital Services- Charity Care, Uninsured Discounts and Provision for Doubtful Accounts.

Self-Insured/Other Insurance Risks: We provide for self-insured risks, primarily general and professional liability claims and workers' compensation claims. Our estimated liability for self-insured professional and general liability claims is based on a number of factors including, among other things, the number of asserted claims and reported incidents, estimates of losses for these claims based on recent and historical settlement amounts, estimate of incurred but not reported claims based on historical experience, and estimates of amounts recoverable under our commercial insurance policies. All relevant information, including our own historical experience is used in estimating the expected amount of claims. While we continuously monitor these factors, our ultimate liability for professional and general liability claims could change materially from our current estimates due to inherent uncertainties involved in making this estimate. Our estimated self-insured reserves are reviewed and changed, if necessary, at each reporting date and changes are recognized currently as additional expense or as a reduction of expense. In addition, we also: (i) own a commercial health insurer headquartered in Reno, Nevada, and; (ii) maintain self-insured employee benefits programs for employee healthcare and dental claims. The ultimate costs related to these programs/operations include expenses for claims incurred and paid in addition to an accrual for the estimated expenses incurred in connection with claims incurred but not yet reported. Given our significant insurance-related exposure, there can be no assurance that a sharp increase in the number and/or severity of claims asserted against us will not have a material adverse effect on our future results of operations.

The total accrual for our professional and general liability claims and workers' compensation claims was \$277 million as of March 31, 2016, of which \$82 million is included in current liabilities. The total accrual for our professional and general liability claims and workers' compensation claims was \$271 million as of December 31, 2015, of which \$82 million is included in current liabilities.

Recent Accounting Standards: For a summary of accounting standards, please see Note 12 to the Consolidated Financial Statements, as included herein.

Results of Operations

Three-month periods ended March 31, 2016 and 2015:

The following table summarizes our results of operations and is used in the discussion below for the three-month periods ended March 31, 2016 and 2015 (dollar amounts in thousands):

	Three months ended		Three months ended	
	March 31, 2016		March 31, 2015	
	% of Net		% of Net	
	Amount	Revenues	Amount	Revenues
Net revenues before provision for doubtful accounts	\$2,619,593		\$2,380,101	
Less: Provision for doubtful accounts	169,795		154,748	

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Net revenues	2,449,798	100.0	%	2,225,353	100.0	%
Operating charges:						
Salaries, wages and benefits	1,148,139	46.9	%	1,031,703	46.4	%
Other operating expenses	561,584	22.9	%	505,966	22.7	%
Supplies expense	255,250	10.4	%	238,741	10.7	%
Depreciation and amortization	104,049	4.2	%	98,998	4.4	%
Lease and rental expense	24,452	1.0	%	22,891	1.0	%
Subtotal-operating expenses	2,093,474	85.5	%	1,898,299	85.3	%
Income from operations	356,324	14.5	%	327,054	14.7	%
Interest expense, net	29,600	1.2	%	30,037	1.3	%
Income before income taxes	326,724	13.3	%	297,017	13.3	%
Provision for income taxes	111,005	4.5	%	102,694	4.6	%
Net income	215,719	8.8	%	194,323	8.7	%
Less: Income attributable to noncontrolling interests	24,960	1.0	%	20,024	0.9	%
Net income attributable to UHS	\$ 190,759	7.8	%	\$ 174,299	7.8	%

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Net revenues increased 10%, or \$224 million, to \$2.45 billion during the three-month period ended March 31, 2016 as compared to \$2.23 billion during the first quarter of 2015. The net increase was primarily attributable to: (i) a \$173 million or 8% increase in net revenues generated from our acute care hospital services and behavioral health services operated during both periods (which we refer to as “same facility”), and; (ii) \$51 million of other combined revenue increases consisting primarily of the revenues generated at 4 behavioral health care hospitals acquired in the U.K. during the third quarter of 2015 and 4 inpatient facilities and 8 outpatient centers acquired during the third quarter of 2015 as a result of our acquisition of Foundations Recovery Network, LLC.

Income before income taxes (before deduction for income attributable to noncontrolling interests) increased \$30 million to \$327 million during the three-month period ended March 31, 2016 as compared to \$297 million during the comparable quarter of the prior year. The net increase in our income before income taxes during the first quarter of 2016, as compared to the comparable quarter of 2015, was due to:

- a. an increase of \$31 million at our acute care facilities as discussed below in Acute Care Hospital Services;
- b. an increase of \$12 million at our behavioral health care facilities, as discussed below in Behavioral Health Services, and;
- c. \$13 million of other combined net decreases.

Net income attributable to UHS increased \$16 million to \$191 million during the three-month period ended March 31, 2016 as compared to \$174 million during the comparable prior year quarter. The increase during the first quarter of 2016, as compared to the comparable prior year quarter, consisted of:

- an increase of \$30 million in income before income taxes, as discussed above;
- a decrease of \$5 million resulting from an increase in the income attributable to noncontrolling interests, and;
- a decrease of \$8 million resulting from an increase in the provision for income taxes recorded on the \$25 million increase in pre-tax income (\$30 million increase in income before income taxes less \$5 million increase in income attributable to noncontrolling interests).

Acute Care Hospital Services

Same Facility Basis Acute Care Hospital Services

We believe that providing our results on a “Same Facility” basis, which includes the operating results for facilities and businesses operated in both the current year and prior year periods, is helpful to our investors as a measure of our operating performance. Our Same Facility results also neutralize the impact of the EHR applications, the effect of items that are non-operational in nature including items such as, but not limited to, gains on sales of assets and businesses, impacts of settlements, legal judgments and lawsuits and other amounts that may be reflected in the current or prior year financial statements that relate to prior periods. Our Same Facility basis results reflected on the tables below also exclude from net revenues and other operating expenses, provider tax assessments incurred in each period as discussed below Sources of Revenue-Variou State Medicaid Supplemental Payment Programs. However, these provider tax assessments are included in net revenues and other operating expenses as reflected in the table below under All Acute Care Hospitals. The provider tax assessments had no impact on the income before income taxes as reflected on the tables below since the amounts offset between net revenues and other operating expenses.

The following table summarizes the results of operations for our acute care facilities on a same facility basis and is used in the discussion below for the three-month periods ended March 31, 2016 and 2015 (dollar amounts in thousands):

	Three months ended March 31, 2016		Three months ended March 31, 2015	
	% of Net		% of Net	
	Amount	Revenues	Amount	Revenues
Net revenues before provision				
for doubtful accounts	\$1,408,961		\$1,257,470	
Less: Provision for doubtful accounts	139,755		124,350	
Net revenues	1,269,206	100.0 %	1,133,120	100.0 %
Operating charges:				
Salaries, wages and benefits	509,396	40.1 %	455,944	40.2 %
Other operating expenses	285,046	22.5 %	253,097	22.3 %
Supplies expense	206,768	16.3 %	191,282	16.9 %
Depreciation and amortization	59,046	4.7 %	57,080	5.0 %
Lease and rental expense	13,042	1.0 %	12,553	1.1 %
Subtotal-operating expenses				