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October 11, 2011

VIA HAND DELIVERY

Office of the Attorney General
Attn.: Assistant Attorney General Gary W. Hawes
55 Elm Street
P.O. Box 120
Hartford, CT 06141-0120

Commissioner of Public Health
Attn.: Melanie A. Dillon, Esq.
410 Capitol Avenue
Hartford, CT 06134

RE: **Saint Mary's Health System, Inc. / LHP Hospital Group, Inc.'s Completeness Responses Set Two**

Dear Attorneys Hawes and Dillon:

As requested, Saint Mary's Health System, Inc. and LHP Hospital Group, Inc. hereby submit the attached responses and additional exhibit regarding their Application for a proposed joint venture. One hard copy and one electronic copy have been hand delivered to each office.

Please date/time stamp a copy of the Responses and return it with our messenger.

If you have any questions or need anything further, please contact me at 860.509.6517. Thank you for your assistance in this matter.

Very truly yours,

BROWN RUDNICK LLP

Robert Anthony /s/ ct

Robert J. Anthony

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STATE OF CONNECTICUT
OFFICE OF THE ATTORNEY GENERAL
DEPARTMENT OF PUBLIC HEALTH

IN RE: SAINT MARY'S HEALTH SYSTEM, INC. AND LHP HOSPITAL GROUP, INC.'S APPLICATION FOR APPROVAL OF A JOINT VENTURE.	: : : :	**October 11, 2011**

RESPONSES TO COMPLETENESS QUESTIONS

SET TWO

Saint Mary's Health System, Inc. ("Saint Mary's") and LHP Hospital Group, Inc. ("LHP") (collectively, the "Applicants") hereby respectfully submit to the Attorney General and the Commissioner of the Department of Public Health the following responses and additional exhibits regarding their application for a proposed joint venture (the "Application" or "CON").

1. **Please state whether and, if so how, Saint Mary's considered the impact of Waterbury Hospital's potential inclusion in the joint venture on the value received from partnering with LHP. For example, has Saint Mary's considered whether 20% ownership, certain capital commitments by LHP and equal governance in a two-party joint venture with LHP have equal or greater value to Saint Mary's than 10% ownership, different capital commitments by LHP and less than equal governance of a three-party venture with LHP and Waterbury Hospital? Please provide information and documentation reflecting such consideration.**

As was recently publicized, Saint Mary's, Waterbury Hospital ("WH") and LHP have been discussing the formation of a three-party joint venture (the "three-party JV"), which would include the addition of WH as a member of the proposed joint venture limited liability company (the "LLC") between Saint Mary's and LHP. At the present time, only a non-binding Letter of Intent (the "LOI"), which outlines general principles of the three-party JV, exists between WH and the to-be-formed LLC.

Under the terms of the LOI, WH would contribute certain assets to the three-party JV and LHP would contribute cash and a commitment to fund the construction of a new facility for the three-party JV. In exchange for the contribution of its assets, WH would receive 10% of the equity of the three-party JV. LHP would maintain its 80% equity interest by contributing an additional $108 million, which would be used in connection with the construction of a replacement hospital expected to cost approximately $400 million. As Saint Mary's is not contributing additional assets or cash, its equity interest will be reduced to 10% in the three-party JV.

Although Saint Mary's equity ownership in the three-party JV will be 10%, it is believed that the three-party JV will create significant clinical growth opportunities as well as clinical, operational and financial synergies. Therefore, it is expected that Saint Mary's 10% interest will be of equal or greater value than its 20% interest in the LLC.

2. **Under the current proposal, Saint Mary's will have the option to increase its ownership from 20% to 40%. Will Saint Mary's continue to have the option to increase its ownership interest in the LLC in light of the proposed joint venture between LHP, Saint Mary's, and Waterbury Hospital?**

This is one of several issues that will necessarily have to be renegotiated in order to accommodate the entry of WH into the three-party JV. It is expected that Saint Mary's will continue to have the option to increase its ownership interest in the LLC and that WH will be granted a similar option.

3. **The LLC's board consists of ten members: five elected by Saint Mary's (the "SMH Directors") and five elected by LHP sub (the "LHP directors"), as long as Saint Mary's maintains a 20% interest in the joint venture. (App. at 59.) How will the proposed joint venture between LHP, Saint Mary's, and Waterbury Hospital affect the membership of the LLC's Board of Directors?**

Under the LOI for the proposed three-party JV between LHP, Saint Mary's and WH, there will be two categories of Directors on the three-party JV Board of Directors, with each category of Directors having six members. LHP will appoint the members of one category of Directors (the "LHP Directors"), with one LHP Director selected from the active medical staff of each of WH and Saint Mary's. Saint Mary's and WH each will appoint three members of the second category of Directors (the "Saint Mary's/Waterbury Directors"). Actions requiring the approval of the three-party JV Board of Directors will be accomplished through "block voting" – i.e., such actions will require approval of both a majority of the LHP Directors and a majority of the Saint Mary's/Waterbury Directors.

4. **Please provide an updated Fairness Evaluation reflecting consideration of the impact on the value received by Saint Mary's in the two-party transaction if the joint venture is expanded to include Waterbury Hospital.**

   An updated Fairness Opinion is not yet available because many fundamental terms of the three-party JV, including the final capital structure, operating plan, financial projections, and the total cost of the new facility are incomplete. However, as stated above in the response to question 1, it is believed that the three-party JV will produce significant clinical growth opportunities as well as clinical, operational and financial synergies. The principals of Hammond Hanlon Camp, LLC ("H2C"), who were formerly with Morgan Keegan & Company, Inc., have been advising Saint Mary's since the inception of the discussions with LHP and will continue to be involved in the analysis and development of the business plan and projections for the three-party JV. Once confirmatory due diligence, as well as the business plan, projections and construction costs, are completed, H2C will be prepared to issue an updated Fairness Opinion.

5. **Please provide information and documents demonstrating that Saint Mary's has evaluated LHP's capacity to fund capital improvements and meet other obligations under a three-party transaction.**

   LHP has provided H2C, Saint Mary's financial advisors, documentation evidencing line of credit commitments from LHP's bank group. H2C has also reviewed documents regarding commitments from LHP's equity sponsors, as well as LHP's financial commitments to other joint ventures. H2C and Saint Mary's are comfortable that LHP has the capacity to fund its obligations to the three-party JV.

6. **Provide a copy of LHP Hospital Group, Inc.'s audited financial statements (if available) for the most recent and previous two completed fiscal years.**

   The Consolidated Financial Statements for LHP for the years ended 2008, 2009 and 2010 are attached as **Exhibit 30**.

7. **What impact will the proposed joint venture between LHP, Saint Mary's, and Waterbury Hospital have on LHP's financial projections provided with respect to the current application (pages 272-274)?**

   The parties have not yet prepared financial projections for the three-party JV that correspond to the financial projections for the LLC that were submitted with the Application on pages 272-274; however, the parties expect that the addition of WH to the LLC will have a materially positive impact upon such projections.

8. **According to page 31 of the application, at the time of closing, Saint Mary's will retain approximately $23.7 M in cash and receive a distribution from the LLC of $ 108.0 M to be used to pay off existing debt, fund the pension's liabilities and establish the Community Foundation. Will the cash proceeds distribution from the LLC to Saint Mary's change as the result of the proposed joint venture between LHP, Saint Mary's, and Waterbury Hospital?**

   No, the cash proceeds distribution from the LLC to Saint Mary's are not expected to change as a result of the proposed three-party JV between LHP, Saint Mary's and WH.

9. **In light of the representations that LHP and Saint Mary's will eventually partner with Waterbury Hospital and that a new hospital will be built, please address the following:**

   a. **Will there be changes in clinical services offered by Saint Mary's that were not previously contemplated'?**
   Yes; please see the response to question 9.b below.

   b. **How and when will the duplication of services be addressed between the two hospitals?**
   Dealing with duplication of services between the two hospitals will require a planning process that will evolve over the coming months and more work remains to be done before such plans are finalized. At this point it is anticipated that the duplication of services between Saint Mary's and WH will be addressed in three distinct phases, as follows:

   Phase 1 – Services that can be consolidated onto a single campus with little or no expansion of capacity necessary on the part of the host facility. These could include services such as neonatal intensive care and open heart surgery. Sufficient capacity currently exists on either campus to consolidate the volumes of both. The consolidations in Phase 1 would begin occurring immediately following the closing of the three-party JV transaction and should be complete within the 6 – 8 months thereafter.

   Phase 2 - Services that can be consolidated onto a single campus with minimal expense and minor reconfiguration of existing space. These could include services such as women's services, orthopedics, cardiac rehab, cardiovascular services, etc. These consolidations would likely begin approximately 6 months following the closing of the transaction and should be complete approximately 18 months post-closing.

   Phase 3 – Total facility consolidation would occur upon the completion of construction and commissioning of the new facility.

   c. **How and when will the services between the two hospitals be integrated and what services will be located at which campus'?**

Please see the response to question 9.b above.

10. Saint Mary's indicates on page 69 of the Application that it is implementing a $12 million electronic medical records system. In light of the proposed joint venture among LHP, Saint Mary's, and Waterbury Hospital, will Saint Mary's be able to proceed with the development of the EMR system or will this project be delayed pending approval of the joint venture between LHP, Saint Mary's, and Waterbury Hospital as well as the proposed construction of a new hospital?

The formation of the three-party JV will not affect Saint Mary's plan to proceed with the development and implementation of the EMR system. Saint Mary's, in cooperation with LHP, is currently completing contract negotiations with all vendors for required services to implement the EMR plan. Saint Mary's projects to be compliant with Stage 1 of the ARRA Hi-tech stimulus rules no later than December 31, 2012. Long-term plans for the Saint Mary's EMR include all steps necessary to be fully compliant with all stages of the ARRA Hi-tech stimulus requirements within the current timelines as required in order to maintain optimal Medicare reimbursement under the guidelines.

11. Changes to reimbursement contracts are not anticipated as a result of current proposal and the joint venture will assume all of the existing payer contracts. How will these contracts be affected by the proposed joint venture between LHP, Saint Mary's, and Waterbury?

It is anticipated that all existing contracts at both facilities would be assumed by the three-party JV. Those contracts would continue in place until the two provider numbers are combined into a single provider number, the timing for which will depend upon the pace of the Phase 1 and 2 consolidations and the level of coordination that can be achieved between the two campuses.

12. Please re-affirm the LLC's commitment to continue providing health care services to the uninsured and under insured in light of the proposed joint venture between LHP, Saint Mary's, and Waterbury Hospital.

Under the LOI for the proposed three-party JV between LHP, Saint Mary's and WH, the communities served by Saint Mary's and WH will have continued access to all services that are presently provided. In addition, the three-party JV will commit to operate in accordance with the "community benefit standards" set forth in Revenue Ruling 69-545, including, without limitation, the (i) acceptance of all Medicare and Medicaid patients, (ii) acceptance of all emergency patients without regard to ability to pay, (iii) maintenance of an open medical staff, (iv) provision of public health programs of educational benefit to the community, and (v) general promotion of public health, wellness, and welfare to the community through the provision of health care at a reasonable cost.

13. Please provide a summary of LHP's strategic plan with respect to the proposed joint ventures with SMH and Waterbury Hospital and the establishment of a new hospital in Waterbury, Connecticut.

The strategic plan to be implemented by the three-party JV at Saint Mary's, WH and the new replacement hospital will be developed and approved by the Board of Directors of the three-party JV. That Board of

Directors has not yet been formed. As noted above in the response to question 3, LHP will appoint only 6 of 12 members of the three-party JV Board of Directors and the remaining members will be appointed by Saint Mary's and WH. At such time as the three-party JV Board of Directors is seated, the respective members thereof will begin a collaborative strategic planning process regarding these issues.

EXHIBIT 30

CONSOLIDATED FINANCIAL STATEMENTS

Legacy Hospital Partners, Inc.
(A Development Stage Company)
Year Ended December 31, 2008 and the Period From
October 5, 2007 (Inception) Through December 31, 2008

Ernst & Young LLP

ERNST & YOUNG

Legacy Hospital Partners, Inc.
(A Development Stage Company)

Consolidated Financial Statements

Year Ended December 31, 2008 and the Period
From October 5, 2007 (Inception) Through December 31, 2008

Contents

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Report of Independent Auditors

The Board of Directors
Legacy Hospital Partners, Inc.

We have audited the accompanying consolidated balance sheet of Legacy Hospital Partners, Inc. (a development stage company) as of December 31, 2008, and the related consolidated statements of operations and cash flows for the year ended December 31, 2008, and for the period from October 5, 2007 (inception) through December 31, 2008, and the related consolidated statements of stockholder's deficit for the year ended December 31, 2008, and for the period from October 5, 2007 (inception) through December 31, 2007. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Legacy Hospital Partners, Inc. (a development stage company) at December 31, 2008, and for the period from October 5, 2007 (inception) through December 31, 2008, and the results of its operations and its cash flows for the periods then ended in conformity with U.S. generally accepted accounting policies.

As described in Note 3 to the financial statements, the Company's recurring losses from operations and negative operating cash flows and stockholder's deficit raise substantial doubt about its ability to continue as a going concern. Management's plans as to these matters are also described in Note 3. The 2008 financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Ernst + Young LLP

July 16, 2009

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Legacy Hospital Partners, Inc.
(A Development Stage Company)

Consolidated Balance Sheet

December 31, 2008

Assets		
Current assets:		
Cash	$	1,172,125
Prepaids and other		374,907
Total current assets		1,547,032
Property and equipment, at cost:		
Buildings and improvements		117,075
Furniture and equipment		290,311
		407,386
Accumulated depreciation		(87,989)
Property and equipment, net		319,397
Total assets	$	1,866,429
Liabilities and stockholder's deficit		
Current liabilities:		
Accounts payable	$	111,075
Accrued salaries, wages and benefits		1,438,379
Other accrued expenses		960,922
Due to related party		54,930
Total current liabilities		2,565,306
Deferred rent		31,680
Total liabilities		2,596,986
Commitments and contingencies		
Stockholder's deficit		
Preferred stock, $0.01 par value, 2,000 shares authorized, 17.4 shares isued and outstanding		-
Common stock, $0.01 par value, 1,000 shares authorized; no shares issued and outstanding		-
Additional paid-in capital		8,700,000
Deficit accumulated during the development stage		(9,430,557)
Total stockholder's deficit		(730,557)
Total liabilities and stockholder's deficit	$	1,866,429

See accompanying notes.

Legacy Hospital Partners, Inc.
(A Development Stage Company)

Consolidated Statements of Operations

	Year Ended December 31, 2008	Period from October 5, 2007 (Inception) Through December 31, 2008
Expenses:		
Salaries, wages and employee benefits	$ 3,948,082	$ 3,949,974
Supplies	107,383	109,525
Professional fees	988,493	2,037,357
Contract services	707,628	713,629
Repairs and maintenance	401,447	408,310
Rents and leases	925,343	972,176
Other operating expenses	1,058,289	1,202,688
Depreciation expense	87,989	87,989
Loss before other income	(8,224,654)	(9,481,648)
Other income:		
Interest income	50,091	50,091
Other	1,000	1,000
Net loss	$ (8,173,563)	$ (9,430,557)

See accompanying notes.

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Legacy Hospital Partners, Inc.
(A Development Stage Company)

Consolidated Statements of Stockholder's Deficit

	Shares	Par Value	Additional Paid-In Capital	Deficit Accumulated During the Development Stage	Total
October 5, 2007 (inception)	-	$ -	$ -	$ -	$ -
Preferred stock issued	0.2	-	100,000	-	100,000
Intercompany receivable	-	-	(100,000)	-	(100,000)
Net loss	-	-	-	(1,256,994)	(1,256,994)
Balance at December 31, 2007	0.2	-	-	(1,256,994)	(1,256,994)
Preferred stock issued	17.2	0.17	8,700,000	-	8,700,000
Net loss	-	-	-	(8,173,563)	(8,173,563)
Balance at December 31, 2008	17.4	$ 0.17	$ 8,700,000	$ (9,430,557)	$ (730,557)

See accompanying notes.

Legacy Hospital Partners, Inc.
(A Development Stage Company)

Consolidated Statements of Cash Flows

	Year Ended December 31 2008	Period From October 5, 2007 (Inception) Through December 31, 2008
Cash flows from operating activities		
Net loss	$ (8,173,563)	$ (9,430,557)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation expense	87,989	87,989
Increase (decrease) in cash from operating assets and liabilities:		
Prepaids and other	(272,025)	(374,907)
Accounts payable, accrued expenses and other	1,495,185	2,565,306
Deferred rent	31,680	31,680
Net cash used in operating activities	(6,830,734)	(7,120,489)
Cash flows from investing activity		
Purchases of property and equipment	(322,076)	(407,386)
Net cash used in investing activity	(322,076)	(407,386)
Cash flows from financing activities		
Payments of start-up funding loan from Holdings	(551,128)	(551,128)
Proceeds from start-up funding loan from Holdings	-	551,128
Issuance of Preferred Stock	8,700,000	8,700,000
Net cash provided by financing activities	8,148,872	8,700,000
Change in cash	996,062	1,172,125
Cash at beginning of period	176,063	-
Cash at end of period	$ 1,172,125	$ 1,172,125

See accompanying notes.

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Legacy Hospital Partners, Inc.
(A Development Stage Company)

Notes to Consolidated Financial Statements

NOTE 1-BUSINESS OVERVIEW

Reporting Entity

Legacy Hospital Partners, Inc. ("LHP") is a privately held company established to form joint ventures, in cooperation with local hospitals, to acquire, own, operate and manage acute care facilities in small cities and select urban markets throughout the United States. LHP is a wholly-owned subsidiary of Legacy Hospital Partners (Holdings), LLC. LHP was incorporated on October 5, 2007 under the laws of Delaware and commenced operations on December 10, 2007. LHP is currently a development stage company for financial reporting purposes as it has not begun to generate revenue from its primary business purpose. The terms "we", "our", "the Company", "us" and "LHP" refer to the business of Legacy Hospital Partners, Inc., and our wholly owned subsidiaries, LHP Management Services, LLC and LHP Pocatello, LLC and subsidiaries.

NOTE 2-SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The Company is considered a development stage company as defined by Statement of Financial Accounting Standards ("SFAS") No. 7 "*Accounting and Reporting by Development Stage Enterprises,*" as amended, as we have no principal operations or revenues from any source. Operations from the inception of the development stage have been devoted primarily to strategic planning and the formation of joint ventures for acquiring acute care facilities.

Principals of Consolidation

The consolidated financial statements include the accounts of LHP and all its wholly-owned subsidiaries. All material intercompany transactions have been eliminated.

Use of 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 the consolidated financial statements and these accompanying notes. We regularly evaluate the accounting policies and estimates we use. In general, we base our estimates on assumptions that we believe to be reasonable given the particular circumstances in which we operate. Although we believe all adjustments considered necessary for fair presentation have been included, actual results may vary from those estimates.

NOTE 2-SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Property and Equipment

Property and equipment are recorded at cost. Routine maintenance and repairs are charged to expense when incurred. Expenditures that increase capacities or extend the useful lives of the assets are capitalized.

Depreciation expense is calculated using the straight-line method and was $87,989 for the year ended December 31, 2008 and for the period October 5, 2007 (inception) through December 31, 2008. Building improvements are depreciated over a useful life of 3 years. Equipment is depreciated over useful lives ranging from 3 to 10 years.

Repairs and maintenance

LHP records fuel as repairs and maintenance. The cost of fuel is separate from our related party lease with JJS Aviation, LLC (see note 6). LHP recorded $250,672 and $253,985 in fuel expense for the year ended December 31, 2008 and for the period October 5, 2007 (inception) through December 31, 2008, respectively.

Impairment of Long-Lived Assets

LHP evaluates the carrying value of its property and equipment under the provisions of Statement of Financial Accounting Standards No.144, "*Accounting for the Impairment or Disposal of Long-Lived Assets,*" as amended ("SFAS 144"). Under SFAS 144, when events, circumstances or operating results indicate the carrying value of certain long-lived assets to be held and used might be impaired, we prepare projections of the undiscounted cash flows expected to result from the use and eventual disposition of the assets. If the projections indicate the recorded amounts are not expected to be recoverable, such amounts are reduced to estimated fair value. No indicators of impairment were identified for the year ended December 31, 2008 and for the period October 5, 2007 (inception) through December 31, 2008.

Recent Accounting Pronouncements

In December 2007, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 141(R) "*Business Combinations,*" ("SFAS 141R"). SFAS 141R established principles and requirements for recognizing and measuring identifiable assets and goodwill

NOTE 2-SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

acquired, liabilities assumed and any noncontrolling interest in an acquisition at their fair values as of the acquisition date, as well as requiring the expensing of acquisition-related costs as incurred. Furthermore, SFAS 141R determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS 141R is effective January 1, 2009. The impact on the Company of adopting SFAS No. 141(R) will depend on the nature, terms and size of business combinations completed after the effective date.

In December 2007, FASB issued Statement of Financial Accounting Standards No. 160 "*Noncontrolling Interests in Consolidated Financial Statements-an amendment of ARB No. 51,*" ("SFAS 160"). SFAS 160 amends Accounting Research Bulletin 51 to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 clarifies that a noncontrolling interest in the consolidated entity should be reported as equity in the consolidated financial statements. SFAS 160 also requires consolidated net income to be reported at amounts that include the amounts attributable to both the parent and the noncontrolling interest. SFAS 160 establishes that a change in a parent's ownership interest in a subsidiary that does not result in deconsolidation is an equity transaction. A gain or loss in net income is recognized for changes that result in deconsolidation. SFAS 160 is effective January 1, 2009. The adoption of SFAS No. 160 is not expected to have a material effect on the Company's results of operations, cash flows or financial position.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, "*Fair Value Measurements,*" ("SFAS 157"). SFAS 157 clarifies the definition of fair value, establishes a framework for measuring fair value in accordance with accounting principles generally accepted in the United States, and expands disclosures about fair value measurements. For financial assets and liabilities, SFAS 157 was effective for fiscal years beginning after November 15, 2007 and for nonfinancial assets and liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis, SFAS 157 is effective for fiscal years beginning after November 15, 2008, The adoption of SFAS 157 did not have a material impact on the Company's results of operations or financial condition.

NOTE 3-LIQUIDITY

LHP has incurred losses inception-to-date of ($9,430,557) through December 31, 2008 and has been dependent on funding operations through issuance of additional equity. Management's plans are to finance future operations through cash flow from operations, additional capital contributions from Holdings, and various forms of debt financing. However, no assurance can be given at this time as to whether LHP will be able to achieve this objective. As with any new company, it is uncertain as to when LHP will begin to generate income. Furthermore, the financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classifications of liabilities that may result from the outcome of this uncertainty.

From January 1, 2009 through May 31, 2009, Holdings contributed additional capital contributions totaling $85.9 million, which was used to fund on-going operations and the acquisition of a 77% interest in a hospital and its related operations (see Note 9).

NOTE 4-STOCKHOLDER'S EQUITY

LHP, a wholly owned subsidiary of Legacy Hospital Partners (Holdings) has authorized two classes of stock, which are described below:

Preferred Stock

As of December 31, 2008, LHP has 2,000 shares of preferred stock authorized with 17.4 shares issued and outstanding.

Common stock

As of December 31, 2008, LHP has 1,000 shares of common stock authorized with no shares issued or outstanding.

NOTE 5-RETIREMENT PLAN

LHP has a contributory benefit plan which is available to employees who meet certain minimum requirements. The plan requires LHP to match 100% of a participant's contribution up to the first 3% of the participant's compensation and an additional 50% of the participant's contributions up to the next 6% of the participant's compensation. LHP recorded contribution expense of $79,561 for the year ended December 31, 2008 and for the period from October 5, 2007 (inception) through December 31, 2008.

NOTE 6-TRANSACTIONS WITH RELATED PARTIES

LHP has entered into certain contracts with JJS Aviation, LLC and JJS Hangar, LLC, each of which is owned indirectly by the Chairman of the Board of Directors of LHP. The contracts are leases for aircraft hours (excluding fuel charges) and normal scheduled maintenance, and the aircraft's hanger space. The base rental rate is for a minimum of 200 hours per year with an additional per hour charge for flight hours in excess of 200 hours. LHP recorded combined expense related to the aircraft rental and the hangar space of $742,996 and $789,829 for the year ended December 31, 2008 and for the period from October 5, 2007 (inception) through December 31, 2008, respectively. LHP also recorded $133,994 in maintenance expense for the year ended December 31, 2008 and for the period from October 5, 2007 (inception) through December 31, 2008. At December 31, 2008, the Company has recorded a payable to JJS Aviation, LLC totaling $54,930 for aviation hours in excess of our lease and routine maintenance.

NOTE 7-INCOME TAXES

LHP recognizes deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements. Deferred tax assets and liabilities are determined by the differences between the financial statements and the tax basis of assets and liabilities using current tax rates. A deferred tax liability is recognized for temporary differences that will result in taxable amounts in future years. A deferred tax asset is recognized for temporary differences that will result in deductible amounts in future years. A valuation allowance against a deferred tax asset is recognized if, based on the weight of available evidence, it is more likely than not that some portion or all of the deferred tax asset will not be realized.

At December 31, 2008, the sources of the deferred tax asset are as follows:

Accrued incentive plan	$ 322,382
Deferred compensation	65,130
Federal NOL	2,891,483
Depreciation	13,292
Total deferred tax asset	3,292,287
Valuation allowance	(3,292,287)
Net deferred tax asset	$ –

At December 31, 2008, LHP has recorded a valuation allowance against the deferred tax asset, because management believes that, after considering all the available evidence, it is more likely than not that the deferred tax asset will not be realized.

NOTE 7-INCOME TAXES (continued)

The differences between the actual income tax benefit and the amount computed by applying the statutory federal rate to the loss before income taxes are as follows:

	Year Ended December 31, 2008	Period from October 5, 2007 (Inception) Through December 31, 2008
Benefit computed at federal statutory rate	$ (2,860,747)	$ (3,300,695)
Permanent differences	8,150	8,398
Increase in valuation reserve	3,292,287	3,292,297
Other	(439,690)	–
Income tax benefit	$ –	$ –

At December 31, 2008, LHP has approximately $8.1 million of federal net operating loss carryforwards which will begin to expire in 2028. LHP, at December 31, 2008, does not have any state net operating loss.

NOTE 8-OFFICE LEASE

LHP has a 38-month operating lease for the use of office space. The lease contains a rent escalation clause and a rent holiday. Payments are recognized as rent expense on a straight-line basis over the term of the lease. The difference between the rent expense recognized for financial reporting purposes and the actual payments made in accordance with the lease is recognized as deferred rent. Lease expense was $176,668 for the year ended December 31, 2008 and for the period October 5, 2007 (inception) through December 31, 2008. Future minimum lease commitments under this operating lease for the fiscal years ending 2009, 2010 and 2011 are $189,104, $193,369 and $32,347, respectively.

NOTE 9-SUBSQUENT EVENTS

Effective February 1, 2009, LHP closed under a definitive agreement to form a joint venture to acquire, own and operate a hospital in Pocatello, Idaho and to develop a replacement hospital. LHP, through a wholly-owned subsidiary, contributed approximately $45 million and a promissory note for approximately $141 million to the joint venture in exchange for a 77% interest in the joint venture. Bannock County, Idaho (the "County"), the owner of the hospital, contributed the hospital's current operations, including real estate and equipment, to the joint venture in exchange for a 23% interest in the joint venture. The County then transferred its interest in the joint venture to a local foundation. As part of the transaction, Holdings also made payments of approximately $15.0 million to the County to cover certain costs and fund certain community health programs.

In March 2009, LHP entered into an agreement with McKesson Corporation to purchase clinical and hospital financial software and hardware with an initial cost of $4.6 million. The conversion of the current information systems is anticipated to be complete during the first quarter of 2010.

In May 2009, LHP entered into an agreement with a third party to outsource its current information technology services for a ten-year period and to deploy system-wide clinical, electronic medical record and financial applications. The expected total contract value is approximately $31.3 million.

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Consolidated Financial Statements

LHP Hospital Group, Inc.
December 31, 2009 and 2008
With Report of Independent Auditors

Ernst & Young LLP

LHP Hospital Group, Inc.

Consolidated Financial Statements

Years Ended December 31, 2009 and 2008

Contents

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Report of Independent Auditors

The Board of Directors
LHP Hospital Group, Inc.

We have audited the accompanying consolidated balance sheets of LHP Hospital Group, Inc. (formerly Legacy Hospital Partners, Inc.) as of December 31, 2009 and 2008, and the related consolidated statements of operations, stockholder's equity, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of LHP Hospital Group, Inc. at December 31, 2009 and 2008, and the consolidated results of its operations, stockholder's equity, and cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

Ernst + Young LLP

April 30, 2010

LHP Hospital Group, Inc.

Consolidated Balance Sheets

	December 31 2009	December 31 2008
Assets		
Current assets:		
Cash	$ 17,526,287	$ 1,172,125
Restricted cash	435,000	–
Accounts receivable, less allowance for doubtful accounts of $11,440,066 and $0	25,597,713	–
Inventories	5,300,520	–
Other receivables	2,284,158	–
Other	2,040,729	374,907
Total current assets	53,184,407	1,547,032
Property and equipment, at cost:		
Land	13,085,000	–
Building and improvements	43,061,403	117,075
Furniture and equipment	24,468,929	290,311
Construction in progress	38,463,723	–
	119,079,055	407,386
Accumulated depreciation and amortization	(11,193,801)	(87,989)
Property and equipment, net	107,885,254	319,397
Other assets:		
Investments in and advances to affiliate	194,611	–
Goodwill	14,331,719	–
Intangibles, net	474,667	–
Notes receivable	2,574,146	–
Total assets	$ 178,644,804	$ 1,866,429

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	December 31	
	2009	**2008**
Liabilities and Stockholder's Equity		
Current liabilities:		
Accounts payable	**$ 16,729,199**	$ 953,688
Accrued salaries, wages and benefits	**7,880,975**	1,438,379
Other accrued expenses	**4,842,149**	118,309
Current portion of long-term debt and capital lease obligations	**892,325**	–
Income tax payable	**376,437**	–
Due to related party	**16,370**	54,930
Total current liabilities	**30,737,455**	2,565,306
Long-term liabilities:		
Note payable	**1,875,661**	–
Capital leases obligations	**1,981,315**	–
Due to parent	**592,716**	–
Other	**1,154,437**	31,680
Total long-term liabilities	**5,604,129**	31,680
Commitments and contingencies		
Equity:		
Stockholder's equity:		
Preferred stock, $0.01 par value, 2,000 shares authorized, 221.3 and 17.4 shares issued and outstanding in 2009 and 2008, respectively	**2**	–
Common stock $0.01 par value, 1,000 shares authorized and no shares issued and outstanding	**–**	–
Additional paid-in capital	**110,645,498**	8,700,000
Retained deficit	**(29,332,949)**	(9,430,557)
Total stockholder's equity (deficit)	**81,312,551**	(730,557)
Noncontrolling interest	**60,990,669**	–
Total equity (deficit)	**142,303,220**	(730,557)
Total liabilities and equity	**$ 178,644,804**	$ 1,866,429

See accompanying notes.

LHP Hospital Group, Inc.

Consolidated Statements of Operations

	Year Ended December 31, 2009	2008
Net revenue	**$ 161,888,932**	$ –
Operating expenses:		
Salaries and benefits	**74,011,022**	3,948,082
Supplies	**29,650,675**	107,383
Other operating expenses	**40,947,786**	3,373,572
Provision for doubtful accounts	**10,281,314**	–
Equity in earnings of affiliates	**(165,227)**	–
Contract services	**13,909,319**	707,628
Depreciation and amortization	**11,201,177**	87,989
Interest expense (income), net	**306,009**	(50,091)
Gain on sale of assets	**(439,134)**	–
Other	**(14,723)**	(1,000)
Loss before taxes	**(17,799,286)**	(8,173,563)
Income tax provision	**376,437**	
Net loss	**(18,175,723)**	(8,173,563)
Income attributable to noncontrolling interests	**1,726,669**	–
Net loss attributable to LHP Hospital Group, Inc.	**$ (19,902,392)**	$ (8,173,563)

See accompanying notes.

LHP Hospital Group, Inc.

Consolidated Statements of Stockholders' Equity

	Shares	Amounts	Additional Paid-In Capital	Retained Deficit	Equity Attributable to Noncontrolling Interests	Total
January 1, 2008	0.2	$ –	$ –	$ (1,256,994)	$ –	$ (1,256,994)
Preferred stock issued	17.2	–	8,700,000	–	–	8,700,000
Net loss		–	–	(8,173,563)	–	(8,173,563)
December 31, 2008	17.4	–	8,700,000	(9,430,557)	–	(730,557)
Preferred stock issued	203.9	2	101,945,498	–	–	101,945,500
Contributions received from noncontrolling interest:						
Portneuf Health Care Foundation	–	–	–	–	55,671,500	55,671,500
Physicians Partners	–	–	–	–	3,592,500	3,592,500
Equity based compensation plans	–	–	–	–	–	–
Net loss	–	–	–	(19,902,392)	1,726,669	(18,175,723)
December 31, 2009	221.3	$ 2	$ 110,645,498	$ (29,332,949)	$ 60,990,669	$ 142,303,220

See accompanying notes.

LHP Hospital Group, Inc.

Consolidated Statements of Cash Flows

	Year Ended December 31, 2009	2008
Cash flows from operating activities		
Net loss	$ (19,902,392)	$ (8,173,563)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Provision for doubtful accounts	10,281,314	–
Depreciation and amortization	11,201,177	87,989
Income attributable to noncontrolling interests	1,726,669	–
Equity in earnings of unconsolidated affiliates	(165,227)	–
Gain on sale of assets	(439,134)	–
Increase (decrease) in cash from operating assets and liabilities, net of acquisitions:		
Accounts receivable	(7,618,898)	–
Inventories and other assets	(1,101,733)	(272,025)
Accounts payable and accrued expenses	11,335,290	1,495,185
Other	(342,021)	31,680
Net cash provided by (used in) operating activities	4,975,045	(6,830,734)
Cash flows from investing activities		
Purchases of property and equipment	(44,965,693)	(322,076)
Acquisitions, net of cash acquired	(48,292,352)	–
Due to parent	592,716	
Other	24,776	–
Net cash used in investing activities	(92,640,553)	(322,076)
Cash flows from financing activities		
Payments for capital leases	(788,414)	–
Payments for long-term debt	(47,416)	–
Proceeds from issuance of preferred stock	101,945,500	8,700,000
Payments of start-up funding loan from Holdings	–	(551,128)
Contributions from noncontrolling interest	2,910,000	–
Net cash provided by financing activities	104,019,670	8,148,872
Change in cash and cash equivalents	16,354,162	996,062
Cash and cash equivalents at beginning of year	1,172,125	176,063
Cash and cash equivalents at end of year	$ 17,526,287	$ 1,172,125
Supplemental noncash disclosure		
Noncontrolling interests issued to Physician Partners	$ 682,500	$ –

See accompanying notes.

LHP Hospital Group, Inc.

Notes to Consolidated Financial Statements

December 31, 2009

1. Business Overview

Reporting Entity

LHP Hospital Group, Inc. (LHP) (formerly Legacy Hospital Partners, Inc.) is a privately held company established to form joint ventures, in cooperation with local hospitals, to acquire, own, operate and manage acute care facilities in small cities and select urban markets throughout the United States. LHP is a wholly owned subsidiary of Legacy Hospital Partners (Holdings), LLC. LHP was incorporated on October 5, 2007 under the laws of Delaware and commenced operations on December 10, 2007. The terms "we", "our", "the Company", "us" and "LHP" refer to the business of LHP Hospital Group, Inc., and our wholly owned subsidiaries, LHP Management Services, LLC and LHP Pocatello, LLC and subsidiaries.

Prior to February 1, 2009, the Company was considered a development stage company as defined by Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 915, *Accounting and Reporting by Development Stage Enterprises*, as amended. As a result during 2008 the Company did not have any revenues or expenses related to the revenue cycle. Effective February 1, 2009, LHP formed a joint venture to acquire, own and operate an acute care hospital in Pocatello, Idaho (Pocatello Joint Venture) and to develop a replacement hospital. The Company, through a wholly owned subsidiary, contributed approximately $45 million and a promissory note for approximately $141 million to the joint venture in exchange for a 77% interest in the joint venture. Bannock County, Idaho (the County), the owner of the Pocatello hospital, contributed the hospital's current operations, including real estate and equipment, to the joint venture in exchange for a 23% interest in the joint venture. The County then transferred its interest in the joint venture to a local foundation. As part of the transaction, the Company also made payments of approximately $15.0 million to the County to cover certain costs and fund certain community health programs.

2. Summary of Significant Accounting Policies

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumption that affect amounts reported in the consolidated financial statements and the accompanying notes. We regularly evaluate the accounting policies and estimates we use. In general, we base our estimates on assumptions that we believe to be reasonable given the particular circumstances in which we operate. Although we believe all adjustments considered necessary for presentation have been included, actual results could differ from those estimates.

2. Summary of Significant Accounting Policies (continued)

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and all subsidiaries and entities controlled by the Company through the Company's direct or indirect ownership of a majority interest and exclusive rights granted to the Company as the sole general partner or controlling member of such entities. All significant intercompany accounts and transactions have been eliminated upon consolidation.

Net Patient Services Revenues

Revenues consist primarily of net patient service revenues that are recorded based upon established billing rates less allowances for contractual adjustments. Revenues are recorded during the period the health care services are provided, based upon the estimated amounts due from the patients and third-party payers. Third-party payers include federal and state agencies (under the Medicare and Medicaid programs) and other third-party payers such as health maintenance organizations, preferred provider organizations and other private insurers. The amounts received from these third-party payers are generally less than the Company's established billing rates. Accordingly, the revenues reported in the Company's consolidated financial statements are recorded at the net amount that is expected to be received. The Company derives a significant portion of its revenues from Medicare, Medicaid and other payers that receive discounts from its established billing rates. The Company must estimate the total amount of these discounts to prepare its consolidated financial statements. The Medicare and Medicaid regulations and the various managed care contracts under which these discounts must be calculated are complex and are subject to interpretation and adjustments. The Company estimates the allowance for contractual discounts on a payer specific basis given its interpretation of the applicable regulation or contractual terms. As a result, there is a possibility that the recorded estimates could change by a material amount.

Patients treated at hospitals for nonelective care, who have income below certain amounts that are based on federal poverty level guidelines, are eligible for charity care. Charity care, based on our cost of service, totaled \$0.9 million for the year ended December 31, 2009. The federal poverty level is established by the federal government and is based on income and family size. We provide discounts to uninsured patients who do not qualify for Medicaid or charity care. These discounts are similar to discounts provided to many local managed care plans and totaled \$0.1 million for the year ended December 31, 2009. In implementing our discount policy, we

2. Summary of Significant Accounting Policies (continued)

first attempt to qualify uninsured patients for Medicaid, other federal or state assistance or charity care. If an uninsured patient does not qualify for these programs, the uninsured discount is applied.

We are required to meet certain financial reporting requirements to participate in the Medicare and Medicaid programs. Federal regulations require the submission of annual cost reports covering medical cost and expenses associated with the services provided by the hospital to program beneficiaries. Cost report settlements under reimbursement agreements with Medicare and Medicaid are estimated and recorded in the period the related services are rendered and are adjusted in future periods as final settlements are determined. There is a possibility that the recorded estimates could change by a material amount. There were no adjustments recorded to net revenues in 2009 as prior year cost report settlements were the responsibility of the previous owners. The net estimated cost report settlement due from the Company as of December 31, 2009 is included in accounts receivable in the accompanying consolidated balance sheets and was approximately $0.3 million.

Laws and regulations governing Medicare and Medicaid programs are complex and subject to interpretation. The Company believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigation involving allegations of potential wrongdoing that would have a material effect on the Company's consolidated financial statements. Compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action including but not limited to fines, penalties and exclusion from the Medicare and Medicaid programs.

Cash and Cash Equivalents

The Company considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. Cash and cash equivalents consist of cash on hand, money market funds and a certificate of deposit in the amount of $0.4 million at December 31, 2009 that served as collateral for the Company's worker's compensation program, which has been classified as restricted cash on the consolidated balance sheets. The Company places its cash in financial institutions that are federally insured.

2. Summary of Significant Accounting Policies (continued)

Accounts Receivable and Allowance for Doubtful Accounts

We receive payments for services rendered from federal and state agencies (under the Medicare and Medicaid programs), third-party payers and patients. The Company's ability to collect outstanding receivables is critical to its results of operations and cash flows. To provide for accounts receivable that could become uncollectible in the future, the Company establishes an allowance for doubtful accounts to reduce the carrying value of such receivables to their estimated net realizable value.

The Company has a process to determine the adequacy of the allowance for doubtful accounts that relies on a number of analytical tools and benchmarks to arrive at a reasonable allowance. No single statistic or measurement determines the adequacy of the allowance for doubtful accounts. Some of the tools that the Company utilizes include, but are not limited to, historical cash collections experience and revenue trends by payer classification. Accounts are written off when all reasonable internal and external collection efforts have been exhausted.

Inventories

Inventories are stated at average cost or market. Market is determined on the basis of estimated realizable values.

Property and Equipment

Property and equipment are recorded at cost. Property and equipment acquired in connection with a business combination are recorded at their estimated fair value in accordance with the acquisition method of accounting as prescribed in ASC Topic 805-10, *Business Combinations*. Property and equipment under capital leases are stated at the present value of minimum lease payments. Routine maintenance and repairs are charged to expense when incurred. Expenditures that increase capacities or extend useful lives of assets are capitalized.

Depreciation expense is computed by applying the straight-line method over the estimated useful lives of the assets. Assets held under capital leases are amortized on a straight-line basis over the shorter of the lease term or estimated useful life of the asset. The estimated useful life of buildings and improvements generally range from 10 to 40 years, while the estimated useful lives of furniture and equipment range from 3 to 10 years. Total depreciation (including amortization of capital leases) for the years ended December 31, 2009 and 2008 was $11.2 million and $0.1 million, respectively.

2. Summary of Significant Accounting Policies (continued)

The Company is obligated under capital leases covering certain buildings and equipment. At December 31, 2009 and 2008, the gross amount of buildings and equipment and related accumulated amortization recorded under capital leases were as follows (in millions):

	2009	2008
Buildings and improvements	$ 1.7	$ –
Equipment	3.4	–
	5.1	–
Accumulated amortization	(1.2)	–
	$ 3.9	$ –

Long-lived Assets

When events, circumstances or operating results indicate the carrying values of certain long-lived assets and related identifiable intangible assets (excluding goodwill and indefinite-lived intangibles) expected to be held and used, might be impaired, we prepare projections of the undiscounted cash flows expected to result from the use and eventual disposition of the assets. If the projections indicate the recorded amounts are not expected to be recoverable, such amounts are reduced to estimated fair value. No indicators of impairment were identified for the years ended December 31, 2009 and 2008.

Amortizable Intangibles

Amortizable intangible assets include two covenants not to compete. The agreements not to compete are amortized over the five-year terms of the agreements using the straight-line method.

Goodwill and Indefinite-lived Intangible Assets

Goodwill is the excess of the purchase price over the fair value of identifiable assets acquired. Under FASB ASC Topic 350, *Intangibles – Goodwill and Other,* goodwill and intangibles with indefinite lives are not amortized, but tested for impairment annually or more frequently if certain indications of impairment arise.

2. Summary of Significant Accounting Policies (continued)

Goodwill impairment is determined using a two-step test. The first step is to identify if a potential impairment exists by comparing the fair value of the reporting unit with its carrying amount, including goodwill. If the fair value of the reporting unit exceeds its carrying amount, goodwill is not considered to have a potential impairment and the second step of the impairment test is not required. However, if the carrying amount of the reporting unit exceeds its fair value, the second step is performed to determine if goodwill is impaired and to measure the amount of impairment loss to be recognized, if any. The second step compares the implied fair value of goodwill with the carrying amount of goodwill. If the implied fair value of goodwill exceeds its carrying amount, then goodwill is not considered impaired. However, if the carrying amount of goodwill exceeds its implied fair value, an impairment loss is recognized for any excess of the carrying amount of the reporting unit's goodwill over the implied fair value of that goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation and the residual fair value after this allocation is the implied fair value of the reporting unit goodwill. Fair value of the reporting unit is estimated based upon internal evaluations of the related long-lived assets for each reporting unit that include quantitative analyses of revenues and cash flows. The Company determined that there have been no goodwill impairment indicators since the Pocatello acquisition.

Professional and General Liability

Our professional and general liability insurance is provided by a commercial carrier. The policy is a claims made policy and has limits of $1.0 million per claim and $3.0 million annual aggregate for medical professional liability claims and $1.0 million per occurrence and $3.0 million annual aggregate for general liability claims. The deductible is $25,000 per occurrence. In addition to the primary coverage umbrella and excess coverage is maintained with shared limits of $15.0 million.

Self-Insured Liabilities

The Company is self-insured for substantially all of the medical benefits of its employees. The reserve for medical benefits reflects known claims and an estimate of incurred but not reported losses based upon an actuarial analysis as of the balance sheet date. The reserve for self-insured medical benefits was $0.5 million as of December 31, 2009. In 2008, the Company was not self-insured; therefore, no reserves for self-insured medical benefit were recorded.

2. Summary of Significant Accounting Policies (continued)

The Company is self-insured for workers' compensation claims with a stop loss limit of $250,000 per occurrence. Estimated liabilities for worker's compensation claims were $0.5 million at December 31, 2009. During 2008, the Company purchased workers' compensation coverage from a commercial carrier.

Noncontrolling Interest

Noncontrolling interest represent the portion of equity in the Pocatello Joint Venture not attributable, directly or indirectly, to us. The Company's accompanying consolidated financial statements include all assets, liabilities, revenues and expenses of the Pocatello Joint Venture, which include amounts attributable to the Company and the noncontrolling interest. The Company recognizes as a separate component of equity and earnings the portion of the income or loss attributable to noncontrolling interest based on the portion of the entity not owned by the Company.

Equity-Based Compensation

We account for equity-based compensation in accordance with ASC Topic 718, *Compensation – Stock Compensation*. ASC Topic 718 requires the Company to recognize compensation expense, for all equity-based awards granted to employees, using a fair value measurement method. Under the fair value method, the estimated fair value of awards that are expected to vest is recognized over the requisite service period, which is generally the vesting period. The Company estimates grant date fair value using the Black-Scholes-Merton option pricing model.

Fair Value

The Company's financial instruments include cash and cash equivalents, accounts receivable, notes and other receivables and accounts payable and accrued expenses. Management believes the carrying value of cash and cash equivalents, accounts receivable, other receivables and accounts payable and accrued expenses approximates fair value due to their short-term maturity. Management believes the fair value of notes receivable approximates fair value based on current interest rate assumptions and remaining term to maturity.

2. Summary of Significant Accounting Policies (continued)

Recently Issued Accounting Pronouncements

Effective January 1, 2009, the Company adopted Statement of ASC Topic 805, *Business Combinations*. ASC Topic 805 established principles and requirements for recognizing and measuring identifiable assets and goodwill acquired, liabilities assumed and any noncontrolling interest in an acquisition at their fair values as of the acquisition date, as well as requiring the expensing of acquisition-related costs as incurred. Furthermore, ASC Topic 805 determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination.

Effective January 1, 2009, the Company adopted ASC Topic 810, *Consolidation*. ASC Topic 810 amends *Accounting Research Bulletin 51* to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. ASC Topic 810 clarifies that a noncontrolling interest in the consolidated entity should be reported as equity in the consolidated financial statements. ASC Topic 810 also requires consolidated net income to be reported at amounts that include the amounts attributable to both the parent and the noncontrolling interest. ASC Topic 810 establishes that a change in a parent's ownership interest in a subsidiary that does not result in deconsolidation is an equity transaction. A gain or loss in net income is recognized for changes that result in deconsolidation.

In June 2009, the Company adopted ASC Topic 855 *Subsequent Events*. ASC Topic 855 establishes general standards of accounting for and disclosures of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. ASC Topic 855 requires the Company to disclose the date through which the Company has evaluated subsequent event and the basis for the date.

Effective for the Company's annual financial statements issued for December 31, 2009, the Company adopted FASB ASC Topic 105, which establishes the FASB ASC as the single source of authoritative accounting principles recognized by the FASB to be applied to nongovernmental entities in the preparation of financial statements in conformity with Generally Accepted Accounting Principles (GAAP). Accordingly, all references to GAAP provided in the Company's notes to its consolidated financial statements are in accordance with ASC Topic 105.

2. Summary of Significant Accounting Policies (continued)

The FASB has issued Accounting Standards Update (ASU) 2009-17, *Improvements to Financial Reporting by Enterprises involved with Variable Interest Entities* (ASU 2009-17). ASU 2009-17 changes how a reporting entity determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) should be consolidated. The determination of whether a reporting entity is required to consolidate another entity is based on, among other factors, the other entity's purpose and design and the reporting entity's ability to direct the activities of the other entity that most significantly impact the other entity's economic performance.

ASU 2009-17 also requires a reporting entity to provide additional disclosures about its involvement with variable interest entities and any significant changes in risk exposure due to that involvement. A reporting entity will be required to disclose how its involvement with a variable interest entity affects the reporting entity's financial statements. ASU 2009-17 is effective beginning January 1, 2010. The adoption of ASU 2009-17 could have a material impact on the Company's future results of operations, cash flows and financial position due to the Company involvement with a variable interest entity in connection with the formation of a joint venture to acquire a hospital in Sherman, Texas.

3. Acquisitions

On February 1, 2009, the Company acquired a 77% interest in a joint venture formed to acquire, own and operate a hospital in Pocatello, Idaho and to develop a replacement hospital. The hospital is licensed for 250 beds. The assets and liabilities for the acquisition were recorded at their fair market values as of the effective acquisition date. The Company, through a wholly owned subsidiary, contributed cash of $45.0 million and a promissory note for approximately $141.0 million to the joint venture in exchange for a 77% interest in the joint venture. Under the acquisition method of accounting, in accordance with ASC Topic 805-10, the purchase was allocated to the identifiable assets acquired and liabilities assumed based upon their estimated fair value as of February 1, 2009. The excess of the purchase price over the estimated fair value of the identifiable assets acquired and liabilities assumed was recorded as goodwill. The results of operations have been included in the Company's results of operations beginning February 1, 2009.

The acquisition date fair value of the consideration transferred totaled $186.0 million, which consisted of the following (in millions):

Cash	$	45.0
Note payable to Pocatello Joint Venture		141.0
Total	$	186.0

The Company recognized $15.0 million in acquisition related costs that were expensed in the current period. The acquisition costs are included in the consolidated statements of operations as other operating expenses.

3. Acquisitions (continued)

The fair values of the assets acquired and liabilities assumed at the acquisition date are as follows (in millions):

Assets:		
Cash	$	3.8
Accounts receivables		27.0
Inventories		4.9
Other current assets		5.7
Property and equipment		70.3
Investments in affiliates		1.5
Intangible assets		0.6
Total identifiable assets acquired		113.8
Liabilities:		
Accounts payable		5.9
Accrued liabilities		8.5
Note payable		1.9
Capital lease obligations		3.6
Total liabilities assumed		19.9
Net identifiable assets acquired		93.9
Goodwill		6.8
Net assets acquired	$	100.7

As part of the initial acquisition of the hospital in Pocatello, Idaho, the Company acquired a 20.1% equity investment in Rocky Mountain Surgery Center, LLC. Effective August 1, 2009, the Company acquired all of the assets in Rocky Mountain Surgery Center as part of a business combination achieved in stages in exchange for $6.9 million in cash and a noncontrolling interest in a subsidiary of Pocatello Health System, LLC, with a value of $0.7 million. The acquisition date fair value of the previous equity interest was $1.5 million, and was included in the measurement of the consideration transferred. The Company recognized a gain of $0.4 million as a result of re-measuring its equity interest in Rocky Mountain Surgery Center prior to the business combination. The gain is included in gain on sale of assets in the accompanying consolidated statement of operations. The Company accounted for this transaction under the business combination achieved in stages, in accordance with ASC Topic 805-10. The amount of goodwill assigned to the acquisition of Rocky Mountain Surgery Center was $7.5 million.

3. Acquisitions (continued)

The amounts of revenue and earnings of the Pocatello Joint Venture included in the Company's consolidated statement of operations from the acquisition date to December 31, 2009 are as follows (in millions):

		2009
Net revenues	$	161.9
Earnings	$	5.8

The following represents the unaudited pro forma consolidated statements of operations as if Pocatello Joint Venture had been included in the consolidated results of the Company for the entire years ended December 31, 2009 and 2008 (in millions):

	Year Ended			
		2009		2008
Net revenues	**$**	**183.4**	$	167.2
Net loss	**$**	**(16.5)**	$	(13.5)

The fair value of the 23% noncontrolling interest in the Pocatello Joint Venture is estimated to be $55.7 million. The fair value of the noncontrolling interest was estimated using a combination of the cost and market approaches. The fair value of estimate was based on a independent third-party valuation.

In October 2009, the Company issued additional noncontrolling interests in a subsidiary of Pocatello Hospital, LLC to members of the hospital's medical staff in exchange for cash of $2.9 million.

4. Goodwill and Other Intangible Assets

The acquired intangible assets subject to amortization related to covenants not to compete, which have a useful life of five years. Amortization expense was $0.1 million and $0 for the years ended December 31, 2009 and 2008, respectively.

4. Goodwill and Other Intangible Assets (continued)

Amortization of intangible assets over the next five years is as follows (in millions):

2010	$	0.1
2011		0.1
2012		0.1
2013		0.1
2014		–

The gross carrying amount and accumulated amortization at December 31, 2009 and 2008 are as follows (in millions):

	2009	2008
Amortizable intangible assets:		
Covenants not to compete agreements	$ 0.6	$ –
Less accumulated amortization	0.1	–
Net amortizable intangible assets	$ 0.5	$ –
Indefinite-lived intangible assets:		
Trade name	$ 0.1	$ –

Changes in the value of goodwill were as follows:

	December 31 2009	2008
Balance at January 1	$ –	$ –
Goodwill acquired	14.3	–
Balance at December 31	$ 14.3	$ –

5. Stockholder's Equity

LHP has authorized two classes of stock, which are described below:

Preferred Stock

As of December 31, 2009, LHP has 2,000 shares of preferred stock authorized with 221.3 shares issued and outstanding. Holders of the preferred stock are entitled to receive certain distributions

5. Stockholder's Equity (continued)

in preference to holders of the common stock. Holders of the preferred stock are first entitled to receive an annual special dividend equal to 30% of 1% of the aggregate amount of capital contributions made by CCMP Capital Advisors, LLC (CCMP) and the CPP Investment Board (CPPIB) in Legacy Hospital Partners (Holdings), LLC; the annual special dividend is not payable, however, until LHP attains positive earnings (as defined in LHP's Restated Certificate of Incorporation) for the fiscal year. Next, the holders of the preferred stock are entitled to receive a dividend accruing daily at the rate of 8% per annum of the original cost of each share of preferred stock. Finally, holders of the preferred stock are entitled to receive a return of an amount equal to the original cost of such preferred stock prior to the making of any payments to holders of the common stock.

As of December 31, 2009 the total cumulative annual dividends were $0.3 million or $1,489 per share and the 8% cumulative dividends were $7.3 million or $32,810 per share.

Common Stock

As of December 31, 2009, LHP has 1,000 shares of common stock authorized with no shares issued or outstanding.

6. Equity-Based Compensation

In 2009, LHP adopted an equity incentive plan (the Plan) pursuant to which the Company's board of directors may grant stock options, restricted stock or stock units (Awards) to employees, consultants and directors of the Company and its subsidiaries. The Plan authorizes grants of up to 1,000,000 shares of authorized but unissued common stock. Awards can be granted with an exercise price not less than the greater of the par value of the common stock or below 100% of the fair market value of the common stock on the date of grant. In the case of any person who at the time of grant possesses more than 10% of the total combined voting power of all classes of stock of the Company, Awards can be granted with an exercise price not less than the greater of the par value of the common stock or 110% of the fair market value of the common stock. All Awards generally vest over a four-year period. As of December 31, 2009, no Awards have been issued under this plan. Subsequent to December 31, 2009, LHP granted 17,375 shares of restricted stock to certain employees with a fair value on the date of grant of $1.00 per share.

7. Notes Payable

In connection with the Company's acquisition of an interest in the Pocatello Joint Venture, the Company acquired a note payable for land in the amount of $1.9 million. As of December 31, 2009, approximately $1.9 million is recorded in long-term debt. The note bears an interest rate of 8% with quarterly principal and interest payments and matures September, 2027.

8. Retirement Plan

The Company has a contributory benefit plan that is available to employees who meet certain minimum requirements. With respect to the year 2009, the plan required the Company to match 100% of a participant's contributions up to the first 3% of the participant's compensation and an additional 50% of the participant's contributions up to the next 6% of the participant's compensation. The Company recorded contribution expense of $2.2 million and $0.1 million for the years ended December 31, 2009 and 2008, respectively.

9. Transactions with Related Parties

The Company entered into certain contracts with JJS Aviation, LLC and JJS Hangar, LLC, each of which is owned indirectly by the Chairman of the Board of Directors of LHP. The contracts represent leases for aircraft hours (excluding aviation fuel charges), normal scheduled maintenance, and the aircraft's hanger space. The base rental rate is for a minimum of 200 hours per year with an additional per hour charge for flight hours in excess of 200 hours. The Company recorded combined expense related to the aircraft rental and the hangar space of $0.7 million for each of the years ended December 31, 2009 and 2008. The Company also recorded $0.2 million and $0.1 million in maintenance expense for the years ended December 31, 2009 and 2008. At December 31, 2009, the Company has recorded a payable to JJS Aviation, LLC, in the amount of $16,370 for routine maintenance.

10. Income Taxes

LHP recognizes deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the consolidated financial statements. Deferred tax assets and liabilities are determined by the differences between the consolidated financial statements and the tax basis of assets and liabilities using current tax rates. A deferred tax liability is recognized for temporary differences that will result in taxable amounts in future years. A deferred tax asset

10. Income Taxes (continued)

is recognized for temporary differences that will result in deductible amounts in future years. A valuation allowance against a deferred tax asset is recognized if, based on the weight of available evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

At December 31, 2009 and 2008, the sources of the deferred tax assets are as follows (in millions):

	2009	2008
Accrued incentive plan	$ 0.1	$ 0.3
Deferred compensation	0.1	0.1
Accrued medical and dental	0.3	–
Federal NOL	1.2	2.9
Workers compensation	0.2	–
Partnership basis-investment in Pocatello Joint Venture	9.6	–
Total deferred tax asset	11.5	3.3
Valuation allowance	(11.5)	(3.3)
Net deferred tax asset	$ –	$ –

At December 31, 2009, the Company has recorded a valuation allowance against the deferred tax asset, because management believes that, after considering all the available evidence, it is more likely than not that the deferred tax assets will not be realized.

10. Income Taxes (continued)

For the years ended December 31, 2009 and 2008, the differences between the actual income tax benefit and the amount computed by applying the statutory federal rate to the loss before income taxes are as follows (in millions):

	2009	2008
Benefit computed at federal statutory rate	$ (7.2)	$ (2.9)
Minority interest on state tax	0.4	
State income tax benefit, net of federal tax effect at state statutory rates	(1.0)	–
Increase in valuation allowance	8.2	3.3
Other	–	(0.4)
Income tax benefit	$ (0.4)	$ –

At December 31, 2009, LHP has approximately $3.6 million of federal net operating losses carryforwards which will begin to expire in 2028. LHP, at December 31, 2009, does not have any state net operating losses.

11. Leases

The Company leases real estate, buildings, vehicles and equipment under cancelable and non-cancelable leases. The leases expire at various times and have various renewal options. Certain leases that meet the lease capitalization criteria in accordance with ASC Topic 840-10, *Leases*, assets have been recorded at their fair value at the date of acquisition and liabilities at the net present value of the minimum lease payments at the inception of the lease. Rental expense of operating leases for the years ended December 31, 2009 and 2008 was $4.7 million and $0.9 million, respectively.

11. Leases (continued)

Future minimum lease payments at December 31, 2009, are as follows (in millions):

	Operating Leases	Capital Lease Obligations	Total
2010	$ 3.7	$ 1.1	$ 4.8
2011	2.9	0.4	3.3
2012	2.5	0.3	2.8
2013	2.3	0.2	2.5
2014	2.2	0.2	2.4
Thereafter	13.8	2.6	16.4
	$ 27.4	4.8	$ 32.2
Less: imputed interest portion		(2.0)	
Long-term obligations under capital leases		$ 2.8	

12. Guarantees

The Company has entered into agreements whereby it has guaranteed certain loans entered into by patients for whom services were performed at our facility. These loans are provided by various financial institutions who determine whether the loans are made. The Company would be obligated to repay the financial institutions if a patient fails to repay his or her loans. The Company could then pursue collections from the patient. We record a reserve for estimated defaults on these loans at the historical default rates, which at December 31, 2009 was approximately 21%. At December 31, 2009, loans subject to guarantees totaled $2.2 million.

13. Regulatory Matters

All healthcare providers are required to comply with a significant number of laws and regulations at the federal and state government levels. These laws are extremely complex, and in many instances, providers do not have the benefit of significant regulatory or judicial interpretation as to how to interpret and/or apply these laws and regulations. The U.S. Department of Justice and other federal and state agencies are increasing resources dedicated to regulatory investigations and compliance audits of healthcare providers. As a healthcare provider, the Company is subject to these regulatory efforts. Healthcare providers that do not comply with these laws and regulations may be subject to civil or criminal penalties, the loss of

13. Regulatory Matters (continued)

their licenses, or restrictions on their ability to participate in various federal and state healthcare programs. We endeavor to conduct our business in compliance with applicable laws and regulations, including healthcare fraud and abuse laws. As a result of our hospital's state licensures and certifications under the Medicare and various Medicaid programs, we are subject to regular reviews, surveys, audits and investigations conducted by, or on behalf of, federal and state agencies, including Centers for Medicare & Medicaid Services (CMS), which are responsible for the oversight of these programs. These agency's reviews may include reviews or surveys of our compliance with required conditions of participation regulations. The purpose of these surveys is to ensure that healthcare providers are in compliance with governmental requirements, including requirements such as adequacy of medical care, equipment, personnel, operating policies and procedures, maintenance of adequate records, compliance with building codes and environmental protection and healthcare fraud and abuse. These surveys may identify deficiencies with conditions of participation which require corrective actions to be made by the hospital within a given time frame. If a hospital is not successful in addressing the deficiencies and conditions in a timely manner, CMS reserves the right to deem the hospital to be out of compliance with Medicare conditions of participation and may terminate the hospital from participation in the Medicare program. Termination of a hospital from the Medicare program would have a material adverse effect on our results of operations and cash flows.

Additionally, these agencies may review our compliance with various payment regulations and conduct audits under CMS's Recovery Audit Contractor (RAC) program. The RAC program has been made permanent and was required to be expanded broadly to healthcare providers pursuant to the Tax Relief and Health Care Act of 2006. The results of the enhanced medical necessity reviews and the RAC program audits could have an adverse effect on our business, financial position, result of operations and liquidity. To the extent these reviews result in an adverse finding, we may contest the adverse finding vigorously; however, these matters can result in significant legal expense and consume our resources.

14. Commitments and Contingencies

Legal

The Company is, from time to time, subject to claims and suits arising in the ordinary course of business including, claims for damage for personal injuries, medical malpractice, breach of contract, wrongful restriction of or interference with physicians' staff privileges and employment related claims. In certain of these actions, plaintiffs request payment for damages, including

14. Commitments and Contingencies (continued)

punitive damages that may not be covered by insurance. The Company is currently not a party to any pending or threatened proceedings, which, in management's opinion, would have a material adverse effect on the Company's business, financial condition or results of operations.

Physician Commitments

The Company has committed to provide certain financial assistance pursuant to recruiting agreements, or "physician minimum revenue guarantees," with various physicians practicing in the communities it serves. In consideration for a physician relocating to our communities and agreeing to engage in private practice for the benefit of the respective community, the Company may advance funding to a physician to assist in establishing his or her practice.

The Company accounts for its physician income guarantees in accordance with the provisions of ASC Topic 460-10, *Guarantees* (ASC 460-10). Under the provision of ASC Topic 460-10, the Company records a contract-based asset and a related guarantee liability for new physician minimum revenue guarantees. The contract-based asset is amortized as a component of other operating expense, in the accompanying consolidated statements of operations, over the period of the physician contract, which typically ranges from three to five years. At December 31, 2009, the maximum potential amount of future payments under our income guarantees was $0.4 million. We have assets, net of accumulated amortization of $0.8 million, recorded in other assets and liabilities of $0.4 million recorded for the fair value of these guarantees, included in other current liabilities at December 31, 2009.

Information Systems

In March 2009, the Company entered into an agreement with McKesson Corporation to purchase clinical and hospital financial software and hardware with an initial cost of $7.7 million. The Company has incurred approximately $3.5 million of cost related to this project as of December 31, 2009. The conversion of the current information systems is anticipated to be complete during the second quarter of 2010.

In May 2009, the Company entered into an agreement with a third party to outsource its current information technology services for a ten-year period and to deploy system-wide clinical, electronic medical record and financial applications. The expected total contract value approximates $31.3 million.

14. Commitments and Contingencies (continued)

Capital Expenditure Commitments

The Company is currently building a replacement hospital and related ancillary projects in Pocatello, Idaho. The Company has incurred approximately $35.0 million of costs related to this project as of December 31, 2009, which is included as construction in progress in the Company's consolidated balance sheets. At December 31, 2009, the estimated amount to complete this project was $119.0 million.

15. Business Concentrations

The Company grants credit without collateral to their patients, most of whom are local residents and are insured under third-party payer agreements. The mix of gross receivables from patients and third-party payers at December 31, 2009 is as follows:

	2009
Medicare	23%
Medicaid	10
Managed care organizations	31
Other	9
Self-pay	27
	100%

16. Subsequent Events

In February 2010, LHP, through a subsidiary of the Pocatello Joint Venture, acquired certain assets of Idaho Medical Imaging, LLC, and Radiology Physicians of Idaho, P.C., in consideration for a purchase price of $3.5 million. Also in February 2010, LHP, through a subsidiary of the Pocatello Joint Venture, acquired all of the assets of Pocatello Cardiology Associates in consideration for a cash payment of $0.3 million and entered into employment agreements with certain shareholder employees and physician employees of Pocatello Cardiology Associates.

On April 15, 2010, LHP, through a joint venture with Texas Health Resources, purchased a hospital in Sherman, Texas for a purchase price of $72.5 million, subject to certain adjustments. The joint venture has committed to invest $25.0 million in capital improvements in the hospital over the next four years.

16. Subsequent Events (continued)

On April 15, 2010, LHP Operations Co., LLC, (Op Co), a wholly owned subsidiary of LHP, entered into a Credit Agreement with a group of four lending banks. Under the terms of the Credit Agreement, Op Co is the borrower and LHP is a guarantor. The Credit Agreement includes a $45.0 million term loan for a 3.5 year term, a $15.0 million revolving line of credit and $100.0 million accordion feature that can, subject to certain conditions, be accessed to fund future expansion.

Quarterly principal payments of $0.1 million are due on the term loan beginning on June 30, 2010 and until October 15, 2013, at which time the remaining balance of $40.5 million will become due. Interest on the term loan is computed on variable rates and is paid, in arrears, either quarterly, or if the interest rate for a period is based on a period that is shorter than a quarter, at the end of the period on which the interest rate is based.

Op Co pays quarterly an unused commitment fee equal to 100 basis points per year on the unused portion of the revolving line of credit.

The Company has evaluated subsequent events from the balance sheet date through April 30, 2010, the date at which the financial statements were available to be issued, and determined there are no other items to disclose.

4. Goodwill and Other Intangible Assets (continued)

Amortization of intangible assets over the next five years is as follows (in millions):

2010	$	0.1
2011		0.1
2012		0.1
2013		0.1
2014		–

The gross carrying amount and accumulated amortization at December 31, 2009 and 2008 are as follows (in millions):

	2009	2008
Amortizable intangible assets:		
Covenants not to compete agreements	$ 0.6	$ –
Less accumulated amortization	0.1	–
Net amortizable intangible assets	$ 0.5	$ –
Indefinite-lived intangible assets:		
Trade name	$ 0.1	$ –

Changes in the value of goodwill were as follows:

	December 31 2009	2008
Balance at January 1	$ –	$ –
Goodwill acquired	14.3	–
Balance at December 31	$ 14.3	$ –

5. Stockholder's Equity

LHP has authorized two classes of stock, which are described below:

Preferred Stock

As of December 31, 2009, LHP has 2,000 shares of preferred stock authorized with 221.3 shares issued and outstanding. Holders of the preferred stock are entitled to receive certain distributions

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CONSOLIDATED FINANCIAL STATEMENTS

LHP Hospital Group, Inc.
Years Ended December 31, 2010 and 2009
With Report of Independent Auditors

Ernst & Young LLP

ERNST & YOUNG

LHP Hospital Group, Inc.

Consolidated Financial Statements

Years Ended December 31, 2010 and 2009

Contents

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Report of Independent Auditors

The Board of Directors
LHP Hospital Group, Inc.

We have audited the accompanying consolidated balance sheets of LHP Hospital Group, Inc. (formerly Legacy Hospital Partners, Inc.) as of December 31, 2010 and 2009, and the related consolidated statements of operations, equity, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of LHP Hospital Group, Inc. at December 31, 2010 and 2009, and the consolidated results of its operations and its cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

Ernst + Young LLP

April 27, 2011

1101-1217845

LHP Hospital Group, Inc.

Consolidated Balance Sheets

	December 31 2010	2009
Assets		
Current assets:		
Cash and cash equivalents	**$ 22,514,058**	$ 17,526,287
Restricted cash	**965,000**	435,000
Accounts receivable, less allowance for doubtful accounts of $24,511,187 and $11,440,066	**42,886,926**	25,597,713
Inventories	**7,781,503**	5,300,520
Other receivables, net	**5,100,967**	2,360,389
Other	**2,161,675**	2,040,729
Total current assets	**81,410,129**	53,260,638
Property and equipment, at cost:		
Land	**17,766,322**	13,085,000
Building and improvements	**75,935,489**	43,061,403
Furniture and equipment	**54,044,296**	24,468,929
Construction in progress	**109,619,744**	38,463,723
	257,365,851	119,079,055
Accumulated depreciation and amortization	**(21,672,189)**	(11,193,801)
Property and equipment, net	**235,693,662**	107,885,254
Other assets:		
Investments in and advances to affiliates	**335,804**	194,611
Goodwill	**24,516,835**	14,331,719
Intangibles, net	**797,579**	474,667
Notes receivable	**3,149,437**	2,497,915
Other	**1,806,376**	–
Total assets	**$ 347,709,822**	$ 178,644,804

	December 31 2010	2009
Liabilities and equity		
Current liabilities:		
Accounts payable	**$ 26,212,646**	$ 16,582,383
Accrued salaries, wages, and benefits	**11,930,250**	6,953,951
Other accrued expenses	**8,674,105**	5,932,091
Interest payable	**301,390**	268
Current portion of long-term debt	**10,535,374**	–
Current portion of capital lease obligations	**216,829**	892,325
Income tax payable	**372,448**	376,437
Total current liabilities	**58,243,042**	30,737,455
Long-term liabilities:		
Long-term debt	**46,208,265**	1,875,661
Capital lease obligations	**1,769,733**	1,981,315
Due to Legacy Hospital Partners (Holdings), LLC	**587,864**	592,716
Other	**1,351,266**	1,154,437
Total long-term liabilities	**49,917,128**	5,604,129
Commitments and contingencies		
Equity:		
Stockholders' equity:		
Preferred stock, $0.01 par value, 2,000 shares authorized, 387.1 and 222.5 shares issued and outstanding in 2010 and 2009, respectively	**4**	2
Common stock $0.01 par value, 1,000 shares authorized, no shares issued and outstanding	–	–
Additional paid-in capital	**192,968,960**	110,645,498
Retained deficit	**(25,649,110)**	(29,332,949)
Total stockholders' equity	**167,319,854**	81,312,551
Noncontrolling interest	**72,229,798**	60,990,669
Total equity	**239,549,652**	142,303,220
Total liabilities and equity	**$ 347,709,822**	$ 178,644,804

See accompanying notes.

LHP Hospital Group, Inc.

Consolidated Statements of Operations

	Year Ended December 31	
	2010	**2009**
Net revenue	**$ 290,324,999**	$ 158,895,305
Operating expenses:		
Salaries and benefits	**122,878,315**	74,219,681
Supplies	**53,673,434**	29,486,405
Other operating expenses	**41,414,046**	41,068,067
Provision for doubtful accounts	**32,729,226**	10,281,314
Equity in earnings of affiliates	**(44,610)**	(165,227)
Contract services	**19,885,139**	13,744,649
Depreciation and amortization	**14,100,401**	11,201,177
Income (loss) from operations	**5,689,048**	(20,940,761)
Interest expense, net	**2,360,433**	306,009
(Gain) loss on sale of assets	**9,612**	(439,134)
Other income, net	**(3,680,381)**	(3,008,350)
Income (loss) before taxes	**6,999,384**	(17,799,286)
Income tax provision	**1,572,834**	376,437
Net income (loss)	**5,426,550**	(18,175,723)
Income attributable to noncontrolling interests	**1,742,711**	1,726,669
Net income (loss) attributable to LHP Hospital Group, Inc.	**$ 3,683,839**	$ (19,902,392)

See accompanying notes.

LHP Hospital Group, Inc.

Consolidated Statements of Equity

	Shares	Amounts	Additional Paid-In Capital	Retained Deficit	Equity Attributable to Noncontrolling Interests	Total
January 1, 2009	17.4	$ 0.2	$ 8,700,000	$ (9,430,557)	$ –	$ (730,557)
Preferred stock issued	205.1	2.1	101,945,498	–	–	101,945,500
Contributions received from noncontrolling interest:						
Portneuf Health Care Foundation	–	–	–	–	55,671,500	55,671,500
Physician partners	–	–	–	–	3,592,500	3,592,500
Net loss	–	–	–	(19,902,392)	1,726,669	(18,175,723)
December 31, 2009	222.5	2.3	110,645,498	(29,332,949)	60,990,669	142,303,220
Preferred stock issued	164.6	1.6	82,318,180	–	–	82,318,182
Contributions received from noncontrolling interest:						
Portneuf Health Care Foundation	–	–	–	–	–	–
Texas Health Resources	–	–	–	–	8,181,818	8,181,818
Seton Healthcare	–	–	–	–	2,575,000	2,575,000
Physician partners	–	–	–	–	308,080	308,080
Distributions made to noncontrolling interest:						
Portneuf Health Care Foundation	–	–	–	–	(1,250,318)	(1,250,318)
Physician partners	–	–	–	–	(318,162)	(318,162)
Equity-based compensation plans	–	–	5,282	–	–	5,282
Net income	–	–	–	3,683,839	1,742,711	5,426,550
December 31, 2010	387.1	$ 3.9	$ 192,968,960	$ (25,649,110)	$ 72,229,798	$ 239,549,652

See accompanying notes.

LHP Hospital Group, Inc.

Consolidated Statements of Cash Flows

		Year Ended December 31		
		2010		2009
Operating activities				
Net income (loss)	$	3,683,839	$	(19,902,392)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:				
Provision for doubtful accounts		32,729,226		10,281,314
Depreciation and amortization		14,100,401		11,201,177
Income attributable to noncontrolling interests		1,742,711		1,726,669
Equity in earnings of unconsolidated affiliates		(44,610)		(165,227)
(Gain) loss on sale of assets		9,612		(439,134)
Amortization of debt issuance costs		432,717		–
Share-based compensation expense		5,282		–
Increase (decrease) in cash from operating assets and liabilities, net of acquisitions:				
Accounts receivable		(39,632,852)		(7,618,898)
Inventories and other assets		(1,306,505)		(1,101,733)
Accounts payable and accrued expenses		8,408,956		11,335,290
Other		(53,535)		(342,021)
Net cash provided by operating activities		20,075,242		4,975,045
Investing activities				
Purchases of property and equipment		(81,070,913)		(44,965,693)
Advances to noncontrolling interests, net		(1,568,480)		–
Proceeds received on sale of assets		42,225		24,776
Acquisitions, net of cash acquired		(69,173,352)		(48,292,352)
Due (from) to Legacy Hospital Partners (Holdings), LLC		(4,852)		592,716
Other		84,339		–
Net cash used in investing activities		(151,691,033)		(92,640,553)
Financing activities				
Payments for borrowings		(1,298,774)		(835,830)
Proceeds from borrowings		55,000,000		–
Payment of debt issue costs		(1,990,847)		–
Proceeds from issuance of preferred stock		82,318,183		101,945,500
Contributions from noncontrolling interest		2,575,000		2,910,000
Net cash provided by financing activities		136,603,562		104,019,670
Change in cash and cash equivalents		4,987,771		16,354,162
Cash and cash equivalents at beginning of year		17,526,287		1,172,125
Cash and cash equivalents at end of year	$	22,514,058	$	17,526,287
Supplemental disclosures				
Cash received (paid) for:				
Noncontrolling interests issued to Physician partners	$	–	$	682,500
Interest	$	1,655,190	$	327,858
Income taxes	$	1,576,823	$	–

See accompanying notes.

LHP Hospital Group, Inc.

Notes to Consolidated Financial Statements

December 31, 2010

1. Business Overview

Reporting Entity

LHP Hospital Group, Inc. (LHP) (formerly Legacy Hospital Partners, Inc.) is a privately held company established to form joint ventures, in cooperation with local hospitals, to acquire, own, operate, and manage acute care facilities in small cities and select urban markets throughout the United States. LHP is a wholly owned subsidiary of Legacy Hospital Partners (Holdings), LLC. LHP was incorporated on October 5, 2007 under the laws of Delaware and commenced operations on December 10, 2007. The terms "we", "our", "the Company", "us", and "LHP" refer to the business of LHP Hospital Group, Inc., and all of our wholly owned subsidiaries.

2. Summary of Significant Accounting Policies

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect amounts reported in the consolidated financial statements and the accompanying notes. We regularly evaluate the accounting policies and estimates we use. In general, we base our estimates on assumptions that we believe to be reasonable given the particular circumstances in which we operate. Although we believe all adjustments considered necessary for presentation have been included, actual results could differ from those estimates.

Principles of Consolidation

The consolidated financial statements include the accounts of LHP and its subsidiaries, all of which are either controlled by us through majority voting control or are variable interest entities (VIEs) for which the Company is the primary beneficiary. VIEs represent situations in which consolidation is required even though the usual condition of consolidation (owning a majority voting interest) does not apply. A VIE occurs when an entity holds an interest in another business enterprise that was achieved through arrangements that do not involve voting interests and result in a disproportionate relationship between the entity's voting interest in, and its exposure to the economic risks and potential rewards of, the other business enterprise.

2. Summary of Significant Accounting Policies (continued)

The Company must consolidate a VIE if we determine that we are the primary beneficiary of the VIE. The primary beneficiary has both: (a) the power to direct the activities of the VIE that most significantly impact the entity's economic performance, and (b) the obligation to absorb losses or the right to receive benefits from that VIE that could potentially be significant to the VIE.

The Company holds a 49.9% equity interest in a joint venture with Texas Health Resources (THR) which acquired a hospital in Sherman, Texas (see Note 3). Through a wholly owned subsidiary, the Company loaned the joint venture $49.6 million. The Company has determined that the joint venture is a VIE and the Company is the primary beneficiary of the VIE because it has: (a) the power to direct certain activities that significantly impact the economic performance of the VIE, and (b) the obligation to absorb losses of and the right to receive benefits from the VIE through its equity interest and its loan to the joint venture. Accordingly, the Company consolidates this entity. At December 31, 2010, $82.5 million in assets and $62.9 million in liabilities of the VIE are included in the Company's consolidated balance sheet.

We have completed various acquisitions and a joint venture transaction. The accounts of these entities have been included in our consolidated financial statements for periods subsequent to our acquisition of controlling interests.

All significant intercompany accounts and transactions have been eliminated upon consolidation.

Reclassification

Certain amounts within current liabilities have been reclassified to conform to the 2010 presentation.

Net Patient Service Revenues

Revenues consist primarily of net patient service revenues that are recorded based upon established billing rates less allowances for contractual adjustments. Revenues are recorded during the period the healthcare services are provided, based upon the estimated amounts due from the patients and third-party payers. Third-party payers include federal and state agencies (under the Medicare and Medicaid programs) and other third-party payers such as health maintenance organizations, preferred provider organizations, and other private insurers. The amounts received from these third-party payers are generally less than the Company's

2. Summary of Significant Accounting Policies (continued)

established billing rates. Accordingly, the revenues reported in the Company's consolidated financial statements are recorded at the net amount that is expected to be received. The Company derives a significant portion of its revenues from Medicare, Medicaid, and other payers that receive discounts from its established billing rates. The Company must estimate the total amount of these discounts to prepare its consolidated financial statements. The Medicare and Medicaid regulations and the various managed care contracts under which these discounts must be calculated are complex and are subject to interpretation and adjustments. The Company estimates the allowance for contractual discounts on a payer-specific basis given its interpretation of the applicable regulation or contractual terms. As a result, there is a possibility that the recorded estimates could change by a material amount.

Patients treated at hospitals for nonelective care, who have income below certain amounts that are based on federal poverty level guidelines, are eligible for charity care. Charity care, based on our cost of service, totaled $13.2 million and $0.9 million for the years ended December 31, 2010 and 2009, respectively. The federal poverty level is established by the federal government and is based on income and family size. We provide discounts to uninsured patients who do not qualify for Medicare or Medicaid or charity care. These discounts are similar to discounts provided to many local managed care plans and totaled $3.5 million and $0.1 million for the years ended December 31, 2010 and 2009, respectively. In implementing our discount policy, we first attempt to qualify uninsured patients for Medicare or Medicaid, other federal or state assistance, or charity care. If an uninsured patient does not qualify for these programs, the uninsured discount is applied.

We are required to meet certain financial reporting requirements to participate in the Medicare and Medicaid programs. Federal regulations require the submission of annual cost reports covering medical cost and expenses associated with the services provided by the hospital to program beneficiaries. Cost report settlements under reimbursement agreements with Medicare and Medicaid are estimated and recorded in the period the related services are rendered and are adjusted in future periods as final settlements are determined. There is a possibility that the recorded estimates could change by a material amount. The adjustments to estimated reimbursement amounts in 2010 increased revenues $0.6 million; these adjustments were related to settlements and changes in estimates for reserves related to previously filed cost reports. There were no adjustments recorded to net revenues in 2009 as prior year cost report settlements were the responsibility of the previous owners. The net estimated cost report settlement due from the Company as of December 31, 2010 and 2009 is included in accounts receivable in the accompanying consolidated balance sheets and was approximately $2.3 million and $0.3 million, respectively.

2. Summary of Significant Accounting Policies (continued)

Laws and regulations governing Medicare and Medicaid programs are complex and subject to interpretation. The Company believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigation involving allegations of potential wrongdoing that would have a material effect on the Company's consolidated financial statements. Compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action including but not limited to fines, penalties, and exclusion from the Medicare and Medicaid programs.

During the years ended December 31, 2010 and 2009, approximately 51.3% and 45.4%, respectively, of the Company's revenues related to patients participating in the Medicare and Medicaid programs, collectively. The Company's management recognizes that revenues and receivables from government agencies are significant to the Company's operations, but it does not believe that there are significant credit risks associated with these government agencies. The Company's management does not believe that there are any other significant concentrations of revenues from any particular payor that would subject the Company to any significant credit risks in the collection of its accounts receivable.

Cash and Cash Equivalents

The Company considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. Cash and cash equivalents consist of cash on hand, money market funds, and a certificate of deposit in the amount of $1.0 million and $0.4 million at December 31, 2010 and 2009, respectively, that served as collateral for the Company's workers' compensation program, which has been classified as restricted cash on the consolidated balance sheets. The Company places its cash in financial institutions that are federally insured.

Accounts Receivable and Allowance for Doubtful Accounts

The Company receives payments for services rendered from federal and state agencies (under the Medicare and Medicaid programs), third-party payers, and patients. The Company's ability to collect outstanding receivables is critical to its results of operations and cash flows. To provide for accounts receivable that could become uncollectible in the future, the Company establishes an allowance for doubtful accounts to reduce the carrying value of such receivables to their estimated net realizable value.

2. Summary of Significant Accounting Policies (continued)

The Company has a process to determine the adequacy of the allowance for doubtful accounts that relies on a number of analytical tools and benchmarks to arrive at a reasonable allowance. No single statistic or measurement determines the adequacy of the allowance for doubtful accounts. Some of the tools that the Company utilizes include, but are not limited to, historical cash collections experience and revenue trends by payer classification. Accounts are written off when all reasonable internal and external collection efforts have been exhausted.

At December 31, the mix of gross receivables from patients and third-party payers is as follows:

	2010	2009
Medicare	29%	23%
Medicaid	11	10
Managed care organizations	28	31
Other	10	9
Self-pay	22	27
	100%	100%

Inventories

Inventory is carried at the lower of cost or market and consists mainly of drugs and medical supplies. Cost is determined based on the first-in, first-out method.

Property and Equipment

Property and equipment are recorded at cost. Property and equipment acquired in connection with a business combination are recorded at their estimated fair value in accordance with the acquisition method of accounting as prescribed in Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 805-10, *Business Combinations*. Property and equipment under capital leases are stated at the present value of minimum lease payments. Routine maintenance and repairs are charged to expense when incurred. Expenditures that increase capacities or extend useful lives of assets are capitalized.

2. Summary of Significant Accounting Policies (continued)

Depreciation expense is computed by applying the straight-line method over the estimated useful lives of the assets. Assets held under capital leases are amortized on a straight-line basis over the shorter of the lease term or estimated useful life of the asset. The estimated useful life of buildings and improvements generally range from 10 to 40 years, while the estimated useful lives of furniture and equipment range from 3 to 10 years. Total depreciation (including amortization of capital leases) for the years ended December 31, 2010 and 2009 was $13.9 million and $11.2 million, respectively.

The Company is obligated under capital leases covering certain buildings and equipment. At December 31, the gross amount of buildings and equipment and related accumulated amortization recorded under capital leases were as follows (in millions):

	2010	2009
Buildings and improvements	$ 1.7	$ 1.7
Equipment	3.4	3.4
	5.1	5.1
Accumulated amortization	(2.2)	(1.2)
	$ 2.9	$ 3.9

Long-lived Assets

When events, circumstances, or operating results indicate the carrying values of certain long-lived assets and related identifiable intangible assets (excluding goodwill and indefinite-lived intangibles) expected to be held and used might be impaired, we prepare projections of the undiscounted cash flows expected to result from the use and eventual disposition of the assets. If the projections indicate the recorded amounts are not expected to be recoverable, such amounts are reduced to estimated fair value. No indicators of impairment were identified for the years ended December 31, 2010 and 2009.

Income Taxes

LHP recognizes deferred tax assets and liabilities for the expected future tax consequences of items that have been included in the consolidated financial statements. Deferred tax assets and liabilities are determined by the differences between the consolidated financial statements and

2. Summary of Significant Accounting Policies (continued)

the tax basis of assets and liabilities using current tax rates. A deferred tax liability is recognized for temporary differences that will result in taxable amounts in future years. A deferred tax asset is recognized for temporary differences that will result in deductible amounts in future years. A valuation allowance against a deferred tax asset is recognized if, based on the weight of available evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

The Company recognizes a tax benefit for uncertain tax positions if the Company believes it is more likely than not that the position will be upheld on audit based solely on the technical merits of the tax position. The Company evaluates uncertain tax positions after consideration of all available information. As of December 31, 2010 and 2009, the Company had no tax benefit for uncertain tax positions. Interest and penalties associated with uncertain tax positions, if any, are recorded within interest expense and income tax expense, respectively.

Amortizable Intangibles

Amortizable intangible assets include covenants not to compete. The agreements not to compete are amortized over the terms of the agreements using the straight-line method.

Goodwill and Indefinite-lived Intangible Assets

Goodwill is the excess of the purchase price over the fair value of identifiable assets acquired. Under FASB ASC Topic 350, *Intangibles – Goodwill and Other*, goodwill and intangibles with indefinite lives are not amortized, but tested for impairment annually or more frequently if certain indications of impairment arise.

Goodwill impairment is determined using a two-step test. The first step is to identify if a potential impairment exists by comparing the fair value of the reporting unit with its carrying amount, including goodwill. If the fair value of the reporting unit exceeds its carrying amount, goodwill is not considered to have a potential impairment and the second step of the impairment test is not required. However, if the carrying amount of the reporting unit exceeds its fair value, the second step is performed to determine if goodwill is impaired and to measure the amount of impairment loss to be recognized, if any. The second step compares the implied fair value of goodwill with the carrying amount of goodwill. If the implied fair value of goodwill exceeds its carrying amount, then goodwill is not considered impaired. However, if the carrying amount of goodwill exceeds its implied fair value, an impairment loss is recognized for any excess of the

2. Summary of Significant Accounting Policies (continued)

carrying amount of the reporting unit's goodwill over the implied fair value of that goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation and the residual fair value after this allocation is the implied fair value of the reporting unit goodwill. Fair value of the reporting unit is estimated based upon internal evaluations of the related long-lived assets for each reporting unit that include quantitative analyses of revenues and cash flows. The Company has identified the reporting unit at the joint venture level. The Company determined that there are no goodwill impairment indicators during the years ended 2010 and 2009.

The Company's total cumulative amortizable goodwill for tax purposes was $16.4 million and $7.3 million as of December 31, 2010 and 2009, respectively. The goodwill expected to be deductible for tax purposes is limited to the Company's ownership interest in the respective joint venture to which the remaining amortizable goodwill is assigned.

Other Accrued Expenses

Other accrued expenses consist of the following (in millions):

	2010	2009
Health benefits	$ 1.9	$ 0.5
Workers' compensation	0.6	0.5
Taxes other than income	3.0	2.4
Physician recruitment	1.7	0.4
Other	1.5	2.1
	$ 8.7	$ 5.9

Professional and General Liability

Our professional and general liability insurance is provided by a commercial carrier. The policy is a claims made policy and has limits of $1.0 million per claim and $3.0 million annual aggregate for medical professional liability claims and $1.0 million per occurrence and $3.0 million annual aggregate for general liability claims. The deductible is $0.1 million per occurrence. In addition to the primary coverage, umbrella and excess coverage is maintained with shared limits of $15.0 million. Reserves are established for estimates of loss that will

2. Summary of Significant Accounting Policies (continued)

ultimately be incurred on claims that have been reported but not paid and claims that have been incurred but not reported. These reserves are established based on consultation with independent actuaries. Management believes the use of actuarial methods to account for these reserves provides a consistent and effective way to measure these accruals. However, recorded reserves could differ from ultimate costs related to these claims. The reserve for professional and general liability was $1.0 million at December 31, 2010. No reserve was considered necessary at December 31, 2009.

Self-Insured Liabilities

The Company is self-insured for substantially all of the medical benefits of its employees. The reserve for medical benefits reflects known claims and an estimate of incurred but not reported claims based upon an actuarial analysis as of the balance sheet date. The reserve for self-insured medical benefits was $1.9 million and $0.5 million at December 31, 2010 and 2009, respectively.

The Company is self-insured for workers' compensation claims with a stop loss limit of $250,000 per occurrence. Estimated liabilities for workers' compensation claims were $0.6 million and $0.5 million at December 31, 2010 and 2009, respectively.

Noncontrolling Interest

Noncontrolling interests represent the portion of equity in a subsidiary not attributable, directly or indirectly, to us. The Company's accompanying consolidated financial statements include all assets, liabilities, revenues, and expenses at their consolidated amounts, which include the amounts attributable to the Company and the noncontrolling interest. The Company recognizes as a separate component of equity and earnings the portion of income or loss attributable to noncontrolling interests based on the portion of the entity not owned by the Company.

Equity-Based Compensation

We account for equity-based compensation in accordance with FASB ASC Topic 718, *Compensation – Stock Compensation*. ASC Topic 718 requires the Company to recognize compensation expense for all equity-based awards granted to employees, using a fair value measurement method. Under the fair value method, the estimated fair value of awards that are expected to vest is recognized over the requisite service period, which is generally the vesting period. The Company estimates grant date fair value using the Black-Scholes-Merton option pricing model.

2. Summary of Significant Accounting Policies (continued)

Recently Issued Accounting Pronouncements

In August 2010, the FASB issued Accounting Standards Update (ASU) 2010-24, *Health Care Entities (Topic 954), Presentation of Insurance Claims and Related Insurance Recoveries.* ASU 2010-24 provides clarification to health care companies on the accounting for professional liability insurance. ASU 2010-24 states that receivables related to insurance recoveries should not be netted against the related claim liability and the claim liability should be determined without considering insurance recoveries. ASU 2010-24 is effective January 1, 2011 for the Company. The adoption of ASU 2010-24 is not expected to impact the Company's consolidated results of operations and consolidated financial position.

In August 2010, the FASB issued ASU 2010-23, *Health Care Entities (Topic 954), Measuring Charity Care for Disclosure.* ASU 2010-23 standardized the basis of disclosure of charity care and requires health care companies to use their direct and indirect costs of providing charity care as the measurement basis of charity care disclosures. ASU 2010-23 is effective January 1, 2011 for the Company. The adoption of ASU 2010-23 is not expected to impact the Company's consolidated results of operations and consolidated financial position.

In January 2010, the FASB issued ASU 2010-06, *Improving Disclosures about Fair Value Measurements*, amending ASC Topic 820, *Fair Value Measurements and Disclosures*, to increase disclosure requirements regarding recurring and nonrecurring fair value measurements. The Company adopted ASU 2010-06 for the period ended December 31, 2010, except for the disclosures about activity in Level 3 fair value measurements, which will be effective for the Company's fiscal year beginning January 1, 2011. The adoption of ASU 2010-06 did not have a material impact on the Company's financial statements and is not expected to have a material impact on the Company's financial statements once fully implemented.

On January 1, 2010, the Company adopted ASU 2010-17, *Improvements to Financial Reporting by Enterprises involved with Variable Interest Entities*, which changes how a reporting entity determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) should be consolidated. The determination of whether a reporting entity is required to consolidate another entity is based on, among other factors, the other entity's purpose and design and the reporting entity's ability to direct the activities of the other entity that most significantly impact the other entity's economic performance.

3. Acquisitions

On April 15, 2010, the Company, through a joint venture with THR (Sherman Joint Venture), purchased a hospital in Sherman, Texas (The Wilson N. Jones Memorial Hospital) for approximately $75.0 million, including acquisition-related costs of $0.1 million, which were expensed in the period. The hospital is licensed for 241 beds. The Company, through a wholly owned subsidiary, contributed cash of $17.2 million for a 49.9% interest in the Sherman Joint Venture. The Sherman Joint Venture borrowed $49.6 million of the purchase price from LHP Operations Co., LLC (a wholly owned subsidiary of LHP) consisting of a $30.0 million senior secured note and a $19.6 million junior subordinate convertible note. The Sherman Joint Venture committed to invest $25.0 million in capital improvements in the hospital over the next four years. Purchase price amounts have been allocated to the related assets acquired and liabilities assumed based upon their respective fair values, as determined by an independent third-party valuation using a combination of the cost and market approaches. As of December 31, 2010, the amount of the purchase price paid in excess of the fair value of identifiable net assets acquired that is recorded as goodwill is approximately $7.9 million. The Sherman Joint Venture is consolidated in accordance with FASB ASC Topic 805-10. The results of operations have been included in the Company's consolidated statements of operations beginning April 15, 2010.

The fair value of the 50.1% noncontrolling interest in the Sherman Joint Venture is estimated to be $8.2 million and was based on an independent third-party valuation using a combination of the cost and market approaches.

The Company recognized $0.1 million in acquisition-related costs that were expensed in 2010 and are included in the consolidated statements of operations as other operating expenses.

3. Acquisitions (continued)

The table below summarizes the fair values of the assets acquired and liabilities assumed from the above acquisition transactions (in millions):

Assets:		
Cash	$	1.3
Accounts receivable		10.4
Inventories		3.0
Other current assets		1.3
Property and equipment		57.1
Investments in affiliates		0.1
Notes receivable		0.8
Total identifiable assets acquired		74.0
Liabilities:		
Accounts payable		3.8
Accrued liabilities		2.6
Notes payable		0.3
Noncontrolling interest		0.3
Total liabilities assumed		7.0
Net identifiable assets acquired		67.0
Goodwill		7.9
Net assets acquired	$	74.9

On February 1, 2009, the Company acquired a 77% interest in a joint venture (Pocatello Joint Venture) formed to acquire, own, and operate a hospital (Portneuf Medical Center) in Pocatello, Idaho, and to develop a replacement hospital. The hospital is licensed for 250 beds. The Company, through a wholly owned subsidiary, contributed cash of $45.0 million and a promissory note for approximately $141.0 million to the joint venture in exchange for a 77% interest in the joint venture. Purchase price amounts have been allocated to the related assets acquired and liabilities assumed based upon their respective fair values. As of December 31, 2010, the amount of the purchase price paid in excess of the fair value of identifiable net assets acquired that is recorded as goodwill is approximately $6.8 million. The results of operations have been included in the Company's consolidated statements of operations beginning February 1, 2009.

3. Acquisitions (continued)

The fair value of the 23% noncontrolling interest in the Pocatello Joint Venture is estimated to be $55.7 million and was based on an independent third-party valuation using a combination of the cost and market approaches.

The Company recognized $15.0 million in acquisition-related costs that were expensed in 2009 and are included in the consolidated statements of operations as other operating expenses.

As part of the initial acquisition of the hospital in Pocatello, Idaho, the Company acquired a 20.1% equity investment in Rocky Mountain Surgery Center, LLC. Effective August 1, 2009, the Company acquired all of the assets in Rocky Mountain Surgery Center in exchange for $6.9 million in cash and a noncontrolling interest in a subsidiary of the Pocatello Joint Venture, with a value of $0.7 million. The acquisition date fair value of the previous equity interest was $1.5 million, and was included in the measurement of the consideration transferred. The Company recognized a gain of $0.4 million as a result of remeasuring its equity interest in Rocky Mountain Surgery Center prior to the business combination. The gain is included in gain on sale of assets in the accompanying consolidated statement of operations. The Company accounted for this transaction under the business combination achieved in stages, in accordance with FASB ASC Topic 805-10. The amount of goodwill assigned to the acquisition of Rocky Mountain Surgery Center was $7.5 million.

The operating results of the foregoing acquisitions have been included in the consolidated statements of operations from their respective dates of acquisition. The table below summarizes the operating results for the acquisition that closed during their respective years (in millions):

	2010	2009
Net revenues	$ **97.5**	$ 161.9
Net income	**0.1**	5.8

The following represents the unaudited pro forma consolidated statements of operations as if the acquisitions above had been included in the consolidated results of the Company for the entire years ended December 31, 2010 and 2009 (in millions):

	2010	2009
Net revenues	$ **330.5**	$ 314.2
Net income (loss)	**3.7**	(19.3)

3. Acquisitions (continued)

Additionally, during 2010, the Company paid approximately $3.8 million to acquire the operating assets and related businesses of certain physician practices and other ancillary businesses that operate within the communities served by its hospitals. In connection with these acquisitions the Company allocated approximately $1.5 million to identifiable assets acquired and the remaining $2.3 million was allocated to goodwill.

In October 2009, the Company issued additional noncontrolling interests in a subsidiary of the Pocatello Joint Venture to members of the hospital's medical staff in exchange for cash of $2.9 million.

4. Goodwill and Other Intangible Assets

The acquired intangible assets subject to amortization relate to covenants not to compete, which have useful lives ranging from two to five years. At December 31, the gross carrying amount and accumulated amortization are as follows (in millions):

	2010	2009
Amortizable intangible assets:		
Covenants not to compete agreements	$ 1.0	$ 0.6
Less accumulated amortization	0.3	0.1
Net amortizable intangible assets	$ 0.7	$ 0.5
Indefinite-lived intangible assets:		
Trade name	$ 0.1	$ 0.1

Amortization expense was $0.2 million and $0.1 million for the years ended December 31, 2010 and 2009, respectively. Future amortization of intangible assets is as follows (in millions):

2011	$ 0.5
2012	0.1
2013	0.1

4. Goodwill and Other Intangible Assets (continued)

Changes in the value of goodwill were as follows:

Balance at January 1, 2009	$	–
Goodwill acquired		14.3
Balance at December 31, 2009		14.3
Goodwill acquired		10.2
Balance at December 31, 2010	$	24.5

5. Stockholders' Equity

LHP has authorized two classes of stock, which are described below:

Preferred Stock

As of December 31, 2010, LHP has 2,000 shares of preferred stock authorized with 387.1 shares issued and outstanding. Holders of the preferred stock are entitled to receive certain distributions in preference to holders of the common stock. Holders of the preferred stock are first entitled to receive an annual special dividend equal to 30% of 1% of the aggregate amount of capital contributions made by CCMP Capital Advisors, LLC (CCMP) and the CPP Investment Board (CPPIB) in Legacy Hospital Partners (Holdings), LLC; the annual special dividend is not payable, however, until LHP attains positive earnings (as defined in LHP's Restated Certificate of Incorporation) for the fiscal year. Next, the holders of the preferred stock are entitled to receive a dividend accruing daily at the rate of 8% per annum of the original cost of each share of preferred stock. Finally, holders of the preferred stock are entitled to receive a return of an amount equal to the original cost of such preferred stock prior to the making of any payments to holders of the common stock.

As of December 31, 2010, the total cumulative annual dividends were $0.9 million or $2,265 per share and the 8% cumulative dividends were $13.3 million or $34,456 per share. As of December 31, 2009, the total cumulative dividends were $0.3 million or $1,489 per share and the 8% cumulative dividends were $7.3 million or $32,810 per share.

Common Stock

As of December 31, 2010, LHP has 1,000 shares of common stock authorized with no shares issued and outstanding.

6. Equity-Based Compensation

In 2009, LHP adopted an equity incentive plan (the Plan) pursuant to which the Company's Board of Directors may grant stock options, restricted stock, or stock units (Awards) to employees, consultants, and directors of the Company and its subsidiaries. The Plan authorizes grants of up to 1,000,000 shares of authorized but unissued common stock. Awards can be granted with an exercise price not less than the greater of the par value of the common stock or 100% of the fair market value of the common stock on the date of grant. In the case of any person who at the time of grant possesses more than 10% of the total combined voting power of all classes of stock of the Company, Awards can be granted with an exercise price not less than the greater of the par value of the common stock or 110% of the fair market value of the common stock. All Awards generally vest over a four-year period. As of December 31, 2010, LHP had granted 17,375 shares of restricted stock to certain employees with a fair value on the date of grant of $1.00 per share.

A summary of the status of the Company's restricted stock as of December 31, 2010, and changes during the year ended December 31, 2010, is presented below:

	Units	Weighted-Average Grant-Date Fair Value
Nonvested at January 1, 2010	–	$ –
Granted	17,375	1
Vested	8,846	1
Nonvested at December 31, 2010	8,529	1

The total fair value of restricted stock units that vested during the year ended December 31, 2010 was $8,846.

As of December 31, 2010, there was $8,529 (pretax) of unrecognized equity-based compensation expense related to the Company's equity incentive plan. The unrecognized expense amount is expected to be recognized over a weighted-average period of 2.5 years.

7. Long-Term Debt

At December 31, the Company's long-term debt consists of the following (in millions):

	2010	2009
Term loan	$ 44.7	$ –
Revolving line of credit	10.0	–
Note payable	1.8	1.9
Other	0.2	–
	56.7	1.9
Less current portion	10.5	–
	$ 46.2	$ 1.9

On April 15, 2010, LHP Operations Co., LLC (the Borrower) entered into a Credit Agreement with a group of four financial institutions (the Lenders). The Credit Agreement consists of three components: (a) $45,000,000 Term Loan, (b) $15,000,000 Revolving Line of Credit, and (c) $100,000,000 of Additional Facilities.

Term Loan

The Term Loan matures on October 15, 2013. Beginning June 30, 2010, the Term Loan requires quarterly payments of principal in the amount of $112,500 on the last day of each quarter. The balance must be repaid in full on October 15, 2013. Interest on the Term Loan consists of a Base Rate, which fluctuates based upon market interest rates, plus an Applicable Margin. At the Borrower's option, the Base Rate can be tied to either the Prime Rate or the London Inter-Bank Offer Rate (LIBOR). If the Base Rate is tied to the Prime Rate, the Applicable Margin is 3.5% per year. If the Base Rate is tied to LIBOR, the Applicable Margin is 4.5% per year. Interest on the Term Loan is due monthly if the Base Rate is tied to the Prime Rate and at the end of the LIBOR contract term if the Base Rate is tied to LIBOR. To date, the Company has elected either 30-day or 90-day LIBOR as the Base Rate. Base rates have ranged from 0.24860% to 0.35219% (0.28438% at December 31, 2010).

7. Long-Term Debt (continued)

The Term Loan is secured by all of the property owned on the date of the loan or at any time in the future of the Borrower, all wholly owned subsidiaries of the Borrower (including units of interest in joint venture companies owned, or to be owned by the Borrower and its subsidiaries), and Sherman/Grayson Health System, LLC and its subsidiaries. The Term Loan is not secured by the assets of the joint venture companies other than Sherman/Grayson Health System, LLC and its subsidiaries.

The Term Loan contains various customary operating and financial covenants. The financial maintenance covenants establish a consolidated leverage ratio, a senior leverage ratio, and a fixed charge ratio. Management believes it is in compliance with all debt covenants as of December 31, 2010.

Revolving Line of Credit

The Revolving Line of Credit can be accessed and repaid by the Borrower at any time during the term of the Term Loan. The unused portion of the Revolving Line of Credit is subject to an unused commitment fee equal to 1% per year. At December 31, 2010, $10,000,000 had been drawn on the Revolving Line of Credit.

Interest on loans under the Revolving Line of Credit is calculated separately from interest on the Term Loan; however, the terms under which interest is calculated on the Term Loan apply equally to loans under the Revolving Line of Credit. Similarly, loans under the Revolving Line of Credit are secured by the same property that secures the Term Loan and are subject to the same operating and financial covenants that apply to the Term Loan.

Additional Facilities

Subject to the terms and conditions of the Credit Agreement, the Borrower may, from time to time, request the Lenders to provide Additional Facilities up to $100,000,000. In order to access the Additional Facilities, the Borrower must be in compliance with the operating and financial covenants and not be in default under the Credit Agreement. Additionally, until the Borrower's trailing twelve months earnings before income tax, depreciation and amortization exceed $50,000,000, and the Borrower's consolidated debt must be less than 45% of total invested capital.

7. Long-Term Debt (continued)

Interest on the Additional Facilities consists of a Base Rate, which fluctuates based upon market interest rates, plus an Applicable Margin. At the Borrower's option, the Base Rate can be tied to either the Prime Rate or LIBOR. The Applicable Margin will be determined at the time the Additional Facilities are accessed by the Borrower; however, the Applicable Margin on the Additional Facilities cannot exceed the Applicable Margin on Term and Revolving Credit Loans by more than 25 basis points. Interest on the loans under the Additional Facilities will be due monthly if the Base Rate is tied to the Prime Rate and at the end of the LIBOR contract term if the Base Rate is tied to LIBOR. At December 31, 2010, no amounts had been borrowed under the Additional Facilities provision.

Note Payable

In connection with the Company's acquisition of an interest in the Pocatello Joint Venture, the Company acquired a note payable for land in the amount of $1.9 million. As of December 31, 2010 and 2009, approximately $1.8 million and $1.9 million, respectively, is recorded in long-term debt. The note bears an interest rate of 8% with quarterly principal and interest payments and matures September 2027.

The Company had net debt issue costs of $1.6 million as of December 31, 2010, which is recorded in other assets in the accompanying consolidated balance sheet. These costs are being amortized using the effective interest method over the life of the related debt. Amortization of debt issue cost was $0.4 million for the year ended December 31, 2010.

Future maturities of long-term debt for each of the following five years and thereafter are as follows (in millions):

2011	$ 10.7
2012	0.5
2013	43.8
2014	0.1
2015	0.1
Thereafter	1.5
	$ 56.7

8. Retirement Plan

The Company has a contributory benefit plan that is available to employees who meet certain minimum requirements. In 2010, the plan required the Company to match 100% of a participant's contributions up to the first 3% of the participant's compensation. In 2009, the plan required an additional contribution of 50% of the participant's contributions up to the next 6% of the participant's compensation. The Company recorded contribution expense of $2.2 million for each of the years ended December 31, 2010 and 2009.

9. Transactions With Related Parties

In connection with the Sherman Joint Venture, the hospital pays monthly administrative and royalty fees to THR in an amount equal to 1% of net revenue each month. As of December 31, 2010, $1.0 million in fees have been recorded as management fees in the Company's consolidated statement of operations. At December 31, 2010, the Company has recorded a payable to THR in the amount of $0.1 million.

10. Income Taxes

For the years ended December 31, 2010 and 2009, the differences between the actual income tax benefit and the amount computed by applying the statutory federal rate to the income (loss) before income taxes are as follows:

	2010	**2009**
Income tax provision (benefit):		
Provision (benefit) at federal statutory rate	**35.0%**	(35.0%)
State income tax provision (benefit), net of federal tax effect at statutory rates	**12.9**	(5.1)
Permanent differences	**(3.9)**	–
Increase (decrease) in valuation allowance	**(14.3)**	42.0
Other	**0.2**	–
Effective income tax rate	**29.9%**	1.9%

10. Income Taxes (continued)

At December 31, the sources of the deferred tax assets are as follows (in millions):

	2010	2009
Accrued incentive plan	$ 0.3	$ 0.1
Deferred compensation	0.1	0.1
Accrued medical and dental	0.7	0.3
Federal net operating loss carryforward	–	1.2
Workers' compensation	0.3	0.2
Partnership basis-investment in the Pocatello Joint Venture	9.3	9.6
Total deferred tax asset	10.7	11.5
Valuation allowance	(10.7)	(11.5)
Net deferred tax asset	$ –	$ –

At December 31, 2010, LHP has recorded a valuation allowance against the deferred tax asset, because management believes that, after considering all the available evidence, it is more likely than not that the deferred tax assets will not be realized.

Tax expense recognized in 2010 pertains to current tax expense. LHP has no federal or state net operating loss carryforwards nor tax credits at December 31, 2010.

The only periods subject to examination for the Company's federal tax returns are the 2008 and 2009 tax years.

11. Leases

The Company leases real estate, buildings, vehicles, and equipment under cancelable and noncancelable leases. The leases expire at various times and have various renewal options. For certain leases that meet the lease capitalization criteria in accordance with FASB ASC Topic 840-10, *Leases*, assets have been recorded at their fair value at the date of acquisition and liabilities at the net present value of the minimum lease payments at the inception of the lease. Rental expense on operating leases for the years ended December 31, 2010 and 2009 was $9.3 million and $4.7 million, respectively.

11. Leases (continued)

Future minimum lease payments at December 31, 2010, are as follows (in millions):

	Operating Leases	Capital Lease Obligations	Total
2011	$ 5.2	$ 0.4	$ 5.6
2012	4.1	0.3	4.4
2013	3.3	0.3	3.6
2014	2.6	0.2	2.8
2015	2.1	0.2	2.3
Thereafter	9.5	2.4	11.9
	$ 26.8	3.8	$ 30.6
Less imputed interest portion		(1.8)	
Obligations under capital leases		$ 2.0	

12. Fair Value of Financial Instruments

Fair value accounting includes a framework for measuring fair value, which is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price). It also includes disclosures about fair value measurements which prioritize the inputs to valuation techniques used to measure fair value into a fair value hierarchy.

The classification of a financial instrument within the valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability on the measurement date. The three levels of the hierarchy in order of priority of inputs to the valuation technique are defined as follows:

Level 1: Observable quoted market prices in active markets for identical assets or liabilities.

Level 2: Observable inputs other than Level 1, such as quoted prices in active markets for similar assets or liabilities, quoted prices for identical or similar assets or liabilities in markets that are not active, or inputs other than quoted prices that are observable for the asset or liability.

12. Fair Value of Financial Instruments (continued)

Level 3: Unobservable inputs for the asset or liability that are significant to the fair value of the assets or liabilities.

The Company utilizes the best available information in measuring fair value. The following table summarizes the valuation of the Company's assets and liabilities measured at fair value on a recurring basis for the years ended December 31, 2010 and 2009 (in millions):

	Fair Value Measurements			Assets/ Liabilities at Fair Value
	Level 1	Level 2	Level 3	
December 31, 2010:				
Assets:				
Cash and cash equivalents, including restricted cash	$ 23.5	$ –	$ –	$ 23.5
Liabilities	$ –	$ –	$ –	$ –

	Fair Value Measurements			Assets/ Liabilities at Fair Value
	Level 1	Level 2	Level 3	
December 31, 2009:				
Assets:				
Cash and cash equivalents, including restricted cash	$ 17.9	$ –	$ –	$ 17.9
Liabilities	$ –	$ –	$ –	$ –

Cash and cash equivalents, including restricted cash

Cash and cash equivalents include all cash balances and highly liquid investments with initial maturities of three months or less. The carrying value approximates fair value because of the short-term maturity of these investments.

Nonrecurring Measurements

In 2010, the Company purchased a hospital in Sherman, Texas. The assets acquired and liabilities assumed were measured at fair value using Level 3 inputs. See further discussion in Note 3.

12. Fair Value of Financial Instruments (continued)

Fair Value Disclosures

The Company currently has no other financial instruments subject to fair value measurement on a recurring basis. Disclosures about fair value of financial instruments require disclosure of fair value information about those financial instruments, whether or not recognized in the balance sheet, but would be practicable to estimate that value. Management believes the carrying value of accounts receivable, other receivables, accounts payable, and accrued expenses approximates fair value due to their short-term maturity. Management believes the fair value of notes receivable approximates fair value based on current interest rate assumptions and remaining term to maturity. Management believes the carrying amounts of the Company's long-term debt (including current portion) approximates fair value due to the floating interest rates associated with the debt agreements.

13. Guarantees

The Company has entered into agreements whereby it has guaranteed certain loans entered into by patients for whom services were performed at our facilities in Idaho. These loans are provided by various financial institutions who determine whether the loans are made. The Company would be obligated to repay the financial institutions if a patient fails to repay his or her loans. The Company could then pursue collections from the patient. We record a reserve for estimated defaults on these loans at the historical default rates, which at December 31, 2010, were approximately 22%. Loans subject to guarantees totaled $1.4 million and $2.2 million for the years ended December 31, 2010 and 2009, respectively.

14. Regulatory Matters

All healthcare providers are required to comply with a significant number of laws and regulations at the federal and state government levels. These laws are extremely complex, and in many instances, providers do not have the benefit of significant regulatory or judicial interpretation as to how to interpret and/or apply these laws and regulations. The U.S. Department of Justice and other federal and state agencies are increasing resources dedicated to regulatory investigations and compliance audits of healthcare providers. As a healthcare provider, the Company is subject to these regulatory efforts. Healthcare providers that do not comply with these laws and regulations may be subject to civil or criminal penalties, the loss of their licenses, or restrictions on their ability to participate in various federal and state healthcare programs. We endeavor to conduct our business in compliance with applicable laws and

14. Regulatory Matters (continued)

regulations, including healthcare fraud and abuse laws. As a result of our hospitals' state licensures and certifications under the Medicare and various Medicaid programs, we are subject to regular reviews, surveys, audits, and investigations conducted by, or on behalf of, federal and state agencies, including the Centers for Medicare & Medicaid Services (CMS), which are responsible for the oversight of these programs. These agencies' reviews may include reviews or surveys of our compliance with required conditions of participation regulations. The purpose of these surveys is to ensure that healthcare providers are in compliance with governmental requirements, including requirements such as adequacy of medical care, equipment, personnel, operating policies and procedures, maintenance of adequate records, compliance with building codes and environmental protection, and healthcare fraud and abuse. These surveys may identify deficiencies with conditions of participation which require corrective actions to be made by the hospital within a given time frame. If a hospital is not successful in addressing the deficiencies and conditions in a timely manner, CMS reserves the right to deem the hospital to be out of compliance with Medicare conditions of participation and may terminate the hospital from participation in the Medicare program. Termination of a hospital from the Medicare program would have a material adverse effect on our results of operations and cash flows.

Additionally, these agencies may review our compliance with various payment regulations and conduct audits under CMS's Recovery Audit Contractor (RAC) program. The RAC program has been made permanent and was required to be expanded broadly to healthcare providers pursuant to the Tax Relief and Health Care Act of 2006. The results of the enhanced medical necessity reviews and the RAC program audits could have an adverse effect on our business, financial position, results of operations, and liquidity. To the extent these reviews result in an adverse finding, we may contest the adverse finding vigorously; however, these matters can result in significant legal expense and consume our resources.

15. Commitments and Contingencies

Legal

The Company is, from time to time, subject to claims and suits arising in the ordinary course of business including claims for damage for personal injuries, medical malpractice, breach of contract, wrongful restriction of or interference with physicians' staff privileges, and employment related claims. In certain of these actions, plaintiffs request payment for damages, including punitive damages that may not be covered by insurance. The Company is currently not a party to any pending or threatened proceedings, which, in management's opinion, would have a material adverse effect on the Company's business, financial condition, or results of operations.

15. Commitments and Contingencies (continued)

Physician Commitments

The Company has committed to provide certain financial assistance pursuant to recruiting agreements, or "physician minimum revenue guarantees," with various physicians practicing in the communities it serves. In consideration for a physician relocating to our communities and agreeing to engage in private practice for the benefit of the respective community, the Company may advance funding to a physician to assist in establishing his or her practice.

The Company accounts for its physician income guarantees in accordance with the provisions of FASB ASC Topic 460-10, *Guarantees*. Under the provision of ASC Topic 460-10, the Company records a contract-based asset and a related guarantee liability for new physician minimum revenue guarantees. The contract-based asset is amortized as a component of other operating expense, in the accompanying consolidated statements of operations, over the period of the physician contract, which typically ranges from three to five years. At December 31, 2010, the maximum potential amount of future payments under our income guarantees was $2.3 million. We have assets, net of accumulated amortization, of $3.0 million recorded in Notes receivable and liabilities of $1.7 million recorded for the fair value of these guarantees included in Other accrued expenses at December 31, 2010.

Capital Expenditure Commitments

On December 20, 2010, the Company entered into the formation of a joint venture with Seton Healthcare (the Harker Heights Joint Venture) to construct a new 83 licensed bed hospital in Harker Heights, Texas. The estimated cost of the project is approximately $97.7 million and is expected to be completed during the third quarter of 2012. At December 31, 2010, the Harker Heights Joint Venture has incurred approximately $0.7 million of costs which is included in construction in progress.

The Pocatello Joint Venture is currently building a replacement hospital and related ancillary projects in Pocatello, Idaho. The Pocatello Joint Venture has incurred approximately $123.0 million of costs related to this project as of December 31, 2010, which is included in property and equipment in the Company's consolidated balance sheets. At December 31, 2010, the estimated amount to complete this project was $38.7 million.

15. Commitments and Contingencies (continued)

The Sherman Joint Venture has committed to spend $25.0 million over the next four years in capital improvements. As of December 31, 2010, the Sherman Joint Venture has incurred approximately $1.0 million, which is included in property and equipment in the Company's consolidated balance sheets.

16. Subsequent Events

On April 1, 2011, the Harker Heights Joint Venture acquired for $0.6 million a 67.74% interest in The Surgery Center of Temple, LLC (the ASC LLC), which owns and operates a surgery center in Temple, Texas, near the location of the new hospital to be constructed by the Harker Heights Joint Venture. Simultaneously with such acquisition, 32.26% of the interests in the ASC LLC were sold to various physicians on the active medical staff of the surgery center for $30 thousand.

On March 22, 2011, the Company entered into a non-binding letter of intent to form a joint venture to acquire a 347 licensed bed hospital in Waterbury, Connecticut. This transaction is subject to review and approval from the appropriate regulatory bodies.

Management has evaluated events and transactions subsequent to December 31, 2010 through April 27, 2011, the date the financial statements were issued or available to be issued.

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