



FINANCIAL STATEMENTS

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

Ernst & Young LLP

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Southern Maryland Hospital, Inc.

Financial Statements

Years Ended December 31, 2010 and 2009

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Report of Independent Auditors

Stockholders
Southern Maryland Hospital, Inc.

We have audited the accompanying balance sheets of Southern Maryland Hospital, Inc. (a Maryland corporation) as of December 31, 2010 and 2009, and the related statements of revenues and expenses, changes in stockholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Corporation'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 Corporation'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 Corporation'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 Southern Maryland Hospital, Inc. at December 31, 2010 and 2009, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.

Ernst & Young LLP

April 29, 2011

Southern Maryland Hospital, Inc.

Balance Sheets

	December 31	
	2010	2009
Assets		
Current assets:		
Cash and cash equivalents	\$ 1,296,200	\$ 39,200
Accounts receivable, less allowance for uncollectible accounts of \$18,535,700 and \$19,398,400, respectively	36,111,600	31,527,100
Prepaid expenses and other assets	22,627,600	28,152,200
Inventories	3,948,800	3,531,800
Total current assets	63,984,200	63,250,300
Advances to related parties, net	–	1,254,100
Property and equipment:		
Buildings and land under capital leases	42,975,700	42,975,700
Furniture, fixtures and minor equipment	16,152,700	14,213,800
Major movable equipment	30,633,100	27,232,900
Leasehold improvements	7,736,400	4,893,000
Construction in progress	2,201,400	507,100
	99,699,300	89,822,500
Less accumulated depreciation and amortization	(69,383,700)	(64,050,800)
Property and equipment, net	30,315,600	25,771,700
Total assets	\$ 94,299,800	\$ 90,276,100

	December 31	
	2010	2009
Liabilities and stockholders' equity		
Current liabilities:		
Line of credit	\$ 3,000,000	\$ 3,000,000
Accounts payable	825,100	388,700
Accrued salaries, wages and employee benefits	5,766,000	4,830,700
Current portion of capital lease obligations	4,001,000	5,433,200
Advances from third-party payors	8,048,600	6,790,900
Other accrued liabilities	5,612,500	5,805,900
Total current liabilities	<u>27,253,200</u>	<u>26,249,400</u>
Noncurrent liabilities:		
Capital lease obligations, less current portion	13,849,900	15,902,500
Estimated professional liability	6,493,600	7,791,200
Advances from related parties	1,316,900	–
Total noncurrent liabilities	<u>21,660,400</u>	<u>23,693,700</u>
Total liabilities	<u>48,913,600</u>	<u>49,943,100</u>
Stockholders' equity:		
Common stock, no par value, 10,000 shares authorized; 100 shares issued and outstanding	100	100
Additional paid-in capital	9,943,500	9,943,500
Retained earnings	35,442,600	30,389,400
Total stockholders' equity	<u>45,386,200</u>	<u>40,333,000</u>
Total liabilities and stockholders' equity	<u>\$ 94,299,800</u>	<u>\$ 90,276,100</u>

See accompanying notes.

Southern Maryland Hospital, Inc.

Statements of Revenues and Expenses

	Year Ended December 31	
	2010	2009
Operating revenues		
Net patient service revenue	\$ 208,108,100	\$ 210,089,800
Net physician revenue	14,220,800	13,694,700
Other operating revenue	943,100	718,000
Total operating revenues	<u>223,272,000</u>	<u>224,502,500</u>
Operating expenses		
Salaries, wages and employee benefits	93,704,000	95,212,100
Drugs, hospital supplies and other expenses	52,363,200	52,871,300
Purchased services	31,503,400	30,012,500
Physician expenses	17,152,900	16,963,800
Depreciation and amortization	5,831,200	6,185,900
Interest	1,720,400	2,158,300
Provision for bad debts	15,899,400	16,965,400
Total operating expenses	<u>218,174,500</u>	<u>220,369,300</u>
Income from operations	5,097,500	4,133,200
Nonoperating gains	121,900	50,600
Net income with no income taxes provided	<u>\$ 5,219,400</u>	<u>\$ 4,183,800</u>
Pro forma amounts if the corporation, rather than the stockholders, paid income taxes (unaudited)		
Net income with no income taxes provided	\$ 5,219,400	\$ 4,183,800
Provision for income taxes (at statutory tax rate)	(1,826,800)	(1,464,300)
Pro forma net income (unaudited)	<u>\$ 3,392,600</u>	<u>\$ 2,719,500</u>

See accompanying notes.

Southern Maryland Hospital, Inc.

Statements of Changes in Stockholders' Equity

	Common Stock	Additional Paid-in Capital	Retained Earnings	Total
Balance at December 31, 2008	\$ 100	\$ 9,943,500	\$ 26,504,600	\$ 36,448,200
Net income with no income taxes provided	–	–	4,183,800	4,183,800
Distributions to stockholders, net	–	–	(299,000)	(299,000)
Balance at December 31, 2009	100	9,943,500	30,389,400	40,333,000
Net income with no income taxes provided	–	–	5,219,400	5,219,400
Distributions to stockholders, net	–	–	(166,200)	(166,200)
Balance at December 31, 2010	\$ 100	\$ 9,943,500	\$ 35,442,600	\$ 45,386,200

See accompanying notes.

Southern Maryland Hospital, Inc.

Statements of Cash Flows

	Year Ended December 31	
	2010	2009
Operating activities		
Net income with no income taxes provided	\$ 5,219,400	\$ 4,183,800
Adjustments to reconcile net income to net cash provided by operating activities:		
Loss on disposal of property and equipment	49,500	-
Depreciation and amortization	5,831,200	6,185,900
Changes in operating assets and liabilities, net	1,661,500	(2,253,100)
Net cash provided by operating activities	12,761,600	8,116,600
Investing activities		
Purchases of property and equipment, net	(6,758,300)	(3,202,000)
Net cash used in investing activities	(6,758,300)	(3,202,000)
Financing activities		
Borrowing on line of credit	3,000,000	3,000,000
Payments on line of credit	(3,000,000)	(3,000,000)
Payments on capital lease obligations	(5,410,200)	(5,540,000)
Distributions to stockholders, net	(166,200)	(299,000)
Increase (decrease) in advances from related parties, net	830,100	(308,500)
Net cash used in financing activities	(4,746,300)	(6,147,500)
Net increase (decrease) in cash and cash equivalents	1,257,000	(1,232,900)
Cash and cash equivalents, at beginning of year	39,200	1,272,100
Cash and cash equivalents, at end of year	\$ 1,296,200	\$ 39,200
Changes in operating assets and liabilities		
(Increase) decrease in accounts receivable, net	\$ (4,584,500)	\$ 595,900
Decrease (increase) in prepaid expenses and other	5,524,600	(2,811,900)
Increase in inventories	(417,000)	(113,600)
Increase (decrease) in accounts payable	436,400	(159,300)
Increase in accrued salaries, wages and employee benefits	935,300	255,000
Increase (decrease) in advances from third-party payors	1,257,700	(348,900)
Decrease in other accrued liabilities	(193,400)	(846,700)
(Decrease) increase in estimated professional liability	(1,297,600)	1,176,400
Changes in operating assets and liabilities, net	\$ 1,661,500	\$ (2,253,100)
Supplemental disclosure of cash flow information		
Cash paid for interest	\$ 1,721,100	\$ 2,207,300
Supplemental disclosure of noncash investing and financing activities		
Equipment and buildings acquired under capital leases	\$ 1,925,400	\$ 170,100

See accompanying notes.

Southern Maryland Hospital, Inc.

Notes to Financial Statements

December 31, 2010

1. Organization

Southern Maryland Hospital, Inc. (the Corporation), is a subchapter “S” corporation that operates an acute care hospital in Clinton, Maryland (suburban area in southern Maryland, east of Washington, D.C.). The Corporation is a full-service, regional healthcare facility that provides a complete range of inpatient, outpatient and community services for the residents of southern Maryland. The Corporation also operates a hospital-based sub-acute care unit. The Corporation is a resource center seeking to prevent illness and promote health through education and screening. The Corporation’s mission is to assist the residents of southern Maryland in attaining the highest possible level of physical and mental healthcare, and thereby improve the quality of life in the community.

2. Summary of Significant Accounting Policies

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Fair Value of Financial Instruments

The carrying amounts of financial instruments, including cash, accounts receivable, prepaid expenses and other assets, due to/from related parties, line of credit, accounts payable, accrued salaries, wages and employee benefits, advances from third-party payors and other accrued liabilities approximate fair value, given the short-term nature of these financial instruments.

Cash and Cash Equivalents

Cash and cash equivalents include amounts invested in accounts that are readily convertible to cash. Investments with contractual maturities of ninety days or less from the date of original purchase are classified as cash and cash equivalents.

Southern Maryland Hospital, Inc.

Notes to Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Accounts Receivable and Contractual Allowances

The Corporation provides services to patients in southern Maryland, the majority of whom are covered by third-party health insurance. The Corporation bills the insurer directly for services provided.

Insurance coverage and credit information is obtained from patients upon admission, when available. The Corporation's policy is to perform in-house collection procedures for approximately 120 days. A determination is made at that time as to what additional collection efforts to pursue. A provision for uncollectible accounts is recorded for amounts not yet written off, which are expected to become uncollectible.

The major payors routinely review patient billings and deny payment for certain charges as medically unnecessary or as performed without appropriate preauthorization. Accounts receivable from these third-party payors have been adjusted to reflect the difference between charges and the estimated reimbursable amounts.

Approximately 27% and 24% of accounts receivable were due from the Medicare program at December 31, 2010 and 2009, respectively. Approximately 14% and 12% of accounts receivable were due from CareFirst at December 31, 2010 and 2009, respectively.

Prepaid Expenses and Other Assets

At December 31, 2010 and 2009, the Corporation has prepaid expenses and other assets of \$22,627,600 and \$28,152,200, respectively, which relates to various purchased services and supplies. Included in these balances are amounts prepaid to related parties (see Note 4).

Inventories

Inventories of supplies are carried at lower of cost or market, using the first-in, first-out method.

Southern Maryland Hospital, Inc.

Notes to Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Property and Equipment

Buildings and land under capital leases, furniture, fixtures and minor equipment, major movable equipment and leasehold improvements are recorded at cost and depreciated and amortized using the straight-line method over the lesser of the estimated useful lives of the assets or the terms of these leases as follows:

Buildings and land under capital leases	3 to 32 years
Furniture, fixtures and minor equipment	3 to 20 years
Major movable equipment	5 to 20 years
Leasehold improvements	5 to 25 years

Line of Credit and Letters of Credit

The Corporation has a \$3,000,000 line of credit with a bank which has an indefinite maturity. Borrowings bear interest at the bank's prime interest rate, as defined, which was 3.25% at December 31, 2010 and 2009. As of December 31, 2010 and 2009, the balance outstanding was \$3,000,000. This line of credit is payable on demand. All of the assets of the Corporation are pledged as collateral for this line of credit. Amounts outstanding under the line of credit as of December 31, 2009 were repaid in January 2010, and amounts outstanding as of December 31, 2010 were repaid in January 2011.

A bank has also issued the Corporation a \$3,850,000 letter of credit related to its professional liability insurance coverage (see Note 7) which has no expiration date. In March 2011, a bank issued the Corporation an additional \$3,600,000 letter of credit that also has no expiration date.

Net Patient Service Revenue

Net patient service revenue is reported at the estimated realizable amounts from patients, third-party payors and others for services rendered. A significant portion of the Corporation's patient service revenue is reimbursed through Medicare and Medicaid. Reimbursements by these third-party payors are based upon the Corporation's approved billing rates less a 6% discount. Contractual discounts and certain denials of payment for services rendered are recorded as reductions of net patient service revenue.

Southern Maryland Hospital, Inc.

Notes to Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Patient service revenue reimbursed through these programs has been recorded at the net realizable amount in the accompanying statements of revenues and expenses. All other payors reimburse the Corporation at the Corporation's standard rates, adjusted for certain prompt pay discounts, which do not exceed 2%.

The Corporation's principal sources of net patient service revenue may be summarized as follows:

	Year Ended December 31	
	2010	2009
Medicare	39%	39%
Commercial Insurers (including Health Maintenance Organizations (HMO))	18	19
Blue Cross	16	18
Medicaid (including Medicaid HMO)	18	16
Other	9	8
	100%	100%

A substantial amount of the Corporation's revenues are received from health maintenance organizations and other managed care payors. Managed care payors generally use case management activities to control hospital utilization. These payors also have the ability to select health care providers offering the most cost-effective care. Management does not believe that the Corporation has undue exposure to any managed care payor.

The provision for bad debts is based upon management's assessment of historical and expected net collections considering economic conditions, trends in health care coverage and other collection indicators. During the year, management assesses the adequacy of the allowance for uncollectible accounts based upon historical write-off experience by payor category. The results of this review are then utilized in the determination of the provision for bad debts to establish an appropriate allowance for uncollectible receivables.

Southern Maryland Hospital, Inc.

Notes to Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Net Physician Revenue

The Corporation employs physicians in several hospital-based specialties including anesthesia, emergency room, cardiology, pediatrics/neonatology, obstetrics, intensive care, and hospitalists. The Corporation bills for the services provided by these physicians. The net physician revenue is recognized when the services are provided and recorded at the estimated net realizable value based on the contractual arrangements with third-party payors and the expected payments from the third-party payors and the patients. The differences between the billed charges and the estimated net realizable value are recorded as a reduction in physician revenue when the services are provided. As of December 31, 2010 and 2009, approximately \$2,941,300 and \$2,867,500, respectively, of net physician accounts receivable are included in accounts receivable in the accompanying balance sheets.

Effective January 1, 2011, the emergency room physician group was contracted to an unrelated group who will bill and collect independently for their services.

Charity Care

The Corporation provided care to patients who met certain criteria under its charity care policy, without charge or at amounts less than its approved rates. Because the Corporation did not pursue collection of amounts determined to qualify as charity care, they are not reported as net patient service revenue in the accompanying statements of revenues and expenses. The amounts written off as charity care for 2010 and 2009 were \$3,031,300 and \$1,126,800, respectively.

Income Taxes

The Corporation has elected to be taxed as a Subchapter "S" corporation for federal and state income tax purposes, reporting corporate taxable income or loss on the stockholders' individual income tax returns. The unaudited pro forma provision for income taxes in the accompanying statements of revenues and expenses reflects an amount equal to the provision for income taxes on the Corporation's net income at corporate statutory income tax rates that would have been recognized by the Corporation had the "S" election not been in effect.

Southern Maryland Hospital, Inc.

Notes to Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

New Accounting Standards

In June 2009, the Financial Accounting Standards Board (FASB) issued an amendment which modifies the accounting and disclosure requirements for the consolidation of variable interest entities, or VIEs under ASC 810-10, *Consolidation*. This amendment requires an enterprise to perform a qualitative analysis when determining whether or not it must consolidate a VIE. The amendment also requires an enterprise to continuously reassess whether it must consolidate a VIE. Additionally, the amendment requires enhanced disclosures about an enterprise's involvement with VIEs and any significant change in risk exposure due to that involvement, as well as how its involvement with VIEs impacts the enterprise's financial statements. Finally, an enterprise is required to disclose significant judgments and assumptions used to determine whether or not to consolidate a VIE. This amendment was effective for financial statements issued for fiscal years beginning after November 15, 2009 and, therefore, the Corporation adopted the new provisions of ASC 810-10 on January 1, 2010. The adoption of this standard did not have a material impact on the financial statements.

3. Health Care Regulation

Health Services Cost Review Commission

The Corporation's rate structure for most hospital-based services is subject to review and approval by the Maryland Health Services Cost Review Commission (HSCRC). Under the HSCRC rate setting system, the Corporation's inpatient charges are subject to an inpatient charge per case target (the Charge Per Case Target). The Charge Per Case Target is adjusted annually for inflation, case mix changes and other factors.

Under the Charge Per Case Target methodology, the Corporation monitors its average charge per case compared to HSCRC case mix adjusted targets on a monthly basis. Also, under the Commission's rate methodology for certain outpatient services, a target average Charge Per Visit was established in fiscal 2010 for the Corporation based on 2010 actual charges and case mix indices. The actual average 2011 Charge Per Visit will be compared with the 2010 target average Charge Per Visit and to the actual average exceeds or is less than the target, the Corporation's future rates may be prospectively adjusted.

Southern Maryland Hospital, Inc.

Notes to Financial Statements (continued)

3. Health Care Regulation (continued)

The Corporation's policy is to recognize revenue based on actual charges for services to patients in the year in which the services are performed. The Corporation's revenues may be subject to adjustment as a result of examination by government regulations, medical diagnosis, charge coding, medical necessity, or other contract terms. The resolution of these matters, if any, often is not finalized until subsequent to the period during which the services were rendered.

As of December 31, 2010, the Corporation's actual average charge per case was greater than the HSCRC's target average charge per case. In addition, as of December 31, 2010, the Corporation's actual average outpatient unit charges were greater than the approved charges. The net amount overcharged by the Corporation was \$684,800 at December 31, 2010. Provided the Corporation remains in compliance with other rate corridors, the Corporation will be able to adjust rates during the period from January 1, 2011 through June 30, 2011 to achieve compliance with the HSCRC Charge Per Case Target rate and approved outpatient unit charges. Management believes that the Corporation will be within the HSCRC rate corridors and in compliance with the HSCRC's target average charge per case and outpatient unit charges at June 30, 2011 and, therefore, no liability has been recorded as of December 31, 2010. As of December 31, 2009, the net amount overcharged by the Corporation was \$2,822,600, which was adjusted through lower rates in 2010.

Other

The Medicare and Medicaid reimbursement programs represent a substantial portion of the Corporation's revenues and its operations are subject to the numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for patient services and Medicare and Medicaid fraud and abuse.

The health care industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government health care program participation requirements and reimbursement for patient services. Recently, government activity has increased with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by health care providers. Violations of these laws and regulations could result in expulsion from government health care programs, together with the imposition of fines and penalties, as well as repayments for patient services previously billed. Compliance with such laws and regulations can be subject to future government review and interpretation. Also, future changes in federal and state reimbursement funding mechanisms and related government budgeting constraints could have an adverse effect on the Corporation.

Southern Maryland Hospital, Inc.

Notes to Financial Statements (continued)

4. Related Party Transactions

Capital Leases

Since July 1, 1979, the Corporation has leased its land, buildings and certain fixed and movable equipment under a 32-year lease from Southern Maryland Hospital Center (the Partnership), a related party. Management expects to negotiate a five-year extension of the capital lease with the Partnership before the current lease expires June 30, 2011. The lease was capitalized at \$24,972,000, which was the fair market value of the property as determined by independent appraisal. Rentals under this lease were \$11,829,700 and \$11,794,800 in 2010 and 2009, respectively. Based on the CPI Housing Index, rentals increased 0.3% during 2010 and decreased 0.3% during 2009, respectively, related to changes in utility costs, property taxes and changes in the market value of the property.

The Corporation leases additional space from a related party that was capitalized in 1983 at \$225,000, with annual lease payments of \$58,200, as adjusted for escalation of costs. This lease was recapitalized in 2006 for renovations associated with cardiac services at \$1,125,400, with annual lease payments of \$183,400.

In 1984, the Corporation began leasing warehouse space, which was capitalized at \$594,600, with annual lease payments of \$75,800, as adjusted for escalation of costs. These leases are with the Partnership and expire between 2013 and 2014.

The Corporation leases building space housing women's services, support services and storage space which was capitalized for \$8,735,500, with annual lease payments of \$1,206,400, as adjusted for escalation of costs. The leases are with the Partnership and expire in 2026.

Effective July 1, 1996, the Corporation began leasing additional building space for the sub-acute unit under capital leases which were capitalized at \$3,221,900, with annual lease payments of \$523,000, as adjusted for escalation of costs. These leases are with the Partnership and expire in 2026.

Effective July 1, 1998, the Corporation began leasing additional parking lots from the Partnership. The lease was capitalized at \$1,670,000, with annual lease payments of \$249,100, as adjusted for escalation of costs. This lease expires in 2013.

Southern Maryland Hospital, Inc.

Notes to Financial Statements (continued)

4. Related Party Transactions (continued)

Effective October 1, 2003, the Corporation began leasing additional building space for the emergency room under a capital lease, which was capitalized at \$1,989,200, with annual lease payments of \$211,500, as adjusted for escalation of costs. This lease expires in 2023.

Effective November 2010, the Corporation began leasing newly renovated space from the Partnership under a capital lease, which was capitalized at \$1,925,400, with annual lease payments of \$195,000 as adjusted for escalation of costs. This lease expires in 2025.

Included in the accompanying statements of revenues and expenses for the years ended December 31, 2010 and 2009 are \$1,721,100 and \$2,154,000, respectively, of interest expense and \$9,745,100 and \$9,688,800, respectively, of executory costs related to the above capital leases.

Since these capital lease obligations were entered into with the Partnership, which is a related party, the fair value of these obligations is not readily determinable.

Operating Leases

The Corporation rents several office suites in a professional building owned by the minority stockholder of the Corporation. The total rental payments in 2010 and 2009 were \$160,200. The annual rental payments under these operating leases are commensurate with those charged to other tenants of the professional building.

The Corporation also rents a warehouse owned by the stockholders of the Corporation. Annual rental payments were \$46,000 in 2010 and 2009.

The Corporation also rents parking lot facilities from the minority stockholder of the Corporation. Annual rental payments were \$76,400 in 2010 and 2009.

Other Transactions

The principal stockholder of the Corporation is the sole owner of several companies, which provided administrative, financial, data processing and certain operational services to the Corporation during 2010 and 2009. Charges for these services are covered by a management fee of 10% of the Corporation's gross patient service revenue during 2010 and 2009.

Southern Maryland Hospital, Inc.

Notes to Financial Statements (continued)

4. Related Party Transactions (continued)

The Corporation has prepaid amounts for rental payments, leases, administrative and financial services to related parties. These amounts were \$9,981,300 and \$14,147,600 as of December 31, 2010 and 2009, respectively, and are included in prepaid expenses and other assets in the accompanying balance sheets.

The Corporation uses a nursing agency owned by the principal stockholder of the Corporation to staff temporary nursing positions. Total nursing fees paid (which approximated local market rates) to the nursing agency in 2010 and 2009 were \$1,093,100 and \$1,416,300, respectively.

The Corporation uses Professional Billing Inc. (PBI) owned by the principal stockholder of the Corporation, to process its physician billings. Total PBI service fees paid in 2010 and 2009 were \$1,589,400 and \$1,546,900, respectively.

The Corporation uses Chesapeake Receivables Management, owned by an executive of the Corporation, to process its collections services. Total service fees paid in 2010 and 2009 were \$730,500 and \$568,500, respectively.

Advances from related parties as of December 31, 2010 and advances to related parties as of December 31, 2009 represent net amounts payable and receivable, respectively, from the Partnership and other entities owned by the stockholders of the Corporation for funds advanced by or owed to the Corporation.

Guarantee of Partnership Debt

In December 2010, the Corporation became a guarantor for a new \$4,000,000 term loan that the Partnership obtained from a bank. The term loan matures in December 2017 and carries an annual variable interest rate of LIBOR plus 2.18%. The proceeds of the term loan were used by the Partnership to finance the construction of two new facilities that have been/will be leased by the Corporation under long-term capital leases. The Corporation expects that the Partnership will be able to fully repay the term loan and at December 31, 2010 the Corporation is not required to recognize a liability under ASC 450, *Contingencies*, for this guarantee.

Southern Maryland Hospital, Inc.

Notes to Financial Statements (continued)

5. Lease Commitments

Capital Leases

The Corporation has capitalized land, buildings, and fixed and movable equipment leases with a basis of \$51,684,500 and \$52,063,100 and accumulated amortization of \$40,484,200 and \$38,365,100 as of December 31, 2010 and 2009, respectively. Amortization of assets recorded under capital leases is included with depreciation expense in the accompanying statements of revenues and expenses.

Future minimum lease payments under these capital leases, as of December 31, 2010, are as follows:

2011	\$ 10,886,400
2012	3,522,100
2013	2,975,800
2014	2,811,600
2015	2,799,800
Thereafter	<u>47,034,300</u>
Total	70,030,000
Less – amount representing executory costs (such as supply and service contracts, property taxes, heat, light, power, rent escalation and profit, included in total minimum lease payments)	<u>(41,601,100)</u>
Net minimum lease payments	28,428,900
Less – amount representing interest	<u>(10,578,000)</u>
Present value of future minimum lease payments	<u>\$ 17,850,900</u>

Included in total capital lease obligations are amounts due to related parties. As of December 31, 2010 and 2009, such amounts were \$15,578,700 and \$16,974,500, respectively.

Southern Maryland Hospital, Inc.

Notes to Financial Statements (continued)

5. Lease Commitments (continued)

Operating Leases

The Corporation has entered into operating leases for equipment and office suites. As of December 31, 2009, future minimum rental payments are \$367,400. All amounts are due in 2010.

Included in future minimum rental payments are amounts due to related parties. As of December 31, 2010 and 2009, such amounts were \$258,300 and \$236,600, respectively.

Rental expense for 2010 and 2009 was \$452,800 and \$428,700, respectively.

6. Defined Contribution Plan

In 2010 and 2009, the Corporation maintained a defined contribution 401(k) plan covering substantially all employees who have completed at least 500 hours of service within the first six consecutive months of employment. Eligible employees may contribute a percentage of their salary in any taxable year not to exceed a dollar limit, which is set by law.

The Corporation's contributions vest 20% each year after completing one year of service until they are fully vested after six years of service. The Corporation contributed approximately \$965,800 and \$781,300, respectively, for the years ended December 31, 2010 and 2009.

7. Insurance

The Corporation participates in the Maryland Hospital Association Workers' Compensation Self-Insurance Group (the Group). Under this arrangement, the Corporation pays monthly premiums based on estimated payroll costs. Total premiums for the years ended December 31, 2010 and 2009 were \$1,185,000 and \$1,600,500, respectively. In 2010, the Corporation also received a dividend of \$801,000 related to 2010 and prior-year premiums paid, which was applied against the 2010 gross premium expense of \$1,185,000, reducing it to \$384,000.

The Corporation has a claims-made policy for its professional liability insurance coverage and its general liability coverage. Should the claims-made policy not be renewed or replaced with equivalent insurance, claims based on occurrences during its term but reported subsequently will be uninsured. However, the insurance carrier has a contractual obligation to provide coverage, at an undetermined price, for incidents which occurred during the years covered by a claims-made policy but reported subsequent to the claims-made policy's term. The Corporation renewed its general and professional liability policies through November 16, 2011.

Southern Maryland Hospital, Inc.

Notes to Financial Statements (continued)

7. Insurance (continued)

During 2001, the Corporation's former insurance carrier filed for bankruptcy protection and coverage was replaced with another carrier on November 16, 2001. As a result, the former insurance carrier may not be able to provide coverage for incidents that were reported but not paid up to the termination date of its policy. The State of Maryland established the Property and Casualty Insurance Guarantee Corporation, which covers up to \$300,000 per incident, less a \$100 deductible for claims that would have been covered by the bankrupt insurer, subject to the review and approval of the administrators of this fund. As of December 31, 2010 and 2009, management of the Corporation does not believe that the Corporation has exposure for claims reported to its former carrier that may not be covered under its policy or covered by the State of Maryland Property and Casualty Insurance Guarantee Corporation. Therefore, the Corporation has not recorded estimates for any such exposures as of December 31, 2010 and 2009.

For the period from November 16, 2004 through November 15, 2005, the Corporation's professional liability coverage was subject to a deductible of \$250,000 per incident and a \$750,000 annual maximum. For the periods from November 16, 2005 through November 15, 2009, the deductible and annual maximums were changed to \$250,000 and \$2,500,000, respectively. For the period from November 16, 2009 through November 15, 2011, the deductible was increased to \$500,000 per case with no annual maximum.

As of December 31, 2010 and 2009, the Corporation has estimated its exposures related to deductibles and incurred but not reported claims based on an undiscounted actuarial analysis of the outstanding known claims and incurred but not reported claims and discussion with legal counsel. These amounts are included in estimated professional liability in the accompanying balance sheets. Management believes, after consultation with legal counsel, that the ultimate liability from these matters will not have a material adverse effect on the accompanying financial statements.

8. Litigation

There are several lawsuits pending in which the Corporation has been named as a defendant. In the opinion of the Corporation's management, after consultation with legal counsel, the amount of liability, if any, not covered by insurance will not have a material adverse impact on the Corporation's financial position.

Southern Maryland Hospital, Inc.

Notes to Financial Statements (continued)

9. Subsequent Events

The Corporation evaluated the impact of subsequent events through April 29, 2011, representing the date at which the financial statements were available to be issued, and noted no subsequent events that required disclosure.

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