Frederick Memorial Hospital, Inc. and Subsidiaries
Financial Report and Management Discussion
For the Nine Months Ended March 31, 2008

This report is presented in accordance with the continuing disclosure requirements of the First Supplemental Loan Agreement, article II section 2.03, between Maryland Health and Higher Educational Facilities and Frederick Memorial Hospital, Inc. (FMH) dated as of August 6, 2002 and the continuing disclosure requirements of Appendix D of the Official Statement dated May 23, 2006 between Maryland Health and Higher Educational Facilities and FMH.

This report is prepared with a focus on the financial results for the Nine Months Ended March 31, 2008. A comprehensive overview of fiscal year ended June 30, 2007 and comparisons to fiscal year ended June 30, 2006 and budget FY 2007 can be found in the June 30, 2007 Annual Report that is posted on the DAC website (www.dacbond.com).

The following presentation may include forward-looking information including budget information and discussions about future expectations and events. Actual results could differ materially from what is presented or said.

All of the financial and statistical information contained herein is unaudited.

Management Overview

The results of operations for Frederick Memorial Hospital, Inc. and Subsidiaries (known as Frederick Memorial Healthcare System or FMHS) for the Nine Months Ended March 31, 2008 (the period) resulted in a consolidated operating gain of $2.1 million versus a budgeted operating gain of $2.2 million. The consolidated operating earnings before interest and taxes (EBIDA) of $20.5 million (9.9%) for the period were short of the budget of $20.7 million (9.9%). Inpatient adult and pediatric cases exceeded budget by 2.2% while nursery discharges fell short of budget by 9.0%. Case mix continued to exceed target for the period. Positive variances to budget in net inpatient revenues of $805 thousand and in Frederick Health Services' (FHSC) occupational health practice of $812 thousand were more than offset by shortfalls in all other areas including a $1.2 million (4.0%) unregulated outpatient deficit. Total net patient services revenue was under budget by $215 thousand.

FMH inpatient admissions (adult and pediatric) were over budget for the period by 290 (2.2%), nursery discharges fell short by 188 (9.0%) and the Transitional Care Unit (TCU) admissions were 38 under budget (8.1%). Equivalent Inpatient Admissions (EIPA) of 25,272 was near budgeted levels and 1.5% greater than last year. Average length of stay (adult and pediatric) of 4.05 days was over the budget of 4.00 and over last year's 3.98.

Days Cash On Hand (DCOH) is 130 days, 5 days lower than June 30, 2007. Cash provided by operations was driven by strong operating results, partially offset by increases in accounts receivable and prepaid expenses and further reduced by pension plan funding and capital expenditures. (See Statement of Cash Flows and Overview to follow). Days revenue in accounts receivable (net) increased to 56.4 days at December 31, 2007 from 52.6 days at June 30, 2007. Maximum annual debt service (MADS) coverage held steady at 3.4 times for the period. Debt-to-Capitalization increased slightly to 49.7% from 48.9% at June 30, 2007.

Further discussion of the operating results for the period is provided in conjunction with the financial and statistical tables presented below.

The following table illustrates the consolidated results for fiscal years ended June 30, 2006 and 2007 and the consolidated operating budget for fiscal year ending June 30, 2008:

FMH and Subsidiaries
Statement of Operations
(000's)

	Audit FY 2006	Audit FY 2007	Budget 2008*
Revenues:			
Net patient service revenues	$ 234,875	$ 253,898	$ 265,933
Other operating revenues	10,461	12,545	11,082
Total Revenue	245,336	266,443	277,015
Non-Capital Expenses:	223,921	240,296	250,587
Operating EBIDA	21,415	26,147	26,428
Capital Expenses:			
Depreciation/Amortization	14,821	15,850	17,771
Interest Expense	6,380	6,743	7,014
Operating Income (Loss)	214	3,554	1,643
Other income(expense):	(1,239)	9,146	5,185
Excess of Revenues over Expenses	$ (1,025)	$ 12,700	$ 6,828

* This budget includes a new interventional cardiology (C-Port) program that was not included in the budget presented in the previous FY 2008 quarterly filings. The FMH Board of Directors approved the original budget without the C-Port program as this potential new program was still being analyzed and had not yet been recommended to or approved by the Board. The Board subsequently approved the C-Port program which began during the QE March 31, 2008. As such, the budget related to this program is now incorporated in the consolidated budget presented.

The following tables compare the consolidated results to prior year and current year budget and the variances to budget for the period as well as Operating EBIDA by consolidating entity:

FMH and Subsidiaries Statement of Operations For the nine months ended March 31, 2008 (000's)				
	Prior	**Current**	**Budget**	**Variance**
Revenues:				
Net patient service revenues	$ 189,599	$ 199,299	$ 199,514	$ (215)
Other operating revenues	7,455	8,131	8,313	(182)
Total Operating Revenue	197,054	207,430	207,827	(397)
Non-Capital Expenses	178,202	186,901	187,159	(258)
Operating EBIDA	**18,852**	**20,529**	**20,668**	**(139)**
Capital Expenses:				
Depreciation/Amortization	12,079	12,097	13,145	(1,048)
Interest Expense	5,282	6,309	5,270	1,039
Operating Income	**1,491**	**2,123**	**2,253**	**(130)**
Other income(expense):				
Nonoperating revenue	3,485	6,197	4,295	1,902
Net unrealized appreciation (depreciation) on investments	2,455	(7,642)		(7,642)
Mark-to-market adjustment - interest rate swap	(2,482)	(7,614)	-	(7,614)
Excess of Revenues over Expenses	**4,949**	**(6,936)**	**6,548**	**(13,484)**
Other changes in unrestricted net assets:				
Net assets released from restriction	-	1,029	-	1,029
Other	-	-	-	-
Increase (decrease) in unrestricted net assets	**$ 4,949**	**$ (5,907)**	**$ 6,548**	**$ (12,455)**

Operating EBIDA By Entity For the nine months ended March 31, 2008 (000's)				
	Prior	**Current**	**Budget**	**Variance**
FMH	**$ 19,461**	**$ 20,108**	**$ 20,362**	**$ (254)**
Subsidiaries				
FHSC	(687)	477	327	150
Emmitsburg	-	-	-	-
Hospice	78	(56)	(21)	(35)
Total Subsidiaries	(609)	421	306	115
Operating EBIDA	**$ 18,852**	**$ 20,529**	**$ 20,668**	**$ (139)**

* See “Subsidiary Results” section for FHSC discussion.

Hospital Revenue and Other Changes in Net Assets

Total net patient service revenue for the period was under budget by $824 thousand. The volume and gross charge components of that variance are described below.

Frederick Memorial Hospital Net Patient Services Revenue - Variance to Budget For the nine months ended: March 31, 2008 (000's)	
Gross Revenues - variance to Budget	
Inpatient - Regulated	$ 2,111
Outpatient - Regulated	(120)
Outpatient - Unregulated	(2,623)
TCU	(329)
subtotal - Gross Revenues variance	(961)
Deductions from Revenue - Variance to Budget	
Inpatient - Regulated	$ (1,306)
Outpatient - Regulated	(25)
Outpatient - Unregulated	1,446
TCU	22
subtotal - Deductions from Revenue variance	137
Net Patient Services Revenue - Variance to Budget	**$ (824)**

Inpatient cases (including nursery) totaled 15,104; 102 cases over budget and 716 cases over prior year. At the budgeted rate for the period of $7,897 average gross revenue per case, the favorable inpatient volume variance was approximately $805 thousand. In addition, case mix resulted in a favorable $87 per case rate variance resulting in a $1.3 million favorable variance.

Net regulated outpatient revenue was below budget by approximately $145 thousand the net result of strong volumes in the emergency department and campus-based imaging offset by lower than projected cardiovascular volumes related to the timing of commencing the interventional cardiology program.

Net unregulated outpatient revenues were unfavorable to budget by approximately $1.2 million for the period. This was the net result of shortfalls in off-campus imaging volumes at Rosehill and Crestwood as well as shortfalls in hospice nursing and immediate care. Offsetting this negative variance were positive results in home oxygen/DME and physician practices.

Inpatient admissions related to the Transitional Care Unit (TCU) were 38 under budget. ALOS was 0.6% higher than budget resulting in patient days that were 7.5% under budget and related net revenues that were approximately $307 thousand under budget for the period.

The combined deductions from revenue and provision for uncollectible accounts expense as a percent of gross revenues was favorable to budget for the period by **.**2%.

Other operating revenue, consisting primarily of retail pharmacy, cafeteria, rental income, transcription services and contributions revenue was favorable to budget by $399 thousand for the period. This was driven by unrestricted contributions partially offset by shortfalls in the retail pharmacy.

Other income (non-operating revenue) consists primarily of realized and unrealized investment income and the mark-to-market adjustment related to the interest rate swap. Other income fell short of budget by approximately $12.9 million for the period resulting from a negative $7.6 million mark-to-market adjustment and $7.2 unrealized losses on investments partially offset by stronger than budgeted investment income. The FY 2008 budget does not include estimates for the mark-to-market adjustment or unrealized gains (losses) on investments.

Prior to June 30, 2007 FMH classified their investment portfolio as “other than trading” and accounted for those investments on the basis of quoted market prices. Unrealized holding gains and losses were excluded from earnings and were reported as a separate component in “Other Changes in Unrestricted Net Assets” unless declines in fair value were deemed to be other than temporary. Investment income (interest, dividends, realized gains or losses) from all unrestricted investments was included in the consolidated statements of operations and changes in net assets as part of non-operating income and losses.

During fiscal 2007, the SEC issued guidance that clarified how investment portfolios classified as “other than trading” should be analyzed in determining reportable unrealized losses for impairment deemed other than temporary. This guidance was recognized by the Financial Accounting Standards Board to apply to any company holding significant investment portfolios who reported their financial information to external parties. The impact of the guidance is to report all unrealized losses determined to be other than temporary as a separate line in the “Non-operating income and losses” section of the consolidated statements of operations and changes in net assets. These losses were previously reported in the “Other changes in unrestricted net assets” section combined in a line with the unrealized gains on investments.

Alternatively, by changing the classification of the investment portfolio to “trading,” all unrealized gains and losses from unrestricted investments are classified in the non-operating income and losses section of the consolidated statements of operations and changes in net assets. We believe that this reporting method provides a more complete representation of the financial performance of the investment portfolio. As a result, FMH has elected to classify the investment portfolio as “trading” effective July 1, 2006 as reflected in the Fiscal Year 2007 Audited Financial Statements.

In addition, FMH confirmed that this change to a trading classification does not affect any bond covenants as unrealized gains and losses are excluded from any covenant calculations in the same way that the mark-to-market adjustments for contracts under SFAS No.133 are excluded.

Other changes in unrestricted net assets consists primarily of net assets released from temporarily restricted (for capital purposes) of $1.0 million.

Hospital Volumes and EIPA's

The following tables compare the Hospital volumes to prior year and current year budget and the variances to budget for the period:

FMH Hospital Only For the Nine Months Ended Mar. 31, 2008					
	Prior	**Current**	**Budget**	**Variance**	**Variance %**
Utilization Statistics:					
Inpatient Admissions - Acute	12,415	13,203	12,913	290	2.2%
Patient Days - Acute	49,359	53,538	51,666	1,872	3.6%
Average Length of Stay	3.98	4.05	4.00	0.05	1.3%
Nursery Discharges	1,973	1,901	2,089	(188)	-9.0%
Inpatient Admissions - TCU	472	434	472	(38)	-8.1%
Average Length of Stay - TCU	10.41	10.85	10.78	0.07	0.6%
Emergency Dept. Visits	47,529	51,689	48,971	2,718	5.6%
Immediate Care Visits	30,000	24,776	31,780	(7,004)	-22.0%
Inpatient Surgery Cases	3,572	3,937	3,501	436	12.5%
Outpatient Surgery Visits	6,049	6,118	6,556	(438)	-6.7%
Equivalent Admissions (EIPA's)	24,895	25,272	25,174	98	0.4%
HSCRC Case Mix Index	0.8894	0.9080	0.8930	0.0150	1.7%
Payor Mix:					
Medicare	41.1%	40.8%	xx		
Medicaid	6.4%	6.2%	xx		
United MAMSI	15.5%	16.0%	xx		
CareFirst	12.0%	14.7%	xx		
HMO's	16.2%	12.5%	xx		
Commercial	2.7%	2.7%	xx		
Self Pay/Other	6.0%	7.1%	xx		
	100.0%	100.0%			

Acute inpatient admissions (adult and pediatric) were over budget for the period by 290 (2.2%), nursery discharges fell short by 188 (9.0%) and TCU admissions were 38 under budget (8.1%). Average length of stay (adult and pediatric) of 4.05 days was slightly over the budget of 4.00 for the period and over the prior year of 3.98. Emergency Department visits were favorable to budget by 5.6% for the period. Immediate care visits are down approximately 22% to budget and 17% to prior year due primarily to challenges with clinical staffing and hours of operations. Inpatient surgery cases exceeded budget by 12.5% for the period driven largely by Orthopedics, Vascular, General Surgery and OB/GYN volumes. Outpatient surgery cases are 6.7% under budget for the period primarily related to outpatient endoscopies that have shifted to physician offices and other ambulatory sites.

FMH Hospital Only EIPA's For the nine months ended: March 31, 2008				
	Prior	**Current**	**Budget**	**Variance**
Inpatient Revenue (000's)	$ 110,958	$ 125,315	$ 123,533	$ 1,782
IP Admissions/discharges	12,415	13,203	12,913	290
IP Revenue per admission	$ 8,937	$ 9,491	$ 9,567	$ (75)
Outpatient Revenue (000's)	$ 111,542	$ 114,551	$ 117,294	(2,743)
IP Revenue per admission	$ 8,937	$ 9,491	$ 9,567	$ (75)
IP Equivalent admissions	12,480	12,069	12,261	(192)
EIPA's	**24,895**	**25,272**	**25,174**	**98**

One measure of relative utilization performance is the equivalent inpatient admission (EIPA). EIPA is an industry standard measure that gives effect to the relative value of outpatient activity to arrive at a blended statistical unit for the Hospital inpatient and outpatient operations. The table above shows the calculation of EIPA's for the periods presented. EIPA's were slightly favorable to budget and 1.5% higher than last year.

Hospital Only Non-Capital Expenses

The following tables compare the Hospital Only Non-Capital expenses to prior year and current year budget and the variances to budget for the period:

FMH Hospital Only Non-Capital Expenses For the nine months ended: March 31, 2008 (000's)				
	Prior	**Current**	**Budget**	**Variance**
Salaries and Benefits	$ 95,227	$ 103,076	$ 103,175	$ (99)
Services and Fees	19,785	22,433	20,951	1,482
Supplies, Drugs & Other	53,842	56,762	58,316	(1,554)
Total Non-Capital Expenses	**$ 168,854**	**$ 182,271**	**$ 182,442**	**$ (171)**

Salaries and benefits were under budget by $99 thousand. Employee benefits were favorable to budget by $1.3 million driven primarily by employee group health insurance self-insured costs that are trending favorably. Offsetting benefits was salaries and wages which were over budget by $1.2 million primarily due to increased patient days and higher than budgeted average hourly nursing rates. The patient days increase is the result of higher admissions/census, increased acuity of patients and throughput issues. Average daily census in the medical/surgical units was significantly higher than projected, particularly in the quarter ended March 31, 2008. As a result, nursing staffing shortages were experienced causing an increase in premium pay and float pool usage that drove up average hourly rates. In addition, the shortage in nursing appears to have contributed in part to the increased average length of stay. Management is working on recruitment and retention strategies to help alleviate this issue in the future.

Services and fees were over budget by approximately $1.5 million for the period due to contract nursing, service contracts and the implementation of a new patient transport service.

Supplies, drugs and other are under budget by approximately $1.6 million for the period. All categories experienced favorable variances, the most significant were supplies which was under budget by $584 thousand (7.9%) related primarily to favorable variances in lab reagent costs, printed materials and other operating room supplies and the provision for uncollectible accounts is favorable to budget by $429 thousand (5.4%) primarily due to larger numbers of patients qualifying for charity care.

The following table shows the non-capital expenses per EIPA. The variances in expenses per EIPA are consistent with the expense dollar variances described above.

FMH Hospital Only Non-Capital Expenses per EIPA For the nine months ended: March 31, 2008 (000's)				
	Prior	Current	Budget	Variance
Salaries and Benefits	$ 3,825	$ 4,079	$ 4,099	$ (20)
Services and Fees	795	888	832	55
Supplies, Drugs & Other	2,163	2,246	2,317	(70)
Total Non-Capital Expenses	**$ 6,783**	**$ 7,212**	**$ 7,247**	**$ (35)**

Non-capital expenses per EIPA increased 6.3% over prior year but are .5% under budget for the period as described above.

Hospital Only Interest Expense

In May 2006, FMH issued $75 million in auction rate securites (ARS) and concurrently entered into a fixed rate swap arrangement on the full $75 million. The ARS and the swap were both insured through Financial Guarantee Insurance Company (FGIC). In February 2008, the ARS market began to deteriorate in reaction to the credit down-grades of many bond insurance companies including FGIC as a result of liquidity declines related to mortgage-backed securities losses. These down-grades resulted initially in significant increases in interest rates on the ARS and ultimately in failed auctions, i.e. not enough investor interest to buy the entire issue at auction. When an auction fails for FMH's ARS, the interest rate on FMH's ARS defaults to a maximum rate of 15%. FMH experienced significant increases in interest rates and periodic failed auctions for several weeks until recently when the interest rates have stabilized at approximately 5 - 6%.

FMH has been working diligently on a refinancing strategy which will advance refund the ARS through the issuance of Variable Rate Demand Obligations (VRDO) backed by a letter of credit facility. The current plan of finance targets a completion date of early June 2008. Interest expense was over budget by approximately $1.0 million dollars through March 31, 2008.

Subsidiary Results

FMH subsidiaries include its for-profit, wholly-owned subsidiary, Frederick Health Services Corporation (FHSC); Emmitsburg Properties, LLC and Hospice of Frederick County, Inc. (HFC).

FHSC has four wholly-owned subsidiaries: Rosehill of Frederick, LLC, Mt. Airy Plaza, LLC, and Corporate Occupational Health Solutions, LLC, which are for-profit limited liability companies, and Frederick Surgical Services Corporation (FSSC). Effective July 1, 2007, FHSC sold a 50% interest in Mt.Airy Plaza, LLC and it is therefore treated as an Equity Method investment going forward. A gain on the sale of this interest of approximately $1.6 million was recorded as a non-operating gain. In 2006, FHSC owned a 100% interest in Frederick Surgical Center, LLC (FSC). In April 2007, FHSC contributed 100% of the assets of FSC for a 39% interest in a newly formed entity which now is accounted for under the equity method. FHSC operations have resulted in an operating loss of $82 thousand versus a budgeted operating loss of $123 thousand. Year-to-date operating EBIDA is $477 thousand versus budget of $327 thousand.

Emmitsburg Properties, LLC holds investments related to donated properties that were previously liquidated and has no current operating activities.

HFC is controlled by the Hospital and operates as a fundraising organization for the benefit of hospice services and operates the Kline Hospice House. HFC has posted an operating loss of $119 thousand versus a budgeted loss of $21 thousand to date.

Consolidated Balance Sheets and Statement of Cash Flows

The Balance Sheets for FMHS as of March 31, 2008 and June 30, 2007 and the Statement of Changes in Cash and Investments for the Nine Months Ended March 31, 2008 are shown in the tables below. The Nine Months Ended March 31, 2008 resulted in a net decrease of $383 thousand in combined unrestricted cash, short-term and long-term investments. Cash flow from operating activities was a net increase of approximately $7.3 million. This cash provided by operations was driven by strong results of operations, partially offset by increases in accounts receivable and prepaid expenses and further reduced by pension plan funding. Net cash used in investing activities was approximately $6.7 million. This was the net result of approximately $11.7 million in capital expenditures partially offset by $3.3 million of proceeds from other investments. Net cash used in financing activities was approximately $1.0 million which was primarily related to principal payments on long-term debt.

FMH and Subsidiaries
Balance Sheet
Unaudited

	31-Mar-08	30-Jun-07	Change
Assets:			
Cash and Short Term Investments	$ 29,432	$ 27,651	$ 1,781
Patient Receivables, net	40,907	36,597	4,310
Property and Equipment, net	184,312	186,326	(2,014)
Assets Limited As To Use	14,840	18,990	(4,150)
Other Assets	17,370	16,475	895
Long Term Investments	61,665	63,829	(2,164)
Donor Restricted Assets	6,927	8,010	(1,083)
Total Assets	**355,453**	**357,878**	**(2,425)**
Liabilities:			
Accounts Payable/Accrued Expenses	32,799	34,365	(1,566)
Advances from Third Party Payors	7,934	8,344	(410)
Current Portion of LTD & Capital Lease Obligations	1,947	1,932	15
Interest Rate Swap Contract	7,994	381	7,613
Long Term Debt & Capital Lease Obligations	145,687	147,060	(1,373)
Total Liabilities	**196,361**	**192,082**	**4,279**
Net Assets:			
Unrestricted	151,879	157,786	(5,907)
Temporarily Restricted	6,237	7,034	(797)
Permanently Restricted	976	976	-
Total Net Assets	**159,092**	**165,796**	**(6,704)**
Total Liabilities and Net Assets	**$ 355,453**	**$ 357,878**	**$ (2,425)**

Frederick Memorial Hospital, Inc. and Subsidiaries
Consolidated Statements of Cash Flows
Unaudited
(in thousands of dollars)

	For the nine months ended March 31, 2008
Cash flows from operating activities	
Change in net assets	$ (6,704)
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:	
Depreciation of property and equipment	12,097
Amortization of original issue discount and bond issue costs	228
Equity in earnings of joint ventures	52
(Gain) loss on sale of property and equipment	(1,700)
Change in unrealized (gains) losses on trading securities, net	7,642
Proceeds from realized gains on investments-trading	(672)
(Increase) decrease in investments-trading	(4,538)
Proceeds from restricted contributions	(429)
Change in pledges receivable	1,083
Change in fair value of interest rate swap contract	7,613
Change in operating assets and liabilities:	
Receivables, patient and other	(3,975)
Inventories and other assets	(1,423)
Accounts payable	93
Accrued expenses	(72)
Accrued pension expense	(1,681)
Advances from third party payors	(410)
Other short-term liabilities	277
Other long-term liabilities	(183)
Net cash provided by (used in) operating activities	7,298
Cash flows from investing activities	
Purchases of property and equipment	(11,654)
(Increase) decrease in assets limited as to use, non-trading, net	4,150
Net proceeds from other investments	3,271
Change in investments, trading	(2,432)
Net cash used in investing activities	(6,665)
Cash flows from fundraising and financing activities	
Proceeds from restricted contributions	429
Repayments of long-term debt	(1,445)
Net cash (used in) provided by fundraising and financing activities	(1,016)
Net increase (decrease) in cash and investments	(383)
Cash and investments at the beginning of the year	91,480
Cash and investments at the end of the period	$ 91,097

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