Financial Statements and Report of Independent Certified Public Accountants

Methodist Health System

September 30, 2008 and 2007

Methodist Health System

TABLE OF CONTENTS

Audit – Tax – Advisory

Grant Thornton LLP
1717 Main Street, Suite 1500
Dallas, TX 75201-9436

T 214.561.2300
F 214.561.2370
www.GrantThornton.com

Report of Independent Certified Public Accountants

To the Board of Directors of
Methodist Hospitals of Dallas
d/b/a Methodist Health System:

We have audited the accompanying consolidated statement of financial position of Methodist Hospital of Dallas d/b/a Methodist Health System (the "System") as of September 30, 2008, and the related statements of operations and changes in net assets, and cash flows for the year then ended. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of the System as of and for the year ended September 30, 2007, were audited by other auditors. Those auditors expressed an unqualified opinion on those financial statements in their report dated January 18, 2008.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America as established by the American Institute of Certified Public Accountants. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, An audit includes 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 System'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, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the 2008 consolidated financial statements referred to above present fairly, in all material respects, the financial position of the System as of September 30, 2008, and the consolidated changes in their net assets and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Grant Thornton LLP

Dallas, Texas
December 16, 2008

Methodist Health System

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

September 30,
(In thousands)

ASSETS	2008	2007
Current assets		
Cash and cash equivalents	$140,278	$ 246,888
Short-term investments	160,039	189,646
Patient accounts receivable (net of allowance for uncollectible accounts of $59,500 in 2008 and $50,089 in 2007 - Note 2)	91,302	81,439
Health insurance programs reimbursement receivable	4,885	9,452
Other accounts receivable - Note 7	5,906	27,919
Other current assets	19,984	18,194
Total current assets	422,394	573,538
Long-term investments	1,026	-
Net property, plant and equipment - Note 3	383,302	360,571
Assets whose use is limited - Notes 4 through 6	60,506	93,995
Other assets - Note 8	17,625	16,313
Total assets	$884,853	$1,044,417
LIABILITIES AND NET ASSETS		
Current liabilities:		
Accounts payable and accrued expenses - Notes 7 and 8	$ 60,077	$ 80,681
Accrued construction costs	1,838	5,836
Current installments of long-term debt - Note 4	4,300	1,600
Total current liabilities	66,215	88,117
Long-term debt - Note 4	196,200	370,500
Interest rate swaps liability - Note 4	16,268	3,228
Other liabilities - Note 6	19,287	23,323
Total liabilities	297,970	485,168
Commitments and contingencies - Notes 3 and 6		
Net assets - Note 5:		
Unrestricted	567,875	541,642
Temporarily restricted	15,492	15,007
Permanently restricted	3,516	2,600
Total net assets	586,883	559,249
Total liabilities and net assets	$884,853	$1,044,417

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

Methodist Health System

CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS

For the years ended September 30,
(In thousands)

	2008	2007
Net patient service revenue - Note 1	$649,060	$541,594
Other operating revenue	11,877	13,873
Total operating revenue	660,937	555,467
Operating expenses - Notes 8 and 9		
Salaries, wages and benefit costs	315,443	286,198
Other operating expenses	202,816	157,908
Provision for bad debts	44,286	37,673
Depreciation and amortization	42,185	38,170
Total operating expenses	604,730	519,949
Income from operations	56,207	35,518
Nonoperating gains (losses), net - Note 1	(30,470)	10,740
Excess of revenue over expenses	$ 25,737	$ 46,258

The accompanying notes are an integral part of these financial statements, including Page 12, containing information on charity care of approximately $187 million and $138 million provided during 2008 and 2007, respectively.

Methodist Health System

CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS

For the years ended September 30,
(In thousands)

	2008	2007
Changes in unrestricted net assets:		
Excess of revenue over expenses	$ 25,737	$ 46,258
Other changes in unrestricted net assets:		
Effect of implementation of FAS No. 158	-	559
Unrecognized pension loss	(456)	-
Net assets released from restrictions used for capital	952	389
Increase in unrestricted net assets	26,233	47,206
Changes in temporarily restricted net assets:		
Restricted grants, gifts, and bequests	3,566	6,171
Income (loss) from investments	(1,051)	806
Net assets released from restrictions	(2,030)	(1,402)
Increase in temporarily restricted net assets	485	5,575
Changes in permanently restricted net assets:		
Restricted grants, gifts, and bequests	916	6
Increase in permanently restricted net assets	916	6
Increase in net assets	27,634	52,787
Net assets - beginning of year	559,249	506,462
Net assets -end of year	$586,883	$559,249

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

Methodist Health System

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the years ended September 30,
(In thousands)

	2008	2007
Cash flows from operating activities:		
Increase in net assets	$ 27,634	$ 52,787
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Operating depreciation and amortization	42,185	38,170
Nonoperating depreciation and amortization	8,503	2,389
Provision for bad debts	44,286	37,673
Capitalized interest	(518)	(1,875)
Net book value of retired assets	3,158	583
Unrealized loss on interest rate swaps	13,040	3,228
Unrealized and realized losses (gains) on investments	9,038	(5,039)
Restricted grants, gifts, and bequests	(4,482)	(6,177)
Changes in operating assets and liabilities:		
Increase in patient accounts receivable	(54,149)	(50,575)
Decrease (increase) in health insurance programs reimbursement receivable	4,567	(5,445)
Decrease (increase) in other accounts receivable	22,013	(23,151)
Increase in other current assets	(1,790)	(3,309)
Increase in other assets	(4,479)	(2,344)
Increase (decrease) in accounts payable and accrued expenses	(20,604)	30,005
Decrease in other liabilities	(4,036)	(5,210)
Net cash provided by operating activities	84,366	61,710
Cash flows from investing activities:		
Purchases of investments	(260,144)	(314,839)
Maturities and sales of investments	279,687	342,237
Purchases of property, plant and equipment	(75,726)	(98,515)
Increase (decrease) in assets whose use is limited	33,489	(40,726)
Net cash used in investing activities	(22,694)	(111,843)

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

Methodist Health System

CONSOLIDATED STATEMENTS OF CASH FLOWS - CONTINUED

For the years ended September 30,
(In thousands)

	2008	2007
Cash flows from financing activities:		
Principal payments on debt	$ (1,600)	$ (1,400)
Issuance of long-term debt	-	200,000
Debt issuance costs paid	(1,164)	(4,354)
Debt repurchased	(170,000)	-
Restricted grants, gifts, and bequests	4,482	6,177
Net cash provided by (used in) financing activities	(168,282)	200,423
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(106,610)	150,290
Cash and cash equivalents, beginning of year	246,888	96,598
Cash and cash equivalents, end of year	$ 140,278	$ 246,888
Supplemental disclosure of cash flow information:		
Cash paid for interest	$ 13,251	$ 8,064
Accrued construction costs	1,838	5,836

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

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Methodist Hospitals of Dallas, a 501(c)(3) tax-exempt corporation doing business as Methodist Health System (MHS), owns and operates three hospitals. Two hospitals, Methodist Dallas Medical Center, a 515-licensed-bed tertiary care hospital, and Methodist Charlton Medical Center, a 254-licensed-bed community hospital, are located in Dallas, Texas. The third hospital, Methodist Mansfield Medical Center, an 88-licensed-bed community hospital located in Mansfield, Texas, opened in December 2006. In addition, MHS is the majority owner of Methodist Rehabilitation Hospital, LLC, a 40-bed post-acute hospital located in Dallas, Texas that is a joint venture with Centerre Corporation, and Methodist McKinney Hospital, LLC, and Methodist Hospital for Specialty Surgery, LLC, both of which are joint venture specialty hospitals. The partners in the Methodist McKinney and the Methodist Specialty Hospital joint ventures include MHS, physician owners and Nueterra Healthcare. The McKinney hospital is under construction and is located in McKinney, Texas. The Specialty Hospital is in development and will be located in Dallas, Texas. The consolidated financial statements include accounts of MHS, Methodist Health System Foundation (Foundation), and Pavilion Properties. The Foundation is a 501(c)(3) tax-exempt corporation that was established to raise funds to support the operations of MHS. Pavilion Properties is a 501(c)(2) tax-exempt title-holding corporation. MHS has other subsidiaries, affiliates, and joint ventures, none of which it considers significant for consolidation, which are recorded as investments in other assets, and the results of their operations are recorded on the equity method in nonoperating gains in the accompanying consolidated statements of operations and changes in net assets. All significant intercompany items are eliminated in consolidation.

<u>Recent Accounting Pronouncements</u> - In September 2006 the FASB issued SFAS No. 157, *Fair Value Measurements* (FAS157), which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. FAS157 applies under other accounting pronouncements that require or permit fair value measurements. The provisions of FAS157 are effective for MHS financial assets and liabilities with its fiscal year 2009. MHS is currently evaluating the effect this standard will have on its consolidated financial statements.

In February 2007 the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities - Including an amendment of FASB Statement No. 115* (FAS159), which permits entities to choose to measure many financial instruments and certain other items at fair value. The accounting provisions of FAS159 are effective for MHS beginning with its fiscal year 2009. MHS is currently evaluating the effect this standard will have on its consolidated financial statements; however, it does not believe the effect of the adoption will have a material impact on its financial position and results of operations.

In July 2006, the FASB issued FASB (FIN) 48, *Accounting for Uncertainty in Income Taxes: an interpretation of FASB Statement No. 109* (FIN 48). FIN 48, which clarifies FASB Statement No. 109, *Accounting for Income Taxes*, establishes the criterion that an individual tax position has to meet for some or all of the benefits of that position to be recognized in the financial statements. On initial application, FIN 48 is applied to all tax positions for which the statute of limitations remains open. Only tax positions that meet the more-likely-than-not recognition threshold at the adoption date will be recognized or continue to be recognized.

MHS has concluded that it does not have any unrecognized tax benefits resulting from current or prior period tax positions. Accordingly, no additional disclosures have been made on the financial statements regarding FIN 48. MHS does not have any outstanding interest or penalties, and none have been recorded in the statement of activities for the year ended September 30, 2008.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

U.S. Income Tax Status - MHS is exempt from federal income taxes under Section 501(a) of the Internal Revenue Code (IRC), as an organization described in IRC Section 501(c)(3). MHS has been classified as an organization that is not a private foundation under IRC Sections 509(a)(3), and as such, contributions to MHS qualify for deduction as charitable contributions. However, income generated from activities unrelated to MHS's exempt purpose is subject to tax under IRC Section 511. MHS did not have any material unrelated business income tax liability or expense for the years ended September 30, 2008 and 2007.

Use of Estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States (US GAAP) requires estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses for the reporting period. Actual results could differ from those estimates.

Reclassifications - Certain reclassifications have been made to the 2007 amounts for consistency with presentation of 2008 amounts. The most significant of these include reclassifying Medicaid disproportionate share grant of approximately $8.2 million to net patient service revenue, reclassifying approximately $4.4 million of debt issuance costs from cash used by operating activities to cash used by financing activities, and reclassifying changes in donor restricted assets of $0.6 million from cash provided by operating activities to $5.6 million of cash used in investing activities and $6.2 million of cash provided by financing activities. Management believes these reclassifications are immaterial to the financial statements as a whole.

Cash and Cash Equivalents - Cash equivalents include commercial paper, corporate notes, and U.S. government securities having maturities, at time of purchase, of 90 days or less.

Investments - Investments include those held by the Foundation. Short-term investments have maturities, measured at balance sheet dates, of less than one year. Long-term investments have maturities of greater than one year.

Investment income is comprised of the following:

	Years ended September 30,	
	2008	2007
	(in thousands)	
Interest and dividend income	$ 13,194	$16,570
Realized gains and losses, net	1,716	1,355
Unrealized gains and losses, net	(11,895)	4,247
	$ 3,015	$22,172

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Investments are comprised of the following:

	Years ended September 30, 2008	2007
	(in thousands)	
Cash and money market funds	$ 695	$ 497
U.S. government and agency securities	109,355	109,645
Asset backed securities	-	63
Repurchase agreements	-	10,000
Certificates of deposit	1,773	4,050
Corporate bonds	42,737	27,334
Commercial paper	7,948	27,161
Common stock	1,868	2,534
Mutual funds	34,865	40,077
Real property	26	6,064
	$199,267	$227,425

Short-term investments as defined above total approximately $198,241,000 and $224,591,000 at September 30, 2008 and 2007, respectively. Long-term investments total approximately $1,026,000 and $2,834,000 at September 30, 2008 and 2007, respectively. Long-term investments at September 30, 2007 are included in assets whose use is limited.

Debt Repurchase - Investments and Long-Term Debt (Note 4) reflect MHS's temporary secondary market repurchase of $170 million of its Series 1985 and 1998 bonds. The repurchase was made with available cash and results in reduced amounts of unrestricted cash and investments. The purchase was made to reduce net interest expense. US GAAP require that the purchase be reported as a reduction of long-term debt. MHS expects to reoffer these bonds in the secondary market, but may also choose to refund them depending upon market conditions at a future time.

Inventory - Inventories are valued at cost or amounts approximating cost.

Property, Plant and Equipment - Property, plant and equipment are stated at cost. Depreciation is provided on the straight-line method using the estimated economic lives of depreciable assets, ranging from 3 to 40 years. Expenditures that materially increase values, change capacities, or extend useful lives are capitalized. Routine maintenance and repair items are charged to current operations.

Assets Whose Use Is Limited - Assets whose use is limited include cash and cash equivalents of approximately $17,901,000 and $52,587,000 as of September 30, 2008 and 2007, respectively; short-term investments of approximately $38,202,000 and $37,779,000 as of September 30, 2008 and 2007, respectively; and other assets including pledges receivable.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Disclosures About Fair Value of Financial Instruments - SFAS No. 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations*, requires that investments held in equity securities with readily determinable fair values and all investments in debt securities be reported at fair value with gains and losses included in the statements of operations and changes in net assets.

MHS's cash and cash equivalents and short-term and long-term investments are in fixed income securities with maturities, at time of purchase, generally not exceeding fourteen months. Because of their short maturities, the investments are carried at cost which approximates fair value and no unrealized gains or losses have been reported in the financial statements. It is MHS's general practice and intent to hold its financial instruments to maturity and to not engage in trading or sales activities.

Investments in corporate bonds are carried at amortized cost which approximates fair value. Adjustments for amortization of premium and accretion of discount are included in interest income. Gains or losses on the sale of securities are recognized upon realization using the specific identification method.

All Foundation investments with readily determinable fair values, except corporate bonds, are recorded at fair values based on quoted market prices. Investments of the Foundation are considered trading securities. Unrealized gains and losses on investments recorded at fair value are included in the statements of operations and changes in net assets as increases or decreases in unrestricted net assets unless their use is temporarily or permanently restricted by explicit donor stipulations or law.

Variable rate long-term debt carrying values approximate fair value because of the frequency with which the interest rates are reset.

Derivative Instruments and Hedging - SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, requires that every derivative instrument be recorded on the balance sheet as either an asset or liability, be measured at its fair value, and requires that changes in the derivative's fair value be recognized currently in earnings, unless specific hedge accounting criteria are met. MHS utilized six interest rate swap agreements to minimize the risks and costs associated with its financing activities (see Note 4). The interest rate swaps were not designated as hedging instruments. MHS has no other derivative instruments.

Investments in Unconsolidated Companies - Investments in unconsolidated companies owned 20 percent or more are recorded on an equity basis. Investments in companies less than 20 percent owned, and for which MHS does not exercise significant influence, are carried at cost. While certain of these companies meet the criteria for consolidation, management believes such presentation is not material to the financial statements.

Temporarily and Permanently Restricted Net Assets - Temporarily and permanently restricted net assets represent those net assets whose use has been limited by donors to a specific purpose. Permanently restricted net assets have been restricted by donors to be maintained in perpetuity and the income to be used for specific purposes.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Net Patient Service Revenue - Net patient service revenue is reported at the estimated net realizable amounts from patients and third-party payors for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors.

Charity Care - MHS provides care to patients who meet certain criteria under its charity care policy, without charge or for amounts less than its established rates. The amount by which established rates exceed the amount, if any, expected to be collected from patients receiving charity care is not reported as net patient service revenue.

MHS maintains records to identify and monitor the level of charity care it provides under its charity care policy. The amount of charges foregone for charity was approximately $187 million and $138 million during 2008 and 2007, respectively, representing 12.6% and 11.3% of total charges, respectively. The unreimbursed cost of charity services provided, including the unreimbursed cost of Medicaid services, was approximately $76 million in 2008 and $69 million in 2007. The cost estimate is derived from applying the ratio of costs to charges to serve all patients to the charity care charges.

Medicare and Medicaid Program Reimbursement - Net patient service revenue includes amounts reimbursable by the Medicare and Medicaid programs. Revenue from the Medicare and Medicaid programs, including managed care contracts, accounted for approximately 32.5% and 9.1%, respectively, of MHS's net patient service revenue for the year ended September 30, 2008, and approximately 35.0% and 10.5%, respectively, of net patient service revenue for the year ended September 30, 2007. Reimbursement for Medicare inpatient services is based on a combination of prospectively determined amounts for operating costs, capital costs, and medical education, and retrospective reimbursement for other costs. Reimbursement for Medicaid inpatient services is based on prospectively determined amounts. Reimbursement for Medicare and Medicaid outpatient services is based on either the hospitals' operating costs, as defined, prospectively determined amounts, or a blend of the operating costs and prospectively determined amounts, depending on the services provided. The commercial managed Medicare and Medicaid inpatient and outpatient business is paid on negotiated rates.

Those payments that are not prospectively determined under the Medicare and Medicaid programs are reimbursed at tentative rates with final settlement determined after submission of annual cost reports, and audits thereof by the Medicare and Medicaid fiscal intermediary. Final amounts due are subject to determination by the fiscal intermediary. The difference between final determination after audit and the estimated amount accrued is included in net patient service revenue in the year of determination. The 2008 net patient service revenue increased approximately $1,702,000 due to decreases in allowances and 2007 net patient service revenue increased approximately $4,851,000, due to decreases in allowances required as a result of final settlement and current estimates based on the status of audits that are in process or completed but not final.

Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. MHS believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

MHS received funds of approximately $8.3 million and $8.2 million in its fiscal years 2008 and 2007, respectively, from the Texas Health and Human Services' Medicaid Disproportionate Share program. The program obtains funding from intra-governmental transfers of public hospital funds that are matched by U.S. government federal funds and distributed to hospitals that serve a disproportionately large share of uninsured and Medicaid health insurance program patients. MHS qualifies for funds because the distribution is based upon the percentage of low-income inpatients served. The amount of funds to be received is determined prospectively for the state fiscal year ending August 31 and is generally announced in September. MHS has been informed that it qualifies for state fiscal 2008 funding and expects to receive approximately $11 million during its fiscal year 2009.

Interest - There was no interest cost included in operating expenses in 2008 and 2007.

Advertising Costs - Advertising costs are expensed as incurred and were approximately $2,617,000 and $2,302,000 for the years ended September 30, 2008 and 2007, respectively.

Nonoperating Gains - Net nonoperating gains primarily include interest expense on the hospital revenue bonds Series 1985-B, Series 1998, Series 2007, and Series 2008, loss on interest rates swaps, and all interest income. Interest expense was approximately $13.3 million and $8.4 million for 2008 and 2007, respectively. Interest paid was approximately $13.3 million and $8.0 million for 2008 and 2007, respectively. Interest of approximately $500 thousand and $1.9 million was capitalized for 2008 and 2007, respectively. Loss on interest rate swaps was approximately $13.0 million and $3.2 million for 2008 and 2007, respectively.

Contributions - Unconditional contributions to give cash and other assets to MHS and the Foundation are reported at fair value when the eligibility requirements established by the donor have been satisfied. Pledges are written unconditional promises to make future contribution payments which, if all eligibility requirements have been satisfied, are recognized as pledges receivable and contribution income at their discounted present value based on future expected collections. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received or becomes an unconditional promise. Undiscounted pledges receivable at September 30, 2008, were approximately $3,240,000, exceeding their discounted present value by approximately $159,000. The discount rate used to discount pledges receivable at September 30, 2008 was 3.05%. At September 30, 2008, there are two conditional promises to give totaling approximately $230,000. Contributions are recorded as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When expenditures are made which meet the donor specified purpose, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the statement of activities and changes in net assets as net assets released from restrictions. All pledges receivable are deemed collectible by management; thus, no allowance is required.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Pledges outstanding are expected to be collected in the following periods:

	September 30, 2008	September 30, 2007
One year or less	$1,364,193	$ 819,598
Between one and five years	1,717,226	2,034,484
	$3,081,419	$2,854,082

Pledges receivable are a component of assets whose use is limited.

NOTE 2 - PATIENT ACCOUNTS RECEIVABLE

MHS provides health care services to patients regardless of their ability to pay. Patient accounts receivable are stated at net realizable value. Concentrations of receivables from patients include:

	September 30, 2008	September 30, 2007
Government-related programs	19%	18%
Managed care providers	62	63
Self-pay patients	8	7
Commercial insurers and other payers	11	12
	100%	100%

Receivables from government programs (primarily Medicare and Medicaid) represent the only concentrated group of credit risk for MHS, and management does not believe that there are any significant credit risks associated with these government agencies. Commercial and managed care receivables consist of receivables from various payors involved in diverse activities and subject to differing economic conditions and do not represent any significant concentrated credit risks to MHS. MHS maintains an allowance for uncollectible accounts for estimated losses resulting from a payor's inability to make payments on accounts. The allowance is based on historical write-offs and the aging of the accounts; management continually monitors and adjusts the allowance for uncollectible accounts receivable. Accounts are written off when routine billing and communication with the payor are not expected to result in payment. MHS collection efforts continue, and recoveries of accounts written off are accounted for as reductions in the provision for bad debts.

NOTE 3 - PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment and the related accumulated depreciation and amortization are as follows:

	September 30,			
	2008		2007	
	Cost	Accumulated depreciation and amortization	Cost	Accumulated depreciation and amortization
	(in thousands)			
Land	$ 26,498	$ -	$ 16,340	$ -
Land improvements	24,015	13,462	21,277	12,360
Buildings	354,949	136,677	310,275	123,899
Fixed equipment	66,840	60,600	67,431	59,668
Movable equipment	249,519	153,533	244,517	148,556
Construction in progress	25,753	-	45,214	-
	$747,574	$364,272	$705,054	$344,483
Net book value	$383,302		$360,571	

MHS has several construction and renovation projects in progress for which it has commitments of approximately $58 million at September 30, 2008.

NOTE 4 - LONG-TERM DEBT

Long-term debt is as follows:

	September 30, 2008	September 30, 2007
	(in thousands)	
North Central Texas Health Facilities Development Corporation Hospital Revenue Bonds Series 1985-B -- at a daily adjustable interest rate not to exceed 18% (average interest rate of 3.02% and 3.68% for the years ended September 30, 2008 and 2007, respectively) interest due monthly and principal due annually through 2015.	$ 20,500	$ 22,100
North Central Texas Health Facilities Development Corporation Flexible Rate Hospital Revenue Bonds Series 1998 -- average interest rate of 3.27% and 3.65% for the years ended September 30, 2008 and 2007, respectively.	150,000	150,000
Tarrant County Cultural Education Facilities Finance Corporation Hospital Revenue Bonds Series 2007 - auction rate securities payable weekly with an average interest rate of 4.07% for the year ended September 30, 2008 and 3.76% from issuance through September 30, 2007.	-	200,000
Tarrant County Cultural Education Facilities Finance Corporation Hospital Revenue Bonds Series 2008 - auction rate securities payable weekly with an average interest rate of 4.66% from issuance through September 30, 2008, principal payable beginning in 2009 through 2042.	200,000	-
Debt repurchased (Note 1)	(170,000)	-
	200,500	372,100
Less current installments	(4,300)	(1,600)
Total	$ 196,200	$370,500

The aggregate long-term debt maturing during the five years following fiscal 2008 and thereafter is as follows: 2009 -- $4,300,000; 2010 -- $3,800,000; 2011 -- $3,800,000; 2012 -- $3,900,000; 2013 -- $3,900,000; thereafter -- $180,800,000.

NOTE 4 - LONG-TERM DEBT - Continued

In 1985, MHS borrowed the proceeds of the North Central Texas Health Facilities Development Corporation Hospital Revenue Bonds Series 1985-A and Series 1985-B ("Bonds"). The Bonds were issued by the North Central Texas Health Facilities Development Corporation pursuant to a Trust Indenture ("Indenture") dated October 1, 1985. The proceeds of the Series 1985-A Bonds were used to defease $47,450,000 of Series 1979 Hospital Revenue Bonds ("Series 1979 Bonds"). The remaining balance of the defeased Series 1979 Bonds totaled $4,330,000 at September 30, 2008.

The Series 1985-A Bonds were called October 1, 1995. The proceeds of the Series 1985-B Bonds and other funds available from operations were used for a capital improvement program.

In 1991, MHS borrowed the proceeds of the North Central Texas Health Facilities Development Corporation Flexible Rate Hospital Revenue Bonds Series 1991-A and Series 1991-B ("Series 1991 Bonds") issued by the North Central Texas Health Facilities Development Corporation. The proceeds and other funds available from operations were used for a capital improvement program. The bonds were refunded in 1998.

In 1998, MHS borrowed the proceeds of the North Central Texas Health Facilities Development Corporation Flexible Rate Hospital Revenue Bonds Series 1998 ("Series 1998 Bonds"). The Series 1998 Bonds were issued by the North Central Texas Health Facilities Development Corporation pursuant to a Trust Indenture dated March 1, 1991 and a First supplement to Trust Indenture dated August 15, 1998 ("Indenture"). A portion of the proceeds was used to refund the Series 1991 Bonds. The remainder of the proceeds, and other funds available from operations, were used for a capital improvement program. The Series 1998 Bonds contain covenants that require the maintenance of certain financial ratios.

In June 2007, MHS borrowed the proceeds of the Tarrant County Cultural Education Facilities Finance Corporation Hospital Revenue Bonds Series 2007 ("Series 2007 Bonds"). The Series 2007 Bonds were issued by the Tarrant County Cultural Education Facilities Finance Corporation pursuant to a Trust Indenture dated June 1, 2007. A portion of the proceeds were deposited into a project fund and were used to reimburse costs of capital improvements to and equipment for MHS, including the construction of Methodist Mansfield Medical Center and a new bed tower at Methodist Charlton Medical Center. The bonds were refunded in 2008.

In September 2008, MHS borrowed the proceeds of the Tarrant County Cultural Education Facilities Finance Corporation Hospital Revenue Bonds Series 2008 ("Series 2008 Bonds"). The Series 2008 Bonds were issued by the Tarrant County Cultural Education Facilities Finance Corporation pursuant to a Trust Indenture dated June 1, 2007. The proceeds were used to refund the Series 2007 bonds.

The Series 1985-B Bonds are variable rate bonds in a daily mode and can be tendered by holders upon demand. The Series 1998 Bonds are issued in a flexible mode and bear interest for interest periods of 270 days or less. The Series 2008 consist of Series 2008A Bonds which are issued in a daily rate period and Series 2008B Bonds which are issued in a weekly rate period. A remarketing agent selected by MHS determines the interest rates and markets each series of bonds. The Series 2007 Bonds were auction rate securities generally bearing interest for successive seven-day auction periods at variable rates.

NOTE 4 - LONG-TERM DEBT - Continued

As additional security for the payment of the purchase price of the Series 1985-B Bonds and the Series 1998 Bonds, MHS has entered into a Standby Bond Purchase Agreement ("Agreement"), for each series of bonds, with a bank pursuant to which the bank will purchase any bonds the remarketing agent is unable to market. The Agreements include covenants that are customary in credit agreements of this nature and exist solely for the benefit of the bank, which may waive or amend any of such covenants. The Agreements' stated expiration date is July 3, 2014.

Additional security for payment of the principal and interest of any Series 2008 Bonds tendered and not remarketed is provided under an irrevocable Letter of Credit issued by a bank. The letter of credit expires September 4, 2011.

In 2007, MHS entered into six interest rate swap transactions in order to substantially fix the expected net interest expenses associated with its bonds. MHS is obligated to make payments to the related swap counterparties at fixed rates of 3.7048% per annum on a notional amount of $100,000,000 and 3.792% per annum on a notional amount of $100,000,000, and the related swap counterparties are obligated to make reciprocal floating rate payments at a rate equal to 64% of the U.S. dollar one-month LIBOR rate reset weekly, plus 0.196%. Under SFAS No. 133, the instruments' fair value and changes therein must be measured in MHS's consolidated financial statements. The market value of the swaps, included in noncurrent liabilities, is approximately $16.2 million and $3.2 million at September 30, 2008 and 2007, respectively, and the amount included in nonoperating gains related to the change in value of the swaps is a loss of approximately $13.0 million and $3.2 million for the years ended September 30, 2008 and 2007, respectively. The fair value of the interest rate swaps is estimated based on quotes from the market makers of these investments and represents the estimated amounts MHS could expect to receive or pay to terminate the agreements.

Assets held by the trustee, included in assets whose use is limited at September 30, 2008 and 2007, include reserve funds required by the Indentures. MHS is in compliance with all debt covenants as of September 30, 2008 and 2007.

NOTE 5 - TEMPORARILY AND PERMANENTLY RESTRICTED NET ASSETS

Temporarily restricted net assets were approximately $15,492,000 and $15,007,000 as of September 30, 2008 and 2007, respectively. Permanently restricted net assets were approximately $3,516,000 and $2,600,000 as of September 30, 2008 and 2007, respectively

Temporarily restricted net assets are available for the following:

	September 30,	
	2008	2007
	(in thousands)	
Golden Cross Indigent Care Program	$ 3,629	$ 4,370
Specific Purpose Funds:		
Capital Projects & Equipment	1,558	1,157
Women & Children Services	1,519	977
Indigent Care Programs	911	911
Research	251	339
Transplant	149	180
Oncology	201	203
Education & Training	348	159
Cardiology	41	41
Other	369	352
Nursing Scholarships	642	701
Future Fund	434	536
General Endowment	1,173	1,173
Income Endowment	4,267	3,908
	$15,492	$15,007

Net assets released from restriction for operations were approximately $1,078,000 and $1,013,000 for the years ended September 30, 2008 and 2007, respectively. Net assets released from restriction for capital were approximately $952,000 and $389,000 for the years ended September 30, 2008 and 2007, respectively.

Permanently restricted net assets are restricted to:

	September 30,	
	2008	2007
	(in thousands)	
Golden Cross Endowment	$2,118	$1,205
General Endowment	434	434
Nursing Scholarship Fund	305	305
Income Fund	659	656
	$3,516	$2,600

NOTE 5 - TEMPORARILY AND PERMANENTLY RESTRICTED NET ASSETS - Continued

Permanently restricted net assets consist of donor restricted endowment funds which require that the principal be invested in perpetuity and only earnings be expended.

NOTE 6 - CONTINGENCIES

MHS is a defendant in various legal proceedings arising in the ordinary course of business. Although the results of litigation cannot be predicted with certainty, management believes the outcome of pending litigation will not have a material adverse effect on MHS's financial statements.

MHS covers its professional and general liability risks through a program of self-insurance and commercial claims-made insurance policies from unrelated companies. The primary self-insurance coverage has a $5,000,000 retention per claim for all claims incurred after August 31, 2003. The self-insurance program is funded in MHS's self-insurance trust based upon a third-party actuarial study with projected future payments discounted at a 5% discount rate. Under the trust agreement, trust assets, which are included in assets whose use is limited, can only be used for certain payments, primarily claim indemnity payments, expenses and the cost of administering the trust. MHS has limited its liability for losses incurred prior to September 1, 2002 to $1,000,000 per claim and $5,000,000 in the aggregate through purchase of a tail insurance option in the expiring policy.

MHS holds a 59.02% interest in Methodist McKinney Hospital Property, LLC (MMHP JV), a limited liability company established to own and construct a 15 to 20 bed surgical hospital to be leased to Methodist McKinney Hospital JV. The other members in MMHP JV are Nueterra Holdings, LLC with a 15.61% interest, and various physicians and physician groups with a cumulative interest of 25.37%. In June, 2008 MMHP JV signed a construction loan agreement to borrow up to $33 million, of which approximately $4 million had been disbursed at September 30, 2008. The loan is irrevocably and unconditionally guaranteed by the members of MMHP JV in an amount proportionate to their ownership interest.

NOTE 7 - UPL PROGRAM

During fiscal 2007, MHS entered into an Indigent Care Affiliation Agreement with Dallas County Hospital District, North Texas Division, Inc. (which owns and operates the Medical City Hospital in Dallas), Baylor Health Care System and Texas Health Resources for the purpose of participation in the Private Hospital Medicaid Supplemental Payment Program authorized by Medicaid State Plan Amendment TX-05-011 (UPL Program). The private hospitals and health care systems who are parties to the Indigent Care Affiliation Agreement are referred to herein as the affiliated hospitals. As a result of this agreement and others which include UT Southwestern Medical Center at Dallas (UTSW), MHS has recorded receipts and disbursements in its financial statements at September 30, 2007. During 2007, the Centers for Medicare and Medicaid Services (CMS), in hindsight, decided to review the Texas private hospital arrangements and deferred further federal funding for Texas private UPL Programs pending the outcome of its review.

NOTE 7 - UPL PROGRAM - Continued

Because of the decision by CMS to defer federal funds for this program and because questions raised by CMS were unresolved, MHS accounted for the 2007 Medicaid UPL award receipt amounts ($31.5 million) as a current liability potentially refundable to the original payer. Amounts disbursed during 2007 ($22.6 million) by MHS for its share of the costs required by agreements between the affiliated hospitals and UTSW and its share of costs for obligations of the Dallas County Indigent Care Corporation (DCICC) were accounted for as a current asset potentially refundable to MHS. DCICC is an entity created by the affiliated hospitals to take over the contract the affiliated hospitals had with UTSW as part of the UPL Program. Because of the decision by CMS to defer federal funds for the program and because questions raised by CMS were unresolved and because of the assurances provided by the parties to the various agreements that the transaction would be unwound should CMS find the UPL Program unacceptable, MHS chose to account for the program receipts as a current liability and the disbursements as a current asset.

During fiscal 2008, CMS resolved its questions regarding the Dallas Medicaid Private Hospital program and resolved all issues related to its previous deferral decision, thus removing the doubts about the program's viability which had been raised by CMS's initial questions and deferral action. Resolution of CMS's questions resulted in, among other things, additional UPL receipts during 2008. In addition, through contributions received from the affiliated hospitals, Dallas County Indigent Care Corporation provided support to Project Access Dallas in addition to the professional services it arranges to be provided to the indigent through the contractual arrangement in place with UTSW and to pay consulting expenses related to administration of the UTSW contract. During 2008 MHS recognized a total of $35.4 million of UPL payments in patient service revenue and $22.7 million in expense for community benefits provided through the Dallas County Indigent Care Corporation.

NOTE 8 - RETIREMENT PLAN

The Methodist Health System Employees Retirement Plan (Plan) has both defined benefit and defined contribution features. The Plan's defined benefit feature was frozen effective January 1, 1993 and replaced with an enhanced defined contribution feature. Plan participants are required to contribute 2.5% of compensation, which is matched by MHS at amounts ranging from 2.5% to 6.25% of the participant's compensation depending on the participant's length of service. The participant's contributions are invested in tax-sheltered annuities in each participant's name. The MHS match is contributed to the Plan. The participant becomes fully vested in the MHS matching contribution after three years of service. Substantially all Plan assets are invested in fixed income and equity mutual funds managed by open-end investment companies. MHS's contributions for the defined contribution feature of the Plan, reflected in salaries, wages and benefit costs in the accompanying consolidated statements of operations and changes in net assets, totaled approximately $6,158,000 and $5,551,000 for the years ended September 30, 2008 and 2007, respectively.

NOTE 8 - RETIREMENT PLAN - Continued

MHS adopted the provisions of FAS158 for the year ended September 30, 2007. FAS158 requires an employer to recognize the overfunded or underfunded status of defined benefit pension and postretirement plans as an asset or liability in its balance sheets and to recognize changes in that funded status in the year in which the changes occur through net assets. There was no material impact on the consolidated financial statements as a result of implementation of this standard.

The following table sets forth the obligations, assets and net periodic pension cost of the frozen defined benefit feature of the Plan. The accrued pension asset or liability is included in other assets or other liabilities, respectively, in MHS's consolidated statements of financial position. The net periodic pension cost is included in salaries, wages and benefits costs in MHS's consolidated statements of operations and changes in net assets.

	Years ended September 30, 2008	2007
	(in thousands)	
Benefit obligation at end of year	$(2,164)	$(2,518)
Fair value of plan assets at end of year	1,806	2,569
Funded status	$ (358)	$ 51
Accrued pension asset (liability)	$ (358)	$ 51
Net actuarial gain (loss) recognized in unrestricted net assets	$ (456)	$ 559
Net periodic benefit cost	$ (29)	$ (28)
Employer contribution	$ -	$ -
Benefits paid	$ (324)	$ (394)

	September 30, 2008	2007
Weighted-average assumptions:		
Discount rate	6.0%	6.0%
Expected return on plan assets	7.0%	7.0%
Allocation of plan assets:		
Cash equivalents	-	7%
Debt securities	31%	23%
Equity mutual funds	69%	70%

The expected return on plan assets is based on long-term historical returns for a balanced portfolio of equities and fixed income investments. The target allocation of plan assets is cash equivalents between 0% - 10%, debt securities between 20% - 60%, and equity investments between 40% - 70%. The overall investment goals are to achieve a favorable relative return as compared with inflation, preserve the capital, attain long-term growth and achieve an above average rate of return relative to capital markets as measured by specific indices.

NOTE 8 - RETIREMENT PLAN - Continued

Projected defined benefit payments during the ten years following fiscal 2008 are as follows: 2009 -- $320,000; 2010 - $304,000; 2011 - $287,000; 2012 - $267,000; 2013 -- $250,000; 2014 through 2018 -- $921,000.

The estimated net periodic benefit cost for the next fiscal year is approximately $5,000, which does not include any recognition of net actuarial gains. MHS expects to make a defined benefit contribution of $66,000 for the 2009 plan year.

NOTE 9 - FUNCTIONAL EXPENSES

MHS provides general health care services. Expenses related to providing these services are as follows:

	Years ended September 30,	
	2008	2007
	(in thousands)	
Patient care	$399,091	$356,267
General and administrative	149,143	112,164
Medical education	12,744	11,836
Depreciation and amortization	42,185	38,170
Other	1,567	1,512
	$604,730	$519,949

NOTE 10 - SUBSEQUENT EVENT

Subsequent to year-end, the credit and liquidity crisis in the United States and throughout the global financial system, often referred to as the "Sub-Prime Lending Crisis," has resulted in substantial volatility in world financial markets and the banking system. These and other events have had a significant impact on foreign and domestic financial markets, including the overall interest rate environment. As a result, MHS's investment portfolio and interest rate swaps have incurred significant volatility in fair value since September 30, 2008. However, because the values of MHS's individual investments and interest rate swaps have and will fluctuate in response to changing market conditions, the amount of losses that may be recognized in subsequent periods, if any, cannot be determined.