

COMMUNITY HEALTH SYSTEMS INC
Form 10-Q
July 27, 2012
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2012

Commission file number 001-15925

COMMUNITY HEALTH SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

Delaware
*(State or other jurisdiction of
incorporation or organization)*

4000 Meridian Boulevard

Franklin, Tennessee
(Address of principal executive offices)

13-3893191
(I.R.S. Employer

Identification Number)

37067

(Zip Code)

615-465-7000

(Registrant's telephone number)

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

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

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

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

As of July 19, 2012, there were outstanding 90,963,226 shares of the registrant's Common Stock, \$0.01 par value.

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Community Health Systems, Inc.

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For the Three and Six Months Ended June 30, 2012

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Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements****COMMUNITY HEALTH SYSTEMS, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS***(In thousands, except share data)**(Unaudited)*

	June 30,	December 31,
	2012	2011
ASSETS		
<i>Current assets</i>		
Cash and cash equivalents	\$ 115,109	\$ 129,865
Patient accounts receivable, net of allowance for doubtful accounts of \$2,105,051 and \$1,891,334 at June 30, 2012 and December 31, 2011, respectively	2,055,292	1,834,167
Supplies	358,597	346,611
Prepaid income taxes	16,721	101,389
Deferred income taxes	89,797	89,797
Prepaid expenses and taxes	126,883	112,613
Other current assets	234,764	231,647
Total current assets	2,997,163	2,846,089
<i>Property and equipment</i>		
Property and equipment	9,808,757	9,369,528
Less accumulated depreciation and amortization	(2,760,532)	(2,513,552)
Property and equipment, net	7,048,225	6,855,976
<i>Goodwill</i>		
Goodwill	4,372,993	4,264,845
<i>Other assets, net</i>		
Other assets, net	1,454,625	1,241,930
Total assets	\$ 15,873,006	\$ 15,208,840
LIABILITIES AND EQUITY		
<i>Current liabilities</i>		
Current maturities of long-term debt	\$ 83,877	\$ 63,706
Accounts payable	770,450	748,997
Accrued interest	82,742	110,121
Accrued liabilities	962,056	988,315
Total current liabilities	1,899,125	1,911,139
<i>Long-term debt</i>		
Long-term debt	9,241,489	8,782,798
<i>Deferred income taxes</i>		
Deferred income taxes	704,725	704,725

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<i>Other long-term liabilities</i>	998,984	949,990
<i>Total liabilities</i>	12,844,323	12,348,652
<i>Redeemable noncontrolling interests in equity of consolidated subsidiaries</i>	367,909	395,743
<i>EQUITY</i>		
<i>Community Health Systems, Inc. stockholders' equity</i>		
Preferred stock, \$.01 par value per share, 100,000,000 shares authorized; none issued	-	-
Common stock, \$.01 par value per share, 300,000,000 shares authorized; 91,917,432 shares issued and 90,941,883 shares outstanding at June 30, 2012, and 91,547,079 shares issued and 90,571,530 shares outstanding at December 31, 2011	919	915
Additional paid-in capital	1,101,224	1,086,008
Treasury stock, at cost, 975,549 shares at June 30, 2012 and December 31, 2011	(6,678)	(6,678)
Accumulated other comprehensive loss	(159,546)	(184,479)
Retained earnings	1,660,163	1,501,330
Total Community Health Systems, Inc. stockholders' equity	2,596,082	2,397,096
<i>Noncontrolling interests in equity of consolidated subsidiaries</i>	64,692	67,349
<i>Total equity</i>	2,660,774	2,464,445
<i>Total liabilities and equity</i>	\$ 15,873,006	\$ 15,208,840

See accompanying notes to the condensed consolidated financial statements.

Table of Contents**COMMUNITY HEALTH SYSTEMS, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF INCOME***(in thousands, except share and per share data)**(Unaudited)*

	Three Months Ended		Six Months Ended	
	June 30, 2012	June 30, 2011	June 30, 2012	June 30, 2011
Operating revenues (net of contractual allowances and discounts)	\$ 3,746,428	\$ 3,433,829	\$ 7,529,919	\$ 6,787,881
Provision for bad debts	503,454	433,002	989,910	832,971
<i>Net operating revenues</i>	3,242,974	3,000,827	6,540,009	5,954,910
<i>Operating costs and expenses:</i>				
Salaries and benefits	1,497,446	1,384,096	3,022,421	2,763,463
Supplies	489,729	449,279	988,308	907,096
Other operating expenses	736,225	654,737	1,445,168	1,269,530
Electronic health records incentive reimbursement	(16,802)	-	(42,970)	-
Rent	66,463	62,431	133,687	125,601
Depreciation and amortization	179,801	161,376	354,155	319,531
Total operating costs and expenses	2,952,862	2,711,919	5,900,769	5,385,221
<i>Income from operations</i>	290,112	288,908	639,240	569,689
<i>Interest expense, net</i>	151,607	163,230	303,782	326,448
<i>Loss from early extinguishment of debt</i>	-	-	63,429	-
<i>Equity in earnings of unconsolidated affiliates</i>	(13,181)	(12,017)	(25,194)	(30,151)
<i>Income from continuing operations before income taxes</i>	151,686	137,695	297,223	273,392
<i>Provision for income taxes</i>	49,519	44,821	95,338	88,913
<i>Income from continuing operations</i>	102,167	92,874	201,885	184,479
<i>Discontinued operations, net of taxes:</i>				
Income (loss) from operations of entities sold	-	235	(466)	(1,443)
Impairment of hospitals sold	-	(39,562)	-	(47,930)
Loss on sale, net	-	-	-	(3,234)
<i>Loss from discontinued operations, net of taxes</i>	-	(39,327)	(466)	(52,607)
<i>Net income</i>	102,167	53,547	201,419	131,872
Less: Net income attributable to noncontrolling interests	18,808	18,158	42,586	35,159
Net income attributable to Community Health Systems, Inc.	\$ 83,359	\$ 35,389	\$ 158,833	\$ 96,713

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<i>Basic earnings (loss) per share attributable to Community Health Systems, Inc. common stockholders(1):</i>								
Continuing operations	\$	0.94	\$	0.82	\$	1.79	\$	1.64
Discontinued operations		-		(0.43)		(0.01)		(0.58)
Net income	\$	0.94	\$	0.39	\$	1.79	\$	1.06

<i>Diluted earnings (loss) per share attributable to Community Health Systems, Inc. common stockholders(1):</i>								
Continuing operations	\$	0.93	\$	0.81	\$	1.79	\$	1.62
Discontinued operations		-		(0.43)		(0.01)		(0.57)
Net income	\$	0.93	\$	0.39	\$	1.78	\$	1.05

<i>Weighted-average number of shares outstanding:</i>								
Basic		89,147,472		91,130,672		88,911,126		91,069,876
Diluted		89,530,639		91,783,725		89,191,651		91,960,610

(1) Total per share amounts may not add due to rounding.

See accompanying notes to the condensed consolidated financial statements.

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COMMUNITY HEALTH SYSTEMS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

(Unaudited)

	Three Months Ended		Six Months Ended	
	June 30, 2012	2011	June 30, 2012	2011
Net income	\$ 102,167	\$ 53,547	\$ 201,419	\$ 131,872
Other comprehensive income (loss), net of income taxes:				
Net change in fair value of interest rate swaps	9,976	(8,969)	20,512	27,477
Net change in fair value of available-for-sale securities	(527)	268	2,140	1,338
Amortization and recognition of unrecognized pension cost components	1,140	807	2,281	1,579
Other comprehensive income (loss)	10,589	(7,894)	24,933	30,394
Comprehensive income	112,756	45,653	226,352	162,266
Less: Comprehensive income attributable to noncontrolling interests	18,808	18,158	42,586	35,159
Comprehensive income attributable to Community Health Systems, Inc.	\$ 93,948	\$ 27,495	\$ 183,766	\$ 127,107

See accompanying notes to the condensed consolidated financial statements.

Table of Contents**COMMUNITY HEALTH SYSTEMS, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS***(In thousands)**(Unaudited)*

	Six Months Ended June 30,	
	2012	2011
<i>Cash flows from operating activities</i>		
Net income	\$ 201,419	\$ 131,872
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	354,155	324,367
Stock-based compensation expense	20,624	20,732
Loss on sale, net	-	3,234
Impairment of hospitals sold	-	47,930
Loss from early extinguishment of debt	63,429	-
Excess tax benefit relating to stock-based compensation	(1,037)	(4,659)
Other non-cash expenses, net	16,461	4,313
Changes in operating assets and liabilities, net of effects of acquisitions and divestitures:		
Patient accounts receivable	(199,383)	(83,082)
Supplies, prepaid expenses and other current assets	(39,920)	9,374
Accounts payable, accrued liabilities and income taxes	51,843	129,518
Other	15,336	1,086
Net cash provided by operating activities	482,927	584,685
<i>Cash flows from investing activities</i>		
Acquisitions of facilities and other related equipment	(245,227)	(204,264)
Purchases of property and equipment	(386,461)	(351,383)
Proceeds from disposition of ancillary operations	-	18,464
Proceeds from sale of property and equipment	3,437	8,034
Increase in other investments	(162,316)	(75,211)
Net cash used in investing activities	(790,567)	(604,360)
<i>Cash flows from financing activities</i>		
Proceeds from exercise of stock options	1,269	18,831
Repurchase of restricted stock shares for payroll tax withholding requirements	(9,074)	-
Deferred financing costs	(63,986)	(234)
Excess tax benefit relating to stock-based compensation	1,037	4,659
Stock buy-back	-	(50,002)
Proceeds from noncontrolling investors in joint ventures	637	863
Redemption of noncontrolling investments in joint ventures	(35,888)	(3,303)
Distributions to noncontrolling investors in joint ventures	(34,590)	(30,078)
Borrowings under credit agreements	5,244,263	-
Issuance of long-term debt	1,025,000	-
Proceeds from receivables facility	300,000	-
Repayments of long-term indebtedness	(6,135,784)	(28,798)
Net cash provided by (used in) financing activities	292,884	(88,062)

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<i>Net change in cash and cash equivalents</i>	(14,756)	(107,737)
<i>Cash and cash equivalents at beginning of period</i>	129,865	299,169
<i>Cash and cash equivalents at end of period</i>	\$ 115,109	\$ 191,432
<i>Supplemental disclosure of cash flow information:</i>		
Interest payments	\$ 331,161	\$ 327,717
Income tax paid (refunds received), net	\$ 22,028	\$ (25,697)

See accompanying notes to the condensed consolidated financial statements.

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COMMUNITY HEALTH SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

The unaudited condensed consolidated financial statements of Community Health Systems, Inc. and its subsidiaries (the Company) as of June 30, 2012 and December 31, 2011 and for the three-month and six-month periods ended June 30, 2012 and June 30, 2011, have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP). In the opinion of management, such information contains all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the results for such periods. All intercompany transactions and balances have been eliminated. The results of operations for the three and six months ended June 30, 2012, are not necessarily indicative of the results to be expected for the full fiscal year ending December 31, 2012. Certain information and disclosures normally included in the notes to consolidated financial statements have been condensed or omitted as permitted by the rules and regulations of the Securities and Exchange Commission (the SEC). The Company believes the disclosures are adequate to make the information presented not misleading. The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto for the year ended December 31, 2011, contained in the Company's Annual Report on Form 10-K.

Noncontrolling interests in less-than-wholly-owned consolidated subsidiaries of the parent are presented as a component of total equity on the condensed consolidated balance sheets to distinguish between the interests of the parent company and the interests of the noncontrolling owners. Noncontrolling interests that are redeemable or may become redeemable at a fixed or determinable price at the option of the holder or upon the occurrence of an event outside of the control of the Company are presented in mezzanine equity on the condensed consolidated balance sheets.

Allowance for Doubtful Accounts. In July 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2011-07, which requires healthcare organizations that perform services for patients for which the ultimate collection of all or a portion of the amounts billed or billable cannot be determined at the time services are rendered to present all bad debt expense associated with patient service revenue as an offset to the patient service revenue line item in the statement of operations. The ASU also requires qualitative disclosures about the Company's policy for recognizing revenue and bad debt expense for patient service transactions and quantitative information about the effects of changes in the assessment of collectibility of patient service revenue. This ASU was adopted by the Company on January 1, 2012. Upon adoption, the Company's provision for bad debts was presented as a reduction of operating revenues after contractual adjustments and discounts. The condensed consolidated statement of income for the three and six months ended June 30, 2011 has been restated to present the provision for bad debts as a reduction of operating revenues for comparative purposes with the June 30, 2012 presentation.

Accounts receivable are reduced by an allowance for amounts that could become uncollectible in the future. Substantially all of the Company's receivables are related to providing healthcare services to its hospitals' patients.

The Company estimates the allowance for doubtful accounts by reserving a percentage of all self-pay accounts receivable without regard to aging category, based on collection history, adjusted for expected recoveries and, if present, anticipated changes in trends. For all other non-self-pay payor categories, the Company reserves 100% of all accounts aging over 365 days from the date of discharge. The percentage used to reserve for all self-pay accounts is based on the Company's collection history. The Company collects substantially all of its third-party insured receivables, which include receivables from governmental agencies.

Collections are impacted by the economic ability of patients to pay and the effectiveness of the Company's collection efforts. Significant changes in payor mix, business office operations, economic conditions or trends in federal and state governmental healthcare coverage could affect the Company's collection of accounts receivable and the estimates of the collectability of future accounts receivable. The process of estimating the allowance for doubtful accounts requires the Company to estimate the collectability of self-pay accounts receivable, which is primarily based on its collection history, adjusted for expected recoveries and, if available, anticipated changes in collection trends. The Company also continually reviews its overall reserve adequacy by monitoring historical cash collections as a percentage of trailing net revenue less provision for bad debts, as well as by analyzing current period net revenue and admissions by payor classification, aged accounts receivable by payor, days revenue outstanding, and the impact of recent acquisitions and dispositions.

Table of Contents**COMMUNITY HEALTH SYSTEMS, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

Operating revenues, net of contractual allowances and discounts (but before the provision for bad debts), recognized during the three and six months ended June 30, 2012 and 2011, were as follows (in thousands):

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2012	2011	2012	2011
Medicare	\$ 950,887	\$ 918,669	\$ 2,015,043	\$ 1,842,533
Medicaid	396,566	348,232	711,657	669,757
Managed Care and other third-party payors	1,911,861	1,751,817	3,818,350	3,451,677
Self-pay	487,114	415,111	984,869	823,914
Total	\$ 3,746,428	\$ 3,433,829	\$ 7,529,919	\$ 6,787,881

Electronic Health Records Incentive Reimbursement. The American Recovery and Reinvestment Act of 2009 included provisions for implementing health information technology under the Health Information Technology for Economic and Clinical Health Act (HITECH). These provisions were designed to increase the use of electronic health records (EHR) technology and establish the requirements for a Medicare and Medicaid incentive payments program beginning in 2011 for eligible hospitals and providers that adopt and meaningfully use certified EHR technology. Eligibility for annual Medicare incentive payments is dependent on providers demonstrating meaningful use of EHR technology in each period over a four-year period. Initial Medicaid incentive payments are available to providers that adopt, implement or upgrade certified EHR technology; but providers must demonstrate meaningful use of such technology in subsequent years to qualify for additional incentive payments. Medicaid EHR incentive payments are fully funded by the federal government and administered by the states; however, the states are not required to offer EHR incentive payments to providers.

During the three and six months ended June 30, 2012, the Company recognized approximately \$16.8 million and \$43.0 million, respectively, of incentive reimbursement for HITECH incentives from Medicare and Medicaid related to certain of the Company's hospitals and from Medicare and Medicaid for certain of the Company's employed physicians that have demonstrated meaningful use of certified EHR technology or have completed attestations to their adoption or implementation of certified EHR technology. These incentive reimbursements were presented as a reduction of operating expenses on the condensed consolidated statement of income. During the three and six months ended June 30, 2012, the Company received cash related to the incentive reimbursement for HITECH incentives of approximately \$22.6 million and \$28.8 million, respectively. No incentive reimbursements were recognized during the three-month and six-month periods ended June 30, 2011.

Reimbursement Settlements. Included in net operating revenues for the six months ended June 30, 2012 is approximately \$101.8 million of net operating revenues from an industry-wide settlement with the United States Department of Health and Human Services and Centers for Medicare and Medicaid Services, based on a claim that acute-care hospitals in the U.S. were underpaid from the Medicare inpatient prospective payment system in federal fiscal years 1999 through 2011. The underpayments resulted from calculations related to the rural floor budget neutrality adjustments implemented in connection with the Balanced Budget Act of 1997. Also included in net operating revenues for the six months ended June 30, 2012 is an unfavorable adjustment of approximately \$21.0 million related to the newly issued Supplemental Security Income ratios for federal fiscal years 2006 through 2009 utilized for calculating Medicare Disproportionate Share Hospital reimbursements.

Throughout these notes to the condensed consolidated financial statements, Community Health Systems, Inc. (the Parent), and its consolidated subsidiaries are referred to on a collective basis as the Company. This drafting style is not meant to indicate that the publicly-traded Parent or any subsidiary of the Parent owns or operates any asset, business, or property. The hospitals, operations and businesses described in this filing are owned and operated, and management services provided, by distinct and indirect subsidiaries of Community Health Systems, Inc.

2. ACCOUNTING FOR STOCK-BASED COMPENSATION

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Stock-based compensation awards are granted under the Community Health Systems, Inc. Amended and Restated 2000 Stock Option and Award Plan, amended and restated as of March 24, 2009 (the "2000 Plan"), and the Community Health Systems, Inc. 2009 Stock Option and Award Plan, amended and restated as of March 18, 2011 (the "2009 Plan").

Table of Contents**COMMUNITY HEALTH SYSTEMS, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

The 2000 Plan allows for the grant of incentive stock options intended to qualify under Section 422 of the Internal Revenue Code (the IRC), as well as stock options which do not so qualify, stock appreciation rights, restricted stock, restricted stock units, performance-based shares or units and other share awards. Prior to being amended in 2009, the 2000 Plan also allowed for the grant of phantom stock. Persons eligible to receive grants under the 2000 Plan include the Company's directors, officers, employees and consultants. To date, all options granted under the 2000 Plan have been nonqualified stock options for tax purposes. Generally, vesting of these granted options occurs in one-third increments on each of the first three anniversaries of the award date. Options granted prior to 2005 have a 10-year contractual term, options granted in 2005 through 2007 have an eight-year contractual term and options granted in 2008 or later have a 10-year contractual term. As of June 30, 2012, 446,221 shares of unissued common stock were reserved for future grants under the 2000 Plan.

The 2009 Plan provides for the grant of incentive stock options intended to qualify under Section 422 of the IRC and for the grant of stock options which do not so qualify, stock appreciation rights, restricted stock, restricted stock units, performance-based shares or units and other share awards. Persons eligible to receive grants under the 2009 Plan include the Company's directors, officers, employees and consultants. To date, all options granted under the 2009 Plan have been nonqualified stock options for tax purposes. Options granted in 2011 have a 10-year contractual term. As of June 30, 2012, 1,627,477 shares of unissued common stock were reserved for future grants under the 2009 Plan.

The exercise price of all options granted is equal to the fair value of the Company's common stock on the option grant date.

The following table reflects the impact of total compensation expense related to stock-based equity plans on the reported operating results for the respective periods (in thousands):

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2012	2011	2012	2011
Effect on income from continuing operations before income taxes	\$ (10,129)	\$ (10,814)	\$ (20,624)	\$ (20,732)
Effect on net income	\$ (6,432)	\$ (6,867)	\$ (13,096)	\$ (13,165)

At June 30, 2012, \$54.9 million of unrecognized stock-based compensation expense was expected to be recognized over a weighted-average period of 21 months. Of that amount, \$11.0 million related to outstanding unvested stock options was expected to be recognized over a weighted-average period of 20 months and \$43.9 million related to outstanding unvested restricted stock and restricted stock units was expected to be recognized over a weighted-average period of 21 months. There were no modifications to awards during the three-month and six-month periods ended June 30, 2012.

The fair value of stock options was estimated using the Black Scholes option pricing model with the following assumptions and weighted-average fair values during the three and six months ended June 30, 2012 and 2011:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2012	2011	2012	2011
Expected volatility	59.9 %	38.1 %	57.8 %	31.5 %
Expected dividends	-	-	-	-
Expected term	4 years	4 years	4.1 years	4 years
Risk-free interest rate	0.6 %	1.4 %	0.7 %	1.7 %

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In determining the expected term, the Company examined concentrations of option holdings and historical patterns of option exercises and forfeitures, as well as forward-looking factors, in an effort to determine if there were any discernable employee populations. From this analysis, the Company identified two primary employee populations, one consisting of certain senior executives and the other one consisting of substantially all other recipients.

The expected volatility rate was estimated based on historical volatility. In determining expected volatility, the Company also reviewed the market-based implied volatility of actively traded options of its common stock and determined that historical volatility utilized to estimate the expected volatility rate did not differ significantly from the implied volatility.

The expected term computation is based on historical exercise and cancellation patterns and forward-looking factors, where present, for each population identified. The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of the grant. The pre-vesting forfeiture rate is based on historical rates and forward-looking factors for each population identified. The Company adjusts the estimated forfeiture rate to its actual experience.

Options outstanding and exercisable under the 2000 Plan and the 2009 Plan as of June 30, 2012, and changes during each of the three-month periods following December 31, 2011, were as follows (in thousands, except share and per share data):

	Shares	Weighted-Average Exercise Price	Weighted- Average Remaining Contractual Term	Aggregate Intrinsic Value as of June 30, 2012
Outstanding at December 31, 2011	8,389,142			