Accounting for the Legal Fiction Called **Tracking Stock**

By Robert L. Maddox, III, Esq.

How a tracking-stock recapitalization can artificially inflate parent-company earnings by more than 40%.

When raising new equity capital, public holding companies historically have been faced with two choices: issuing new holding company shares or issuing new shares of one or more of their subsidiaries. In recent years, some holding company issuers have attempted to combine these two methods by issuing a new series of holding company common stock called tracking stock. In doing so, issuers typically recapitalize their holding company stock into two separate series: the original nontracking holding company common and a new tracking holding company common. The earnings streams from the company's various subsidiary business units are then allocated between the holding company's tracking and nontracking common stocks.

When issuing tracking stock, issuers sometimes allocate less than 100% interest in the business units being tracked to the new tracking stockholders. In other words, instead of allocating 100% of the earnings of the business units being tracked to the new tracking stock, a company might allocate 40% of the earnings of the tracked business units to the new tracking stock and the other 60% to the original nontracking stock. In doing so, such issuers have, in essence, attempted to convert their existing holding company common stock into "super equity." Specifically, the original nontracking stock is allocated not only 100% of the earnings from the nontracked business units but also 60% of the earnings from the tracked business units.

A significant potential accounting pitfall arises when a company's management grants a so-called retained/intergroup interest in the tracked business units to its existing stockholders in lieu of issuing tracking stock to them outright. In such situations, issuers typically designate (i.e., reserve) such shares of tracking stock for future issuance to the nontracking stockholders at management's discretion. What internal and outside auditors need to keep in mind is that the typical tracking stock is nothing more than another series of holding company common stock and not common stock in a separate legal entity. Therefore, no parent/subsidiary relationship exists between the holding company's original stockholders and its new tracking stockholders. That is, both sets of stockholders are owners of holding company stock—they simply own different series. The issuer has created a legal fiction whereby it allocates earnings from certain of its subsidiary business units to

its existing holding company stockholders and earnings from its other subsidiary business units to its new tracking stockholders. Thus, the newly issued shares of holding company tracking stock do not represent a direct legal interest in the subsidiary business units partially or wholly attributed to them. Rather, they represent a direct equity interest in the company's assets and liabilities *as a whole*, and holders thereof are subject to all risks related to an equity investment in the entire holding company.

Such retained/intergroup interests typically are created as follows: First, management issues a proxy proposal to its existing stockholders, seeking their approval to amend the company's articles of incorporation and create the new holding company tracking stock. Then, following a positive stockholder vote, each outstanding share of its existing holding company stock is reclassified as one share of nontracking stock. Simultaneously, a new series of holding company stock, designated as tracking stock, is created and sold to outside investors.

Pursuant to the company's revised articles of incorporation, management designates the number of shares of tracking stock that are reserved for future issuance to its original (i.e., nontracking) stockholders as evidence of their retained/intergroup interest in the earnings of the tracked business units. As noted, the total number of these shares typically is equal to the percentage of the earnings from the tracked business units that the company wants to redirect to its original stockholders.

For example, say a publicly traded holding company wants to issue five million shares of a new series of holding company common stock as tracking stock and have such shares represent only 25% of the earnings of the tracked business units, with the remaining 75% of the tracked business units' earnings being allocated to existing shareholders via a retained/intergroup interest. Under such circumstances, the company would designate an additional 15 million shares of its new holding tracking stock as shares that could be issued in the future to the nontracking stockholders to evidence their retained/intergroup interest in the earnings of the tracked business units.

But if the company does not actually issue such additional shares of tracking stock, the shares are not technically outstanding, and the aforementioned potential pitfall arises. Specifically, despite having never been issued formally, the shares may nevertheless have to be counted as fully issued securities and, accordingly, included in the issuer's calculation of its basic (and, if applicable, diluted) earnings per share pursuant to the Financial Accounting Standards Board's (FASB's) Statement of Financial Accounting Standards (SFAS) No. 128, "Earnings per Share." Such is generally the case if the retained/intergroup interests fall within SFAS No. 128's definitions of convertible securities (in which case the if-converted method may apply) and/or vested contingently issuable securities.

The If-Converted Method

Paragraphs 60 and 61 of SFAS No. 128 set forth the methods for calculating earnings per share for issuers with participating securities and/or two classes of common stock. The first sentence of Paragraph 61 mandates that the "if-converted method shall be used for those securities that are convertible into common stock if the effect is dilutive." The if-converted method is defined in Appendix E of SFAS No. 128 as "a method of computing earnings per share data that assumes conversion of convertible securities at the beginning of the reporting period (or at the time of issuance, if later)."

Paragraph 26 of SFAS No. 128 makes it clear that the if-converted method applies to diluted earnings per share. In the past, however, concerns had arisen about its applicability to basic earnings per share under paragraphs 60 and 61. To address such concerns, FASB's Emerging Issues Task Force (EITF) issued Topic D-95, "Effect of Participating Convertible Securities on the Computation of Basic Earnings Per Share," in April 2001. In Topic D-95, the EITF specifically applied the if-converted method to basic earnings per share for issuers with participating convertible securities. According to Topic D-95: "The FASB staff believes that participating securities that are convertible into common stock must be included in basic EPS if the effect is dilutive."

Thus, with respect to retained/intergroup interests, the analysis required by SFAS No. 128 becomes twofold. First, does the typical retained/intergroup interest constitute a security covered by SFAS No. 128? Second, is the typical retained/intergroup interest a con-

vertible security within the meaning of SFAS No. 128? If the answer to both questions is, yes, in any given situation, then the if-converted method should be used when computing basic—and, if applicable, diluted—earnings per share.

Let's examine these two questions in the context of the typical issuance of tracking stock. First, are such retained/intergroup interests "securities" under SFAS No. 128? A security is defined in Appendix E of SFAS No. 128 to be "the evidence of debt or ownership or a related right." Thus, the typical retained/intergroup interest is a security for purposes of SFAS No. 128. Second, are such retained/intergroup interests "convertible securities" within the meaning of SFAS No. 128? The answer to this question usually can be found in the issuer's restated articles of incorporation and/or its prospectus and proxy materials for the tracking stock. If the retained/intergroup interests can be converted into shares of the issuer's tracking stock (or any other class of such issuer's stock) either at the request of the stockholder or at management's discretion, then the answer to this question is also, yes.

What's the result of a "yes" answer to both questions? The if-converted method should be applied, and the shares of tracking stock backing the retained/intergroup interests should be considered outstanding when calculating the issuer's basic—and, if applicable, diluted—earnings per share.

A further complication arises if the newly issued shares of tracking stock ultimately are convertible back into shares of nontracking stock. Under such circumstances, use of SFAS No. 128's two-class methodology of calculating earnings per share is inappropriate because the two-class methodology applies only if an issuer has two distinct classes of nonconvertible securities outstanding. If the tracking stock is convertible into shares of nontracking stock, then, on a fully converted basis, only one class of common stock truly exists—the nontracking stock. This analysis is bolstered by the reality that the tracking stocks of several financially distressed issuers (e.g., WorldCom) have been folded back into such companies via their conversion to nontracking stock, thereby resulting in the existence of only one class of holding company common stock.

"Vested" Contingently Issuable Shares

A second manner in which reserved but unissued shares backing retained/intergroup interests may have to be included in basic and/or diluted earnings per share is if they fall within the definition of vested contingently issuable shares contained in SFAS No. 128. In accordance with Paragraph 10 of SFAS No. 128, contingently issuable shares are shares issuable for little or no cash consideration upon the satisfaction of specified conditions pursuant to a contingent stock agreement. This paragraph also sets forth the basic earnings per share provisions governing contingently issuable shares. Specifically, any contingently issuable shares must be considered outstanding and included in the computation of a company's basic earnings per share as of the date that they become "vested"—i.e., when all necessary conditions to their issuance have been satisfied and the issuance of such shares is no longer contingent.[1]

In addition, if an issuer must report diluted earnings per share (e.g., if it has options and/or other potentially dilutive common shares outstanding), then Paragraph 30 of SFAS No. 128 makes it clear that any contingently issuable shares also must be included in the calculation of diluted earnings per share. In accordance with Paragraph 30, if all necessary conditions to the issuance of such shares have been satisfied and the shares have thus become "vested" by the end of the reporting period to which the report relates, then such contingently issuable shares should be considered outstanding and be included in the company's diluted earnings per share as of the first day of such reporting period.[2] As a result, when examining retained/intergroup interests in tracked business units, the key question becomes: Do the shares of tracking common stock issuable in the future constitute vested contingently issuable shares within the meaning of SFAS No. 128? The answer to this question in most cases is, yes.

First, according to Paragraph 10 and Appendix E of SFAS No. 128, contingently issuable shares are shares "issuable for little or no cash consideration upon the satisfaction of certain conditions pursuant to a contingent stock agreement."[3] Second, Appendix E defines a contingent stock agreement as "an agreement to issue common stock (usually in connection with a business

combination accounted for by the purchase method) that is dependent on the satisfaction of certain conditions." As a result, if the shares of tracking stock backing a retained/intergroup interest are (1) issuable for little or no cash consideration, (2) vested (i.e., all necessary conditions to their issuance have been satisfied), and (3) issued pursuant to a contingent stock agreement, then they must be included as outstanding shares in the calculation of basic—and, if applicable, diluted—earnings per share.

Now let's examine each of the foregoing elements in the context of the typical retained/intergoup interest. First, any shares of tracking stock issued in the future to evidence such interests will be "issuable for no additional cash consideration" because the consideration for such shares has already been paid (at the time the original stockholders purchased their shares). Second, the shares are vested. That is, no additional conditions exist that need to be satisfied before they can be issued. Once the existing shareholders vote to accept management's tracking stock proposal, the only real condition left is the filing of the company's revised articles of incorporation with the applicable secretary of state. After that, all that remains is for the company's management to physically issue the shares. Such physical issuance is a mere act by management, not a condition, and, as such, should not cause the shares to fail to vest.

Third, such shares of tracking stock will have been issued pursuant to a contingent stock agreement within the definition of SFAS No. 128. What is the contingent stock agreement in this instance, and who are the parties to it? The agreement is between the corporation that needs the existing stockholders' approval to restate its articles of incorporation and the existing shareholders who are desirous of obtaining a capital structure that management has assured them will be beneficial to the company and their investment in it. In order for a valid agreement to be formed, there typically must be formal offer and acceptance. Here the offer is management's proxy proposal, and the acceptance is the existing shareholders' positive vote.

A Trap for the Unwary

What is the potential pitfall if the shares of tracking stock issuable to retained/intergoup interest holders in the future are not included in basic—and, if applicable, diluted—earnings per share? Such noninclusion can result in a significant misstatement of the earnings per share reported for the nontracking stock. This misstatement occurs when management transfers the earnings from the newly issued tracking stock to the original nontracking stock without diluting them by the corresponding number of shares of tracking stock that may be issued in the future.

Hypothetical Illustration

Let's look at hypothetical Holding Company A ("HCA") as an example. HCA has four subsidiaries: W, X, Y, and Z. Each subsidiary consists of two divisions—Subsidiary W/Division 1, Subsidiary W/Division 2, and so on. As of the end of fiscal 1999, HCA had one billion shares of holding company common stock outstanding. During fiscal 2000, HCA amended its existing capital structure to allow for the issue of five million shares of a new series of holding company common stock that it designated Subsidiary Z/Division 2 tracking stock. The new tracking stock was intended to track the performance of Subsidiary Z/Division 2. Despite its name, the Subsidiary Z/Division 2 tracking stock was simply another series of the holding company's common stock and not common stock of a separate subsidiary or division of HCA.

When taking its tracking stock public, HCA's management allocated the earnings from its various subsidiary business units between its two series of holding company common stock, tracking and nontracking, as follows:

1. To the original nontracking stock:
   a) 100% of Subsidiary W,
   b) 100% of Subsidiary X,
   c) 100% of Subsidiary Y,
   d) 100% of Subsidiary Z/Division 1, and
   e) 90% of Subsidiary Z/Division 2.
2. To the newly issued (tracking) stock:
   a) 10% of Subsidiary Z/Division 2.

Rather than issue actual shares of tracking stock to its existing stockholders to evidence their 90% interest in the earnings of Subsidiary Z/Division 2, HCA's management granted those existing shareholders a retained/intergroup interest in such earnings. HCA's manage-

Table 1: Earnings of HCA and Subsidiaries

Fiscal Year Ended:	1997	1998	1999	2000	2001	2002
Holding Company A	$33,379,000	$46,297,000	$59,005,000	$71,191,000	$107,800,000	$161,150,000
Subsidiary Z/Division 2	$ 1,542,000	$ 4,610,000	$ 7,809,000	$17,482,000	$ 31,763,000	$ 64,394,000
Subsidiary Z/Division 1 & Subsidiaries W, X, and Y	$31,837,000	$41,687,000	$51,196,000	$53,709,000	$ 76,037,000	$ 96,756,000

ment then reserved 45 million shares of tracking stock as shares that, at its discretion, could be issued to the nontracking stockholders in the future to formally evidence their retained/intergroup interest.

After issuing its new tracking stock, HCA's capital structure looked like this:

a) 100 million shares of holding company nontracking common stock issued and outstanding,
b) five million shares of holding company tracking common stock issued and outstanding, and
c) 45 million shares of reserved but unissued holding company tracking common stock (held for future issuance to nontracking stockholders via their retained/intergroup interest).

Table 1 shows the earnings of Subsidiary Z/Division 2 for the six fiscal years ended December 31, 2002, versus the overall earnings of HCA over the same period, as measured by comparing the total net income of each.

Table 2 is a comparison of the percentage increases in earnings growth from Subsidiary Z/Division 2 versus the percentage increases in earnings growth from the rest of HCA's subsidiary business units for the past five fiscal years.

As you can see, the average total net income percentage gain over the past five fiscal years for Subsidiary Z/Division 2 was almost five times that of all of HCA's other subsidiary business units.

In Tables 3 and 4, let's examine the net income per share and percentage earnings growth for HCA's nontracking holding company stock both with and without siphoning off a large percentage of the earnings of Subsidiary Z/Division 2 over the past two fiscal years (taking into account a two-for-one stock split in 2002 on each share of tracking and nontracking stock).

This points out an interesting anomaly facing most tracking stock issuers and their accountants: The unissued shares of tracking stock are included for purposes of calculating the tracking stock's earnings per share (and dilutive) but are not considered outstanding (and nondilutive) for purposes of calculating the nontracking stock's earnings per share.

As you can see, the annual percentage increase in earnings per share for HCA's nontracking, original stock declines from +47.9% to +7.0% for fiscal 2001 and from +48.1% to +26.3% for fiscal 2002 if Subsidiary Z/Division 2's earnings are not included. Such a potential overstatement of the nontracking stock's earnings could lead to claims of a conflict of interest if management owns a disproportionate number of shares of nontracking stock and relatively few shares of tracking stock (which is typically the case unless management buys or otherwise retains an equivalent percentage of the newly issued tracking stock in its initial public offering).

Table 2: HCA's Earnings Growth Rates

Year-to-Year Increase in Total Net Income	1998	1999	2000	2001	2002	5-Year Average
Holding Company A	+ 38.7%	+27.4%	+ 20.7%	+51.4%	+ 49.5%	+ 37.5%
Subsidiary Z/Division 2	+199.0%	+69.4%	+123.9%	+81.7%	+102.7%	+115.3%
Subsidiary Z/Division 1 & Subsidiaries W, X, and Y	+ 30.9%	+22.8%	+ 4.9%	+41.6%	+ 27.2%	+ 25.5%

Table 3: HCA's Disaggregated Earnings, 2001

Entity/Shareholder Group	FYE 2001	FYE 2001 EPS	Year-to-Year Percentage Increase
Holding Company A			
Earnings	$107,800,000		
Avg. Weighted Basic Shares at FYE:			
Nontracking Common	100,000,000		
Tracking Common	5,000,000		
Tracking Common (including retained interest shares)	50,000,000		
100% of Subsidiary Z/Division 2			
Earnings	$ 31,763,000		
90% of Subsidiary Z/Division 2			
Earnings	$ 28,586,700		
10% of Subsidiary Z/Division 2			
Earnings	$ 3,176,300		
Reported Nontracking Common			
EPS (including 90% of Subsidiary Z/Division 2 Earnings)	$104,623,700	$1.05 (vs. $0.71 year earlier*)	+47.9%
Core Nontracking Common			
EPS (excluding 100% of Subsidiary Z/Division 2 Earnings)	$ 76,037,000	$0.76 (vs. $0.71 year earlier)	+ 7.0%
Tracking Common EPS			
(incl. retained interest shares)	$ 3,176,300	$0.06**	
Tracking Common EPS			
(excl. retained interest shares)	$ 3,176,300	$0.06**	

* Calculated as follows: (a) $71,191,000 total HCA earnings divided by (b) 100,000,000 total outstanding shares of HCA common stock (i.e., pretracking stock outstanding shares) equals (c) $0.71 per share.

** Calculated as follows: (a) $3,176,000 in tracking stock allocated earnings (i.e., 10% of the total tracking stock earnings) divided by (b) 50,000,000 tracking stock shares equals (c) $0.06 per share.

In addition, in HCA's case, a strong argument can be made under Paragraph 61 of SFAS No. 128 (and corresponding Illustration 6 to Appendix C) that the application of the two-class method of calculating earnings per share is inappropriate. The reason is that HCA's revised articles of incorporation grant its management the ability, at any time, to convert shares of its tracking stock into shares of its nontracking stock at a ratio of .90 shares of nontracking stock for each 1.00 share of tracking stock. Because of the circularity of this conversion feature, HCA's capitalization can be said to consist solely of shares of nontracking stock. More specifically, the retained/intergroup interests are convertible into shares of HCA tracking stock at some time in the future, and such shares of tracking stock are convertible into shares of HCA nontracking stock at a ratio of .90 to 1.00. Thus, on a fully converted basis, earnings per share could be calculated assuming that only one class of HCA's holding company stock is outstanding—its nontracking stock. As a result, HCA's capitalization can be viewed as consisting solely of 290 million shares of nontracking stock.[4]

Table 4: HCA's Disaggregated Earnings, 2002

Entity/Shareholder Group	FYE 2002	FYE 2002 EPS	Year-to-Year Percentage Increase
Holding Company A			
Earnings	$161,150,000		
Avg. Weighted Basic Shares at FYE:			
Nontracking Common	200,000,000		
Tracking Common	10,000,000		
Tracking Common (including retained interest shares)	100,000,000		
100% of Subsidiary Z/Division 2			
Earnings	$ 64,394,000		
90% of Subsidiary Z/Division 2			
Earnings	$ 57,954,600		
10% of Subsidiary Z/Division 2			
Earnings	$ 6,439,400		
Reported Nontracking Common			
EPS (including 90% of Subsidiary Z/Division 2 Earnings)	$154,710,600	$0.77 (vs. $0.52 year earlier*)	+48.1%
Core Nontracking Common			
EPS (excluding 100% of Subsidiary Z/Division 2 Earnings)	$ 96,756,000	$0.48 (vs. $0.38 year earlier**)	+26.3%
Tracking Common EPS			
(incl. retained interest shares)	$ 6,439,400	$0.06	
Tracking Common EPS			
(excl. retained interest shares)	$ 6,439,400	$0.06	

* As adjusted for a two-for-one stock split.

** Calculated as follows: (a) $76,037,000 in core nontracking stock earnings per share for FYE 2001 divided by (b) 200,000,000 nontracking stock shares equals (c) $0.38 per share.

The Solution?

So what earnings per share figure should HCA be reporting under SFAS No. 128? If the retained/intergroup interests in the tracking stock are recharacterized as convertible securities and/or vested contingently issuable shares under SFAS No. 128, then HCA's management should have included the shares issuable in the future to evidence the retained/intergroup interests in its calculation of its earnings per share.

As a result, if the two-class method of calculating earnings per share is applied, HCA's basic earnings for the past two years would look like this:

Class of Holding Company Stock	2001 Reported EPS	2001Actual Earnings[5]
Nontracking Common	$1.05 per share	$0.76 per share[6]
Tracking Common EPS	$0.06 per share	$0.64 per share[7]
Class of Holding Company Stock	**2002 Reported EPS**	**2002 Actual Earnings**
Nontracking Common	$0.77 per share	$ 0.48 per share[8]
Tracking Common	$0.06 per share	$ 0.64 per share[9]

Via the circular nature of the convertibility feature applicable to HCA's tracking stock (i.e., into nontracking stock at a ratio of .90 to 1.00), however, the use of the two-class methodology is improper, and HCA's earnings should have been calculated as follows:

Class of Holding Company Stock	2001 Reported EPS	2001Actual Earnings
Nontracking Common	$1.05 per share	$0.74 per share[10]
Class of Common Company Stock	**2002 Reported EPS**	**2002 Actual Earnings**
Nontracking Common	$0.77 per share	$ 0.56 per share[11]

Thus, HCA has arguably overstated its reported basic earnings per share from $0.74 per share to $1.05 per share (i.e., $0.31 or +41.9%) in fiscal 2001 and from $0.56 to $0.77 (i.e., $0.21 or +37.5%) in fiscal 2002. This would put the total size of HCA's overstatement of its nontracking stock earnings at approximately $31 million for fiscal 2001 and approximately $42 million for fiscal 2002, for a combined total overstatement of nontracking common earnings of approximately $73 million.[12]

Such overstatement would presumably have been exacerbated in the marketplace by the fact that the nontracking common would have no doubt been categorized as a high-growth stock due to its perceived 40%+ annual increases in net income in 2001 and 2002 and assigned a high price-to-earnings (PE) ratio. Thus, assuming the closing price of HCA's nontracking common stock on March 31, 2003, was $42.00 per share and the price reflected a PE ratio of 54, the potential market overvaluation of HCA's nontracking common earnings would be approximately $11.76 per share.[13] With 200 million weighted average shares of nontracking stock outstanding at the end of fiscal 2002, HCA's potential earnings per share overstatement on its nontracking stock would have resulted in a market valuation that was at least $2.35 billion too high.[14] ■

Robert L. Maddox, III, Esq., is an executive vice president with Vanderbilt Capital Advisors, LLC, headquartered in New York City. Bob is head of the Vanderbilt's Midwest office. He was graduated from Harvard University cum laude in 1982 and Duke School of Law with honors in 1987. He can be reached at (502) 426-0348 or rmaddox@vcallc.com.

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1 For further elaboration on Paragraph 10, see Paragraph 92 of SFAS No. 128, which states, in relevant part, that "a few respondents to the Exposure Draft suggested that contingently issuable shares should never be included in the computation of basic EPS because basic EPS is supposed to be an EPS ratio with no dilution. They said that the denominator should include only actual shares outstanding. The Board considered that view but decided to retain the provision that 'vested' contingently issuable shares should be considered in the computation of EPS because consideration for those shares has been received."

2 Please note that this analysis applies regardless of whether or not the two-class method of calculating earnings per share under SFAS No. 128 is employed. For example, Paragraph 61 of SFAS No.128, which deals with the two-class method, states that "for the diluted EPS computation, outstanding common shares shall include all potential common shares assumed issued."

3 Footnote 1 to SFAS No. 128 states that terms defined in Appendix E, which is the glossary to SFAS No. 128, are set in boldface type the first time they appear. Because the term "contingently issuable shares" appears in boldface in Paragraph 10, an examination of such term in Appendix E appears warranted.

4 Calculated as follows: (a) 200,000,000 outstanding shares of nontracking common stock plus (b) 81,000,000 shares of nontracking common stock (i.e., 90,000,000 shares of tracking common stock issuable in respect of the nontracking stockholders' 90% retained interest times the .90 conversion ratio) plus (c) 9,000,000 shares of tracking stock (i.e., 10,000,000 outstanding shares of tracking common stock times the .90 conversion ratio) equals (d) 290,000,000 shares of nontracking stock.

5 Assumes issuance of the tracking stock shares backing the nontracking stockholders' 90% retained interest.

6 Calculated as follows: (a) $76,037,000 in core nontracking stock total earnings (i.e., $107,800,000 HCA total earnings minus $31,763,000 Subsidiary Z/Division 2 total earnings) divided by (b) 100,00,000 in total average weighted nontracking common shares outstanding equals (c) $0.76 per share.

7 Calculated as follows: (a) $31,763,000 Subsidiary Z/Division 2 total earnings divided by (b) 50,000,000 in total average weighted tracking common shares equals (c) $0.64 per share.

8 Calculated as follows: (a) $96,756,000 in core nontracking stock total earnings (i.e., $161,150,000 HCA total earnings minus $64,394,000 Subsidiary Z/Division 2 total earnings) divided by (b) 200,000,000 in total average weighted nontracking common stock shares equals (c) $0.48 per share.

9 Calculated as follows: (a) $64,394,000 in Subsidiary Z/Division 2 total earnings divided by (b) 100,000,000 in total average weighted tracking stock common shares equals (c) $0.64 per share.

10 Calculated as follows: (a) $107,800,000 in HCA total earnings

divided by (b) 145,000,000 shares of nontracking common stock on a fully converted basis equals (c) $0.74 per share.

11 Calculated as follows: (a) $161,150,000 in HCA total earnings divided by (b) 290,000,000 shares of nontracking common stock on a fully converted basis equals (c) $0.56 per share.

12 2001 calculated as follows: (a) $0.31 per share times (b) 100,000,000 average weighted nontracking common shares in 2001 equals (c) $31,000,000. 2002 calculated as follows: (a) $0.21 per share times (b) 200,000,000 average weighted nontracking common shares in 2002 equals (c) $42,000,000.

13 PE ratio calculated as follows: (a) $42.00 per share divided by (b) $0.77 earnings per share for FYE 2002 equals (c) 54. HCA's nontracking common earnings calculated as follows: (a) the nontracking common stock's closing price of $42.00 per share on 3/31/03 minus (b) $30.24 per share (i.e., a 54 PE times actual nontracking stock earnings of $0.56 per share) equals (c) $11.76 per share.

14 Calculated as follows: (a) $11.76 per shares times (b) 200,000,000 average weighted shares of nontracking stock equals (c) $2,352,000,000.