

ERICSSON LM TELEPHONE CO

Form 6-K

January 21, 2009

# **SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

## **FORM 6-K**

### **REPORT OF FOREIGN ISSUER**

**Pursuant to Rule 13a-16 or 15d-16 of  
the Securities Exchange Act of 1934**

**January 21 , 2009**

## **LM ERICSSON TELEPHONE COMPANY**

**(Translation of registrant's name into English)**

**Torshamnsgatan 23, Kista**

**SE-164 83, Stockholm, Sweden**

**(Address of principal executive offices)**

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Indicate by check mark whether the registrant files or will file annual reports under cover Form 20-F or Form 40-F. Form 20-F ☒ Form 40-F ☐

Indicate by check mark whether the registrant by furnishing the information contained in this Form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934. Yes ☐ No ☒

Announcement of LM Ericsson Telephone Company, dated January 21, 2009 regarding Ericsson reports strong fourth quarter.

**FOURTH QUARTER REPORT**

**January 21, 2009**

**Ericsson reports strong**

**fourth quarter**

Sales SEK 67.0 (54.5) b., up 23%, full year SEK 208.9 (187.8) b., up 11%

Operating income<sup>1) 2)</sup> SEK 9.2 (7.6) b., full year SEK 23.9 (30.6) b.

Operating margin<sup>1) 2)</sup> 13.7% (14.0%), full year 11.4% (16.3%)

Cash flow SEK 7.0 (12.0) b., full year SEK 24.0 (19.2) b.

Net income<sup>2) 3)</sup> SEK 4.1 (5.8) b., full year SEK 11.7 (22.1) b.

Earnings per share<sup>2) 3) 4)</sup> SEK 1.21 (1.77), full year SEK 3.52 (6.84)

Board of Directors proposes dividend of SEK 1,85 per share

- 1) *Excluding restructuring charges of SEK 3.0 b. in the quarter and SEK 7.6 b. for the full year*
- 2) *Including capital gains of SEK 0.2 b. in first quarter and SEK 0.8 b. in fourth quarter 2008*
- 3) *Attributable to stockholders of the Parent Company, excluding minority interests*
- 4) *A reverse split 1:5 was made in June 2008, comparable figures restated accordingly*

**CEO COMMENTS**

We have had a solid performance in 2008, said Carl-Henric Svanberg, President and CEO of Ericsson (NASDAQ:ERIC). Sales grew by 11% with good demand for our entire portfolio and across the world. Changes in currency rates had very small effect on full year growth. Professional services have continued to show strong growth. Operating margins, excluding Sony Ericsson, have steadily improved, and our financial position is strong with net cash of SEK 35 b. Sony Ericsson is affected by the economic downturn and the declining demand in the consumer market and has taken necessary actions.

During the year, we saw some 650 million new mobile subscriptions and the 4 billion milestone is now reached. 2008 was also a breakthrough year for mobile broadband. Communication is a basic human need. It plays a critical role in the development of a sustainable and prosperous society, and the positive long-term prospects for the industry remain.

The economic recession is spreading across the world. The effects on the global mobile network market should not be that significant as most operators have healthy financial positions, there is a strong traffic growth and the networks are fairly loaded. It remains, however, difficult to more precisely predict to what extent consumer telecom spending will be affected and how operators will act. To date, our infrastructure business is hardly impacted at all, but it would be unreasonable to think that this would be the case also throughout 2009.

We have exceeded our cost reduction targets launched in 2008. In the present environment, we will continue to reduce costs, across all parts of the company at the same pace as in 2008 with restructuring charges of SEK 6-7 b., targeting annual savings of SEK 10 b. from the second half of 2010. We are leveraging synergies between our different technologies and taking advantage of opportunities in the transformation to all-IP networks. As the savings largely are the result of more efficient ways of working, our strategy will remain intact and our unique capabilities should not be affected, concluded Carl-Henric Svanberg.



## FOURTH QUARTER REPORT

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## FINANCIAL HIGHLIGHTS

## Income statement and cash flow

SEK b.	Fourth quarter			Third quarter		Full year		
	2008 <sup>1) 5)</sup>	2007	Change	2008 <sup>1)</sup>	Change	2008 <sup>1) 5)</sup>	2007	Change
Net sales	67.0	54.5	23%	49.2	36%	208.9	187.8	11%
Gross margin	35.2%	36.1%		37.0%		36.8%	39.3%	
EBITDA margin	16.8%	18.4%		15.3%		15.6%	20.8%	
Operating income	9.2	7.6	21%	5.7	62%	23.9	30.6	-22%
Operating margin	13.7%	14.0%		11.5%		11.4%	16.3%	
Operating margin excl Sony Ericsson	14.6%	9.8%		11.5%		11.3%	12.5%	
Income after financial items	9.5	7.6	25%	6.2	54%	24.8	30.7	-19%
Net income <sup>2) 3)</sup>	3.9	5.6	-31%	2.8	37%	11.3	21.8	-48%
EPS diluted, SEK <sup>2) 3) 4)</sup>	1.21	1.77	-32%	0.89	36%	3.52	6.84	-49%
Cash flow from operating activities	7.0	12.0		3.8		24.0	19.2	
Cash flow excl. Sony Ericsson	7.0	12.0		2.4		20.4	15.3	

1) Excluding restructuring charges of SEK 3.0 b.in the fourth quarter 2008, SEK 2.0 b.in the third quarter 2008, SEK 1.8 b. in the second quarter and SEK 0.8 b. in the first quarter

2) Including restructuring charges in 2008

3) Attributable to stockholders of the Parent Company, excluding minority interests

4) A reverse split 1:5 was made in June 2008. Comparable figures are restated accordingly

5) Fourth quarter 2008 includes a capital gain of SEK 0.8 b. from divestment of shares in Symbian

Sales in the quarter increased by 23% year-over-year and by 11% for the full year. Currency exchange rates have had limited effects on full year sales. The currency exchange rate swings, especially towards the end of the year, have positively impacted sales growth in the fourth quarter significantly. Excluding currency exchange rate effects, the fourth quarter still showed the strongest growth in the year.

In the quarter, gross margin was 35.2% (36.1%), excluding restructuring charges. Full year gross margin amounted to 36.8% (39.3%). The sequential decline was mainly due to a high proportion of network rollout services. The network rollout sales increased sequentially by 61%.

Operating expenses amounted to SEK 15.3 (15.2) b. in the quarter, excluding restructuring charges. Expense run-rate is decreasing as a result of cost savings activities but this was partly offset by currency exchange rate effects. Operating expenses as a percentage of sales decreased from 28% to 27% for the full year.

In the quarter, Sony Ericsson contributed a result of EUR -67 (251) million, excluding restructuring charges of EUR 65 million. For the full year, Sony Ericsson showed a break-even result, excluding restructuring charges.

Operating income before restructuring charges amounted to SEK 9.2 (7.6) b. in the quarter and SEK 23.9 (30.6) b. for the full year. The operating income for the quarter includes a capital gain of SEK 0.8 b. from the divestment of shares in Symbian and a loss of SEK 0.7 b. from Sony Ericsson.

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In the quarter, weaker SEK exchange rates affected income positively, but to a much lesser extent than sales. The currency translation effects during the quarter were offset by the negative effects of transaction hedges.

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Restructuring charges in Ericsson amounted to SEK 2.3 (-) b. in the quarter and to SEK 6.7 (-) b. for the full year. Ericsson's share of the restructuring charges in Sony Ericsson amounted to SEK 0.7 (-) b. for the quarter and SEK 0.9 (-) b. for the full year.

Financial net was SEK 0.3 (0.0) b. in the quarter and SEK 1.0 (0.1) b. for the full year. Positive effects from improved interest rates were to some extent offset by negative effects from changing currency exchange rates.

Net income amounted to SEK 4.1 (5.8) b. in the quarter and SEK 11.7 (22.1) b. for the full year, impacted by restructuring charges and a dramatic drop in the contribution from Sony Ericsson.

Cash flow from operating activities reached SEK 7.0 (12.0) b. in the quarter and SEK 24.0 (19.2) b. for the full year. Changes in net operating assets were negative at SEK 2.3 b. in the quarter. Despite good collections, trade receivables increased due to high year-end sales. This was partly offset by reduced inventories and increased current liabilities. Cash conversion for the full year increased to 92% (66%).

For the year, the tax rate has increased to 32.3% (28.0%) due to changed mix of high and low tax countries. The deferred tax assets have also been revalued due to change in the statutory tax rate in Sweden from 2009 that has increased the tax cost for 2008.

**Balance sheet and other performance indicators**

	Full year 2008	Nine months 2008	Six months 2008	Three months 2008	Full year 2007
SEK b.					
Net cash	34.7	30.2	27.9	28.3	24.3
Interest-bearing provisions and post-employment benefits	40.4	35.4	29.2	32.0	33.4
Trade receivables	75.9	62.6	56.7	56.4	60.5
Days sales outstanding	106	115	107	110	102
Inventory	27.8	29.7	26.6	24.5	22.5
Of which work in progress	16.5	18.4	16.3	13.8	12.5
Inventory turnover	5.3 <sub>1)</sub>	4.5 <sub>1)</sub>	4.7 <sub>1)</sub>	4.6 <sub>1)</sub>	5.2
Payable days	55	57	56	57	57
Customer financing, net	2.8	2.2	2.4	2.7	3.4
Return on capital employed	16% <sup>1)</sup>	13% <sup>1)</sup>	12% <sup>1)</sup>	12% <sup>1)</sup>	21%
Equity ratio	50%	52%	55%	56%	55%

1) Excluding effects from restructuring

The net cash position increased sequentially to SEK 34.7 (30.2) b. Cash, cash equivalents and short-term investments amounted to SEK 75.0 (57.7) b. Of a total debt position of SEK 30.5 b., SEK 5.5 b. matures in the next twelve months.

Customer financing remain at a low level and amounted to SEK 2.8 (2.2) b.

During the quarter, approximately SEK 2.3 b. of provisions related to warranty and project commitments and other items were utilized, of which SEK 1.0 b. were related to restructuring. Additions of SEK 3.8 b. were made, of which SEK 1.2 b. related to restructuring. Reversals of SEK 0.8 b. were made. The net impact on operating income, excluding restructuring charges, was negative by SEK 1.8 b.





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Days sales outstanding decreased in the quarter to 106 days but are up year-over-year from 102. Currency exchange rates have had a negative effect.

**Cost reductions**

In February 2008, a cost reduction plan of SEK 4 b. in annual savings was announced, including estimated charges of the same size. All activities with related charges were launched by the third quarter, and it was announced that further charges would be made in the fourth quarter.

Charges in the fourth quarter amount to SEK 2.3 b. and for the full year 2008 to SEK 6.7 b. In total, this has resulted in annual savings of approximately SEK 6.5 b. from year-end.

Cost savings will continue also in 2009. Restructuring charges are estimated to SEK 6-7 b. and annual savings of SEK 10 b. are expected by the second half of 2010, with an equal split between cost of sales and operating expenses.

We are leveraging synergies between our different technologies, in-house and acquired, and taking advantage of opportunities in the transformation to all-IP. We will reduce the number of software platforms and increase the re-use of hardware. We will also move certain activities to low-cost countries.

Cost reductions will be achieved through reduction of the number of consultants and other temporary staff, consolidation of R&D sites and layoffs. These activities will result in a reduction of the number of employees by some 5,000, of which about 1,000 in Sweden, primarily in Stockholm.

Restructuring charges Isolated quarters, SEK b.	Accumulated	2008			
		Q4	Q3	Q2	Q1
Cost of sales	-2.5	-1.1	-0.6	-0.6	-0.2
Research and development expenses	-2.7	-0.7	-0.3	-1.1	-0.6
Selling and administrative expenses	-1.5	-0.5	-0.9	-0.1	-0.0
Share in Sony Ericsson charges	-0.9	-0.7	-0.2		
<b>Total</b>	<b>-7.6</b>	<b>-3.0</b>	<b>-2.0</b>	<b>-1.8</b>	<b>-0.8</b>

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## SEGMENT RESULTS

SEK b.	Fourth quarter			Third quarter		Full year		
	2008 <sup>1)</sup>	2007	Change	2008 <sup>1)</sup>	Change	2008 <sup>1) 2)</sup>	2007	Change
<b>Networks sales</b>	<b>45.8</b>	<b>37.5</b>	<b>22%</b>	<b>33.0</b>	<b>39%</b>	<b>142.0</b>	<b>129.0</b>	<b>10%</b>
Of which network rollout	7.6	6.4	17%	4.7	61%	21.5	18.5	16%
Operating margin	14%	10%		11%		11%	13%	
EBITDA margin	17%	15%		15%		16%	19%	
<b>Professional Services sales</b>	<b>16.2</b>	<b>12.1</b>	<b>34%</b>	<b>11.8</b>	<b>38%</b>	<b>49.0</b>	<b>42.9</b>	<b>14%</b>
Of which managed services	4.3	3.3	29%	3.5	23%	14.3	12.2	17%
Operating margin	18%	15%		16%		16%	15%	
EBITDA margin	19%	16%		19%		17%	16%	
<b>Multimedia sales</b>	<b>5.0</b>	<b>4.9</b>	<b>4%</b>	<b>4.4</b>	<b>14%</b>	<b>17.9</b>	<b>15.9</b>	<b>13%</b>
Operating margin	12% <sup>4)</sup>	-9%		3%		1% <sup>4)</sup>	-1%	
EBITDA margin	21% <sup>4)</sup>	-3%		12%		11% <sup>3)4)</sup>	4%	
<b>Total sales</b>	<b>67.0</b>	<b>54.5</b>	<b>23%</b>	<b>49.2</b>	<b>36%</b>	<b>208.9</b>	<b>187.8</b>	<b>11%</b>

1) Excluding restructuring costs in 2008

2) First quarter 2008 is restated for the transfer of the IPX operations from Professional Services to Multimedia

3) Affected by SEK 0.2 b. due to changed allocation of capitalized development expenses during second quarter 2008

4) Fourth quarter 2008 includes a capital gain of SEK 0.8 b. from divestment of shares in Symbian

## Networks

Sales in Networks increased by 22% in the quarter, year-over-year, positively impacted by a weaker SEK. For the full year sales grew by 10%. 2008 was another record year for rollout of GSM. In addition, major 3G rollouts are ongoing in many markets while key markets, such as China and India, will soon start their 3G buildouts.

Mobile broadband is now firmly established and networks with speeds of 21 Mbps have been launched in several countries. LTE is established as a true global world standard for mobile broadband. In January, 2009, Ericsson announced its first contract for a commercial LTE network.

The transition from traditional circuit switching to softswitching has come far and Ericsson has established a clear leadership position. Sales of Redback's SmartEdge products noted very strong growth for the second consecutive quarter.

Sales of network rollout services increased 61% sequentially, reflecting a high proportion of completions of large new network buildouts.

## Professional Services

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Sales of Professional Services increased by 34% in the quarter, year-over-year, and by 14% for the full year. Growth in constant currencies amounted to 26% and 13% respectively. Managed services continued to grow substantially, and consulting and systems integration showed strong growth due to a high amount of customer projects finalized during the quarter. Operating margins in the quarter reached 18% (15%) due to favorable mix, continued efficiency gains and high volumes.

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During the quarter, 11 new managed services contracts were signed. The total number of subscribers in managed operations now amounts to 250 million, of which 60% are in high-growth markets. The growth in managed services is fueled by operators' desire to reduce operating expenses and improve efficiency in network operation and maintenance.

**Multimedia**

Sales in Multimedia increased by 4% in the quarter, year-over-year, and by 13% for the full year. For comparable units, i.e. excluding divestment of the enterprise PBX operations and adjusted for the transfer of the IPX operations, sales grew by 21% in the quarter, year-over-year and by 16% for the full year. Tandberg Television and revenue management continued to show good growth while the mobile platform business is starting to experience effects of the weakening handset market. Operating income in the quarter, excluding effects from the divestment of shares in Symbian, was SEK -0.2 (-0.4) b.

**Sony Ericsson Mobile Communications**

For information on transactions with Sony Ericsson Mobile Communications, please see Financial statements and Additional information.

**Fourth quarter**  
**Change**

**Third quarter**  
**2008 Change**

any number of economic or demographic factors could cause private insurers, hospitals or managed care companies to reduce the rates they pay us or to refuse to pay price increases or to work to reduce the rate of our price increases;

a portion of our business that is currently reimbursed by private insurers or hospitals may become reimbursed by managed care organizations, which generally have lower rates for our services; or

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a portion of our business that is currently reimbursed by private insurers at rates based on our billed charges may become reimbursed under a contract at lower rates.

### **If Congress or CMS changes the Medicare or Medicaid programs for dialysis, then our net revenue and earnings could decrease.**

If the government changes the Medicare, Medicaid or other government programs or the rates those programs pay for our services, then our revenue and earnings may decline. We estimate that approximately 55% of our net revenue for 2003, 53% of our net revenue for 2004, and 56% of our net revenue in 2005 consisted of reimbursements from Medicare, Medicaid and comparable state programs, including reimbursement for the administration of EPO. Any of the following actions in connection with government programs could cause our revenue and earnings to decline:

a reduction of the amount paid to us under government programs;

an increase in the costs associated with performing our services that are subject to inflation, such as labor and supply costs, without a corresponding increase in reimbursement rates;

the inclusion of some or all ancillary services, for which we are now reimbursed separately, in the flat composite rate for a dialysis treatment; or

changes in laws, or the interpretations of laws, which could cause us to modify our operations.

We cannot predict whether any of the proposed cuts will be made or how they will affect us. In addition, Congress and CMS have proposed expanding the drugs and services that are included in the flat composite rate. CMS has indicated that it believes such a mechanism would be fairer and easier to administer. In addition, Congress mandated a change in the way we are paid for some of the drugs, including EPO, that we bill for outside of the flat composite rate. This change has resulted in lower reimbursement for these drugs and a higher composite rate. Under recently adopted regulations, in 2006 we will be reimbursed for separately billable ESRD drugs at average sales price plus 6.0%. In addition, the composite rate was increased by 14.7% to account for the change in drug reimbursement. Other regulations include changes in the geographic designations and wage indices used to calculate the composite rate in specific areas.

### **If states lower Medicaid reimbursement, then we would be less profitable.**

The Medicaid programs in Alaska and New Mexico currently reimburse us for some items at rates higher than those paid by Medicare. These programs may reduce payment levels to be at or close to Medicare rates. In addition, a number of the states in which we operate are experiencing budget shortfalls, and some of these states may consider reducing Medicaid reimbursement, changing their Medicaid programs or not paying claims to address these shortfalls and cut costs. We are unable to predict whether and, if so, when any reductions in Medicaid reimbursement might occur and what their precise effect will be.

### **If reimbursement for EPO decreases, then we could be less profitable.**

If government or private payors reduce reimbursement rates for EPO, for which we are currently reimbursed separately outside of the flat composite rate, then our revenue and earnings will decline. Revenues from the administration of EPO were approximately 24% of our net revenue for 2003, 26% of our net revenue for 2004 and 24% of our net revenue for 2005. Most of our payments for EPO come from government programs. For the year ended December 31, 2005, Medicare and Medicaid reimbursement represented approximately 56% of the total revenue we derived from EPO. A reduction in the reimbursement rate for EPO or the inclusion of EPO in the list of items covered by the flat composite rate could materially and adversely affect our net revenue and earnings. As discussed above, as part of the Medicare Modernization Act, Congress mandated a change in the way we are reimbursed for EPO, and CMS has adopted regulations to implement the change. In 2005 we were reimbursed for EPO at an average acquisition price. In 2006, we will be reimbursed for CMS published proposed rules for EPO at average sales price plus 6.0%. This average sales price plus 6.0% will be substantially less than average acquisition price.

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### **If Amgen raises the price for EPO or if EPO becomes in short supply, then we could be less profitable.**

EPO is produced by a single manufacturer, Amgen, Inc. In April 2002, Amgen announced a 3.9% increase in the price of EPO. This price increase adversely affected our earnings in 2003, and changes in the rebate structure under our contracts with Amgen adversely affected our earnings in 2004 and 2005. In June 2005, Amgen implemented a 4.9% increase in the price of EPO. This price increase will not affect us in 2006. Further changes in the rebate structure under our current contract with Amgen or in Amgen's packaging process for EPO, may adversely affect our earnings in 2006. If Amgen imposes additional EPO price increases or if Amgen or other factors interrupt the supply of EPO, then our net revenue and earnings will decline.

### **If Amgen markets Aranesp® for ESRD patients, then we could be less profitable.**

Amgen has developed and obtained FDA approval for another drug to treat anemia that is marketed as Aranesp® (darbepoetin alfa). Aranesp® is a longer acting form of bio-engineered protein that, like EPO, can be used to treat anemia. EPO is usually administered in conjunction with each dialysis treatment. Aranesp® can remain effective for two to three weeks. If Amgen markets Aranesp® for the treatment of dialysis patients, then our earnings could be materially and adversely affected by either of the following factors:

- our margins realized from the administration of Aranesp® could be lower than the margins realized on the administration of EPO; or

- physicians could decide to administer Aranesp® in their offices, and we would not recognize net revenue or profit from the administration of EPO or Aranesp®.

### **Changes in our clinical practices or reimbursement rules for EPO and other drugs could substantially reduce our revenue and earnings.**

The administration of EPO and other drugs accounted for approximately 35% of our net revenue during 2005. Changes in physician practices or prescription patterns, changes in private and governmental reimbursement criteria or the introduction of new drugs or new types of drug administration could materially reduce our net revenue and profits. For example, some Medicare fiscal intermediaries have implemented or may implement local medical review policies for EPO and other drugs that would effectively limit reimbursement for those drugs. In 2005, CMS adopted a national policy that will establish limits on reimbursement for EPO. This policy will become effective in April 2006. These changes may have an adverse impact on our net revenue and earnings.

### **If our business is alleged or found to violate health care or other applicable laws, our net revenue and earnings could decrease.**

We are subject to extensive federal, state and local regulation. The laws that apply to our operations include, but are not limited to, the following:

- fraud and abuse prohibitions under state and federal health care laws;

- prohibitions and limitations on patient referrals;

- billing and reimbursement rules, including false claims prohibitions under health care reimbursement laws;

- rules regarding the collection, use, storage and disclosure of patient health information, including HIPAA, and state law equivalents of HIPAA;

- facility licensure;

- health and safety requirements;

- environmental compliance; and

- medical and toxic waste disposal.



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Much of the regulation of our business, particularly in the areas of fraud and abuse and patient referral, is complex and open to differing interpretations. Due to the broad application of the statutory provisions and the absence in many instances of regulations or court decisions addressing the specific arrangements through which we conduct our business, including our arrangements with medical directors, physician stockholders and physician joint venture partners, governmental agencies could challenge some of our practices under these laws.

New regulations governing electronic transactions and the collection, use, storage, and disclosure of health information impose significant administrative and financial obligations on our business. If, after the required compliance date, we are found to have violated these regulations, we could be subject to:

- criminal or civil penalties, including significant fines;

- claims by people who believe their health information has been improperly used or disclosed; and

- administrative penalties by payors.

### **Government investigations could adversely affect Renal Care Group.**

Government investigations of health care providers, including dialysis providers, have continued to increase. We have been the subject of investigations in the past, we are involved in current investigations, and the government may investigate our business in the future. One of our competitors, DaVita, Inc., has announced that it is the subject of an investigation by the U.S. Attorney for the Eastern District of Pennsylvania. In December 2004, another competitor, Gambro Healthcare, Inc., settled matters related to an investigation by the U.S. Attorney's Office in St. Louis, Missouri and paid approximately \$350.0 million in connection with the settlement.

In March 2005, the office of the United States Attorney for the Eastern District of Missouri served a subpoena on DaVita, Inc. requiring the production of a broad range of documents. In April 2005, the office of the United States Attorney for the Eastern District of Missouri served a similar subpoena on Fresenius Medical Care.

On August 9, 2005, we received a subpoena from the office of the United States Attorney for the Eastern District of Missouri. The subpoena requires us to produce documents related to numerous aspects of our business and operations. The subpoena includes specific requests for documents related to our supply company, pharmaceutical and other services we provide to patients (including the administration of EPO), our relationships with pharmaceutical companies, our relationships with physicians, medical director compensation, joint ventures with physicians and our purchases of dialysis equipment from Fresenius Medical Care. The subpoena was issued in connection with a joint civil and criminal investigation. We are cooperating with the government's investigation; we have produced numerous documents to the government in response to this subpoena. We have incurred significant legal and other expenses in responding to the subpoena and have experienced some distraction of management attention. Compliance with the subpoena will require us to incur substantial additional legal expenses and will require further management attention. To our knowledge, no proceedings have been initiated against Renal Care Group at this time, but we cannot predict whether or when proceedings might be initiated. In addition, we cannot predict the outcome of any proceedings that may be initiated against us as a result of this investigation. Any such proceeding could have a material adverse effect on our business, financial condition results of operations.

On October 25, 2004, we received a subpoena from the office of the United States Attorney for the Eastern District of New York. The subpoena requires us to provide documents related to numerous aspects of our business and operations, including those of RenaLab, Inc., our laboratory. The subpoena includes specific requests for documents related to testing for parathyroid hormone (PTH) levels and vitamin D therapies. Our competitors DaVita, Fresenius Medical Care, and Gambro Healthcare, as well as other participants in the dialysis industry, have announced that they have received similar subpoenas. We are cooperating with the government's investigation. We have produced numerous documents to the government in response to this subpoena. We have incurred significant legal and other expenses responding to the subpoena. Compliance with this subpoena will require us to incur additional legal expenses and could distract management attention. To our knowledge, no proceedings have been initiated against Renal Care Group at this time, but we cannot predict whether or when proceedings might be initiated. We cannot predict the outcome of any proceedings that may be initiated against us a result of this investigation. Any such proceedings could have a material adverse effect on our business, financial condition and results of operations.



If any aspect of our operations is found to violate applicable laws, then we may be subject to severe sanctions and we could be required to alter or discontinue the challenged conduct or both. If sanctions are imposed on us, then there could be a material adverse effect on our business, financial condition and results of operations. If we are required to alter or discontinue practices, then we may not be able to do so successfully, which could have a material adverse effect on our business, financial condition and results of operations.

**If our joint ventures violate the law, our business could be damaged.**

A number of the dialysis centers we operate are owned by joint ventures in which we hold a controlling interest and one or more physicians or physician practice groups hold a minority interest. The physician owners may also provide medical director services to those centers or other centers we own and operate. Our joint venture arrangements do not satisfy all elements of any safe harbor under

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the Anti-Kickback statutes. If one or more of our joint ventures were found to be in violation of the Anti-Kickback Statute or the Stark Law, we could be required to restructure them or refuse to accept referrals for designated health services from the physicians with whom those particular joint venture centers have a relationship. We also could be required to repay to Medicare amounts received by the joint ventures pursuant to prohibited referrals, and we could be subject to monetary penalties. If we are subject to any of these penalties, our business could be damaged.

**Changes in the health care delivery, financing or reimbursement systems could adversely affect our business.**

The health care industry in the United States may be entering a period of change and uncertainty. Health care organizations, public or private, may dramatically change the way they operate and pay for services. Our business is designed to function within the current health care financing and reimbursement system. During the past several years, the health care industry has been subject to increasing levels of government regulation of, among other things, reimbursement rates and relationships with referring physicians. In addition, proposals to reform the health care system have been considered by Congress. In light of the continued increases in the cost of health care and the current economic situation coupled with the federal budget deficit, there may be new proposals to change the health care system and control costs. These proposals, if enacted, could further increase the government's oversight role and involvement in health care, lower reimbursement rates and otherwise change the operating environment for health care companies. We cannot predict the likelihood of those events or what impact they may have on our business.

**If local physicians stop sending patients to our centers or were prohibited from doing so for regulatory reasons, then our revenue and earnings would decline.**

Our dialysis centers depend on local nephrologists sending patients to the centers. Typically, one or a few physicians' patients make up all or a significant portion of the patient base at each of our dialysis centers, and the loss of the patient base of one or more of these physicians could have a material adverse effect on the operations of that center. The loss of the patient base of a significant number of local physicians could cause our revenue and earnings to decline. In many instances, the primary referral sources for our centers are physicians who also serve as medical directors of our centers and may be shareholders or minority participants in a joint venture. If the medical director relationship, stock ownership or joint venture relationship were found to violate applicable federal or state law, including fraud and abuse laws and laws prohibiting self-referrals, then these physicians could be forced to stop referring patients to our centers.

A number of our medical director agreements will expire over the next three years, unless they are renewed or renegotiated. We did not renew or renegotiate a small number of our medical director agreements that expired in 2005, and we may not be able to renew or renegotiate expiring medical director agreements successfully, or we may not be able to enforce the non-competition provisions of some of our medical director or other agreements. Any of these factors could result in a loss of patients, since dialysis patients are typically treated at a center where their physician, or a member of his or her practice group serves as medical director. We believe that our future success will depend in part on our ability to attract and retain qualified physicians to serve as medical directors of our dialysis centers.

**The dialysis business is highly competitive. If we do not compete effectively in our markets, then we could lose market share and our rate of growth could slow.**

The dialysis industry is largely consolidated, and the consolidation trend continues as large providers acquire other providers. In October 2005, DaVita acquired Gambro Healthcare's United States dialysis services business. As a result there are now three large dialysis companies (including Renal Care Group) that compete for the acquisition of outpatient dialysis centers and the development of relationships with referring physicians. The other two competitors are significantly larger companies, which may enable them to pay more or otherwise compete more effectively for acquisitions. In addition Fresenius Medical Care also manufactures dialysis equipment, which may allow it to benefit from lower equipment costs. We also face competition from new entrants into the market, including centers established by former medical directors or other referring physicians. We cannot assure you that we will be able to compete effectively with any of our competitors.

**If we are unable to make acquisitions in the future, then our rate of growth will slow.**

Much of our historical growth has come from acquisitions. In May 2005 we announced the definitive agreement under which Fresenius Medical Care has agreed to acquire Renal Care Group, subject to several conditions. While

this transaction is pending it is unlikely that we will be able to complete acquisitions consistent with our historical practices, because of uncertainty concerning Renal Care Group and restrictions in the merger agreement. We may be unable to identify and complete suitable acquisitions at prices we are

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willing to pay, or we may be unable to obtain the necessary financing. Further, due to the increased size of our business, the amount that acquired businesses contribute to our revenue and profits will continue to be smaller on a percentage basis. Also, we believe competition for acquisitions has intensified in light of the smaller pool of available acquisition candidates and other market forces. As a result, we believe it will be more difficult for us to acquire suitable companies on favorable terms. Further, the businesses we acquire may not perform well enough to justify our investment. If we are unable to make additional acquisitions on suitable terms, then we may not meet our growth expectations.

### **If acquired businesses have unknown liabilities, then we could be exposed to liabilities that could harm our business and profitability.**

Businesses we acquire may have unknown or contingent liabilities, including liabilities for failure to comply with health care laws. Although we attempt to identify practices that may give rise to unknown or contingent liabilities and conform them to our standards after the acquisition, private plaintiffs or governmental agencies may still assert claims. Even though we generally seek to obtain indemnification from the sellers of businesses we buy, unknown and contingent liabilities may not be covered by indemnification or may exceed contractual limits or the financial capacity of the indemnifying party.

### **We may not have sufficient cash flow from our business to pay our substantial debt.**

As of December 31, 2005, we had total consolidated debt of approximately \$576.1 million, including a \$20.8 million fair value premium on the 9.0% senior subordinated notes, and cash of approximately \$2.5 million. Also, subject to limitations, including those in our credit facility and those included in the indenture for our 9.0% senior subordinated notes, we are not and will not be prohibited from incurring additional debt.

Due to the large amount of our consolidated debt, we may not generate enough cash from our operations to meet these obligations or to fund other liquidity needs. Our ability to generate cash in the future is, to some extent, subject to risks and uncertainties that are beyond our control, including those described in this Risk Factors section. If we are unable to meet our debt obligations, we may need to refinance all or a portion of our indebtedness, sell assets or raise funds in the capital markets. However, we cannot assure you that, if we are unable to pay our debt, we will be able to refinance it, obtain additional equity capital or sell assets, in each case on commercially reasonable terms, or at all, or otherwise be able to fund our liquidity needs.

If for any reason we are unable to meet our debt obligations, we would be in default under the terms of the agreements governing our outstanding debt. If such a default were to occur, the lenders under our credit facility could elect to declare all amounts outstanding under the credit facility immediately due and payable, and the lenders would not be obligated to continue to advance funds to us under our credit facility. In addition, if such a default were to occur, the 9.0% senior subordinated notes would become immediately due and payable. If these debt obligations are accelerated, we cannot assure you that our assets will be sufficient to repay the money we owe to banks and other debt holders.

### **The large amount and terms of our outstanding debt may prevent us from taking actions we would otherwise consider in our best interest.**

The indenture governing our 9.0% senior subordinated notes and our credit facility contain numerous financial and operating covenants that limit our ability to engage in activities such as:

- incurring additional debt;

- acquiring and developing new dialysis centers;

- making investments;

- creating liens;

- creating restrictions on the ability of our subsidiaries to pay dividends or other amounts to us;

- disposing of assets;

paying dividends on our capital stock;

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repurchasing our capital stock;

engaging in transactions with our affiliates; or

consolidating, merging or selling all or substantially all of our assets.

Our credit facility also requires us to comply with financial covenants, including a net worth test, a leverage ratio test and a fixed charge coverage ratio test. Our ability to comply with these covenants may be affected by events beyond our control, including those described in this Risk Factors section. A breach of any of the covenants contained in our credit facility or our inability to comply with the required financial covenants could result in an event of default, which would allow the lenders under our credit facility to declare all borrowings outstanding to be due and payable, and triggering an event of default under the indenture governing our 9.0% senior subordinated notes. In addition, our lenders could require us to apply all of our available cash to repay our borrowings or they could prevent us from making debt service payments on our 9.0% senior subordinated notes. If the amounts outstanding under our credit facility or these notes are accelerated, we cannot assure you that our assets would be sufficient to repay in full the money we owe the banks and our other debt holders.

The large amount of our outstanding debt and the limitations our credit facility impose on us could have adverse consequences, including:

having to use much of our cash flow for scheduled debt service rather than for operations, future business opportunities or other purposes, such as funding working capital and capital expenditures;

being unable to increase our borrowings under our credit facility or obtain other debt financing for future working capital, capital expenditures, acquisitions or other corporate purposes;

being less able to take advantage of significant business opportunities, including acquisitions or divestitures;

difficulty satisfying our obligations under our 9.0% senior subordinated notes;

increasing our vulnerability to general adverse economic and industry conditions; and

causing us to be at a competitive disadvantage to competitors with less debt.

### **If our costs of insurance and claims increase, then our earnings could decrease.**

We currently maintain programs of general and professional liability insurance and directors and officers insurance with significant deductible or self-insured retention amounts on each claim. In addition, we generally self-insure our employee health plan and workers compensation program, while maintaining excess insurance for some very large claims. We have accepted higher deductibles and self-insurance exposure in each of the last several years to offset part of the increases in premiums for the programs. These deductibles and premiums increased substantially in 2002 and 2003. The rate of increase in deductibles and premiums has moderated somewhat, but there have still been increases, and there may be larger increases in the future. Our earnings could be materially and adversely affected by any of the following:

increases in premiums, deductibles and self-insurance retentions;

increases in the number of liability claims against us or the cost of settling or trying cases related to those claims; and

an inability to obtain one or more types of insurance on acceptable terms.

### **If our board of directors does not approve an acquisition or change in control, then our shareholders may not realize the full value of their stock.**

We have agreed to be acquired by Fresenius Medical Care, subject to a number of conditions. The merger agreement includes provisions that would make it difficult for a competing bidder to acquire Renal Care Group. These provisions include our agreements not to solicit other offers and not to provide information to a potential

bidder, as well as our agreement to pay a termination fee to Fresenius Medical Care if we terminate the merger agreement and complete another transaction. In addition, our certificate of

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incorporation and bylaws contain a number of provisions that may delay, deter or inhibit a future acquisition or change in control that is not first approved by our board of directors. This could occur even if our shareholders receive an attractive offer for their shares or if a substantial number or even a majority of our shareholders believe the takeover is in their best interest. These provisions are intended to encourage any person interested in acquiring us to negotiate with and obtain approval from our board of directors before pursuing a transaction. Provisions that could delay, deter or inhibit a future acquisition or change in control include the following:

- a staggered board of directors that would require two annual meetings to replace a majority of the board of directors;

- restrictions on calling special meetings at which an acquisition or change in control might be brought to a vote of the shareholders;

- blank check preferred stock that may be issued by our board of directors without shareholder approval and that may be substantially dilutive or contain preferences or rights objectionable to an acquirer; and

- a poison pill that would substantially dilute the interest sought by an acquirer.

These provisions could also discourage bids for our common stock at a premium and cause the market price of our common stock to decline.

**Our stock price is volatile and as a result, the value of your investment may go down for reasons unrelated to the performance of our business.**

Our common stock is traded on the New York Stock Exchange. The market price of our common stock has been volatile, ranging from a low closing price of \$35.60 per share to a high closing price of \$47.44 per share during the year ended December 31, 2005. The market price for our common stock could fluctuate substantially based on a variety of factors, including the following:

- the failure to complete the transaction with Fresenius Medical Care;

- future announcements concerning us, our competitors or the health care market;

- the threat, commencement or outcome of litigation or government investigation;

- changes in government regulations; and

- changes in earnings estimates by analysts.

Furthermore, stock prices for many companies fluctuate widely for reasons that may be unrelated to their operating results. These fluctuations, coupled with changes in demand or reimbursement levels for our services and general economic, political and market conditions, could cause the market price of our common stock to decline.

## **Forward-Looking Statements**

Some of the information in this annual report on Form 10-K represents forward-looking statements that involve substantial risks and uncertainties. You can identify these statements by forward-looking words such as *may*, *will*, *expect*, *anticipate*, *believe*, *intend*, *estimate* and *continue* or similar words. You should read statements that contain these words carefully for the following reasons:

- the statements discuss our future expectations;

- the statements contain projections of our future earnings or of our financial condition; and

- the statements state other forward-looking information.

We believe it is important to communicate our expectations to our investors. There may, however, be events in the future that we are not accurately able to predict or over which we have no control. The risk factors listed above, as well as any cautionary language in or incorporated by reference into this annual report on Form 10-K, provide



examples of risks, uncertainties and events that may

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cause our actual results to differ materially from the expectations we describe in our forward-looking statements. The SEC allows us to incorporate by reference the information we file with them, which means we can disclose important information to you by referring you to those documents. Before you invest in our common stock, you should be aware that the occurrence of any of the events described in the above risk factors, elsewhere in or incorporated by reference into this quarterly report on Form 10-Q and other events that we have not predicted or assessed could have a material adverse effect on our earnings, financial condition and business. If the events described above or other unpredicted events occur, then the trading price of our common stock could decline and you may lose all or part of your investment.

**Item 1B. *Unresolved Staff Comments***

None.

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As of December 31, 2005, we operated 456 outpatient dialysis centers in 34 states, of which 407 are located in leased facilities and 49 are owned. The following is a summary of our outpatient dialysis centers by state:

**OUTPATIENT FACILITIES BY STATE**

Alabama	19
Alaska	4
Arizona	31
Arkansas	11
Colorado	3
Florida	20
Georgia	21
Idaho	2
Illinois	34
Indiana	25
Iowa	1
Kansas	13
Kentucky	9
Louisiana	8
Massachusetts	2
Michigan	12
Mississippi	35
Missouri	26
Nebraska	3
Nevada	3
New Jersey	16
New Mexico	4
North Carolina	1
Ohio	29
Oklahoma	7
Oregon	10
Pennsylvania	17
Rhode Island	2
South Carolina	3
Tennessee	21
Texas	48
Virginia	4
Washington	10
Wisconsin	2
<b>TOTAL</b>	<b>456</b>

Our leases generally have terms ranging from one to 15 years and typically contain renewal options. The size of our centers ranges from approximately 1,000 to 25,000 square feet. We lease office space in Nashville, Tennessee for our corporate headquarters under a lease that expires in 2009. We lease other office space in and around Nashville, Tennessee for certain billing and computer operations. We consider our physical properties to be in good operating condition and suitable for the purposes for which they are being used.

Expansion or relocation of our dialysis centers is subject to compliance with conditions relating to participation in the Medicare ESRD program. In states that require a certificate of need or permit of approval, approval of the required application is usually necessary for expansion of an existing dialysis center or development of a new center.

We typically own the equipment used in our outpatient centers. We consider our equipment generally to be in good operating condition and suitable for the purposes for which it is being used.

**Table of Contents****Item 3. Legal Proceedings**

On August 9, 2005, we received a subpoena from the office of the United States Attorney for the Eastern District of Missouri. The subpoena requires the production of documents related to numerous aspects of our business and operations. The subpoena includes specific requests for documents related to our supply company, pharmaceutical and other services we provide to patients (including the administration of EPO), our relationships with pharmaceutical companies, our relationships with physicians, medical director compensation, joint ventures with physicians and our purchases of dialysis equipment from Fresenius Medical Care. The subpoena was issued in connection with a joint civil and criminal investigation. We are cooperating with the government's investigation; we have produced numerous documents to the government in response to the subpoena. We have incurred significant legal and other expenses responding to the subpoena and have experienced distraction of management attention. Compliance with the subpoena will require us to incur substantial additional legal and other expenses and will require further management attention. To our knowledge, no proceedings have been initiated against Renal Care Group at this time, but we cannot predict whether or when proceedings might be initiated. We cannot predict the outcome of any proceedings that may be initiated as a result of this investigation. Any such proceedings could have a material adverse effect on our business, financial condition and results of operation.

On October 25, 2004, we received a subpoena from the office of the United States Attorney for the Eastern District of New York. The subpoena requires the production of documents related to numerous aspects of our business and operations, including those of RenaLab, Inc., the Company's laboratory. The subpoena includes specific requests for documents related to testing for parathyroid hormone (PTH) levels and vitamin D therapies. We are cooperating with the government's investigation. We have produced numerous documents to the government in response to this subpoena. We have incurred significant legal and other expenses responding to the subpoena. Compliance with this subpoena will require us to incur significant additional legal and other expenses and could distract management attention. To our knowledge no proceedings have been initiated against us at this time, but we cannot predict whether or when proceedings might be initiated. We cannot predict the outcome of any proceedings that may be initiated against us as a result of this investigation. Any such proceedings could have a material adverse effect on our business financial condition and results of operations.

On May 11, 2005, Renal Care Group was served with a complaint in the Chancery Court for the State of Tennessee Twentieth Judicial District at Nashville styled *Plumbers Local #65 Pension Fund, on behalf of itself and all others similarly situated, Plaintiff, vs. Renal Care Group, Inc., William P. Johnston, Gary Brukardt, Peter J. Grua, Joseph C. Hutts, Harry R. Jacobson, William V. Lapham, Thomas A. Lowery, Stephen D. McMurray and C. Thomas Smith, Defendants*. On May 26, 2005, we were served with a complaint in the Chancery Court for the State of Tennessee Twentieth Judicial District at Nashville styled *Hawaii Structural Ironworkers Pension Trust Fund, on behalf of itself and all others similarly situated, Plaintiff, vs. Renal Care Group, Inc., William P. Johnston, Gary Brukardt, Peter J. Grua, Joseph C. Hutts, Harry R. Jacobson, William V. Lapham, Thomas A. Lowery, Stephen D. McMurray and C. Thomas Smith, Defendants*. On May 31, 2005, we were served with a complaint in the Chancery Court for the State of Tennessee Twentieth Judicial District at Nashville styled *Indiana State District Council of Laborers and Hod Carriers Pension Fund, on behalf of itself and others similar situated, Plaintiff, vs. Renal Care Group, Inc., William P. Johnston, Gary Brukardt, Peter J. Grua, Joseph C. Hutts, Harry R. Jacobson, William V. Lapham, Thomas A. Lowery, Stephen D. McMurray and C. Thomas Smith, Defendants*. The original complaints in these three lawsuits were substantially identical. Each complaint was brought by the plaintiff shareholder as a purported class action on behalf of all shareholders similarly situated. The complaints allege that Renal Care Group and its directors engaged in self-dealing and breached their fiduciary duties to Renal Care Group's shareholders in connection with the merger agreement between Renal Care Group and Fresenius Medical Care because, among other things, Renal Care Group used a flawed process, the existence of the previously disclosed subpoena from the Department of Justice, the lack of independence of one of Renal Care Group's financial advisors and the existence of Renal Care Group's supplemental executive retirement plan. Renal Care Group removed these cases to federal court in June 2005.

The plaintiffs in the first two cases dismissed them without prejudice in July 2005, and the third plaintiff filed an amended complaint. The amended complaint asserts the same grounds articulated in the original complaint adding

more specific allegations regarding the termination fee, the no solicitation clause and the matching rights provision in the Merger Agreement, and it adds allegations that the our Proxy Statement makes material misrepresentations and omissions regarding the process by which the Merger Agreement was negotiated. Specifically, the Amended Complaint asserts that the Proxy Statement makes material misstatements or omissions regarding: (1) the reason why our management and Board engaged in a closed process of negotiating a potential merger with Fresenius and did not solicit potential competing bids from alternative purchasers; (2) the reason why our Board did not appoint a special committee to evaluate the fairness of the merger; (3) the alternatives available to Renal Care Group, including potential alternative transactions and other strategic business opportunities, which purportedly were considered by the our Board during the strategic planning process the Board engaged in during the second half of 2004; (4) all information regarding conflicts of interest suffered by defendants and their financial and legal advisors as alleged herein; (5) all information regarding past investment banking services Bank of America has performed for Renal Care Group and Fresenius Medical Care and the compensation Bank of America received for those services; (6) the forecasts and projections prepared by our management for fiscal years 2005 through 2008 that were referenced in the fairness opinions by Morgan Stanley; (7) the estimates of transaction synergies provided by our management that were referenced in the fairness opinions by Morgan Stanley; and (8) information concerning the amount of money Bank of America and Morgan Stanley will receive in connection with the Proposed Acquisition. Renal Care Group believes that the allegations in the pending complaint are without merit. Completion of the merger is subject to customary conditions, including the absence of any order or injunction prohibiting the closing. The pending complaint seeks to enjoin and prevent the parties from completing the Fresenius Medical Care transaction. The pending complaint was remanded to Tennessee state court in September 2005.

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We are involved in litigation and regulatory investigations arising in the ordinary course of business. In the opinion of management, after consultation with legal counsel, management believes these matters will be resolved without material adverse effect on Renal Care Group's consolidated financial position or results of operations.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. We believe that we are in compliance with all applicable laws and regulations governing the Medicare and Medicaid programs.

**Item 4. *Submission of Matters to a Vote of Security Holders***

We did not submit any matter to a vote of our shareholders during the fourth quarter of 2005.

**PART II****Item 5. *Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities*****PRICE RANGE OF COMMON STOCK**

Our common stock is traded on the New York Stock Exchange under the symbol RCI. The following table sets forth the quarterly high and low closing sales prices as reported on the New York Stock Exchange for the last two fiscal years.

	<b>2004</b>	<b>High</b>	<b>Low</b>
First quarter		\$31.43	\$27.55
Second quarter		\$34.29	\$29.93
Third quarter		\$33.24	\$30.09
Fourth quarter		\$36.10	\$30.00
	<b>2005</b>	<b>High</b>	<b>Low</b>
First quarter		\$40.00	\$35.60
Second quarter		\$46.38	\$37.20
Third quarter		\$47.32	\$46.15
Fourth quarter		\$47.44	\$46.85

**HOLDERS**

As of March 9, 2006, the approximate number of registered stockholders was 131, and we had approximately 40,500 beneficial owners.

**DIVIDEND POLICY**

We have never paid any cash dividend on our capital stock. We currently anticipate that all of our earnings will be retained to finance the growth and development of our business or to repurchase common stock. We currently do not anticipate that any cash dividend will be declared or paid on our common stock in the foreseeable future. Any future declaration of dividends will be subject to the discretion of our Board of Directors and its review of our earnings, financial condition, capital requirements and surplus, contractual restrictions to pay such dividends and other factors the Board of Directors deems relevant.

**Table of Contents****Item 6. Selected Financial Data**

The selected financial data for the years ended December 31, 2001, 2002, 2003, 2004 and 2005 are derived from the audited consolidated financial statements of the Company and its subsidiaries. The consolidated financial statements and related notes for the years ended December 31, 2003, 2004 and 2005, together with the related Reports of Independent Registered Public Accounting Firm are included elsewhere in this annual report on Form 10-K. Please read the following data in conjunction with the financial statements and related notes and Management's Discussion and Analysis of Financial Condition and Results of Operations that appear elsewhere in this annual report on Form 10-K.

Selected Financial Data  
(in thousands, except per share data)

	<b>Year Ended December 31,</b>				
	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>
<b>INCOME STATEMENT DATA:</b>					
Net revenue	\$ 755,082	\$ 903,387	\$ 1,005,319	\$ 1,345,047	\$ 1,570,226
Patient care costs	489,271	589,696	653,307	893,478	1,039,268
General and administrative expenses	64,530	78,079	90,249	106,823	141,210
Provision for doubtful accounts	20,290	23,501	26,200	32,550	31,978
Depreciation and amortization	38,945	40,432	44,905	58,349	71,400
Total operating costs and expenses	613,036	731,708	814,661	1,091,200	1,283,856
Income from operations	142,046	171,679	190,658	253,847	286,370
Interest expense, net	2,636	1,140	629	20,628	32,908
Income before minority interest and income taxes	139,410	170,539	190,029	233,219	253,462
Minority interest	15,478	21,410	25,431	35,169	35,837
Income before income taxes	123,932	149,129	164,598	198,050	217,625
Provision for income taxes	47,331	56,669	62,542	76,217	87,912
Net income	\$ 76,601	\$ 92,460	\$ 102,056	\$ 121,833	\$ 129,713
Basic net income per share	\$ 1.06	\$ 1.26	\$ 1.40	\$ 1.80	\$ 1.90
Basic weighted average shares outstanding	72,170	73,467	72,719	67,581	68,110
Diluted net income per share	\$ 1.01	\$ 1.21	\$ 1.37	\$ 1.74	\$ 1.83
Diluted weighted average shares outstanding	75,650	76,151	74,753	69,892	70,834
<b>BALANCE SHEET DATA:</b>					
Working capital	\$ 104,047	\$ 110,481	\$ 122,667	\$ 126,965	\$ 140,191



Total assets	651,049	740,123	819,873	1,429,585	1,662,033
Long-term debt	3,776	10,161	2,652	479,645	533,923
Stockholders' equity	510,251	543,888	570,845	592,121	739,637

**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*The following discussion and analysis contains forward-looking statements about our plans and expectations of what may happen in the future. Forward-looking statements are based on a number of assumptions and estimates that are inherently subject to significant risks and uncertainties, and our results could differ materially from the results anticipated by our forward-looking statements as a result of many known or unknown factors, including, but not limited to, those factors discussed on pages 18 to 27 under the heading Risk Factors. Also, please read the cautionary notice regarding forward-looking statements set forth at the beginning of this annual report.*

*Please read the following discussion in conjunction with our consolidated financial statements and the related notes contained elsewhere in this annual report on Form 10-K.*

**Overview**

Renal Care Group provides dialysis services to patients with chronic kidney failure. As of December 31, 2005, we provided dialysis and ancillary services to over 32,300 patients through 456 outpatient dialysis centers in 34 states, in addition to providing acute dialysis services to more than 200 hospitals.

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Our net revenue has been derived primarily from the following sources:

outpatient hemodialysis services;

ancillary services associated with outpatient dialysis, primarily the administration of EPO and other drugs;

home dialysis services;

inpatient hemodialysis services provided to acute care hospitals and skilled nursing facilities;

laboratory services; and

management contracts with hospital-based medical university dialysis programs.

Most patients with ESRD receive three dialysis treatments each week in an outpatient setting. Reimbursement for these services is provided primarily by the Medicare ESRD program based on rates established by CMS. For the year ended December 31, 2005, approximately 56% of our net revenue was derived from reimbursement under the Medicare and Medicaid programs. Medicare reimbursement is subject to rate and other legislative changes by Congress and periodic changes in regulations, including changes that may reduce payments under the ESRD program. Congress approved increases in the composite rate of 1.6% for each of 2005 and 2006. The average revenue per treatment we receive from Medicare and Medicaid is less than our average cost per treatment. Management expects this situation to continue. Any reduction in Medicare and Medicaid payments or shift in our revenue mix toward Medicare or Medicaid reimbursement could materially adversely affect our business and financial condition.

The Medicare composite rate applies to a designated group of outpatient dialysis services, including the dialysis treatment, supplies used for the treatment, certain laboratory tests and medications, and most of the home dialysis services we provide. We receive separate reimbursement outside the composite rate for some other services, drugs (including specific drugs such as EPO) and some physician-ordered tests, including laboratory tests, provided to dialysis patients.

If a patient has private health insurance, then that patient's treatment is typically reimbursed at rates significantly higher than those paid by Medicare during the first 30 months of care. After that period, Medicare becomes the primary payor. Reimbursement for dialysis services provided pursuant to a hospital contract is negotiated with the individual hospital and is usually higher than Medicare rates. Because dialysis is a life-sustaining therapy to treat a chronic disease, utilization is predictable and is not subject to seasonal fluctuations.

We derive a significant portion of our net revenue and net income from the administration of EPO. EPO is manufactured by a single company, Amgen, Inc. In April 2002, Amgen implemented its third EPO price increase of 3.9% in as many years. Because we were already under contract with Amgen through 2002, this price increase did not affect our results of operations during 2002. Key components of the 2002 pricing formula were maintained in our 2003 contract with Amgen. Therefore, while the 2002 price increase had an adverse effect on our 2003 results of operations, we were able to mitigate approximately 80% of the increase. Amgen did not implement a price increase in 2003, but changes in our contract with Amgen for 2004 resulted in an increase in our cost of EPO. Changes in our contract with Amgen for 2005 along with changes in Amgen's packaging practices for EPO resulted in an increase in our cost of EPO in 2005. Changes in our contract with Amgen for 2006 may result in an increase in our cost of EPO in 2006.

In addition, Congress mandated a change in the way we are paid beginning in 2005 for some drugs, including EPO, that we bill for outside of the flat composite rate. This change will result in lower reimbursement for these drugs and a higher composite rate. Under recently adopted regulations, in 2006 we will be reimbursed for separately billable ESRD drugs at the rate of average sales price plus 6.0%. In addition, the composite rate has been increased by 14.7% in 2006 to account for the change in drug reimbursement. These regulations also include geographic designations and wage indices used to calculate the composite rate as well as a budget-neutrality adjustment. We believe these changes coupled with the 1.6% increase in the Medicare composite rate approved for 2006 will have a positive effect on our revenue per treatment and earnings in 2006.



**Table of Contents****Critical Accounting Policies**

In accordance with SEC financial reporting release, FR-60, *Cautionary Advice Regarding Disclosure About Critical Accounting Policies*, we have identified accounting policies that we consider critical to our business. Management identified these policies based on their importance to our Consolidated Financial Statements and on the degrees of subjectivity and complexity involved in these policies. In addition to these critical policies, a summary of significant accounting policies is included in our consolidated financial statements and related notes, contained elsewhere in this annual report on Form 10-K.

The discussion and analysis of our financial condition and results of operations in this annual report on Form 10-K are based upon our Consolidated Financial Statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, net revenues and expenses, and related disclosures of contingent assets and liabilities. We regularly evaluate our critical accounting policies and estimates, including those related to net revenue and contractual provisions and provision for doubtful accounts. We base our estimates on historical experience and upon assumptions that we believe are reasonable under the circumstances. The results of these estimates form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting policies require significant judgments and estimates in the preparation of our consolidated financial statements.

*Net Revenue and Contractual Provisions*

We recognize revenue net of contractual provisions as services are provided and invoices for those services are issued. Contractual provisions represent the difference between our gross billed charges and the amount we expect to receive. Under the Medicare ESRD program, Medicare reimbursement rates for outpatient dialysis treatments are fixed under a composite rate structure. The composite rate applies to a designated group of outpatient dialysis services, including dialysis treatment, supplies, some laboratory tests and some medications. There are other drugs, laboratory tests and services that are eligible for separate reimbursement outside the composite rate. Most state Medicaid plans follow reimbursement methodologies that are similar to the Medicare program, but other payors, particularly private insurance plans and managed care payors, reimburse us under contractual arrangements or based on our charges. Each of these sources of revenues presents unique challenges to the process of recording contractual provisions.

We have made significant investments in human resources and information systems to enable us to estimate the appropriate amount of contractual provisions as we provide services. Actual levels of reimbursement, however, are sometimes difficult to determine due to the complexity of the applicable regulations or contracts. As a result, we may in fact collect more or less than the amount we expected when we provided and billed for the services. In addition, regulations and contracts may be changed, making system updates and maintenance necessary for estimating net revenue accurately. As a result, management may make adjustments to the contractual provisions estimated by the system based on actual collection experience and other factors.

*Provision for Doubtful Accounts*

Collecting outstanding accounts receivable is critical to our success. Our primary source of collection risk is related to the portion of our charges for which the patient is responsible. For Medicare patients, the patients responsibility is 20% of Medicare allowable charges, and for other patients, the patients responsibility varies based on their health coverage. We record an estimate of the provision for doubtful accounts in the period in which the revenue is recognized based on management's estimate of the net collectibility of the accounts receivable. Management estimates and monitors the net collectibility of accounts receivable based upon a variety of factors, including the analysis of payor mix, subsequent collection analysis and review of detailed agings of accounts receivable. Significant changes in our payor mix or business office operations could have a significant impact on our results of operations and cash flows.

**Table of Contents***Self-Insurance Accruals*

From time to time, we are subject to professional liability, general liability and workers compensation claims or lawsuits in the ordinary course of business. To mitigate a portion of this risk, we maintain insurance for professional liability and general liability claims exceeding certain individual amounts and for workers compensation claims exceeding certain individual and aggregate amounts. We estimate the self-insured retention portion of professional liability, general liability and workers compensation risks using third-party actuarial calculations that include historical claims data, demographic factors and other assumptions. The estimated accrual for professional liability, general liability and workers compensation claims could be significantly affected if current and future occurrences differ from historical claims trends. While management monitors current claims closely and considers outcomes when estimating its self-insurance accruals, the complexity of the claims, the wide range of potential outcomes and changes in the legal climate often complicate our ability to make precise estimates.

*Impairment of Goodwill and Long-Lived Assets*

Pursuant to SFAS No. 142, *Goodwill and Other Intangible Assets*, we review goodwill for impairment at a reporting unit level at least annually. Goodwill is tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. Goodwill is assigned to each reporting unit based on the geographic location of assets. If the fair value of a reporting unit is determined to be less than its carrying amount, then the Company compares the implied fair value of the goodwill to its carrying value. If the implied fair value of the goodwill is less than its carrying value, then an impairment loss is recognized for that difference. No goodwill impairment losses were recognized during 2003, 2004 or 2005.

In accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, when events, circumstances or operating results indicate that the carrying value of certain long-lived assets and related identifiable intangible assets (excluding goodwill) that are expected to be held and used, might be impaired, we evaluate such assets for impairment based on estimated undiscounted cash flows expected to result from the use and eventual disposition of the assets. If related long-lived assets are identified as impaired, the impairment is equal to the amount by which the carrying value of the assets exceeds the fair value of those assets as determined by independent appraisals or estimates of discounted future cash flows. Long-lived assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

*Income Taxes*

We account for income taxes under the asset and liability method and recognize deferred tax assets and liabilities for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which these temporary differences are expected to be recovered or settled. The effect of a change in tax rates on deferred tax assets and liabilities is recognized in income in the period that includes the enactment date for the change. Management identifies deferred tax assets that more likely than not will not be realized and records a valuation allowance. We also establish accruals for tax uncertainties that we deem to be probable of loss and that can be reasonably estimated.

**Results of Operations**

The following table sets forth results of operations (in thousands) for the periods indicated and the percentage of net revenue represented by the financial line items shown:

	Year Ended December 31,					
	2003		2004		2005	
Net revenue	\$ 1,005,319	100.0%	\$ 1,345,047	100.0%	\$ 1,570,226	100.0%
Patient care costs	653,307	65.0	893,478	66.4	1,039,268	66.2
General and administrative expenses	90,249	9.0	106,823	7.9	141,210	9.0
	26,200	2.6	32,550	2.4	31,978	2.0

Provision for doubtful accounts						
Depreciation and amortization	44,905	4.4	58,349	4.3	71,400	4.5
Total operating costs and expenses	814,661	81.0	1,091,200	81.1	1,283,856	81.8
Income from operations	190,658	19.0	253,847	18.9	286,370	18.2
Interest expense, net	629	0.1	20,628	1.5	32,908	2.1
Minority interest	25,431	2.5	35,169	2.6	35,837	2.3
Income before income taxes	164,598	16.4	198,050	14.7	217,625	13.9
Provision for income taxes	62,542	6.2	76,217	5.7	87,912	5.6
Net income	\$ 102,056	10.2%	\$ 121,833	9.1%	\$ 129,713	8.3%

**Table of Contents****Year Ended December 31, 2005 Compared to Year Ended December 31, 2004**

*Net Revenue.* Net revenue increased from \$1,345.0 million for the year ended December 31, 2004 to \$1,570.2 million for the year ended December 31, 2005, an increase of \$225.2 million, or 16.7%. This increase resulted primarily from a 14.1% increase in the number of treatments we performed from 4,240,440 in 2004 to 4,837,565 in 2005 and a 2.2% increase in the average patient revenue per dialysis treatment from \$316 in 2004 to \$323 in 2005. The increase was largely due to the impact of price increases to our commercial payors and benefits from renegotiating certain managed care contracts. In addition, revenue per treatment increased modestly as a result of the net impact of Medicare's 1.6% composite rate increase and changes in its reimbursement for separately billable drugs, along with the case mix adjustment that became effective in April 2005, all of which resulted from the Medicare Modernization Act. These favorable effects on our revenue per treatment were partially offset by increases in the percentage of total net revenue that was derived from reimbursement under the Medicare and Medicaid programs. We expect our 2006 patient service revenue per dialysis treatment increases to be consistent with the increase experienced in 2006.

*Patient Care Costs.* Patient care costs consist of costs directly related to the care of patients, including direct labor, drugs and other medical supplies, and operational costs of facilities. Patient care costs increased from \$893.5 million for the year ended December 31, 2004 to \$1,039.3 million for the year ended December 31, 2005, an increase of 16.3%. This increase was due principally to the increase in the number of treatments performed during the period, which was reflected in corresponding increases in the use of labor, drugs and supplies. Patient care costs as a percentage of net revenue decreased slightly from 66.4% in 2004 to 66.2% in 2005. Patient care costs per treatment increased 1.9% from \$211 in 2004 to \$215 in 2005. The increase in patient care costs per treatment was primarily due to increased labor costs, as we utilized more contract labor in 2005 than we used in 2004 and as labor and benefit costs rose generally. The effect of these increases was partially offset by decreases in our accruals for self-insurance liabilities and workers' compensation liabilities.

*General and Administrative Expenses.* General and administrative expenses include corporate office costs and other costs not directly related to the care of patients, including facility administration, accounting, billing and information systems. General and administrative expenses increased from \$106.8 million for the year ended December 31, 2004 to \$141.2 million for the year ended December 31, 2005, an increase of 32.2%. The increase in general and administrative expenses included \$14.9 million of transaction costs that we incurred in connection with the agreement by Fresenius Medical Care to acquire Renal Care Group. In addition, we experienced significant increases in legal costs during 2005 as we responded to the investigations under the subpoenas we received from the offices of the United States Attorney for the Eastern District of Missouri and the United States Attorney for the Eastern District of New York. General and administrative expenses as a percentage of net revenue increased from 7.9% in 2004 to 9.0% in 2005. Excluding the effect of the \$14.9 million of costs related to the transaction with Fresenius Medicare Care, general and administrative costs as a percentage of revenue were 8.0% in 2005. Management believes that we will continue to face significant increases in general and administrative expenses in connection with both the Fresenius Medical Care transaction and compliance with the Missouri and New York subpoenas.

*Provision for Doubtful Accounts.* Management determines the provision for doubtful accounts as a function of payor mix, billing practices and other factors. We reserve for doubtful accounts in the period when we recognize revenue based on management's estimate of the net collectibility of the accounts receivable. Management estimates the net collectibility of accounts receivable based upon a variety of factors. These factors include, but are not limited to, analyzing revenues generated from payor sources, performing subsequent collection testing and regularly reviewing detailed accounts receivable agings. Management makes adjustments to the allowance for doubtful accounts as necessary based on the results of management's reviews of the net collectibility of accounts receivable. The provision for doubtful accounts decreased from \$32.6 million in 2004 to \$32.0 million in 2005, a decrease of \$572,000, or 1.8%. The provision for doubtful accounts as a percentage of net revenue decreased from 2.4% in 2004 to 2.0% in 2005. The decrease in the provision for doubtful accounts was the result of our collection of approximately \$4.3 million in Medicare cost report payments in the third quarter of 2005. Specifically, during the third quarter of 2005 we recorded the final determination of significant Medicare cost report amounts related to acquired National



Nephrology Associates operations. Excluding the impact of any additional Medicare bad debt recoveries, management expects the provision for doubtful accounts for 2006 to be in our historic range of between 2.0% and 2.5% of net revenue.

*Depreciation and Amortization.* Depreciation and amortization increased from \$58.3 million for the year ended December 31, 2004 to \$71.4 million for the year ended December 31, 2005, an increase of 22.4%. This increase was due to the start-up of dialysis facilities, the normal replacement costs of dialysis facilities and equipment, the purchase of information systems and the amortization



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of separately identifiable intangible assets associated with acquisitions. Depreciation and amortization as a percentage of net revenue increased from 4.3% in 2004 to 4.5% in 2005.

*Income from Operations.* Income from operations increased from \$253.8 million for the year ended December 31, 2004 to \$286.4 million for the year ended December 31, 2005, an increase of 12.8%. Income from operations as a percentage of net revenue decreased from 18.9% in 2004 to 18.2% in 2005 period as a result of the combined effects of the factors discussed above, principally the increase in general and administrative expenses.

*Interest Expense, Net.* Interest expense increased from \$20.6 million for the year-ended December 31, 2004 to \$32.9 million for the year ended December 31, 2005. This increase was the result of higher average borrowings in 2005, which were primarily associated with the recent acquisitions, our purchases of noncontrolling interests in joint venture entities that we consolidated. In addition, interest expense was higher as a result of increases in the Company's weighted average borrowing rate as interest rates rose throughout 2005.

*Minority Interest.* Minority interest represents the proportionate equity interest of other owners in consolidated entities that we do not wholly own. The financial results of those entities are included in the Company's consolidated results. Minority interest as a percentage of net revenue decreased from 2.6% in 2004 to 2.3% in 2005. The reduction in minority interest expense as a percentage of revenue was the result of our purchase of the interests of the minority partners in some of our joint ventures coupled with a slight decrease in the profitability of some of the facilities that we operate as joint ventures. During 2005, we purchased minority partner interests in ten joint ventures. As of December 31, 2005, we were the majority and controlling owner in 64 joint ventures as compared to 70 as of December 31, 2004.

*Provision for Income Taxes.* Income tax expense increased from \$76.2 million in 2004 to \$87.9 million in 2005, an increase of \$11.7 million or 15.3%. The increase is a result of increases in pre-tax earnings and our effective tax rate. Our effective tax rate was 38.5% for the 2004 period compared to 40.4% for the 2005 period. The increase is primarily attributable to the fact that some of the transaction costs we incurred in connection with the agreement with Fresenius Medical Care to acquire Renal Care Group will not be deductible for income tax purposes.

*Net Income.* Net income increased from \$121.8 million in 2004 to \$129.7 million in 2005, an increase of \$7.9 million or 6.5%. This increase was a result of the items discussed above.

### **Year Ended December 31, 2004 Compared to Year Ended December 31, 2003**

*Net Revenue.* Net revenue increased from \$1,005.3 million for the year ended December 31, 2003 to \$1,345.0 million for the year ended December 31, 2004, an increase of \$339.7 million, or 33.8%. This increase resulted primarily from a 30.3% increase in the number of treatments we performed from 3,254,447 in 2003 to 4,240,440 in 2004 and a 2.6% increase in the average patient revenue per dialysis treatment from \$308 in 2003 to \$316 in 2004. This growth in treatments was largely the result of our acquisition of NNA in April 2004 and our other 2004 acquisitions, along with a 3.3% increase in same-market treatments for 2004 over 2003. The increase in patient revenue per treatment from 2003 was largely due to the impact of our annual price increase implemented in the fourth quarter of 2003 along with favorable renegotiations of some of our managed care contracts, increased utilization of some ancillary drugs, primarily EPO, and the favorable resolution of several contractual issues with payors during 2004. This increase was partially offset by lower revenue per treatment in the former NNA operations.

*Patient Care Costs.* Patient care costs increased from \$653.3 million for the year ended December 31, 2003 to \$893.5 million for the year ended December 31, 2004, an increase of 36.8%. This increase was due principally to the increase in the number of treatments performed during the period, which was reflected in corresponding increases in the use of labor, drugs and supplies. Patient care costs as a percentage of net revenue increased from 65.0% in 2003 to 66.4% in 2004. This increase was due to generally higher salary and benefit costs, lease costs and routine supply costs experienced in the former NNA facilities. Patient care costs per treatment increased 5.0% from \$201 in 2003 to \$211 in 2004. The increase in patient care costs per treatment was due to increases in the price and utilization of EPO, increased labor costs, increases in the cost of insurance, increases in self-insurance accruals, and changes in the utilization of certain ancillary drugs, as well as the higher cost structure in the former NNA facilities.

*General and Administrative Expenses.* General and administrative expenses increased from \$90.2 million for the year ended December 31, 2003 to \$106.8 million for the year ended December 31, 2004, an increase of 18.4%. The increase in general and administrative expenses over 2003 was due to increased costs associated with the acquisitions

that we closed in 2004. General and administrative expenses as percentage of revenue decreased from 9.0% in 2003 to 7.9% in 2004 as we leveraged our corporate functions over a larger base of revenue as a result of our acquisitions in

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2004 and because general and administrative expenses for 2004 did not include the \$5.4 million charge we incurred in the first quarter of 2003 for a retirement benefit plan for our former chairman, chief executive officer and president. General and administrative expenses in the fourth quarter of 2004 included write-offs of expenses incurred in connection with several acquisitions that were not completed and the cost of complying with the subpoena we received from the United States Attorney's Office for the Eastern District of New York.

*Provision for Doubtful Accounts.* The provision for doubtful accounts increased from \$26.2 million in 2003 to \$32.6 million in 2004, an increase of \$6.4 million, or 24.2%. The provision for doubtful accounts as a percentage of net revenue decreased in 2004 to 2.4% from 2.6% in 2003 principally as a result of our improved collection experience.

*Depreciation and Amortization.* Depreciation and amortization increased from \$44.9 million for the year ended December 31, 2003 to \$58.3 million for the year ended December 31, 2004, an increase of 29.9%. This increase was due to the start-up of dialysis facilities, the normal replacement costs of dialysis facilities and equipment, the purchase of information systems and the amortization of separately identifiable intangible assets associated with acquisitions. Depreciation and amortization as a percentage of net revenue decreased from 4.5% in 2003 to 4.3% in 2004 principally as a result of NNA's practice of leasing dialysis equipment under operating leases, which resulted in lower depreciation and amortization and higher patient care costs.

*Income from Operations.* Income from operations increased from \$190.7 million for the year ended December 31, 2003 to \$253.8 million for the year ended December 31, 2004, an increase of 33.1%. Income from operations as a percentage of net revenue decreased slightly from 19.0% in 2003 to 18.9% in 2004 period principally as a result of the acquisition of NNA, which had generally lower margins than the Company as a result of NNA's lower revenue per treatment and higher patient care costs and other factors discussed above.

*Interest Expense, Net.* Interest expense increased from \$629,000 for the year-ended December 31, 2003 to \$20.6 million for the year ended December 31, 2004. This increase was the result of substantially higher average borrowings in 2004, which were associated with the completion of our program to repurchase \$250.0 million in common stock between November 2003 and March 2004, our 2004 acquisitions and the assumption of NNA's \$160.0 million 9.0% senior subordinated notes.

*Minority Interest.* Minority interest as a percentage of net revenue increased to 2.6% in 2004 from 2.5% in 2003. The change in minority interest expense as a percentage of revenue occurred as acquisitions in 2004 increased the percentage of our facilities that operate as joint ventures. As of December 31, 2004, we were the majority and controlling owner in 70 joint ventures, as compared to 50 as of December 31, 2003.

*Provision for Income Taxes.* Income tax expense increased from \$62.5 million in 2003 to \$76.2 million in 2004, an increase of \$13.7 million or 21.9%. The increase is a result of increases in pre-tax earnings and our effective tax rate. Our effective tax rate was 38.0% for the 2003 period compared to 38.5% for the 2004 period. The increase reflects a higher overall effective rate associated with the operations acquired from NNA.

*Net Income.* Net income increased from \$102.1 million in 2003 to \$121.8 million in 2004, an increase of \$19.8 million or 19.4%. This increase was a result of the items discussed above.

**Liquidity and Capital Resources**

We require capital primarily to acquire and develop dialysis centers, to purchase property and equipment for existing centers, to repurchase shares of our common stock and to finance working capital needs. At December 31, 2005, our working capital was \$140.2 million; cash and cash equivalents were \$2.5 million; and our current ratio was 1.5 to 1.0.

Net cash provided by operating activities was \$190.0 million for the year ended December 31, 2005. Cash provided by operating activities consists primarily of net income before depreciation and amortization expense, adjusted for changes in components of working capital, primarily accounts receivable. Net cash used in investing activities was \$285.5 million for the year ended December 31, 2005. Cash used in investing activities consisted primarily of \$91.4 million of purchases of property and equipment, \$146.8 million of cash paid for acquisitions, net of cash acquired and \$51.0 million of cash paid for noncontrolling interests in consolidated subsidiaries. Net cash provided by financing activities was \$80.1 million for the year ended December 31, 2005. Cash provided by financing activities primarily reflects proceeds from the issuance of long-term debt, net of payments of \$77.7 million,

net proceeds of \$17.0 million from the issuance of common stock, offset by \$9.4 million in repurchases of our common stock.

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We are a party to a credit agreement with a group of banks totaling up to \$700.0 million. The credit agreement has a \$150.0 million revolving credit facility, a \$325.0 million term loan facility, a \$100.0 million second term loan, and a \$125.0 million incremental term loan facility. Borrowings under the incremental term loan facility are subject to obtaining commitments from the banks and finalizing specific terms. In May 2005, we finalized the terms of a \$100.0 million incremental term loan under the credit agreement, and we refer to this loan as the second term loan. We used the proceeds of this second term loan to finance some of our 2005 acquisitions. The revolving credit facility and the \$425.0 million term loans have a final maturity of February 10, 2009. Each of our wholly-owned subsidiaries has guaranteed all of our obligations under the credit agreement. Further, our obligations under the credit agreement, and our subsidiaries' obligations under their guarantees, are secured by a pledge of the equity interests we hold in each of our subsidiaries. The credit agreement includes financial covenants that are customary based on the amount and duration of the agreement.

Borrowings under the \$150.0 million revolving credit facility may be used for acquisitions, repurchases of our stock, capital expenditures, working capital and general corporate purposes. As of December 31, 2005, we can borrow up to \$150.0 million under the revolving credit facility but cannot borrow any additional amounts under the \$325.0 million term loan facility, the \$100.0 million second term loan, or the \$125.0 million incremental term loan facility. At December 31, 2005, our outstanding indebtedness was \$576.1 million, including a remaining balance of \$290.5 million under the term loan facility, \$100.0 million under the second term loan, \$180.5 million of 9.0% senior subordinated notes assumed in our acquisition of NNA and \$5.1 million of other indebtedness, primarily capital leases.

Borrowings under our credit agreement bear interest at variable rates determined by our leverage ratio. These variable rate debt instruments carry a degree of interest rate risk, and we will face higher interest costs on this debt if interest rates rise.

Effective June 30, 2004, we entered into interest rate swap agreements to hedge the interest rate risk on \$150.0 million of our \$325.0 million term loan facility. Under these interest rate swap agreements we exchange fixed and variable rate interest payments based on a \$150.0 million notional principal amount through March 30, 2007. The notional amount of \$150.0 million and the interest rate of 3.5% are fixed in the agreements. The changes in cash flows under these agreements are expected to offset the changes in interest rate payments attributable to fluctuations in LIBOR. The hedge is structured to qualify for the shortcut method; therefore, we record changes in the fair value of the agreement directly in other comprehensive income. The interest payments under this agreement are settled on a net basis each calendar quarter.

The 9.0% senior subordinated notes we assumed in the NNA transaction bear interest at the rate of 9.0% on the face amount. As of December 31, 2005 these notes have a remaining face value of \$159.7 million and are recorded at their carrying value of \$180.5 million. These notes do not provide for scheduled principal amortization and are scheduled to mature on November 1, 2011. Each of our wholly-owned subsidiaries has guaranteed all of our obligations under these notes. The rights of the noteholders and our obligations under these notes are set forth in an indenture we assumed in connection with the NNA acquisition. The indenture includes customary financial covenants.

As a result of our indebtedness, we will incur substantial interest expense in and after 2006. Based on our outstanding funded indebtedness of \$555.3 million, excluding the unamortized fair value premium of \$20.8 million on the 9.0% Senior Subordinated Notes, the aggregate maturities of our borrowings are as follows: 2006 \$42.2 million; 2007 \$80.3 million; 2008 \$208.0 million; 2009 \$62.0 million; 2010 \$318,000; and thereafter \$162.6 million.

We plan to make capital expenditures of between \$90.0 million and \$100.0 million in 2006, primarily for equipment replacement, expansion of existing dialysis facilities and construction of de novo facilities. We expect that these capital expenditures will be funded with cash provided by operating activities and our existing credit facility. Management believes that capital resources available to us will be sufficient to meet the needs of our business, both on a short- and long-term basis.

We have a stock repurchase program. Pending the completion of the Fresenius Medical Care transaction we do not plan to repurchase shares under this program. During 2004, we repurchased 4.6 million shares for \$137.8 million, and

in the first quarter of

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2005, we repurchased 252,000 shares of common stock for approximately \$9.4 million. As of December 31, 2005, we had repurchased an aggregate of 14.8 million shares under our stock repurchase plan, for a total of approximately \$381.6 million.

SEC financial reporting release, FR-61, *Commission Statement about Management's Discussion and Analysis of Financial Condition and Results of Operations* encourages public companies to give investors additional information about funds that will be required to operate their businesses in the future under agreements that are in place today. In accordance with FR-61, the following table gives information about our existing contractual obligations. At December 31, 2005, we had no significant contingent commitments.

Contractual Obligations	Total	Payments Due by Period (in thousands)			
		Less than 1 year	1 - 3 years	3 - 5 years	After 5 years
Long-term debt	\$ 550,695	\$ 42,260	\$ 287,031	\$ 61,719	\$ 159,685
Capital leases	7,126	800	1,401	1,191	3,734
Operating leases	302,306	47,961	86,376	66,054	101,915
Medical director fee obligations	168,511	28,971	52,686	38,847	48,007
Total contractual cash obligations	\$ 1,028,638	\$ 119,992	\$ 427,494	\$ 167,811	\$ 313,341

**Newly Issued Accounting Standards**

In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123 (revised 2004), *Share-Based Payment* (SFAS No. 123(R)), which is a revision of SFAS No. 123, *Accounting for Stock-Based Compensation* (SFAS No. 123). SFAS No. 123(R) supersedes APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and amended SFAS No. 95, *Statement of Cash Flows*. Generally, the approach in SFAS No. 123(R) is similar to the approach described in SFAS No. 123. However, SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative. We adopted SFAS No. 123(R) on January 1, 2006.

As permitted by SFAS No. 123, for periods ended prior to January 1, 2006 we accounted for share-based payments to employees using APB Opinion No. 25's intrinsic value method and, as such, generally recognize no compensation cost for employee stock options. We cannot predict the impact of adopting of SFAS No. 123(R) because it will depend on levels of share-based payments granted in the future. However, had we adopted SFAS No. 123(R) in prior periods, the impact of that standard would have approximated the impact of SFAS No. 123 as described in the disclosure of pro forma net income and earnings per share in Note 9 to our consolidated financial statements. SFAS No. 123(R) also requires the benefits of tax deductions in excess of recognized compensation cost to be reported as a financing cash flow, rather than as an operating cash flow as required under current literature. This requirement will reduce net operating cash flows and increase net financing cash flows in periods after we adopt SFAS 123(R). While we cannot estimate what those amounts will be in the future (because they depend on, among other things, when employees exercise stock options), the amount of operating cash flows recognized in prior periods for such excess tax deductions were \$13.6 million, \$11.3 million and \$8.6 million in 2003, 2004, and 2005, respectively.

**Impact of Inflation**

A substantial portion of our net revenue is subject to reimbursement rates that are regulated by the federal government and do not automatically adjust for inflation. We are unable to increase the amount we receive for the services provided by our dialysis business that are reimbursed under or by reference to the Medicare composite rate. Increased operating costs due to inflation, such as labor and supply costs (including the cost of EPO), without a corresponding increase in reimbursement rates, may adversely affect our results of operations, financial condition and business.

### **Off-Balance Sheet Arrangements**

We have no off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

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We maintain all cash in United States dollars in highly liquid, interest-bearing, investment grade instruments with maturities of less than three months, which we consider cash equivalents; therefore, we have no market risk sensitive instruments.

**Outstanding Debt**

As of December 31, 2005, we had outstanding debt of \$576.1 million, including a \$20.8 million fair value premium on the 9.0% senior subordinated notes. This debt consisted of \$290.5 million outstanding under a term loan facility and \$100.0 million outstanding under a second term loan, \$180.5 million of indebtedness relating to the 9.0% senior subordinated notes due 2011 and approximately \$5.1 million outstanding under various capital leases and notes payable. Borrowings of \$140.5 million under the term loan facility and the \$100.0 million under the second term loan bear interest at variable rates based on LIBOR rates or the prime rate that are determined by our leverage ratio. The remaining \$150.0 million under the term loan are fixed at a rate of 3.5% plus an additional spread based on the Company's leverage ratio under interest rate swap agreements that became effective on June 30, 2004. Our weighted average borrowing rates under the term loan facility and the second term loan as of December 31, 2005, were 5.7% and 5.4%, respectively. We expect these rates to rise in the future if interest rates rise on the portion that bears interest at floating rates. Outstanding senior subordinated notes bear nominal interest at 9.0% on the \$159.7 million outstanding face amount of the notes. The unamortized \$20.8 million fair value premium is being recognized over the life of the notes using the effective interest method and is recorded as a reduction to interest expense. Accordingly, the effective interest rate on the notes was 6.4% as of December 31, 2005. At December 31, 2005, the fair value of our indebtedness under the credit facility and senior subordinated notes approximated carrying value. At the December 31, 2005 borrowing levels and giving effect to the impact of our interest rate swap agreements, if there had been a 1% increase in the variable interest rates, then our pre-tax income would have decreased by approximately \$5.3 million for the year ended December 31, 2005.

**Item 8. *Financial Statements and Supplementary Data***

The consolidated financial statements and financial statement schedule in Part IV, Item 15(a) (1) and (2) of the report are incorporated by reference into this Item 8.

**Item 9. *Changes in and Disagreements with Accountants on Accounting and Financial Disclosure***

None.

**Item 9A. *Controls and Procedures***

Our Chief Executive Officer and Chief Financial Officer evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this report. Our Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this report, we maintain disclosure controls and procedures that provide reasonable assurance that information that we are required to disclose in the reports that we file or submit under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and our Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

There were no changes in our internal control over financial reporting that occurred during the year ended December 31, 2005 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Management's Report on Internal Control Over Financial Reporting set forth on Page F-1 in Part IV, Item 15(a) of this report and the Attestation Report of the Registered Public Accounting Firm set forth on Page F-3 are incorporated by reference into this Item 9A.

**Item 9B. *Other Information***

None.

**Table of Contents****PART III****Item 10. Directors and Executive Officers of the Registrant**

The information required by this item will appear in, and is incorporated by reference from, the sections entitled Proposals for Stockholder Action Proposal 1. Election of Directors and Management Directors and Executive Officers included in the Company's definitive Proxy Statement relating to the 2006 Annual Meeting of Stockholders.

We have adopted a code of ethics that applies to all of our directors, officers and employees. This code is publicly available in the investor relations area of our website at [www.renalcaregroup.com](http://www.renalcaregroup.com). This code of ethics is not incorporated in this report by reference. Copies of our code of ethics may also be requested in print by writing to Investor Relations at Renal Care Group, Inc., 2525 West End Avenue, Suite 600, Nashville, Tennessee 37203.

**Item 11. Executive Compensation**

The information required by this item will appear in the section entitled Executive Compensation included in the Company's definitive Proxy Statement relating to the 2006 Annual Meeting of Stockholders, which information, other than the Compensation Committee Report and Performance Graph required by Items 402(k) and (l) of Regulation S-K, is incorporated herein by reference.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**  
**Securities Authorized for Issuance Under Equity Compensation Plans** (number of shares in thousands)

The following table summarizes our equity compensation plans as of December 31, 2005:

<b>Plan Category (1)</b>	<b>Number of Shares to Be Issued Upon Exercise of Outstanding Options, Warrants And Rights (a)</b>	<b>Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights (b)</b>	<b>Number of Shares Remaining Available For Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected In Column (a)) (c)</b>
Equity compensation plans approved by stockholders	7,893	\$ 20.83	7,116
Equity compensation plans not approved by stockholders (2)	124	\$ 7.80	
<b>Total</b>	<b>8,017</b>	<b>\$ 21.48</b>	<b>7,116</b>

(1) Renal Care Group currently has three option plans that were assumed in connection with a merger, acquisition or other transaction. The first such plan was adopted by Renal Disease Management by Physicians, Inc. in 1997, and there are 9 options issued and outstanding to purchase shares at a weighted average exercise price of \$15.16. The second plan was adopted by Dialysis Centers of America, Inc. in 1995, and there are 18 options issued and outstanding to purchase shares at a weighted average exercise price of \$17.05. The third plan was adopted in 1994, and there are 13 options issued and outstanding under such plan to purchase shares at a weighted average exercise price of \$2.22.

(2) These options were issued outside of our existing stock option plans to certain employees, officers, directors, and other key persons. These options vest over various periods up to five years and have a term of 10 years from the

date of issuance.

Further information concerning these plans is incorporated by reference to Note 9 in the Consolidated Financial Statements included in this annual report on Form 10-K.

The other information required by this item will appear in, and is incorporated by reference from, the section entitled "Security Ownership of Directors, Officers and Principal Stockholders" included in the Company's definitive Proxy Statement relating to the 2006 Annual Meeting of Stockholders.

**Item 13. *Certain Relationships and Related Transactions***

The information required by this item will appear in, and is incorporated by reference from, the sections entitled "Compensation Committee Interlocks and Insider Participation" and "Certain Relationships and Related Transactions" included in the Company's definitive Proxy Statement relating to the 2006 Annual Meeting of Stockholders.

**Item 14. *Principal Accountant Fees and Services***

The information required by this item will appear in, and is incorporated by reference from, the section entitled "Auditors" included in the Company's definitive Proxy Statement relating to the 2006 Annual Meeting of Stockholders.

**Table of Contents****PART IV****Item 15. Exhibits and Financial Statement Schedules**

	<b>Page</b>
(a) Documents filed as part of this Report:	
(1) Consolidated Financial Statements	
<u>Management's Report on Internal Control over Financial Reporting</u>	F- 1
<u>Report of Independent Registered Public Accounting Firm</u>	F- 2
<u>Report of Independent Registered Public Accounting Firm</u>	F- 3
<u>Consolidated Balance Sheets at December 31, 2004 and 2005</u>	F- 4
<u>Consolidated Income Statements for the years ended December 31, 2003, 2004, and 2005</u>	F- 6
<u>Consolidated Statements of Stockholders' Equity for the years ended December 31, 2003, 2004, and 2005</u>	F- 7
<u>Consolidated Statements of Cash Flows for the years ended December 31, 2003, 2004, and 2005</u>	F- 8
<u>Notes to Consolidated Financial Statements</u>	F-10
(2) Consolidated Financial Statement Schedules	
<u>Schedule II - Consolidated Schedule-Valuation and Qualifying Accounts</u>	F-30
(3) The Exhibits are listed in the Index of Exhibits Required by Item 601 of Regulation S-K included herewith, which is incorporated by reference.	
(b) None.	

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**MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

Management of Renal Care Group, Inc. is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act rules 13a-15(f). The Company's internal control over financial reporting is a process designed under the supervision of the Company's chief executive officer and chief financial officer to provide reasonable assurance about the reliability of financial reporting and the preparation of the Company's financial statements for external reporting purposes in accordance with U.S. generally accepted accounting principles.

As of December 31, 2005 management conducted an assessment of the effectiveness of the Company's internal control over financial reporting based on the framework established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, management has determined that the Company's internal control over financial reporting as of December 31, 2005 is effective.

The Company's internal control over financial reporting includes policies and procedures that (1) pertain to the maintenance of records that accurately and fairly reflect transactions and dispositions of assets in reasonable detail; (2) provide reasonable assurances that the Company records transactions as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles, and that the Company makes receipts and expenditures only in accordance with authorizations of management of the Company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the Company's financial statements.

Management's assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2005 has been audited by Ernst & Young LLP, an independent registered public accounting firm, as stated in that firm's attestation report appearing on page F-3.

/s/ Gary A. Brukardt

*President and Chief Executive  
Officer*

/s/ David M. Dill

*Executive Vice President and Chief  
Financial Officer*

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To The Board of Directors and Shareholders of  
Renal Care Group, Inc.

We have audited the accompanying consolidated balance sheets of Renal Care Group, Inc. as of December 31, 2004 and 2005 and the related consolidated income statements, statements of stockholders' equity, and statements of cash flows for each of the three years in the period ended December 31, 2005. Our audits also included the financial statement schedule listed in the Index at Item 15(a). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Renal Care Group, Inc. at December 31, 2004 and 2005 and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2005, in conformity with U. S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Renal Care Group, Inc.'s internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated March 10, 2006 expressed an unqualified opinion thereon.

Nashville,	/s/ ERNST &
Tennessee	YOUNG LLP
March 10,	
2006	

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Shareholders of  
Renal Care Group, Inc.

We have audited management's assessment, included in the accompanying Management's Report on Internal Control Over Financial Reporting, that Renal Care Group, Inc. maintained effective internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that Renal Care Group, Inc. maintained effective internal control over financial reporting as of December 31, 2005, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, Renal Care Group, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets as of December 31, 2004 and 2005, and the related consolidated income statements, statements of stockholders' equity, and statements of cash flows for each of the three years in the period ended December 31, 2005 of Renal Care Group, Inc., and our report dated March 10, 2006 expressed an unqualified opinion thereon.

Nashville,  
Tennessee  
March 10,  
2006

/s/ ERNST &  
YOUNG LLP

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**Renal Care Group, Inc.**  
**Consolidated Balance Sheets**  
(in thousands)

	<b>December 31</b>	
	<b>2004</b>	<b>2005</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 17,931	\$ 2,511
Accounts receivable, less allowance for doubtful accounts of \$45,131 in 2004 and \$28,560 in 2005	275,373	297,983
Inventories	23,359	34,801
Prepaid expenses and other current assets	26,817	30,976
Income taxes receivable		3,700
Deferred income taxes	29,604	32,989
Total current assets	373,084	402,960
Property, plant and equipment, net	316,532	362,224
Intangible assets, net	34,320	39,177
Goodwill	694,264	849,879
Other assets	10,780	7,793
Total assets	\$ 1,428,980	\$ 1,662,033

See accompanying notes to consolidated financial statements.

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**Renal Care Group, Inc.**  
**Consolidated Balance Sheets**  
(in thousands, except per share data)

	<b>December 31</b>	
	<b>2004</b>	<b>2005</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 29,075	\$ 34,158
Accrued compensation	54,129	62,335
Due to third-party payors	80,007	60,156
Income taxes payable	399	
Accrued expenses and other current liabilities	56,326	63,922
Current portion of long-term debt	23,969	42,198
Total current liabilities	243,905	262,769
Long-term debt, net of current portion	479,645	533,923
Deferred income taxes	51,419	55,827
Other long-term liabilities	16,271	17,102
Minority interest	45,619	52,775
Total liabilities	836,859	922,396
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, \$0.01 par value, 10,000 shares authorized, none issued		
Common stock, \$0.01 par value, 150,000 shares authorized, 82,317 and 83,286 shares issued at December 31, 2004 and 2005, respectively	823	833
Treasury stock, 14,514 and 14,766 shares of common stock at December 31, 2004 and 2005, respectively	(372,249)	(381,635)
Additional paid-in capital	411,888	437,478
Retained earnings	551,863	681,576
Accumulated other comprehensive (loss) income, net of tax	(204)	1,385
Total stockholders' equity	592,121	739,637
Total liabilities and stockholders' equity	\$ 1,428,980	\$ 1,662,033

See accompanying notes to consolidated financial statements.

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**Renal Care Group, Inc.**  
**Consolidated Income Statements**  
(in thousands, except per share data)

	<b>Year Ended December 31</b>		
	<b>2003</b>	<b>2004</b>	<b>2005</b>
Net revenue	\$ 1,005,319	\$ 1,345,047	\$ 1,570,226
Operating costs and expenses:			
Patient care costs	653,307	893,478	1,039,268
General and administrative expenses	90,249	106,823	141,210
Provision for doubtful accounts	26,200	32,550	31,978
Depreciation and amortization	44,905	58,349	71,400
Total operating costs and expenses	814,661	1,091,200	1,283,856
Income from operations	190,658	253,847	286,370
Interest expense, net	629	20,628	32,908
Income before minority interest and income taxes	190,029	233,219	253,462
Minority interest	25,431	35,169	35,837
Income before income taxes	164,598	198,050	217,625
Provision for income taxes	62,542	76,217	87,912
Net income	\$ 102,056	\$ 121,833	\$ 129,713
Net income per share:			
Basic	\$ 1.40	\$ 1.80	\$ 1.90
Diluted	\$ 1.37	\$ 1.74	\$ 1.83
Weighted average shares outstanding:			
Basic	72,719	67,581	68,110
Diluted	74,753	69,892	70,834

See accompanying notes to consolidated financial statements.

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**Renal Care Group, Inc.**  
**Consolidated Statements of Stockholders' Equity**  
(in thousands)

	Common Stock		Treasury Stock		Additional Paid-In	Retained	Accumulated Other Comprehensive (Loss)/Income Net of Tax	Total Stockholders' Equity
	Shares	Amount	Shares	Amount	Capital	Earnings		Equity
Balance at December 31, 2002	76,764	\$ 768	4,475	\$ (93,953)	\$ 309,099	\$ 327,974	\$	\$ 543,888
Net income						102,056		102,056
Common stock issued and related income tax benefit	3,701	37			65,315			65,352
Repurchase of common stock held in treasury			5,487	(140,451)				(140,451)
Balance at December 31, 2003	80,465	805	9,962	(234,404)	374,414	430,030		570,845
Comprehensive income:								
Net income						121,833		121,833
Other comprehensive loss							(204)	(204)
Total comprehensive income						121,833	(204)	121,629
Common stock issued and related income tax benefit	1,852	18			37,474			37,492
Repurchase of common stock held in treasury			4,552	(137,845)				(137,845)
Balance at December 31, 2004	82,317	823	14,514	(372,249)	411,888	551,863	(204)	592,121
Comprehensive income:								
Net income						129,713		129,713

Other comprehensive income								1,589	1,589
Total comprehensive income						129,713		1,589	131,302
Common stock issued and related income tax benefit	969	10			25,590				25,600
Repurchase of common stock held in treasury			252	(9,386)					(9,386)
Balance at December 31, 2005	83,286	\$ 833	14,766	\$ (381,635)	\$ 437,478	\$ 681,576	\$ 1,385	\$	739,637

See accompanying notes to consolidated financial statements.

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**Renal Care Group, Inc.**  
**Consolidated Statements of Cash Flows**  
(in thousands)

	<b>Year Ended December 31</b>		
	<b>2003</b>	<b>2004</b>	<b>2005</b>
<b>OPERATING ACTIVITIES</b>			
Net income	\$ 102,056	\$ 121,833	\$ 129,713
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	44,905	58,349	71,400
Loss on sale of property and equipment	886	1,123	589
Income applicable to minority interest	25,431	35,169	35,837
Distributions to minority shareholders	(24,634)	(26,073)	(21,966)
Deferred income taxes	19,517	15,821	10,321
Changes in operating assets and liabilities, net of effects from acquisitions:			
Accounts receivable	(20,253)	(56,284)	(21,488)
Inventories	(2,754)	8,762	(10,929)
Prepaid expenses and other current assets	(8,564)	4,208	(3,690)
Accounts payable	3,140	(18,265)	4,271
Accrued compensation	8,553	1,646	8,078
Due to third-party payors	13,313	26,741	(19,851)
Accrued expenses and other current liabilities	8,838	(15,673)	2,758
Income taxes	10,217	13,696	5,376
Other long-term liabilities	5,898	6,473	(447)
Net cash provided by operating activities	186,549	177,526	189,972
<b>INVESTING ACTIVITIES</b>			
Proceeds from sale of property and equipment	2,270	4,569	483
Cash paid for acquisitions, net of cash acquired	(14,154)	(297,885)	(146,809)
Cash paid for noncontrolling interests in consolidated subsidiaries			(50,984)
Purchases of property and equipment	(63,762)	(103,363)	(91,408)
Change in other assets	(2,858)	(11,158)	3,205
Net cash used in investing activities	(78,504)	(407,837)	(285,513)
<b>FINANCING ACTIVITIES</b>			
Net proceeds from issuance of long-term debt		325,000	100,000
Payments on long-term debt	(380)	(12,188)	(22,345)
Net payments under line of credit	(7,080)	(1,831)	(5,148)
Net proceeds from issuance of common stock	51,802	24,811	17,000
Repurchase of treasury shares	(140,451)	(137,845)	(9,386)
Net cash (used in) provided by financing activities	(96,109)	197,947	80,121
Increase (decrease) in cash and cash equivalents	11,936	(32,364)	(15,420)
Cash and cash equivalents, at beginning of year	38,359	50,295	17,931
Cash and cash equivalents, at end of year	\$ 50,295	\$ 17,931	\$ 2,511

See accompanying notes to consolidated financial statements.

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**Renal Care Group, Inc.**  
**Consolidated Statements of Cash Flows**  
(in thousands)

	<b>Year Ended December 31</b>		
	<b>2003</b>	<b>2004</b>	<b>2005</b>
<b>DISCLOSURES OF CASH FLOW INFORMATION:</b>			
Cash paid during the year for:			
Interest	\$ 922	\$ 19,198	\$ 36,548
Income taxes	\$ 32,808	\$ 47,588	\$ 69,548
<b>DISCLOSURES OF BUSINESS ACQUISITIONS:</b>			
Fair value of assets acquired	\$ 14,388	\$ 567,576	\$ 150,486
Liabilities assumed	234	269,691	3,677
Cash paid for acquisitions, net of cash acquired	\$ 14,154	\$ 297,885	\$ 146,809

See accompanying notes to consolidated financial statements.

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**Renal Care Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**(dollars in thousands, except per share data)**  
**December 31, 2005**

**1. ORGANIZATION**

Renal Care Group, Inc. (the Company) provides dialysis services to patients with chronic kidney failure, also known as end-stage renal disease (ESRD). As of December 31, 2005, the Company provided dialysis and ancillary services to over 32,300 patients through 456 outpatient dialysis centers in 34 states. In addition to its outpatient dialysis center operations, as of December 31, 2005, the Company provided acute dialysis services through contractual relationships with more than 200 hospitals.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES****Basis of Presentation and Consolidation**

The consolidated financial statements include the accounts of the Company, its wholly-owned subsidiaries and its majority-owned subsidiaries and joint venture entities over which the Company exercises majority-voting control and for which control is other than temporary. All significant intercompany transactions and accounts are eliminated in consolidation.

**Use of Estimates**

Management has made a number of estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities to prepare these financial statements in conformity with U.S. generally accepted accounting principles. Actual results could differ from those estimates.

**Cash Equivalents**

The Company considers all highly-liquid investments with original maturities of three months or less to be cash equivalents. The Company places its cash in financial institutions that are federally insured and limits the amount of credit exposure with any one financial institution.

**Inventories**

Inventories consist of drugs, supplies and parts used in dialysis treatments and are stated at the lower of cost or market. Cost is determined using either the first-in, first-out method or the average cost method.

**Property, Plant and Equipment**

Property, plant and equipment are stated at cost less accumulated depreciation. Routine maintenance and repairs are charged to expense as incurred. Depreciation is calculated on the straight-line method over the useful lives of the related assets, ranging from three to thirty years. Leasehold improvements are amortized using the straight-line method over the shorter of the related lease terms or the useful lives.

**Goodwill and Other Intangibles**

The Company accounts for goodwill and other intangible assets in accordance with Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets* (SFAS No. 142). For all periods presented, the Company did not amortize goodwill or intangible assets with indefinite lives in accordance with SFAS No. 142. As of December 31, 2004 and 2005, the carrying amount of goodwill was \$694,264 and \$849,879, respectively. For all periods presented, all separately identifiable intangible assets with definite lives were amortized over their respective useful lives.



**Table of Contents****Due to Third-Party Payors**

Amounts reflected as due to third-party payors include amounts received in excess of revenue recognized for specific billed charges. These amounts are commonly referred to as overpayments. Overpayments received from federally funded programs are reported to the federal program in accordance with the program's established procedures. For overpayments received from non-federally funded payors, the Company uses various procedures to communicate and refund such amounts to the payors. These amounts remain classified as due to third-party payors until the Company makes a refund, the payor makes a recoupment or the amount is otherwise recognized based on final resolution with the payor.

**Minority Interest**

Minority interest represents the proportionate equity interest of other owners in the Company's consolidated entities that are not wholly owned. As of December 31, 2005, the Company was the majority and controlling owner in 64 joint ventures.

**Stock Based Compensation**

SFAS No. 148, *Accounting for Stock-Based Compensation-Transition and Disclosure* (SFAS No. 148), which amended SFAS No. 123, *Accounting for Stock-Based Compensation* (SFAS No. 123), provides alternative methods of transition for a voluntary change to the fair value-based method of accounting for stock-based employee compensation. SFAS No. 148 also amends the disclosure requirements of SFAS No. 123 to require more prominent and more frequent disclosures in financial statements about the effects of stock-based compensation. These consolidated financial statements and related notes include the disclosure requirements of SFAS No. 148. However, the Company has elected to account for its stock-based compensation plans under the intrinsic value-based method of accounting prescribed by APB Opinion No. 25, *Accounting for Stock Issued to Employees* (APB Opinion No. 25), and does not utilize the fair value method.

On December 16, 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123 (revised 2004), *Share-Based Payment* (SFAS No. 123(R)), which is a revision of SFAS No. 123. SFAS No. 123(R) supersedes APB Opinion No. 25 and amended SFAS No. 95, *Statement of Cash Flows*. Generally, the approach in SFAS No. 123(R) is similar to the approach described in SFAS No. 123. However, SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative. The Company adopted SFAS No. 123(R) on January 1, 2006.

As permitted by SFAS No. 123, for periods ended prior to January 1, 2006, the Company has accounted for share-based payments to employees using APB Opinion No. 25's intrinsic value method and, as such, generally recognizes no compensation cost for employee stock options. The impact of adopting of SFAS No. 123(R) cannot be predicted at this time because it will depend on levels of share-based payments in the future. However, had the Company adopted SFAS No. 123(R) in prior periods, the impact of that standard would have approximated the impact of SFAS No. 123 as described in the disclosure of pro forma net income and earnings per share in Note 9 to these consolidated financial statements. SFAS No. 123(R) also requires the Company to recognize the benefits of tax deductions in excess of recognized compensation cost as a financing cash flow, rather than as an operating cash flow as required under current literature. This requirement will reduce net operating cash flows and increase net financing cash flows in periods after the Company adopts SFAS 123(R). While the Company cannot estimate what those amounts will be in the future (because they depend on, among other things, when employees exercise stock options), the amount of operating cash flows recognized in prior periods for such excess tax deductions were \$13,550, \$11,300 and \$8,600 in 2003, 2004, and 2005, respectively.

**Net Revenue**

Net revenue is recognized as services are provided and invoiced at the estimated net realizable amount from Medicare, Medicaid, commercial insurers and other third-party payors. The Company's net revenue is largely derived from the following sources:

- Outpatient hemodialysis;

Ancillary services associated with outpatient dialysis, primarily the administration of erythropoietin (EPO) and other drugs;

Home dialysis services;

Inpatient hemodialysis services provided to acute care hospitals and skilled nursing facilities;

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Laboratory services; and

Management contracts with hospital-based medical university dialysis programs.

The Medicare and Medicaid programs, along with certain third-party payors, reimburse the Company at amounts that are different from the Company's established rates. Contractual adjustments represent the difference between the amounts billed for these services and the amounts that are reimbursable by third-party payors. A summary of the basis for reimbursement with these payors follows:

***Medicare***

The Company is reimbursed by the Medicare program predominantly on a prospective payment system for dialysis services. Under the prospective payment system, each facility receives a composite rate per treatment. The composite rate is subject to regional differences based on various factors, including labor costs. Some drugs and other ancillary services are reimbursed on a fee for service basis.

***Medicaid***

Medicaid is a program funded by the federal and state governments. It is administered by the states, with reimbursements varying by state. The Medicaid programs are separately administered in each state in which the Company operates, and the state Medicaid programs reimburse the Company predominantly on a prospective payment system for dialysis services rendered.

***Third-Party Settlements***

During the year ended December 31, 2005 the Company obtained final determination of certain Medicare cost report settlements. Accordingly, during this period the Company recognized a change in estimate of \$2,611 (net of related tax expense of \$1,676) resulting in a reduction to the provision for doubtful accounts.

***Other***

Payments from commercial insurers, other third-party payors and patients are received pursuant to a variety of reimbursement arrangements. Generally payments from commercial insurers and other third-party payors are greater than those received from the Medicare and Medicaid programs.

Reimbursements from Medicare and Medicaid approximated 55%, 53% and 56% of net revenue for the years ended December 31, 2003, 2004 and 2005, respectively.

**Provision for Doubtful Accounts**

The provision for doubtful accounts is determined as a function of payor mix, billing practices and other factors. The Company reserves for doubtful accounts in the period in which the revenue is recognized based on management's estimate of the net collectibility of the accounts receivable. Management estimates and monitors the net collectibility of accounts receivable based upon a variety of factors. These factors include, but are not limited to, analyzing revenues generated from payor sources, performing subsequent collection testing and regularly reviewing detailed accounts receivable agings.

**Income Taxes**

The Company accounts for income taxes under the asset and liability method. The Company recognizes deferred tax assets and liabilities for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which these temporary differences are expected to be recovered or settled. The effect of a change in tax rates on deferred tax assets and liabilities is recognized in income in the period that includes the enactment date for the change. The Company identifies deferred tax assets that more likely than not will not be realized and records a valuation allowance. The Company also establishes accruals for tax uncertainties that it deems to be probable of loss and that can be reasonably estimated.

**Self Insurance**

The Company is subject to professional liability, general liability and workers compensation claims or lawsuits in the ordinary course of business. Accordingly, the Company maintains insurance for professional liability and general liability claims exceeding certain individual amounts. Premiums paid under the Company's professional liability policy may be retrospectively adjusted depending upon claims experience during the policy term. Similarly, the

Company maintains workers compensation insurance for claims exceeding certain individual and aggregate amounts. The Company estimates its self-insured retention portion of professional liability, general liability and workers

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compensation risks using third party actuarial calculations that include historical claims data, demographic factors and other assumptions.

**Fair Value of Financial Instruments***Cash and Cash Equivalents*

The carrying amounts reported in the consolidated balance sheets for cash and cash equivalents approximate fair value.

*Accounts Receivable, Accounts Payable and Accrued Liabilities*

The carrying amounts reported in the consolidated balance sheets for accounts receivable, accounts payable and accrued liabilities approximate fair value. Accounts receivable are generally unsecured.

*Long-Term Debt*

Based upon the borrowing rates currently available to the Company, the carrying amounts reported in the consolidated balance sheets for long-term debt approximate fair value.

**Concentration of Credit Risks**

The Company's primary concentration of credit risk exists within accounts receivable, which consist of amounts owed by various governmental agencies, insurance companies and private patients. Receivables from Medicare and Medicaid represented 45% and 42% of gross accounts receivable at December 31, 2004 and 2005, respectively.

Concentration of credit risk relating to accounts receivable is limited to some extent by the diversity of the number of patients and payors and the geographic dispersion of the Company's operations.

The Company administers EPO to most of its patients to treat anemia, a medical complication frequently experienced by dialysis patients. Revenue from the administration of EPO was 24% of the net revenue of the Company for the year ended December 31, 2003, 26% of the net revenue of the Company for the year ended December 31, 2004 and 24% of the net revenue of the Company for the year ended December 31, 2005. EPO is produced by a single manufacturer.

**Impairment of Goodwill and Long-Lived Assets to be Disposed Of**

Pursuant to SFAS No. 142, *Goodwill and Other Intangible Assets*, the Company reviews goodwill for impairment at a reporting unit level at least annually. Goodwill is tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. Goodwill is assigned to each reporting unit based on the geographic location of assets acquired. If the fair value of a reporting unit is determined to be less than its carrying amount, then the Company compares the implied fair value of the goodwill to its carrying value. If the implied fair value of the goodwill is less than its carrying value, then an impairment loss is recognized for that difference. No goodwill impairment losses were recognized during 2003, 2004 or 2005.

In accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, when events, circumstances or operating results indicate that the carrying value of certain long-lived assets and related identifiable intangible assets (excluding goodwill) that are expected to be held and used, might be impaired, the Company evaluates such assets for impairment based on estimated undiscounted cash flows expected to result from the use and eventual disposition of the assets. If related long-lived assets are identified as impaired, the impairment is equal to the amount by which the carrying value of the assets exceeds the fair value of those assets as determined by independent appraisals or estimates of discounted future cash flows. Long-lived assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

**Derivative Financial Instruments**

The Company manages its interest rate risk by using interest rate swaps to achieve an overall desired position on floating interest rates. Effective June 30, 2004, the Company entered into an interest rate swap agreement to hedge the interest rate risk on \$150,000 of our term loan. These derivative financial instruments are not held or issued for trading purposes. The derivatives are recognized as either assets or liabilities in the statement of financial position and measured at fair value. The hedge is structured to qualify for the shortcut

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method; therefore, changes in the fair value of the agreement are recorded as other comprehensive income (loss). During 2005 the fair value of the interest rate swaps, net of a tax expense of \$989, increased by approximately \$1,589 and was recognized as other comprehensive income.

**Reclassifications**

Certain prior year balances have been reclassified to conform to the current year presentation. These reclassifications had no effect on the results of operations as previously reported.

**3. ACQUISITION BY FRESENIUS MEDICAL CARE AG**

On May 3, 2005 the Company entered into a definitive merger agreement with Fresenius Medical Care AG in which Fresenius Medical Care agreed to acquire all of Renal Care Group's outstanding stock. Fresenius Medical Care will pay \$48.00 for each of the Company's outstanding shares of common stock. Fresenius Medical Care will acquire Renal Care Group subject to its outstanding indebtedness, which was approximately \$576,121 as of December 31, 2005. In connection with the Fresenius Medical Care transaction, the Company incurred general and administrative expenses of approximately \$14,925 pre-tax in the year ended December 31, 2005.

The Company's Board of Directors and the management and supervisory boards of Fresenius Medical Care have approved the transaction, and on August 24, 2005 the Company's stockholders voted to approve the transaction. Completion of the transaction is subject to customary conditions to closing, including the termination or expiration of the waiting period under the Hart-Scott Rodino Antitrust Improvements Act of 1976, as amended. In June 2005, the Company received a request for additional information under the Hart-Scott Rodino Act from the Federal Trade Commission. The Company is providing information to the Federal Trade Commission to respond to this request. The Fresenius Medical Care transaction may not be completed before 30 days after certification by the Company and Fresenius Medical Care of substantial compliance with the Federal Trade Commission's request for additional information or until earlier satisfaction by the Federal Trade Commission that the transactions will not raise anticompetitive concerns. Management believes the transaction will close in the first quarter of 2006.

On February 15, 2006, the Company announced that the Company and Fresenius Medical Care had entered into a definitive agreement to sell approximately 100 dialysis centers to National Renal Institutes, Inc., a wholly owned subsidiary of DSI Holding Company, Inc. The divestiture of these centers is an important step toward concluding the review by the United States Federal Trade Commission (FTC) of Fresenius Medical Care's acquisition of the Company. The purchase price for the divested centers is approximately \$450 million to be paid in cash, subject to post-closing adjustments for working capital and other routine matters. The sale of the centers is expected to close shortly after the completion of the Company's acquisition by Fresenius Medical Care. Both the divestiture and the transaction with Fresenius Medical Care remain subject to FTC approval.

On May 11, 2005, the Company was served with a complaint in the Chancery Court for the State of Tennessee Twentieth Judicial District at Nashville styled *Plumbers Local #65 Pension Fund, on behalf of itself and all others similarly situated, Plaintiff, vs. Renal Care Group, Inc., William P. Johnston, Gary Brukardt, Peter J. Grua, Joseph C. Hutts, Harry R. Jacobson, William V. Lapham, Thomas A. Lowery, Stephen D. McMurray and C. Thomas Smith, Defendants*. On May 26, 2005, the Company was served with a complaint in the Chancery Court for the State of Tennessee Twentieth Judicial District at Nashville styled *Hawaii Structural Ironworkers Pension Trust Fund, on behalf of itself and all others similarly situated, Plaintiff, vs. Renal Care Group, Inc., William P. Johnston, Gary Brukardt, Peter J. Grua, Joseph C. Hutts, Harry R. Jacobson, William V. Lapham, Thomas A. Lowery, Stephen D. McMurray and C. Thomas Smith, Defendants*. On May 31, 2005, the Company was served with a complaint in the Chancery Court for the State of Tennessee Twentieth Judicial District at Nashville styled *Indiana State District Council of Laborers and Hod Carriers Pension Fund, on behalf of itself and others similar situated, Plaintiff, vs. Renal Care Group, Inc., William P. Johnston, Gary Brukardt, Peter J. Grua, Joseph C. Hutts, Harry R. Jacobson, William V. Lapham, Thomas A. Lowery, Stephen D. McMurray and C. Thomas Smith, Defendants*. The original complaints in these three lawsuits were substantially identical. Each complaint was brought by the plaintiff shareholder as a purported class action on behalf of all shareholders similarly situated. The complaints allege that the Company and its directors engaged in self-dealing and breached their fiduciary duties to the Company's shareholders in connection with the merger agreement between the Company and Fresenius Medical Care because, among other things, the Company used a flawed process, the existence of the previously disclosed subpoena from the Department



of Justice, the lack of independence of one of the Company's financial advisors and the existence of the Company's supplemental executive retirement plan. The Company removed these cases to federal court in June 2005. The plaintiffs in the first two cases dismissed them without prejudice in July 2005, and the third plaintiff filed an amended complaint. The amended complaint asserts the same grounds articulated in the original complaint adding more specific allegations regarding the termination fee, the non-solicitation clause and the matching rights provision in the Merger Agreement, and it adds allegations that our proxy statement makes material misrepresentations and omissions regarding the process by which the merger agreement was negotiated. Specifically, the amended complaint asserts that the proxy statement makes material misstatements or omissions regarding: (1) the reason the Company's management and board engaged in a closed process of negotiating a potential merger with Fresenius Medical Care and did not solicit potential competing bids from alternative purchasers; (2) the reason the Company's board did not appoint a special committee to evaluate the fairness of the merger; (3) the alternatives available to the Company including potential alternative transactions and other strategic business opportunities, which purportedly were considered by the Company's board during the strategic planning process the board engaged in during the second half of 2004; (4) all information regarding conflicts of interest suffered by defendants and their financial and legal advisors as alleged herein; (5) all information regarding past investment banking services Bank of America has performed for the Company and Fresenius Medical Care and the compensation Bank of America received for those services; (6) the forecasts and projections prepared by the Company's management for fiscal years 2005 through 2008 that were referenced in the fairness opinions by Morgan Stanley; (7) the estimates of transaction synergies provided by the Company's management that were referenced in the fairness opinions by Morgan Stanley; and (8) information concerning the amount of money Bank of America and Morgan Stanley will receive in connection with the proposed merger. The Company believes that the allegations in the pending complaint are without merit. Completion of the merger is subject to customary conditions, including the absence of any order or injunction prohibiting the closing. The pending complaint seeks to enjoin and prevent the parties from completing the Fresenius Medical Care transaction. The pending complaint was remanded to Tennessee state court in September 2005.

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**Table of Contents****4. BUSINESS ACQUISITIONS****2005 Acquisitions**

During 2005, the Company completed five acquisitions. The combined net assets acquired and resulting net cash purchase price paid in these acquisitions were \$146,809. The purchase price in these transactions consisted exclusively of cash. Each of the transactions involved the acquisition of one or more entities that provide care to ESRD patients through owned dialysis facilities. The acquired businesses either strengthened existing market share within a specific geographic area or provided an entrance into a new market. Goodwill resulting from these transactions amounted to \$124,017, and the Company expects that all of the goodwill will be deductible for income tax purposes. Intangible assets typically represent the value assigned to certain contracts such as non-competition agreements and acute dialysis service agreements entered into in the transactions. These amounts are amortized over the lives of the contracts, which generally range from five to fifteen years.

The following table summarizes the preliminarily estimated fair values of the assets acquired and liabilities assumed at the date of acquisition for the five acquisitions the Company completed during 2005:

Accounts receivable, net	\$ 1,122
Inventory and other current assets	807
Property, plant and equipment, net	17,199
Intangible assets	7,341
Goodwill	124,017
Total assets acquired	150,486
Total liabilities assumed, net	(3,677)
Net assets acquired	\$ 146,809

The Company began recording the results of operations for each of these acquired businesses at the effective date of the transaction.

In 2005 the Company purchased noncontrolling interests in 14 consolidated subsidiaries for an aggregate purchase price of \$50,984. As a result of these transactions approximately \$9,998 of minority interest liabilities were extinguished, and \$40,986 of goodwill and other intangible assets resulted from the transaction.

**2004 Acquisitions**

During 2004, the Company completed eight acquisitions. The combined net assets acquired and resulting net cash purchase price paid in these acquisitions were \$297,885. Our largest acquisition was the purchase of National Nephrology Associates, Inc. ( NNA ) on April 2, 2004. The purchase price of NNA consisted of a net cash payment of approximately \$163,000 and the assumption of all of NNA 's outstanding debt, including its \$160,000, 9.0% senior subordinated notes. NNA provided dialysis services to approximately 5,600 patients and operated 87 outpatient dialysis facilities in 15 states, as well as providing acute dialysis services to more than 50 hospitals.

Each of the eight transactions involved the acquisition of one or more entities that provide care to ESRD patients through owned dialysis facilities. The acquired businesses either strengthened existing market share within a specific geographic area or provided an entrance into a new market. Goodwill resulting from these transactions amounted to \$407,686, and approximately \$225,856 of that goodwill is deductible for income tax purposes.

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The following table summarizes the preliminarily estimated fair values of the assets acquired and liabilities assumed at the date of acquisition for the eight acquisitions the Company completed during 2004:

Accounts receivable, net	\$ 45,410
Inventory and other current assets	23,778
Property, plant and equipment, net	50,713
Intangible assets	20,646
Goodwill	407,686
Other Assets	19,343
 Total assets acquired	 567,576
Total liabilities assumed	(269,691)
 Net assets acquired	 \$ 297,885

The Company began recording the results of operations for each of these acquired businesses at the effective date of the transaction.

Some of the estimated fair values of assets and liabilities were preliminary and were adjusted in 2005. The adjustments primarily included deferred tax assets and liabilities. As of December 31, 2005, management does not anticipate any additional adjustments related to 2004 acquisitions. Intangible assets primarily represent the value assigned to contracts such as non-competition agreements and acute dialysis service agreements entered into in the transactions. Related amounts are amortized over the lives of the contracts, which generally range from five to fifteen years.

**2003 Acquisitions**

During 2003, the Company completed three acquisitions, which were accounted for under the purchase method of accounting. The combined purchase price paid in these acquisitions was \$14,154 and consisted exclusively of cash. Each of the transactions involved the acquisition of assets of entities that provide care to ESRD patients through owned dialysis facilities. The acquired businesses either strengthened the Company's existing market share within a specific geographic area or provided the Company with an entrance into a new market.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition for the three acquisitions the Company completed in 2003:

Accounts receivable, net	\$ 986
Inventory	255
Property, plant and equipment, net	1,579
Intangible assets	656
Goodwill	10,912
 Total assets acquired	 14,388
Total liabilities assumed	(234)
 Net assets acquired	 \$ 14,154

The Company began recording the results of operations for each of these acquired businesses at the effective date of the transaction.

Goodwill resulting from these transactions amounted to \$10,912, and the Company expects that all of that goodwill will be deductible for income tax purposes. Intangible assets typically represent the value assigned to certain contracts such as non-competition agreements and acute dialysis service agreements entered into in the transactions. These amounts are amortized over the lives of the contracts, which generally range from five to ten years.



**Table of Contents****Pro Forma Data (unaudited)**

The following summary, prepared on a pro forma basis, combines the results of operations of the Company and the acquired businesses, as if each of the 2005 acquisitions had been consummated as of the beginning of each year below, giving effect to adjustments such as amortization of intangibles, interest expense and related income taxes.

	<b>2004</b>	<b>2005</b>
Pro forma net revenue	\$ 1,419,259	\$ 1,595,441
Pro forma net income	\$ 130,807	\$ 132,444
Pro forma net income per share		
Basic	\$ 1.94	\$ 1.94
Diluted	\$ 1.87	\$ 1.87

The unaudited pro forma results of operations are not necessarily indicative of what actually would have occurred if the acquisitions had been completed prior to the beginning of the periods presented.

**5. PROPERTY, PLANT AND EQUIPMENT**

Property, plant and equipment (including assets recorded under capital leases) consist of the following:

	<b>December 31,</b>	
	<b>2004</b>	<b>2005</b>
Medical equipment	\$ 190,267	\$ 224,543
Computer software and equipment	69,072	86,570
Furniture and fixtures	34,011	38,858
Leasehold improvements	145,882	179,705
Buildings	45,132	53,033
Construction-in-progress	16,341	15,462
	500,705	598,171
Less accumulated depreciation	(184,173)	(235,947)
	\$ 316,532	\$ 362,224

Depreciation expense was \$42,561, \$53,538 and \$64,952 for the years ended December 31, 2003, 2004 and 2005, respectively.

**6. GOODWILL AND INTANGIBLE ASSETS**

In accordance with the requirements of SFAS No. 142, the Company discontinued amortizing goodwill effective January 1, 2002, and it is required to disclose goodwill separately from other intangible assets in the balance sheet. Additionally, the Company must test goodwill for impairment on a periodic basis. The Company completed its annual impairment testing and identified no impairments as of December 31, 2005.

Changes in the carrying amount of goodwill for the years ended December 31, 2004 and 2005, are as follows:

Balance as of December 31, 2003	\$ 286,578
Goodwill acquired during the period	407,686
Balance as of December 31, 2004	694,264
Goodwill acquired during the period	124,017
Goodwill resulting from acquiring noncontrolling interests	40,386

Purchase price allocation period adjustment	(8,788)
Balance as of December 31, 2005	\$ 849,879

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The Company's separately-identifiable intangible assets, which consist primarily of non-competition agreements and acute dialysis services agreements, are as follows:

	<b>December 31,</b>	
	<b>2004</b>	<b>2005</b>
Carrying amount	\$ 49,012	\$ 59,737
Accumulated amortization	(14,692)	(20,560)
Net	\$ 34,320	\$ 39,177

Separately-identifiable intangible assets are being amortized over their useful lives, ranging from five to fifteen years. Amortization expense was \$2,344, \$4,811 and \$6,448 for the years ended December 31, 2003, 2004 and 2005, respectively. Estimated amortization expense for each of the next five fiscal years is as follows:

<b>Year ending December 31,</b>	<b>Amount</b>
2006	\$ 6,126
2007	5,456
2008	5,088
2009	3,857
2010	2,868

**7. LONG-TERM DEBT**

Long-term debt consisted of the following as of December 31, 2004 and December 31, 2005:

	<b>December 31, 2004</b>	<b>December 31, 2005</b>
Term loan facility, bearing interest at a variable rate (5.7% at December 31, 2005)	\$ 312,813	\$ 290,469
Second term loan, bearing interest at a variable rate (5.4% at December 31, 2005)		100,000
9.0% senior subordinated notes	159,685	159,685
Obligations under capital leases	4,151	4,624
Other	3,357	542
Total indebtedness, excluding fair value premium	480,006	555,320
Add: 9.0% senior subordinated notes fair value premium	23,608	20,801
Total long-term debt	503,614	576,121
Less: current portion	23,969	42,198
	\$ 479,645	\$ 533,923

**Credit Agreements**

The Company is a party to a credit agreement (the 2004 Agreement) with a group of banks totaling up to \$700,000. The 2004 agreement has a \$150,000 revolving credit facility, a \$325,000 term loan facility, a \$100,000 second term loan facility and a \$125,000 incremental term loan facility. In May 2005, the Company completed an incremental term loan of \$100,000 under the 2004 Agreement. The Company used the proceeds of this incremental term loan to finance some of its 2005 acquisitions. The revolving credit facility, the \$425,000 term loan facilities have a final maturity of February 10, 2009. Each of the Company's wholly-owned subsidiaries has guaranteed all of its obligations

under the 2004 Agreement. Further, the Company obligations under the 2004 Agreement, and its subsidiaries obligations under their guarantees, are secured by a pledge of the equity interests the Company holds in each of its subsidiaries. The 2004 Agreement includes financial covenants that are customary based on the amount and duration of the agreement.

The revolving credit facility under the 2004 Agreement may be used for acquisitions, repurchases of Company common stock, capital expenditures, working capital and general corporate purposes. Borrowings under the 2004 Agreement accrue interest at variable rates determined by the Company's leverage ratio. Effective June 30, 2004, the Company entered into interest rate swap agreements to hedge interest rate risk on \$150,000 of our term loan (See Interest Rate Swap below). The portion of the Company's borrowings that is subject to variable rates carries a degree of interest rate risk. Specifically, the Company will face higher interest costs on this debt if interest rates rise.

#### **9.0% Senior Subordinated Notes**

With the acquisition of NNA, the Company assumed all of NNA's outstanding debt including its 9.0% senior subordinated notes (the Notes), due 2011. The Company recorded the Notes at the face value of \$160,000 plus an additional \$25,600 representing the difference between the fair

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value of the Notes and the face amount on the date of acquisition. Accordingly, the Notes were recorded at the estimated fair value of \$185,600. As of December 31, 2005, the carrying value of the Notes was \$180,486. The Notes bear interest at the rate of 9.0% per annum on the face amount. The fair value premium is being recognized over the life of the Notes using the effective interest method and is recorded as a reduction to interest expense. Accordingly, the effective interest rate on the Notes as of December 31, 2005 was 6.4%. Each of the Company's wholly-owned subsidiaries has guaranteed all of the Company's obligations under these notes. The rights of the noteholders and the Company's obligations under these notes are set forth in an indenture that NNA entered into in October 2003, which the Company assumed in connection with the NNA acquisition. The indenture includes customary financial covenants.

**Interest Rate Swap**

Effective June 30, 2004, the Company entered into interest rate swap agreements to hedge the interest rate risk on \$150,000 of its term loan. Under these interest rate swap agreements the Company will exchange fixed and variable rate interest payments based on a \$150,000 notional principal amount through March 30, 2007. The notional amount of \$150,000 and interest payments of 3.5% are fixed in the agreements. The interest payments are subject to adjustment based on our leverage ratio. The changes in cash flows under these agreements are expected to offset the changes in interest rate payments attributable to fluctuations in LIBOR. The hedge is structured to qualify for the shortcut method as prescribed by Statement of Financial Accounting Standard No. 133, *Accounting for Derivative Instruments and Hedging Activities*; therefore, the Company will record changes in the fair value of the agreement directly in comprehensive income. As of December 31, 2005, the notional amount of the swap agreements was \$150,000 and its fair value was a \$2,247 asset, resulting in other comprehensive income during 2005 of \$1,589 (net of a related tax expense of \$989).

**Obligations Under Capital Leases**

Obligations under capital leases consist primarily of capital leases for buildings and equipment maturing at various times through May 2020. See the maturity schedule for capital leases included at Note 10.

**Other**

The other long-term debt consists primarily of notes maturing at various times through February 2009.

**Maturities of Long-Term Debt**

The aggregate maturities of long-term debt, excluding the fair value premium, at December 31, 2005 are as follows:

2006	\$ 42,198
2007	80,250
2008	207,977
2009	61,993
2010	318
Thereafter	162,584
	\$ 555,320

**Table of Contents****Guarantor Information**

Our wholly-owned subsidiaries have guaranteed the Notes as well as our obligations under the 2004 Agreement. The Company conducts substantially all of its business through subsidiaries. Presented below is condensed consolidating financial information as of December 31, 2004 and 2005 and for each of the three years in the period ended December 31, 2005. The information segregates Renal Care Group, Inc. (the parent company), the combined wholly-owned subsidiary guarantors and the combined non-guarantor subsidiaries and reflects consolidating adjustments. All of the subsidiary guarantees are both full and unconditional, and joint and several.

**Condensed Consolidating Balance Sheets**

	<b>Parent Company</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries</b>	<b>Consolidating Adjustments</b>	<b>Consolidated Total</b>
<b>As of December 31, 2004</b>					
Cash and cash equivalents	\$	\$	\$ 31,945	\$ (14,014)	\$ 17,931
Accounts receivable, net		198,778	76,595		275,373
Other current assets	45,749	23,320	10,711		79,780
Total current assets	45,749	222,098	119,251	(14,014)	373,084
Property, plant and equipment, net	29,542	189,434	96,408	1,148	316,532
Goodwill	1,483	574,815	117,666	300	694,264
Other assets	10,828	99,033	7,436	(72,197)	45,100
Total assets	\$ 87,602	\$ 1,085,380	\$ 340,761	\$ (84,763)	\$ 1,428,980
Current liabilities (including intercompany assets and liabilities)	\$ (699,042)	\$ 813,091	\$ 157,344	\$ (27,488)	\$ 243,905
Long-term debt	476,184	(259)	3,720		479,645
Long-term liabilities	64,976	2,253	461		67,690
Minority interest		39,610	5,989	20	45,619
Stockholders' equity	245,484	230,685	173,247	(57,295)	592,121
Total liabilities and stockholders' equity	\$ 87,602	\$ 1,085,380	\$ 340,761	\$ (84,763)	\$ 1,428,980
	<b>Parent Company</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries</b>	<b>Consolidating Adjustments</b>	<b>Consolidated Total</b>
<b>As of December 31, 2005</b>					
Cash and cash equivalents	\$	\$	\$ 24,006	\$ (21,495)	\$ 2,511
Accounts receivable, net		230,013	69,154	(1,184)	297,983
Other current assets	50,919	35,516	12,332	3,699	102,466
Total current assets	50,919	265,529	105,492	(18,980)	402,960
Property, plant and equipment, net	35,000	236,315	86,094	4,815	362,224
Goodwill	1,483	734,116	113,980	300	849,879
Other assets	9,885	104,985	6,066	(73,966)	46,970



Total assets	\$ 97,287	\$ 1,340,945	\$ 311,632	\$ (87,831)	\$ 1,662,033
Current liabilities (including intercompany assets and liabilities)	\$ (694,545)	\$ 920,339	\$ 81,436	\$ (44,461)	\$ 262,769
Long-term debt	529,236	265	4,422		533,923
Long-term liabilities	63,098	6,558	1,888	1,385	72,929
Minority interest		42,713	10,114	(52)	52,775
Stockholders equity	199,498	371,070	213,772	(44,703)	739,637
Total liabilities and stockholders equity	\$ 97,287	\$ 1,340,945	\$ 311,632	\$ (87,831)	\$ 1,662,033

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**Table of Contents****Condensed Consolidating Income Statements**

	<b>Parent Company</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries</b>	<b>Consolidating Adjustments</b>	<b>Consolidated Total</b>
<b>For the year ended December 31, 2003</b>					
Net revenue	\$ 1,524	\$ 688,379	\$ 319,680	\$ (4,264)	\$ 1,005,319
Total operating costs and expenses	43,611	520,870	254,444	(4,264)	814,661
Income (loss) from operations	(42,087)	167,509	65,236		190,658
Interest expense, net	629				629
Minority interest		23,853	1,578		25,431
Provision (benefit) for income taxes	(16,231)	54,584	24,189		62,542
Net income (loss)	\$ (26,485)	\$ 89,072	\$ 39,469	\$	\$ 102,056
<b>For the year ended December 31, 2004</b>					
Net revenue	\$ 2,224	\$ 926,046	\$ 422,419	\$ (5,642)	\$ 1,345,047
Total operating costs and expenses	48,077	731,419	317,346	(5,642)	1,091,200
Income (loss) from operations	(45,853)	194,627	105,073		253,847
Interest expense, net	16,966	2,630	1,032		20,628
Minority interest		32,418	2,751		35,169
Provision (benefit) for income taxes	(24,174)	61,411	38,980		76,217
Net income (loss)	\$ (38,645)	\$ 98,168	\$ 62,310	\$	\$ 121,833
<b>For the year ended December 31, 2005</b>					
Net revenue	\$ 2,990	\$ 1,132,875	\$ 441,025	\$ (6,664)	\$ 1,570,226
Total operating costs and expenses	78,655	876,422	335,443	(6,664)	1,283,856
Income (loss) from operations	(75,665)	256,453	105,582		286,370
Interest expense (income), net	36,433	(4,433)	908		32,908
Minority interest		32,727	3,110		35,837
Provision (benefit) for income taxes	(38,933)	87,774	39,071		87,912

Net income (loss)	\$ (73,165)	\$ 140,385	\$ 62,493	\$ 129,713
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**Table of Contents****Condensed Consolidating Statements of Cash Flows**

	<b>Parent Company</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries</b>	<b>Consolidating Adjustments</b>	<b>Consolidated Total</b>
<b>For the year ended December 31, 2003</b>					
Cash flows from operating activities:					
Net income (loss)	\$ (26,485)	\$ 89,072	\$ 39,469	\$	\$ 102,056
Changes in operating and intercompany assets and liabilities and non-cash items included in net income	136,739	(53,679)	10,517	(9,084)	84,493
Net cash provided by operating activities	110,254	35,393	49,986	(9,084)	186,549
Net cash used in investing activities	(9,985)	(35,231)	(34,052)	764	(78,504)
Net cash used in financing activities	(80,112)		(24,633)	8,636	(96,109)
Increase (decrease) in cash and cash equivalents	20,157	162	(8,699)	316	11,936
Cash and cash equivalents, at beginning of period		2,484	36,191	(316)	38,359
Cash and cash equivalents, at end of period	\$ 20,157	\$ 2,646	\$ 27,492	\$	\$ 50,295

	<b>Parent Company</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries</b>	<b>Consolidating Adjustments</b>	<b>Consolidated Total</b>
<b>For the year ended December 31, 2004</b>					
Cash flows from operating activities:					
Net income (loss)	\$ (38,645)	\$ 98,168	\$ 62,310	\$	\$ 121,833
Changes in operating and intercompany assets and liabilities and non-cash items included in net income	(83,456)	100,204	9,845	29,100	55,693
Net cash provided by (used in) operating activities	(122,101)	198,372	72,155	29,100	177,526
Net cash used in investing activities	(167,881)	(200,068)	(41,478)	1,590	(407,837)
Net cash provided by (used in) financing activities	269,825	(950)	(26,224)	(44,704)	197,947

Increase (decrease) in cash and cash equivalents	(20,157)	(2,646)	4,453	(14,014)	(32,364)
Cash and cash equivalents, at beginning of period	20,157	2,646	27,492		50,295
Cash and cash equivalents, at end of period	\$	\$	\$ 31,945	\$ (14,014)	\$ 17,931

	<b>Parent Company</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries</b>	<b>Consolidating Adjustments</b>	<b>Consolidated Total</b>
<b>For the year ended December 31, 2005</b>					
Cash flows from operating activities:					
Net income (loss)	\$ (73,165)	\$ 140,385	\$ 62,493	\$	\$ 129,713
Changes in operating and intercompany assets and liabilities and non-cash items included in net income	10,123	107,500	(40,958)	(16,406)	60,259
Net cash provided by (used in) operating activities	(63,042)	247,885	21,535	(16,406)	189,972
Net cash used in investing activities	(25,229)	(248,409)	(8,208)	(3,667)	(285,513)
Net cash provided by (used in) financing activities	88,271	524	(21,266)	12,592	80,121
Decrease in cash and cash equivalents			(7,939)	(7,481)	(15,420)
Cash and cash equivalents, at beginning of period			31,945	(14,014)	17,931
Cash and cash equivalents, at end of period	\$	\$	\$ 24,006	\$ (21,495)	\$ 2,511

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**Table of Contents****8. INCOME TAXES**

The provision for income taxes consists of the following:

	<b>Year Ended December 31,</b>		
	<b>2003</b>	<b>2004</b>	<b>2005</b>
Current:			
Federal	\$ 38,716	\$ 52,274	\$ 66,910
State and local	4,309	8,020	10,681
	43,025	60,294	77,591
Deferred:			
Federal	17,152	14,062	9,580
State and local	2,365	1,861	741
	19,517	15,923	10,321
Provision for income taxes	\$ 62,542	\$ 76,217	\$ 87,912

At December 31, 2005, the Company had net operating loss carryforwards of approximately \$249,000 for state income tax purposes that expire in years 2006 through 2023, and a capital loss carryforward of approximately \$2,245, the majority of which expires in 2006. The utilization of the state net operating loss carryforwards in future years is dependent upon the profitability of certain subsidiary corporations. The utilization of the capital loss carryforward requires capital gain income in the future. Therefore, the Company has recorded a valuation allowance of \$8,323 against the deferred tax asset attributable to the state net operating loss carryforwards and the capital loss carryforward, which represents a decrease in the valuation allowance of \$2,036 in 2005.

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

Components of the Company's deferred tax liabilities and assets are as follows:

	<b>December 31,</b>	
	<b>2004</b>	<b>2005</b>
Deferred tax assets:		
Net operating loss carryforwards	\$ 9,531	\$ 7,539
Capital loss carryforward	828	853
Allowance for doubtful accounts	6,973	9,999
Accrued vacation and other accrued liabilities	28,243	29,165
Notes revaluation	8,971	7,904
Investment in partnerships	226	1,205
Other	781	114
Less: valuation allowance	(10,359)	(8,323)
	45,194	48,456
Deferred tax liabilities:		
Depreciation	25,967	19,843
Amortization	41,042	51,451
	67,009	71,294

Net deferred tax liability	\$ 21,815	\$ 22,838
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In addition to the provision for income taxes included in the accompanying statements of operations, a deferred tax expense of \$989 related to the interest rate swap agreement has been reflected in the accumulated other comprehensive income as reported in stockholders' equity for the year ended December 31, 2005.

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The following is a reconciliation of the statutory federal and state income tax rates to the effective rates as a percentage of income before provision for income taxes as reported in the consolidated financial statements:

	<b>Year Ended December 31,</b>		
	<b>2003</b>	<b>2004</b>	<b>2005</b>
U.S. federal income tax rate	35.0%	35.0%	35.0%
State income tax, net of federal income tax benefit	1.7	2.5	4.2
Decrease in valuation allowances	1.0	0.7	(0.8)
Nondeductible merger-related costs			1.8
Other	0.3	0.3	0.2
Effective income tax rate	38.0%	38.5%	40.4%

**9. STOCKHOLDERS EQUITY (numbers of shares in thousands)****Stock Option Plans**

As of December 31, 2005, the Company had seven stock option plans. The Company has also issued options, referred to in these financial statements as Free Standing Options outside of these plans. Options issued as Free Standing Options are for employees, officers, directors, and other key persons. Free Standing Options vest over various periods up to five years and have a term of ten years from the date of issuance.

Options issued under the 2004, 1999 and 1996 Employee Plans have similar terms and purposes. Specifically, options under each of these plans are available for grant to eligible employees and other key persons, the options generally vest over four to five years and have a term of ten years from the date of issuance. These plans were adopted in 2004, 1999 and 1996, and have 6,750, 11,250, and 9,000 shares of common stock reserved for issuance, respectively.

Options issued under the Equity Compensation Plan ( Equity Plan ), adopted by Dialysis Centers of America, Inc. ( DCA ) in 1995, are for eligible employees and other key persons. The options vest over periods up to three years and have a term of ten years from the date of issuance. There are 525 shares of common stock reserved for issuance. The Company merged with DCA in a pooling-of-interests transaction in February 1999.

Options issued under the 1994 Stock Option Plan ( 1994 Plan ) are for directors, officers and other key persons. These options vest over four years, and have a term of ten years from the date of issuance. This plan was adopted in 1994, and there are 1,080 shares of common stock reserved for issuance.

Options issued under the Directors Plan are for non-management directors. These options vest immediately, and have a term of ten years from the date of issuance. The plan was adopted in 1996, and there are 337 shares of common stock reserved for issuance.

Options issued under the RDM Plan, adopted by Renal Disease Management by Physicians, Inc. ( RDM ) in 1997, are for directors, officers, and other key persons. These options vest immediately upon grant and have a term of 5 to 10 years from the date of issuance. There are 163 shares of common stock reserved for issuance. The Company merged with RDM in a pooling-of-interests transaction in April 2000.

The Company has adopted the disclosure-only provisions of SFAS No. 123 and SFAS No. 148, but applies APB Opinion No. 25 and related interpretations in accounting for its plans. Therefore, compensation expense would generally be recorded only if on the date of grant the then-current market price of the underlying stock exceeded the exercise price.



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The following is a summary of option transactions during the period from January 1, 2003 through December 31, 2005:

	<b>Free</b>	<b>2004</b>	<b>1999</b>	<b>1996</b>	<b>Equity</b>	<b>1994</b>	<b>Directors</b>	<b>RDM</b>	<b>Exercise</b>	<b>Weighted</b>
	<b>Standing</b>	<b>Employee</b>	<b>Employee</b>	<b>Employee</b>	<b>Plan</b>	<b>Plan</b>	<b>Plan</b>	<b>Plan</b>	<b>Price</b>	<b>Average</b>
		<b>Plan</b>	<b>Plan</b>	<b>Plan</b>					<b>Range</b>	<b>Exercise</b>
										<b>Price</b>
Balance at										
December 31,										
2002	926		6,600	2,896	25	13	110	20	\$ 2.22 \$21.80	\$ 14.44
Granted			2,868				43		20.00 25.21	22.97
Exercised	(344)		(1,986)	(1,200)	(1)			(7)	2.22 19.35	13.87
Forfeited	(52)		(817)	(92)					10.63 23.10	18.35
Balance at										
December 31,										
2003	530		6,665	1,604	24	13	153	13	2.22 25.21	17.13
Granted		1,639					93		27.92 33.16	31.57
Exercised	(189)		(847)	(546)	(6)		(34)	(4)	2.22 23.10	14.02
Forfeited	(34)	(5)	(114)	(5)					10.63 31.57	20.94
Balance at										
December 31,										
2004	307	1,634	5,704	1,053	18	13	212	9	2.22 33.16	20.44
Granted		100					59		39.49 46.36	42.04
Exercised	(183)	(50)	(338)	(220)	(1)			(1)	5.33 31.57	14.94
Forfeited		(28)	(247)	(9)	(1)	(13)		(1)	2.22 31.57	21.14
Balance at										
December 31,										
2005	124	1,656	5,119	824	16		271	7	\$ 2.22 \$46.36	\$ 21.48
Available for										
grant at										
December 31,										
2005		5,056	1,684	367			9			
Exercisable at										
December 31,										
2003	441		1,560	1,499	24	13	152	14		
Exercisable at										
December 31,										
2004	289	25	2,499	1,038	18	13	212	9		

Exercisable at  
December 31,  
2005

124      1,656      5,119      824      16      271      7

The weighted-average fair value of options granted during 2003, 2004 and 2005 is \$8.99, \$12.12 and \$16.14, respectively.

The following table summarizes information about stock options outstanding at December 31, 2005:

		Number Outstanding	Weighted		Number Exercisable	
		as of December	Average Remaining	Weighted Average	as of December	Weighted Average
Range of Exercise Prices		31, 2005	Contractual Life	Exercise Price	31, 2005	Exercise Price
\$2.22	\$18.68	2,298	3.70	\$13.11	2,298	\$13.11
\$18.87	\$23.10	3,597	7.06	21.01	3,597	21.01
\$23.26	\$39.49	2,063	8.48	30.92	2,063	30.92
\$46.36	\$46.36	59	9.44	46.36	59	46.36
\$2.22	\$46.36	8,017	6.48	\$21.48	8,017	\$21.48

Pro forma information regarding net income and net income per share is required by SFAS No. 123 and SFAS No. 148, and has been determined as if the Company had accounted for its employee stock options under the fair value method of that Statement. The fair value for these options was estimated at the date of grant using a Black-Scholes option pricing model with the following weighted-average assumptions:

	Year Ended December 31,		
	2003	2004	2005
Expected volatility	39%	37%	35%
Expected dividend yield	None	None	None
Risk-free interest rate	3.25%	3.70%	4.20%
	5		
Expected life of options	years	4 years	4 years

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The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options, which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's employee stock options have characteristics that are significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

All outstanding stock options and all of the outstanding nonvested stock awards became fully vested on August 24, 2005, as a result of the stockholders' vote to approve Fresenius Medical Care's acquisition of Renal Care Group, which represented a change of control under the applicable provisions of the Company's stock-based compensation plans. The information set forth below reflects the estimated pro-forma after tax charge the Company would have incurred during each period presented. As a result of the accelerated vesting of stock options all remaining unamortized stock option expense is reflected in the 2005 period.

The following table presents the pro forma effect on net income and net income per share as if we had applied the fair value based method and recognition provisions of SFAS No. 123, *Accounting for Stock-Based Compensation*, to stock-based compensation to employees and directors:

	<b>Year Ended December 31</b>		
	<b>2003</b>	<b>2004</b>	<b>2005</b>
Net income, as reported	\$ 102,056	\$ 121,833	\$ 129,713
Add: stock-based compensation expense, net of related tax effects, included in the determination of net income as reported	424	244	431
Less: stock-based compensation expense, net of related tax effects, determined by the fair value-based method	(8,663)	(10,365)	(23,236)
Pro forma net income	\$ 93,817	\$ 111,712	\$ 106,908
Net income per share:			
Basic, as reported	\$ 1.40	\$ 1.80	\$ 1.90
Basic, pro forma	\$ 1.29	\$ 1.65	\$ 1.57
Diluted, as reported	\$ 1.37	\$ 1.74	\$ 1.83
Diluted, pro forma	\$ 1.26	\$ 1.60	\$ 1.51

The effect of applying SFAS No. 123 and SFAS No. 148 for providing pro forma disclosure is not likely to be representative of the effect on reported net income for future years.

**Stock Split**

On April 27, 2004, the Company announced a three-for-two stock split in the form of a stock dividend distributed to shareholders of record as of May 7, 2004. On May 24, 2004 the Company issued one share for every two shares held by shareholders as of the record date. The par value of our common stock remained unchanged at \$0.01. All share amounts in these financial statements have been restated to reflect the stock split.

**Authorized Shares**

On June 9, 2004, the Company's shareholders approved an amendment to the certificate of incorporation increasing the number of authorized shares of common stock from 90,000 to 150,000.

**Table of Contents****10. LEASES**

The Company rents office space and space for its dialysis facilities under lease agreements that are classified as operating leases for financial statement purposes. The Company's capital leases are primarily for buildings and equipment. At December 31, 2005, future minimum rental payments for non-cancelable operating leases with terms of one year or more, and capital leases consisted of the following:

	<b>Operating Leases</b>	<b>Capital Leases</b>
2006	\$ 47,961	\$ 800
2007	45,417	743
2008	40,959	658
2009	35,226	588
2010	30,828	603
Thereafter	101,915	3,734
Less: portion representing interest		(2,502)
	\$ 302,306	\$ 4,624

Certain leases of the Company contain escalating payments and are recorded on a straight-line basis. Rent expense was \$30,729, \$45,055 and \$52,040 for the years ended December 31, 2003, 2004 and 2005, respectively.

**11. EMPLOYEE BENEFIT PLANS****Defined Contribution Plans**

The Company has qualified defined contribution plans covering substantially all employees that permit participants to make voluntary contributions. The Company pays all general and administrative expenses of the plans and makes matching contributions on behalf of the employees. The Company made contributions relating to these plans totaling \$2,978, \$3,294 and \$3,541 for the years ended December 31, 2003, 2004 and 2005, respectively.

**Defined Benefit Plans**

On January 1, 2005, the Company adopted a Supplemental Executive Retirement Plan (SERP) that provides retirement benefits to the Company's executive officers. The SERP is accounted for as a defined benefit plan under SFAS No. 87, *Employers' Accounting for Pensions*. For the year ended December 31, 2005, the Company has recognized pension costs of \$1,354. As of December 31, 2005 the Company has recorded an accrued pension liability of \$2,864 and an intangible asset of \$1,510.

Effective January 29, 2003, the Company implemented a retirement benefit plan for Sam A. Brooks, the Company's former Chairman, Chief Executive Officer and President. Mr. Brooks died March 20, 2003. The plan provides that the Company will make 120 monthly payments of \$54 each to Mr. Brooks' beneficiary, beginning in April 2003. As a result, the Company recorded a \$5,350 charge representing the pre-tax net present value of such payments during the first quarter of 2003. As of December 31, 2005 the Company has accrued liabilities totaling \$4,085 related to this defined benefit plan.

**Employee Stock Purchase Plan**

The Company has an Employee Stock Purchase Plan (Stock Purchase Plan) that provides substantially all employees an opportunity to purchase shares of its common stock in amounts not to exceed 10% of eligible compensation or \$25 of common stock each calendar year. Annually, the participant's December 31 account balance is used to purchase shares of stock at the lesser of 85% of the fair market value of shares at the beginning of the year or December 31. On May 14, 2005 the Company discontinued employee contributions to the Employee Stock Purchase Plan as a result of the pending Fresenius Medical Care transaction. At December 31, 2004 and 2005, \$4,511 and \$2,036, respectively, were included in accrued wages and benefits relating to the Stock Purchase Plan.

**12. EARNINGS PER SHARE**

Basic net income per share is based on the weighted average number of common shares outstanding during the periods. Diluted net income per share is based on the weighted average number of common shares outstanding during the periods plus the effect of dilutive stock options calculated using the treasury stock method.

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The following table sets forth the computation of basic and diluted net income per share.

	2003	2004	2005
Numerator:			
Numerator for basic and diluted net income per share	\$ 102,056	\$ 121,833	\$ 129,713
Denominator:			
Denominator for basic net income per share weighted-average shares	72,719	67,581	68,110
Effect of dilutive securities:			
Stock options	2,034	2,311	2,724
Denominator for diluted net income per share-adjusted weighted-average shares and assumed conversions	74,753	69,892	70,834
Basic net income per share	\$ 1.40	\$ 1.80	\$ 1.90
Diluted net income per share	\$ 1.37	\$ 1.74	\$ 1.83

**13. COMMITMENTS AND CONTINGENCIES**

On August 9, 2005, the Company received a subpoena from the office of the United States Attorney for the Eastern District of Missouri. The subpoena requires the Company to produce documents related to numerous aspects of our business and operations. The subpoena includes specific requests for documents related to the Company's supply company, pharmaceutical and other ancillary services the Company provides to patients (including the administration of EPO), the Company's relationships with pharmaceutical companies, the Company's relationships with physicians, medical director compensation, joint ventures with physicians and the Company's purchases of dialysis equipment from Fresenius Medical Care. The subpoena was issued in connection with a joint civil and criminal investigation. The Company is cooperating with the government's investigation; the Company has produced numerous documents to the government in response to this subpoena. The Company has incurred significant legal and other expenses responding to the subpoena and has experienced distraction of management attention. Compliance with the subpoena will require the Company to incur substantial additional legal and other expenses and will require further management attention. To the Company's knowledge, no proceedings have been initiated against it at this time, but the Company cannot predict whether or when proceedings might be initiated. In addition, the Company cannot predict the outcome of any proceedings that may be initiated against the Company as a result of this investigation. Any such proceedings could have a material adverse effect on the Company's business, financial condition and results of operations.

On October 25, 2004, the Company received a subpoena from the office of the United States Attorney for the Eastern District of New York. The subpoena requires the Company to produce documents related to numerous aspects of our business and operations, including those of RenaLab, Inc., the Company's laboratory. The subpoena includes specific requests for documents related to testing for parathyroid hormone (PTH) levels and vitamin D therapies. The Company is cooperating with the government's investigation. The Company has produced numerous documents to the government in response to this subpoena. The Company has incurred significant legal and other expenses responding to the subpoena. Compliance with this subpoena will require the Company to incur additional legal expenses and could distract management attention. To the Company's knowledge, no proceedings have been initiated against the Company at this time, but the Company cannot predict whether or when proceedings might be initiated. The Company cannot predict the outcome of any proceedings that may be initiated against it as a result of this investigation. Any such proceedings could have a material adverse effect on the Company's business, financial condition and results of operations.

If any aspect of the Company's operations is found to violate applicable laws, then the Company may be subject to severe sanctions, and the Company could be required to alter or discontinue the challenged conduct or both. If sanctions are imposed on the Company, then there could be a material adverse effect on the Company's business,

financial condition and results of operations. If the Company is required to alter or discontinue practices, then the Company may not be able to do so successfully, which could have a material adverse effect on the Company's business, financial condition and results of operations.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. The Company believes that it is in compliance with all applicable laws and regulations governing the Medicare and Medicaid programs. Compliance with such laws and regulations can be subject to additional government review and interpretation as well as significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid programs.

The Company is involved in other litigation and regulatory investigations arising in the ordinary course of business. In the opinion of management, after consultation with legal counsel, these matters will be resolved without material adverse effect on the Company's consolidated financial position or results of operations.

The Company generally engages practicing board-certified or board-eligible nephrologists to serve as medical directors for its centers. Medical directors are responsible for the administration and monitoring of the Company's patient care policies, including patient education, administration of dialysis treatment, development programs and assessment of all patients. The Company pays medical director fees that are consistent with the fair market value of the required supervisory services. Such medical director agreements typically have a term of five to ten years with renewal options of two or three years. As of December 31, 2005, estimated commitments for medical director fees for the year 2006 are \$28,971 and are \$139,540 over the remaining lives of the agreements.

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**Table of Contents****14. SELECTED QUARTERLY FINANCIAL DATA (unaudited)**

The following tables include, for 2004 and 2005, certain selected quarterly financial data. In the opinion of the Company's management, this unaudited information has been prepared on the same basis as the audited information and includes all adjustments necessary to present fairly the information included therein. The operating results for any quarter are not necessarily indicative of results for any future period.

	<b>2004</b>			
	<b>First Quarter</b>	<b>Second Quarter</b>	<b>Third Quarter</b>	<b>Fourth Quarter</b>
Net revenue	\$ 278,028	\$ 340,854	\$ 356,111	\$ 370,054
Operating expenses	209,158	265,239	274,200	284,254
Depreciation and amortization	12,163	14,900	15,344	15,942
Income from operations	56,707	60,715	66,567	69,858
Interest expense, net	965	5,765	6,869	7,029
Minority interest	7,214	7,690	10,158	10,107
Income before income taxes	48,528	47,260	49,540	52,722
Provision for income taxes	18,441	18,077	19,072	20,627
Net income	\$ 30,087	\$ 29,183	\$ 30,468	\$ 32,095
Net income per share:				
Basic	\$ 0.43	\$ 0.44	\$ 0.45	\$ 0.48
Diluted	\$ 0.42	\$ 0.42	\$ 0.44	\$ 0.46

	<b>2005</b>			
	<b>First Quarter</b>	<b>Second Quarter</b>	<b>Third Quarter</b>	<b>Fourth Quarter</b>
Net revenue	\$ 373,509	\$ 384,329	\$ 402,230	\$ 410,158
Operating expenses	285,413	299,862	307,560	319,621
Depreciation and amortization	16,787	17,775	18,173	18,665
Income from operations	71,309	66,692	76,497	71,872
Interest expense, net	7,261	7,981	8,715	8,951
Minority interest	9,362	9,132	9,915	7,428
Income before income taxes	54,686	49,579	57,867	55,493
Provision for income taxes	21,054	21,362	22,636	22,860
Net income	\$ 33,632	\$ 28,217	\$ 35,231	\$ 32,633
Net income per share:				
Basic	\$ 0.50	\$ 0.41	\$ 0.52	\$ 0.48
Diluted	\$ 0.48	\$ 0.40	\$ 0.50	\$ 0.46





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**Renal Care Group, Inc.**  
**Consolidated Schedule Valuation and Qualifying Accounts**  
**(in thousands)**

	<b>Balance Beginning of Period</b>	<b>Allowances Acquired</b>	<b>Amount Charged to Expense</b>	<b>Write-Offs</b>	<b>Balance End of Period</b>
Allowance for doubtful accounts:					
Year ended December 31, 2003	\$43,677	\$	\$26,200	\$(37,716)	\$32,161
Year ended December 31, 2004	\$32,161	\$19,651	\$32,550	\$(39,231)	\$45,131
Year ended December 31, 2005	\$45,131	\$	\$31,978	\$(48,549)	\$28,560

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**Table of Contents****SIGNATURES**

Pursuant to the requirements of Section 13 or 15 (d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Report on Form 10-K to be signed on its behalf by the undersigned, thereunto duly authorized in the City of Nashville, State of Tennessee, on the 13<sup>th</sup> day of March, 2006.

RENAL CARE GROUP, INC.

By: /s/ Gary A.  
Brukardt

Gary A. Brukardt  
*President and  
Chief Executive  
Officer*

KNOW ALL MEN BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Gary A. Brukardt and David M. Dill and either of them (with full power in each to act alone) as true and lawful attorneys-in-fact with full power of substitution, for him and in his name, place and stead, in any and all capacities, to sign any and all amendments to this Annual Report on Form 10-K, and to file the same, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that said attorneys-in-fact, or their substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this Annual Report on Form 10-K has been signed by the following persons in the capacities and on the dates indicated.

/s/ Gary A. Brukardt	President, Chief Executive Officer and Director (Principal Executive Officer)	March 13, 2006
Gary A. Brukardt		
/s/ David M. Dill	Executive Vice President, Chief Financial Officer and Treasurer (Principal Financial and Accounting Officer)	March 13, 2006
David M. Dill		
/s/ Peter J. Grua	Director	March 13, 2006
Peter J. Grua		
/s/ Joseph C. Hutts	Director	March 13, 2006
Joseph C. Hutts		
/s/ Harry R. Jacobson, M.D.	Director	March 13, 2006
Harry R. Jacobson, M.D.		
/s/ William P. Johnston	Chairman of the Board Director	March 13, 2006
William P. Johnston		
/s/ William V. Lapham	Director	March 13, 2006

William V. Lapham

/s/ Thomas A. Lowery, M.D.

Director

March 13, 2006

Thomas A. Lowery, M.D.

/s/ Stephen D. McMurray, M.D.

Director

March 13, 2006

Stephen D. McMurray, M.D.

/s/ C. Thomas Smith

Director

March 13, 2006

C. Thomas Smith

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**EXHIBIT INDEX**

<b>Exhibit Number</b>	<b>Description of Exhibits</b>
2.1	Agreement and Plan of Merger dated February 2, 2004 by and among Renal Care Group, Inc., Titan Merger Subsidiary, Inc., National Nephrology Associates, Inc. and certain equity holders of National Nephrology Associates, Inc.(24)
2.1.1	Agreement, dated May 3, 2005, by and among Renal Care Group, Inc., Fresenius Medical Care AG, Fresenius Medical Care Holdings, Inc. and Florence Acquisitions, Inc.(28)
2.1.2	Letter Agreement among Fresenius AG, Fresenius Medical Care AG, Fresenius Medical Care Holdings, Inc. and Renal Care Group, Inc., dated May 3, 2005(28)
3.1	Amended and Restated Certificate of Incorporation of the Company (1)
3.1.1	Certificate of Amendment of Certificate of Incorporation of the Company(2)
3.1.2	Certificate of Designation, Preferences, and Rights of Series A Junior Participating Preferred Stock of the Company (2)
3.1.3	Certificate of Amendment of Amended and Restated Certification of Incorporation of the Company(10)
3.1.4	Certificate of Amendment of Amended and Restated Certificate of Incorporation of the Company (26)
3.2	Amended and Restated Bylaws of the Company (1)
4.1	Indenture, dated as of October 22, 2003, by and among National Nephrology Associates, Inc., the Guarantors named therein, and Wells Fargo Bank Minnesota, N.A.(24)
4.2	First Supplemental Indenture, dated as of April 2, 2004, by and among Renal Care Group, Inc., the Guarantors named therein and Wells Fargo Bank, N.A.(24)
4.3	Reserved
4.4	Purchase Agreement, dated as of October 16, 2003, by and among National Nephrology Associates, Inc., the Guarantors named therein and the Initial Purchasers named therein(24)
4.5	Registration Rights Agreement dated as of October 22, 2003, by and among National Nephrology Associates, Inc., the Guarantors named herein and the Initial Purchasers named herein(24)
4.6	Form of 9.0% Senior Subordinated Note Due 2011, including Form of Guarantee (included in Exhibit 4.1)
4.7	First Amendment, dated as of May 3, 2005, to the Shareholder Protection Rights Agreement dated as of May 2, 1990 between Renal Care Group, Inc. and Wachovia Bank, National

Association, as rights agent (incorporated by reference from Exhibit 4.1 to the Company's current report on Form 8-K filed on May 3, 2005)

- 10.1 Employment Agreement, effective as of December 15, 2003, between the Company and Raymond Hakim, M.D.(22)\*
- 10.2 Medical Director Services Agreement, dated February 12, 1996, between the Company and Indiana Dialysis Management, P.C. (4)
  - 10.2.1 Amendment Number 1, to Medical Director Services Agreement, effective as of January 1, 1999, between the Company and Indiana Dialysis Management, P.C.(22)
  - 10.2.2 Amendment Number 2 to Medical Director Services Agreement, effective as of February 12, 2002, between the Company and Indiana Dialysis Management.(22)
- 10.3 Medical Director Services Agreement, effective as of February 12, 2003, between the Company and Tyler Nephrology Associates, P.A.(22)
- 10.4 Lease Agreement, dated February 12, 1996, among the Company and Thomas A. Lowery, M.D., James R. Cotton, M.D., Roy D. Gerard, M.D. and Kevin A. Curran, M.D., relating to property in Carthage, Texas (4)
- 10.5 Lease Agreement, dated February 12, 1996, among the Company and Thomas A. Lowery, M.D., James R. Cotton, M.D., Roy D. Gerard, M.D., and Kevin A. Curran, M.D., relating to property in Tyler, Texas (4)
- 10.6 Sublease Agreement, dated February 12, 1996, with Tyler Nephrology Associates, Inc. (4)
- 10.7 Dialysis Center Management Agreement, effective as of July 1, 2001, between Renal Group, Inc. and Vanderbilt University (22)

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<b>Exhibit Number</b>	<b>Description of Exhibits</b>
10.8	1996 Stock Option Plan for Outside Directors (1)*
10.9	Fourth Amended and Restated 1996 Stock Incentive Plan (5)*
10.10	Amended and Restated Employee Stock Purchase Plan (2)*
10.11	Employment Agreement, April 28, 2003, between the Company and Gary Brukardt (20)*
10.12	Credit Agreement, dated as of February 10, 2004, by and among Renal Care Group, Inc., the Guarantors (as defined therein), the Lenders (as defined therein) and Bank of America, N.A. as Administrative Agent (16)
10.12.1	Incremental Term Loan Commitment Agreement, dated as of May 27, 2005, by and among Renal Care Group, Inc., Guarantors (as defined therein) and Bank of America, N.A. (29)
10.13	Stock Option Agreement, dated April 30, 1997, between the Company and Gary Brukardt (2)*
10.14	Asset Purchase Agreement with an effective date of February 1, 1997 among the Company, RCG Indiana, LLC, Eastern Indiana Kidney Center, Indiana Kidney Center, Indiana Kidney Center South, LLC, St. Vincent Dialysis Center, Saint Joseph Dialysis Center and Indiana Dialysis Services PC and Community Hospitals of Indiana, Inc., Seton Health Corporation of Central Indiana, Inc., Reid Hospital & Health Care Services, Inc., and Saint Joseph Hospital and Health Care Center of Kokomo, Indiana, Inc. and Indiana Dialysis Services, PC, Reid Hospital Physicians, Greenwood Dialysis Services, PC and certain individuals named on the signature pages thereto and Indiana Nephrology & Internal Medicine, P.C. (6)
10.15	Stock Option Agreement, dated May 22, 1998, between the Company and Gary A. Brukardt (7)*
10.16	Stock Option Agreement, dated May 22, 1998, between the Company and Raymond Hakim, M.D. (7)*
10.17	Stock Option Agreement, dated June 5, 1998, between the Company and Joseph C. Hutts (7)*
10.18	Stock Option Agreement, dated June 5, 1998, between the Company and Harry R. Jacobson, M.D. (7)*
10.19	Agreement No. 20060024, between Renal Care Group, Inc. and Amgen Inc. (The Company has requested confidential treatment of certain portions of this Exhibit.)
10.20	Restricted Stock Award Agreement, dated January 25, 1999, between the Company and Harry R. Jacobson (8)*
10.21	Restricted Stock Award Agreement, dated January 25, 1999, between the Company and Stephen D. McMurray (8)*

- 10.22 Renal Care Group, Inc. 1999 Long-Term Incentive Plan (9)\*
- 10.22.1 Amendment to the Renal Care Group, Inc. 1999 Long-Term Incentive Plan (12)\*
- 10.22.2 Amended and Restated Renal Care Group, Inc. 1999 Long-Term Incentive Plan (19)\*
- 10.23 Stock Option Agreement, dated August 30, 1999, between the Company and Gary A. Brukardt (11)\*
- 10.24 Stock Option Agreement, dated August 30, 1999, between the Company and Raymond Hakim, M.D. (11)\*
- 10.25 Stock Option Agreement, dated June 2, 1999, between the Company and Joseph C. Hutts (11)\*



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<b>Exhibit Number</b>	<b>Description of Exhibits</b>
10.26	Stock Option Agreement, dated June 2, 1999, between the Company and Harry R. Jacobson, M.D. (11)*
10.27	Stock Option Agreement, dated July 22, 1999, between the Company and William V. Lapham (11)*
10.28	Stock Option Agreement, dated June 8, 2000, between the Company and Joseph C. Hutts (13)*
10.29	Stock Option Agreement, dated June 8, 2000, between the Company and Harry R. Jacobson, M.D.(13)*
10.30	Stock Option Agreement, dated June 8, 2000, between the Company and William V. Lapham(13)*
10.31	Stock Option Agreement, dated September 19, 2000, between the Company and Gary A. Brukardt(13)*
10.32	Stock Option Agreement, dated September 19, 2000, between the Company and Raymond Hakim, M.D.(13)*
10.33	Stock Option Agreement dated August 2, 2001 between the Company and Gary Brukardt(14)*
10.34	Stock Option Agreement dated August 2, 2001 between the Company and Raymond Hakim(14)*
10.35	Stock Option Agreement dated June 7, 2001 between the Company and Joseph C. Hutts(15)*
10.36	Stock Option Agreement dated June 7, 2001 between the Company and William V. Lapham(15)*
10.37	Form of Stock Option Agreement for stock option grants to executive employees under the Company's 1999 Long-Term Incentive Plan(17)
10.38	Form of Stock Option Agreement for stock option grants to non-management directors under the Company's 1996 Stock Option Plan for Outside Directors(17)
10.39	Medical Director Services Agreement, dated May 1, 2002, between the Company and Tyler Nephrology Associates, P.A.(18)
10.40	Medical Director Services Agreement, dated July 11, 2002 between the Company and Tyler Nephrology Associates, P.A.(18)
10.41	Renal Care Group Supplemental Benefit Plan(19)*

10.42	[RESERVED]
10.43	Form of Indemnity Agreement between the Company and directors and certain officers(19)
10.44	Employment Agreement, effective as of November 3, 2003, between the Company and David M. Dill(22)*
10.45	Employment Agreement, effective as of November 30, 2003, between the Company and Timothy P. Martin(22)*
10.46	Employment Agreement effective as of December 31, 2003 between the Company and Douglas B. Chappell(22)*
10.47	2004 Stock and Incentive Compensation Plan(23)
10.48	Form of Stock Option Agreement for stock option grants to executive employees under the Company's 2004 Stock and Incentive Compensation Plan(25)
10.49	Employment Agreement, effective as of February 3, 2005, between the Company and David M. Maloney(26)*
10.50	Supplemental Executive Retirement Plan for certain executive officers effective January 1, 2005(27)
10.51	Limited Liability Company Agreement for Maumee Dialysis Services, LLC effective December 1, 2001(27)
10.51.1	Management Agreement dated December 1, 2001 between Maumee Dialysis Services, LLC and DMN of Indiana Corporation(27)
10.51.2	Amendment Number 1 to Limited Liability Company Agreement dated July 1, 2002 between Maumee Dialysis Services LLC, RCG Indiana, LLC and Indiana Dialysis Management, P.C.(27)

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<b>Exhibit Number</b>	<b>Description of Exhibits</b>
10.52	Limited Liability Company Agreement for Three Rivers Dialysis Services, LLC effective March 31, 2001(27)
10.52.1	Management Agreement dated March 31, 2001 between Three Rivers Dialysis Services, LLC and DMN of Indiana Corporation(27)
10.52.2	Amendment Number 1 to Limited Liability Company Agreement dated July 1, 2002 between Three Rivers Dialysis Services, LLC, RCG Indiana, LLC and Indiana Dialysis Management, P.C.(27)
21.1	List of subsidiaries of the Company
23.1.1	Consent of Ernst & Young LLP
23.1.2	Consent of Ernst & Young LLP
24.1	Power of Attorney (contained on the signature page of this report)
31.1	Certification pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1* *	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2* *	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
(1)	Incorporated by reference to the Company's Registration Statement on Form S-1 (Reg. No. 333-80221) effective February 6, 1996.
(2)	Incorporated by reference to the Company's Form 10-Q for the quarter ended June 30, 1997 (Commission File No. 0-27640).
(3)	Incorporated by reference to the Company's Current Report on Form 8-K filed May 5, 1997 (Commission File No. 0-27640).
(4)	Incorporated by reference to the Company's Form 10-Q for the quarter ended March 31, 1996 (Commission File No. 0-27640).
(5)	Incorporated by reference to Appendix A to the Company's definitive Proxy Statement filed April 27, 1998 relating to the 1998 Annual Meeting of Stockholders (Commission File No. 0-27640).
(6)	

Incorporated by reference to the Company's Form 10-K for the year ended December 31, 1996 (Commission File No. 0-27640).

- (7) Incorporated by reference to the Company's Form 10-Q for the quarter ended June 30, 1998 (Commission File No. 0-27640).
- (8) Incorporated by reference to the Company's Form 10-Q for the quarter ended March 31, 1999 (Commission File No. 0-27640).
- (9) Incorporated by reference to Appendix A to the Company's definitive Proxy Statement filed April 27, 1999 relating to the 1999 Annual Meeting of Stockholders (Commission File No. 0-27640).
- (10) Incorporated by reference to the Company's Form 10-Q for the quarter ended June 30, 1999 (Commission File No. 0-27640).
- (11) Incorporated by reference to the Company's Form 10-Q for the quarter ended September 30, 1999 (Commission File No. 0-27640).
- (12) Incorporated by reference to the Company's definitive Proxy Statement filed April 28, 2000 relating to the 2001 Annual Meeting of Stockholders (Commission File No. 0-27640).
- (13) Incorporated by reference to the Company's Form 10-K for the year ended December 31, 2000 (Commission File No. 0-27640).
- (14) Incorporated by reference to the Company's Form 10-Q for the quarter ended September 30, 2001 (Commission File No. 0-27640).
- (15) Incorporated by reference to the Company's Form 10-K for the year ended December 31, 2001 (Commission File No. 0-27640).
- (16) Incorporated by reference to the Company's Form 10-Q for the quarter ended June 30, 2002 (Commission File No. 0-27640).
- (17) Incorporated by reference to the Company's Form 10-Q for the quarter ended September 30, 2002 (Commission File No. 0-27640).
- (18) Incorporated by reference to the Company's Form 10-K for the year ended December 31, 2002 (Commission File No. 0-27640).
- (19) Incorporated by reference to the Company's Form 10-Q for the quarter ended March 31, 2003 (Commission File No. 0-27640).
- (20) Incorporated by reference to the Company's Form 10-Q for the quarter ended June 30, 2003 (Commission File No. 0-27640).
- (21) Incorporated by reference to the Company's Form 10-Q for the quarter ended September 30, 2003 (Commission File No. 0-27640).
- (22) Incorporated by reference to the Company's Form 10-K for the year ended December 31, 2003 (Commission File No. 0-27640).

- (23) Incorporated by reference to the Company's definitive Proxy Statement filed May 6, 2004 relating to the 2004 Annual Meeting of Stockholders (Commission File No. 0-27640).
- (24) Incorporated by reference to the Company's Form 8-K dated as of April 26, 2004 (Commission File No. 0-27640).
- (25) Incorporated by reference to the Company's Form 10-Q for the quarter ended September 30, 2004 (Commission File No. 0-27640).
- (26) Incorporated by reference to the Company's Form 10-K for the year ended December 31, 2005 (Commission File No. 0-27640).
- (27) Incorporated by reference to the Company's Form 10-Q for the quarter ended March 31, 2005 (Commission File No. 0-27640).
- (28) Incorporated by reference to the Company's Form 8-K dated as of May 3, 2005 (Commission File No. 000-27640).