

DAVITA INC
Form 10-Q
November 05, 2010
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

For the Quarterly Period Ended

September 30, 2010

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

Commission File Number: 1-14106

DAVITA INC.

1551 Wewatta Street

Denver, CO 80202

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Telephone number (303) 405-2100

Delaware
(State of incorporation)

51-0354549
(I.R.S. Employer Identification No.)

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

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

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

(Do not check if a smaller reporting company)

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

As of October 29, 2010, the number of shares of the Registrant's common stock outstanding was approximately 97.2 million shares and the aggregate market value of the common stock outstanding held by non-affiliates based upon the closing price of these shares on the New York Stock Exchange was approximately \$7.0 billion.

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DAVITA INC.

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Note: Items 3, 4 and 5 of Part II are omitted because they are not applicable.

Table of Contents**DAVITA INC.****CONSOLIDATED STATEMENTS OF INCOME****(unaudited)****(dollars in thousands, except per share data)**

	Three months ended September 30,		Nine months ended September 30,	
	2010	2009	2010	2009
Net operating revenues	\$ 1,651,649	\$ 1,573,915	\$ 4,797,974	\$ 4,540,596
Operating expenses and charges:				
Patient care costs	1,146,382	1,095,857	3,339,723	3,153,622
General and administrative	148,041	134,931	421,422	394,370
Depreciation and amortization	58,486	56,813	174,307	172,121
Provision for uncollectible accounts	43,938	42,021	127,868	119,990
Equity investment income	(1,789)	(708)	(6,968)	(1,066)
Total operating expenses and charges	1,395,058	1,328,914	4,056,352	3,839,037
Operating income	256,591	245,001	741,622	701,559
Debt expense	(39,490)	(45,535)	(127,728)	(140,924)
Debt redemption charges			(4,127)	
Other income	759	999	2,329	3,026
Income before income taxes	217,860	200,465	612,096	563,661
Income tax expense	74,979	74,195	220,322	209,485
Net income	142,881	126,270	391,774	354,176
Less: Net income attributable to noncontrolling interests	(23,494)	(15,340)	(55,111)	(41,216)
Net income attributable to DaVita Inc.	\$ 119,387	\$ 110,930	\$ 336,663	\$ 312,960
Earnings per share:				
Basic earnings per share attributable to DaVita Inc.	\$ 1.16	\$ 1.07	\$ 3.27	\$ 3.01
Diluted earnings per share attributable to DaVita Inc.	\$ 1.15	\$ 1.06	\$ 3.22	\$ 3.00
Weighted average shares for earnings per share:				
Basic	102,608,844	104,127,334	102,989,010	103,904,768
Diluted	104,022,458	104,607,318	104,408,939	104,315,019

See notes to condensed consolidated financial statements.

Table of Contents**DAVITA INC.****CONSOLIDATED BALANCE SHEETS****(unaudited)****(dollars in thousands, except per share data)**

	September 30, 2010	December 31, 2009
ASSETS		
Cash and cash equivalents	\$ 534,565	\$ 539,459
Short-term investments	22,945	26,475
Accounts receivable, less allowance of \$244,176 and \$229,317	1,082,676	1,105,903
Inventories	68,950	70,041
Other receivables	249,445	263,456
Other current assets	38,798	40,234
Income tax receivables	44,284	
Deferred income taxes	220,342	256,953
Total current assets	2,262,005	2,302,521
Property and equipment, net	1,121,604	1,104,925
Amortizable intangibles, net	124,217	136,732
Equity investments	25,679	22,631
Long-term investments	8,049	7,616
Other long-term assets	32,428	32,615
Goodwill	4,053,123	3,951,196
	\$ 7,627,105	\$ 7,558,236
LIABILITIES AND EQUITY		
Accounts payable	\$ 321,179	\$ 176,657
Other liabilities	337,221	461,092
Accrued compensation and benefits	357,132	286,121
Current portion of long-term debt	96,252	100,007
Income taxes payable		23,064
Total current liabilities	1,111,784	1,046,941
Long-term debt	3,266,190	3,532,217
Other long-term liabilities	89,919	87,692
Alliance and product supply agreement, net	26,650	30,647
Deferred income taxes	387,717	334,855
Total liabilities	4,882,260	5,032,352
Commitments and contingencies		
Noncontrolling interests subject to put provisions	368,369	331,725
Equity:		
Preferred stock (\$0.001 par value, 5,000,000 shares authorized; none issued)		
Common stock (\$0.001 par value, 450,000,000 shares authorized; 134,862,283 shares issued; 101,330,359 and 103,062,698 shares outstanding)	135	135
Additional paid-in capital	631,062	621,685
Retained earnings	2,648,797	2,312,134

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Treasury stock, at cost (33,531,924 and 31,799,585 shares)	(958,680)	(793,340)
Accumulated other comprehensive income (loss)	119	(5,548)
Total DaVita Inc. shareholders' equity	2,321,433	2,135,066
Noncontrolling interests not subject to put provisions	55,043	59,093
Total equity	2,376,476	2,194,159
	\$ 7,627,105	\$ 7,558,236

See notes to condensed consolidated financial statements.

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DAVITA INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)
(dollars in thousands)

	Nine months ended September 30,	
	2010	2009
Cash flows from operating activities:		
Net income	\$ 391,774	\$ 354,176
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	174,307	172,121
Stock-based compensation expense	33,492	33,850
Tax benefits from stock award exercises	15,755	12,434
Excess tax benefits from stock award exercises	(2,079)	(8,115)
Deferred income taxes	61,499	45,417
Equity investment income, net	(3,048)	(1,066)
Loss on disposal of assets and other non-cash charges	5,650	15,323
Debt redemption charges	4,127	
Changes in operating assets and liabilities, other than from acquisitions and divestitures:		
Accounts receivable	21,680	(68,235)
Inventories	3,041	15,858
Other receivables and other current assets	16,596	(2,164)
Other long-term assets	187	5,641
Accounts payable	95,350	(58,995)
Accrued compensation and benefits	72,501	20,733
Other current liabilities	(118,305)	(68,383)
Income taxes	(55,703)	55,226
Other long-term liabilities	2,308	(9,702)
Net cash provided by operating activities	719,132	514,119
Cash flows from investing activities:		
Additions of property and equipment	(169,376)	(205,653)
Acquisitions	(137,643)	(64,001)
Proceeds from asset sales	18,471	6,256
Purchase of investments available for sale	(955)	(1,737)
Purchase of investments held-to-maturity	(23,540)	(16,942)
Proceeds from sale of investments available for sale	900	16,537
Proceeds from maturities of investments held-to-maturity	26,916	16,123
Purchase of equity investments and other assets	(436)	(260)
Distributions received on equity investments	350	929
Net cash used in investing activities	(285,313)	(248,748)
Cash flows from financing activities:		
Borrowings	14,736,519	13,924,642
Payments on long-term debt	(15,006,754)	(13,961,667)
Debt call premium	(3,314)	

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Purchase of treasury stock	(148,669)	(61,223)
Excess tax benefits from stock award exercises	2,079	8,115
Stock award exercises and other share issuances, net	39,416	30,309
Distributions to noncontrolling interests	(61,112)	(46,888)
Contributions from noncontrolling interests	5,365	11,117
Proceeds from sales of additional noncontrolling interests	3,205	7,733
Purchases from noncontrolling interests	(5,402)	(6,668)
Deferred financing costs	(46)	(42)
Net cash used in financing activities	(438,713)	(94,572)
Net (decrease) increase in cash and cash equivalents	(4,894)	170,799
Cash and cash equivalents at beginning of period	539,459	410,881
Cash and cash equivalents at end of period	\$ 534,565	\$ 581,680

See notes to condensed consolidated financial statements.

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DAVITA INC.
CONSOLIDATED STATEMENTS OF EQUITY
AND COMPREHENSIVE INCOME

(unaudited)

(dollars and shares in thousands)

	Non-controlling interests subject to put provisions	Common stock		DaVita Inc. Shareholders' Equity		Treasury stock Shares	Equity Amount	Accumulated other comprehensive income (loss)	Total	Non-controlling interests not subject to put provisions	Comprehensive income
		Shares	Amount	Additional paid-in capital	Retained earnings						
Balance at December 31, 2008	\$ 291,397	134,862	\$ 135	\$ 584,358	\$ 1,889,450	(31,109)	\$ (691,857)	\$ (14,339)	\$ 1,767,747	\$ 59,152	
Comprehensive income:											
Net income	38,381				422,684				422,684	18,694	479,759
Unrealized losses on interest rate swaps, net of tax								(2,578)	(2,578)		(2,578)
Less reclassification of net swap realized losses into net income, net of tax								10,542	10,542		10,542
Unrealized gains on investments, net of tax								986	986		986
Less reclassification of net investment realized gains into net income, net of tax								(159)	(159)		(159)
Total comprehensive income											\$ 488,550
Stock purchase shares issued				2,135		107	2,387		4,522		
Stock unit shares issued				(1,570)		69	1,570				
Stock options and SSARs exercised				15,598		2,036	48,055		63,653		
Stock-based compensation expense				44,422					44,422		
Excess tax benefits from stock awards exercised				6,150					6,150		

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Distributions to noncontrolling interests	(44,277)								(23,471)	
Contributions from noncontrolling interests	10,502								2,569	
Sales and assumptions of additional noncontrolling interests	13,483		(529)					(529)	4,039	
Purchases from noncontrolling interests	(2,594)		(3,721)					(3,721)	(544)	
Changes in fair value of noncontrolling interests	24,819		(24,819)					(24,819)		
Other adjustments	14		(339)					(339)	(1,346)	
Purchase of treasury stock					(2,903)	(153,495)		(153,495)		
Balance at December 31, 2009	\$ 331,725	134,862	\$ 135	\$ 621,685	\$ 2,312,134	(31,800)	\$ (793,340)	\$ (5,548)	\$ 2,135,066	\$ 59,093
Comprehensive income:										
Net income	40,461				336,663				336,663	14,650
Unrealized losses on interest rate swaps, net of tax								(134)	(134)	(134)
Less reclassification of net swap realized losses into net income, net of tax								5,557	5,557	5,557
Unrealized gains on investments, net of tax								231	231	231
Less reclassification of net investment realized losses into net income, net of tax								13	13	13
Total comprehensive income										\$ 397,441
Stock purchase shares issued				2,130	86	2,151			4,281	
Stock unit shares issued				(685)	26	685				
Stock options and SSARs exercised				6,461	1,191	30,358			36,819	
Stock-based compensation expense				33,492					33,492	
Excess tax benefits from stock awards exercised				2,079					2,079	
Distributions to noncontrolling interests	(39,701)									(21,411)
Contributions from	1,441									3,924

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noncontrolling interests											
Sales and assumptions of additional noncontrolling interests	2,888		(301)				(301)		1,990		
Purchases from noncontrolling interests	(1,420)		(779)				(779)		(3,203)		
Impact on fair value due to change in methodology	(24,571)		24,571				24,571				
Changes in fair value of noncontrolling interests	57,546		(57,546)				(57,546)				
Other adjustments			(45)				(45)				
Purchase of treasury stock						(3,035)	(198,534)		(198,534)		
Balance at September 30, 2010	\$ 368,369	134,862	\$ 135	\$ 631,062	\$ 2,648,797	(33,532)	\$ (958,680)	\$ 119	\$ 2,321,433	\$ 55,043	

See notes to condensed consolidated financial statements.

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DAVITA INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

(dollars and shares in thousands)

Unless otherwise indicated in this Quarterly Report on Form 10-Q the Company, we, us, our and similar terms refer to DaVita Inc. and its consolidated subsidiaries.

1. Condensed consolidated interim financial statements

The condensed consolidated interim financial statements included in this report are prepared by the Company without audit. In the opinion of management, all adjustments consisting only of normal recurring items necessary for a fair presentation of the results of operations are reflected in these consolidated interim financial statements. All significant intercompany accounts and transactions have been eliminated. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. The most significant estimates and assumptions underlying these financial statements and accompanying notes generally involve revenue recognition and provisions for uncollectible accounts, impairments and valuation adjustments, fair value estimates, accounting for income taxes, variable compensation accruals, purchase accounting valuation estimates and stock-based compensation. The results of operations for the nine months ended September 30, 2010 are not necessarily indicative of the operating results for the full year. The consolidated interim financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2009. Prior year balances and amounts have been classified to conform to the current year presentation. The Company has evaluated subsequent events through the date these condensed consolidated financial statements were issued and has included all necessary disclosures.

2. Earnings per share

Basic net income per share is calculated by dividing net income attributable to DaVita Inc. net of the decrease (increase) in noncontrolling interest redemption rights in excess of fair value, by the weighted average number of common shares and vested stock units outstanding. Diluted net income per share includes the dilutive effect of outstanding stock options, stock-settled stock appreciation rights and unvested stock units (under the treasury stock method).

Table of Contents**DAVITA INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)****(unaudited)**

(dollars and shares in thousands)

The reconciliations of the numerators and denominators used to calculate basic and diluted earnings per share are as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2010	2009	2010	2009
Basic:				
Net income attributable to DaVita Inc.	\$ 119,387	\$ 110,930	\$ 336,663	\$ 312,960
Decrease (increase) in noncontrolling interest redemption rights in excess of fair value	26		(45)	
Net income for basic earnings per share calculation	119,413	110,930	336,618	312,960
Weighted average shares outstanding during the period	102,602	104,118	102,982	103,896
Vested stock units	7	9	7	9
Weighted average shares for basic earnings per share calculation	102,609	104,127	102,989	103,905
Basic net income per share attributable to DaVita Inc.	\$ 1.16	\$ 1.07	\$ 3.27	\$ 3.01
Diluted:				
Net income for diluted earnings per share calculation	\$ 119,387	\$ 110,930	\$ 336,663	\$ 312,960
Decrease (increase) in noncontrolling interest redemption rights in excess of fair value	26		(45)	
Net income for diluted earnings per share calculation	119,413	110,930	336,618	312,960
Weighted average shares outstanding during the period	102,602	104,118	102,982	103,896
Vested stock units	7	9	7	9
Assumed incremental shares from stock plans	1,413	480	1,420	410
Weighted average shares for diluted earnings per share calculation	104,022	104,607	104,409	104,315
Diluted net income per share attributable to DaVita Inc.	\$ 1.15	\$ 1.06	\$ 3.22	\$ 3.00
Share-based anti-dilutive awards excluded from calculation ⁽¹⁾	1,804	9,696	1,368	13,125

⁽¹⁾ Shares associated with stock options and stock-settled stock appreciation rights that are excluded from the diluted denominator calculation because they are anti-dilutive under the treasury stock method.

3. Stock-based compensation and other common stock transactions

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Stock-based compensation recognized in a period represents the amortization during that period of the estimated grant-date fair value of current and prior stock-based awards over their vesting terms, adjusted for expected forfeitures. Shares issued upon exercise of stock awards are generally issued from shares in treasury. The Company has used the Black-Scholes-Merton valuation model for estimating the grant-date fair value of stock options and stock-settled stock appreciation rights granted in all periods. During the nine months ended September 30, 2010, the Company granted 1,932 stock-settled stock appreciation rights with a grant-date fair value of \$30,566 and a weighted-average expected life of approximately 3.5 years, and also granted 466 stock units with a grant-date fair value of \$29,260 and a weighted-average expected life of approximately 2.5 years.

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DAVITA INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(unaudited)

(dollars and shares in thousands)

For the nine months ended September 30, 2010 and 2009, the Company recognized \$33,492 and \$33,850, respectively, in stock-based compensation expense for stock options, stock-settled stock appreciation rights, stock units and discounted employee stock plan purchases, which are primarily included in general and administrative expenses. The estimated tax benefit recorded for stock-based compensation through September 30, 2010 and 2009 was \$12,690 and \$12,820, respectively. As of September 30, 2010, there was \$93,427 of total estimated unrecognized compensation cost related to nonvested stock-based compensation arrangements under the Company's equity compensation and stock purchase plans. The Company expects to recognize this cost over a weighted average remaining period of 1.5 years.

During the nine months ended September 30, 2010 and 2009, the Company received \$36,819 and \$27,304, respectively, in cash proceeds from stock option exercises and \$15,755 and \$12,434, respectively, in actual tax benefits upon the exercise of stock awards.

During the third quarter of 2010, the Company repurchased a total of 1,448 shares of its common stock for \$98,486 or an average price of \$68.02 per share. During the first nine months of 2010, the Company repurchased a total of 3,035 shares of its common stock for \$198,534 or an average price of \$65.41 per share. As of September 30, 2010, a total of \$49,865 of share repurchases have not yet been settled in cash. In addition, the Company also repurchased a total of 4,244 shares of its common stock from October 1, 2010 through October 22, 2010, for \$301,479 or an average price of \$71.03 per share, which completed the Company's previous board authorization for share repurchases. On November 3, 2010, the Company's Board of Directors authorized an additional \$800,000 of share repurchases of the Company's common stock.

In connection with a proposal to stockholders requesting approval of an increase in the number of shares authorized for issuance under the Company's equity compensation plan, the Board of Directors has committed to our stockholders that over the three-year period commencing on April 1, 2010 it will not grant a number of shares subject to stock awards under the Company's equity compensation plan, including stock options, stock appreciation rights, restricted stock units or other stock awards, at an average annual rate greater than 4.02% of the number of shares of the Company's common stock that management believes will be outstanding over such three-year period. This 4.02% rate is the average of the 2009 and 2010 three-year average median grant rate plus one standard deviation as published by RiskMetrics Group for the Russell 3000 companies in the GICS 3510 industry segment. Awards that are settled in cash, awards that are granted pursuant to stockholder approved exchange programs, awards sold under our employee stock purchase plan and awards assumed or substituted in business combination transactions will be excluded from our grant rate calculation. For purposes of calculating the number of shares granted, any full-value awards (i.e., restricted stock, restricted stock unit, performance share or any other award that does not have an exercise price per share at least equal to the per share fair market value of our common stock on the grant date) will count as equivalent to 3.0 shares. The Company will publicly report its compliance with this three-year average annual grant rate commitment, and the data necessary to independently confirm it, in a public filing shortly after March 31, 2013.

Table of Contents**DAVITA INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)****(unaudited)**

(dollars and shares in thousands)

4. Long-term debt

Long-term debt was comprised of the following:

	September 30, 2010	December 31, 2009
Senior Secured Credit Facilities:		
Term loan A	\$ 87,500	\$ 153,125
Term loan B	1,705,875	1,705,875
Senior and senior subordinated notes	1,550,000	1,750,000
Acquisition obligations and other notes payable	10,503	15,891
Capital lease obligations	6,956	4,635
Total debt principal outstanding	3,360,834	3,629,526
Premium on the 6 ⁵ / ₈ % senior notes	1,608	2,698
	3,362,442	3,632,224
Less current portion	(96,252)	(100,007)
	\$ 3,266,190	\$ 3,532,217

On October 20, 2010, the Company entered into a \$3,000,000 new Senior Secured Credit Agreement (the Credit Agreement), consisting of a five year \$250,000 revolving line of credit, a five year \$1,000,000 Term Loan A and a six year \$1,750,000 Term Loan B. The Company also has the right to request an increase to the borrowing capacity to a total aggregate principal amount of not more than \$4,000,000 subject to bank participation. The revolving line of credit and the Term Loan A will initially bear interest at LIBOR plus an interest rate margin of 2.75% which is subject to adjustment depending upon the Company's leverage ratio and can range from 2.25% to 2.75%. The Term Loan A requires annual principal payments of \$50,000 in 2011, \$50,000 in 2012, \$100,000 in 2013, and \$150,000 in 2014, with the balance of \$650,000 due in 2015. The Term Loan B bears interest at LIBOR (floor of 1.50%) plus 3.00% subject to a ratings based step-down to 2.75%. The Term Loan B requires annual principal payments of \$17,500 in each year from 2011 through 2015 with the balance of \$1,662,500 due in 2016. The borrowings under the Credit Agreement are guaranteed by substantially all of the Company's direct and indirect wholly-owned domestic subsidiaries and are secured by substantially all of the Company's and its guarantors' assets. The Credit Agreement contains customary affirmative and negative covenants such as various restrictions on investments, acquisitions, the payment of dividends, redemptions and acquisitions of capital stock, capital expenditures and other indebtedness, as well as limitations on the amount of tangible net assets in non-guarantor subsidiaries. However, many of these restrictions will not apply as long as the Company leverage ratio is below 3.50:1.00. In addition, the Credit Agreement requires compliance with financial covenants including an interest coverage ratio and a leverage ratio that determines the interest rate margins as described above.

On October 20, 2010, the Company also issued \$775,000 aggregate principal amount of 6 ³/₈% senior notes due 2018 and \$775,000 aggregate principal amount of 6 ⁵/₈% senior notes due 2020 (collectively the New Senior Notes). The New Senior Notes will pay interest on May 1 and November 1 of each year, beginning May 1, 2011. The New Senior Notes are unsecured senior obligations and rank equally to other unsecured senior indebtedness. The New Senior Notes are guaranteed by substantially all of the Company's direct and indirect wholly owned domestic

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subsidiaries. The Company may redeem some or all of the 6³/₈% senior notes at any time on or after November 1, 2013 at certain redemption prices and may redeem some or all of the 6⁵/₈% senior notes at any time on or after November 1, 2014 at certain redemption prices.

Table of Contents**DAVITA INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)****(unaudited)**

(dollars and shares in thousands)

The Company received total proceeds of \$4,300,000 from these transactions, \$2,750,000 from the borrowings on Term Loan A and Term Loan B and an additional \$1,550,000 from the issuance of the Senior Notes. The Company used a portion of the proceeds to pay-off the outstanding principal balances of its existing Senior Secured Credit Facilities plus accrued interest totaling \$1,795,363 and to purchase pursuant to a cash tender offer \$557,644 of the outstanding principal balances of the Company's \$700,000 6⁵/₈% senior notes due 2013 and \$730,827 of the outstanding balances of the Company's \$850,000 7¹/₄% senior subordinated notes due 2015, (the Existing Notes), plus accrued interest totaling \$1,297,215. The total amount paid for the Existing Notes was \$1,019.06 per \$1,000 principal amount of the 6⁵/₈% senior notes and \$1,038.75 per \$1,000 principal amount of the 7¹/₄% senior subordinated notes. This resulted in the Company paying a cash tender premium of \$38,933 in order to extinguish this portion of the Existing Notes. On November 19, 2010, the Company will redeem the remaining outstanding balance of the existing 6⁵/₈% Senior Notes of \$142,356 at 101.656% per \$1,000 and the remaining outstanding balance of the existing 7¹/₄% Senior Subordinated Notes of \$119,173 at 103.625% per \$1,000 plus accrued interest totaling \$264,742. In addition, the Company will pay a call premium totaling \$6,677. The Company also paid an additional \$70,000 in fees, discounts and other expenses. As a result of the above transactions, the Company received approximately \$827,000 in excess cash which it intends to use for general purposes and other opportunities, including share repurchases, potential acquisitions and other growth investments.

In connection with these transactions, the Company is expected to expense one time refinancing charges ranging from \$65,000 to \$75,000 in the fourth quarter of 2010, which includes the write off of existing deferred financing costs, the cash tender and call premiums, as described above and other expenses.

On June 7, 2010, the Company redeemed \$200,000 aggregate principal amount of its outstanding 6⁵/₈% senior notes due 2013, at a price of 101.656% plus accrued interest. As a result of this transaction, the Company incurred pre-tax debt redemption charges of \$4,127, which includes the call premium and the net write-off of other finance costs.

During the first nine months of 2010, the Company made mandatory principal payments totaling \$65,625 on the prior Term Loan A.

On September 30, 2010, the Company's interest rate swap agreements expired. The Company had entered into several interest rate swap agreements as a means of hedging its exposure to and volatility from variable-based interest rate changes as part of its overall risk management strategy. These agreements were not held for trading or speculative purposes, and had the economic effect of converting portions of the Company's variable rate debt to a fixed rate. These agreements were designated as cash flow hedges, and as a result, hedge-effective gains or losses resulting from changes in the fair values of these swaps were reported in other comprehensive income until such time as each specific swap tranche was realized, at which time the amounts were reclassified into net income. Net amounts paid or received for each specific swap tranche that have settled were reflected as adjustments to debt expense. These agreements did not contain credit-risk contingent features.

The agreements that were effective during the third quarter of 2010 had the economic effect of modifying the LIBOR-based variable interest rate on an equivalent amount of the Company's debt to fixed rates ranging from 4.05% to 4.70%, resulting in an overall weighted average effective interest rate of 5.87% on the hedged portion of the Company's Senior Secured Credit Facilities, including the Term Loan B margin of 1.50%.

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(dollars and shares in thousands)

The following table summarizes our derivative instruments as of September 30, 2010 and December 31, 2009:

	Interest rate swap liabilities			
	September 30, 2010		December 31, 2009	
Derivatives designated as hedging instruments	Balance sheet location	Fair value	Balance sheet location	Fair value
Interest rate swap agreements	Other current liabilities	\$	Other current liabilities	\$ 10,792

The following table summarizes the effects of our interest rate swap agreements for the nine months ended September 30, 2010 and 2009:

	Amount of gains (losses) recognized in OCI on interest rate swap agreements				Location of (losses) gains reclassified from accumulated OCI into income	Amount of gains (losses) reclassified from accumulated OCI into income			
	Three months ended September 30,		Nine months ended September 30,			Three months ended September 30,		Nine months ended September 30,	
Derivatives designated as cash flow hedges	2010	2009	2010	2009		2010	2009	2010	2009
Interest rate swap agreements	\$ (3)	\$ (1,722)	\$ (217)	\$ (3,681)	Debt expense	\$ (1,942)	\$ (4,450)	\$ (9,093)	\$ (13,280)
Tax expense benefit	1	670	83	1,433		756	1,731	3,536	5,166
Total	\$ (2)	\$ (1,052)	\$ (134)	\$ (2,248)		\$ (1,186)	\$ (2,719)	\$ (5,557)	\$ (8,114)

Total comprehensive income for the three and nine months ended September 30, 2010 was \$144,461 and \$397,441, respectively, including an increase to other comprehensive income for amounts reclassified into income, net of unrealized valuation loss on interest rate swaps of \$1,184 and \$5,423 net of tax, respectively, and an increase to other comprehensive income for unrealized valuation gains on investments, and the amounts reclassified into income of \$396 and \$244, net of tax, respectively.

Total comprehensive income for the three and nine months ended September 30, 2009 was \$128,465 and \$360,677, respectively, including an increase to comprehensive income for amounts reclassified into income, net of unrealized valuation losses on interest rate swaps of \$1,667 and \$5,866, net of tax, respectively, and an increase to other comprehensive income for unrealized valuation gains on investments, net of amounts reclassified into income of \$527 and \$635, net of tax, respectively.

As of September 30, 2010, the Company's interest rates were fixed on approximately 46% of its total debt.

The Company's overall weighted average effective interest rate on the Senior Secured Credit Facilities was 1.80%, based upon the current margins in effect of 1.50%, as of September 30, 2010.

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The Company's overall weighted average effective interest rate during the third quarter of 2010 was 4.45% and as of September 30, 2010 was 4.18%.

As of September 30, 2010, the Company had undrawn revolving credit facilities totaling \$250,000 of which approximately \$52,000 was committed for outstanding letters of credit.

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(dollars and shares in thousands)

5. Contingencies

The majority of the Company's revenues are from government programs and may be subject to adjustment as a result of: (1) examination by government agencies or contractors, for which the resolution of any matters raised may take extended periods of time to finalize; (2) differing interpretations of government regulations by different fiscal intermediaries or regulatory authorities; (3) differing opinions regarding a patient's medical diagnosis or the medical necessity of services provided; and (4) retroactive applications or interpretations of governmental requirements. In addition, the Company's revenues from commercial payors may be subject to adjustment as a result of potential claims for refunds, as a result of government actions or as a result of other claims by commercial payors.

Inquiries by the Federal Government

In March 2005, the Company received a subpoena from the U.S. Attorney's Office for the Eastern District of Missouri in St. Louis. The subpoena requires production of a wide range of documents relating to the Company's operations, including documents related to, among other things, pharmaceutical and other services provided to patients, relationships with pharmaceutical companies, and financial relationships with physicians and joint ventures. The subpoena covers the period from December 1, 1996 through the present. In October 2005, the Company received a follow-up request for additional documents related to specific medical director and joint venture arrangements. In February 2006, the Company received an additional subpoena for documents, including certain patient records relating to the administration and billing of EPO. In May 2007, the Company received a request for documents related to durable medical equipment and supply companies owned and operated by the Company. The Company is cooperating with the inquiry and is producing the requested records. The subpoenas have been issued in connection with a joint civil and criminal investigation. It is possible that criminal proceedings may be initiated against the Company in connection with this inquiry.

In February 2007, the Company received a request for information from the Office of Inspector General, U.S. Department of Health and Human Services, or OIG, for records relating to EPO claims submitted to Medicare. In August 2007, the Company received a subpoena from the OIG seeking similar documents. The requested documents relate to services provided from 2001 to 2004 by a number of the Company's centers. The request and subpoena were sent from the OIG's offices in Houston and Dallas, Texas. The Company has cooperated with the inquiry and has produced all previously requested records to date. The Company has been in contact with the U.S. Attorney's Office for the Eastern District of Texas, which has stated that this is a civil inquiry related to EPO claims. On July 6, 2009, the United States District Court for the Eastern District of Texas lifted the seal on the civil qui tam complaint related to these allegations and the Company was subsequently served with a complaint by the relator. The government did not intervene and is not actively pursuing this matter. The Company believes that there is some overlap between this issue and the ongoing review of EPO utilization and claims by the U.S. Attorney's Office for the Eastern District of Missouri in St. Louis described above.

In December 2008, the Company received a subpoena for documents from the OIG relating to the pharmaceutical products Zemplar, Hectorol, Venofer, Ferrlecit and Epogen®, or EPO, as well as other related matters. The subpoena covers the period from January 2003 to the present. The Company has been in contact with the United States Attorney's Office, or U.S. Attorney's Office, for the Northern District of Georgia and the U.S. Department of Justice in Washington, DC, since November 2008 relating to this matter, and has been advised that this is a civil inquiry. On June 17, 2009, the Company learned that the allegations underlying this inquiry were made as part of a civil qui tam complaint filed by individuals and brought pursuant to the federal False Claims Act. The case remains under seal in the United States District Court for the Northern District of Georgia. The Company is cooperating with the inquiry and is producing the requested records.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(unaudited)

(dollars and shares in thousands)

In May 2010, the Company received a subpoena from the OIG's office in Dallas, Texas. The subpoena covers the period from January 1, 2005, through the present, and seeks production of a wide range of documents relating to the Company's operations, including documents related to, among other things, financial relationships with physicians and joint ventures. The subject matter of this subpoena overlaps with the subject matter of the investigation being conducted by the United States Attorney's Office for the Eastern District of Missouri in St. Louis as described above. The Company met with representatives of the government to discuss the scope of the subpoena and the production of responsive documents. The Company is cooperating with the inquiry and is producing the requested records. It is possible that criminal proceedings may be initiated against the Company in connection with this inquiry.

To the Company's knowledge, no proceedings have been initiated against the Company at this time in connection with any of the inquiries by the federal government as set forth above. Although the Company cannot predict whether or when proceedings might be initiated or when these matters may be resolved, it is not unusual for investigations such as these to continue for a considerable period of time. Responding to the subpoenas will continue to require management's attention and significant legal expense. Any negative findings could result in substantial financial penalties against the Company, exclusion from future participation in the Medicare and Medicaid programs and, to the extent criminal proceedings may be initiated against the Company as indicated above, possible criminal penalties.

Other

The Company has received several notices of claims from commercial payors and other third parties related to historical billing practices and claims against DVA Renal Healthcare (formerly known as Gambro Healthcare), a subsidiary of the Company, related to historical Gambro Healthcare billing practices and other matters covered by its 2004 settlement agreement with the Department of Justice and certain agencies of the U.S. government. At least one commercial payor has filed an arbitration demand against the Company, as described below, and additional commercial payors have threatened litigation. The Company intends to defend against these claims vigorously; however, the Company may not be successful and these claims may lead to litigation and any such litigation may be resolved unfavorably.

Several wage and hour claims have been filed against the Company in the Superior Court of California, each of which has been styled as a class action. In February 2007, June 2008, October 2008 and December 2008, the Company was served with five separate complaints in California, including two in October 2008, by various former employees, each of which alleges, among other things, that the Company failed to provide rest and meal periods, failed to pay compensation in lieu of providing such rest or meal periods, failed to pay the correct amount of overtime, failed to pay the rate on the wage statement, and failed to comply with certain other California Labor Code requirements. The Company has reached a settlement and release of all claims against it in connection with the complaints served in February 2007 and December 2008 and one of the complaints served in October 2008. The Company has funded the settlement during the first quarter of 2010, which pursuant to the terms of the settlement agreement will result in a dismissal of the underlying court proceedings against it. The overall settlement amount was not material. The Company has reached an agreement with plaintiffs to settle the claims in the second complaint filed in October 2008. That settlement must be approved by the Court. If it is approved, the amount of the overall settlement will not be material. The Company intends to vigorously defend against the remaining claims and to vigorously oppose the certification of the remaining matters as class actions. Any potential settlements of these remaining claims are not anticipated to be material.

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(unaudited)

(dollars and shares in thousands)

In October 2007, the Company was contacted by the Attorney General's Office for the State of Nevada. The Attorney General's Office informed the Company that it was conducting a civil and criminal investigation of the Company's operations in Nevada and that the investigation related to the billing of pharmaceuticals, including EPO. In February 2008, the Attorney General's Office informed the Company that the civil and criminal investigation had been discontinued. The Attorney General's Office further advised the Company that Nevada Medicaid intended to conduct audits of end stage renal disease (ESRD) dialysis providers in Nevada, including the Company, and such audits would relate to the issues that were the subjects of the investigation. To the Company's knowledge, no court proceedings have been initiated against the Company at this time. Any negative audit findings could result in a substantial repayment by the Company.

In August 2005, Blue Cross/Blue Shield of Louisiana filed a complaint in the United States District Court for the Western District of Louisiana against Gambro AB, DVA Renal Healthcare (formerly known as Gambro Healthcare) and related entities. The plaintiff sought to bring its claims as a class action on behalf of itself and all entities that paid any of the defendants for health care goods and services from on or about January 1991 through at least December 2004. The complaint alleged, among other things, damages resulting from facts and circumstances underlying Gambro Healthcare's 2004 settlement agreement with the Department of Justice and certain agencies of the U.S. government. In March 2006, the case was dismissed and the plaintiff was compelled to seek arbitration to resolve the matter. In November 2006, the plaintiff filed a demand for class arbitration against the Company and DVA Renal Healthcare, a subsidiary of the Company. The Company intends to vigorously defend against these claims. The Company also intends to vigorously oppose the certification of this matter as a class action. At this time, the Company cannot predict the ultimate outcome of this matter or the potential range of damages, if any.

In June 2004, Gambro Healthcare (now known as DVA Renal Healthcare and a subsidiary of the Company) was served with a complaint filed in the Superior Court of California by one of its former employees who worked for its California acute services program. The complaint, which is styled as a class action, alleges, among other things, that DVA Renal Healthcare failed to provide overtime wages, defined rest periods and meal periods, or compensation in lieu of such provisions and failed to comply with certain other California Labor Code requirements. The Company intends to vigorously defend against these claims. The Company also intends to vigorously oppose the certification of this matter as a class action. At this time, the Company cannot predict the ultimate outcome of this matter or the potential range of damages, if any.

In addition to the foregoing, the Company is subject to claims and suits, including from time to time, contractual disputes and professional and general liability claims, as well as audits and investigations by various government entities, in the ordinary course of business. The Company believes that the ultimate resolution of any such pending proceedings, whether the underlying claims are covered by insurance or not, will not have a material adverse effect on its financial condition, results of operations or cash flows.

6. Investments in debt and equity securities

Based on the Company's intentions and strategy involving investments in debt and equity securities, the Company classifies certain debt securities as held-to-maturity and records them at amortized cost. Equity securities that have readily determinable fair values and certain other debt securities classified as available for sale are recorded at fair value.

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(dollars and shares in thousands)

The Company's investments consist of the following:

	September 30, 2010			December 31, 2009		
	Held to maturity	Available for sale	Total	Held to maturity	Available for sale	Total
Certificates of deposit, money market funds and U.S. treasury notes due within one year	\$ 21,745	\$	\$ 21,745	\$ 25,275	\$	\$ 25,275
Investments in mutual funds		9,249	9,249		8,816	8,816
	\$ 21,745	\$ 9,249	\$ 30,994	\$ 25,275	\$ 8,816	\$ 34,091
Short-term investments	\$ 21,745	\$ 1,200	\$ 22,945	\$ 25,275	\$ 1,200	\$ 26,475
Long-term investments		8,049	8,049		7,616	7,616
	\$ 21,745	\$ 9,249	\$ 30,994	\$ 25,275	\$ 8,816	\$ 34,091

The cost of the certificates of deposit, money market funds and U.S. treasury notes at September 30, 2010 and December 31, 2009 approximates their fair value. As of September 30, 2010 and December 31, 2009, the available for sale investments included \$195 and (\$205), of gross pre-tax unrealized gains and (losses), respectively. During the nine months ended September 30, 2010, the Company recorded gross pre-tax unrealized gains of \$378, or \$231 after tax, in other comprehensive income associated with changes in the fair value of these investments. During the nine months ended September 30, 2010, the Company sold equity securities in mutual funds for net proceeds of \$900, and recognized a pre-tax loss of \$22, or \$13 after tax, that was previously recorded in other comprehensive income. During the nine months ended September 30, 2009, the Company sold equity securities in mutual funds for net proceeds of \$16,537, and recognized a pre-tax gain of \$255, or \$156 after tax, that was previously recorded in other comprehensive income. These pre-tax amounts are included in other income.

As of September 30, 2010, investments totaling \$18,498 classified as held to maturity are investments used to maintain certain capital requirements of the special need plans of VillageHealth, which is a wholly-owned subsidiary of the Company. As of December 31, 2009, the Company discontinued the VillageHealth special needs plans and is in the process of paying out all incurred claims. The Company expects to liquidate these investments as soon as all of the claims are paid and the various state regulatory agencies approve the release of these investments. The investments in mutual funds classified as available for sale are held in trust to fund existing obligations associated with several of the Company's non-qualified deferred compensation plans.

On July 22, 2010, the Company entered into a First Amended and Restated National Service Provider Agreement, or the Agreement, with NxStage Medical Inc., or NxStage. The Agreement supersedes the National Service Provider Agreement that the Company entered into with NxStage on February 7, 2007. Under terms of the Agreement, the Company will have the ability to continue to purchase NxStage System One hemodialysis machines and related supplies at discounted prices. In addition, under the Agreement, the Company may earn warrants to purchase NxStage common stock subject to certain requirements, including the Company's ability to achieve certain System One home patient growth targets. The Agreement provides for a range of warrant amounts that may be earned annually depending upon the achievement of various home patient targets. The maximum amount of shares underlying warrants that the Company can earn over three years is 5,500. The exercise price of the warrants is \$14.22 per share. In connection therewith, the Company entered into a Registration Rights Agreement whereby NxStage has agreed to register any shares issued to the Company under the warrants. The Agreement expires on June 30, 2013, and will be automatically

extended on a monthly basis unless terminated by either party pursuant to the Agreement.

Table of Contents**DAVITA INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)****(unaudited)**

(dollars and shares in thousands)

7. Fair value of financial instruments

Effective December 15, 2009, FASB amended certain fair value disclosure requirements to include additional disclosures related to significant transfers in and out of the various fair value hierarchy levels and to clarify existing disclosures by providing disaggregate levels for each class of assets and liabilities. The Company is also required to provide additional disclosures on the valuation techniques and inputs used to measure fair value, as well as changes to the valuation techniques and inputs, for both recurring and nonrecurring assets and liabilities carried at fair value. In addition, the Company is also required to disclose the reason for making changes to its valuation techniques, assumptions and or other unobservable market inputs. Certain other disclosures on reporting the gross activity rather than the net activity for Level 3 fair value measurements is effective for fiscal years beginning after December 31, 2010. See Note 8 to the condensed consolidated financial statements for further discussion.

The Company measures the fair value of certain assets and noncontrolling interests subject to put provisions based upon certain valuation techniques that include observable or unobservable inputs and assumptions that market participants would use in pricing these assets, liabilities and commitments. The Company also has classified certain assets and noncontrolling interests subject to put provisions that are measured at fair value into the appropriate fair value hierarchy levels.

The following table summarizes the Company's assets and temporary equity measured at fair value on a recurring basis as of September 30, 2010:

	Total	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets				
Available for sale securities	\$ 9,249	\$ 9,249	\$	\$
Temporary equity				
Noncontrolling interests subject to put provisions	\$ 368,369	\$	\$	\$ 368,369

The available for sale securities represent investments in various open-ended registered investment companies, or mutual funds, and are recorded at fair value based upon the quoted market prices as reported by each mutual fund. See Note 6 to the condensed consolidated financial statements for further discussion.

See Note 8 to the condensed consolidated financial statements for a discussion of the Company's methodology for estimating the fair value of noncontrolling interests subject to put obligations.

The Company has other financial instruments in addition to the above that consist primarily of cash, accounts receivable, notes receivable, accounts payable, other accrued liabilities, and debt. The balances of the non-debt financial instruments are presented in the condensed consolidated financial statements at September 30, 2010 at their approximate fair values due to the short-term nature of their settlements. Borrowings under the Company's Senior Secured Credit Facilities totaled \$1,793,375 as of September 30, 2010 and the fair value was \$1,784,408 based upon quoted market prices. The fair value of the Company's senior and senior subordinated notes was approximately

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\$1,590,000 at September 30, 2010, based upon quoted market prices, as compared to the carrying amount of \$1,551,608, which includes the premium on the 6 ⁵/₈% senior notes.

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DAVITA INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(unaudited)

(dollars and shares in thousands)

8. Noncontrolling interests subject to put provisions and other commitments

The Company has potential obligations to purchase the noncontrolling interests held by third parties in several of its joint ventures and non-wholly-owned subsidiaries. These obligations are in the form of put provisions and are exercisable at the third-party owners' discretion within specified periods as outlined in each specific put provision. If these put provisions were exercised, the Company would be required to purchase the third-party owners' noncontrolling interests at either the appraised fair market value or a predetermined multiple of earnings or cash flow attributable to the noncontrolling interests put to the Company, which is intended to approximate fair value. The methodology the Company uses to estimate the fair values of noncontrolling interests subject to put provisions assumes either the higher of a liquidation value of net assets or an average multiple of earnings, based on historical earnings, patient mix and other performance indicators, as well as other factors. During the second quarter of 2010, the Company refined its methodology used to estimate the fair value of noncontrolling interests subject to put provisions by eliminating an annual inflation factor that was previously applied to the put provisions until they became exercisable. The Company believes that eliminating an annual inflation factor will result in a better representation of the estimated actual fair value of the noncontrolling interests subject to put provisions as of the reporting date. The estimated fair values of the noncontrolling interests subject to put provisions can fluctuate and the implicit multiple of earnings at which these noncontrolling interests obligations may be settled will vary significantly depending upon market conditions including potential purchasers' access to the capital markets, which can impact the level of competition for dialysis and non-dialysis related businesses, the economic performance of these businesses and the restricted marketability of the third-party owners' noncontrolling interests. The amount of noncontrolling interests subject to put provisions that contractually employ a predetermined multiple of earnings rather than fair value are immaterial.

Additionally, the Company has certain other potential commitments to provide operating capital to several dialysis centers that are wholly-owned by third parties or centers in which the Company owns an equity investment as well as to physician-owned vascular access clinics that the Company operates under management and administrative services agreements of approximately \$4,200.

Certain consolidated joint ventures are contractually scheduled to dissolve after terms ranging from ten to fifty years. Accordingly, the noncontrolling interests in these joint ventures are considered mandatorily redeemable instruments for which the classification and measurement requirements have been indefinitely deferred. Future distributions upon dissolution of these entities would be valued below the related noncontrolling interest carrying balances in the condensed consolidated balance sheet.

In July 2010, the Company announced that it will construct a new corporate headquarters in Denver, Colorado. In July 2010, the Company acquired the land and existing improvements for approximately \$11,000 and estimates that the total construction costs of the building will be approximately \$90,000. Construction is expected to begin in early 2011, and is estimated to be complete in the second half of 2012.

9. Income taxes

As of September 30, 2010, the Company's total liability for unrecognized tax benefits relating to tax positions that do not meet the more-likely-than-not threshold is \$18,661, of which \$11,336 would impact the Company's effective tax rate if recognized. The balance represents a decrease of \$12,032 from the December 31, 2009 balance, primarily due to a tax accounting method change initiated during the quarter ending March 31, 2010 and reductions due to statute lapses. The decrease associated with the tax accounting method change did not impact the Company's effective tax rate. It is reasonably possible that \$7,325 of unrecognized tax benefits may be recognized within the next 12 months and will not impact the Company's effective tax rate.

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(dollars and shares in thousands)

The Company recognizes accrued interest and penalties related to unrecognized tax benefits in its income tax expense. At September 30, 2010 and December 31, 2009, the Company had approximately \$3,636 and \$3,226, respectively, accrued for interest and penalties related to unrecognized tax benefits, net of federal tax benefits.

10. Segment reporting

The Company operates principally as a dialysis and related lab services business but also operates other ancillary services and strategic initiatives. These ancillary services and strategic initiatives consist of pharmacy services, infusion therapy services, disease management services, vascular access services, ESRD clinical research programs and physician services. For internal management reporting, the dialysis and related lab services business and each of the ancillary services and strategic initiatives have been defined as separate operating segments by management as separate financial information is regularly produced and reviewed by the Company's chief operating decision maker in making decisions about allocating resources and assessing financial results. The Company's chief operating decision maker is its Chief Executive Officer. The dialysis and related lab services business qualifies as a separately reportable segment and all of the other ancillary services and strategic initiatives operating segments have been combined and disclosed in the other segments category.

The Company's operating segment financial information is prepared on an internal management reporting basis that the Chief Executive Officer uses to allocate resources and analyze the performance of operating segments. For internal management reporting, segment operations include direct segment operating expenses with the exception of stock-based compensation expense and equity investment income.

The following is a summary of segment revenues, segment operating income (loss), and a reconciliation of segment operating income to consolidated income before income taxes:

	Three months ended September 30, 2010	2009	Nine months ended September 30, 2010	2009
Segment revenues:				
Dialysis and related lab services ⁽¹⁾	\$ 1,553,374	\$ 1,491,271	\$ 4,528,039	\$ 4,309,009
Other Ancillary services and strategic initiatives	98,275	82,644	269,935	231,587
Consolidated revenues	\$ 1,651,649	\$ 1,573,915	\$ 4,797,974	\$ 4,540,596
Segment operating income (loss):				
Dialysis and related lab services	\$ 265,613	\$ 258,554	\$ 771,403	\$ 741,971
Other Ancillary services and strategic initiatives	282	(2,824)	(3,257)	(7,628)
Total segment operating income	265,895	255,730	768,146	734,343
Reconciliation of segment operating income to consolidated income before income taxes:				
Stock-based compensation	(11,093)	(11,437)	(33,492)	(33,850)
Equity investment income	1,789	708	6,968	1,066

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Consolidated operating income	256,591	245,001	741,622	701,559
Debt expense	(39,490)	(45,535)	(127,728)	(140,924)
Debt redemption charges			(4,127)	
Other income	759	999	2,329	3,026
Consolidated income before income taxes	\$ 217,860	\$ 200,465	\$ 612,096	\$ 563,661

⁽¹⁾ Includes management fees related to providing management and administrative services to dialysis centers that are wholly-owned by third parties or centers in which the Company owns an equity investment.

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(dollars and shares in thousands)

Depreciation and amortization expense for the dialysis and related lab services for the three and nine months ended September 30, 2010 were \$56,859 and \$169,391, respectively, and were \$1,627 and \$4,916, respectively, for the ancillary services and strategic initiatives.

Depreciation and amortization expense for the dialysis and related lab services for the three and nine months ended September 30, 2009 were \$55,072 and \$166,844, respectively, and were \$1,741 and \$5,277, respectively, for the ancillary services and strategic initiatives.

Summary of assets by segment is as follows:

	September 30, 2010	December 31, 2009
Segment assets		
Dialysis and related lab services	\$ 7,409,828	\$ 7,333,850
Other Ancillary services and strategic initiatives	217,277	224,386
Consolidated assets	\$ 7,627,105	\$ 7,558,236

For the three and nine months ended September 30, 2010, the total amount of expenditures for property and equipment for the dialysis and related lab services were \$67,739 and \$168,054, respectively, and were \$2,286 and \$4,108, respectively, for the ancillary services and strategic initiatives.

For the three and nine months ended September 30, 2009, the total amount of expenditures for property and equipment for the dialysis and related lab services were \$66,863 and \$203,315, respectively, and were \$585 and \$2,338, respectively, for the ancillary services and strategic initiatives.

11. Changes in DaVita Inc. s ownership interest in consolidated subsidiaries

The effects of changes in DaVita Inc. s ownership interest on the Company s equity are as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2010	2009	2010	2009
Net income attributable to DaVita Inc.	\$ 119,387	\$ 110,930	\$ 336,663	\$ 312,960
Decrease in paid-in capital for sales of noncontrolling interest in one and four joint ventures in 2010 and three and ten joint ventures in 2009	(125)	(503)	(301)	(837)
Decrease in paid-in capital for the purchase of noncontrolling interests in four joint ventures for the nine months ended September 30, 2010 and two and five joint ventures in 2009		(1,184)	(779)	(3,639)

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Net transfer to noncontrolling interests	(125)	(1,687)	(1,080)	(4,476)
Change from net income attributable to DaVita Inc. and transfers to noncontrolling interests	\$ 119,262	\$ 109,243	\$ 335,583	\$ 308,484

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DAVITA INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(unaudited)

(dollars and shares in thousands)

12. Variable interest entities

Effective January 1, 2010, the FASB eliminated the quantitative approach previously required for determining the primary beneficiary of a variable interest entity, and required additional disclosures about an enterprise's involvement in variable interest entities. An entity is required to perform an analysis to determine whether the enterprise's variable interest or interests give it a controlling financial interest in a variable interest entity by having both the power to direct the activities of a variable interest entity that most significantly impact the entity's economic performance and the obligation to absorb losses of the entity, or the right to receive benefits from the entity. In addition, the FASB established new guidance for determining whether an entity is a variable interest entity, requiring an ongoing reassessment of whether an enterprise is the primary beneficiary of a variable interest entity, and adding an additional reconsideration event for determining whether an entity is a variable interest entity when any changes in facts and circumstances occur such that the holders of the equity investment at risk, as a group, lose the power from voting rights or similar rights of those investments to direct the activities of the entity that most significantly impact the entity's economic performance. Except for the new disclosures requirements, there was no other impact to the Company's financial statements as a result of implementing these new requirements.

The Company is deemed to be the primary beneficiary of all of the variable interest entities (VIEs) with which it is associated. These VIEs are principally operating subsidiaries owned by related party nominee owners for the Company's benefit in jurisdictions in which the Company does not qualify for direct ownership under applicable regulations or joint ventures that require subordinated support in addition to their equity capital to finance operations. These include dialysis operating entities in New York and other states and physician practice management entities in various states.

Under the terms of the applicable arrangements, the Company bears most of the economic risks and rewards of ownership for these operating VIEs. The Company has contractual arrangements with its respective related party nominee owners which indemnify them from the economic losses, and entitle the Company to the economic benefits, that may result from ownership of these VIEs. DaVita Inc. manages these VIE subsidiaries and provides operating and capital funding as necessary to accomplish its operational and strategic objectives. Accordingly, since the Company bears the majority of the risks and rewards attendant to their ownership, the Company consolidates these variable interest entities as their primary beneficiary.

Total assets of these consolidated operating VIEs were approximately \$25,000 and their liabilities to unrelated third parties were approximately \$15,000 at September 30, 2010.

The Company also sponsors certain deferred compensation plans whose trusts qualify as VIEs and as their primary beneficiary the Company consolidates each of these plans. The assets of these plans are recorded in short-term or long-term investments with matching offsetting liabilities in accrued compensation and benefits and other long-term liabilities. See Note 6 for disclosures on the assets of these consolidated non-qualified deferred compensation plans.

13. Condensed consolidating financial statements

The following information is presented in accordance with Rule 3-10 of Regulation S-X. The operating and investing activities of the separate legal entities included in the consolidated financial statements are fully interdependent and integrated. Revenues and operating expenses of the separate legal entities include intercompany charges for management and other services. The Existing Notes were issued by the Company and are guaranteed by substantially all of the Company's direct and indirect wholly-owned subsidiaries. Each of the guarantor subsidiaries has guaranteed the notes on a joint and several, full and unconditional basis. Non-wholly-owned subsidiaries, joint venture partnerships and other third parties are not guarantors of these obligations.

Table of Contents**DAVITA INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)****(unaudited)**

(dollars and shares in thousands)

Condensed Consolidating Statements of Income

	DaVita Inc.	Guarantor subsidiaries	Non-Guarantor subsidiaries	Consolidating adjustments	Consolidated total
For the three months ended September 30, 2010					
Net operating revenues	\$ 113,670	\$ 1,363,230	\$ 292,173	\$ (117,424)	\$ 1,651,649
Operating expenses	63,399	1,232,959	216,124	(117,424)	1,395,058
Operating income	50,271	130,271	76,049		256,591
Debt (expense)	(39,961)	(36,507)	(75)	37,053	(39,490)
Other income	37,683		129	(37,053)	759
Income tax expense	18,560	55,603	816		74,979
Equity earnings in subsidiaries	89,954	51,424		(141,378)	
Net income	119,387	89,585	75,287	(141,378)	142,881
Less: Net income attributable to noncontrolling interests				(23,494)	(23,494)
Net income attributable to DaVita Inc.	\$ 119,387	\$ 89,585	\$ 75,287	\$ (164,872)	\$ 119,387
For the three months ended September 30, 2009					
Net operating revenues	\$ 104,771	\$ 1,310,558	\$ 269,201	\$ (110,615)	\$ 1,573,915
Operating expenses	57,742	1,158,277	223,510	(110,615)	1,328,914
Operating income	47,029	152,281	45,691		245,001
Debt (expense)	(46,434)	(37,146)	(253)	38,298	(45,535)
Other income	39,175		122	(38,298)	999
Income tax expense	15,854	56,754	1,587		74,195
Equity earnings in subsidiaries	87,014	28,298		(115,312)	
Net income	110,930	86,679	43,973	(115,312)	126,270
Less: Net income attributable to noncontrolling interests				(15,340)	(15,340)
Net income attributable to DaVita Inc.	\$ 110,930	\$ 86,679	\$ 43,973	\$ (130,652)	\$ 110,930
For the nine months ended September 30, 2010					
Net operating revenues	\$ 327,095	\$ 3,954,517	\$ 859,170	\$ (342,808)	\$ 4,797,974
Operating expenses	189,676	3,528,983	680,501	(342,808)	4,056,352
Operating income	137,419	425,534	178,669		741,622
Debt (expense)	(132,762)	(120,122)	(408)	121,437	(131,855)
Other income	122,823		943	(121,437)	2,329
Income tax expense	50,355	166,109	3,858		220,322

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Equity earnings in subsidiaries	259,538	119,016		(378,554)	
Net income	336,663	258,319	175,346	(378,554)	391,774
Less: Net income attributable to noncontrolling interests				(55,111)	(55,111)
Net income attributable to DaVita Inc.	\$ 336,663	\$ 258,319	\$ 175,346	\$ (433,665)	\$ 336,663

For the nine months ended September 30, 2009

Net operating revenues	\$ 296,696	\$ 3,800,836	\$ 758,233	\$ (315,169)	\$ 4,540,596
Operating expenses	181,435	3,336,776	635,995	(315,169)	3,839,037
Operating income	115,261	464,060	122,238		701,559
Debt (expense)	(142,757)	(116,095)	(1,062)	118,990	(140,924)
Other income	121,628		388	(118,990)	3,026
Income tax expense	37,653	167,702	4,130		209,485
Equity earnings in subsidiaries	256,481	74,180		(330,661)	
Net income	312,960	254,443	117,434	(330,661)	354,176
Less: Net income attributable to noncontrolling interests				(41,216)	(41,216)
Net income attributable to DaVita Inc.	\$ 312,960	\$ 254,443	\$ 117,434	\$ (371,877)	\$ 312,960

Table of Contents**DAVITA INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)****(unaudited)**

(dollars and shares in thousands)

Condensed Consolidating Balance Sheets

As of September 30, 2010	DaVita Inc.	Guarantor subsidiaries	Non-Guarantor subsidiaries	Consolidating adjustments	Consolidated total
Cash and cash equivalents	\$ 533,417	\$	\$ 1,148	\$	\$ 534,565
Accounts receivable, net		934,513	148,163		1,082,676
Other current assets	8,004	611,513	25,247		644,764
Total current assets	541,421	1,546,026	174,558		2,262,005
Property and equipment, net	27,264	905,985	188,355		1,121,604
Amortizable intangibles, net	21,976	99,319	2,922		124,217
Investments in subsidiaries	5,402,889	496,657		(5,899,546)	
Intercompany receivables		11,120	146,623	(157,743)	
Other long-term assets and investments	8,153	57,450	553		66,156
Goodwill		3,709,018	344,105		4,053,123
Total assets	\$ 6,001,703	\$ 6,825,575	\$ 857,116	\$ (6,057,289)	\$ 7,627,105
Current liabilities	\$ 64,000	\$ 975,885	\$ 71,899	\$	\$ 1,111,784
Intercompany payables	128,747	17,876	11,120	(157,743)	
Long-term debt and other long-term liabilities	3,245,019	511,017	14,440		3,770,476
Noncontrolling interests subject to put provisions	242,504			125,865	368,369
Total DaVita Inc. shareholders' equity	2,321,433	5,320,797	578,749	(5,899,546)	2,321,433
Noncontrolling interest not subject to put provisions			180,908	(125,865)	55,043
Total equity	2,321,433	5,320,797	759,657	(6,025,411)	2,376,476
Total liabilities and equity	\$ 6,001,703	\$ 6,825,575	\$ 857,116	\$ (6,057,289)	\$ 7,627,105
As of December 31, 2009					
Cash and cash equivalents	\$ 534,550	\$	\$ 4,909	\$	\$ 539,459
Accounts receivable, net		961,946	143,957		1,105,903
Other current assets	15,619	597,086	44,454		657,159
Total current assets	550,169	1,559,032	193,320		2,302,521
Property and equipment, net	11,232	900,969	192,724		1,104,925
Amortizable intangibles, net	30,212	101,931	4,589		136,732
Investments in subsidiaries	5,130,035	509,733		(5,639,768)	
Intercompany receivables	293,062		138,482	(431,544)	
Other long-term assets and investments	7,700	19,528	35,634		62,862

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Goodwill		3,622,885	328,311		3,951,196
Total assets	\$ 6,022,410	\$ 6,714,078	\$ 893,060	\$ (6,071,312)	\$ 7,558,236
Current liabilities	\$ 170,061	\$ 781,870	\$ 95,010	\$	\$ 1,046,941
Intercompany payables		418,529	13,015	(431,544)	
Long-term debt and other long-term liabilities	3,507,753	458,779	18,879		3,985,411
Noncontrolling interests subject to put provisions	209,530			122,195	331,725
Total DaVita Inc. shareholders' equity	2,135,066	5,054,900	584,868	(5,639,768)	2,135,066
Noncontrolling interest not subject to put provisions			181,288	(122,195)	59,093
Total equity	2,135,066	5,054,900	766,156	(5,761,963)	2,194,159
Total liabilities and equity	\$ 6,022,410	\$ 6,714,078	\$ 893,060	\$ (6,071,312)	\$ 7,558,236

Table of Contents**DAVITA INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)****(unaudited)**

(dollars and shares in thousands)

Condensed Consolidating Statements of Cash Flows

For the nine months ended September 30, 2010	DaVita Inc.	Guarantor subsidiaries	Non-Guarantor subsidiaries	Consolidating adjustments	Consolidated total
Cash flows from operating activities:					
Net income	\$ 336,663	\$ 258,319	\$ 175,346	\$ (378,554)	\$ 391,774
Changes in operating assets and liabilities and non-cash items included in net income	(561,408)	593,402	(83,190)	378,554	327,358
Net cash (used in) provided by operating activities	(224,745)	851,721	92,156		719,132
Cash flows from investing activities:					
Additions of property and equipment, net	(19,797)	(126,490)	(23,089)		(169,376)
Acquisitions		(137,643)			(137,643)
Proceeds from asset sales		18,471			18,471
Proceeds from investment sales and other items	(300)	3,535			3,235
Net cash used in investing activities	(20,097)	(242,127)	(23,089)		(285,313)
Cash flows from financing activities:					
Long-term debt and related financing costs, net	(270,481)	3,921	(6,990)		(273,550)
Intercompany borrowing	621,409	(611,318)	(10,091)		
Other items	(107,219)	(2,197)	(55,747)		(165,163)
Net cash provided by (used in) financing activities	243,709	(609,594)	(72,828)		(438,713)
Net decrease in cash and cash equivalents	(1,133)		(3,761)		(4,894)
Cash and cash equivalents at beginning of period	534,550		4,909		539,459
Cash and cash equivalents at end of period	\$ 533,417	\$	\$ 1,148	\$	\$ 534,565
For the nine months ended September 30, 2009					
Cash flows from operating activities:					
Net income	\$ 312,960	\$ 254,443	\$ 117,434	\$ (330,661)	\$ 354,176
Changes in operating assets and liabilities and non-cash items included in net income	(637,351)	450,984	15,649	330,661	159,943
Net cash (used in) provided by operating activities	(324,391)	705,427	133,083		514,119

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Cash flows from investing activities:				
Additions of property and equipment, net	(944)	(156,362)	(48,347)	(205,653)
Acquisitions		(64,001)		(64,001)
Proceeds from asset sales		6,256		6,256
Proceeds from investment sales and other items	14,800	(150)		14,650
Net cash provided by (used in) investing activities	13,856	(214,257)	(48,347)	(248,748)
Cash flows from financing activities:				
Long-term debt and related financing costs, net	(38,632)	(1,289)	2,854	(37,067)
Intercompany borrowing	539,452	(490,946)	(48,506)	
Other items	(22,799)	1,065	(35,771)	(57,505)
Net cash provided by (used in) financing activities	478,021	(491,170)	(81,423)	(94,572)
Net increase in cash and cash equivalents	167,486		3,313	170,799
Cash and cash equivalents at beginning of period	397,576		13,305	410,881
Cash and cash equivalents at end of period	\$ 565,062	\$	\$ 16,618	\$ 581,680

Table of Contents**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.
Forward-looking statements**

This Quarterly Report on Form 10-Q contains statements that are forward-looking statements within the meaning of the federal securities laws. All statements that do not concern historical facts are forward-looking statements and include, among other things, statements about our expectations, beliefs, intentions and/or strategies for the future. These forward-looking statements include statements regarding our future operations, financial condition and prospects, expectations for treatment growth rates, revenue per treatment, expense growth, levels of the provision for uncollectible accounts receivable, operating income, cash flow, operating cash flow, estimated tax rates, capital expenditures, the development of new centers and center acquisitions, government and commercial payment rates, revenue estimating risk and the impact of our related level of indebtedness on our financial performance, including earnings per share. These statements involve substantial known and unknown risks and uncertainties that could cause our actual results to differ materially from those described in the forward-looking statements, including, but not limited to, risks resulting from the regulatory environment in which we operate, economic and market conditions, competitive activities, other business conditions, accounting estimates, the variability of our cash flows, the concentration of profits generated from commercial payor plans, continued downward pressure on average realized payment rates from commercial payors, which may result in the loss of revenue or patients, a reduction in the number of patients under higher-paying commercial plans, a reduction in government payment rates or changes to the structure of payments under the Medicare ESRD program or other government-based programs, including, for example, the implementation of a bundled payment rate system beginning January 2011, which will lower reimbursement for services we provide to Medicare patients, and the impact of health care reform legislation that was enacted in the United States in March 2010, changes in pharmaceutical or anemia management practice patterns, payment policies, or pharmaceutical pricing, our ability to maintain contracts with physician medical directors, legal compliance risks, including our continued compliance with complex government regulations, the resolution of ongoing investigations by various federal and state government agencies, continued increased competition from large and medium sized dialysis providers that compete directly with us, our ability to complete any acquisitions, mergers or dispositions that we might be considering or announce, or integrate and successfully operate any business we may acquire and the risk factors set forth in this Quarterly Report on Form 10-Q. We base our forward-looking statements on information currently available to us, and we undertake no obligation to update or revise these statements, whether as a result of changes in underlying factors, new information, future events or otherwise.

The following should be read in conjunction with our condensed consolidated financial statements.

Results of operations

We operate principally as a dialysis and related lab services business but also operate other ancillary services and strategic initiatives. These ancillary services and strategic initiatives consist of pharmacy services, infusion therapy services, disease management services, vascular access services, ESRD clinical research programs and physician services. The dialysis and related lab services business qualifies as a separately reportable segment and all of the other ancillary services and strategic initiatives segments have been combined and disclosed in the other segments category.

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Our consolidated operating results for the third quarter of 2010 compared with the prior sequential quarter and the same quarter of 2009 as well as the nine months ended September 30, 2010 compared to the same period in 2009 were as follows:

	Three months ended						Nine months ended			
	September 30, 2010		June 30, 2010		September 30, 2009		September 30, 2010		September 30, 2009	
(dollar amounts rounded to nearest million)										
Net operating revenues	\$ 1,652	100%	\$ 1,587	100%	\$ 1,574	100%	\$ 4,798	100%	\$ 4,541	100%
Operating expenses and charges:										
Patient care costs	1,146	69%	1,111	70%	1,096	70%	3,340	70%	3,154	70%
General and administrative	148	9%	136	9%	135	9%	421	9%	394	9%
Depreciation and amortization	58	4%	58	4%	57	4%	174	4%	172	4%
Provision for uncollectible accounts	44	3%	42	3%	42	3%	128	3%	120	3%
Equity investment income	(2)		(3)		(1)		(7)		(1)	
Total operating expenses and charges	1,395	85%	1,345	85%	1,329	84%	4,056	85%	3,839	85%
Operating income	\$ 257	15%	\$ 242	15%	\$ 245	16%	\$ 742	15%	\$ 702	15%

The following table summarizes consolidated net operating revenues:

	Three months ended						Nine months ended			
	September 30, 2010		June 30, 2010		September 30, 2009		September 30, 2010		September 30, 2009	
(dollar amounts rounded to nearest million)										
Dialysis and related lab services	\$ 1,553		\$ 1,496		\$ 1,491		\$ 4,528		\$ 4,309	
Other Ancillary Services and Strategic Initiatives	98		91		83		270		232	
Consolidated net operating revenues	\$ 1,652		\$ 1,587		\$ 1,574		\$ 4,798		\$ 4,541	

The following table summarizes consolidated operating income:

	Three months ended						Nine months ended			
	September 30, 2010		June 30, 2010		September 30, 2009		September 30, 2010		September 30, 2009	
(dollar amounts rounded to nearest million)										
Dialysis and related lab services	\$ 266		\$ 254		\$ 259		\$ 771		\$ 742	
Other Ancillary Services and Strategic Initiatives			(2)		(3)		(3)		(8)	
Total segment operating income	266		252		256		768		734	
Reconciling items:										
Stock-based compensation	(11)		(12)		(11)		(33)		(34)	
Equity investment income	2		3		1		7		1	
Consolidated operating income	\$ 257		\$ 242		\$ 245		\$ 742		\$ 702	

Table of Contents*Consolidated net operating revenues*

Consolidated net operating revenues for the third quarter of 2010 increased by approximately \$65 million, or approximately 4.1%, as compared to the second quarter of 2010. The increase in consolidated net operating revenues was primarily due to an increase in dialysis and related lab services net revenues of approximately \$57 million, principally due to an increase in the number of treatments as a result of one additional treatment day in the third quarter of 2010 and additional treatments from non-acquired growth and acquisitions, as well as an increase of approximately \$4 in the average dialysis revenue per treatment. The increase in consolidated net revenues was also due to an increase of approximately \$7 million in the ancillary services and strategic initiatives net revenues primarily as a result of volume growth in our pharmacy services.

Consolidated net operating revenues for the third quarter of 2010 increased by approximately \$78 million, or approximately 5.0%, as compared to the third quarter of 2009. The increase in consolidated net operating revenues was primarily due to an increase in dialysis and related lab services net revenues of approximately \$62 million, principally due to an increase in the number of treatments from non-acquired treatment growth in existing and new centers and growth through acquisitions, partially offset by a decrease of approximately \$4 in the average dialysis revenue per treatment. The increase in consolidated net revenues was also due to an increase of approximately \$15 million in the ancillary services and strategic initiatives net revenues primarily from growth in our pharmacy services.

Consolidated net operating revenues for the nine months ended September 30, 2010 increased by approximately \$257 million, or approximately 5.7%, as compared to same period in 2009. The increase in consolidated net operating revenues was primarily due to an increase in dialysis and related lab services net revenues of approximately \$219 million, principally due to an increase in the number of treatments from non-acquired treatment growth in existing and new centers and growth through acquisitions, partially offset by a decrease of approximately \$1 in the average dialysis revenue per treatment. The increase in consolidated net revenues was also due to an increase of approximately \$38 million in the ancillary services and strategic initiatives net revenues primarily from growth in our pharmacy services, partially offset by a decrease in revenue in our disease management services and in our clinical research services.

Consolidated operating income

Consolidated operating income for the third quarter of 2010 increased by approximately \$15 million, or approximately 6.2%, as compared to the second quarter of 2010. The increase in consolidated operating income was primarily due to strong treatment growth as a result of one additional treatment day in the quarter and from non-acquired growth and acquisitions as well as an increase of approximately \$4 in the average dialysis revenue per treatment. The increase was partially offset by higher labor and benefit costs, higher pharmaceuticals costs, a decline in the intensities of physician-prescribed pharmaceuticals, a decline in productivity and an increase in professional fees.

Consolidated operating income for the third quarter of 2010 increased by \$12 million, or approximately 4.9%, as compared to the third quarter of 2009. The increase in consolidated operating income was primarily due to growth in revenue in the dialysis and related lab services, primarily from additional treatments, partially offset by a decrease in the average dialysis revenue per treatment. Consolidated operating income also increased as a result of cost control initiatives, improved productivity as well as a decrease of \$3 million in operating losses in the ancillary services and strategic initiatives. However, consolidated operating income was negatively impacted by a decline in the intensities of physician-prescribed pharmaceuticals, higher labor costs and pharmaceutical costs and an increase in professional fees.

Consolidated operating income for the nine months ended September 30, 2010 increased by \$40 million, or approximately 5.7%, as compared to the same period in 2009. The increase in consolidated operating income was primarily due to growth in revenue in the dialysis and related lab services, primarily from additional treatments,

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cost control initiatives, improved productivity and lower benefit costs, partially offset by higher pharmaceutical costs, labor costs and related payroll taxes and an increase in other operating costs of our dialysis centers.

*Operating segments**Dialysis and related lab services*

	September 30, 2010	Three months ended June 30, 2010 (dollar amounts rounded to nearest million, except per treatment)	September 30, 2009	Nine months ended September 30, 2010	September 30, 2009
Revenues	\$ 1,553	\$ 1,496	\$ 1,491	\$ 4,528	\$ 4,309
Segment operating income	\$ 266	\$ 254	\$ 259	\$ 771	\$ 742
Dialysis treatments	4,578,622	4,462,565	4,339,195	13,335,307	12,649,812
Average dialysis treatments per treatment day	57,957	57,212	54,927	56,988	54,175
Average dialysis revenue per dialysis treatment (including the lab)	\$ 339	\$ 335	\$ 343	\$ 339	\$ 340
<i>Net operating revenues</i>					

Dialysis and related lab services net operating revenues for the third quarter of 2010 increased by approximately \$57 million, or approximately 3.8%, as compared to the second quarter of 2010. The increase in net operating revenues was primarily due to an increase in the number of treatments as a result of one additional treatment day in the third quarter of 2010 and additional treatments from non-acquired growth and acquisitions totaling approximately 2.5%. This increase was also due to an increase in our average dialysis revenue per treatment of approximately \$4, or approximately 1.2%. The increase in the average dialysis revenue per treatment was primarily due to an increase in some of our commercial payment rates, an increase in our reimbursement rates for average sale price, or ASP, associated with EPO and seasonal flu shots administrations, partially offset by a decline in the intensities of physician-prescribed pharmaceuticals and a decline in the commercial payor mix.

Dialysis and related lab services net operating revenues increased by approximately \$62 million, or 4.2%, in the third quarter of 2010, as compared to the third quarter of 2009. The increase in net operating revenues in the third quarter of 2010 was principally due to an increase in the number of treatments of approximately 5.3%, partially offset by a decrease in the average dialysis revenue per treatment of approximately \$4, or 1.3%. The increase in the number of treatments was primarily attributable to non-acquired treatment growth at existing and new centers and growth through acquisitions. The decrease in the average dialysis revenue per treatment was primarily due to a decline in the commercial payor mix, a decline in the intensities of physician-prescribed pharmaceuticals and a decrease in our reimbursement rates for ASP, associated with EPO, partially offset by an increase in some of our commercial payment rates, and a 1% increase in the Medicare composite rate.

Dialysis and related lab services net operating revenues increased by approximately \$219 million, or 5.1%, for the nine months ended September 30, 2010, as compared to the same period in 2009. The increase in net operating revenues was principally due to an increase in the number of treatments, partially offset by a slight decrease of approximately \$1 in the average dialysis revenue per treatment. The increase in the number of treatments was due to the same factors as discussed above for the increase in the third quarter of 2010 as compared to the third quarter of 2009.

Operating expenses and charges

Patient care costs. Dialysis and related lab services patient care costs on a per treatment basis in the third quarter of 2010 increased by approximately \$1, as compared to the second quarter of 2010. The increase in our

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per treatment costs was attributable to several items including an increase in labor and benefit costs, an increase in pharmaceutical costs and a decline in productivity, partially offset by a decline in the intensity of physician-prescribed pharmaceuticals.

Dialysis and related lab services patient care costs on a per treatment basis decreased by approximately \$5 in the third quarter of 2010 as compared to the third quarter of 2009. The decrease in the per treatment costs was primarily attributable to several items which include a decline in the intensities of physician-prescribed pharmaceuticals, lower benefit costs and improved productivity, partially offset by an increase in other operating costs of our dialysis centers, an increase in pharmaceutical costs and an increase in labor costs.

Dialysis and related lab services patient care costs on a per treatment basis decreased by approximately \$1 for the nine months ended September 30, 2010 as compared to the same period in 2009. The decrease in the per treatment costs was primarily attributable to several items which include improved productivity and lower benefit costs, partially offset by an increase in pharmaceuticals costs, labor costs and related payroll taxes, and other operating costs of our dialysis centers.

General and administrative expenses. Dialysis and related lab services general and administrative expenses of approximately \$122 million for the third quarter of 2010 increased by approximately \$13 million as compared to the second quarter of 2010. The increase was primarily due to higher labor and benefit costs and related payroll taxes, higher professional fees for legal, compliance and international initiatives and the timing of certain expenditures. In absolute dollars, general and administrative expenses increased by approximately \$15 million in the third quarter of 2010, as compared to the same period in 2009. The increase was primarily due to the same factors as discussed above. General and administrative expenses as a percentage of dialysis and related lab services revenue was 7.8% for the third quarter of 2010, 7.3% for the second quarter of 2010 and was 7.1% for the third quarter of 2009.

In absolute dollars, general and administrative expenses increased by approximately \$27 million for the nine months ended September 30, 2010, as compared to the same period in 2009. The increase was primarily due to higher labor and benefit costs, related payroll costs and the timing of certain expenditures. General and administrative expenses as a percentage of dialysis and related lab services revenue was 7.6% for the nine months ended September 30, 2010, as compared to 7.3% for the same period in 2009.

Depreciation and amortization. Depreciation and amortization for dialysis and related lab services was approximately \$57 million in the both the third quarter and second quarter of 2010, as compared to \$55 million for the third quarter of 2009. The slight increase of \$2 million in depreciation and amortization for dialysis and related lab services in the third quarter of 2010, as compared to the third quarter of 2009, was primarily due to growth in newly developed centers and from centers through acquisitions.

Depreciation and amortization for dialysis and related lab services was approximately \$169 million for the nine months ended September 30, 2010, as compared to \$167 million for the same period in 2009. This slight increase of \$2 million was primarily due to growth in new centers and expansions of certain existing centers.

Provision for uncollectible accounts. The provision for uncollectible accounts receivable for dialysis and related lab services was 2.8% for all periods presented. We assess our level of the provision for uncollectible accounts based upon our historical cash collection experience and trends, and will adjust the provision as necessary as a result of changes in our cash collections.

Segment operating income

Dialysis and related lab services operating income for the third quarter of 2010 increased by approximately \$12 million, as compared to the second quarter of 2010. The increase in operating income was primarily attributable to an increase in revenue as a result of additional treatments in the third quarter of 2010 as described above, and an increase in the average dialysis revenue per treatment of approximately \$4, as also discussed

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above. However, dialysis and related lab operating income was negatively affected by a decline in the intensities of physician-prescribed pharmaceuticals, higher labor and benefit costs, higher pharmaceutical costs, a decline in productivity as well as an increase in professional fees.

Dialysis and related lab services operating income for the third quarter of 2010 increased by approximately \$7 million, as compared to the third quarter of 2009. The increase in operating income was primarily attributable to growth in revenue from additional treatments as a result of non-acquired treatment growth and growth through acquisitions, partially offset by a decrease in our average dialysis revenue per treatment of approximately \$4 as discussed above. Dialysis and related lab services operating income also increased as a result of cost control initiatives and improved productivity, partially offset by a decline in the intensities of physician-prescribed pharmaceuticals, an increase in labor costs and pharmaceutical costs, an increase in other operating costs of our dialysis centers as well as an increase in professional fees.

Dialysis and related lab services operating income for the nine months ended September 30, 2010 increased by approximately \$29 million, as compared to the same period in 2009. The increase in operating income was primarily attributable to growth in revenue from additional treatments, cost control initiatives, improved productivity and lower benefit costs, partially offset by higher labor costs and related payroll taxes, pharmaceutical costs and other operating costs of our dialysis centers.

Other Ancillary Services and Strategic Initiatives

	September 30, 2010	Three months ended June 30, 2010	September 30, 2009	Nine months ended September 30, 2010	September 30, 2009
	(dollar amounts rounded to nearest million)				
Revenues	\$ 98	\$ 91	\$ 83	\$ 270	\$ 232
Segment operating (loss)	\$	\$ (2)	\$ (3)	\$ (3)	\$ (8)

Net operating revenues

The ancillary services and strategic initiatives net operating revenues for the third quarter of 2010 increased by approximately \$7 million as compared to the second quarter of 2010. The increase was primarily volume growth in our pharmacy services, infusion therapy services and disease management services.

The increase in net operating revenues for the third quarter of 2010 of approximately \$15 million, as compared to the third quarter of 2009, was primarily due to growth in our pharmacy services and in our infusion therapy services, partially offset by a decrease in net operating revenues in disease management services as a result of discontinuing the special needs plans and in our clinical research services.

The increase in net operating revenues for the nine months ended September 30, 2010 of approximately \$38 million, as compared to the same period in 2009, was primarily due to growth in our pharmacy services and in our infusion therapy services, partially offset by a decrease in disease management services as described above, and a decrease in our clinical research services and physician services.

Operating expenses

Ancillary services and strategic initiatives operating expenses for the third quarter of 2010 increased by approximately \$5 million as compared to the second quarter of 2010, primarily as a result of volume growth in our pharmacy services.

Ancillary services and strategic initiatives operating expenses for the third quarter of 2010 increased by approximately \$12 million as compared to the same period in 2009, primarily due to volume growth associated with the pharmacy services and slight increases in labor and benefit costs, partially offset by lower costs as a result of discontinuing the disease management services special needs plans.

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Ancillary services and strategic initiatives operating expenses for the nine months ended September 30, 2010 increased by approximately \$33 million as compared to the same period in 2009. The increase was attributable to the same factors that were discussed above for the increase in operating expenses for the third quarter of 2010 as compared to the third quarter of 2009.