DAVITA INC
Form 10-Q
November 05, 2009
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

For the Quarterly Period Ended

September 30, 2009

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE

SECURITIES EXCHANGE ACT OF 1934

Commission File Number: 1-14106

DAVITA INC.

601 Hawaii Street

El Segundo, California 90245

Telephone number (310) 536-2400

Delaware	**51-0354549**
(State of incorporation)	**(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 x 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 x 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 x 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 x

As of October 30, 2009, the number of shares of the Registrant s common stock outstanding was approximately 102.2 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 $5.4 billion.

Table of Contents

DAVITA INC.

INDEX

		Page No.
	PART I. FINANCIAL INFORMATION	
Item 1.	Condensed Consolidated Financial Statements:	
	Consolidated Statements of Income for the three and nine months ended September 30, 2009 and September 30, 2008	1
	Consolidated Balance Sheets as of September 30, 2009 and December 31, 2008	2
	Consolidated Statements of Cash Flows for the nine months ended September 30, 2009 and September 30, 2008	3
	Consolidated Statements of Equity and Comprehensive Income for the nine months ended September 30, 2009 and for the year ended December 31, 2008	4
	Notes to Condensed Consolidated Financial Statements	5
Item 2.	Management s Discussion and Analysis of Financial Condition and Results of Operations	22
Item 3.	Quantitative and Qualitative Disclosures about Market Risk	35
Item 4.	Controls and Procedures	35
	PART II. OTHER INFORMATION	
Item 1.	Legal Proceedings	37
Item 1A.	Risk Factors	37
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	49
Item 6.	Exhibits	50
Signature		51

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,	
	2009	2008	2009	2008
Net operating revenues	$ 1,573,915	$ 1,447,135	$ 4,540,596	$ 4,199,163
Operating expenses and charges:				
Patient care costs	1,095,857	1,005,648	3,153,622	2,909,143
General and administrative	134,931	128,617	394,370	374,581
Depreciation and amortization	56,813	54,970	172,121	160,673
Provision for uncollectible accounts	42,021	37,305	119,990	109,433
Equity investment income	(708)	(1,177)	(1,066)	(654)
Total operating expenses and charges	1,328,914	1,225,363	3,839,037	3,553,176
Operating income	245,001	221,772	701,559	645,987
Debt expense	(45,535)	(54,505)	(140,924)	(168,891)
Other income	999	2,481	3,026	10,331
Income before income taxes	200,465	169,748	563,661	487,427
Income tax expense	74,195	62,010	209,485	175,853
Net income	126,270	107,738	354,176	311,574
Less: Net income attributable to noncontrolling interests	(15,340)	(13,828)	(41,216)	(35,779)
Net income attributable to DaVita Inc.	$ 110,930	$ 93,910	$ 312,960	$ 275,795
Earnings per share:				
Basic earnings per share attributable to DaVita Inc.	$ 1.07	$ 0.90	$ 3.01	$ 2.61
Diluted earnings per share attributable to DaVita Inc.	$ 1.06	$ 0.89	$ 3.00	$ 2.59
Weighted average shares for earnings per share:				
Basic	104,127,334	104,556,770	103,904,768	105,569,971
Diluted	104,607,318	105,577,823	104,315,019	106,421,184

See notes to condensed consolidated financial statements.

1

Table of Contents

DAVITA INC.

CONSOLIDATED BALANCE SHEETS

(unaudited)

(dollars in thousands, except per share data)

	September 30, 2009	December 31, 2008
ASSETS		
Cash and cash equivalents	$ 581,680	$ 410,881
Short-term investments	20,680	35,532
Accounts receivable, less allowance of $225,931 and $211,222	1,142,861	1,075,457
Inventories	69,014	84,174
Other receivables	235,785	239,165
Other current assets	34,816	33,761
Income tax receivable		32,130
Deferred income taxes	223,697	217,196
Total current assets	2,308,533	2,128,296
Property and equipment, net	1,088,446	1,048,075
Amortizable intangibles, net	141,925	160,521
Investments in third-party dialysis businesses	24,011	19,274
Long-term investments	7,567	5,656
Other long-term assets	34,262	47,330
Goodwill	3,932,964	3,876,931
	$ 7,537,708	$ 7,286,083
LIABILITIES AND EQUITY		
Accounts payable	$ 256,707	$ 282,883
Other liabilities	426,856	495,239
Accrued compensation and benefits	314,677	312,216
Current portion of long-term debt	100,677	72,725
Income taxes payable	14,592	
Total current liabilities	1,113,509	1,163,063
Long-term debt	3,555,853	3,622,421
Other long-term liabilities	100,722	101,442
Alliance and product supply agreement, net	31,980	35,977
Deferred income taxes	304,675	244,884
Total liabilities	5,106,739	5,167,787
Commitments and contingencies		
Noncontrolling interests subject to put provisions	292,636	291,397
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; 103,232,774 and 103,753,673 shares outstanding)	135	135
Additional paid-in capital	638,253	584,358
Retained earnings	2,202,410	1,889,450
Treasury stock, at cost (31,629,509 and 31,108,610 shares)	(756,157)	(691,857)
Accumulated other comprehensive loss	(7,838)	(14,339)

Total DaVita Inc. shareholders equity	2,076,803	1,767,747
Noncontrolling interests not subject to put provisions	61,530	59,152
Total equity	2,138,333	1,826,899
	$ 7,537,708	$ 7,286,083

See notes to condensed consolidated financial statements.

Table of Contents

DAVITA INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

(dollars in thousands)

	Nine months ended September 30, 2009	2008
Cash flows from operating activities:		
Net income	$ 354,176	$ 311,574
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	172,121	160,673
Stock-based compensation expense	33,850	29,975
Tax benefits from stock award exercises	12,434	10,174
Excess tax benefits from stock award exercises	(8,115)	(5,054)
Deferred income taxes	45,417	56,157
Equity investment income	(1,066)	(654)
Loss on disposal of assets	7,826	9,688
Non-cash debt and non-cash rent charges	7,497	9,971
Changes in operating assets and liabilities, other than from acquisitions and divestitures:		
Accounts receivable	(68,235)	(130,022)
Inventories	15,858	(1,248)
Other receivables and other current assets	(2,164)	(28,684)
Other long-term assets	5,641	(12,761)
Accounts payable	(58,995)	(12,800)
Accrued compensation and benefits	20,733	(11,752)
Other current liabilities	(68,383)	29,838
Income taxes	55,226	(3,086)
Other long-term liabilities	(9,702)	3,163
Net cash provided by operating activities	514,119	415,152
Cash flows from investing activities:		
Additions of property and equipment	(205,653)	(223,851)
Acquisitions	(64,001)	(77,157)
Proceeds from asset sales	6,256	451
Purchase of investments available for sale	(1,737)	(1,695)
Purchase of investments held-to-maturity	(16,942)	(19,005)
Proceeds from sale of investments available for sale	16,537	5,323
Proceeds from maturities of investments held-to-maturity	16,123	18,728
Distributions received on equity investments	929	802
Purchase of intangible assets and other	(260)	(65)
Net cash used in investing activities	(248,748)	(296,469)
Cash flows from financing activities:		
Borrowings	13,924,642	12,937,047
Payments on long-term debt	(13,961,667)	(12,938,297)
Deferred financing costs	(42)	(130)
Purchase of treasury stock	(61,223)	(169,673)
Excess tax benefits from stock award exercises	8,115	5,054

Stock award exercises and other share issuances, net	30,309	33,670
Distributions to noncontrolling interests	(46,888)	(43,391)
Contributions from noncontrolling interests	11,117	13,525
Proceeds from sales of additional noncontrolling interests	7,733	8,422
Purchases from noncontrolling interests	(6,668)	(24,009)
Net cash used in financing activities	(94,572)	(177,782)
Net increase (decrease) in cash and cash equivalents	170,799	(59,099)
Cash and cash equivalents at beginning of period	410,881	447,046
Cash and cash equivalents at end of period	$ 581,680	$ 387,947

See notes to condensed consolidated financial statements.

Table of Contents

DAVITA INC.

CONSOLIDATED STATEMENTS OF EQUITY

AND COMPREHENSIVE INCOME

(unaudited)

(dollars and shares in thousands)

	Non-controlling interests subject to put provisions	DaVita Inc. Shareholders Equity								Non-controlling interests not subject to put provisions	Comprehensive income
		Common stock		Additional paid-in capital	Retained earnings	Treasury stock		Accumulated other comprehensive income (loss)	Total		
		Shares	Amount			Shares	Amount				
Balance at December 31, 2007	$ 330,467	134,862	$ 135	$ 479,115	$ 1,515,290	(27,732)	$ (487,744)	$ (2,511)	$ 1,504,285	$ 48,178	
Comprehensive income:											
Net income.	30,401				374,160				374,160	16,759	$ 421,320
Unrealized losses on interest rate swaps, net of tax								(12,947)	(12,947)		(12,947)
Reclassification of net swap realized losses into net income, net of tax								2,590	2,590		2,590
Unrealized losses on investments, net of tax								(1,174)	(1,174)		(1,174)
Reclassification of net investment realized gains into net income, net of tax								(297)	(297)		(297)
Total comprehensive income											$ 409,492
Stock purchase shares issued				2,981		98	1,730		4,711		
Stock unit shares issued				(2,670)		181	3,544		874		
Stock options and SSARs exercised				12,278		1,133	23,328		35,606		
Stock-based compensation expense				41,235					41,235		
Excess tax benefits from stock awards exercised				8,165					8,165		
Purchase of treasury stock						(4,789)	(232,715)		(232,715)		
Distributions to noncontrolling interests	(40,016)									(19,341)	
Contributions from noncontrolling interests	7,305									11,769	
Sales and assumptions of additional noncontrolling	9,389									1,993	

interests											
Purchases from noncontrolling interests	(2,347)									(754)	
Changes in fair value of noncontrolling interests	(43,254)			43,254					43,254		
Other adjustments to noncontrolling interests	(548)									548	
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	27,824				312,960				312,960	13,392	354,176
Unrealized losses on interest rate swaps, net of tax								(2,248)	(2,248)		(2,248)
Reclassification of net swap realized losses into net income, net of tax								8,114	8,114		8,114
Unrealized gains on investments, net of tax								791	791		791
Reclassification of net investment realized gains into net income, net of tax								(156)	(156)		(156)
Total comprehensive income											$ 360,677
Stock purchase shares issued				2,135		107	2,387		4,522		
Stock unit shares issued				(1,342)		59	1,342				
Stock options and SSARs exercised				945		1,166	26,359		27,304		
Stock-based compensation expense				33,850					33,850		
Excess tax benefits from stock awards exercised				8,371					8,371		
Purchase of treasury stock						(1,853)	(94,388)		(94,388)		
Distributions to noncontrolling interests	(29,929)									(16,959)	
Contributions from noncontrolling interests	8,653									2,575	
Sales and assumptions of additional noncontrolling interests	12,022			(837)					(837)	4,115	
Purchases from noncontrolling interests	(2,594)			(3,639)					(3,639)	(435)	
Changes in fair value of noncontrolling interests	(14,750)			14,750					14,750		
Other adjustments to noncontrolling interests	13			(338)					(338)	(310)	
Balance at September 30, 2009	$ 292,636	134,862	$ 135	$ 638,253	$ 2,202,410	(31,630)	$ (756,157)	$ (7,838)	$ 2,076,803	$ 61,530	

See notes to condensed consolidated financial statements.

Table of Contents

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, 2009 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, 2008. Prior year balances and amounts have been classified to conform to the current year presentation. The Company has evaluated subsequent events through November 5, 2009, which is the date these condensed consolidated financial statements were issued.

2. Significant new accounting policies

On June 29, 2009, the Financial Accounting Standards Board (FASB) established the FASB Accounting Standards Codification (Codification) as the single source of authoritative U.S. generally accepted accounting principles (GAAP) for all nongovernmental entities. Rules and interpretive releases of the Securities and Exchange Commission (SEC) are also sources of authoritative U.S. GAAP for SEC registrants. The Codification does not change U.S. GAAP but takes previously issued FASB standards and other U.S. GAAP authoritative pronouncements, changes the way the standards are referred to, and includes them in specific topic areas. The Codification is effective for financial statements issued for interim and annual periods ending after September 15, 2009. The adoption of the Codification did not have any impact on the Company s financial statements.

Effective January 1, 2009, the Company was required to treat noncontrolling interests as a separate component of equity, but apart from the Company s equity, and not as a liability or other item outside of equity. The Company was also required to identify and present consolidated net income attributable to the Company and to noncontrolling interests on the face of the consolidated statement of income. Previously, the Company had reported minority interests (noncontrolling interests) as a reduction to operating income. In addition, changes in the Company s ownership interest while it retains a controlling financial interest are required to be accounted for as equity transactions. The Company was also required to expand disclosures in the financial statements to include a reconciliation of the beginning and ending balances of the equity attributable to the Company and the noncontrolling owners and a schedule showing the effects of changes in the Company s ownership interest in a subsidiary on the equity attributable to the Company. This change did not have a material impact on the Company s consolidated financial statements; however, it did change the presentation of minority interests in the Company s consolidated financial statements. In conjunction with adopting these requirements, the Company is required to classify securities with redemption features that are not solely within the Company s control such as its noncontrolling interests that are subject to put provisions outside of permanent equity and to measure these

DAVITA INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(unaudited)

(dollars and shares in thousands)

noncontrolling interests at fair value. See Note 9 to the condensed consolidated financial statements for further details. These presentation and disclosure requirements have been applied retrospectively for all prior periods presented.

All business combinations consummated after January 1, 2009 are required to be accounted for under the acquisition method (previously referred to as the purchase method). Under the acquisition method, the acquirer recognizes the assets acquired, the liabilities assumed, contractual contingencies, as well as any noncontrolling interests in the acquiree at their fair values at the acquisition date. Noncontractual contingencies are recognized at the acquisition date at their fair values only if it is more likely than not that they meet the definition of an asset or a liability. Transaction costs are excluded from the acquisition cost and are expensed as incurred. Any contingent consideration included by the acquirer as part of the purchase price must also be measured at fair value at the acquisition date and is classified as either equity or a liability. A Company that obtains control but acquires less than 100% of an acquiree is required to record 100% of the fair value of the acquiree assets, liabilities, and noncontrolling interests at the acquisition date. The adoption of these requirements did not have a material impact on the Company s consolidated financial statements.

3. Earnings per share

Basic net income per share is calculated by dividing net income attributable to DaVita Inc. 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).

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,	
	2009	2008	2009	2008
	(shares in thousands)			
Basic:				
Net income attributable to DaVita Inc.	$ 110,930	$ 93,910	$ 312,960	$ 275,795
Weighted average shares outstanding during the period	104,118	104,548	103,896	105,561
Vested stock units	9	9	9	9
Weighted average shares for basic earnings per share calculation	104,127	104,557	103,905	105,570
Basic net income per share attributable to DaVita Inc	$ 1.07	$ 0.90	$ 3.01	$ 2.61
Diluted:				
Net income for diluted earnings per share calculation	$ 110,930	$ 93,910	$ 312,960	$ 275,795
Weighted average shares outstanding during the period	104,118	104,548	103,896	105,561
Vested stock units	9	9	9	9
Assumed incremental shares from stock plans	480	1,021	410	851

Weighted average shares for diluted earnings per share calculation	104,607	105,578	104,315	106,421
Diluted net income per share attributable to DaVita Inc.	$ 1.06	$ 0.89	$ 3.00	$ 2.59
Shares subject to anti-dilutive awards excluded from calculation [(1)]	9,696	6,333	13,125	10,218

Table of Contents

DAVITA INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(unaudited)

(dollars and shares in thousands)

(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.

4. Stock-based compensation and other common stock transactions

Stock-based compensation recognized during a period is based on the estimated grant-date fair value of the portion of the stock-based awards vesting during that period, adjusted for expected forfeitures. Stock-based compensation recognized in these condensed consolidated financial statements for the three and nine months ended September 30, 2009 and 2008 includes compensation cost for stock-based awards granted prior to, but not fully vested as of, January 1, 2006 and subsequent stock-based awards granted through September 30, 2009 and 2008, respectively. 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 first nine months of 2009, the Company granted 3,991 stock-settled stock appreciation rights with a grant-date fair value of $47,833 and a weighted-average expected life of approximately 3.5 years, and also granted 14 stock units with a grant-date fair value of $647 and a weighted-average expected life of approximately 0.6 of a year.

For the nine months ended September 30, 2009 and 2008, the Company recognized $33,850 and $29,975, 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, 2009 and 2008 was $12,820 and $11,306, respectively. As of September 30, 2009, there was $88,023 of total estimated unrecognized compensation cost related to nonvested stock-based compensation arrangements under our 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, 2009 and 2008, the Company received $27,304 and $29,876, respectively, in cash proceeds from stock option exercises and $12,434 and $10,174, respectively, in actual tax benefits upon the exercise of stock awards.

During the third quarter of 2009, the Company repurchased 1,109 shares of its common stock for $62,373 or an average price of $56.25 per share. For the first nine months of 2009, the Company repurchased a total of 1,853 shares of its common stock for $94,388 or an average price of $50.93 per share. As of September 30, 2009, a total of $33,165 of share repurchases had not yet been settled in cash. In addition, the Company repurchased 1,049 additional shares of its common stock from October 1, 2009 through October 7, 2009 for $59,107, or an average price of $56.32 per share. All of these share repurchases were consummated pursuant to previously announced authorizations by the Company s Board of Directors. On October 8, 2009, the Company s Board of Directors authorized an additional $500,000 for share repurchases. The Company has not repurchased any additional shares of its common stock from October 8, 2009 through November 5, 2009 under this Board authorization. Therefore, the total outstanding authorization for share repurchases as of November 5, 2009 was $500,000. This stock repurchase program has no expiration date.

DAVITA INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(unaudited)

(dollars and shares in thousands)

5. Long-term debt

Long-term debt was comprised of the following:

	September 30, 2009	December 31, 2008
Senior secured credit facilities:		
Term loan A	$ 175,000	$ 214,375
Term loan B	1,705,875	1,705,875
Senior and senior subordinated notes	1,750,000	1,750,000
Acquisition obligations and other notes payable	18,001	15,266
Capital lease obligations	4,746	5,873
Total debt principal outstanding	3,653,622	3,691,389
Premium on the 6 ^{5}/8% senior notes	2,908	3,757
	3,656,530	3,695,146
Less current portion	(100,677)	(72,725)
	$ 3,555,853	$ 3,622,421

Scheduled maturities of long-term debt at September 30, 2009 are as follows:

2009 (remainder of the year)	$ 32,661
2010	90,520
2011	67,752
2012	1,707,625
2013	901,783
2014	845
Thereafter	852,436

During the first nine months of 2009, the Company made mandatory principal payments totaling $39,375 on the term loan A.

Effective January 1, 2009, the Company was required to provide enhanced disclosures about the Company s derivative and hedging activities. The Company is required to provide additional disclosures about (a) how and why the Company uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for, and (c) how derivative instruments and related hedged items affect the Company s financial position, financial performance, and cash flows. These requirements did not have a material impact on the Company s consolidated financial statements. The Company has elected to provide comparative disclosures for the prior period presented.

The Company has 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 are not held for trading or speculative purposes, and have the economic effect of converting portions of our variable rate debt to a fixed rate. These agreements are designated as cash flow hedges, and as a result, hedge-effective gains or losses resulting from changes in the fair values of these swaps are reported in other comprehensive income

until such time as each specific swap tranche is realized, at which time the amounts are reclassified into net income. Net amounts paid or received for each specific swap tranche that have settled have been reflected as adjustments to debt expense. These agreements do not contain credit-risk contingent features.

Table of Contents

DAVITA INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(unaudited)

(dollars and shares in thousands)

As of September 30, 2009, the Company maintained a total of eight interest rate swap agreements with amortizing notional amounts totaling $482,600. These agreements 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 3.88% to 4.70%, resulting in an overall weighted average effective interest rate of 5.70% on the hedged portion of the Company s Senior Secured Credit Facilities, including the term loan B margin of 1.50%. The swap agreements expire in 2010 and require quarterly interest payments. The Company estimates that approximately $12,300 of existing unrealized pre-tax losses in other comprehensive income at September 30, 2009 will be reclassified into income over the next twelve months.

The following table summarizes our derivative instruments as of September 30, 2009 and December 31, 2008:

	Interest rate swap liabilities			
	September 30, 2009		December 31, 2008	
Derivatives designated as hedging instruments	**Balance sheet location**	**Fair value**	**Balance sheet location**	**Fair value**
Current settlement of interest rate swap agreements	Other current liabilities	$ 2,541	Other current liabilities	$ 18
Interest rate swap agreements	Other long-term liabilities	12,310	Other long-term liabilities	21,886
Total		$ 14,851		$ 21,904

The following table summarizes the effects of our interest rate swap agreements for the nine months ended September 30, 2009 and 2008:

	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	**2009**	**2008**	**2009**	**2008**		**2009**	**2008**	**2009**	**2008**
Interest rate swap agreements	$ (1,722)	$ (1,260)	$ (3,681)	$ (6,500)	Debt expense	$ (4,450)	$ (2,301)	$ (13,280)	$ (3,671)
Tax expense benefit (expense)	670	490	1,433	2,528		1,731	895	5,166	1,428
Total	$ (1,052)	$ (770)	$ (2,248)	$ (3,972)		$ (2,719)	$ (1,406)	$ (8,114)	$ (2,243)

Total comprehensive income for the three and nine months ended September 30, 2009 was $128,465 and $360,677, respectively, including an increase to other 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.

Total comprehensive income for the three and nine months ended September 30, 2008 was $107,943 and $309,239 including adjustments to other comprehensive income for valuation gains (losses) on interest rate swaps, net of amounts reclassified into income of $636 and $(1,729), net of tax, respectively, and adjustments to

DAVITA INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(unaudited)

(dollars and shares in thousands)

other comprehensive income for unrealized losses on investments, net of amounts reclassified into income of ($431) and ($606), net of tax, respectively.

As of September 30, 2009, the interest rates were economically fixed on approximately 25% of the Company s variable rate debt and approximately 61% of its total debt.

As a result of the swap agreements, the overall effective weighted average interest rate on the Senior Secured Credit Facilities was 2.81%, based upon the current margins in effect of 1.50%, as of September 30, 2009.

The Company s overall average effective interest rate during the third quarter of 2009 was 4.79% and as of September 30, 2009 was 4.76%.

As of September 30, 2009, the Company has undrawn revolving credit facilities totaling $250,000 of which approximately $48,000 was committed for outstanding letters of credit. In addition, the Company currently has undrawn revolving credit facilities totaling $3,000 associated with several of its joint ventures. These revolving credit facilities are typically guaranteed by DaVita Inc. or one of its wholly-owned operating subsidiaries based upon its proportionate ownership percentage.

6. 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 December 2008, the Company received a subpoena for documents from the Office of Inspector General, U.S. Department of Health and Human Services, or 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 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. To the Company s knowledge, no proceedings have been initiated by the federal government against the Company at this time. 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 subpoena will continue to require management s attention and significant legal expense. Any negative findings could result in substantial financial penalties against us and exclusion from future participation in the Medicare and Medicaid programs.

DAVITA INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(unaudited)

(dollars and shares in thousands)

In February 2007, the Company received a request for information from the 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 is cooperating with the inquiry and is producing the requested records. 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. There appears to be substantial 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 below. To the Company s knowledge, no proceedings have been initiated by the federal government against the Company at this time. 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 these inquiries will continue to require management s attention and significant legal expense. Any negative findings could result in substantial financial penalties against the Company and exclusion from future participation in the Medicare and Medicaid programs.

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 our 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. To the Company s knowledge, no proceedings have been initiated against the Company at this time. 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 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) related to historical Gambro Healthcare billing practices and other matters covered by their 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.

DAVITA INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(unaudited)

(dollars and shares in thousands)

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 separate complaints 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, and failed to comply with certain other California labor code requirements. The Company has reached a tentative settlement in the complaints served on February 2007, October 2008 and December 2008 and is waiting for court approval of the settlement. In October 2008, the Company was served with a complaint which alleges, among other things, that the Company failed to pay the rate on the wage statement, and failed to comply with other California labor code requirements. The Company intends to vigorously defend against these claims. The Company also intends to vigorously oppose the certification of these matters as class actions.

In August 2007, Sheet Metal Workers National Health Fund and Glenn Randle filed a complaint in the United States District Court for the Central District of California against the Company. The complaint also names as defendants Amgen Inc. and Fresenuis Medical Care Holdings, Inc. The complaint is styled as a class action and alleges four claims against the Company, including violations of the federal RICO statute, California s unfair competition law, California s false advertising law and for unjust enrichment. The complaint s principal allegations against the Company are that the defendants engaged in a scheme to unlawfully promote the administration of EPO to hemodialysis patients intravenously, as opposed to subcutaneously, and to over-utilize EPO. On December 17, 2008, the Court dismissed the complaint and allegations in their entirety with permission of plaintiffs to amend the complaint. The Company was not named as a defendant in plaintiff s amended complaint. In June 2009, the Court dismissed the remainder of the case. Following the dismissal, plaintiffs filed a notice of appeal. The notice of appeal seeks review by the U. S. Court of Appeals for the Ninth Circuit of all of the district court s dismissal rulings, including the ruling dismissing the Company as a defendant. The Company intends to continue to vigorously defend this claim.

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 has been discontinued. The Attorney General s Office further advised the Company that Nevada Medicaid intends to conduct audits of end stage renal disease (ESRD) dialysis providers in Nevada, including the Company, and that such audits will 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. 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.

DAVITA INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(unaudited)

(dollars and shares in thousands)

In June 2004, Gambro Healthcare 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.

7. Investments

Based on the Company s intentions and strategy involving investments, 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.

The Company s investments consist of the following:

	September 30, 2009			December 31, 2008		
	Held to maturity	Available for sale	Total	Held to maturity	Available for sale	Total
Certificates of deposit and U.S. treasury notes due within one year	$ 19,920	$	$ 19,920	$ 19,355	$	$ 19,355
Investments in mutual funds		8,327	8,327		21,833	21,833
	$ 19,920	$ 8,327	$ 28,247	$ 19,355	$ 21,833	$ 41,188
Short-term investments	$ 19,920	$ 760	$ 20,680	$ 19,355	$ 16,177	$ 35,532
Long-term investments		7,567	7,567		5,656	5,656
	$ 19,920	$ 8,327	$ 28,247	$ 19,355	$ 21,833	$ 41,188

The cost of the certificates of deposit and U.S. treasury notes at September 30, 2009 and December 31, 2008 approximates their fair value. As of September 30, 2009 and December 31, 2008, the available for sale investments included $519 and $1,558, respectively, of gross pre-tax unrealized losses. During the nine months ended September 30, 2009, the Company recorded gross pre-tax unrealized gains of $1,294, or $791 after tax, in other comprehensive income associated with changes in the fair value of these investments. During the nine months ended September 30, 2009, the Company sold investments 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. The pre-tax gain is included in other income.

The certificates of deposit and U.S. treasury notes 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. 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.

Table of Contents

DAVITA INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(unaudited)

(dollars and shares in thousands)

8. Fair value of financial instruments

The Company measures the fair value of certain assets, liabilities 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, liabilities 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 liabilities measured at fair value on a recurring basis as of September 30, 2009:

	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	$ 8,327	$ 8,327	$	$
Liabilities				
Interest rate swap agreements	$ 14,851	$	$ 14,851	$
Temporary equity				
Noncontrolling interests subject to put provisions	$ 292,636	$	$	$ 292,636

The available for sale securities represent investments in various open or closed-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 7 to the condensed consolidated financial statements for further discussion.

The interest rate swap agreements are recorded at fair value based upon valuation models and a variety of techniques as reported by various broker dealers that are based upon relevant observable market inputs such as current interest rates, forward yield curves, and other credit and liquidity market conditions. The Company does not believe the ultimate amount that could be realized upon settlement of these interest rate swap agreements would be materially different than the fair values as currently reported. See Note 5 to the condensed consolidated financial statements for further discussion.

See Note 9 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, 2009 at their approximate fair values due to the short-term nature of their settlements. Borrowings under the Company s Senior Secured Credit Facilities totaled $1,880,875 as of September 30, 2009 and the fair value was $1,815,919 based upon quoted market prices. The fair value of the Company s senior and senior subordinated notes was approximately $1,747,250 at September 30, 2009, based upon quoted market prices, as compared to the carrying amount of $1,750,000.

14

DAVITA INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(unaudited)

(dollars and shares in thousands)

9. 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 at a predetermined multiple of earnings or cash flow attributable to the noncontrolling interest put to the Company, which is intended to approximate fair value. The methodology the Company used to estimate the fair value of the noncontrolling interests subject to these put provisions assumes either the higher of a liquidation value of net assets or an average multiple of earnings, historical earnings, patient mix and other performance indicators, as well as other factors. The estimated fair values of the noncontrolling interests subject to these put provisions can also fluctuate and the implicit multiple of earnings at which these noncontrolling interest obligations may ultimately be settled could vary significantly from our current estimates depending upon market conditions including potential purchasers access to the credit and 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 using a predetermined multiple of earnings and therefore not at 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 service agreements of approximately $12,200.

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.

10. Income taxes

As of September 30, 2009, the Company s total liability for unrecognized tax benefits relating to tax positions that do not meet the more-likely-than-not threshold was $12,580, all of which would impact the Company s effective tax rate if recognized. This balance represents an increase of $1,693 from the December 31, 2008 balance of $10,887 due to the addition of 2009 liabilities, offset by statute expirations.

The Company recognizes accrued interest and penalties related to unrecognized tax benefits in its income tax expense. At September 30, 2009 and December 31, 2008, the Company had approximately $2,783 and $1,402, respectively, accrued for interest and penalties related to unrecognized tax benefits, net of federal tax benefits.

11. 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 infusion therapy services, pharmacy services, vascular access services, physician services, disease management services

Table of Contents

DAVITA INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(unaudited)

(dollars and shares in thousands)

and full-service special need plans, as well as clinical research programs. 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 gains (losses).

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

	Three months ended September 30,		Nine months ended September 30,	
	2009	2008	2009	2008
Segment revenues:				
Dialysis and related lab services [1]	$ 1,491,260	$ 1,377,977	$ 4,308,988	$ 4,025,934
Other Ancillary services and strategic initiatives	82,655	69,158	231,608	173,229
Consolidated revenues	$ 1,573,915	$ 1,447,135	$ 4,540,596	$ 4,199,163
Segment operating margin (loss):				
Dialysis and related lab services	$ 260,087	$ 235,245	$ 746,069	$ 699,642
Other Ancillary services and strategic initiatives	(4,357)	(3,891)	(11,726)	(24,334)
Total segment margin	$ 255,730	$ 231,354	$ 734,343	$ 675,308
Reconciliation of segment margin to income before income taxes:				
Stock-based compensation	(11,437)	(10,759)	(33,850)	(29,975)
Equity investment income	708	1,177	1,066	654
Consolidated operating income	245,001	221,772	701,559	645,987
Debt expense	(45,535)	(54,505)	(140,924)	(168,891)
Other income	999	2,481	3,026	10,331
Consolidated income before income taxes	$ 200,465	$ 169,748	$ 563,661	$ 487,427

(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.

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.

Table of Contents

DAVITA INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(unaudited)

(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, 2008 were $53,209 and $155,830, respectively, and were $1,761 and $4,843, respectively, for the ancillary services and strategic initiatives.

Summary of assets by segment is as follows:

	September 30, 2009	December 31, 2008
Segment assets		
Dialysis and related lab services	$ 7,296,121	$ 7,031,550
Other Ancillary services and strategic initiatives	241,587	254,533
Consolidated assets	$ 7,537,708	$ 7,286,083

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.

For the three and nine months ended September 30, 2008, the total amount of expenditures for property and equipment for the dialysis and related lab services were $77,374 and $220,896, respectively, and were $1,470 and $2,955, respectively, for the ancillary services and strategic initiatives.

12. 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, 2009	Nine months ended September 30, 2009
Net income attributable to DaVita Inc.	$ 110,930	$ 312,960
Decrease in paid-in capital for sales of noncontrolling interest in three and ten joint ventures, respectively	(503)	(837)
Decrease in paid-in capital for the purchase of noncontrolling interest in two and five joint ventures, respectively	(1,184)	(3,639)
Net transfer from noncontrolling interests	(1,687)	(4,476)
Change from net income attributable to DaVita Inc. and transfers (to) from noncontrolling interests	$ 109,243	$ 308,484

13. Variable interest entities

The FASB, effective for the Company s first annual reporting period that begins after November 15, 2009, is eliminating the quantitative approach previously required for determining the primary beneficiary of a variable interest entity, and requiring additional disclosures about an enterprise s involvement in variable interest entities. An enterprise will be 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

Table of Contents

DAVITA INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(unaudited)

(dollars and shares in thousands)

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 is establishing 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 are 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. The Company is currently in process of assessing the expected impact of this standard on its consolidated financial statements.

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. These include dialysis operating entities in New York state and physician practice management entities in various other states.

Under the terms of the applicable arrangements, the Company bears virtually all of the economic risks and rewards of ownership for each of 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 manages these VIE subsidiaries and provides operating and capital funding as necessary to accomplish its operational and strategic objectives. Accordingly, since the Company bears virtually all of the risks and rewards attendant to their ownership, the Company consolidates these variable interest entities as their primary beneficiary.

Total assets of these operating VIEs were approximately $16,000 and their liabilities to unrelated third parties were approximately $10,000 at September 30, 2009.

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 7 for disclosures on the assets of these consolidated non-qualified deferred compensation plans.

14. 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 senior notes and the senior subordinated 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

For the three months ended September 30, 2009	DaVita Inc.	Guarantor subsidiaries	Non-Guarantor subsidiaries	Consolidating adjustments	Consolidated total
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 three months ended September 30, 2008					
Net operating revenues	$ 92,199	$ 1,226,156	$ 228,496	$ (99,716)	$ 1,447,135
Operating expenses	59,243	1,075,997	189,839	(99,716)	1,225,363
Operating income	32,956	150,159	38,657		221,772
Debt (expense)	(55,565)	(43,574)	(1,832)	46,466	(54,505)
Other income	48,718		229	(46,466)	2,481
Income tax expense	10,413	51,803	(206)		62,010
Equity earnings in subsidiaries	78,214	22,370		(100,584)	
Net income	93,910	77,152	37,260	(100,584)	107,738
Less: Net income attributable to noncontrolling interests				(13,828)	(13,828)
Net income attributable to DaVita Inc.	$ 93,910	$ 77,152	$ 37,260	$ (114,412)	$ 93,910
For the nine months ended September 30, 2009					
Net operating revenues	$ 296,696	$ 3,800,836	$ 758,233	$ (315,169)	$ 4,540,596