DAVITA INC
Form 10-Q
November 07, 2007
**Table of Contents**

# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-Q

**For the Quarterly Period Ended**

# September 30, 2007

**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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨

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 31, 2007, the number of shares of the Registrant s common stock outstanding was approximately 106.7 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.

**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, 2007 and September 30, 2006 | 1 |
| | Consolidated Balance Sheets as of September 30, 2007 and December 31, 2006 | 2 |
| | Consolidated Statements of Cash Flows for the nine months ended September 30, 2007 and September 30, 2006 | 3 |
| | Consolidated Statement of Shareholders Equity and Comprehensive Income for the nine months ended September 30, 2007 and for the year ended December 31, 2006 | 4 |
| | Notes to Condensed Consolidated Financial Statements | 5 |
| Item 2. | Management s Discussion and Analysis of Financial Condition and Results of Operations | 20 |
| Item 3. | Quantitative and Qualitative Disclosures About Market Risk | 29 |
| Item 4. | Controls and Procedures | 29 |
| | **PART II. OTHER INFORMATION** | |
| Item 1. | Legal Proceedings | 31 |
| Item 1A. | Risk Factors | 31 |
| Item 2. | Unregistered Sales of Equity Securities and Use of Proceeds | 41 |
| Item 6. | Exhibits | 42 |
| Signature | | 43 |


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, | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| Net operating revenues | $ 1,318,381 | $ 1,237,041 | $ 3,909,282 | $ 3,608,045 |
| Operating expenses and charges: | | | | |
| Patient care costs | 890,243 | 857,049 | 2,662,841 | 2,517,795 |
| General and administrative | 120,596 | 113,447 | 356,249 | 329,059 |
| Depreciation and amortization | 49,230 | 44,478 | 142,078 | 128,086 |
| Provision for uncollectible accounts | 34,107 | 31,985 | 101,686 | 93,295 |
| Minority interests and equity income, net | 11,793 | 10,956 | 34,757 | 26,857 |
| Valuation gain on Alliance and Product Supply Agreement | | (37,968) | (55,275) | (37,968) |
| Total operating expenses and charges | 1,105,969 | 1,019,947 | 3,242,336 | 3,057,124 |
| Operating income | 212,412 | 217,094 | 666,946 | 550,921 |
| Debt expense | (62,715) | (67,904) | (194,496) | (206,799) |
| Other income | 6,278 | 3,271 | 17,131 | 10,118 |
| Income from continuing operations before income taxes | 155,975 | 152,461 | 489,581 | 354,240 |
| Income tax expense | 61,520 | 59,370 | 193,520 | 139,040 |
| Income from continuing operations | 94,455 | 93,091 | 296,061 | 215,200 |
| Discontinued operations | | | | |
| Gain on disposal of discontinued operations, net of tax | | 1,765 | | 362 |
| Net income | $ 94,455 | $ 94,856 | $ 296,061 | $ 215,562 |
| **Earnings per share:** | | | | |
| Basic earnings per share from continuing operations | $ 0.89 | $ 0.90 | $ 2.80 | $ 2.08 |
| Basic earnings per share | $ 0.89 | $ 0.91 | $ 2.80 | $ 2.09 |
| Diluted earnings per share from continuing operations | $ 0.88 | $ 0.88 | $ 2.76 | $ 2.04 |
| Diluted earnings per share | $ 0.88 | $ 0.90 | $ 2.76 | $ 2.04 |
| Weighted average shares for earnings per share: | | | | |
| Basic | 106,171,473 | 103,784,510 | 105,558,536 | 103,295,407 |
| Diluted | 107,561,139 | 105,923,976 | 107,129,135 | 105,643,406 |

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, 2007 | December 31, 2006 |
|---|---|---|
| **ASSETS** | | |
| Cash and cash equivalents | $ 391,300 | $ 310,202 |
| Short-term investments | 22,177 | 4,734 |
| Accounts receivable, less allowance of $193,644 and $171,757 | 976,285 | 932,385 |
| Inventories | 75,611 | 89,119 |
| Other receivables | 186,282 | 148,842 |
| Other current assets | 27,653 | 25,124 |
| Deferred income taxes | 241,212 | 199,090 |
| Total current assets | 1,920,520 | 1,709,496 |
| Property and equipment, net | 894,164 | 849,966 |
| Amortizable intangibles, net | 185,761 | 203,721 |
| Investments in third-party dialysis businesses | 2,227 | 1,813 |
| Long-term investments | 7,844 | 13,174 |
| Long-term assets | 42,097 | 45,793 |
| Goodwill | 3,728,822 | 3,667,853 |
| | $ 6,781,435 | $ 6,491,816 |
| **LIABILITIES AND SHAREHOLDERS EQUITY** | | |
| Accounts payable | $ 245,976 | $ 251,686 |
| Other liabilities | 444,196 | 473,219 |
| Accrued compensation and benefits | 322,289 | 341,766 |
| Current portion of long-term debt | 9,711 | 20,871 |
| Income taxes payable | 19,408 | 24,630 |
| Total current liabilities | 1,041,580 | 1,112,172 |
| Long-term debt | 3,695,586 | 3,730,380 |
| Other long-term liabilities | 59,310 | 50,076 |
| Alliance and product supply agreement | 42,640 | 105,263 |
| Deferred income taxes | 167,035 | 125,642 |
| Minority interests | 148,018 | 122,359 |
| Commitments and contingencies | | |
| Shareholders 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; 106,658,297 and 104,636,608 shares outstanding) | 135 | 135 |
| Additional paid-in capital | 688,590 | 630,091 |
| Retained earnings | 1,429,573 | 1,129,621 |
| Treasury stock, at cost (28,203,986 and 30,225,675 shares) | (496,042) | (526,920) |
| Accumulated other comprehensive income | 5,010 | 12,997 |
| Total shareholders equity | 1,627,266 | 1,245,924 |

| | | |
|---|---|---|
| | $ 6,781,435 | $ 6,491,816 |

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, | |
|---|---|---|
| | **2007** | **2006** |
| **Cash flows from operating activities:** | | |
| Net income | $ 296,061 | $ 215,562 |
| Adjustments to reconcile net income to cash provided by operating activities: | | |
| Depreciation and amortization | 142,078 | 128,086 |
| Valuation gain on Alliance and product supply agreement | (55,275) | (37,968) |
| Stock-based compensation expense | 25,260 | 18,896 |
| Tax benefits from stock award exercises | 27,000 | 29,261 |
| Excess tax benefits from stock award exercises | (23,632) | (27,146) |
| Deferred income taxes | 25,645 | 1,249 |
| Minority interests in income of consolidated subsidiaries | 35,703 | 28,812 |
| Distributions to minority interests | (35,216) | (25,552) |
| Equity investment income | (946) | (1,955) |
| (Gain) loss on disposal of discontinued operation and other dispositions | (4,944) | 508 |
| Non-cash debt and non-cash rent charges | 11,810 | 13,562 |
| Changes in operating assets and liabilities, net of effect of acquisitions and divestitures: | | |
| Accounts receivable | (32,425) | (46,135) |
| Inventories | 15,144 | (29,118) |
| Other receivables and other current assets | (42,818) | (18,155) |
| Other long-term assets | (11,921) | (5,329) |
| Accounts payable | (6,458) | 16,557 |
| Accrued compensation and benefits | (17,347) | 67,889 |
| Other current liabilities | (26,151) | 63,643 |
| Income taxes | (13,072) | (65,924) |
| Other long-term liabilities | 1,214 | 2,720 |
| Net cash provided by operating activities | 309,710 | 329,463 |
| **Cash flows from investing activities:** | | |
| Purchase of investments | (42,202) | |
| Additions of property and equipment, net | (176,078) | (181,425) |
| Acquisitions and purchases of other ownership interests | (81,782) | (75,580) |
| Proceeds from divestitures and asset sales | 4,643 | 21,348 |
| Proceeds from sale and maturities of investments | 36,918 | |
| Investments in and advances to affiliates, net | 16,204 | 14,605 |
| Purchase of intangible assets | (556) | (5,749) |
| Net cash used in investing activities | (242,853) | (226,801) |
| **Cash flows from financing activities:** | | |
| Borrowings | 10,405,556 | 4,493,339 |
| Payments on long-term debt | (10,451,891) | (4,826,163) |
| Deferred financing costs | (4,462) | 296 |

| | | |
|---|---|---|
| Purchase of treasury stock | (6,350) | |
| Excess tax benefits from stock award exercises | 23,632 | 27,146 |
| Stock award exercises and other share issuances, net | 47,756 | 31,187 |
| Net cash provided by (used in) financing activities | 14,241 | (274,195) |
| Net increase (decrease) in cash and cash equivalents | 81,098 | (171,533) |
| Cash and cash equivalents at beginning of period | 310,202 | 431,811 |
| Cash and cash equivalents at end of period | $ 391,300 | $ 260,278 |

See notes to condensed consolidated financial statements.

Table of Contents

**DAVITA INC.**

**CONSOLIDATED STATEMENT OF SHAREHOLDERS EQUITY**

**AND**

**COMPREHENSIVE INCOME**

**(unaudited)**

**(dollars and shares in thousands)**

| | Common stock | | Additional paid-in capital | Retained earnings | Treasury stock | | Accumulated other comprehensive income | Total |
|---|---|---|---|---|---|---|---|---|
| | Shares | Amount | | | Shares | Amount | | |
| Balance at December 31, 2005 | 134,862 | $ 135 | $ 569,751 | $ 839,930 | (32,927) | $ (574,013) | $ 14,806 | $ 850,609 |
| Comprehensive income: | | | | | | | | |
| Net income | | | | 289,691 | | | | 289,691 |
| Unrealized gain on interest rate swaps, net of tax | | | | | | | 7,862 | 7,862 |
| Less reclassification of net swap valuation gains into net income, net of tax | | | | | | | (9,671) | (9,671) |
| Total comprehensive income | | | | | | | | 287,882 |
| Stock purchase shares issued | | | 1,861 | | 80 | 1,403 | | 3,264 |
| Stock unit shares issued | | | (1,860) | | 160 | 2,790 | | 930 |
| Stock option shares issued | | | (5,023) | | 2,461 | 42,900 | | 37,877 |
| Stock-based compensation expense | | | 26,389 | | | | | 26,389 |
| Tax benefits from stock awards exercised | | | 38,973 | | | | | 38,973 |
| Balance at December 31, 2006 | 134,862 | 135 | 630,091 | 1,129,621 | (30,226) | (526,920) | 12,997 | 1,245,924 |
| Comprehensive income: | | | | | | | | |
| Net income | | | | 296,061 | | | | 296,061 |
| Unrealized loss on interest rate swaps, net of tax | | | | | | | (1,454) | (1,454) |
| Less reclassification of net swap valuation gains into net income, net of tax | | | | | | | (7,052) | (7,052) |
| Unrealized gain on investments, net of tax | | | | | | | 4,207 | 4,207 |
| Less reclassification of net investment gains into net income, net of tax | | | | | | | (3,688) | (3,688) |
| Total comprehensive income | | | | | | | | 288,074 |
| Cumulative effect of change in accounting principle SFAS Interpretation No. (FIN) 48 | | | | 3,891 | | | | 3,891 |
| Stock purchase shares issued | | | 3,820 | | 124 | 2,160 | | 5,980 |
| Stock unit shares issued | | | (1,609) | | 107 | 1,859 | | 250 |
| Stock options & SSARs exercised | | | 8,066 | | 1,902 | 33,209 | | 41,275 |
| Purchase of treasury stock | | | | | (111) | (6,350) | | (6,350) |
| Stock-based compensation expense | | | 25,260 | | | | | 25,260 |
| Tax benefits from stock awards exercised | | | 22,962 | | | | | 22,962 |
| Balance at September 30, 2007 | 134,862 | $ 135 | $ 688,590 | $ 1,429,573 | (28,204) | $ (496,042) | $ 5,010 | $ 1,627,266 |

See notes to condensed consolidated financial statements.

4

Table of Contents

**DAVITA INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(unaudited)**

**(dollars in thousands, except per share data)**

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, 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, 2007 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, 2006. Prior year balances and amounts have been classified to conform to the current year presentation.

**2. Earnings per share**

Basic earnings per share is calculated by dividing net income by the weighted average number of common shares and vested stock units outstanding. Diluted earnings per share includes the dilutive effect of outstanding stock options, 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 in thousands, except per share data)**

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, | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| | (shares in thousands) | | | |
| **Basic:** | | | | |
| Income from continuing operations | $ 94,455 | $ 93,091 | $ 296,061 | $ 215,200 |
| Gain on disposal of discontinued operations, net of tax | | 1,765 | | 362 |
| Net income | $ 94,455 | $ 94,856 | $ 296,061 | $ 215,562 |
| Weighted average shares outstanding during the period | 106,126 | 103,734 | 105,514 | 103,244 |
| Vested stock units | 45 | 51 | 45 | 51 |
| Weighted average shares for basic earnings per share calculations | 106,171 | 103,785 | 105,559 | 103,295 |
| Basic earnings per share from continuing operations | $ 0.89 | $ 0.90 | $ 2.80 | $ 2.08 |
| Gain on disposal of discontinued operations | | 0.01 | | 0.01 |
| **Basic earnings per share** | $ 0.89 | $ 0.91 | $ 2.80 | $ 2.09 |
| **Diluted:** | | | | |
| Income from continuing operations | $ 94,455 | $ 93,091 | $ 296,061 | $ 215,200 |
| Gain on disposal of discontinued operations, net of tax | | 1,765 | | 362 |
| Net income for diluted earnings per share calculation | $ 94,455 | $ 94,856 | $ 296,061 | $ 215,562 |
| Weighted average shares outstanding during the period | 106,126 | 103,734 | 105,514 | 103,244 |
| Vested stock units | 45 | 51 | 45 | 51 |
| Assumed incremental shares from stock plans | 1,390 | 2,139 | 1,570 | 2,348 |
| Weighted average shares for diluted earnings per share calculation | 107,561 | 105,924 | 107,129 | 105,643 |
| Diluted earnings per share from continuing operations | $ 0.88 | $ 0.88 | $ 2.76 | $ 2.04 |
| Gain on disposal of discontinued operations | | 0.02 | | |
| **Diluted earnings per share** | $ 0.88 | $ 0.90 | $ 2.76 | $ 2.04 |

Shares associated with stock options and stock appreciation rights that have exercise or base prices greater than the average market price of shares outstanding during the period were not included in the computation of diluted earnings per share because they were anti-dilutive. These excluded shares were as follows:

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| Stock award shares not included in computation (shares in 000 s) | 305 | 365 | 930 | 352 |
| Exercise or base price range of stock awards not included in computation: | | | | |
| Low | $ 56.74 | $ 54.57 | $ 55.17 | $ 54.67 |
| High | $ 61.77 | $ 60.21 | $ 61.77 | $ 60.21 |

Table of Contents

**DAVITA INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)**

**(unaudited)**

**(dollars in thousands, except per share data)**

**3. Stock-based compensation and other equity matters**

Under SFAS No. 123(R), 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 first nine months of 2007 includes compensation cost for stock-based awards granted prior to, but not fully vested as of, December 31, 2005 and subsequent stock-based awards granted through September 30, 2007. For the first nine months of 2006, stock-based compensation includes compensation cost for stock-based awards granted prior to, but not fully vested as of December 31, 2005 and stock-based awards granted in the first nine months of 2006. Prior to 2006, the Company recognized the effect of stock unit forfeitures as they occurred, and the effect of transitioning to recognition of expense based on expected forfeitures was insignificant. Shares issued upon exercise of stock awards are generally issued from shares in treasury. The Company has utilized the Black-Scholes-Merton valuation model for estimating the grant-date fair value of stock options and stock-settled stock appreciation rights granted in 2007 and all prior periods. During the third quarter of 2007, the Company granted 332,818 stock-based awards with a total grant-date fair value of $5,561, and a weighted-average expected life of approximately 3.5 years.

For the nine months ended September 30, 2007 and 2006, the Company recognized $25,260 and $18,896, respectively, in stock-based compensation expense for stock options, stock-settled stock appreciation rights, stock units and discounted employee stock plan purchases, which is primarily included in general and administrative expenses in continuing operations. The estimated tax benefit recorded for stock-based compensation through September 30, 2007 and 2006 was $9,475 and $6,915, respectively. As of September 30, 2007, there was $86,938 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 1.7 years.

During the nine months ended September 30, 2007 and 2006, the Company received $41,275 and $29,006, respectively, in cash proceeds from stock option exercises and $27,000 and $29,261, respectively, in actual tax benefits upon the exercise of stock awards.

On May 29, 2007, the Company s stockholders approved an amendment to the Company s Amended and Restated Certificate of Incorporation to increase the number of shares of authorized common stock from 195,000,000 to 450,000,000 shares. The Company s stockholders also approved an amendment and restatement of the Company s Employee Stock Purchase Plan to increase the number of shares of common stock available for issuance under that plan by 800,001 shares, and approved an amendment and restatement of the Company s 2002 Equity Compensation Plan to increase the number of shares of common stock available for issuance under that plan by 6,000,000 shares and, among other things, to remove certain available share recycling features, to change the limit on the maximum number of shares of common stock that may be subject to awards granted to any single recipient in any consecutive twenty-four month period so that it applies only to awards of stock options and stock appreciation rights, and to provide additional exceptions from the three year minimum vesting period generally applicable to grants of restricted stock units and other full share awards.

Table of Contents

**DAVITA INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)**

**(unaudited)**

**(dollars in thousands, except per share data)**

**4. Long-term debt**

Long-term debt was comprised of the following:

| | September 30, 2007 | December 31, 2006 |
|---|---|---|
| Term loan A | $ 229,250 | $ 279,250 |
| Term loan B | 1,705,875 | 2,105,875 |
| 6 5/8% Senior Notes and 7 1/4% Senior Subordinated Notes | 1,750,000 | 1,350,000 |
| Capital lease obligations | 4,221 | 6,929 |
| Acquisition obligations and other notes payable | 11,292 | 9,197 |
| Total principal debt outstanding | 3,700,638 | 3,751,251 |
| Premium on the 6 5/8% Senior Notes | 4,659 | |
| | 3,705,297 | 3,751,251 |
| Less current portion | (9,711) | (20,871) |
| | $ 3,695,586 | $ 3,730,380 |

Scheduled maturities of long-term debt at September 30, 2007 were as follows:

| | |
|---|---|
| 2007 | $ 4,890 |
| 2008 | 18,871 |
| 2009 | 63,966 |
| 2010 | 88,973 |
| 2011 | 66,498 |
| 2012 | 1,706,494 |
| Thereafter | 1,750,946 |

On February 23, 2007, the Company issued $400,000 of 6 5/8% senior notes due 2013 in a private offering, realizing $405,080 in proceeds, which included a $5,080 premium, and incurred $2,678 in related deferred financing costs. These senior notes are part of the same series of debt securities as the $500,000 aggregate principal amount of 6 5/8% senior notes that were issued in March 2005. The effective interest rate for the $400,000 of 6 5/ 8% senior notes is 6.45%. The senior notes are guaranteed by substantially all of the Company s direct and indirect wholly-owned subsidiaries and require semi-annual interest payments which began March 15, 2007. The senior notes may be redeemed by the Company in whole or part at any time on or after March 15, 2009, at certain specified prices. The Company used $400,000 of these proceeds to pay down its term loan B and also wrote-off $4,188 of term loan B deferred financing costs, which is included in debt expense.

The Company s senior and senior subordinated notes, as of September 30, 2007, consisted of $900,000 of 6 5/8% senior notes due 2013 and $850,000 of 7 1/4% senior subordinated notes due 2015.

On February 23, 2007, the Company amended and restated its existing Senior Secured Credit Facilities to, among other things, reduce the interest rate margin on its term loan B by 0.50%, and to amend certain financial covenants. The amended term loan B bears interest at LIBOR plus 1.50%, for an overall effective rate of 5.87%, including the impact of the Company s swap agreements as of September 30, 2007. If the Company refinances the term loan B prior to February 23, 2008, the Company will be subject to a prepayment penalty of 1.0%,

Table of Contents

**DAVITA INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)**

**(unaudited)**

**(dollars in thousands, except per share data)**

otherwise the payment terms remain the same. Other terms that were changed included the amount by which the Company can elect to increase the revolving and term loan commitments from $500,000 to $750,000 and certain limitations on purchases, redemptions or acquisitions of capital stock, the payment of dividends and distribution in cash, and growth capital expenditures, including acquisition expenditures, will not apply during the periods in which the Company s leverage ratio is less than 3.5:1. The Company s leverage ratio as of September 30, 2007 was less than 3.5:1. The Company incurred deferred financing costs of $1,781 and expensed $248 of other costs in connection with this transaction, which are included in debt expense.

On February 27, 2007, the Company s interest rate margin on its term loan A was reduced by 0.25% as a result of achieving certain financial ratios as defined in the Senior Secured Credit Facilities. The term loan A currently bears interest at LIBOR plus 1.50%, for an overall effective rate of 6.63% as of September 30, 2007. The margin is subject to adjustment depending upon changes in certain financial ratios of the Company and can range from 1.50% to 2.25% for the term loan A, as well as for the revolving credit facility.

On April 25, 2007, the Company made a principal prepayment of $50,000 on its term loan A and wrote-off $183 of term loan A deferred financing costs, which is included in debt expense. After giving effect to this prepayment, the Company s scheduled mandatory principal payments on the term loan A are due as follows: $14,875 in 2008, $61,250 in 2009, $87,500 in 2010, and $65,625 in 2011.

As of September 30, 2007, the Company maintained a total of nine interest rate swap agreements, with amortizing notional amounts totaling $1,096,000. These agreements had the economic effect of modifying the LIBOR-based variable interest rate on the Company s debt to fixed rates ranging from 3.08% to 4.27%, resulting in a weighted average effective interest rate of 5.37% 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 2008 through 2010 and require quarterly interest payments. During the first nine months of 2007, the Company accrued net benefits of $11,541 from these swaps which is included in debt expense. As of September 30, 2007, the total fair value of these swaps was an asset of $13,037 and is principally included in other long-term assets.

On October 16, 2007, the Company entered into a forward interest rate swap that will have the economic effect of modifying the LIBOR-based interest rate to a fixed rate of 4.70% on $100,000 of the Company s term loan B outstanding debt, effective September 30, 2008. The total notional amount of $100,000 requires quarterly interest payments beginning in December 2008. The interest rate swap expires in 2010.

Total comprehensive income for the three and nine months ended September 30, 2007 was $86,452 and $288,074, respectively, including reductions to other comprehensive income for valuation losses, net of amounts reclassified into income on swaps of $7,098 and $8,506, net of tax, respectively, and adjustments to other comprehensive income for unrealized gains (losses), on investments, net of amounts reclassified into income of ($905) and $519, net of tax, respectively.

Total comprehensive income for the three and nine months ended September 30, 2006 was $84,513 and $214,847, respectively, including other comprehensive income valuation losses on swaps of $10,343 and $715, respectively net of tax.

As of September 30, 2007, the interest rates were economically fixed on approximately 56% of the Company s variable rate debt and approximately 77% of its total debt.

Table of Contents

**DAVITA INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)**

**(unaudited)**

**(dollars in thousands, except per share data)**

As a result of the swap agreements, the overall effective weighted average interest rate on the Senior Secured Credit Facilities was 6.0%, based upon the current margins in effect of 1.50%, as of September 30, 2007.

The Company s overall average effective interest rate excluding the write-off and amortization of deferred financing costs during the third quarter of 2007 was 6.48% and as of September 30, 2007 was 6.43%.

The Company has undrawn revolving credit facilities totaling $250,000 of which approximately $50,000 was committed for outstanding letters of credit. The Company also has undrawn revolving lines of credit totaling $16,500 associated with several of its joint ventures, and non-wholly-owned subsidiaries.

**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.

*United States Attorney inquiries*

On March 4, 2005, the Company received a subpoena from the United States Attorney s Office, or 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 Epogen® (EPO). In May 2007, the Company received a request for documents related to durable medical equipment (DME) and supply companies owned and operated by the Company. The Company is producing documents and providing information to the government. The Company is also cooperating, and intends to continue to cooperate, with the government s investigation, including by participating in discussions and meetings with the government. 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. 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. 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 this to continue for a considerable period of time. Responding to the subpoenas will continue to require management s attention and significant legal expense.

On October 25, 2004, the Company received a subpoena from the U.S. Attorney s Office for the Eastern District of New York in Brooklyn. The subpoena covers the period from 1996 to present and requires the production of a wide range of documents relating to the Company s operations, including DaVita Laboratory

10

Table of Contents

**DAVITA INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)**

**(unaudited)**

**(dollars in thousands, except per share data)**

Services. DVA Renal Healthcare received a similar subpoena in November 2004. The subpoena also includes specific requests for documents relating to testing for parathyroid hormone levels (PTH), and to products relating to vitamin D therapies. The subpoena has been issued in connection with a joint civil and criminal investigation. It is possible that criminal proceedings may be initiated against the Company and DVA Renal Healthcare in connection with this inquiry. Any negative findings could result in substantial financial penalties against the Company and DVA Renal Healthcare, exclusion from future participation in the Medicare and Medicaid programs and criminal penalties. Other participants in the dialysis industry received a similar subpoena, including Fresenius Medical Group and Renal Care Group. To the Company s knowledge, no proceedings have been initiated against the Company or DVA Renal Healthcare 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 may continue to require management s attention and significant legal expense.

In February 2007, the Company received a request for information from the Office of Inspector General, U.S. Department of Health and Human Services (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 was 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. 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. 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 subpoena will require management s attention and significant legal expense.

*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 related to historical DVA Renal Healthcare billing practices and other matters covered by their settlement agreement with the Department of Justice. 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. Although the ultimate outcome of these claims cannot be predicted at this time, an adverse result in excess of the Company s established reserves, with respect to one or more of these claims could have a material adverse effect on the Company s business, financial condition, results of operations and liquidity.

On October 17, 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 has begun an investigation of the Company s operations in Nevada. The investigation relates to the Company s billing of pharmaceuticals, including EPO. The Company is cooperating with the investigation. The Attorney General s Office has informed the Company that this investigation is being initiated as a criminal investigation. 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. To the Company s knowledge, no proceedings have been

Table of Contents

**DAVITA INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)**

**(unaudited)**

**(dollars in thousands, except per share data)**

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 this to continue for a considerable period of time.

On August 28, 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 Fresenius 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. The Company intends to vigorously defend against these claims, however, the Company cannot predict the ultimate outcome of this matter.

The Company has received several informal inquiries from representatives of the New York Attorney General s Medicaid Fraud Control Unit (MFCU) regarding certain aspects of EPO and other billing practices taking place at facilities managed by the Company in New York. The Company is cooperating with the MFCU s informal inquiries and has provided documents and information to the MFCU. To the best of the Company s knowledge, no proceedings have been initiated against the Company and the MFCU has not indicated an intention to do so, although the Company cannot predict whether it will receive further inquiries or whether or when proceedings might be initiated.

On August 8, 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 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 DVA Renal Healthcare s December 2004 settlement agreement with the Department of Justice and certain agencies of the United States 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. At this time, the Company cannot estimate the potential range of damages, if any. The Company is investigating these claims and continues to vigorously defend itself in the matter.

In June 2004, DVA Renal 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 is evaluating the claims and intends to vigorously defend itself in the matter. The Company also intends to vigorously oppose the certification of this matter as a class action. Although the ultimate outcome of these claims cannot be predicted, the Company does not expect that an unfavorable result, if any, would have a material adverse effect on the Company s business, financial condition, liquidity or results of operations.

In addition to the foregoing, the Company is subject to claims and suits in the ordinary course of business, including from time to time, contractual disputes and professional and general liability claims. 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.

Table of Contents

**DAVITA INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)**

**(unaudited)**

**(dollars in thousands, except per share data)**

**6. Other commitments**

The Company has obligations to purchase the third-party interests 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. If these put provisions are exercised, the Company would be required to purchase the third-party owners interests at either the appraised fair market value or a predetermined multiple of cash flow or earnings, which approximates fair value. As of September 30, 2007, the Company s potential obligations under these put provisions totaled approximately $239,000 of which approximately $92,000 was exercisable within one year. Additionally, the Company has certain other potential commitments to provide operating capital to several minority-owned centers and to third-party owned centers that the Company operates under administrative service agreements of approximately $15,000.

The Company is obligated under mandatorily redeemable instruments in connection with certain consolidated joint ventures. Future distributions may be required for the minority partners interests in limited-life entities which dissolve after terms of ten to fifty years. As of September 30, 2007, such distributions would be valued below the related minority interests balances in the consolidated balance sheet.

**7. Investments**

In accordance with SFAS No. 115 and 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 debt securities classified as available for sale are recorded at fair value.

The Company s investments consist of the following:

| | September 30, 2007 | | | December 31, 2006 | | |
|---|---|---|---|---|---|---|
| | Held to Maturity | Available For Sale | Total | Held to Maturity | Available For Sale | Total |
| Certificates of Deposit, and Treasury notes due within 1 year | $ 17,577 | $ | $ 17,577 | $ 1,500 | $ | $ 1,500 |
| Investments in mutual funds | | 12,444 | 12,444 | | 16,408 | 16,408 |
| | $ 17,577 | $ 12,444 | $ 30,021 | $ 1,500 | $ 16,408 | $ 17,908 |
| Short-term investments | $ 17,577 | $ 4,600 | $ 22,177 | $ 1,500 | $ 3,234 | $ 4,734 |
| Long-term investments | | 7,844 | 7,844 | | 13,174 | 13,174 |
| | $ 17,577 | $ 12,444 | $ 30,021 | $ 1,500 | $ 16,408 | $ 17,908 |

The cost of the certificates of deposit, Treasury notes and the investments in mutual funds approximates fair value. During the nine months ended September 30, 2007, the Company recorded $4,207 of unrealized gains, net of tax, in other comprehensive income associated with changes in the fair value of all of its investments. During the first nine months of 2007, the Company sold investments in mutual funds totaling $6,270, and recognized a pre-tax gain of $98, or $60 after-tax, that was previously recorded in other comprehensive income. The pre-tax gain is included in other income. The Company also received $4,780 from maturities of certificates of deposits and treasury notes, during the first nine months of 2007.

On February 7, 2007, the Company entered into a National Provider Agreement with NxStage, Inc. The agreement provides the Company with the ability to purchase NxStage home-based hemodialysis products at a potential discount depending upon the achievement of certain volume targets. The agreement has an initial term of

Table of Contents

**DAVITA INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)**

**(unaudited)**

**(dollars in thousands, except per share data)**

three years, terminating on December 31, 2009, and may be extended in six month increments up to two additional years if certain volume targets are met. As a part of the agreement, the Company purchased outright all of its NxStage System One equipment currently in use for $5,100, and will purchase a majority of its future home-based hemodialysis equipment and supplies from NxStage. In connection with the provider agreement, the Company purchased 2 million shares of NxStage common stock in a private placement offering for $20,000, representing an ownership position of approximately 7% of NxStage. The Company subsequently sold these shares in the second and third quarters of 2007 for net proceeds of $25,868 and recognized a pre-tax gain of $5,938, or $3,628 after tax, that was previously recorded in other comprehensive income. The pre-tax gain is included in other income.

**8. Income taxes**

On January 1, 2007, the Company adopted the provisions of Financial Accounting Standards Board Interpretation 48 (FIN 48) *Accounting for Income Tax Uncertainties*, which clarifies the accounting for uncertainty in income taxes recognized in the financial statements in accordance with SFAS Statement No. 109 *Accounting for Income Taxes*. The Interpretation prescribes a recognition threshold of more-likely-than-not and a measurement attribute on all tax positions taken or expected to be taken in a tax return in order to be recognized in the financial statements. In making this assessment, a company must determine whether it is more-likely-than-not that a tax position will be sustained upon examination, including resolution of any related appeals or litigation processes, based solely on the technical merits of the position and must assume that the tax position will be examined by appropriate taxing authority that would have full knowledge of all relevant information. Once the recognition threshold is met, the tax position is then measured to determine the actual amount of benefit to recognize in the financial statements. In addition, the recognition threshold of more-likely-than-not must continue to be met in each reporting period to support continued recognition of the tax benefit. Tax positions that previously failed to meet the more-likely-than-not recognition threshold should be recognized in the first financial reporting period in which that threshold is met. Previously recognized tax positions that no longer meet the more-likely-than-not recognition threshold should be derecognized in the financial reporting period in which that threshold is no longer met.

As a result of implementing FIN 48, the Company recognized an increase of $22,900 to the beginning balance of its current and long-term deferred tax assets, offset by increases in its current and long-term income taxes payable of $19,000. This recognized net tax benefit of $3,900 was recorded as an increase to the beginning balance of retained earnings on January 1, 2007. The Company also recorded a decrease of $4,950 to the beginning balance of current and long-term deferred tax liabilities, and a corresponding decrease to goodwill as a result of recognizing tax benefits associated with our acquisition of DVA Renal Healthcare.

As of January 1, 2007, the Company s total liability for unrecognized tax benefits relating to tax positions that do not meet the more-likely-than-not threshold was $27,900, of which it is reasonably possible that a decrease of $21,000 will be recognized within the next 12 months, primarily related to the filing of a tax accounting method change request for recently acquired entities. This change will have no impact on the Company s effective tax rate. As of January 1, 2007, unrecognized tax benefits totaling $6,500 would affect the Company s effective tax rate if recognized.

The Company recognizes accrued interest and penalties related to unrecognized tax benefits in its income tax expense. As of January 1, 2007, the Company has accrued approximately $1,300 in interest and penalties related to unrecognized tax benefits.

As of September 30, 2007, the balances of the unrecognized tax benefits and accrued interest and penalties have not changed significantly from the amounts as reported above.

Table of Contents

**DAVITA INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)**

**(unaudited)**

**(dollars in thousands, except per share data)**

The Company and its subsidiaries file U.S. federal income tax returns and various state returns. The Company is no longer subject to U.S. federal state and local examinations by tax authorities for years before 2001. The Internal Revenue Service (IRS) completed an examination of the Company s U.S. federal income tax returns for 2003 through 2004 during the second quarter of 2007. The examination did not result in any material impact to the Company s consolidated financial statements.

**9. Alliance and Product Supply Agreement**

The Company entered into an Alliance and Product Supply Agreement (Product Supply Agreement) with Gambro AB and Gambro Renal Products, Inc. on October 5, 2005, in conjunction with its acquisition of DVA Renal Healthcare. The agreement committed the Company to purchase a significant majority of its hemodialysis products, supplies and equipment at fixed prices through 2015. The agreement was amended on August 25, 2006 (the Amended Product Supply Agreement) to reduce the Company s purchase obligations for certain hemodialysis product supplies and equipment and to allow for the termination of purchase obligations for certain equipment then affected by an import ban issued by the U.S. Food and Drug Administration (FDA) if the import ban was not lifted by June 30, 2007.

As a result of the reductions in the amount of purchase obligations required under the Amended Supply Agreement, the Company recorded a net valuation gain of $37,968 during the third quarter of 2006. This valuation gain represents the difference in the fair value between the Product Supply Agreement and the Amended Supply Agreement, as of the effective date of the amendment.

On July 2, 2007, the Company notified Gambro Renal Products, Inc. that it was electing to be permanently relieved of its obligation under the Amended Product Supply Agreement to purchase dialysis machines (the Affected Products) because the Affected Products remained subject to the FDA import ban after June 30, 2007. All other purchase obligations under the Amended Product Supply Agreement, which continues to require the Company to purchase a significant majority of its hemodialysis non-equipment product supplies, such as dialyzers, at fixed prices, remain in place.

As a result of the termination of the Company s purchase obligations for the Affected Products, the Company recorded a net valuation gain of $55,275 in the second quarter of 2007. This valuation gain represents the difference in the amortized original fair value of the Amended Product Supply Agreement and that of the Amended Product Supply Agreement as adjusted for the termination of the Affected Products as of June 30, 2007.

**10. Acquisitions**

During the first nine months of 2007, the Company acquired dialysis businesses consisting of 10 centers, for a total of $13,031 in cash and deferred purchase price obligations. The assets and liabilities for these acquisitions were recorded at their estimated fair market values at the dates of the acquisitions and are included in the Company s financial statements and operating results from the effective date of the acquisitions. In addition, effective September 1, 2007, the Company purchased 85% of HomeChoice Partners (HCP) pursuant to a stock purchase agreement for approximately $70,207 in cash and deferred purchase price obligations, subject to further contingent price adjustments. HCP provides infusion therapy services to patients with acute or chronic conditions that can be treated at home or at an ambulatory infusion site. The Company has made an initial preliminary estimate of the fair values of assets acquired and liabilities assumed as of the date of the acquisition. These amounts and HCP s results from the effective date of the acquisition are included in these financial statements. The Company is currently in the process of obtaining additional information necessary to determine the final acquisition-date fair values. As such the preliminary purchase price allocations are subject to change.

15

Table of Contents

**DAVITA INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)**

**(unaudited)**

**(dollars in thousands, except per share data)**

The total purchase price allocations for all acquisitions were as follows:

| | Nine months ended September 30, 2007 |
|---|---|
| Tangible assets, including cash of $1,378 | $ 18,852 |
| Amortizable intangible assets | 7,876 |
| Goodwill | 65,843 |
| Liabilities assumed | (1,335) |
| Minority interested assumed | (7,998) |
| Total purchase price | $ 83,238 |

The amortizable intangible assets consisting primarily of non-competition agreements are amortized using the straight-line method over a weighted-average amortization period of ten years. The goodwill associated with these acquisitions is expected to be deductible for tax purposes over a period of 15 years.

**11. 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 in thousands, except per share data)**

**Condensed Consolidating Statements of Income**

| For the three months ended September 30, 2007 | DaVita Inc. | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Consolidating Adjustments | Consolidated Total |
|---|---|---|---|---|---|
| Net operating revenues | $ 89,613 | $ 1,135,618 | $ 188,032 | $ (94,882) | $ 1,318,381 |
| Operating expenses | 52,388 | 978,192 | 158,478 | (94,882) | 1,094,176 |
| Minority interests | | | | 11,793 | 11,793 |
| Operating income | 37,225 | 157,426 | 29,554 | (11,793) | 212,412 |
| Debt expense | (63,535) | (61,609) | (1,566) | 63,995 | (62,715) |
| Other income | 70,112 | | 161 | (63,995) | 6,278 |
| Income tax expense | 17,313 | 44,203 | 4 | | 61,520 |
| Equity earnings in subsidiaries | 67,966 | 15,879 | | (83,845) | |
| Net income | $ 94,455 | $ 67,493 | $ 28,145 | $ (95,638) | $ 94,455 |

| For the three months ended September 30, 2006 | | | | | |
|---|---|---|---|---|---|
| Net operating revenues | $ 88,592 | $ 1,073,137 | $ 168,763 | $ (93,451) | $ 1,237,041 |
| Operating expenses | 45,868 | 926,000 | 130,574 | (93,451) | 1,008,991 |
| Minority interests | | | | 10,956 | 10,956 |
| Operating income | 42,724 | 147,137 | 38,189 | (10,956) | 217,094 |
| Debt expense | (69,103) | (71,190) | (27) | 72,416 | (67,904) |
| Other income | 75,687 | | | (72,416) | 3,271 |
| Income tax expense | 19,363 | 40,007 | | | 59,370 |
| Discontinued operations, net of tax | | 1,765 | | | 1,765 |
| Equity earnings in subsidiaries | 64,911 | 27,206 | | (92,117) | |
| Net income | $ 94,856 | $ 64,911 | $ 38,162 | $ (103,073) | $ 94,856 |

| For the nine months ended September 30, 2007 | DaVita Inc. | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Consolidating Adjustments | Consolidated Total |
|---|---|---|---|---|---|
| Net operating revenues | $ 273,418 | $ 3,377,045 | $ 549,881 | $ (291,062) | $ 3,909,282 |
| Operating expenses | 154,224 | 2,895,570 | 448,847 | (291,062) | 3,207,579 |
| Minority interests | | | | 34,757 | 34,757 |
| Operating income | 119,194 | 481,475 | 101,034 | (34,757) | 666,946 |
| Debt expense | (196,570) | (193,853) | (2,039) | 197,966 | (194,496) |
| Other income | 214,268 | | 829 | (197,966) | 17,131 |

| | | | | | |
|---|---|---|---|---|---|
| Income tax expense | 53,525 | 139,420 | 575 | | 193,520 |
| Equity earnings in subsidiaries | 212,694 | 64,019 | | (276,713) | |
| Net income | $ 296,061 | $ 212,221 | $ 99,249 | $ (311,470) | $ 296,061 |
| **For the nine months ended September 30, 2006** | | | | | |
| Net operating revenues | $ 252,963 | $ 3,153,982 | $ 469,817 | $ (268,717) | $ 3,608,045 |
| Operating expenses | 138,341 | 2,784,676 | 375,967 | (268,717) | 3,030,267 |
| Minority interests | | | | 26,857 | 26,857 |
| Operating income | 114,622 | 369,306 | 93,850 | (26,857) | 550,921 |
| Debt expense | (209,388) | (213,513) | (927) | 217,029 | (206,799) |
| Other income | 227,147 | | | (217,029) | 10,118 |
| Income tax expense | 51,761 | 87,233 | 46 | | 139,040 |
| Discontinued operations, net of tax | | 362 | | | 362 |
| Equity earnings in subsidiaries | 134,942 | 66,020 | | (200,962) | |
| Net income | $ 215,562 | $ 134,942 | $ 92,877 | $ (227,819) | $ 215,562 |

Table of Contents

**DAVITA INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)**

**(unaudited)**

**(dollars in thousands, except per share data)**

**Condensed Consolidating Balance Sheets**

| As of September 30, 2007 | DaVita Inc. | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Consolidating Adjustments | Consolidated Total |
|---|---|---|---|---|---|
| Cash and cash equivalents | $ 389,109 | $ | $ 2,191 | | $ 391,300 |
| Accounts receivable, net | | 832,783 | 143,502 | | 976,285 |
| Other current assets | 10,554 | 527,246 | 15,135 | | 552,935 |
| Total current assets | 399,663 | 1,360,029 | 160,828 | | 1,920,520 |
| Property and equipment, net | 20,975 | 723,174 | 150,015 | | 894,164 |
| Amortizable intangibles, net | 58,573 | 125,843 | 1,345 | | 185,761 |
| Investments in subsidiaries | 4,252,749 | 428,834 | | $ (4,681,583) | |
| Receivables from subsidiaries | 655,106 | | 76,337 | (731,443) | |
| Other long-term assets and investments | 17,402 | 1,319 | 33,447 | | 52,168 |
| Goodwill | 48,113 | 3,438,541 | 242,168 | | 3,728,822 |
| Total assets | $ 5,452,581 | $ 6,077,740 | $ 664,140 | $ (5,413,026) | $ 6,781,435 |
| Current liabilities | $ 126,517 | $ 860,737 | $ 54,326 | | $ 1,041,580 |
| Payables to parent and subsidiaries | | 731,443 | | $ (731,443) | |
| Long-term debt and other long-term liabilities | 3,698,798 | 251,512 | 14,261 | | 3,964,571 |
| Minority interests | | | | 148,018 | 148,018 |
| Shareholders equity | 1,627,266 | 4,234,048 | 595,553 | (4,829,601) | 1,627,266 |
| Total liabilities and shareholders equity | $ 5,452,581 | $ 6,077,740 | $ 664,140 | $ (5,413,026) | $ 6,781,435 |
| **As of December 31, 2006** | | | | | |
| Cash and cash equivalents | $ 299,430 | $ | $ 10,772 | | $ 310,202 |
| Accounts receivable, net | | 809,028 | 123,357 | | 932,385 |
| Other current assets | 6,660 | 448,421 | 11,828 | | 466,909 |
| Total current assets | 306,090 | 1,257,449 | 145,957 | | 1,709,496 |
| Property and equipment, net | 30,130 | 689,039 | 130,797 | | 849,966 |
| Amortizable intangibles, net | 59,371 | 142,394 | 1,956 | | 203,721 |
| Investments in subsidiaries | 3,904,797 | 388,919 | | $ (4,293,716) | |
| Receivables from subsidiaries | 812,201 | | 30,928 | (843,129) | |
| Other long-term assets and investments | 25,190 | 14,650 | 20,940 | | 60,780 |
| Goodwill | | 3,444,224 | 223,629 | | 3,667,853 |
| Total assets | $ 5,137,779 | $ 5,936,675 | $ 554,207 | $ (5,136,845) | $ 6,491,816 |

| | | | | | |
|---|---|---|---|---|---|
| Current liabilities | $ 166,440 | $ 915,554 | $ 30,178 | | $ 1,112,172 |
| Payables to parent and subsidiaries | | 843,129 | | $ (843,129) | |
| Long-term debt and other long-term liabilities | 3,725,415 | 273,195 | 12,751 | | 4,011,361 |
| Minority interests | | | | 122,359 | 122,359 |
| Shareholders equity | 1,245,924 | 3,904,797 | 511,278 | (4,416,075) | 1,245,924 |
| Total liabilities and shareholders equity | $ 5,137,779 | $ 5,936,675 | $ 554,207 | $ (5,136,845) | $ 6,491,816 |

Table of Contents

**DAVITA INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)**

**(unaudited)**

**(dollars in thousands, except per share data)**

**Condensed Consolidating Statements of Cash Flows**

| For the nine months ended September 30, 2007 | DaVita Inc. | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Consolidating Adjustments | Consolidated Total |
|---|---|---|---|---|---|
| Cash flows from operating activities | | | | | |
| Net income | $ 296,061 | $ 212,221 | $ 99,249 | $ (311,470) | $ 296,061 |
| Changes in operating and intercompany assets and liabilities and non cash items included in net income | (158,447) | (14,873) | (124,501) | 311,470 | 13,649 |
| Net cash provided by (used in) operating activities | 137,614 | 197,348 | (25,252) | | 309,710 |
| Cash flows from investing activities | | | | | |
| Additions of property and equipment, net | (3,561) | (134,238) | (38,279) | | (176,078) |
| Acquisitions and purchases of other ownership interests | (68,534) | (13,248) | | | (81,782) |
| Proceeds from divestitures and asset sales | | 4,643 | | | 4,643 |
| Other items | 10,775 | (54,345) | 53,934 | | 10,364 |
| Net cash (used in) provided by investing activities | (61,320) | (197,188) | 15,655 | | (242,853) |
| Cash flows from financing activities | | | | | |
| Long-term debt | (902) | (160) | 1,016 | | (46) |
| Other items | 14,287 | | | | 14,287 |
| Net cash provided by (used in) financing activities | 13,385 | (160) | 1,016 | | 14,241 |
| Net increase (decrease) in cash and cash equivalents | 89,679 | | (8,581) | | 81,098 |
| Cash and cash equivalents at beginning of period | 299,430 | | 10,772 | | 310,202 |
| Cash and cash equivalents at end of period | $ 389,109 | $ | $ 2,191 | $ | $ 391,300 |
| **For the nine months ended September 30, 2006** | | | | | |
| Cash flows from operating activities | | | | | |
| Net income | $ 215,562 | $ 134,942 | $ 92,877 | $ (227,819) | $ 215,562 |
| Changes in operating and intercompany assets and liabilities and non cash items included in net income | (113,039) | 124,309 | (125,188) | 227,819 | 113,901 |
| Net cash provided by (used in) operating activities | 102,523 | 259,251 | (32,311) | | 329,463 |
| Cash flows from investing activities | | | | | |
| Additions of property and equipment, net | (13,024) | (142,600) | (25,801) | | (181,425) |
| Acquisitions and purchases of other ownership interests | | (75,580) | | | (75,580) |
| Proceeds from divestitures and asset sales | 12,742 | 8,606 | | | 21,348 |

| | | | | |
|---|---|---|---|---|
| Other items | | (48,657) | 57,513 | 8,856 |
| Net cash (used in) provided by investing activities | (282) | (258,231) | 31,712 | (226,801) |
| Cash flows from financing activities | | | | |
| Long-term debt | (332,541) | (1,020) | 737 | (332,824) |
| Other items | 58,629 | | | 58,629 |
| Net cash (used in) provided by financing activities | (273,912) | (1,020) | 737 | (274,195) |
| Net (decrease) increase in cash and cash equivalents | (171,671) | | 138 | (171,533) |
| Cash and cash equivalents at beginning of period | 419,546 | | 12,265 | 431,811 |
| Cash and cash equivalents at end of period | $ 247,875 | $ | $ 12,403 | $ $ 260,278 |

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, and 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 concentration of profits generated from commercial payor plans, possible reductions in private and government payment rates, changes in the structure of and payment rates under the Medicare ERSD program which may further reduce Medicare payment rates, 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 and DVA Renal Healthcare s compliance with its corporate integrity agreement, the resolution of ongoing investigations by various federal and state governmental agencies, the successful integration of DVA Renal Healthcare s billing and collection operations 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.*

**Results of operations**

Our operating results for the third quarter of 2007 compared with the prior sequential quarter and the same quarter of last year, and the nine months ended September 30, 2007 compared with the nine months ended September 30, 2006, were as follows:

| | Quarter ended | | | | | | Nine months ended | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | September 30, 2007 | June 30, 2007 | September 30, 2006 | | | | September 30, 2007 | | September 30, 2006 | |
| | (dollar amounts rounded to nearest million, except per treatment data) | | | | | | | | | |
| Total net operating revenue | $ 1,318 | 100% | $ 1,313 | 100% | $ 1,237 | 100% | $ 3,909 | 100% | $ 3,608 | 100% |
| Operating expenses and charges: | | | | | | | | | | |
| Patient care costs | 890 | 68% | 891 | 68% | 857 | 69% | 2,663 | 68% | 2,518 | 69% |
| General and administrative | 121 | 9% | 122 | 9% | 113 | 9% | 356 | 9% | 329 | 9% |
| Depreciation and amortization | 49 | 4% | 47 | 4% | 44 | 4% | 142 | 4% | 128 | 4% |
| Provision for uncollectible accounts | 34 | 3% | 34 | 3% | 32 | 3% | 102 | 3% | 93 | 3% |
| Minority interest and equity income, net | 12 | 1% | 12 | 1% | 11 | 1% | 35 | 1% | 27 | 1% |
| Valuation gain on Product Supply Agreement | | 0% | (55) | (4%) | (38) | (3%) | (55) | (1%) | (38) | (1%) |
| Total operating expenses and charges | 1,106 | 84% | 1,052 | 80% | 1,020 | 83% | 3,242 | 83% | 3,057 | 85% |
| Operating income | $ 212 | | $ 261 | | $ 217 | | $ 667 | | $ 551 | |
| Dialysis treatments | 3,842,763 | | 3,792,419 | | 3,668,999 | | 11,335,453 | | 10,772,598 | |
| Average dialysis treatments per treatment day | 49,266 | | 48,621 | | 46,443 | | 48,567 | | 46,037 | |
| Average dialysis revenue per dialysis treatment (including the lab) | $ 334 | | $ 338 | | $ 331 | | $ 336 | | $ 329 | |

Table of Contents

**Net Operating Revenues**

*Total net operating revenue.* Net operating revenues for the third quarter of 2007 were $1,318 million, an increase of approximately $6 million or approximately 0.4% compared with the second quarter of 2007. The increase in net operating revenues was primarily due to an increase in the number of dialysis treatments, the addition of the operating revenue derived from the acquisition of Home Choice Partners, increases in revenues at the Company s other strategic initiatives, partially offset by a decrease in revenue per treatment. The increase in the number of dialysis treatments was primarily due to non-acquired treatment growth from existing and new centers. Revenue per treatment of $334 in the third quarter of 2007 decreased by approximately $4 as compared to the second quarter of 2007. The decrease in revenue per treatment was primarily due to lower government reimbursement for pharmaceuticals, decreases in certain commercial payment rates and decreases in intensity of physician prescribed pharmaceuticals.

The increase in net operating revenues of approximately 6.6% in the third quarter of 2007, and approximately 8.3% for the nine months ended September 30, 2007 as compared to the same periods in 2006, was principally due to increases in the number of treatments of approximately 5.0% for both periods, increases in the average dialysis revenue per treatment of approximately 1.0% and 2.0% respectively, and increases in other revenues of approximately 1.0% for both periods, due to additional lab, management fees and revenue from ancillary services and strategic initiatives. The increase in the number of treatments was primarily attributable to non-acquired annual treatment growth from existing and new centers, and from acquisitions. The increase in the average dialysis revenue per treatment was due primarily to increases in our standard commercial payment rates, increases in the Medicare composite rate, partially offset by decreases in government reimbursement for pharmaceuticals, and decreases in the intensity of physician prescribed pharmaceuticals.

**Operating Expenses and Charges**

*Patient care costs.* Patient care costs were approximately 67.5% of total operating revenues for the third quarter of 2007, as compared to 67.9% and 69.3% for the second quarter of 2007 and the third quarter of 2006, respectively. On a per treatment basis, patient care costs decreased approximately $3 as compared to the second quarter of 2007, and decreased approximately $2 as compared with the third quarter of 2006. The decrease in the per treatment costs in the third quarter of 2007 as compared to the second quarter of 2007 was primarily attributable to gains from insurance settlements from Hurricane Katrina and a fire at one of our centers, lower professional and general liability insurance costs, a decline in employee benefit costs and worker s compensation, partially offset by higher labor costs. The decrease in the per treatment costs in the third quarter of 2007 as compared to the third quarter of 2006 was primarily attributable to gains from insurance settlements as described above, lower professional and general liability insurance costs, lower benefits costs, partially offset by higher labor and drug costs and higher operating costs of our dialysis centers. For the nine months ended September 30, 2007, patient care costs were 68.1% of total operating revenues, as compared to 69.8% for the same period of 2006. On a per treatment basis, patient care costs increased approximately $1 in the first nine months of 2007, as compared to the first nine months of 2006, primarily due to higher labor costs, an increase in the operating costs of our dialysis centers, partially offset by lower intensity levels of physician prescribed pharmaceuticals, lower benefit costs and lower professional and general liability insurance costs.

*General and administrative expenses.* General and administrative expenses were 9.1% of total operating revenues for the third quarter of 2007, as compared to 9.3% and 9.2% for the second quarter of 2007 and third quarter of 2006, respectively. In absolute dollars, general and administrative expenses for the third quarter of 2007 decreased by approximately $2 million from the second quarter of 2007. The decrease in the third quarter of 2007 compared to the second quarter of 2007, was principally due to lower integration costs, partially offset by higher labor costs, professional fees for legal and compliance initiatives, travel costs and the timing of certain expenditures. For the nine months ended September 30, 2007 and 2006, general and administrative expenses were 9.1% of total operating revenues. In absolute dollars, general and administrative expenses for the third quarter of 2007, and for the nine months ended September 30, 2007 increased by approximately $7 million, and $27 million, respectively, from the same periods in 2006. The increases in the third quarter of 2007 and for the

Table of Contents

nine months ended September 30, 2007, was primarily due to higher labor costs, stock-based compensation costs and professional fees for legal and compliance initiatives, partially offset by lower integration costs.

*Depreciation and amortization*. The increase in depreciation and amortization in the third quarter of 2007 and for the nine months ended September 30, 2007 as compared to the same periods in 2006 was primarily due to growth through new center developments and expansions.

*Provision for uncollectible accounts receivable.* The provision for uncollectible accounts receivable was 2.6% for all quarters presented. The current provision level of 2.6% may increase if we encounter unanticipated problems with the integration of our billing and collecting systems or economic conditions substantially change.

*Debt expense.* Debt expense of $62.7 million in the third quarter of 2007 decreased by approximately $0.2 million from the second quarter of 2007. Excluding the write-offs of deferred financing costs and other costs totaling approximately $0.2 million that are included in debt expense in the second quarter of 2007, debt expense would have remained unchanged. Lower average outstanding principal balances in the third quarter of 2007, were offset by higher interest expense due to an increase in the number of outstanding days in the quarter.

For the third quarter of 2007 and for the nine months ended September 30, 2007, debt expense decreased by approximately $5.2 million and $12 million, respectively, as compared to the same periods of 2006. The decrease was attributable to principal prepayments made during the year resulting in lower average outstanding principal balances, lower interest rate margins on our term loans, and decreases in the LIBOR-based variable interest rates on the unhedged portion of our debt.

Debt expense for the nine months ended September 30, 2007 included write-offs of deferred financing costs of approximately $4.4 million, associated with the principal prepayments on our term loans. Debt expense for the first nine months of 2007 also included approximately $0.2 million of other costs that were expensed in connection with the amendment of the term loan B.

*Minority interests and equity income, net*. Minority interests and equity income, net was $11.8 million for the third quarter of 2007, a net decrease of approximately $0.6 million as compared to the second quarter of 2007. The decrease was primarily due to revenue adjustments at several of our joint ventures. For the nine months ended September 30, 2007 minority interests and equity income, net was $34.8 million, as increase of approximately $7.9 million as compared to the same period of 2006. The increase reflects an ongoing trend toward a higher percentage of our new and existing centers having minority partners, as well as growth in the profitability of joint ventures.

**Alliance and Product Supply Agreement**

We entered into an Alliance and Product Supply Agreement (Product Supply Agreement) with Gambro AB and Gambro Renal Products, Inc. on October 5, 2005, in conjunction with our acquisition of DVA Renal Healthcare. The agreement committed us to purchase a significant majority of our hemodialysis products, supplies and equipment at fixed prices through 2015. The agreement was amended on August 25, 2006 (the Amended Product Supply Agreement) to reduce our purchase obligations for certain hemodialysis product supplies and equipment and to allow for the termination of purchase obligations for certain equipment then affected by an import ban issued by the U.S. Food and Drug Administration (FDA) if the import ban was not lifted by June 30, 2007.

As a result of the reductions in the amount of purchase obligations required under the Amended Supply Agreement, the Company recorded a net valuation gain of $38 million during the third quarter of 2006. This valuation gain represents the difference in the fair value between the Product Supply Agreement and the Amended Supply Agreement, as of the effective date of the amendment.

Table of Contents

On July 2, 2007, we notified Gambro Renal Products, Inc. that we were electing to be permanently relieved of our obligation under the Amended Product Supply Agreement to purchase dialysis machines (the Affected Products) because the Affected Products remained subject to the FDA import ban after June 30, 2007. All other purchase obligations under the Amended Product Supply Agreement, which continues to require us to purchase a significant majority of our hemodialysis non-equipment product supplies, such as dialyzers, at fixed prices, remain in place.

As a result of the termination of our purchase obligations for the Affected Products, we recorded a net valuation gain of $55 million in the second quarter of 2007. This valuation gain represents the difference in the amortized original fair value of the Amended Product Supply Agreement and that of the Amended Product Supply Agreement as adjusted for the termination of the Affected Products as of June 30, 2007.

**Accounts receivable**

Our accounts receivable balances at September 30, 2007 and June 30, 2007 were $976 million and $960 million respectively, which represented approximately 70 and 69 days of revenue, respectively, net of bad debt provision. The increase in our DSO was primarily due to a delay in the timing of Medicare and Medicaid cash collections. Our DSO calculation is based on the current quarter s average revenue per day. There were no significant changes during the third quarter of 2007 in the amount of unreserved accounts receivable or the amounts pending approval from third-party payors.

**Outlook**

*Outlook for 2007 and 2008.* Operating income for the fourth quarter of 2007 is expected to be in the range of $190-200 million. We are narrowing our operating income for 2007 to a range of $800-810 million. Our operating income guidance for 2008, excluding the impact of any potential Medicare legislation, is still projected to be in the range of $790-850 million, however, we believe at this time that operating income is more likely to be in the lower end of the range for 2008. We are entering into a period of unusual earnings uncertainty. Therefore the guidance range for 2008 does not capture as high a percentage of the potential outcomes as usual. These projections and the underlying assumptions involve significant risks and uncertainties and actual results may vary significantly from these current projections. These risks, among others, include those relating to the concentration of profits generated from commercial payor plans, possible reductions in private and government payment rates, changes in the structure of and payment rates under the Medicare ESRD program which may further reduce Medicare payment rates, 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 and DVA Renal Healthcare s compliance with its corporate integrity agreement, the resolution of ongoing investigations by various federal and state governmental agencies, and the successful integration of DVA Renal Healthcare s billing and collection operations. You should read Risk Factors in this Quarterly Report on Form 10-Q and the forward looking statements and associated risks as discussed in Item 2 on page 20 for more information about these and other potential risks. We undertake no obligation to update or revise these projections, whether as a result of changes in underlying factors, new information, future events or otherwise.

**Liquidity and Capital Resources**

*Liquidity and capital resources.* Cash flow from operations during the third quarter of 2007 was $96 million, compared to $97 million during the third quarter of 2006. Non-operating cash outflows for the third quarter of 2007 included capital asset expenditures of $71 million, including $49 million for new center

Table of Contents

developments and relocations, and an additional $76 million for acquisitions. We also repurchased 0.1 million shares of our common stock for approximately $6.4 million. During the third quarter of 2007, we sold investments in mutual funds and NxStage, Inc. common stock totaling $11.5 million. Non-operating cash outflows for the third quarter of 2006 included capital asset expenditures of approximately $66 million, including $35 million for new center developments, and an additional $6 million for acquisitions. During the third quarter of 2007, we acquired 6 centers, opened 18 new dialysis centers, closed one center, and provided administrative services to one additional center. During the third quarter of 2006, we acquired 5 dialysis centers, opened 13 new dialysis centers, and closed 4 centers.

Cash flow from operations during the first nine months of 2007 was $310 million, compared to $329 million during the first nine months of 2006. The first nine months of 2006 included an income tax payment of approximately $85 million associated with the divestitures of certain centers in conjunction with the DVA Renal Healthcare acquisition. Non-operating cash outflows for the first nine months of 2007 included capital asset expenditures of $176 million, including $102 million for new center developments and relocations, and an additional $82 million for acquisitions. We also repurchased 0.1 million shares of our common stock for approximately $6.4 million. During the first nine months of 2007, we sold investments in mutual funds and NxStage, Inc. common stock totaling $36.9 million. Non-operating cash outflows for the first nine months of 2006 included capital asset expenditures of approximately $181 million, including $99 million for new center developments and relocations, and an additional $76 million for acquisitions. During the first nine months of 2007, we acquired 10 centers, opened 39 new dialysis centers, closed two centers, divested one center and provided administrative services to one third-party owned center. During the first nine months of 2006, we acquired 19 dialysis centers, including one center where we previously provided administrative services, opened 29 new dialysis centers, divested, sold or closed 13 centers, and provided administrative services to two new centers.

We expect to spend $110 to $120 million in 2007 for capital asset expenditures related to routine maintenance items and information technology equipment and approximately $200 million to $220 million for new center development, relocations and acquisitions, excluding the acquisition costs of Home Choice Partners. In 2007, we anticipate adding a similar number of centers as 2006, which was 55 centers. We currently expect to generate approximately $480 million to $530 million of operating cash flow in 2007.

On February 7, 2007, we entered into a National Provider Agreement with NxStage, Inc. The agreement provides us the ability to purchase NxStage home-based hemodialysis products at a potential discount depending upon the achievement of certain volume targets. The agreement has an initial term of three years, terminating on December 31, 2009, and may be extended in six month increments up to two additional years if certain volume targets are met. As a part of the agreement, we purchased outright all of our NxStage System One equipment currently in use for $5.1 million, and will purchase a majority of our future home-based hemodialysis equipment and supplies from NxStage. In connection with the provider agreement, we purchased 2 million shares of NxStage common stock in a private placement offering for $20 million, representing an ownership position of approximately 7% of NxStage. We subsequently sold our NxStage, Inc. shares, in the second and third quarters of 2007 for approximately $25.9 million and recognized a pre-tax gain of $5.9 million or $3.6 million after tax.

On February 23, 2007, we issued $400 million of 6 5/8% senior notes due 2013 in a private offering, realizing approximately $405 million in proceeds, which included a $5 million premium, and incurred $2.7 million in related deferred financing costs. These senior notes are part of the same series of debt securities as the $500 million aggregate principal amount of 6 5/8% senior notes that were issued in March 2005. The effective interest rate for the $400 million of 6 5/8% senior notes is 6.45%. The senior notes are guaranteed by substantially all of our direct and indirect wholly-owned subsidiaries and require semi-annual interest payments which began March 15, 2007. The senior notes may be redeemed by us in whole or part at any time on or after March 15, 2009, at certain specified prices. We used $400 million of these proceeds to pay down our term loan B and also wrote-off approximately $4.2 million of term loan B deferred financing costs, which is included in debt expense.

Table of Contents

Our senior and senior subordinated notes, as of September 30, 2007, consisted of $900 million of 6 5/8% senior notes due 2013 and $850 million of 7 1/4% senior subordinated notes due 2015.

On February 23, 2007, we amended and restated our existing Senior Secured Credit Facilities to, among other things, reduce the interest rate margin on our term loan B by 0.50%, and to amend certain financial covenants. The amended term loan B bears interest at LIBOR plus 1.50%, for an overall effective rate of 5.87%, including the impact of our swap agreements as of September 30, 2007. If we refinance the term loan B prior to February 23, 2008, we will be subject to a prepayment penalty of 1.0%, otherwise the payment terms remain the same. Other terms that were changed included the amount by which we can elect to increase the revolving and term loan commitments from $500 million to $750 million and certain limitations on purchases, redemptions or acquisitions of capital stock, the payment of dividends and distribution in cash, and growth capital expenditures, including acquisition expenditures, will not apply during the periods in which our leverage ratio is less than 3.5:1. Our leverage ratio as of September 30, 2007 was less than 3.5:1. Depending on market conditions, we may consider additional acquisitions of our capital stock in the coming months. We incurred approximately $1.8 million of deferred financing costs and expensed approximately $0.2 million of other costs in connection with this transaction, which are included in debt expense.

On February 27, 2007, our interest rate margin on our term loan A was reduced by 0.25% as a result of achieving certain financial ratios as defined in the Senior Secured Credit Facilities. The term loan A currently bears interest at LIBOR plus a margin of 1.50%, for an overall effective rate of 6.63% at September 30, 2007. The margin is subject to adjustment depending upon changes in certain of our financial ratios and can range from 1.50% to 2.25% for the term loan A as well as for the revolving credit facility.

On April 25, 2007, we made a principal prepayment of $50 million on our term loan A and wrote-off $0.2 million of term loan A deferred financing costs, which is included in debt expense. After giving effect to this prepayment, our scheduled mandatory principal payments on the term loan A are due as follows: $14.9 million in 2008, $61.3 million in 2009, $87.5 million in 2010 and $65.6 million in 2011.

As of September 30, 2007, we maintained a total of nine interest rate swap agreements, with amortizing notional amounts totaling $1,096 million. These agreements had the economic effect of modifying the LIBOR-based variable interest rate on our debt to fixed rates ranging from 3.08% to 4.27%, resulting in a weighted average effective interest rate of 5.37% on the hedged portion of our Senior Secured Credit Facilities, including the term loan B margin of 1.50%. The swap agreements expire in 2008 through 2010 and require quarterly interest payments. During the first nine months of 2007, we accrued net benefits of $11.5 million from these swaps which is included in debt expense. As of September 30, 2007, the total fair value of these swaps was an asset of $13.0 million. We recorded $8.5 million, net of tax, as a reduction to comprehensive income for the change in fair value of the effective portions of these swaps, net of amounts reclassified into income during the first nine months of 2007. We also recorded $0.5 million, net of tax in the first nine months of 2007, as an increase to comprehensive income related to unrealized gains on investments, net of amounts reclassified into income.

On October 16, 2007, we entered into a forward interest rate swap that will have the economic effect of modifying the LIBOR-based interest rate to a fixed rate of 4.70% on $100 million of our term loan B outstanding debt, effective September 30, 2008. The total notional amount of $100 million requires quarterly interest payments beginning in December 2008. The interest rate swap expires in 2010.

As of September 30, 2007, the interest rates were economically fixed on approximately 56% of our variable rate debt and approximately 77% of our total debt.

As a result of the swap agreements, the overall effective weighted average interest rate on the Senior Secured Credit Facilities was 6.0%, based upon the current margins in effect of 1.50%, as of September 30, 2007.

Table of Contents

Our overall average effective interest rate excluding the write-off and amortization of deferred financing costs during the third quarter of 2007 was 6.48% and as of September 30, 2007 was 6.43%.

We have undrawn revolving credit facilities totaling $250 million of which approximately $50 million was committed for outstanding letters of credit. We also have undrawn revolving lines of credit totaling $16.5 million associated with several of our joint ventures and non-wholly-owned subsidiaries.

We believe that we will have sufficient liquidity and operating cash flows to fund our scheduled debt service and other obligations for the foreseeable future.

*Stock-based compensation and other equity matters*

Under SFAS No. 123(R), 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 first nine months of 2007 includes compensation cost for stock-based awards granted prior to, but not fully vested as of, December 31, 2005 and subsequent stock-based awards granted through September 30, 2007. For the first nine months of 2006, stock-based compensation includes compensation cost for stock-based awards granted prior to, but not fully vested as of December 31, 2005 and stock-based awards granted in the first nine months of 2006. Prior to 2006, we recognized the effect of stock unit forfeitures as they occurred, and the effect of transitioning to recognition of expense based on expected forfeitures was insignificant. Shares issued upon exercise of stock awards are generally issued from shares in treasury. We have utilized the Black-Scholes-Merton valuation model for estimating the grant-date fair value of stock options and stock-settled stock appreciation rights granted in 2007 and all prior periods. During the third quarter of 2007, we granted approximately 333,000 stock-based awards with a total grant date fair value of $5.6 million and a weighted-average expected life of approximately 3.5 years.

For the first nine months ended September 30, 2007 and 2006, we recognized $25.3 million and $18.9 million, respectively, in stock-based compensation expense for stock options, stock-settled stock appreciation rights, stock units and discounted employee stock plan purchases, which is primarily included in general and administrative expenses in continuing operations. The estimated tax benefit recorded for stock-based compensation through September 30, 2007 and 2006 was $9.5 million and $6.9 million, respectively. As of September 30, 2007, there was $86.9 million of total estimated unrecognized compensation cost related to nonvested stock-based compensation arrangements under our equity compensation and stock purchase plans. We expect to recognize this cost over a weighted average remaining period of 1.7 years.

During the first nine months ended September 30, 2007 and 2006, we received $41.3 million and $29.0 million, respectively, in cash proceeds from stock option exercises and $27.0 million and $29.3 million, respectively, in actual tax benefits upon the exercise of stock awards.

On May 29, 2007, our stockholders approved an amendment to our Amended and Restated Certificate of Incorporation, to increase the number of shares of authorized common stock from 195,000,000 to 450,000,000 shares. Our stockholders also approved an amendment and restatement of our Employee Stock Purchase Plan to increase the number of shares of common stock available for issuance under that plan by 800,001 shares, and approved an amendment and restatement of our 2002 Equity Compensation Plan to increase the number of shares of common stock available for issuance under that plan by 6,000,000 shares and, among other things, to remove certain available share recycling features, to change the limit on the maximum number of shares of common stock that may be subject to awards granted to any single recipient in any consecutive twenty-four month period so that it applies only to awards of stock options and stock appreciation rights, and to provide additional exceptions from the three year minimum vesting period generally applicable to grants of restricted stock units and other full share awards.

Table of Contents

**Off-balance sheet arrangements and aggregate contractual obligations**

In addition to the debt obligations reflected on our balance sheet, we have commitments associated with operating leases, letters of credit and our investments in third-party dialysis businesses. Substantially all of our facilities are leased. We have potential acquisition obligations for several jointly-owned centers and for some of our non-wholly-owned subsidiaries, in the form of put provisions, which are exercisable at the third-party owners future discretion. These put provisions, if exercised, would require us to purchase the third-party owners interests at either the appraised fair market value or a predetermined multiple of earnings or cash flow attributable to the equity interest put to us, which approximates fair value. We also have potential cash commitments to provide operating capital advances as needed to several other third-party owned centers, minority owned centers and physician-owned vascular access clinics that we operate under administrative services agreements.

The following is a summary of these contractual obligations and commitments as of September 30, 2007 reflecting changes that have occurred with our debt instruments and other obligations during the first nine months of 2007 (in millions):

| | Less Than 1 Year | 1-3 Years | 3-5 Years | After 5 Years | Total |
|---|---|---|---|---|---|
| Scheduled payments under contractual obligations: | | | | | |
| Long-term debt | $ 5 | $ 82 | $ 154 | $ 3,456 | $ 3,697 |
| Interest payments on senior and senior subordinated notes | | 243 | 243 | 304 | 790 |
| Capital lease obligations | | 1 | 1 | 2 | 4 |
| Operating leases | 40 | 286 | 226 | 372 | 924 |
| | $ 45 | $ 612 | $ 624 | $ 4,134 | $ 5,415 |
| Potential cash requirements under existing commitments: | | | | | |
| Letters of credit | $ 50 | $ | $ | $ | $ 50 |
| Acquisition of dialysis centers | 92 | 70 | 38 | 39 | 239 |
| Working capital advances to third-parties under administrative services agreements | 15 | | | | 15 |
| | $ 157 | $ 70 | $ 38 | $ 39 | $ 304 |

Not included above are interest payments related to our Senior Secured Credit Facilities. Our Senior Secured Credit Facilities as of September 30, 2007 bear interest at LIBOR plus a margin of 1.50%. The term loan A and the revolving line of credit are adjustable depending upon our achievement of certain financial ratios. At September 30, 2007, our Senior Secured Credit Facilities had an overall effective weighted average interest rate of 6.0%, including the effects of our swap agreements. Interest payments are due at the maturity of specific debt tranches within each term loan, which can range in maturity from one month to twelve months. Future interest payments will depend upon the amount of mandatory principal payments and principal prepayments, as well as changes in the LIBOR-based interest rates and changes in the interest rate margins. Assuming no principal prepayments on our Senior Secured Credit Facilities during the next twelve months and no changes in the effective interest rates, we would pay approximately $118 million of interest over the next twelve months.

Our Amended Alliance and Product Supply Agreement with Gambro AB and Gambro Renal Products, Inc. (the Amended Product Supply Agreement) requires us to purchase a significant majority of certain hemodialysis products, supplies and equipment at fixed prices through 2015. On July 2, 2007, we notified Gambro Renal Products, Inc. that we were electing to be permanently relieved of our purchase obligation under the Amended Product Supply Agreement to purchase dialysis machines (the Affected Products) because the Affected Products remained subject to an FDA import ban after June 30, 2007. Our total expenditures for the three and nine months ended September 30, 2007 on such products were approximately 2% of our total operating costs. The actual amount of purchases in future years under the Amended Product Supply Agreement will depend upon a number of factors, including the operating and capital requirements of our centers, the number of centers we acquire, growth of our existing centers, and Gambro Renal Products ability to meet our needs.

Table of Contents

The settlements of existing FIN 48 liabilities are excluded from the above table as reasonably reliable estimates of their timing cannot be made.

**Significant New Accounting Standards**

On January 1, 2007, we adopted the provisions of Financial Accounting Standards Board Interpretation 48 (FIN 48) *Accounting for Income Tax Uncertainties*, which clarifies the accounting for uncertainty in income taxes recognized in the financial statements in accordance with SFAS Statement No. 109 *Accounting for Income Taxes*. The Interpretation prescribes a recognition threshold of more-likely-than-not and a measurement attribute on all tax positions taken or expected to be taken in a tax return in order to be recognized in the financial statements. In making this assessment, a company must determine whether it is more-likely-than-not that a tax position will be sustained upon examination, including resolution of any related appeals or litigation processes, based solely on the technical merits of the position and must assume that the tax position will be examined by appropriate taxing authority that would have full knowledge of all relevant information. Once the recognition threshold is met, the tax position is then measured to determine the actual amount of benefit to recognize in the financial statements. In addition, the recognition threshold of more-likely-than-not must continue to be met in each reporting period to support continued recognition of the tax benefit. Tax positions that previously failed to meet the more-likely-than-not recognition threshold should be recognized in the first financial reporting period in which that threshold is met. Previously recognized tax positions that no longer meet the more-likely-than-not recognition threshold should be derecognized in the financial reporting period in which that threshold is no longer met. See Note 8 to the condensed consolidated financial statements.

Table of Contents

**Item 3.** ***Quantitative and Qualitative Disclosures About Market Risk***

*Interest rate sensitivity*

The table below provides information, as of September 30, 2007, about our financial instruments that are sensitive to changes in interest rates.

| | Expected maturity date | | | | | | | | Average interest rate | Fair Value |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | Thereafter | Total | | |
| | (dollars in millions) | | | | | | | | | |
| Long-Term Debt | | | | | | | | | | |
| Fixed rate | $ 2 | $ 2 | $ 1 | $ 1 | $ 0 | $ 1 | $ 1,751 | $ 1,758 | 6.89% | $ 1,746 |
| Variable rate | $ 3 | $ 17 | $ 63 | $ 88 | $ 66 | $ 1,706 | $ | $ 1,943 | 6.01% | $ 1,943 |

| | Notional amount | Contract maturity date | | | | | Pay fixed | Receive variable | Fair value |
|---|---|---|---|---|---|---|---|---|---|
| | | 2007 | 2008 | 2009 | 2010 | 2011 | | | |
| | (dollars in millions) | | | | | | | | |
| Swaps: | | | | | | | | | |
| Pay-fixed swaps | $ 1,096 | $ 128 | $ 378 | $ 401 | $ 189 | $ | 3.08% to 4.27% | LIBOR | $ 13.0 |

As of September 30, 2007, we maintained a total of nine interest rate swap agreements, with amortizing notional amounts totaling $1,096 million. These agreements had the economic effect of modifying the LIBOR-based variable interest rate on our debt to fixed rates ranging from 3.08% to 4.27%, resulting in a weighted average effective interest rate of 5.37% on the hedged portion of our Senior Secured Credit Facilities, including the term loan B margin of 1.50%. The swap agreements expire in 2008 through 2010 and require quarterly interest payments. During the first nine months of 2007, we accrued net benefits of $11.5 million from these swaps which is included in debt expense. As of September 30, 2007, the total fair value of these swaps was an asset of $13.0 million. We recorded $8.5 million, net of tax, as a reduction to comprehensive income for the change in fair value of the effective portions of these swaps, net of amounts that were reclassified into income during the first nine months of 2007. We also recorded $0.5 million, net of tax in the first nine months of 2007, as an increase to comprehensive income related to unrealized gains on investments, net of amounts reclassified into income.

On October 16, 2007, we entered into a forward interest rate swap that will have the economic effect of modifying the LIBOR-based interest rate to a fixed rate of 4.70% on $100 million of our term loan B outstanding debt, effective September 30, 2008. The total notional amount $100 million requires quarterly interest payments beginning in December 2008. The interest rate swap expires in 2010.

As of September 30, 2007, the interest rates were economically fixed on approximately 56% of our variable rate debt and approximately 77% of our total debt.

As a result of the swap agreements, the overall effective weighted average interest rate on the Senior Secured Credit Facilities was 6.0%, based upon the current margins in effect of 1.50% as of September 30, 2007.

Our overall average effective interest rate excluding the write-off and amortization of deferred financing costs during the third quarter of 2007 was 6.48% and as of September 30, 2007 was 6.43%.

**Item 4.** ***Controls and Procedures***

Management has established and maintains disclosure controls and procedures designed to ensure that information required to be disclosed in the reports that it files or submits pursuant to the Securities Exchange Act of 1934, as amended, or Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms, and that such information is

Table of Contents

accumulated and communicated to the Company s management, including its Chief Executive Officer and Chief Financial Officer, as appropriate to allow for timely decisions regarding required disclosures.

At the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of the Company s Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures in accordance with the Exchange Act requirements. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company s disclosure controls and procedures are effective for timely identification and review of material information required to be included in the Company s Exchange Act reports, including this report on Form 10-Q. Management recognizes that these controls and procedures can provide only reasonable assurance of desired outcomes, and that estimates and judgments are still inherent in the process of maintaining effective controls and procedures.

There has not been any change in the Company s internal control over financial reporting that was identified during the evaluation that occurred during the fiscal quarter covered by this report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting.

Table of Contents

## PART II

## OTHER INFORMATION

**Item 1.** ***Legal Proceedings***

The information in Note 5 of the Notes to Condensed Consolidated Financial Statements in Part I, Item 1 of this report is incorporated by this reference in response to this item.

**Item 1A.** ***Risk Factors***

*A restated description of the risk factors associated with our business is set forth below. This description includes any material changes to and supercedes the description of the risk factors associated with our business previously disclosed in Part II Item IA of our Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2007. The risks discussed below are not the only ones facing our business. Please read the cautionary notice regarding forward-looking statements under the heading Management s Discussion and Analysis of Financial Condition and Results of Operations .*

**If the average rates that commercial payors pay us decline significantly, it would have a material adverse effect on our revenues, earnings and cash flows.**

Approximately 35% of our dialysis revenue for the quarter ended September 30, 2007 was generated from patients who have commercial payors as the primary payor. The majority of these patients have insurance policies that pay us on terms and at rates materially higher than Medicare rates. The payments we receive from commercial payors generate nearly all of our profit. We are experiencing a decrease in some of our commercial payment rates and we expect that commercial payment rates will be materially lower in the future. The downward pressure on commercial payment rates is a result of, general conditions in the market, recent and future consolidations among commercial payors, downward trends in health insurance premiums, increased focus on dialysis services and other factors.

We are continuously in the process of negotiating agreements with our commercial payors and certain payors have become increasingly aggressive in their negotiations with us. In the event that our negotiations result in overall commercial rate reductions in excess of overall commercial rate increases, the cumulative effect could have a material adverse effect on our financial results. Consolidations have significantly increased the negotiating leverage of commercial payors. We expect that some of our contracted rates with commercial payors will decrease as our negotiations with commercial payors continue. In addition to increasing downward pressure on contracted commercial payor rates, payors have been imposing restrictions and limitations on non-contracted or out-of-network providers. We are aggressively resisting such activity through regulatory, legislative and legal means. Decreases in out-of-network rates and restrictions on out-of-network access combined with decreases in contracted rates could result in a significant decrease in our overall revenue derived from commercial payors. If the average rates that commercial payors pay us decline significantly, it would have a material adverse effect on our revenues, earnings and cash flows.

**If the number of patients with higher-paying commercial insurance declines, then our revenues, earnings and cash flows would be substantially reduced.**

Our revenue levels are sensitive to the percentage of our patients with higher-paying commercial insurance coverage. A patient s insurance coverage may change for a number of reasons, including as a result of changes in the patient s or a family member s employment status. Currently, for a patient covered by an employer group health plan, Medicare generally becomes the primary payor after 33 months, or earlier if the patient s employer group health plan coverage terminates. When Medicare becomes the primary payor, the payment rate we receive for that patient shifts from the employer group health plan rate to the Medicare payment rate. If there is a significant reduction in the number of patients under higher-paying commercial plans relative to government- based programs that pay at lower rates, it would have a material adverse effect on our revenues, earnings and cash flows.

Table of Contents

**Changes in the structure of, and payment rates under the Medicare ERSD program could substantially reduce our revenues, earnings and cash flows.**

Approximately one-half of our dialysis revenue for the quarter ended September 30, 2007 was generated from patients who have Medicare as their primary payor. Currently, the Medicare End Stage Renal Disease (ESRD) program pays us for dialysis treatment services at fixed rates. The Medicare composite rate is the payment rate for a dialysis treatment including the supplies used in those treatments, specified laboratory tests and certain pharmaceuticals. Other services and pharmaceuticals, including EPO (a pharmaceutical used to treat anemia, a common complication associated with ESRD), vitamin D analogs and iron supplements, are separately billed. Unlike most other services covered by Medicare, the Medicare ESRD program has not provided for regular inflation increases in payment rates. We experience increases in operating costs that are subject to inflation, such as labor and supply costs, regardless of whether there is a compensating inflation-based increase in Medicare payment rates. To the extent Medicare rates decline or are not adjusted to keep pace with inflation, our revenues, earnings and cash flows would be adversely affected.

In addition, changes to the structure of the composite rate and separately billable payment rates may occur which reduce our overall payments from the Medicare ESRD program. CMS and Congress continue to examine and propose changes to the payment structure for dialysis services including the addition of services that are currently separately billed into the composite rate, also referred to as bundling. If Medicare begins to bundle other services for payment by including in its composite payment rate the pharmaceuticals, laboratory services or other ancillary services that it currently pays separately at rates that would result in lower overall reimbursement, or if there are further changes to or decreases in the payment rate for these separately billed items without a corresponding increase in the composite rate, it could have a material adverse effect on our revenues, earnings and cash flows.

**Changes in state Medicaid programs or payment rates could reduce our revenues, earnings and cash flows.**

Approximately 5% of our dialysis revenue for the quarter ended September 30, 2007 was generated from patients who have Medicaid as their primary coverage. As state governments face increasing budgetary pressure, they may propose reductions in payment rates, limitations on eligibility or other changes to Medicaid programs. For example, Medicaid eligibility requirements mandate that citizen enrollees in Medicaid programs provide documented proof of citizenship. Our revenues, earnings and cash flows could be negatively impacted to the extent that we are not paid by Medicaid or other state programs for services provided to patients that are unable to satisfy the revised eligibility requirements, including undocumented patients living in the U.S. If state governments reduce the rates paid by those programs for dialysis and related services, further limit eligibility for Medicaid coverage or adopt changes similar to those adopted by Medicare, then our revenues, earnings and cash flows could be adversely affected.

**Delays in state Medicare and Medicaid certification of our dialysis centers could adversely affect our revenues, earnings and cash flows.**

Before we can begin billing for patients treated in our outpatient dialysis centers who are enrolled in government-based programs, we are required to obtain state and federal certification for participation in the Medicare and Medicaid programs. As state governments face increasing budgetary pressure, certain states may have difficulty certifying dialysis centers in the normal course and significant delays may result. If state governments are unable to certify new centers in the normal course and we experience significant delays in our ability to treat and bill for services provided to patients covered under government programs, our revenues, earnings and cash flows could be adversely affected.

**Changes in clinical practices and payment rates or rules for EPO and other pharmaceuticals could substantially reduce our revenues, earnings and cash flows.**

The administration of EPO and other pharmaceuticals accounts for approximately 35% of our dialysis revenue for the quarter ended September 30, 2007. Since late 2006, there has been significant media discussion

Table of Contents

and government scrutiny regarding anemia management practices in the United States. In late 2006, the House Ways and Means Committee held a hearing on the issue of EPO utilization and continues to review the issue. In March 2007, the FDA required changes to the labeling of EPO and Aranesp® to include a black box warning, the FDA s strongest form of warning label, which has created confusion and concern in the nephrology community and which has resulted in a decrease in utilization of EPO by our physicians of approximately 5%. The FDA has held additional hearings to revisit these label changes as they apply to ESRD and continues to examine the issue. The labeling changes have resulted in increased scrutiny by CMS of its EPO reimbursement policies. For example, changes to the existing EPO monitoring policy will go into effect in January 2008 which will further limit reimbursement and could further impact administration practices. The House of Representatives has also proposed legislation which includes language that would decrease EPO reimbursement for larger dialysis providers, including DaVita. The controversy surrounding EPO administration has coincided with increased scrutiny by commercial payors of their administration policies for EPO and, in some cases, modification of EPO administration policies by commercial payors. Further changes in physician practice patterns and accepted clinical practices, changes in labeling of other pharmaceuticals in a manner that alters physician practice patterns or accepted clinical practices, changes in private and governmental payment criteria, including the introduction of EPO administration policies, the introduction of new pharmaceuticals or the conversion to alternate types of administration of EPO or other pharmaceuticals could have a material adverse effect on our revenues, earnings and cash flows. Such changes could also have a negative impact on our patient clinical outcomes.

**Changes in EPO pricing and the use and marketing of alternatives to EPO could materially reduce our revenues, earnings and cash flows and affect our ability to care for our patients.**

Amgen Inc. is the sole supplier of EPO and may unilaterally decide to increase its price for EPO, subject to certain contractual limitations. Future changes in the cost of EPO could have a material adverse effect on our earnings and cash flows and ultimately reduce our income. Although our agreements with Amgen for EPO have included potential pricing discounts which depended upon the achievement of certain clinical and other criteria, we cannot predict whether we will continue to receive the discount structure for EPO that we currently receive, or whether we will continue to achieve the same levels of discounts within that structure as we have historically achieved. Our agreements with Amgen also have provided for specific rebates off of list price and additional incentives based on patient outcomes, process improvement and data submission, purchase volume growth and some combination of these factors. Factors that could impact our ability to qualify for the discounts, rebates and incentives provided for in our agreement with Amgen in the future include our ability to achieve certain clinical outcomes, changes in pharmaceutical intensities and our growth. We have and may from time to time in the future accelerate our EPO purchase volume in a given period to take advantage of certain incentives provided for in these agreements, which could result in an increase in our inventory levels. Failure to qualify for discounts or meet or exceed the targets and earn the specified rebates and incentives due to changes in prescribing patterns or otherwise could have a material adverse effect on our earnings and cash flows.

Amgen has developed and obtained FDA approval for Aranesp®, a pharmaceutical used to treat anemia that may replace EPO or reduce its use with dialysis patients. In addition, Roche has developed and is seeking approval for CERA, a pharmaceutical also used to treat anemia. Unlike EPO, which is generally administered in conjunction with each dialysis treatment, these pharmaceuticals are administered less frequently. In the event that these similar alternatives to EPO are marketed for the treatment of dialysis patients, we may realize lower margins on the administration of such pharmaceuticals than are currently realized with EPO. In addition, to the extent that such pharmaceuticals begin to be administered to patients through channels other than DaVita, we would realize a significant reduction in revenue or profit from such administration. A significant increase in the development and use of similar alternatives to EPO, or a change in administration practices, could have material adverse effect on our revenues, earnings and cash flows.

Table of Contents

**Continued inquiries from various governmental bodies with respect to our utilization of erythropoiesis-stimulating agents will require management s attention, cause us to incur significant legal expense and could result in substantial financial penalties against us, exclusion from future participation in the Medicare and Medicaid programs and could substantially reduce our revenues, earnings and cash flows.**

There is currently significant scrutiny and controversy regarding anemia management practices for ESRD patients in the United States. In response to recent clinical studies identifying risks in certain patient populations related to the utilization of erythropoiesis-stimulating agents, i.e. EPO and Aranesp, and in response to changes in the labeling of EPO and Aranesp, there has been substantial media attention and government scrutiny resulting in hearings and proposed legislation regarding utilization and reimbursement. Although we believe our anemia management practices have been compliant with existing laws and regulations, as a result of the current high level of scrutiny and controversy, we may be subject to increased inquiries from a variety of governmental bodies. For example, the subpoena from the U.S. Attorney s office in the Eastern District of Missouri includes requests for documents regarding the administration of, and billing for, EPO. In August 2007, we received a subpoena from the Office of Inspector General in Houston, Texas for records relating to EPO claims submitted to Medicare. In addition, in August 2007 a complaint was filed against us, Amgen and Fresenius Medical Care Holdings alleging claims related to the administration and use of EPO and in October 2007 the Attorney General s Office for the State of Nevada initiated an investigation of our operations in Nevada related to the billing of pharmaceuticals, including EPO. We have also received inquiries from the Attorney General s Office in New York regarding certain aspects of EPO and other billing practices taking place at facilities managed by us in New York. Additional inquiries from various agencies with respect to this issue would continue to require management s attention and significant legal expense and any negative findings could result in substantial financial penalties against us, exclusion from future participation in the Medicare and Medicaid programs and could substantially reduce our revenues, earnings and cash flows.

**The investigation related to the subpoena we received on March 4, 2005 from the U.S. Attorney s Office for the Eastern District of Missouri could result in substantial penalties against us.**

We are voluntarily cooperating with the U.S. Attorney s Office for the Eastern District of Missouri with respect to the subpoena we received on March 4, 2005, which requested 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 related request for additional documents related to specific medical director and joint venture arrangements we received in October 2005, the related subpoena we received in February 2006 requesting documents related to certain patient records relating to the administration and billing of EPO and the request for additional documents related to durable medical equipment and supply companies owned and operated by us received in May 2007. It is possible that criminal proceedings may be initiated against us in connection with this inquiry. Any negative findings could result in substantial financial penalties against us, exclusion from future participation in the Medicare and Medicaid programs and criminal penalties. To our knowledge, no proceedings have been initiated against us at this time. Although we cannot predict whether or when proceedings might be initiated or when these matters may be resolved, it is not unusual for investigations such as this to continue for a considerable period of time. Responding to the subpoenas will continue to require management s attention and significant legal expense.

**The investigation related to the subpoena we received on October 25, 2004 from the U.S. Attorney s Office for the Eastern District of New York could result in substantial penalties against us.**

We are voluntarily cooperating with the U.S. Attorney s Office for the Eastern District of New York and the OIG with respect to the subpoena we received on October 25, 2004, which requires production of a wide range of documents relating to our operations, including DaVita Laboratory Services. The subpoena also includes specific requests for documents relating to testing for PTH and to products relating to vitamin D therapies. DVA Renal Healthcare received a similar subpoena in November 2004. It is possible that criminal proceedings may be

Table of Contents

initiated against us and DVA Renal Healthcare in connection with this inquiry. Any negative findings could result in substantial financial penalties against us and DVA Renal Healthcare, exclusion from future participation in the Medicare and Medicaid programs and criminal penalties. To our knowledge, no proceedings have been initiated against us or DVA Renal Healthcare at this time. Although we cannot predict whether or when proceedings might be initiated or when these matters may be resolved, it is not unusual for investigations such as this to continue for a considerable period of time. Responding to the subpoenas may require management s attention and significant legal expense.

**If we fail to adhere to all of the complex government regulations that apply to our business, we could suffer severe consequences that would substantially reduce our revenues, earnings and cash flows.**

Our dialysis operations are subject to extensive federal, state and local government regulations, including Medicare and Medicaid payment rules and regulations, federal and state anti-kickback laws, the Stark II physician self-referral prohibition and analogous state referral statutes, and federal and state laws regarding the collection, use and disclosure of patient health information. The Medicare and Medicaid reimbursement rules related to claims submission, cost reporting, and payment processes impose complex and extensive requirements upon dialysis providers, and a violation or departure from such requirements may result in government audits, lower reimbursements, recoupments or voluntary repayments, and the potential loss of certification.

The regulatory scrutiny of healthcare providers, including dialysis providers, has increased significantly in recent years. Medicare has increased the frequency and intensity of its certification inspections of dialysis centers. For example, we are required to provide substantial documentation related to the administration of pharmaceuticals, including EPO, and, to the extent that any such documentation is found insufficient, we may be required to refund any amounts received from such administration by government or private payors, and be subject to substantial penalties under applicable laws or regulations. In addition, fiscal intermediaries have increased their prepayment and post-payment reviews.

We endeavor to comply with all of the requirements for receiving Medicare and Medicaid payments and to structure all of our relationships with referring physicians to comply with state and federal anti-kickback laws and the Stark II physician self-referral law. However, the laws and regulations in this area are complex and subject to varying interpretations. For example, none of our medical director agreements establishes compensation using the Stark II safe harbor method; rather, compensation under our medical director agreements is the result of individual negotiation and, we believe, exceeds amounts determined under the safe harbor method. If an enforcement agency were to challenge the level of compensation that we pay our medical directors, we could be required to change our practices, face criminal or civil penalties, pay substantial fines or otherwise experience a material adverse effect as a result of a challenge to these arrangements.

Because of regulatory considerations unique to each of these states, all of our dialysis operations in New York and some of our dialysis operations in New Jersey are conducted by privately-owned companies to which we provide a broad range of administrative services. These operations accounted for approximately 6% of our dialysis revenue for the nine months ended September 30, 2007. While we have received authorization to directly conduct business in New Jersey and there have been favorable changes to the law in New York, until these changes go into effect we can give no assurances that these arrangements will not be challenged.

If any of our operations are found to violate these or other government regulations, we could suffer severe consequences that would have a material adverse effect on our revenues, earnings and cash flows including:

- Suspension or termination of our participation in government payment programs;
- Refunds of amounts received in violation of law or applicable payment program requirements;
- Loss of required government certifications or exclusion from government payment programs;
- Loss of licenses required to operate healthcare facilities in some of the states in which we operate;

Table of Contents

Reductions in payment rates or coverage for dialysis and ancillary services and related pharmaceuticals;

Fines, damages or monetary penalties for anti-kickback law violations, Stark II violations, submission of false claims, civil or criminal liability based on violations of law, or other failures to meet regulatory requirements;

Claims for monetary damages from patients who believe their protected health information has been used or disclosed in violation of federal or state patient privacy laws;

Mandated practice changes that significantly increase operating expenses; and

Termination of relationships with medical directors.

**If our joint ventures were found to violate the law, we could suffer severe consequences that would have a material adverse effect on our revenues, earnings and cash flows.**

As of September 30, 2007 we owned a controlling interest in approximately 100 dialysis related joint ventures, representing approximately 15% of our dialysis revenue for the third quarter of 2007. We anticipate that we will continue to increase the number of our joint ventures. Many of our joint ventures with physicians or physician groups also have the physician-owners providing medical director services to those centers or other centers we own and operate. Because our relationships with physicians are governed by the anti-kickback statute contained in the Social Security Act, we have sought to structure our joint venture arrangements to satisfy as many safe harbor requirements as we believe are reasonably possible. However, our joint venture arrangements do not satisfy all elements of any safe harbor under the federal anti-kickback statute. Based on the exceptions applicable to ESRD services, we believe that our joint venture arrangements and operations materially comply with the Stark II law. The subpoena we received from the United States Attorney s Office for the Eastern District of Missouri on March 4, 2005, and the related request for additional documents received in October 2005, includes a request for documents related to our joint ventures.

If our joint ventures are found to be in violation of the anti-kickback statute or the Stark provisions, we could be required to restructure the joint ventures or refuse to accept referrals for designated health services from the physicians with whom the joint venture centers have a financial relationship. We also could be required to repay amounts received from Medicare and certain other payors by the joint ventures pursuant to prohibited referrals, and we could be subject to monetary penalties and exclusion from government healthcare programs. If our joint venture centers are subject to any of these penalties, we could suffer severe consequences that would have a material adverse effect on our revenues, earnings and cash flows.

**There are significant estimating risks associated with the amount of dialysis revenue that we recognize and if we are unable to accurately estimate our revenue, it could impact the timing of our revenue recognition or have a significant impact on our operating results.**

There are significant estimating risks associated with the amount of dialysis revenue that we recognize for a reporting period. Ongoing insurance coverage changes, geographic coverage differences, differing interpretations of contract coverage, and other payor issues complicate the billing and collection process. Determining applicable primary and secondary coverage for our approximately 106,500 patients at any point in time, together with the changes in patient coverages that occur each month, requires complex, resource-intensive processes, and errors in determining the correct coordination of benefits may result in refunds to payors. Revenues associated with Medicare and Medicaid programs are also subject to estimating risk related to the amounts not paid by the primary government payor that will ultimately be collectible from other government programs paying secondary coverage, the patient s commercial health plan secondary coverage or the patient. Collections, refunds and payor retractions typically continue to occur for up to three years and longer after services are provided. If our estimates of dialysis revenue are materially inaccurate, it could impact the timing of our revenue recognition and have a significant impact on our operating results.

Table of Contents

**If the ancillary services we provide or the strategic initiatives we invest in are ultimately unsuccessful, we may have to write-off our investment in one or more of these activities.**

Our ancillary services and strategic initiatives include pharmacy services, vascular access services, disease management services, ESRD clinical research programs, ESRD full capitation demonstration projects, ESRD special needs plans, and administrative services provided to minority-owned and third-party owned centers and clinics, each of which is related to our core business of providing dialysis services, as well as home infusion therapy services which are related to our core competencies. If any of our ancillary services or strategic initiatives do not perform at the level that we anticipate, we may be required to write-off our investment in one or more of these activities. As an example, our existing investment in pharmacy services of approximately $18 million at the end of the third quarter of 2007 may be subject to future write-offs.

**If a significant number of physicians were to cease referring patients to our dialysis centers, whether due to regulatory or other reasons, our revenues, earnings and cash flows would be substantially reduced.**

Many physicians prefer to have their patients treated at dialysis centers where they or other members of their practice supervise the overall care provided as medical director of the center. As a result, the primary referral source for most of our centers is often the physician or physician group providing medical director services to the center. Neither our current nor former medical directors have an obligation to refer their patients to our centers. If a medical director agreement terminates, whether before or at the end of its term, and a new medical director is appointed, it may negatively impact the former medical director s decision to treat his or her patients at our center. If we are unable to enforce noncompetition provisions contained in the terminated medical director agreements, former medical directors may choose to provide medical director services for competing providers or establish their own dialysis centers in competition with ours. Also, if the quality of service levels at our centers deteriorates, it may negatively impact patient referrals and treatment volumes.

Our medical director contracts are for fixed periods, generally three to ten years. Medical directors have no obligation to extend their agreements with us. We may take actions to restructure existing relationships or take positions in negotiating extensions of relationships to assure compliance with the safe harbor provisions of the anti-kickback statute, Stark II law and other similar laws. These actions could negatively impact the decision of physicians to extend their medical director agreements with us or to refer their patients to us. If the terms of any existing agreement are found to violate applicable laws, we may not be successful in restructuring the relationship which could lead to the early termination of the agreement, or cause the physician to stop referring patients to our centers. If a significant number of physicians were to cease referring patients to our dialysis centers, whether due to regulatory or other reasons, then our revenues, earnings and cash flows would be substantially reduced.

**If we are not able to continue to make acquisitions on reasonable terms or if we face significant patient attrition to our competitors, it could adversely affect our business.**

We are facing increased competition in the dialysis industry from large and medium-sized providers which compete directly with us for acquisition targets as well as for individual patients. Acquisitions and patient retention are an important part of our growth strategy. If we are not able to continue to make acquisitions on reasonable terms or if we face significant patient attrition to our competitors, it could adversely affect our business.

**The level of our current and future debt could have an adverse impact on our business.**

We have substantial debt outstanding and we may incur additional indebtedness in the future. The high level of our indebtedness, among other things, could:

make it difficult for us to make payments on our debt securities;

increase our vulnerability to general adverse economic and industry conditions;

Table of Contents

require us to dedicate a substantial portion of our cash flow from operations to payments on our indebtedness, thereby reducing the availability of our cash flow to fund working capital, capital expenditures, acquisitions and investments and other general corporate purposes;

expose us to interest rate fluctuations to the extent we have variable rate debt;

limit our flexibility in planning for, or reacting to, changes in our business and the markets in which we operate;

place us at a competitive disadvantage compared to our competitors that have less debt; and

limit our ability to borrow additional funds.

If additional debt financing is not available when required or is not available on acceptable terms, we may be unable to grow our business, take advantage of business opportunities, respond to competitive pressures or refinance maturing debt, any of which could have a material adverse effect on our operating results and financial condition.

**We will require a significant amount of cash to service our indebtedness. Our ability to generate cash depends on many factors beyond our control.**

Our ability to make payments on our indebtedness and to fund planned capital expenditures and expansion efforts, including any strategic acquisitions we may make in the future, will depend on our ability to generate cash. This, to a certain extent, is subject to general economic, financial, competitive, regulatory and other factors that are beyond our control.

We cannot assure you that our business will generate sufficient cash flow from operations in the future, that our currently anticipated growth in revenue and cash flow will be realized on schedule or that future borrowings will be available to us in an amount sufficient to enable us to service our indebtedness, including the senior and senior subordinated notes, or to fund other liquidity needs. We may need to refinance all or a portion of our indebtedness on or before maturity. Our senior secured credit facilities are secured by substantially all of our and our subsidiaries assets. As such, our ability to refinance our debt or seek additional financing could be limited by such security interest. We cannot assure you that we will be able to refinance our indebtedness on commercially reasonable terms or at all.

**If the current shortage of skilled clinical personnel continues or if we experience a higher than normal turnover rate, we may experience disruptions in our business operations and increases in operating expenses.**

We are experiencing increased labor costs and difficulties in hiring nurses due to a nationwide shortage of skilled clinical personnel. We compete for nurses with hospitals and other health care providers. This nursing shortage may limit our ability to expand our operations. If we are unable to hire skilled clinical personnel when needed, or if we experience a higher than normal turnover rate for our skilled clinical personnel, our operations and treatment growth will be negatively impacted, which would result in reduced revenues, earnings and cash flows.

**Our alliance and product supply agreement with Gambro Renal Products Inc. may limit our ability to achieve cost savings with respect to products and equipment we are required to purchase under this agreement.**

We entered into an alliance and product supply agreement with Gambro Renal Products in October 2005 to supply dialysis equipment, machines, dialyzers and certain other products, which was subsequently amended in August 2006, in part to permit the termination of our purchase obligations with respect to dialysis machines under certain circumstances. In July 2007, we notified Gambro Renal Products that we were electing to be

Table of Contents

permanently relieved of our obligation to purchase dialysis machines because such products remained subject to an FDA import ban. If we are unable to realize cost savings on dialysis machines, our revenues, earnings and cash flows could be negatively affected. In addition, all other purchase obligations under the amended supply agreement remain the same and may limit our ability to realize future cost savings in regard to products and equipment for which we remain obligated to make purchases under the agreement. For the quarter and nine months ended September 30, 2007, our total spending on hemodialysis products, supplies and equipment with Gambro Renal Products was approximately 2% of our total operating costs.

**Failure to successfully complete the integration of DVA Renal Healthcare s billing and collection systems into our operations could have a material adverse effect on our revenues, cash flows and operating results.**

The acquisition of DVA Renal Healthcare required the successful implementation of uniform information technology systems, including clinical, billing and collections systems. While a majority of the systems have been integrated, we may experience difficulties in our ability to successfully bill and collect for services rendered as we continue to upgrade and integrate the billing and collection systems. Complications associated with the upgrade and integration of our billing and collections systems could result in a slow-down of collections, a reduction in the amounts we expect to collect, increased risk of retractions from and refunds to commercial and government payors and noncompliance with reimbursement regulations, could have an adverse impact on the claims review required by DVA Renal Healthcare s corporate integrity agreement. The failure to successfully complete the integration and upgrade the billing and collection systems, could have a material adverse effect on our revenues, cash flows and operating results.

**If DVA Renal Healthcare does not comply with its corporate integrity agreement, or DVA Renal Healthcare otherwise has failed or fails to comply with government regulations applicable to its operations, we could be subject to additional penalties and otherwise may be materially harmed.**

In 2004, DVA Renal Healthcare entered into a settlement agreement with the Department of Justice and certain agencies of the United States government relating to the Department of Justice s investigation of DVA Renal Healthcare s Medicare and Medicaid billing practices and its relationships with physicians and pharmaceutical manufacturers. If DVA Renal Healthcare does not comply with the terms of the corporate integrity agreement or otherwise has failed or fails to comply with the extensive federal, state and local government regulations applicable to its operations, we could be subject to additional penalties, including monetary penalties or exclusion from participation in government programs, and otherwise may be materially harmed. The costs associated with compliance with the corporate integrity agreement and cooperation with the government are substantial and may be greater than we currently experience. In addition, as a result of the settlement agreement, some commercial payors and other third parties have initiated legal proceedings against DVA Renal Healthcare related to the billing practices and other matters covered by the settlement agreement and we could receive similar claims in the future.

**Our ability to effectively provide the services we offer could be negatively impacted if certain of our suppliers are unable to meet our needs or if we are unable to effectively access new technology, which could substantially reduce our revenues, earnings and cash flows.**

We have significant suppliers that are either the sole or primary source of products critical to the services we provide or to which we have committed obligations to make purchases, including Amgen, Fresenius Medical Care, Gambro Renal Products, Baxter Healthcare Corporation, as well as others. If any of these suppliers are unable to meet our needs for the products they supply and we are not able to find adequate alternative sources, our revenues, earnings and cash flows could be substantially reduced. Our suppliers may face difficulty in meeting our needs for the products they supply. For example, in July 2007, we notified Gambro Renal Products that we were electing to be permanently relieved of our obligation to purchase dialysis machines which remained subject to an import ban by the FDA. In addition, the technology related to the products critical to the services we provide is subject to new developments and may result in superior products. If we are not able to access superior

Table of Contents

products on a cost-effective basis or if suppliers are not able to fulfill our requirements for such products, we could face patient attrition which could substantially reduce our revenues, earnings and cash flows.

**We may be subject to liability claims for damages and other expenses not covered by insurance that could reduce our earnings and cash flows.**

The administration of dialysis and related services to patients may subject us to litigation and liability for damages. Our business, profitability and growth prospects could suffer if we face negative publicity or we pay damages or defense costs in connection with a claim that is outside the scope of any applicable insurance coverage, including claims related to contractual disputes and professional and general liability claims. In addition, we have received several notices of claims from commercial payors and other third parties related to our historical billing practices and the historical billing practices of DVA Renal Healthcare and other matters related to their settlement agreement with the Department of Justice. Although the ultimate outcome of these claims cannot be predicted, an adverse result with respect to one or more of these claims could have a material adverse effect on our financial condition, results of operations, and cash flows. We currently maintain programs of general and professional liability insurance. However, a successful claim, including a professional liability, malpractice or negligence claim which is in excess of our insurance coverage could have a material adverse effect on our earnings and cash flows.

In addition, if our costs of insurance and claims increase, then our earnings could decline. Market rates for insurance premiums and deductibles have been steadily increasing. Our earnings and cash flows could be materially and adversely affected by any of the following:

- further increases in premiums and deductibles;
- increases in the number of liability claims against us or the cost of settling or trying cases related to those claims; and
- an inability to obtain one or more types of insurance on acceptable terms.

**If businesses we acquire have liabilities that we are not aware of, we could suffer severe consequences that would substantially reduce our revenues, earnings and cash flows.**

Our business strategy includes the acquisition of dialysis centers and businesses that own and operate dialysis centers, as well as other ancillary businesses. Businesses we acquire may have unknown or contingent liabilities or liabilities that are in excess of the amounts that we estimated. Although we generally seek indemnification from the sellers of businesses we acquire for matters that are not properly disclosed to us, we are not always successful. In addition, even in cases where we are able to obtain indemnification, we may discover liabilities greater than the contractual limits or the financial resources of the indemnifying party. In the event that we are responsible for liabilities substantially in excess of any amounts recovered through rights to indemnification, we could suffer severe consequences that would substantially reduce our revenues, earnings and cash flows.

**Provisions in our charter documents, compensation programs and Delaware law may deter a change of control that our stockholders would otherwise determine to be in their best interests.**

Our charter documents include provisions that may deter hostile takeovers, delay or prevent changes of control or changes in our management, or limit the ability of our stockholders to approve transactions that they may otherwise determine to be in their best interests. These include provisions prohibiting our stockholders from acting by written consent, requiring 90 days advance notice of stockholder proposals or nominations to our Board of Directors and granting our Board of Directors the authority to issue preferred stock and to determine the rights and preferences of the preferred stock without the need for further stockholder approval. In addition, on November 14, 2002, the Board of Directors approved a shareholder rights plan that would substantially dilute the interest sought by an acquirer that our Board of Directors does not approve.

Table of Contents

Most of our outstanding employee stock options include a provision accelerating the vesting of the options in the event of a change of control. We also maintain a change of control protection program for our employees who do not have a significant number of stock awards, which provides for cash bonuses to the employees in the event of a change of control. Based on the shares of our common stock outstanding and the market price of our stock on September 30, 2007, these cash bonuses would total approximately $262 million if a change of control transaction occurred at that price and our Board of Directors did not modify this program. These compensation programs may affect the price an acquirer would be willing to pay for the Company.

We are also subject to Section 203 of the Delaware General Corporation Law that, subject to exceptions, would prohibit us from engaging in any business combinations with any interested stockholder, as defined in that section, for a period of three years following the date on which that stockholder became an interested stockholder.

These provisions may discourage, delay or prevent an acquisition of our Company at a price that our stockholders may find attractive. These provisions could also make it more difficult for our stockholders to elect directors and take other corporate actions and could limit the price that investors might be willing to pay for shares of our common stock.

**Item 2.** ***Unregistered Sales of Equity Securities and Use of Proceeds***

*(c) Stock Repurchases*

The following table summarizes the Company s repurchases of its common stock during the third quarter of 2007:

There were no repurchases of the Company s common stock prior to the third quarter of 2007.

| Period | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs(1) | Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (in millions) |
|---|---|---|---|---|
| July 1 31, 2007 | | $ | | $ 249.1 |
| August 1 31, 2007 | 111,300 | 57.05 | 111,300 | 242.8 |
| September 1 30, 2007 | | | | 242.8 |
| Total | 111,300 | $ | 111,300 | $ |

**(1)** On September 11, 2003, we announced that the Board of Directors authorized the repurchase of up to $200 million of our common stock, with no expiration date. On November 2, 2004, we announced that the Board of Directors approved an increase in our authorization to repurchase shares of our common stock by an additional $200 million. We are authorized to make purchases from time to time in the open market or in privately negotiated transactions, depending upon market conditions and other considerations. However, we are subject to share repurchase limitations under the terms of the Senior Secured Credit Facilities and the indentures governing our senior and senior subordinated notes.

**Items 3, 4 and 5 are not applicable.**

Table of Contents

**Item 6.** ***Exhibits.***

| Exhibit Number | |
|---|---|
| 10.1 | Employment Agreement, entered into effective July 16, 2007, by and between DaVita Inc. and Patricia Jones*. ü |
| 12.1 | Ratio of earnings to fixed charges. ü |
| 31.1 | Certification of the Chief Executive Officer, dated November 5, 2007, pursuant to Rule 13a-14(a) or 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. ü |
| 31.2 | Certification of the Chief Financial Officer, dated November 5, 2007, pursuant to Rule 13a-14(a) or 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. ü |
| 32.1 | Certification of the Chief Executive Officer, dated November 5, 2007, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. ü |
| 32.2 | Certification of the Chief Financial Officer, dated November 5, 2007, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. ü |

ü Filed herewith.
* Management contract or executive compensation plan or arrangement.

Table of Contents

**SIGNATURE**

**Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.**

DaVita Inc.

By: /s/ James K. Hilger
**James K. Hilger**
**Vice President and Controller***

November 5, 2007

* Mr. Hilger has signed both on behalf of the Registrant as a duly authorized officer and as the Registrant s chief accounting officer.

Table of Contents

**INDEX TO EXHIBITS**

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