DAVITA INC
Form 10-Q
August 05, 2010
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

For the Quarterly Period Ended

June 30, 2010

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

SECURITIES EXCHANGE ACT OF 1934

Commission File Number: 1-14106

DAVITA INC.

1551 Wewatta Street

Denver, CO 80202

Telephone number (303) 405-2100

Delaware	**51-0354549**
(State of incorporation)	**(I.R.S. Employer Identification No.)**

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

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

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

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company ¨
(Do not check if a smaller reporting company)

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

As of July 30, 2010, the number of shares of the Registrant s common stock outstanding was approximately 102.6 million shares and the aggregate market value of the common stock outstanding held by non-affiliates based upon the closing price of these shares on the New York Stock Exchange was approximately $5.8 billion.

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DAVITA INC.

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DAVITA INC.

CONSOLIDATED STATEMENTS OF INCOME

(unaudited)

(dollars in thousands, except per share data)

	Three months ended June 30,		Six months ended June 30,	
	2010	**2009**	**2010**	**2009**
Net operating revenues	$ 1,586,907	$ 1,519,041	$ 3,146,325	$ 2,966,681
Operating expenses and charges:				
Patient care costs	1,110,552	1,051,879	2,193,341	2,057,765
General and administrative	136,104	132,166	273,381	259,439
Depreciation and amortization	58,353	58,185	115,821	115,308
Provision for uncollectible accounts	42,367	41,233	83,930	77,969
Equity investment income	(2,834)	(376)	(5,179)	(358)
Total operating expenses and charges	1,344,542	1,283,087	2,661,294	2,510,123
Operating income	242,365	235,954	485,031	456,558
Debt expense	(43,655)	(47,088)	(88,238)	(95,389)
Debt redemption charges	(4,127)	-	(4,127)	-
Other income	739	1,273	1,570	2,027
Income before income taxes	195,322	190,139	394,236	363,196
Income tax expense	71,429	70,507	145,343	135,290
Net income	123,893	119,632	248,893	227,906
Less: Net income attributable to noncontrolling interests	(16,040)	(13,813)	(31,617)	(25,876)
Net income attributable to DaVita Inc.	$ 107,853	$ 105,819	$ 217,276	$ 202,030
Earnings per share:				
Basic earnings per share attributable to DaVita Inc.	$ 1.05	$ 1.02	$ 2.11	$ 1.95
Diluted earnings per share attributable to DaVita Inc.	$ 1.04	$ 1.02	$ 2.08	$ 1.94
Weighted average shares for earnings per share:				
Basic	103,003,623	103,705,683	103,182,403	103,791,579
Diluted	104,449,065	103,925,843	104,605,489	104,166,964

See notes to condensed consolidated financial statements.

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DAVITA INC.

CONSOLIDATED BALANCE SHEETS

(unaudited)

(dollars in thousands, except per share data)

	June 30, 2010	December 31, 2009
ASSETS		
Cash and cash equivalents	$ 574,716	$ 539,459
Short-term investments	22,926	26,475
Accounts receivable, less allowance of $234,376 and $229,317	1,070,633	1,105,903
Inventories	69,386	70,041
Other receivables	231,614	263,456
Other current assets	39,222	40,234
Deferred income taxes	256,653	256,953
Total current assets	2,265,150	2,302,521
Property and equipment, net	1,106,028	1,104,925
Amortizable intangibles, net	126,988	136,732
Equity investments	25,412	22,631
Long-term investments	7,190	7,616
Other long-term assets	33,202	32,615
Goodwill	4,013,711	3,951,196
	$ 7,577,681	$ 7,558,236
LIABILITIES AND EQUITY		
Accounts payable	$ 238,219	$ 176,657
Other liabilities	429,399	461,092
Accrued compensation and benefits	348,640	286,121
Current portion of long-term debt	96,590	100,007
Income taxes payable	5,970	23,064
Total current liabilities	1,118,818	1,046,941
Long-term debt	3,287,523	3,532,217
Other long-term liabilities	89,572	87,692
Alliance and product supply agreement, net	27,982	30,647
Deferred income taxes	349,617	334,855
Total liabilities	4,873,512	5,032,352
Commitments and contingencies		
Noncontrolling interests subject to put provisions	347,361	331,725
Equity:		
Preferred stock ($0.001 par value, 5,000,000 shares authorized; none issued)		
Common stock ($0.001 par value, 450,000,000 shares authorized; 134,862,283 shares issued; 102,592,141 and 103,062,698 shares outstanding)	135	135
Additional paid-in capital	638,373	621,685
Retained earnings	2,529,410	2,312,134
Treasury stock, at cost (32,270,142 and 31,799,585 shares)	(865,186)	(793,340)
Accumulated other comprehensive loss	(1,461)	(5,548)

Total DaVita Inc. shareholders equity	2,301,271	2,135,066
Noncontrolling interests not subject to put provisions	55,537	59,093
Total equity	2,356,808	2,194,159
	$ 7,577,681	$ 7,558,236

See notes to condensed consolidated financial statements.

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DAVITA INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

(dollars in thousands)

	Six months ended June 30,	
	2010	**2009**
Cash flows from operating activities:		
Net income	$ 248,893	$ 227,906
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	115,821	115,308
Stock-based compensation expense	22,399	22,412
Tax benefits from stock award exercises	12,896	9,974
Excess tax benefits from stock award exercises	(1,647)	(7,591)
Deferred income taxes	(10,697)	30,006
Equity investment income, net	(2,781)	(358)
Loss on disposal of assets and other non-cash charges	3,085	11,380
Debt redemption charges	4,127	-
Changes in operating assets and liabilities, other than from acquisitions and divestitures:		
Accounts receivable	33,724	(54,073)
Inventories	2,005	19,044
Other receivables and other current assets	33,053	4,026
Other long-term assets	(587)	3,324
Accounts payable	62,255	(51,960)
Accrued compensation and benefits	65,495	37,077
Other current liabilities	(26,127)	(42,359)
Income taxes	(5,103)	35,535
Other long-term liabilities	955	(13,019)
Net cash provided by operating activities	557,766	346,632
Cash flows from investing activities:		
Additions of property and equipment	(99,351)	(138,205)
Acquisitions	(91,701)	(43,314)
Proceeds from asset sales	17,681	5,784
Purchase of investments available for sale	(745)	(1,429)
Purchase of investments held-to-maturity	(15,836)	(15,193)
Proceeds from sale of investments available for sale	900	16,537
Proceeds from maturities of investments held-to-maturity	19,249	15,620
Purchase of equity investments and other assets	(350)	(260)
Distributions received on equity investments	350	88
Net cash used in investing activities	(169,803)	(160,372)
Cash flows from financing activities:		
Borrowings	9,689,658	9,114,319
Payments on long-term debt	(9,938,312)	(9,136,951)
Debt call premium	(3,314)	-
Purchase of treasury stock	(100,048)	(32,016)
Excess tax benefits from stock award exercises	1,647	7,591
Stock award exercises and other share issuances, net	34,113	16,691
Distributions to noncontrolling interests	(37,301)	(29,895)
Contributions from noncontrolling interests	3,408	6,504
Proceeds from sales of additional noncontrolling interests	2,845	5,475
Purchases from noncontrolling interests	(5,402)	(4,704)

Deferred financing costs	-	(42)
Net cash used in financing activities	(352,706)	(53,028)
Net increase in cash and cash equivalents	35,257	133,232
Cash and cash equivalents at beginning of period	539,459	410,881
Cash and cash equivalents at end of period	$ 574,716	$ 544,113

See notes to condensed consolidated financial statements.

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DAVITA INC.

CONSOLIDATED STATEMENTS OF EQUITY

AND COMPREHENSIVE INCOME

(unaudited)

(dollars and shares in thousands)

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

expense											
Excess tax benefits from stock awards exercised				6,150					6,150		
Distributions to noncontrolling interests	(44,277)									(23,471)	
Contributions from noncontrolling interests	10,502									2,569	
Sales and assumptions of additional noncontrolling interests	13,483			(529)					(529)	4,039	
Purchases from noncontrolling interests	(2,594)			(3,721)					(3,721)	(544)	
Changes in fair value of noncontrolling interests	24,819			(24,819)					(24,819)		
Other adjustments	14			(339)					(339)	(1,346)	
Purchase of treasury stock						(2,903)	(153,495)		(153,495)		
Balance at December 31, 2009	$ 331,725	134,862	$ 135	$ 621,685	$ 2,312,134	(31,800)	$ (793,340)	$ (5,548)	$ 2,135,066	$ 59,093	
Comprehensive income:											
Net income	23,319				217,276				217,276	8,298	248,893
Unrealized losses on interest rate swaps, net of tax								(132)	(132)		(132)
Less reclassification of net swap realized losses into net income, net of tax								4,370	4,370		4,370
Unrealized losses on investments, net of tax								(165)	(165)		(165)
Less reclassification of net investment realized losses into net income, net of tax								14	14		14
Total comprehensive income											$ 252,980
Stock purchase shares issued				2,130		86	2,151		4,281		
Stock unit shares issued				(414)		16	414				

Stock options and SSARs exercised				6,467		1,015	25,637		32,104	
Stock-based compensation expense				22,399					22,399	
Excess tax benefits from stock awards exercised				1,647					1,647	
Distributions to noncontrolling interests	(24,672)									(12,629)
Contributions from noncontrolling interests	1,215									2,193
Sales and assumptions of additional noncontrolling interests	2,404			(176)					(176)	1,989
Purchases from noncontrolling interests	(1,216)			(779)					(779)	(3,407)
Impact on fair value due to change in methodology	(24,571)			24,571					24,571	
Changes in fair value of noncontrolling interests	39,157			(39,157)					(39,157)	
Purchase of treasury stock						(1,587)	(100,048)		(100,048)	
Balance at June 30, 2010	$ 347,361	134,862	$ 135	$ 638,373	$ 2,529,410	(32,270)	$ (865,186)	$ (1,461)	$ 2,301,271	$ 55,537

See notes to condensed consolidated financial statements.

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DAVITA INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

(dollars and shares in thousands)

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

1. Condensed consolidated interim financial statements

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

2. Earnings per share

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

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DAVITA INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(unaudited)

(dollars and shares in thousands)

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

	Three months ended June 30,		Six months ended June 30,	
	2010	**2009**	**2010**	**2009**
Basic:				
Net income attributable to DaVita Inc.	$ 107,853	$ 105,819	$ 217,276	$ 202,030
Decrease (increase) in noncontrolling interest redemption rights in excess of fair value	798	-	(71)	-
Net income for basic earnings per share calculation	108,651	105,819	217,205	202,030
Weighted average shares outstanding during the period	102,997	103,697	103,175	103,783
Vested stock units	7	9	7	9
Weighted average shares for basic earnings per share calculation	103,004	103,706	103,182	103,792
Basic net income per share attributable to DaVita Inc.	$ 1.05	$ 1.02	$ 2.11	$ 1.95
Diluted:				
Net income for diluted earnings per share calculation	$ 107,853	$ 105,819	$ 217,276	$ 202,030
Decrease (increase) in noncontrolling interest redemption rights in excess of fair value	798	-	(71)	-
Net income for diluted earnings per share calculation	108,651	105,819	217,205	202,030
Weighted average shares outstanding during the period	102,997	103,697	103,175	103,783
Vested stock units	7	9	7	9
Assumed incremental shares from stock plans	1,445	220	1,423	375
Weighted average shares for diluted earnings per share calculation	104,449	103,926	104,605	104,167
Diluted net income per share attributable to DaVita Inc.	$ 1.04	$ 1.02	$ 2.08	$ 1.94
Shares subject to anti-dilutive awards excluded from calculation [1]	1,648	14,296	1,149	13,585

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

3. Stock-based compensation and other common stock transactions

Stock-based compensation recognized in a period represents the amortization during that period of the estimated grant-date fair value of current and prior stock-based awards over their vesting terms, adjusted for expected forfeitures. Shares issued upon exercise of stock awards are generally issued from shares in treasury. The Company has used the Black-Scholes-Merton valuation model for estimating the grant-date fair value of stock options and stock-settled stock appreciation rights granted in all periods. During the six months ended June 30, 2010, the Company granted 1,497 stock-settled stock appreciation rights with a grant-date fair value of

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DAVITA INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(unaudited)

(dollars and shares in thousands)

$23,674 and a weighted-average expected life of approximately 3.5 years, and also granted 455 stock units with a grant-date fair value of $28,542 and a weighted-average expected life of approximately 2.5 years.

For the six months ended June 30, 2010 and 2009, the Company recognized $22,399 and $22,412, respectively, in stock-based compensation expense for stock options, stock-settled stock appreciation rights, stock units and discounted employee stock plan purchases, which are primarily included in general and administrative expenses. The estimated tax benefit recorded for stock-based compensation through June 30, 2010 and 2009 was $8,518 and $8,504, respectively. As of June 30, 2010, there was $100,260 of total estimated unrecognized compensation cost related to nonvested stock-based compensation arrangements under the Company s equity compensation and stock purchase plans. The Company expects to recognize this cost over a weighted average remaining period of 1.5 years.

During the six months ended June 30, 2010 and 2009, the Company received $32,104 and $15,104, respectively, in cash proceeds from stock option exercises and $12,896 and $9,974, respectively, in actual tax benefits upon the exercise of stock awards.

During the first six months of 2010, the Company repurchased a total of 1,587 shares of its common stock for $100,048 or an average price of $63.04 per share, pursuant to previously announced authorizations by the Board of Directors. The Company has not repurchased any additional shares of its common stock subsequent to June 30, 2010. As a result of these transactions, the total remaining balance in the Company s current authorization for share repurchases is approximately $400,000. This stock repurchase program has no expiration date.

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

DAVITA INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(unaudited)

(dollars and shares in thousands)

4. Long-term debt

Long-term debt was comprised of the following:

	June 30, 2010	December 31, 2009
Senior Secured Credit Facilities:		
Term loan A	$ 109,375	$ 153,125
Term loan B	1,705,875	1,705,875
Senior and senior subordinated notes	1,550,000	1,750,000
Acquisition obligations and other notes payable	11,099	15,891
Capital lease obligations	5,993	4,635
Total debt principal outstanding	3,382,342	3,629,526
Premium on the 6 5/8% senior notes	1,771	2,698
	3,384,113	3,632,224
Less current portion	(96,590)	(100,007)
	$ 3,287,523	$ 3,532,217

Scheduled maturities of long-term debt at June 30, 2010 are as follows:

2010 (remainder of the year)	52,118
2011	66,695
2012	1,707,042
2013	701,218
2014	650
2015	850,432
Thereafter	4,187

On June 7, 2010, the Company redeemed $200,000 aggregate principal amount of its outstanding 6 5/8% senior notes due 2013, at a price of 101.656% plus accrued interest. As a result of this transaction, the Company incurred pre-tax debt redemption charges of $4,127, which includes the call premium and the net write-off of other finance costs.

During the first six months of 2010, the Company made mandatory principal payments totaling $43,750 on the term loan A.

The Company has entered into several interest rate swap agreements as a means of hedging its exposure to and volatility from variable-based interest rate changes as part of its overall risk management strategy. These agreements are not held for trading or speculative purposes, and have the economic effect of converting portions of our variable rate debt to a fixed rate. These agreements are designated as cash flow hedges, and as a result, hedge-effective gains or losses resulting from changes in the fair values of these swaps are reported in other comprehensive income

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

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DAVITA INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(unaudited)

(dollars and shares in thousands)

As of June 30, 2010, the Company maintained a total of six interest rate swap agreements with amortizing notional amounts totaling $350,000. These agreements had the economic effect of modifying the LIBOR-based variable interest rate on an equivalent amount of the Company s debt to fixed rates ranging from 4.05% to 4.70%, resulting in an overall weighted average effective interest rate of 5.83% 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 by September 30, 2010 and require quarterly interest payments. The existing unrealized pre-tax losses of $1,939 in other comprehensive income at June 30, 2010 will be reclassified into income in the third quarter of 2010.

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

	Interest rate swap liabilities			
	June 30, 2010		December 31, 2009	
Derivatives designated as hedging instruments	**Balance sheet location**	**Fair value**	**Balance sheet location**	**Fair value**
Interest rate swap agreements	Other current liabilities	$ 3,469	Other current liabilities	$ 10,792

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

	Amount of gains (losses) recognized in OCI on interest rate swap agreements				Location of (losses) gains reclassified from accumulated OCI into income	Amount of gains (losses) reclassified from accumulated OCI into income			
	Three months ended June 30,		Six months ended June 30,			Three months ended June 30,		Six months ended June 30,	
Derivatives designated as cash flow hedges	**2010**	**2009**	**2010**	**2009**		**2010**	**2009**	**2010**	**2009**
Interest rate swap agreements	$ 68	$ (1,398)	$ (215)	$ (1,960)	Debt expense	$ (3,572)	$ (4,282)	$ (7,151)	$ (8,830)
Tax expense benefit (expense)	(27)	544	83	763		1,389	1,666	2,781	3,435
Total	$ 41	$ (854)	$ (132)	$ (1,197)		$ (2,183)	$ (2,616)	$ (4,370)	$ (5,395)

Total comprehensive income for the three and six months ended June 30, 2010 was $125,752 and $252,980, respectively, including an increase to other comprehensive income for amounts reclassified into income, net of unrealized valuation loss on interest rate swaps of $2,224 and $4,238 net of tax, respectively, and a decrease to other comprehensive income for unrealized valuation gains on investments, and the amounts reclassified into income of $365 and $151, net of tax, respectively.

Total comprehensive income for the three and six months ended June 30, 2009 was $121,710 and $232,212, respectively, including an increase to comprehensive income for amounts reclassified into income, net of unrealized valuation losses on interest rate swaps of $1,762 and $4,198, net of tax, respectively, and an increase to other comprehensive income for amounts reclassified into income, net of unrealized valuation losses on investments of $316 and $108, net of tax, respectively.

As of June 30, 2010, the Company s interest rates were economically fixed on approximately 19% of its variable rate debt and approximately 56% of its total debt.

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DAVITA INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(unaudited)

(dollars and shares in thousands)

As a result of the swap agreements, the Company s overall weighted average effective interest rate on the Senior Secured Credit Facilities was 2.66%, based upon the current margins in effect of 1.50%, as of June 30, 2010.

The Company s overall weighted average effective interest rate during the second quarter of 2010 was 4.68% and as of June 30, 2010 was 4.62%.

As of June 30, 2010, the Company has undrawn revolving credit facilities totaling $250,000 of which approximately $52,000 was committed for outstanding letters of credit. In addition, the Company currently has undrawn revolving credit facilities totaling $3,200 associated with several of its joint ventures. These revolving credit facilities are typically guaranteed by DaVita Inc. or one of its wholly-owned operating subsidiaries based upon its proportionate ownership percentage.

5. Contingencies

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

Inquiries by the Federal Government

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

In February 2007, the Company received a request for information from the Office of Inspector General, U.S. Department of Health and Human Services, or OIG, for records relating to EPO claims submitted to Medicare. In August 2007, the Company received a subpoena from the OIG seeking similar documents. The requested documents relate to services provided from 2001 to 2004 by a number of the Company s centers. The request and subpoena were sent from the OIG s offices in Houston and Dallas, Texas. The Company is cooperating with the inquiry and is producing the requested records. The Company has been in contact with the U.S. Attorney s Office for the Eastern District of Texas, which has stated that this is a civil inquiry related to EPO claims. On July 6, 2009, the United States District Court for the Eastern District of Texas lifted the seal on the civil qui tam complaint related to these allegations and the Company was subsequently served with a

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complaint by the relator. The Company believes that there is some overlap between this issue and the ongoing review of EPO utilization and claims by the U.S. Attorney s Office for the Eastern District of Missouri in St. Louis described above.

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

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

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

Other

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

Several wage and hour claims have been filed against the Company in the Superior Court of California, each of which has been styled as a class action. In February 2007, June 2008, October 2008 and December 2008, the Company was served with five separate complaints in California, including two in October 2008, by various

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

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

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

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

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

6. Investments in debt and equity securities

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

The Company s investments consist of the following:

	June 30, 2010			December 31, 2009		
	Held to maturity	**Available for sale**	**Total**	**Held to maturity**	**Available for sale**	**Total**
Certificates of deposit, money market funds and U.S. treasury notes due within one year	$ 21,726	$	$ 21,726	$ 25,275	$	$ 25,275
Investments in mutual funds		8,390	8,390		8,816	8,816
	$ 21,726	$ 8,390	$ 30,116	$ 25,275	$ 8,816	$ 34,091
Short-term investments	$ 21,726	$ 1,200	$ 22,926	$ 25,275	$ 1,200	$ 26,475
Long-term investments		7,190	7,190		7,616	7,616
	$ 21,726	$ 8,390	$ 30,116	$ 25,275	$ 8,816	$ 34,091

The cost of the certificates of deposit, money market funds and U.S. treasury notes at June 30, 2010 and December 31, 2009 approximates their fair value. As of June 30, 2010 and December 31, 2009, the available for sale investments included $454 and $205, respectively, of gross pre-tax unrealized losses. During the six months ended June 30, 2010, the Company recorded gross pre-tax unrealized losses of $271, or $165 after tax, in other comprehensive income associated with changes in the fair value of these investments. During the six months ended June 30, 2010, the Company sold equity securities in mutual funds for net proceeds of $900, and recognized a pre-tax loss of $22, or $14 after tax, that was previously recorded in other comprehensive income. During the six months ended June 30, 2009, the Company sold equity securities in mutual funds for net proceeds of $16,537, and recognized a pre-tax gain of $255, or $156 after tax, that was previously recorded in other comprehensive income. These pre-tax amounts are included in other income.

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As of June 30, 2010, investments totaling approximately $18,480 classified as held to maturity are investments used to maintain certain capital requirements of the special need plans of VillageHealth, which is a wholly-owned subsidiary of the Company. As of December 31, 2009, the Company discontinued the VillageHealth special needs plans and is in the process of paying out all incurred claims. The Company expects to liquidate these investments as soon as all of the claims are paid and the various state regulatory agencies approve the release of these investments. The investments in mutual funds classified as available for sale are held in trust to fund existing obligations associated with several of the Company s non-qualified deferred compensation plans.

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

7. Fair value of financial instruments

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

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

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The following table summarizes the Company s assets and liabilities measured at fair value on a recurring basis as of June 30, 2010:

	Total	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets				
Available for sale securities	$ 8,390	$ 8,390	$	$
Liabilities				
Interest rate swap agreements	$ 3,469	$	$ 3,469	$
Temporary equity				
Noncontrolling interests subject to put provisions	$ 347,361	$	$	$ 347,361

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

The interest rate swap agreements are recorded at fair value based upon valuation models that include a variety of assumptions and techniques as used by various broker dealers that are based upon relevant observable market inputs such as current interest rates, forward yield curves, and other market conditions. The Company does not believe the ultimate amount that could be realized upon settlement of these interest rate swap agreements would be materially different than the fair values as currently reported. See Note 4 to the condensed consolidated financial statements for further discussion.

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

The Company has other financial instruments in addition to the above that consist primarily of cash, accounts receivable, notes receivable, accounts payable, other accrued liabilities, and debt. The balances of the non-debt financial instruments are presented in the condensed consolidated financial statements at June 30, 2010 at their approximate fair values due to the short-term nature of their settlements. Borrowings under the Company s Senior Secured Credit Facilities totaled $1,815,250 as of June 30, 2010 and the fair value was $1,756,254 based upon quoted market prices. The fair value of the Company s senior and senior subordinated notes was approximately $1,550,000 at June 30, 2010, based upon quoted market prices, as compared to the carrying amount of $1,551,771, which includes the premium on the 6 5/8% senior notes.

8. Noncontrolling interests subject to put provisions and other commitments

The Company has potential obligations to purchase the noncontrolling interests held by third parties in several of its joint ventures and non-wholly-owned subsidiaries. These obligations are in the form of put provisions and are exercisable at the third-party owners discretion within specified periods as outlined in each specific put provision. If these put provisions were exercised, the Company would be required to purchase the third-party owners noncontrolling interests at either the appraised fair market value or a predetermined multiple of earnings or cash flow attributable to the noncontrolling interests put to the Company, which is intended to

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approximate fair value. The methodology the Company uses to estimate the fair values of noncontrolling interests subject to put provisions assumes either the higher of a liquidation value of net assets or an average multiple of earnings, based on historical earnings, patient mix and other performance indicators, as well as other factors. During the second quarter of 2010, the Company refined its methodology used to estimate the fair value of noncontrolling interests subject to put provisions by eliminating an annual inflation factor that was previously applied to the put provisions until they became exercisable. The Company believes that eliminating an annual inflation factor will result in a better representation of the estimated actual fair value of the noncontrolling interests subject to put provisions as of the reporting date. The estimated fair values of the noncontrolling interests subject to put provisions can fluctuate and the implicit multiple of earnings at which these noncontrolling interests obligations may be settled will vary significantly depending upon market conditions including potential purchasers access to the capital markets, which can impact the level of competition for dialysis and non-dialysis related businesses, the economic performance of these businesses and the restricted marketability of the third-party owners noncontrolling interests. The amount of noncontrolling interests subject to put provisions that contractually employ a predetermined multiple of earnings rather than fair value are immaterial.

Additionally, the Company has certain other potential commitments to provide operating capital to several dialysis centers that are wholly-owned by third parties or centers in which the Company owns an equity investment as well as to physician-owned vascular access clinics that the Company operates under management and administrative services agreements of approximately $6,200.

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

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

9. Income taxes

As of June 30, 2010, the Company s total liability for unrecognized tax benefits relating to tax positions that do not meet the more-likely-than-not threshold is $18,871, of which $12,439 would impact the Company s effective tax rate if recognized. The balance represents a decrease of $11,822 from the December 31, 2009 balance, primarily due to a tax accounting method change initiated during the quarter ending March 31, 2010. This decrease did not impact the Company s effective tax rate. It is reasonably possible that $6,432 of unrecognized tax benefits may be recognized within the next 12 months, primarily related to tax accounting method changes, which will also not impact the Company s effective tax rate.

The Company recognizes accrued interest and penalties related to unrecognized tax benefits in its income tax expense. At June 30, 2010 and December 31, 2009, the Company had approximately $4,491 and $3,226, respectively, accrued for interest and penalties related to unrecognized tax benefits, net of federal tax benefits.

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10. Segment reporting

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

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

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

	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
Segment revenues:				
Dialysis and related lab services [1]	$ 1,496,178	$ 1,441,165	$ 2,974,602	$ 2,817,728
Other Ancillary services and strategic initiatives	90,729	77,876	171,723	148,953
Consolidated revenues	$ 1,586,907	$ 1,519,041	$ 3,146,325	$ 2,966,681
Segment operating income (loss):				
Dialysis and related lab services	$ 254,013	$ 249,793	$ 506,574	$ 485,981
Other Ancillary services and strategic initiatives	(2,315)	(2,812)	(4,323)	(7,369)
Total segment operating income	251,698	246,981	502,251	478,612
Reconciliation of segment operating income to consolidated income before income taxes:				
Stock-based compensation	(12,167)	(11,403)	(22,399)	(22,412)
Equity investment income	2,834	376	5,179	358
Consolidated operating income	242,365	235,954	485,031	456,558
Debt expense	(43,655)	(47,088)	(88,238)	(95,389)
Debt redemption charges	(4,127)	-	(4,127)	-
Other income	739	1,273	1,570	2,027
Consolidated income before income taxes	$ 195,322	$ 190,139	$ 394,236	$ 363,196

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

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Depreciation and amortization expense for the dialysis and related lab services for the three and six months ended June 30, 2010 were $56,714 and $112,532, respectively, and were $1,639 and $3,289, respectively, for the ancillary services and strategic initiatives.

Depreciation and amortization expense for the dialysis and related lab services for the three and six months ended June 30, 2009 were $56,398 and $111,772, respectively, and were $1,787 and $3,536, respectively, for the ancillary services and strategic initiatives.

Summary of assets by segment is as follows:

	June 30, 2010	December 31, 2009
Segment assets		
Dialysis and related lab services	$ 7,360,245	$ 7,334,235
Other Ancillary services and strategic initiatives	217,436	224,001
Consolidated assets	$ 7,577,681	$ 7,558,236

For the three and six months ended June 30, 2010, the total amount of expenditures for property and equipment for the dialysis and related lab services were $55,280 and $100,315, respectively, and were $1,485 and $1,822, respectively, for the ancillary services and strategic initiatives.

For the three and six months ended June 30, 2009, the total amount of expenditures for property and equipment for the dialysis and related lab services were $64,094 and $136,452, respectively, and were $908 and $1,753, respectively, for the ancillary services and strategic initiatives.

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

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

	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
Net income attributable to DaVita Inc.	$ 107,853	$ 105,819	$ 217,276	$ 202,030
Decrease in paid-in capital for sales of noncontrolling interest in two and three joint ventures in 2010 and three and seven joint ventures in 2009	(228)	(159)	(176)	(334)
Decrease in paid-in capital for the purchase of noncontrolling interest in three and four joint ventures in 2010 and two and three joint ventures in 2009	(992)	(1,660)	(779)	(2,455)
Net transfer to noncontrolling interests	(1,220)	(1,819)	(955)	(2,789)
	$ 106,633	$ 104,000	$ 216,321	$ 199,241

Change from net income attributable to DaVita Inc. and transfers to noncontrolling interests

12. Variable interest entities

Effective January 1, 2010, the FASB eliminated the quantitative approach previously required for determining the primary beneficiary of a variable interest entity, and required additional disclosures about an enterprise s involvement in variable interest entities. An entity is required to perform an analysis to determine

DAVITA INC.

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

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

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

Total assets of these consolidated operating VIEs were approximately $23,000 and their liabilities to unrelated third parties were approximately $16,000 at June 30, 2010.

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

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13. Condensed consolidating financial statements

The following information is presented in accordance with Rule 3-10 of Regulation S-X. The operating and investing activities of the separate legal entities included in the consolidated financial statements are fully interdependent and integrated. Revenues and operating expenses of the separate legal entities include intercompany charges for management and other services. The 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.

Condensed Consolidating Statements of Income

For the three months ended June 30, 2010	**DaVita Inc.**	**Guarantor subsidiaries**	**Non-Guarantor subsidiaries**	**Consolidating adjustments**	**Consolidated total**
Net operating revenues	$ 109,757	$ 1,296,123	$ 296,427	$ (115,400)	$ 1,586,907
Operating expenses	66,242	1,157,093	236,607	(115,400)	1,344,542
Operating income	43,515	139,030	59,820		242,365
Debt (expense)	(48,103)	(41,392)	(128)	41,841	(47,782)
Other income	41,885		695	(41,841)	739
Income tax expense	14,835	54,766	1,828		71,429
Equity earnings in subsidiaries	85,391	41,999		(127,390)	
Net income	107,853	84,871	58,559	(127,390)	123,893
Less: Net income attributable to noncontrolling interests				(16,040)	(16,040)
Net income attributable to DaVita Inc.	$ 107,853	$ 84,871	$ 58,559	$ (143,430)	$ 107,853
For the three months ended June 30, 2009					
Net operating revenues	$ 99,102	$ 1,268,285	$ 256,664	$ (105,010)	$ 1,519,041
Operating expenses	63,033	1,114,298	210,766	(105,010)	1,283,087
Operating income	36,069	153,987	45,898		235,954
Debt (expense)	(47,718)	(38,640)	(353)	39,623	(47,088)
Other income	40,716		180	(39,623)	1,273
Income tax expense	11,630	57,052	1,825		70,507
Equity earnings in subsidiaries	88,382	29,214		(117,596)	
Net income	105,819	87,509	43,900	(117,596)	119,632
Less: Net income attributable to noncontrolling interests				(13,813)	(13,813)
Net income attributable to DaVita Inc.	$ 105,819	$ 87,509	$ 43,900	$ (131,409)	$ 105,819

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(unaudited)

(dollars and shares in thousands)

	DaVita Inc.	Guarantor subsidiaries	Non-Guarantor subsidiaries	Consolidating adjustments	Consolidated total
For the six months ended June 30, 2010					
Net operating revenues	$ 213,425	$ 2,591,287	$ 566,997	$ (225,384)	$ 3,146,325
Operating expenses	126,277	2,296,024	464,377	(225,384)	2,661,294
Operating income	87,148	295,263	102,620		485,031
Debt (expense)	(92,801)	(83,615)	(333)	84,384	(92,365)
Other income	85,140		814	(84,384)	1,570
Income tax expense	31,795	110,506	3,042		145,343
Equity earnings in subsidiaries	169,584	67,592		(237,176)	
Net income	217,276	168,734	100,059	(237,176)	248,893
Less: Net income attributable to noncontrolling interests				(31,617)	(31,617)
Net income attributable to DaVita Inc.	$ 217,276	$ 168,734	$ 100,059	$ (268,793)	$ 217,276
For the six months ended June 30, 2009					
Net operating revenues	$ 191,925	$ 2,490,278	$ 489,032		