

DAVITA INC
Form 10-Q
May 02, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

For the Quarterly Period Ended

March 31, 2012

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

Commission File Number: 1-14106

DAVITA INC.

1551 Wewatta Street

Denver, CO 80202

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Telephone number (303) 405-2100

Delaware
(State of incorporation)

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

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

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

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

Large accelerated filer ☒ Accelerated filer ☐

Non-accelerated filer ☐ (Do not check if a smaller reporting company) Smaller reporting company ☐

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

As of April 27, 2012, the number of shares of the Registrant's common stock outstanding was approximately 94.0 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 \$8.4 billion.

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

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DAVITA INC.
CONSOLIDATED STATEMENTS OF INCOME

(unaudited)

(dollars in thousands, except per share data)

	Three months ended March 31,	
	2012	2011
Patient service operating revenues	\$ 1,763,700	\$ 1,497,434
Less: Provision for uncollectible accounts related to patient service operating revenues	(53,008)	(41,071)
Net patient service operating revenues	1,710,692	1,456,363
Other revenues	155,943	105,950
Total net operating revenues	1,866,635	1,562,313
Operating expenses and charges:		
Patient care costs	1,263,159	1,114,086
General and administrative	207,389	151,602
Depreciation and amortization	75,975	61,838
Provision for uncollectible accounts	2,024	972
Equity investment income	(2,632)	(1,519)
Total operating expenses and charges	1,545,915	1,326,979
Operating income	320,720	235,334
Debt expense	(61,381)	(58,595)
Other income	1,039	841
Income from continuing operations before income taxes	260,378	177,580
Income tax expense	95,495	62,959
Income from continuing operations	164,883	114,621
Discontinued operations:		
Income from operations of discontinued operations, net of tax		131
Net income.	164,883	114,752
Less: Net income attributable to noncontrolling interests	(24,763)	(20,250)
Net income attributable to DaVita Inc.	\$ 140,120	\$ 94,502
Earnings per share:		
Basic income from continuing operations per share attributable to DaVita Inc.	\$ 1.49	\$ 0.98
Basic net income per share attributable to DaVita Inc.	\$ 1.49	\$ 0.98
Diluted income from continuing operations per share attributable to DaVita Inc.	\$ 1.46	\$ 0.96
Diluted net income per share attributable to DaVita Inc.	\$ 1.46	\$ 0.96

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Weighted average shares for earnings per share:

Basic	93,769,092	96,263,802
Diluted	95,729,105	98,378,371

Amounts attributable to DaVita Inc.:

Income from continuing operations	\$ 140,120	\$ 94,371
Discontinued operations		131
Net income	\$ 140,120	\$ 94,502

See notes to condensed consolidated financial statements.

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

	Three months ended March 31,	
	2012	2011
Net income	\$ 164,883	\$ 114,752
Other comprehensive income (loss), net of tax:		
Unrealized losses on interest rate swap and cap agreements:		
Unrealized losses on interest rate swap and cap agreements	(2,261)	(4,134)
Less: Reclassifications of net swap and cap agreements realized losses into net income	2,520	1,743
Unrealized gains on investments:		
Unrealized gains on investments	1,146	268
Less: Reclassification of net investment realized gains into net income	(75)	(57)
Foreign currency translation adjustments	(619)	
Other comprehensive income (loss)	711	(2,180)
Total comprehensive income	165,594	112,572
Less: Comprehensive income attributable to the noncontrolling interest	(24,763)	(20,250)
Comprehensive income attributable to DaVita Inc.	140,831	\$ 92,322

See notes to condensed consolidated financial statements.

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

	March 31, 2012	December 31, 2011
ASSETS		
Cash and cash equivalents	\$ 449,290	\$ 393,752
Short-term investments	8,616	17,399
Accounts receivable, less allowance of \$289,238 and \$250,343	1,266,869	1,195,163
Inventories	72,285	75,731
Other receivables	216,493	269,832
Other current assets	47,492	49,349
Deferred income taxes	313,355	280,382
Total current assets	2,374,400	2,281,608
Property and equipment, net	1,490,572	1,432,651
Amortizable intangibles, net	160,617	159,491
Equity investments	26,956	27,325
Long-term investments	9,897	9,890
Other long-term assets	30,065	34,231
Goodwill	5,064,577	4,946,976
	\$ 9,157,084	\$ 8,892,172
LIABILITIES AND EQUITY		
Accounts payable	\$ 269,029	\$ 289,653
Other liabilities	347,096	325,734
Accrued compensation and benefits	455,825	412,972
Current portion of long-term debt	89,646	87,345
Income tax payable	80,519	37,412
Total current liabilities	1,242,115	1,153,116
Long-term debt	4,401,865	4,417,624
Other long-term liabilities	139,656	132,006
Alliance and product supply agreement, net	18,655	19,987
Deferred income taxes	448,372	423,098
Total liabilities	6,250,663	6,145,831
Commitments and contingencies		
Noncontrolling interests subject to put provisions	504,491	478,216
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; 93,983,930 and 93,641,363 shares outstanding)	135	135
Additional paid-in capital	575,364	596,300
Retained earnings	3,335,938	3,195,818
Treasury stock, at cost (40,878,353 and 41,220,920 shares)	(1,618,134)	(1,631,694)
Accumulated other comprehensive loss	(18,773)	(19,484)

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Total DaVita Inc. shareholders' equity	2,274,530	2,141,075
Noncontrolling interests not subject to put provisions	127,400	127,050
Total equity	2,401,930	2,268,125
	\$ 9,157,084	\$ 8,892,172

See notes to condensed consolidated financial statements.

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DAVITA INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

(dollars in thousands)

	Three months ended March 31,	
	2012	2011
Cash flows from operating activities:		
Net income	\$ 164,883	\$ 114,752
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	75,975	62,037
Stock-based compensation expense	12,550	9,716
Tax benefits from stock award exercises	10,890	13,868
Excess tax benefits from stock award exercises	(6,101)	(7,196)
Deferred income taxes	(13,335)	18,221
Equity investment income, net	483	1,420
Loss on disposal of assets and other non-cash charges	7,125	5,506
Changes in operating assets and liabilities, other than from acquisitions and divestitures:		
Accounts receivable	(71,706)	(20,461)
Inventories	4,851	7,429
Other receivables and other current assets	56,452	24,922
Other long-term assets	3,742	990
Accounts payable	(20,624)	26,565
Accrued compensation and benefits	41,623	31,542
Other current liabilities	17,462	9,483
Income taxes	43,072	29,878
Other long-term liabilities	4,532	1,111
Net cash provided by operating activities	331,874	329,783
Cash flows from investing activities:		
Additions of property and equipment, net	(112,459)	(67,530)
Acquisitions	(132,699)	(81,523)
Proceeds from asset sales	825	2,812
Purchase of investments available for sale	(489)	(298)
Purchase of investments held-to-maturity	(3,212)	(15,161)
Proceeds from sale of investments available for sale	6,791	1,149
Proceeds from maturities of investments held-to-maturity	7,551	15,163
Distributions received on equity investments	2	
Net cash used in investing activities	(233,690)	(145,388)
Cash flows from financing activities:		
Borrowings	8,634,603	10,983,125
Payments on long-term debt	(8,658,001)	(11,000,635)
Interest rate cap premiums and other deferred financing costs	3	(13,399)
Distributions to noncontrolling interests	(26,405)	(22,187)
Stock award exercises and other share issuances, net	1,663	3,410
Excess tax benefits from stock award exercises	6,101	7,196
Contributions from noncontrolling interests	3,651	3,959

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Proceeds from sales of additional noncontrolling interests	100	785
Purchases from noncontrolling interests	(4,372)	(756)
Net cash used in financing activities	(42,657)	(38,502)
Effect of exchange rate changes on cash and cash equivalents	11	
Net increase in cash and cash equivalents	55,538	145,893
Cash and cash equivalents at beginning of period	393,752	860,117
Cash and cash equivalents at end of period	\$ 449,290	\$ 1,006,010

See notes to condensed consolidated financial statements.

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DAVITA INC.
CONSOLIDATED STATEMENTS OF EQUITY
(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	
Balance at December 31, 2010	\$ 383,052	134,862	\$ 135	\$ 620,546	\$ 2,717,817	(38,861)	\$ (1,360,579)	\$ 503	\$ 1,978,422	\$ 58,712
Comprehensive income:										
Net income	59,135				478,001				478,001	36,259
Other comprehensive loss							(19,987)	(19,987)		
Stock purchase shares issued				4,268		175	6,554		10,822	
Stock unit shares issued				(2,866)		78	2,866			
Stock options and SSARs exercised				(37,370)		1,182	42,813		5,443	
Stock-based compensation expense				48,718					48,718	
Excess tax benefits from stock awards exercised				20,834					20,834	
Distributions to noncontrolling interests	(61,343)									(39,310)
Contributions from noncontrolling interests	12,547									8,463
Sales and assumptions of additional noncontrolling interests	49,343			(1,299)				(1,299)		55,566
Purchases from noncontrolling interests	(2,103)			(9,486)				(9,486)		(2,100)
Changes in fair value of noncontrolling interests	63,762			(63,762)				(63,762)		
Expired put provision	(26,177)			16,717				16,717		9,460
Purchase of treasury stock						(3,795)	(323,348)		(323,348)	
Balance at December 31, 2011	\$ 478,216	134,862	\$ 135	\$ 596,300	\$ 3,195,818	(41,221)	\$ (1,631,694)	\$ (19,484)	\$ 2,141,075	\$ 127,050
Comprehensive income:										
Net income	15,775				140,120				140,120	8,988
Other comprehensive income							711	711		
Stock unit shares issued				(1,095)		28	1,095			
Stock options and SSARs exercised				(11,074)		315	12,465		1,391	
Stock-based compensation expense				12,550					12,550	
Excess tax benefits from stock awards exercised				6,101					6,101	
Distributions to noncontrolling interests	(15,394)									(11,011)
Contributions from noncontrolling interests	2,843									808
Sales and assumptions of additional noncontrolling interests				5					5	1,565

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Purchases from noncontrolling interests	(3,475)	(897)	(897)
Changes in fair value of noncontrolling interests	26,526	(26,526)	(26,526)

Balance at March 31, 2012	\$ 504,491	134,862	\$ 135	\$ 575,364	\$ 3,335,938	(40,878)	\$ (1,618,134)	\$ (18,773)	\$ 2,274,530	\$ 127,400
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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, 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 revenues 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 three months ended March 31, 2012 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, 2011. 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.

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

(dollars and shares in thousands, except per share data)

2. Earnings per share

Basic net income per share is calculated by dividing net income attributable to DaVita Inc., net of the decrease 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-settled stock appreciation rights, stock options and unvested stock units (under the treasury stock method).

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

	Three months ended March 31,	
	2012	2011
Basic:		
Income from continuing operations attributable to DaVita Inc.	\$ 140,120	\$ 94,371
Decrease in noncontrolling interest redemption rights in excess of fair value		27
Income from continuing operations for basic earnings per share calculation	\$ 140,120	\$ 94,398
Discontinued operations attributable to DaVita Inc.		131
Net income attributable to DaVita Inc. for basic earnings per share calculation	\$ 140,120	\$ 94,529
Weighted average shares outstanding during the period	93,766	96,258
Vested stock units	3	6
Weighted average shares for basic earnings per share calculation	93,769	96,264
Basic income from continuing operations per share attributable to DaVita Inc.	\$ 1.49	\$ 0.98
Basic net income per share attributable to DaVita Inc.	\$ 1.49	\$ 0.98
Diluted:		
Income from continuing operations attributable to DaVita Inc.	\$ 140,120	\$ 94,371
Decrease in noncontrolling interest redemption rights in excess of fair value		27
Income from continuing operations for diluted earnings per share calculation	\$ 140,120	\$ 94,398
Discontinued operations attributable to DaVita Inc.		131
Net income attributable to DaVita Inc. for diluted earnings per share calculation	\$ 140,120	\$ 94,529
Weighted average shares outstanding during the period	93,766	96,258
Vested stock units	3	6
Assumed incremental shares from stock plans	1,960	2,114

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Weighted average shares for diluted earnings per share calculation	95,729	98,378
Diluted income from continuing operations per share attributable to DaVita Inc.	\$ 1.46	\$ 0.96
Diluted net income per share attributable to DaVita Inc.	\$ 1.46	\$ 0.96
Anti-dilutive stock-settled awards excluded from calculation ⁽¹⁾	2,309	558

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

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

(dollars and shares in thousands, except per share data)

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-settled stock appreciation rights granted in all periods. During the three months ended March 31, 2012, the Company granted 100 stock-settled stock appreciation rights with an aggregate grant-date fair value of \$1,916 and a weighted-average expected life of approximately 3.5 years, and also granted 8 stock units with an aggregate grant-date fair value of \$672 and a weighted-average expected life of approximately 2.0 years.

For the three months ended March 31, 2012 and 2011, the Company recognized \$12,550 and \$9,716, respectively, in stock-based compensation expense for stock appreciation rights, stock units and discounted employee stock plan purchases, which are primarily included in general and administrative expenses. The estimated tax benefits recorded for stock-based compensation through March 31, 2012 and 2011 was \$4,723 and \$3,673, respectively. As of March 31, 2012, there was \$82,358 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 1.4 years.

During the three months ended March 31, 2012 and 2011, the Company received \$1,391 and \$2,244, respectively, in cash proceeds from stock option exercises and \$10,890 and \$13,868, respectively, in actual tax benefits upon the exercise of stock awards.

4. Long-term debt

Long-term debt was comprised of the following:

	March 31, 2012	December 31, 2011
Senior Secured Credit Facilities:		
Term Loan A	\$ 937,500	\$ 950,000
Term Loan A-2	199,000	199,500
Term Loan B	1,728,125	1,732,500
Senior notes	1,550,000	1,550,000
Acquisition obligations and other notes payable	32,209	37,447
Capital lease obligations	52,104	43,364
 Total debt principal outstanding	 4,498,938	 4,512,811
Discount on long-term debt	(7,427)	(7,842)
	4,491,511	4,504,969
Less current portion	(89,646)	(87,345)
	 \$ 4,401,865	 \$ 4,417,624

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

(dollars and shares in thousands, except per share data)

Scheduled maturities of long-term debt at March 31, 2012 were as follows:

2012 (remainder of the year)	58,189
2013	126,747
2014	178,987
2015	678,555
2016	1,861,859
2017	6,098
Thereafter	1,588,503

During the first three months of 2012, the Company made mandatory principal payments under its Senior Secured Credit Facilities totaling \$12,500 on the Term Loan A, \$500 on the Term Loan A-2 and \$4,375 on the Term Loan B.

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 the LIBOR variable component of the Company's interest rate to a fixed rate. These swap 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. In addition, the Company has entered into several interest rate cap agreements that have the economic effect of capping the Company's maximum exposure to LIBOR variable interest rate changes on specific portions of the Company's Term Loan B debt, as described below. These cap agreements are also designated as cash flow hedges and as a result changes in the fair values of these cap agreements are reported in other comprehensive income. The amortization of the original cap premium is recognized as a component of debt expense on a straight line basis over the term on the cap agreements. The swap and cap agreements do not contain credit-risk contingent features.

As of March 31, 2012, the Company maintained a total of nine interest rate swap agreements with amortizing notional amounts totaling \$937,500. These agreements had the economic effect of modifying the LIBOR variable component of the Company's interest rate on an equivalent amount of the Company's Term Loan A to fixed rates ranging from 1.59% to 1.64%, resulting in an overall weighted average effective interest rate of 4.11%, including the Term Loan A margin of 2.50%. The swap agreements expire by September 30, 2014 and require monthly interest payments. The Company estimates that approximately \$11,900 of existing unrealized pre-tax losses in other comprehensive income at March 31, 2012 will be reclassified into income over the next twelve months.

As of March 31, 2012, the Company maintained five interest rate cap agreements with notional amounts totaling \$1,250,000. These agreements have the economic effect of capping the LIBOR variable component of the Company's interest rate at a maximum of 4.00% on an equivalent amount of the Company's Term Loan B debt. The cap agreements expire on September 30, 2014.

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

(dollars and shares in thousands, except per share data)

The following table summarizes the Company's derivative instruments as of March 31, 2012 and December 31, 2011:

Derivatives designated as hedging instruments	March 31, 2012		December 31, 2011	
	Balance sheet location	Fair value	Balance sheet location	Fair value
Interest rate swap agreements	Other long-term liabilities	\$ 23,196	Other long-term liabilities	\$ 23,145
Interest rate cap agreements	Other long-term assets	\$ 958	Other long-term assets	\$ 1,381

The following table summarizes the effects of the Company's interest rate swap and cap agreements for the three months ended March 31, 2012 and 2011:

Derivatives designated as cash flow hedges	Amount of gains (losses) recognized in OCI on interest rate swap and cap agreements Three months ended March 31,		Location of gains (losses) reclassified from accumulated OCI into income	Amount of gains (losses) reclassified from accumulated OCI into income Three months ended March 31,	
	2012	2011		2012	2011
Interest rate swap agreements	\$ (3,276)	\$ (3,200)	Debt expense	\$ (3,225)	\$ (2,254)
Interest rate cap agreements	(424)	(3,564)	Debt expense	(897)	(598)
Tax benefit	1,439	2,630		1,602	1,109
Total	\$ (2,261)	\$ (4,134)		\$ (2,520)	\$ (1,743)

As of March 31, 2012, interest rates on the Company's Term Loan A-2 and Term Loan B debt are set at their interest rate floors. Interest rates on the Company's senior notes and Term Loan A are fixed and economically fixed, respectively, while rates on \$1,250,000 of the Company's Term Loan B is subject to interest rate caps.

As a result of the swap and cap agreements, the Company's overall weighted average effective interest rate on the Senior Secured Credit Facilities was 4.63%, based upon the current margins in effect of 2.50% for the Term loan A, 3.50% for the Term Loan A-2 and 3.00% for the Term Loan B, as of March 31, 2012.

The Company's overall weighted average effective interest rate during the first quarter of 2012 was 5.27% and as of March 31, 2012 was 5.28%.

As of March 31, 2012, the Company had undrawn revolving credit facilities totaling \$350,000 of which approximately \$52,297 was committed for outstanding letters of credit.

5. Contingencies

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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 Medicare contractors 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

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DAVITA INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(unaudited)

(dollars and shares in thousands, except per share data)

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 and Certain Related Civil Proceedings

2005 U.S. Attorney Investigation: 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 required 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 March 2005. 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®, or 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 cooperated with the inquiry and has produced the requested records. The subpoenas were 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 investigation. The Company has not received a communication from the St. Louis U.S. Attorney's Office on this matter in over two years.

Woodard Private Civil Suit: 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 cooperated with the inquiry and has produced all previously requested records to date. The Company was contacted by the U.S. Attorney's Office for the Eastern District of Texas, which stated that this was a civil investigation 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 previous requests for information. The Company was subsequently served with a complaint by the relator, Ivey Woodard, purportedly on behalf of the federal government, under the *qui tam* provisions of the federal False Claims Act. The government did not intervene and is not actively pursuing this matter. The relator is pursuing the claims independently and the parties are engaged in active litigation. The complaint contains allegations relating to the Company's EPO practices for the period from 1992 through 2010 and seeks monetary damages and civil penalties as well as costs and expenses. The court has ruled that claims earlier than 1996 are beyond the statute of limitations. The Company believes that there is some overlap between the subject of this complaint and the review of EPO utilization in the 2005 U.S. Attorney investigation described above. The Company is vigorously defending this matter and intends to continue to do so. The Company can make no assurances as to the time or resources that will be needed to devote to this litigation or its final outcome.

Vainer Private Civil Suit: In December 2008, The Company received a subpoena for documents from the OIG relating to the pharmaceutical products Zemplar, Hecitorol, Venofer, Ferlecit and EPO, as well as other related matters. The subpoena covers the period from January 2003 to December 2008. The Company was in contact with the 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 were advised that this was a civil inquiry. On June 17, 2009, the Company learned that the allegations underlying this inquiry were made as part of a civil

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complaint filed by individuals and brought pursuant to the *qui tam* provisions of the federal False Claims Act. On April 1, 2011, the United States District Court for the Northern District of Georgia ordered the case to be unsealed. At that time, the Department of Justice and U.S. Attorney's Office filed a notice of declination stating that the United States would not be intervening and not pursuing the relators' allegation in litigation. On July 25, 2011, the relators, Daniel Barbir and Dr. Alon Vainer, filed their amended complaint in the United States District Court for the Northern District of Georgia, purportedly on behalf of the federal government. The allegations in the complaint relate to the Company's drug administration practices for Vitamin D and iron agents for a period from 2003 through 2010. The complaint seeks monetary damages and civil penalties as well as costs and expenses. The Company is vigorously defending this matter and intends to continue to do so. The Company can make no assurances as to the time or resources that will be needed to devote to this litigation or its final outcome.

2010 U.S. Attorney Physician Relationship Investigation: 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 to May 2010, 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 Company met with representatives of the government to discuss the scope of the subpoena and the production of responsive documents. The Company has been advised that this is a civil investigation. The Company is cooperating with the inquiry. The Company can make no assurances as to the time or resources that will be needed to devote to this litigation or its final outcome.

2011 U.S. Attorney Physician Relationship Investigation: In August 2011, the Company announced it had learned that the U.S. Attorney's Office for the District of Colorado would be looking into certain activities of the Company in connection with information being provided to a grand jury. The Company announced further that it understood that this investigation was at a very preliminary stage, and while its precise scope was unclear, it appeared to overlap, at least in part, with the 2010 U.S. Attorney Physician Relationship Investigation described above. Subsequent to the Company's announcement of this 2011 U.S. Attorney Physician Relationship Investigation, it received a subpoena for documents which substantially overlaps with the subpoena in the 2010 U.S. Attorney Physician Relationship Investigation described above and covers the period from January 2006 to September 2011. The Company is cooperating with the government and is producing the requested records. Certain current and former members of the Board and executives received subpoenas in November 2011 and thereafter to testify before the grand jury, and other Company representatives may also receive subpoenas for testimony related to this matter. The Company can make no assurances as to the time or resources that will be needed to devote to this litigation or its final outcome.

2011 U.S. Attorney Medicaid Investigation: In October 2011, the Company announced that it would be receiving a request for documents, which could include an administrative subpoena from the Office of Inspector General for the U.S. Department of Health and Human Services. Subsequent to the Company's announcement of this 2011 U.S. Attorney Medicaid Investigation, the Company received a request for documents in connection with the inquiry by the United States Attorney's Office for the Eastern District of New York. The request relates to payments for infusion drugs covered by Medicaid composite payments for dialysis. The Company believes this inquiry is civil in nature. The Company does not know the time period or scope. The Company understands that certain other providers that operate dialysis clinics in New York may be receiving or have received a similar request for documents. The Company intends to cooperate with the government to provide responsive documents.

Except for the private civil complaints filed by the relators as described above, to the Company's knowledge, no proceedings have been initiated against the Company at this time in connection with any of the

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inquiries by the federal government. Although the Company cannot predict whether or when proceedings might be initiated or when these matters may be resolved, it is not unusual for inquiries such as these to continue for a considerable period of time through the various phases of document and witness requests and on-going discussions with regulators. Responding to the subpoenas or inquiries and defending the Company in the relator proceedings will continue to require management's attention and significant legal expense. Any negative findings in the inquiries or relator proceedings could result in substantial financial penalties or awards 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, possible criminal penalties. At this time, the Company cannot predict the ultimate outcome of these inquiries, or the potential outcome of the relators' claims, or the potential range of damages, if any.

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. The Company has received no further indication that any of these claims are active, and some of them may be barred by applicable statutes of limitations. To the extent any of these claims might proceed, the Company intends to defend against them vigorously; however, the Company may not be successful and these claims may lead to litigation and any such litigation may be resolved unfavorably. At this time, the Company cannot predict the ultimate outcome of this matter or the potential range of damages, if any.

A wage and hour claim, which has been styled as a class action, is pending against the Company in the Superior Court of California. The Company was served with the complaint in this lawsuit in April 2008, and it has been amended since that time. The lawsuit, as amended, alleges that the Company failed to provide meal periods, failed to pay compensation in lieu of providing rest or meal periods, failed to pay overtime, and failed to comply with certain other California Labor Code requirements. In September 2011, the court denied the plaintiffs' motion for class certification. Plaintiffs have appealed that decision. The Company intends to continue to vigorously defend against these claims. Any potential settlement of these claims is not anticipated to be material to the Company's consolidated financial statements.

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 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. At this time, the Company cannot predict the ultimate outcome of this matter or the potential range of damages, if any.

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 parties reached an agreement last year to fully resolve this matter for an amount that did not materially impact the Company's financial results. That settlement has now received final approval from the court.

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.

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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:

	March 31, 2012			December 31, 2011		
	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	\$ 7,416	\$	\$ 7,416	\$ 11,754	\$	\$ 11,754
Investments in mutual funds		11,097	11,097		15,535	15,535
	\$ 7,416	\$ 11,097	\$ 18,513	\$ 11,754	\$ 15,535	\$ 27,289
Short-term investments	\$ 7,416	\$ 1,200	\$ 8,616	\$ 11,754	\$ 5,645	\$ 17,399
Long-term investments		9,897	9,897		9,890	9,890
	\$ 7,416	\$ 11,097	\$ 18,513	\$ 11,754	\$ 15,535	\$ 27,289

The cost of the certificates of deposit and money market funds at March 31, 2012 and in addition, U.S. treasury notes at December 31, 2011, approximates their fair value. As of March 31, 2012 and December 31, 2011, the available for sale investments include \$1,500 and \$(255) of gross pre-tax gains (loss), respectively. During the three months ended March 31, 2012, the Company recorded gross pre-tax unrealized gains of \$1,877, or \$1,146 after tax, in other comprehensive income associated with changes in the fair value of these investments. During the three months ended March 31, 2012, the Company sold investments in mutual funds and its shares of NxStage common stock for net proceeds of \$6,791, and recognized a pre-tax gain of \$123, or \$75 after tax, that was previously recorded in other comprehensive income. During the three months ended March 31, 2011, the Company sold investments in mutual funds for net proceeds of \$1,149, and recognized a pre-tax loss of \$93, or \$57 after tax, that was previously recorded in other comprehensive income.

As of March 31, 2012, investments totaling approximately \$2,900 classified as held to maturity are investments used to maintain certain capital requirements of the special needs 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 still in process of paying out all incurred claims. During the first quarter of 2012, the Company received a total of \$4,339 in cash from various state regulatory agencies. The Company also expects to liquidate these remaining investments as soon as the various state regulatory agencies approve the release of these investments.

The investments in mutual funds classified as available for sale are held within a trust to fund existing obligations associated with several of the Company's non-qualified deferred compensation plans.

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7. Fair value of financial instruments

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

The following table summarizes the Company's assets, liabilities and temporary equity measured at fair value on a recurring basis as of March 31, 2012:

	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	\$ 11,097	\$ 11,097	\$	\$
Interest rate cap agreements	\$ 958	\$	\$ 958	\$
Liabilities				
Interest rate swap agreements	\$ 23,196	\$	\$ 23,196	\$
Temporary equity				
Noncontrolling interests subject to put provisions	\$ 504,491	\$	\$	\$ 504,491

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 quoted prices reported by each mutual fund. See Note 6 to the condensed consolidated financial statements for further discussion.

The interest rate swap and cap agreements are recorded at fair value based upon valuation models utilizing the income approach and commonly accepted valuation techniques that use inputs from closing prices for similar assets and liabilities in active markets as well as other relevant observable market inputs at quoted intervals such as current interest rates, forward yield curves, implied volatility and credit default swap pricing. The Company does not believe the ultimate amount that could be realized upon settlement of these interest rate swap and cap 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 provisions.

The Company has other financial instruments in addition to the above that consist primarily of cash, accounts 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 March 31, 2012 at their approximate fair values due to the short-term nature of their settlements. The carrying amount of the Company's Senior Secured Credit Facilities totaled \$2,857,198 as of March 31, 2012 and the fair value was \$2,863,323 based upon quoted market prices.

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The fair value of the Company's senior notes was approximately \$1,615,720 at March 31, 2012, based upon quoted market prices, as compared to the carrying amount of \$1,550,000.

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8. Noncontrolling interests subject to put provisions and other commitments

The Company has potential obligations to purchase the noncontrolling interests held by third parties in several of its joint ventures and non-wholly-owned subsidiaries. These obligations are in the form of put provisions and are exercisable at the third-party owners' discretion within specified periods as outlined in each specific put provision. If these put provisions were exercised, the Company would be required to purchase the third-party owners' noncontrolling interests at either the appraised fair market value or a predetermined multiple of earnings or cash flow attributable to the noncontrolling interests put to the Company, which is intended to approximate fair value. The methodology the Company uses to estimate the fair values of noncontrolling interests subject to put provisions assumes either the higher of a liquidation value of net assets or an average multiple of earnings, based on historical earnings, patient mix and other performance indicators, as well as other factors. 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 a minority equity investment as well as to physician-owned vascular access clinics that the Company operates under management and administrative services agreements of approximately \$4,000.

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.

9. Income taxes

As of March 31, 2012, the Company's total liability for unrecognized tax benefits relating to tax positions that do not meet the more-likely-than-not threshold is \$9,291, all of which would impact the Company's effective tax rate if recognized. This balance represents an increase of \$348 from the December 31, 2011 balance of \$8,943 mostly due to the addition of interest in 2012.

The Company recognizes accrued interest and penalties related to unrecognized tax benefits in its income tax expense. At March 31, 2012 and December 31, 2011, the Company had approximately \$4,040 and \$3,420, respectively, accrued for interest and penalties related to unrecognized tax benefits, net of federal tax benefits.

10. Acquisitions

Dialysis and other acquisitions

During the first quarter of 2012, the Company acquired dialysis businesses consisting of 28 dialysis centers located in the United States and one direct primary care business for a total of \$132,699 in cash and deferred

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purchase price obligations totaling \$286. The assets and liabilities for all 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 designated effective dates of the acquisitions.

The following table summarizes the assets acquired and liabilities assumed in these transactions and recognized at their acquisition dates at estimated fair values, as well as the estimated fair value of the noncontrolling interests assumed in these transactions:

	Three months ended March 31, 2012
Tangible assets, principally leasehold improvements and equipment	\$ 9,745
Amortizable intangible assets	10,635
Goodwill	117,975
Liabilities assumed	(3,900)
Noncontrolling interests assumed	(1,470)
	\$ 132,985

Amortizable intangible assets acquired during the first three months of 2012 had weighted-average estimated useful lives of 9.3 years. The total amount of goodwill deductible for tax purposes associated with these acquisitions is approximately \$117 million.

The DSI Renal Inc. purchase price allocations will be finalized upon completion of the final short period tax returns.

11. Segment reporting

The Company operates principally as a dialysis and related lab services business but also operates other ancillary services and strategic initiatives. These ancillary services and strategic initiatives consist primarily of pharmacy services, infusion therapy services, disease management services, vascular access services, ESRD clinical research programs, physician services, direct primary care and the Company's international dialysis operations. 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 since 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 U.S. dialysis and related lab services business qualifies as a separately reportable segment and all references to dialysis and related lab services continue to refer only to the Company's U.S. dialysis and related lab services business. All of the other ancillary services and strategic initiatives operating segments, including the Company's international dialysis operations, 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.

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

	Three months ended March 31,	
	2012	2011
Segment operating revenues:		
Dialysis and related lab services		
Patient service operating revenues:		
External sources	\$ 1,762,578	\$ 1,497,434
Intersegment revenues	4,059	2,206
Total dialysis and related lab services patient service operating revenues	1,766,637	1,499,640
Less: Provision for uncollectible accounts related to patient service revenues	(53,008)	(41,071)
Net dialysis and related lab services patient service operating revenues	1,713,629	1,458,569
Other revenues ⁽¹⁾	2,885	2,532
Total net dialysis and related lab services operating revenues	1,716,514	1,461,101
Other Ancillary services and strategic initiatives		
Net patient service operating revenues	\$ 1,122	\$
External sources	153,058	103,418
Intersegment revenues	2,044	2,297
Total ancillary services and strategic initiatives operating revenues	156,224	105,715
Total net segment operating revenues	1,872,738	1,566,816
Elimination of intersegment revenues	(6,103)	(4,503)
Consolidated net operating revenues	\$ 1,866,635	\$ 1,562,313
Consolidated operating revenues before provision for uncollectible accounts	\$ 1,919,643	\$ 1,603,384
Segment operating margin (loss) ⁽²⁾:		
Dialysis and related lab services	\$ 348,030	\$ 252,315
Other Ancillary services and strategic initiatives	(17,392)	(8,784)
Total segment margin	330,638	243,531
Reconciliation of segment operating margin to consolidated income before income taxes:		
Stock-based compensation	(12,550)	(9,716)
Equity investment income	2,632	1,519

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Consolidated operating income	320,720	235,334
Debt expense	(61,381)	(58,595)
Other income	1,039	841
Consolidated income from continuing operations before income taxes	\$ 260,378	\$ 177,580

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- (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 a minority equity investment.
- (2) Certain costs associated with our international operations that were previously reported in the dialysis and related lab services have been reclassified to the ancillary services and strategic initiatives to conform to the current year presentation.

Depreciation and amortization expense for the dialysis and related lab services for the three months ended March 31, 2012 was \$73,726 and was \$2,249 for the ancillary services and strategic initiatives.

Depreciation and amortization expense for the dialysis and related lab services for the three months ended March 31, 2011 was \$60,123, and was \$1,715 for the ancillary services and strategic initiatives.

Summary of assets by segment is as follows:

	March 31, 2012	December 31, 2011
Segment assets		
Dialysis and related lab services	\$ 8,833,197	\$ 8,588,671
Other Ancillary services and strategic initiatives	296,931	276,176
Equity investments	26,956	27,325
Consolidated assets	\$ 9,157,084	\$ 8,892,172

For the three months ended March 31, 2012, the total amount of expenditures for property and equipment including capital leases for the dialysis and related lab services was \$116,456 and was \$5,657 for the ancillary services and strategic initiatives.

For the three months ended March 31, 2011, the total amount of expenditures for property and equipment including capital leases for the dialysis and related lab services were \$67,119 and were \$1,563 for the ancillary services and strategic initiatives.

As of March 31, 2012, there was \$4,968,608 and \$95,969 of goodwill associated with the dialysis and related lab services business and the ancillary services and strategic initiatives, respectively.

As of December 31, 2011, there was \$4,865,864 and \$81,112 of goodwill associated with the dialysis and related lab services business and the ancillary services and strategic initiatives, respectively.

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12. Changes in DaVita Inc. 's ownership interest in consolidated subsidiaries

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

	Three months ended March 31,	
	2012	2011
Net income attributable to DaVita Inc.	\$ 140,120	\$ 94,502
Increase in paid-in capital for sales of noncontrolling interests	5	27
Decrease in paid-in capital for the purchase of noncontrolling interests	(897)	(614)
Net transfer to noncontrolling interests	(892)	(587)
Change from net income attributable to DaVita Inc. and transfers to noncontrolling interests	\$ 139,228	\$ 93,915

13. Variable interest entities

The Company is required to consolidate each entity determined to be a variable interest entity for which the Company is the primary beneficiary. Variable interest entities (VIEs) typically include those for which the entity 's equity is not sufficient to finance its activities without additional subordinated financial support; those for which the equity holders as a group lack the power to direct the activities that most significantly influence the entity 's economic performance, the obligation to absorb the entity 's expected losses, or the right to receive the entity 's expected returns; or those for which the voting rights of some investors are not proportional to their obligations to absorb the entity 's losses.

The Company is deemed to be the primary beneficiary of all the variable interest entities it is associated with. 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 both dialysis operations and physician practice management entities.

Under the terms of the applicable arrangement, the Company bears substantially all of the economic risks and rewards of ownership for these operating VIEs. In some cases, 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 VIEs and provides operating and capital funding as necessary to accomplish their operational and strategic objectives.

Accordingly, since the Company bears the majority of the risks and rewards attendant to their ownership, the Company consolidates these VIEs as their primary beneficiary. Total assets of these consolidated operating VIEs were approximately \$6,000 and their liabilities to unrelated third parties were approximately \$5,000 at March 31, 2012.

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

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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.

14. Accounts receivable

Accounts receivable are reduced by an allowance for doubtful accounts. In evaluating the ultimate collectability and net realizable value of the Company's accounts receivable, the Company analyzes its historical cash collection experience and trends for each of its government payors and commercial payors to estimate the adequacy of the allowance for doubtful accounts and the amount of the provision for bad debts. Management regularly updates its analysis based upon the most recent information available to it to determine its current provision for bad debts and the adequacy of its allowance for doubtful accounts. For receivables associated with services provided to patients covered by government payors, like Medicare, the Company receives 80% of the payment directly from Medicare as established under the governments bundled payment system and determines an appropriate allowance for doubtful accounts and provision for bad debts on the remaining balance due depending upon the Company's estimate of the amounts ultimately collectible from other secondary coverage sources or from the patients. For receivables associated with services to patients covered by commercial payors that are either based upon contractual terms or for non-contracted health plan coverage, the Company provides an allowance for doubtful accounts and a provision for bad debts based upon its historical collection experience, potential inefficiencies in its billing processes and for which collectability is determined to be unlikely. Less than 1% of the Company's accounts receivable are associated with patient pay and it is the Company's policy to reserve 100% of these outstanding accounts receivable balances when the amounts due are outstanding for more than four months.

During the quarter ended March 31, 2012, the Company's allowance for doubtful accounts increased by approximately \$38,895. This was primarily as a result of the provision for bad debts exceeding the amount of write-offs that occurred during the quarter as well as additional reserves associated with acquisitions. There were no unusual transactions impacting the allowance for doubtful accounts.

15. Goodwill

Each of the Company's operating segments described in Note 11 to the condensed consolidated financial statements is considered to represent an individual reporting unit for goodwill impairment testing purposes, except that our new direct primary care segment is comprised of two reporting units and each sovereign jurisdiction within our new international operations segment is considered a separate reporting unit.

Within the U.S. dialysis and related lab services operating segment, the Company considers each of its dialysis centers to constitute an individual business for which discrete financial information is available. However, since these dialysis centers have similar operating and economic characteristics and resource allocation and significant investment decisions concerning these businesses are highly centralized and the benefits broadly distributed, the Company has aggregated these centers and deemed them to constitute a single reporting unit.

The Company has applied a similar aggregation to the infusion therapy branches in its infusion therapy services reporting unit, to the consolidated vascular access service centers in its vascular access services reporting unit, and to the physician practices in its physician services reporting unit. For the Company's

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operating segments not mentioned above, no component below the level of the operating segment is considered a discrete business and therefore these operating segments directly constitute individual reporting units.

During the first quarter of 2012, the Company did not record any goodwill impairment charges and, as of March 31, 2012, none of the goodwill associated with the Company's various reporting units was considered at risk of impairment. Since the date of the Company's last annual goodwill impairment test, there have been no material developments, events, changes in operating performance or other changes in circumstances that would cause management to believe it is more likely than not that the fair value of any of its reporting units would be less than its carrying amount.

16. Significant new accounting standards

On January 1, 2012, we adopted the Financial Accounting Standards Board's, or FASB, Accounting Standard Update (ASU) No. 2011-08, *Intangibles—Goodwill and Other*. This standard amends the current two-step goodwill impairment test required under the existing accounting guidance. This amendment allows entities the option to first assess certain qualitative factors to ascertain whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount to determine if the two-step impairment test is necessary. If an entity concludes that certain events or circumstances prove that it is more likely than not that the fair value of a reporting unit is less than its carrying amount then an entity is required to proceed to step one of the two-step goodwill impairment test. This standard was effective on January 1, 2012. The adoption of this standard did not have a material impact on the Company's consolidated financial statements.

On January 1, 2012, we adopted FASB's ASU No. 2011-07, *Health Care Entities—Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts*. This standard amends the current presentation and disclosure requirements for Health Care Entities that recognize significant amounts of patient service revenues at the time the services are rendered without assessing the patient's ability to pay. This standard requires health care entities to reclassify the provision for bad debts from an operating expense to a deduction from patient service revenues. In addition, this standard requires more disclosure on the policies for recognizing revenue, assessing bad debts, as well as quantitative and qualitative information regarding changes in the allowance for doubtful accounts. This standard was applied retrospectively to all prior periods presented and was effective on January 1, 2012. Upon adoption of this standard, the Company changed its presentation of its provision for uncollectible accounts related to patient service revenues as a deduction from its patient service operating revenues and enhanced its disclosures as indicated above. See Note 14 to the condensed consolidated financial statements for further details.

On January 1, 2012, we adopted FASB's ASU No. 2011-05, *Comprehensive Income—Presentation of Comprehensive Income*. This standard amends the current presentation requirements for comprehensive income by eliminating the presentation of the components of other comprehensive income within the statement of equity. This standard allows two options on how to present the various components of comprehensive income. These options are either to report the components of comprehensive income separately on the income statement or to present total other comprehensive income and the components of other comprehensive income in a separate statement. This standard does not change the items that must be reported in other comprehensive income or when an item must be reclassified into net income. The FASB temporarily deferred the requirement to present separate line items on the statement of income for the amounts that would be realized and reclassified out of accumulated other comprehensive income into net income. No timetable has been set for FASB's reconsideration of this item. This standard, except for the requirements that were deferred, as stated above, was applied retrospectively and

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DAVITA INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(unaudited)

(dollars and shares in thousands, except per share data)

was effective on January 1, 2012. Upon adoption of this standard, the Company presented total other comprehensive income and the components of other comprehensive income in a separate statement of comprehensive income.

On January 1, 2012, we adopted FASB's ASU No. 2011-04, *Fair Value Measurement*. This standard amends the current fair value measurement and disclosure requirements to improve comparability between U.S. GAAP and International Financial Reporting Standards (IFRS). The intent of this standard is to update the disclosures that describe several of the requirements in U.S. GAAP for measuring fair value and to enhance disclosures about fair value measurements which will improve consistency between U.S. GAAP and IFRS. This standard does not change the application of the requirements on fair value measurements and disclosures. This was applied prospectively and was effective on January 1, 2012. The adoption of this standard did not have a material impact on the Company's consolidated financial statements.

17. 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 Company's 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 were issued by the Company on October 20, 2010 and are guaranteed by substantially all of its direct and indirect domestic wholly-owned subsidiaries. Each of the guarantor subsidiaries has guaranteed the notes on a joint and several basis. However, the guarantor subsidiaries can be released from their obligations in the event of a sale or other disposition of all or substantially all of the assets of such subsidiary, if such subsidiary guarantor is designated as an unrestricted subsidiary or otherwise ceases to be a restricted subsidiary, and if such subsidiary guarantor no longer guarantees any other indebtedness of the Company. Non-wholly-owned subsidiaries, certain wholly-owned subsidiaries, foreign subsidiaries, joint ventures, partnerships and third parties are not guarantors of these obligations.

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(dollars and shares in thousands, except per share data)

Condensed Consolidating Statements of Income

For the three months ended March 31, 2012	DaVita Inc.	Guarantor subsidiaries	Non-Guarantor subsidiaries	Consolidating adjustments	Consolidated total
Patient service operating revenues	\$	\$ 1,315,992	\$ 463,090	\$ (15,382)	\$ 1,763,700
Less: Provision for uncollectible accounts		(38,846)	(14,162)		(53,008)
Net patient service operating revenues		1,277,146	448,928	(15,382)	1,710,692
Other revenues	123,593	146,965	21,255	(135,870)	155,943
Total net operating revenues	123,593	1,424,111	470,183	(151,252)	1,866,635
Operating expenses	93,158	1,230,436	373,573	(151,252)	1,545,915
Operating income	30,435	193,675	96,610		320,720
Debt (expense)	(62,181)	(51,218)	(6,366)	58,384	(61,381)
Other income	58,346	632	445	(58,384)	1,039
Income tax expense	10,773	78,112	6,610		95,495
Equity earnings in subsidiaries	124,293	59,540		(183,833)	
Income from continuing operations	140,120	124,517	84,079	(183,833)	164,883
Discontinued operations					
Net income	140,120	124,517	84,079	(183,833)	164,883
Less: Net income attributable to noncontrolling interests				(24,763)	(24,763)
Net income attributable to DaVita Inc.	\$ 140,120	\$ 124,517	\$ 84,079	\$ (208,596)	\$ 140,120