

DAVITA INC  
Form 10-Q  
November 06, 2008  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

For the Quarterly Period Ended

**September 30, 2008**

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

Commission File Number: 1-14106

**DAVITA INC.**

601 Hawaii Street

El Segundo, California 90245

Telephone number (310) 536-2400

**Delaware**  
(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 is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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

(Do not check if a smaller reporting company)

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

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As of October 31, 2008, the number of shares of the Registrant's common stock outstanding was approximately 103.8 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 \$5.9 billion.

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**DAVITA INC.**

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

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

	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
Net operating revenues	\$ 1,447,135	\$ 1,318,381	\$ 4,199,163	\$ 3,909,282
Operating expenses and charges:				
Patient care costs	1,005,648	890,243	2,909,143	2,662,841
General and administrative	128,617	120,596	374,581	356,249
Depreciation and amortization	54,970	49,230	160,673	142,078
Provision for uncollectible accounts	37,305	34,107	109,433	101,686
Minority interests and equity income, net	12,711	11,793	35,168	34,757
Valuation gain on alliance and product supply agreement				(55,275)
Total operating expenses and charges	1,239,251	1,105,969	3,588,998	3,242,336
Operating income	207,884	212,412	610,165	666,946
Debt expense	(54,505)	(62,715)	(168,891)	(194,496)
Other income	2,481	6,278	10,331	17,131
Income before income taxes	155,860	155,975	451,605	489,581
Income tax expense	61,950	61,520	175,810	193,520
Net income	\$ 93,910	\$ 94,455	\$ 275,795	\$ 296,061
<b>Earnings per share:</b>				
Basic earnings per share	\$ 0.90	\$ 0.89	\$ 2.61	\$ 2.80
Diluted earnings per share	\$ 0.89	\$ 0.88	\$ 2.59	\$ 2.76
Weighted average shares for earnings per share:				
Basic	104,556,770	106,171,473	105,569,971	105,558,536
Diluted	105,577,823	107,561,139	106,421,184	107,129,135

See notes to condensed consolidated financial statements.

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

	<b>September 30, 2008</b>	<b>December 31, 2007</b>
<b>ASSETS</b>		
Cash and cash equivalents	\$ 387,947	\$ 447,046
Short-term investments	51,614	40,278
Accounts receivable, less allowance of \$204,594 and \$195,953	1,056,691	927,949
Inventories	82,494	80,173
Other receivables	230,073	198,744
Other current assets	36,010	34,482
Deferred income taxes	219,160	247,578
<b>Total current assets</b>	<b>2,063,989</b>	<b>1,976,250</b>
Property and equipment, net	1,011,702	939,326
Amortizable intangibles, net	165,270	183,042
Investments in third-party dialysis businesses	19,239	19,446
Long-term investments	6,930	22,562
Other long-term assets	48,162	35,401
Goodwill	3,856,601	3,767,933
	<b>\$ 7,171,893</b>	<b>\$ 6,943,960</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Accounts payable	\$ 212,661	\$ 225,461
Other liabilities	515,989	486,151
Accrued compensation and benefits	330,838	334,961
Current portion of long-term debt	64,262	23,431
Income taxes payable		16,492
<b>Total current liabilities</b>	<b>1,123,750</b>	<b>1,086,496</b>
Long-term debt	3,643,275	3,683,887
Other long-term liabilities	83,494	83,448
Alliance and product supply agreement, net	37,310	41,307
Deferred income taxes	214,477	166,055
Minority interests (fair value subject to potential put obligations \$296,000 and \$330,000)	162,908	150,517
Commitments and contingencies		
Shareholders' equity:		
Preferred stock (\$0.001 par value, 5,000,000 shares authorized; none issued)		
Common stock (\$0.001 par value, 450,000,000 shares authorized; 134,862,283 shares issued; 104,787,536 and 107,130,127 shares outstanding)	135	135
Additional paid-in capital	755,579	707,080
Retained earnings	1,791,085	1,515,290
Treasury stock, at cost (30,074,747 and 27,732,156 shares)	(635,274)	(487,744)
Accumulated other comprehensive loss	(4,846)	(2,511)
<b>Total shareholders' equity</b>	<b>1,906,679</b>	<b>1,732,250</b>

\$ 7,171,893      \$ 6,943,960

See notes to condensed consolidated financial statements.

**Table of Contents****DAVITA INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS****(unaudited)****(dollars in thousands)**

	<b>Nine months ended September 30,</b>	
	<b>2008</b>	<b>2007</b>
<b>Cash flows from operating activities:</b>		
Net income	\$ 275,795	\$ 296,061
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	160,673	142,078
Valuation gain on alliance and product supply agreement		(55,275)
Stock-based compensation expense	29,975	25,260
Tax benefits from stock award exercises	10,174	27,000
Excess tax benefits from stock award exercises	(5,054)	(23,632)
Deferred income taxes	56,157	25,645
Minority interests in income of consolidated subsidiaries	35,822	35,703
Distributions to minority interests	(43,391)	(35,216)
Equity investment income	(654)	(946)
Loss (gain) on disposal of assets	9,688	(4,944)
Non-cash debt and non-cash rent charges	9,971	11,810
Changes in operating assets and liabilities, other than from acquisitions and divestitures:		
Accounts receivable	(130,022)	(32,425)
Inventories	(1,248)	15,144
Other receivables and other current assets	(28,684)	(42,818)
Other long-term assets	(12,761)	(11,921)
Accounts payable	(12,800)	(6,458)
Accrued compensation and benefits	(11,752)	(17,347)
Other current liabilities	29,838	(26,151)
Income taxes	(3,129)	(13,072)
Other long-term liabilities	3,163	1,214
<b>Net cash provided by operating activities</b>	<b>371,761</b>	<b>309,710</b>
<b>Cash flows from investing activities:</b>		
Additions of property and equipment, net	(223,851)	(176,078)
Acquisitions and purchases of other ownership interests	(101,166)	(81,782)
Proceeds from asset sales	451	4,643
Purchase of investments available for sale	(1,695)	(21,363)
Purchase of investments held-to-maturity	(19,005)	(20,839)
Proceeds from sale of investments available for sale	5,323	32,138
Proceeds from maturities of investments held-to-maturity	18,728	4,780
Contributions from minority owners	22,749	16,204
Purchase of intangible assets	(65)	(556)
<b>Net cash used in investing activities</b>	<b>(298,531)</b>	<b>(242,853)</b>
<b>Cash flows from financing activities:</b>		
Borrowings	12,937,047	10,405,556
Payments on long-term debt	(12,938,297)	(10,451,891)

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Deferred financing costs	(130)	(4,462)
Purchase of treasury stock	(169,673)	(6,350)
Excess tax benefits from stock award exercises	5,054	23,632
Stock award exercises and other share issuances, net	33,670	47,756
Net cash (used in) provided by financing activities	(132,329)	14,241
Net (decrease) increase in cash and cash equivalents	(59,099)	81,098
Cash and cash equivalents at beginning of period	447,046	310,202
Cash and cash equivalents at end of period	\$ 387,947	\$ 391,300

See notes to condensed consolidated financial statements.

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**DAVITA INC.**  
**CONSOLIDATED STATEMENT OF SHAREHOLDERS EQUITY**  
**AND**  
**COMPREHENSIVE INCOME**  
**(unaudited)**  
**(dollars and shares in thousands)**

	Common Stock			Retained earnings	Treasury stock		Accumulated other comprehensive income (loss)	Total
	Shares	Amount	Additional paid-in capital		Shares	Amount		
Balance at December 31, 2006	134,862	\$ 135	\$ 630,091	\$ 1,129,621	(30,226)	\$ (526,920)	\$ 12,997	\$ 1,245,924
Comprehensive income:								
Net income				381,778				381,778
Unrealized losses on interest rate swaps, net of tax							(7,169)	(7,169)
Less reclassification of net swap realized gains into net income, net of tax							(8,858)	(8,858)
Unrealized gain on investments, net of tax							4,211	4,211
Less reclassification of net investment realized gains into net income, net of tax							(3,692)	(3,692)
Total comprehensive income								366,270
Cumulative effect of change in accounting principle SFAS Interpretation No. (FIN) 48				3,891				3,891
Stock purchase shares issued			3,831		124	2,160		5,991
Stock unit shares issued			(1,848)		120	2,098		250
Stock options and SSARs exercised			13,429		2,361	41,268		54,697
Stock-based compensation expense			34,149					34,149
Excess tax benefits from stock awards exercised			27,428					27,428
Purchase of treasury stock					(111)	(6,350)		(6,350)
Balance at December 31, 2007	134,862	135	707,080	1,515,290	(27,732)	(487,744)	(2,511)	1,732,250
Comprehensive income:								
Net income				275,795				275,795
Unrealized losses on interest rate swaps, net of tax							(3,972)	(3,972)
Less reclassification of net swap realized losses into net income, net of tax							2,243	2,243
Unrealized losses on investments, net of tax							(536)	(536)
Less reclassification of net investment realized gains into net income, net of tax							(70)	(70)
Total comprehensive income								273,460
Stock purchase shares issued			2,981		98	1,730		4,711
Stock unit shares issued			(2,379)		167	3,253		874
Stock options and SSARs exercised			12,716		853	17,160		29,876
Stock-based compensation expense			29,975					29,975
Excess tax benefits from stock awards exercised			5,206					5,206
Purchase of treasury stock					(3,461)	(169,673)		(169,673)

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Balance at September 30, 2008

134,862 \$ 135 \$ 755,579 \$ 1,791,085 (30,075) \$ (635,274) \$ (4,846) \$ 1,906,679

See notes to condensed consolidated financial statements.

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**DAVITA INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(unaudited)**

**(dollars and shares in thousands)**

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

**1. Condensed consolidated interim financial statements**

The condensed consolidated interim financial statements included in this report are prepared by the Company without audit. In the opinion of management, all adjustments consisting only of normal recurring items necessary for a fair presentation of the results of operations are reflected in these consolidated interim financial statements. All significant intercompany accounts and transactions have been eliminated. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. The most significant estimates and assumptions underlying these financial statements and accompanying notes generally involve revenue recognition and provisions for uncollectible accounts, impairments and valuation adjustments, fair value estimates, accounting for income taxes, variable compensation accruals, purchase accounting valuation estimates and stock-based compensation. The results of operations for the nine months ended September 30, 2008 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, 2007. Prior year balances and amounts have been classified to conform to the current year presentation.

**Table of Contents****DAVITA INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)****(unaudited)****(dollars and shares in thousands)****2. Earnings per share**

Basic net income per share is calculated by dividing net income by the weighted average number of common shares and vested stock units outstanding. Diluted net income per share includes the dilutive effect of outstanding stock options, stock-settled stock appreciation rights and unvested stock units (under the treasury stock method).

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

	<b>Three months ended September 30, 2008</b>		<b>Nine months ended September 30, 2008</b>	
	<b>2007</b>	<b>2007</b>	<b>2007</b>	<b>2007</b>
	<b>(shares in thousands)</b>			
<b>Basic:</b>				
Net income	\$ 93,910	\$ 94,455	\$ 275,795	\$ 296,061
Weighted average shares outstanding during the period	104,548	106,126	105,561	105,514
Vested stock units	9	45	9	45
Weighted average shares for basic earnings per share calculation	104,557	106,171	105,570	105,559
<b>Basic net income per share</b>	<b>\$ 0.90</b>	<b>\$ 0.89</b>	<b>\$ 2.61</b>	<b>\$ 2.80</b>
<b>Diluted:</b>				
Net income	\$ 93,910	\$ 94,455	\$ 275,795	\$ 296,061
Weighted average shares outstanding during the period	104,548	106,126	105,561	105,514
Vested stock units	9	45	9	45
Assumed incremental shares from stock plans	1,021	1,390	851	1,570
Weighted average shares for diluted earnings per share calculation	105,578	107,561	106,421	107,129
<b>Diluted net income per share</b>	<b>\$ 0.89</b>	<b>\$ 0.88</b>	<b>\$ 2.59</b>	<b>\$ 2.76</b>
Shares subject to anti-dilutive awards excluded from calculation <sup>(1)</sup>	6,333	305	10,218	930

<sup>(1)</sup> 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 equity transactions**

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Under SFAS No. 123(R), stock-based compensation recognized during a period is based on the estimated grant-date fair value of the portion of the stock-based awards vesting during that period, adjusted for expected forfeitures. Stock-based compensation recognized in these condensed consolidated financial statements for the three and nine months ended September 30, 2008 and 2007 includes compensation cost for stock-based awards granted prior to, but not fully vested as of, December 31, 2005 and subsequent stock-based awards granted through September 30, 2008 and 2007, respectively. Shares issued upon exercise of stock awards are generally issued from shares in treasury. The Company has used the Black-Scholes-Merton valuation model for estimating

**Table of Contents****DAVITA INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)****(unaudited)****(dollars and shares in thousands)**

the grant-date fair value of stock options and stock-settled stock appreciation rights granted in all periods. During the first nine months of 2008, the Company granted 4,491 stock-settled stock appreciation rights with a grant-date fair value of \$49,337 and a weighted-average expected life of approximately 3.35 years, and also granted 33 stock units with a grant-date fair value of \$1,699 and a weighted-average expected life of approximately 1.24 years.

For the nine months ended September 30, 2008 and September 30, 2007, the Company recognized \$29,975 and \$25,260, respectively, in stock-based compensation expense for stock options, stock-settled stock appreciation rights, stock units and discounted employee stock plan purchases, which are primarily included in general and administrative expenses. The estimated tax benefit recorded for stock-based compensation through September 30, 2008 and 2007 was \$11,306 and \$9,475, respectively. As of September 30, 2008, there was \$90,065 of total estimated unrecognized compensation cost related to nonvested stock-based compensation arrangements under our equity compensation and stock purchase plans. The Company expects to recognize this cost over a weighted average remaining period of 1.5 years.

During the nine months ended September 30, 2008 and 2007, the Company received \$29,876 and \$41,275, respectively in cash proceeds from stock option exercises and \$10,174 and \$27,000, respectively, in actual tax benefits upon the exercise of stock awards.

During the first nine months of 2008, the Company repurchased a total of 3,461 shares of its common stock for \$169,673 or an average price of \$49.02 per share, pursuant to previously announced authorizations by the Board of Directors. On May 1, 2008, the Company's Board of Directors authorized an increase of an additional \$143,500 of share repurchases of the Company's common stock. The Company did not repurchase any additional shares of its common stock during the third quarter of 2008. However, during October 2008, the Company repurchased 1,028 shares of its common stock for \$50,000, or an average price of \$48.66 per share. As a result of these transactions, the total outstanding authorization for share repurchases is currently \$166,600. This stock repurchase program has no expiration date.

**4. Long-term debt**

Long-term debt was comprised of the following:

	September 30, 2008	December 31, 2007
<b>Senior secured credit facilities:</b>		
Term loan A	\$ 227,500	\$ 229,250
Term loan B	1,705,875	1,705,875
Senior and senior subordinated notes	1,750,000	1,750,000
Acquisition obligations and other notes payable	14,303	11,047
Capital lease obligations	5,921	6,667
<b>Total debt principal outstanding</b>	<b>3,703,599</b>	<b>3,702,839</b>
Premium on the 6 <sup>5</sup> / <sub>8</sub> % senior notes	3,938	4,479
	3,707,537	3,707,318
Less current portion	(64,262)	(23,431)
	<b>\$ 3,643,275</b>	<b>\$ 3,683,887</b>



**Table of Contents****DAVITA INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)****(unaudited)****(dollars and shares in thousands)**

Scheduled maturities of long-term debt at September 30, 2008 were as follows:

2008	\$ 17,568
2009	69,012
2010	89,433
2011	66,896
2012	1,706,942
2013	901,167
Thereafter	852,581

During the third quarter of 2008, the Company made a mandatory principle payment of \$1,750 on the term loan A.

As of September 30, 2008, the Company maintained a total of ten interest rate swap agreements with amortizing notional amounts totaling \$834,000. 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 3.08% to 4.70%, resulting in an overall weighted average effective interest rate of 5.51% on the hedged portion of the Company's Senior Secured Credit Facilities, including the term loan B margin of 1.50%. The swap agreements expire in 2008 through 2010 and require quarterly interest payments. During the first nine months of 2008, the Company accrued net charges of \$3,671 from these swaps which is included in debt expense. As of September 30, 2008, the total fair value of all of the Company's interest rate swaps was a liability of \$9,306 and is principally included in other long-term liabilities.

Total comprehensive income for the three and nine months ended September 30, 2008 was \$94,115 and \$273,460, including adjustments to other comprehensive income for valuation gains (losses) on interest rate swaps net of amounts reclassified into income of \$636 and \$(1,729), net of tax, respectively, and adjustments to other comprehensive income for unrealized losses on investments net of amounts reclassified into income of (\$431) and (\$606), net of tax, respectively.

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

As of September 30, 2008, the interest rates were economically fixed on approximately 43% of the Company's variable rate debt and approximately 70% of its total debt.

As a result of the swap agreements, the overall effective weighted average interest rate on the Senior Secured Credit Facilities was 5.39%, based upon the current margins in effect of 1.50%, as of September 30, 2008.

The Company's overall average effective interest rate during the third quarter of 2008 was 5.66% and as of September 30, 2008 was 6.09%.

As of September 30, 2008, the Company has undrawn revolving credit facilities totaling \$250,000 of which approximately \$47,001 was committed for outstanding letters of credit. The Company also has undrawn

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**DAVITA INC.**

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

**(unaudited)**

**(dollars and shares in thousands)**

revolving credit facilities totaling \$10,000 associated with several of its joint ventures. These revolving credit facilities are typically guaranteed by DaVita Inc. or one of its wholly-owned operating subsidiaries based upon its proportionate ownership percentage.

**5. Contingencies**

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

*United States Attorney inquiries*

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 Epogen<sup>®</sup>, or 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 United States Attorney's Office, or U.S. Attorney's Office, for the Eastern District of Texas, which has stated that this is a civil inquiry related to EPO claims. There appears to be substantial overlap between this issue and the ongoing review of EPO utilization and claims by the U.S. Attorney's Office, for the Eastern District of Missouri in St. Louis described below. In addition, on November 4, 2008, the Company received a verbal notice of a forthcoming civil inquiry from the Department of Justice and the U.S. Attorney's Office for the Northern District of Georgia relating to the administration of iron and vitamin D pharmaceuticals. The Company expects to receive a request to produce documents and other information and such request may come in the form of a subpoena. The Company intends to cooperate with any such request. To the Company's knowledge, no proceedings have been initiated against the Company in any of the aforementioned inquiries at this time. Although the Company cannot predict whether or when proceedings might be initiated or when these matters may be resolved, it is not unusual for investigations such as these to continue for a considerable period of time. Responding to these inquiries will continue to require management's attention and significant legal expense. Any negative findings could result in substantial financial penalties against the Company and exclusion from future participation in the Medicare and Medicaid programs.

In March 2005, the Company received a subpoena from the U.S. Attorney's Office for the Eastern District of Missouri in St. Louis. The subpoena requires production of a wide range of documents relating to our operations, including documents related to, among other things, pharmaceutical and other services provided to patients, relationships with pharmaceutical companies, and financial relationships with physicians and joint ventures. The subpoena covers the period from December 1, 1996 through the present. In October 2005, the Company received a follow-up request for additional documents related to specific medical director and joint venture arrangements. In February 2006, the Company received an additional subpoena for documents, including certain patient records relating to the administration and billing of EPO. In May 2007, the Company received a

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**DAVITA INC.**

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

**(unaudited)**

**(dollars and shares in thousands)**

request for documents related to durable medical equipment and supply companies owned and operated by the Company. The Company is producing documents and providing information to the government. The Company is also cooperating, and intends to continue to cooperate, with the government's investigation, including by participating in discussions and meetings with the government. The subpoenas have been issued in connection with a joint civil and criminal investigation. It is possible that criminal proceedings may be initiated against the Company in connection with this inquiry. Any negative findings could result in substantial financial penalties against the Company, exclusion from future participation in the Medicare and Medicaid programs and criminal penalties. To the Company's knowledge, no proceedings have been initiated against the Company at this time. Although the Company cannot predict whether or when proceedings might be initiated or when these matters may be resolved, it is not unusual for investigations such as this to continue for a considerable period of time. Responding to the subpoenas will continue to require management's attention and significant legal expense.

In October 2004, the Company received a subpoena from the U.S. Attorney's Office for the Eastern District of New York in Brooklyn. The subpoena covers the period from 1996 to present and requires the production of a wide range of documents relating to the Company's operations, including DaVita Laboratory Services. Gambro Healthcare received a similar subpoena in November 2004. The subpoena also includes specific requests for documents relating to testing for parathyroid hormone levels, or PTH, and to products relating to vitamin D therapies. The subpoena has been issued in connection with a joint civil and criminal investigation. It is possible that criminal proceedings may be initiated against the Company in connection with this inquiry. Any negative findings could result in substantial financial penalties against the Company, exclusion from future participation in the Medicare and Medicaid programs and criminal penalties. Other participants in the dialysis industry received a similar subpoena, including Fresenius Medical Group. To the Company's knowledge, no proceedings have been initiated against the Company at this time. Although the Company cannot predict whether or when proceedings might be initiated or when these matters may be resolved, it is not unusual for investigations such as these to continue for a considerable period of time. Responding to the subpoena may continue to require management's attention and significant legal expense.

*Other*

The Company has received several notices of claims from commercial payors and other third parties related to historical billing practices and claims against DVA Renal Healthcare (formerly known as Gambro Healthcare) related to historical Gambro Healthcare billing practices and other matters covered by their 2004 settlement agreement with the Department of Justice and certain agencies of the U.S. government. At least one commercial payor has filed an arbitration demand against the Company, as described below, and additional commercial payors have threatened litigation. The Company intends to defend against these claims vigorously; however, the Company may not be successful and these claims may lead to litigation and any such litigation may be resolved unfavorably. Although the ultimate outcome of these claims cannot be predicted at this time, an adverse result in excess of the Company's established reserves, with respect to one or more of these claims could have a material adverse effect on the Company's business, financial condition, results of operations and liquidity.

In February 2007, the Company was served with a complaint filed in the Superior Court of California by one of its former employees who worked in one of its chronic facilities as a reuse technician. The complaint, which is styled as a class action, alleges, among other things, that the Company failed to provide rest and meal periods, failed to pay compensation in lieu of providing such rest or meal periods, and failed to comply with certain other California labor code requirements. The Company intends to vigorously defend against this claim. The Company also intends to vigorously oppose the certification of this matter as a class action. Although the

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**DAVITA INC.**

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

**(unaudited)**

**(dollars and shares in thousands)**

ultimate outcome of these claims cannot be predicted, the Company does not expect that an unfavorable result, if any, would have a material adverse effect on the Company's business, financial condition, liquidity or results of operations.

In 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 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 criminal investigation has been discontinued. The Attorney General's Office further advised the Company that Nevada Medicaid intends to conduct audits of ESRD providers in Nevada, including the Company, and that such audits will relate to the issues that were the subjects of the criminal investigation. Any negative findings could result in substantial financial penalties against the Company and exclusion from future participation in the Medicare and Medicaid programs. To the Company's knowledge, no proceedings have been initiated against the Company at this time.

In August 2007, Sheet Metal Workers National Health Fund and Glenn Randle filed a complaint in the United States District Court for the Central District of California against the Company. The complaint also names as defendants Amgen, Inc. and Fresenius Medical Care Holdings, Inc. The complaint is styled as a class action and alleges four claims against the Company, including violations of the federal RICO statute, California's unfair competition law, California's false advertising law and for unjust enrichment. The complaint's principal allegations against the Company are that the defendants engaged in a scheme to unlawfully promote the administration of EPO to hemodialysis patients intravenously, as opposed to subcutaneously, and to over-utilize EPO. The Company intends to vigorously defend against these claims. 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 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 December 2004 settlement agreement with the Department of Justice and certain agencies of the United States Government. In March 2006, the case was dismissed and the plaintiff was compelled to seek arbitration to resolve the matter. In November 2006, the plaintiff filed a demand for class arbitration against the Company and DVA Renal Healthcare. The Company intends to vigorously defend against these claims. The Company also intends to vigorously oppose the certification of this matter as a class action. At this time, the Company cannot predict the ultimate outcome of this matter or the potential range of damages, if any.

In June 2004, Gambro Healthcare 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 (formerly known as Gambro 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 this claim. The Company also intends to vigorously oppose the certification of this matter as a class action. Although the ultimate outcome of these claims cannot be predicted, the Company does not expect that an unfavorable result, if any, would have a material adverse effect on the Company's business, financial condition, liquidity or results of operations.

**Table of Contents****DAVITA INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)****(unaudited)****(dollars and shares in thousands)**

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. Other commitments**

The Company has obligations to purchase the 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' interests at either the appraised fair market value or a predetermined multiple of cash flow or earnings attributable to the equity interest put to the Company, which is intended to approximate fair value. During the second quarter of 2008 the Company updated its methodology used to estimate the fair value of these put provisions. The revised methodology now used to estimate the fair values of these put provisions assumes either a predetermined multiple of earnings, or the higher of a liquidation value 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 these put provisions can fluctuate and the implicit multiple of earnings at which these obligations may be ultimately settled will vary depending upon market conditions including the credit and capital markets, which can impact the level of competition for dialysis and non-dialysis related businesses, the economic performance of these businesses and the restricted marketability of the third-party owners' interests.

The following is a reconciliation of the activity of the put provision obligations during the three and nine months ended September 30, 2008:

	<b>Fair value estimates using significant unobservable inputs (Level 3)</b>	
	<b>Three months ended</b>	
	<b>September 30, 2008</b>	<b>Nine months ended September 30, 2008</b>
Beginning balance	\$ 292,000	\$ 330,000
Changes in fair value and changes due to methodology change	4,000	(68,000)
New agreements		37,000
Purchases pursuant to and exercises of put obligations		(3,000)
<b>Balance at September 30, 2008</b>	<b>\$ 296,000</b>	<b>\$ 296,000</b>

Additionally, the Company has certain other potential commitments to provide operating capital to several nonconsolidated investments and to third-party owned centers and clinics that the Company operates under administrative service agreements of approximately \$25,500.

The Company is obligated under mandatorily redeemable instruments in connection with certain consolidated joint ventures. Future distributions may be required for the minority partners' interests in limited-life entities which dissolve after terms of ten to fifty years. As of September 30, 2008, such distributions would be valued below the related minority interests balances in the consolidated balance sheet.



**Table of Contents****DAVITA INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)****(unaudited)****(dollars and shares in thousands)****7. Investments**

In accordance with SFAS No. 115 and based on the Company's intentions and strategy involving investments, the Company classifies certain debt securities as held-to-maturity and records them at amortized cost. Equity securities that have readily determinable fair values and certain other debt securities classified as available for sale are recorded at fair value.

The Company's investments consist of the following:

	September 30, 2008			December 31, 2007		
	Held to maturity	Available for sale	Total	Held to maturity	Available for sale	Total
Certificates of deposit and U.S. treasury notes due within one year	\$ 20,014	\$	\$ 20,014	\$ 19,804	\$	\$ 19,804
Investments in mutual funds		38,530	38,530		43,036	43,036
	\$ 20,014	\$ 38,530	\$ 58,544	\$ 19,804	\$ 43,036	\$ 62,840
Short-term investments	\$ 20,014	\$ 31,600	\$ 51,614	\$ 19,804	\$ 20,474	\$ 40,278
Long-term investments		6,930	6,930		22,562	22,562
	\$ 20,014	\$ 38,530	\$ 58,544	\$ 19,804	\$ 43,036	\$ 62,840

The cost of the certificates of deposit and U.S. treasury notes at September 30, 2008 and December 31, 2007 approximates their fair value. As of September 30, 2008 and December 31, 2007, the available for sale investments included (\$142) of gross pre-tax unrealized losses and \$850 of gross pre-tax unrealized gains, respectively. During the nine months ended September 30, 2008, the Company recorded gross pre-tax unrealized losses of (\$878), or (\$536), after tax, in other comprehensive income associated with changes in the fair value of these investments. During the nine months ended September 30, 2008, the Company sold investments in mutual funds for net proceeds of \$5,323, and recognized a pre-tax gain of \$114, or \$70 after tax, that was previously recorded in other comprehensive income. During the nine months ended September 30, 2007, the Company sold investments in mutual funds and NxStage, Inc. common stock totaling \$32,138 and recognized a pre-tax gain of \$6,036, or \$3,688 after tax, which was previously recorded in other comprehensive income. The pre-tax gains in each year are included in other income.

The certificates of deposit and U.S. treasury notes classified as held to maturity are investments used to initially capitalize the special needs plans of VillageHealth, which is a wholly-owned subsidiary of the Company. The investments in mutual funds classified as available for sale are held in trust to fund existing obligations associated with several of the Company's non-qualified deferred compensation plans.

**8. Fair value of financial instruments**

On January 1, 2008, the Company adopted SFAS No. 157 *Fair Value Measurements*, except for the nonfinancial assets and liabilities that are subject to a one-year deferral allowed by FASB Staff Position (FSP) FAS 157-2 *Effective Date of FASB Statement No. 157*. This standard establishes a framework for measuring assets and liabilities at fair value and also requires additional disclosures about fair value measurements. The standard applies to assets and liabilities that are carried at fair value on a recurring basis. On February 12, 2008, FSP FAS157-2 was issued delaying the effective date of SFAS No. 157 until fiscal years beginning after November 15, 2008 for nonfinancial assets and liabilities that are not recognized or disclosed at fair value in the financial statements on a recurring basis, at least annually.



**Table of Contents****DAVITA INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)****(unaudited)****(dollars and shares in thousands)**

The following table summarizes the Company's assets and liabilities measured at fair value on a recurring basis as of September 30, 2008:

	<b>Total</b>	<b>Quoted prices in active markets for identical assets (Level 1)</b>	<b>Significant other observable inputs (Level 2)</b>	<b>Significant unobservable inputs (Level 3)</b>
<b>Assets</b>				
Available for sale securities	\$ 38,530	\$ 38,530	\$	\$
<b>Liabilities</b>				
Interest rate swap agreements	\$ 9,306	\$	\$ 9,306	\$
<b>Commitments</b>				
Business interests subject to put obligations	\$ 296,000	\$	\$	\$ 296,000

The available for sale securities represent investments in various open or closed-ended registered investment companies, or mutual funds, and are recorded at fair value based upon the quoted market prices as reported by each mutual fund. See Note 7 to the condensed consolidated financial statements for further discussion.

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

See Note 6 to the condensed consolidated financial statements for a discussion of the Company's methodology for estimating the fair value of the business interests subject to put obligations.

**9. Income taxes**

As of September 30, 2008, the Company's total liability for unrecognized tax benefits relating to tax positions that do not meet the more-likely-than-not threshold is \$10,177, all of which would impact the Company's effective tax rate if recognized. This balance represents a decrease of \$15,567 from the December 31, 2007 balance of \$25,744 primarily due to a tax accounting method change which was initiated during the quarter ending March 31, 2008.

The Company recognizes accrued interest and penalties related to unrecognized tax benefits in its income tax expense. At September 30, 2008, the Company had approximately \$1,520 accrued for interest and penalties related to unrecognized tax benefits, net of federal tax benefits.

**10. Significant new accounting policies**

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In March 2008, the Financial Statement Accounting Board, or FASB, issued statement No. 161 *Disclosures about Derivative Instruments and Hedging Activities*, which amends SFAS No. 133 *Accounting for Derivative Instruments and Hedging Activities*. This standard requires enhanced disclosures about an entity's derivative and hedging activities. Entities will be required to provide additional disclosures about (a) how and why an entity

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**DAVITA INC.**

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

**(unaudited)**

**(dollars and shares in thousands)**

uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under SFAS No. 133, and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. This standard is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, and encourages but does not require comparative disclosures for earlier periods at the initial adoption. The Company is currently in the process of assessing the expected impact of this standard on its consolidated financial statements.

On January 1, 2008, the Company adopted SFAS No. 159 *Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of SFAS No. 115*. This standard allows companies the alternative to measure certain financial assets and liabilities at fair value on an instrument-by-instrument basis that are currently not required to be measured at fair value. The standard is also designed to reduce the volatility in earnings caused by measuring related assets and liabilities differently and establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. The implementation of this standard did not have an impact on the Company's consolidated financial statements.

In December 2007, the FASB issued Statement No. 141(R) *Business Combinations*, which replaces SFAS No. 141 *Business Combinations*. This standard requires all business combinations to be accounted for under the acquisition method (previously referred to as the purchase method). Under the acquisition method, the acquirer recognizes the assets acquired, the liabilities assumed, contractual contingencies, as well as any noncontrolling interest in the acquiree at their fair values at the acquisition date. Noncontractual contingencies are recognized at the acquisition date at their fair values only if it is more likely than not that they meet the definition of an asset or a liability in FASB Concepts Statement No. 6 *Elements of Financial Statements*. Transaction costs are excluded from the acquisition accounting and will be expensed as incurred. Any contingent consideration included by the acquirer as part of the purchase price must also be measured at fair value at the acquisition date and will be classified as either equity or a liability. This standard also requires a company that obtains control but acquires less than 100% of an acquiree to record 100% of the fair value of the acquiree assets, liabilities, and noncontrolling interests at the acquisition date. This standard is effective for periods beginning on or after December 15, 2008. The Company is currently in the process of assessing the expected impact of this standard on its consolidated financial statements.

In December 2007, the FASB issued Statement No. 160 *Noncontrolling Interests in Consolidated Financial Statements*, which amends Accounting Research Bulletin No. 51 *Consolidated Financial Statements*. This standard requires noncontrolling interests to be treated as a separate component of equity, but apart from the parent's equity and not as a liability, or as an item outside of equity. This will eliminate diversity that currently exists in accounting for transactions between an entity and its noncontrolling interests. This standard also specifies that consolidated net income attributable to the parent and to the noncontrolling interest be clearly identified and presented on the face of the consolidated statement of income, and that changes in the parent's ownership interest while it retains a controlling financial interest should be accounted for as equity transactions. This standard also expands disclosures in the financial statements to include a reconciliation of the beginning and ending balances of the equity attributable to the parent and the noncontrolling owners and a schedule showing the effects of changes in a parent's ownership interest in a subsidiary on the equity attributable to the parent. This standard is effective for periods beginning on or after December 15, 2008. The Company is currently in the process of assessing the expected impact of this standard on its consolidated financial statements.

**Table of Contents****DAVITA INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)****(unaudited)****(dollars and shares in thousands)****11. Segment reporting**

The Company operates principally as a dialysis and related lab services business but also operates other ancillary services and strategic initiatives. These ancillary services and strategic initiatives consist of infusion therapy services, pharmacy services, vascular access services, physician services, disease management services and full-service special needs plans, as well as clinical research programs. For internal management reporting the dialysis and related lab services business and each of the ancillary services and strategic initiatives have been defined as separate operating segments by management in accordance with SFAS No. 131 *Disclosures about Segments of an Enterprise and Related Information*, 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 under SFAS No. 131 as a 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 an operating segment. For internal management reporting, segment operations include direct segment operating expenses with the exception of minority interests expense and stock-based compensation expense.

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

	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
<b>Segment revenues:</b>				
Dialysis and related lab services <sup>(1)</sup>	\$ 1,377,977	\$ 1,285,596	\$ 4,025,934	\$ 3,820,585
Other Ancillary services and strategic initiatives	69,158	32,785	173,229	88,697
Consolidated revenues	\$ 1,447,135	\$ 1,318,381	\$ 4,199,163	\$ 3,909,282
<b>Segment operating margin (loss):</b>				
Dialysis and related lab services	\$ 236,062	\$ 247,256	\$ 702,322	\$ 762,440
Other Ancillary services and strategic initiatives	(4,708)	(14,117)	(27,014)	(35,477)
Total segment margin	\$ 231,354	\$ 233,139	\$ 675,308	\$ 726,963
<b>Reconciliation of segment margin to income before income taxes:</b>				
Stock-based compensation	(10,759)	(8,934)	(29,975)	(25,260)
Minority interests and equity income, net	(12,711)	(11,793)	(35,168)	(34,757)
Consolidated operating income	207,884	212,412	610,165	666,946
Debt expense	(54,505)	(62,715)	(168,891)	(194,496)
Other income	2,481	6,278	10,331	17,131
Consolidated income before income taxes	\$ 155,860	\$ 155,975	\$ 451,605	\$ 489,581

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- <sup>(1)</sup> Includes management fees related to providing management and administrative services to nonconsolidated investments and third-party owned dialysis centers.

**Table of Contents****DAVITA INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)****(unaudited)****(dollars and shares in thousands)****Summary of assets by segment is as follows:**

	<b>September 30, 2008</b>	<b>December 31, 2007</b>
<b>Segment assets</b>		
Dialysis and related lab services	\$ 6,915,973	\$ 6,731,647
Other Ancillary services and strategic initiatives	255,920	212,313
Consolidated assets	\$ 7,171,893	\$ 6,943,960

**12. Condensed consolidating financial statements**

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

**Table of Contents****DAVITA INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)****(unaudited)****(dollars and shares in thousands)****Condensed Consolidating Statements of Income**

<b>For the three months ended September 30, 2008</b>	<b>DaVita Inc.</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries</b>	<b>Consolidating Adjustments</b>	<b>Consolidated Total</b>
Net operating revenues	\$ 92,199	\$ 1,226,156	\$ 228,496	\$ (99,716)	\$ 1,447,135
Operating expenses	59,243	1,077,174	189,839	(99,716)	1,226,540
Minority interests and equity income, net				12,711	12,711
Operating income	32,956	148,982	38,657	(12,711)	207,884
Debt (expense)	(55,565)	(43,574)	(1,832)	46,466	(54,505)
Other income	48,718		229	(46,466)	2,481
Income tax expense (benefit)	10,413	51,743	(206)		61,950
Equity earnings in subsidiaries	78,214	23,487		(101,701)	
Net income	\$ 93,910	\$ 77,152	\$ 37,260	\$ (114,412)	\$ 93,910
<b>For the three months ended September 30, 2007</b>					
Net operating revenues	\$ 89,613	\$ 1,135,618	\$ 188,032	\$ (94,882)	\$ 1,318,381
Operating expenses	52,388	978,192	158,478	(94,882)	1,094,176
Minority interests and equity income, net				11,793	11,793
Operating income	37,225	157,426	29,554	(11,793)	212,412
Debt (expense)	(63,535)	(61,609)	(1,566)	63,995	(62,715)
Other income	70,112		161	(63,995)	6,278
Income tax expense	17,313	44,203	4		61,520
Equity earnings in subsidiaries	67,966	15,879		(83,845)	
Net income	\$ 94,455	\$ 67,493	\$ 28,145	\$ (95,638)	\$ 94,455
<b>For the nine months ended September 30, 2008</b>					
Net operating revenues	\$ 270,617	\$ 3,570,339	\$ 651,147	\$ (292,940)	\$ 4,199,163
Operating expenses	168,054	3,129,975	548,741	(292,940)	3,553,830
Minority interests and equity income, net				35,168	35,168
Operating income	102,563	440,364	102,406	(35,168)	610,165
Debt (expense)	(171,203)	(141,663)	(5,136)	149,111	(168,891)
Other income	158,897		545	(149,111)	10,331
Income tax expense	35,110	140,253	447		175,810
Equity earnings in subsidiaries	220,648	60,988		(281,636)	
Net income	\$ 275,795	\$ 219,436	\$ 97,368	\$ (316,804)	\$ 275,795

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**For the nine months ended September 30, 2007**

Net operating revenues	\$ 273,418	\$ 3,377,045	\$ 549,881	\$ (291,062)	\$ 3,909,282
Operating expenses	154,224	2,895,570	448,847	(291,062)	3,207,579
Minority interests and equity income, net				34,757	34,757
Operating income	119,194	481,475	101,034	(34,757)	666,946
Debt (expense)	(196,570)	(193,853)	(2,039)	197,966	(194,496)
Other income	214,268		829	(197,966)	17,131
Income tax expense	53,525	139,420	575		193,520
Equity earnings in subsidiaries	212,694	64,019		(276,713)	
Net income	\$ 296,061	\$ 212,221	\$ 99,249	\$ (311,470)	\$ 296,061

**Table of Contents****DAVITA INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)****(unaudited)****(dollars and shares in thousands)****Condensed Consolidating Balance Sheets**

<b>As of September 30, 2008</b>	<b>DaVita Inc.</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries</b>	<b>Consolidating Adjustments</b>	<b>Consolidated Total</b>
Cash and cash equivalents	\$ 375,655	\$	\$ 12,292	\$	\$ 387,947
Accounts receivable, net		911,473	145,218		1,056,691
Other current assets	30,431	543,316	45,604		619,351
<b>Total current assets</b>	<b>406,086</b>	<b>1,454,789</b>	<b>203,114</b>		<b>2,063,989</b>
Property and equipment, net	15,402	832,916	163,384		1,011,702
Amortizable intangibles, net	47,558	116,119	1,593		165,270
Investments in subsidiaries	4,675,445	421,171		(5,096,616)	
Receivables from subsidiaries	487,771		91,957	(579,728)	
Other long-term assets and investments	14,607	15,230	44,494		74,331
Goodwill	51,817	3,543,896	260,888		3,856,601
<b>Total assets</b>	<b>\$ 5,698,686</b>	<b>\$ 6,384,121</b>	<b>\$ 765,430</b>	<b>\$ (5,676,344)</b>	<b>\$ 7,171,893</b>
<b>Current liabilities</b>	<b>\$ 165,280</b>	<b>\$ 890,751</b>	<b>\$ 67,719</b>	<b>\$</b>	<b>\$ 1,123,750</b>
Payables to parent		500,064	79,664	(579,728)	
Long-term debt and other long-term liabilities	3,626,727	335,902	15,927		3,978,556
Minority interests				162,908	162,908
Shareholders' equity	1,906,679	4,657,404	602,120	(5,259,524)	1,906,679
<b>Total liabilities and shareholders' equity</b>	<b>\$ 5,698,686</b>	<b>\$ 6,384,121</b>	<b>\$ 765,430</b>	<b>\$ (5,676,344)</b>	<b>\$ 7,171,893</b>
<b>As of December 31, 2007</b>					
Cash and cash equivalents	\$ 443,157	\$	\$ 3,889	\$	\$ 447,046
Accounts receivable, net		786,765	141,184		927,949
Other current assets	26,528	557,357	17,370		601,255
<b>Total current assets</b>	<b>469,685</b>	<b>1,344,122</b>	<b>162,443</b>		<b>1,976,250</b>
Property and equipment, net	19,317	766,596	153,413		939,326
Amortizable intangibles, net	55,629	126,202	1,211		183,042
Investments in subsidiaries	4,286,853	427,436		(4,714,289)	
Receivables from subsidiaries	698,868		61,015	(759,883)	
Other long-term assets and investments	22,729	16,052	38,628		77,409
Goodwill	49,791	3,476,124	242,018		3,767,933
<b>Total assets</b>	<b>\$ 5,602,872</b>	<b>\$ 6,156,532</b>	<b>\$ 658,728</b>	<b>\$ (5,474,172)</b>	<b>\$ 6,943,960</b>
<b>Current liabilities</b>	<b>\$ 182,419</b>	<b>\$ 856,638</b>	<b>\$ 47,439</b>	<b>\$</b>	<b>\$ 1,086,496</b>

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Payables to parent		759,883		(759,883)	
Long-term debt and other long-term liabilities	3,688,203	272,488	14,006		3,974,697
Minority interests				150,517	150,517
Shareholders' equity	1,732,250	4,267,523	597,283	(4,864,806)	1,732,250
Total liabilities and shareholders' equity	\$ 5,602,872	\$ 6,156,532	\$ 658,728	\$ (5,474,172)	\$ 6,943,960

**Table of Contents****DAVITA INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)****(unaudited)****(dollars and shares in thousands)****Condensed Consolidating Statements of Cash Flows**

<b>For the nine months ended September 30, 2008</b>	<b>DaVita Inc.</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries</b>	<b>Consolidating Adjustments</b>	<b>Consolidated Total</b>
<b>Cash flows from operating activities</b>					
Net income	\$ 275,795	\$ 219,436	\$ 97,368	\$ (316,804)	\$ 275,795
Changes in operating assets and liabilities and non cash items included in net income	(421,137)	339,594	(139,295)	316,804	95,966
Net cash (used in) provided by operating activities	(145,342)	559,030	(41,927)		371,761
<b>Cash flows from investing activities</b>					
Additions of property and equipment, net	(1,308)	(191,272)	(31,271)		(223,851)
Acquisitions and purchases of other ownership interests	(39)	(91,906)	(9,221)		(101,166)
Proceeds from divestitures and asset sales		451			451
Purchase of investments and other items	3,628	(33,121)	55,528		26,035
Net cash provided by (used in) investing activities	2,281	(315,848)	15,036		(298,531)
<b>Cash flows from financing activities</b>					
Long-term debt, net	(4,459)	(444)	3,653		(1,250)
Intercompany borrowing	211,097	(242,738)	31,641		
Other items	(131,079)				(131,079)
Net cash provided by (used in) financing activities	75,559	(243,182)	35,294		(132,329)
Net (decrease) increase in cash and cash equivalents	(67,502)		8,403		(59,099)
Cash and cash equivalents at beginning of period	443,157		3,889		447,046
Cash and cash equivalents at end of period	\$ 375,655	\$	\$ 12,292	\$	\$ 387,947
<b>For the nine months ended September 30, 2007</b>					
<b>Cash flows from operating activities</b>					
Net income	\$ 296,061	\$ 212,221	\$ 99,249	\$ (311,470)	\$ 296,061
Changes in operating assets and liabilities and non cash items included in net income	(315,542)	96,813	(79,092)	311,470	13,649
Net cash (used in) provided by operating activities	(19,481)	309,034	20,157		309,710
<b>Cash flows from investing activities</b>					
Additions of property and equipment, net	(3,561)	(134,238)	(38,279)		(176,078)
Acquisitions and purchases of other ownership interests	(68,534)	(13,248)			(81,782)

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Proceeds form divestitures and asset sales		4,643		4,643
Purchase of investments and other items	10,775	(54,345)	53,934	10,364
Net cash (used in) provided by investing activities	(61,320)	(197,188)	15,655	(242,853)
<b>Cash flows from financing activities</b>				
Long-term debt, net	(902)	(160)	1,016	(46)
Intercompany borrowing	157,095	(111,686)	(45,409)	
Other items	14,287			14,287
Net cash provided by (used in) financing activities	170,480	(111,846)	(44,393)	14,241
Net increase (decrease) in cash and cash equivalents	89,679		(8,581)	81,098
Cash and cash equivalents at beginning of period	299,430		10,772	310,202
Cash and cash equivalents at end of period	\$ 389,109	\$	\$ 2,191	\$ 391,300

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

*This Quarterly Report on Form 10-Q contains statements that are forward-looking statements within the meaning of the federal securities laws. All statements that do not concern historical facts are forward-looking statements and include, among other things, statements about our expectations, beliefs, intentions and/or strategies for the future. These forward-looking statements include statements regarding our future operations, financial condition and prospects, expectations for treatment growth rates, revenue per treatment, expense growth, levels of the provision for uncollectible accounts receivable, operating income, cash flow, operating cash flow, estimated tax rates, capital expenditures, the development of new centers and center acquisitions, revenue estimating risk and our related level of indebtedness on our financial performance, including earnings per share. These statements involve substantial known and unknown risks and uncertainties that could cause our actual results to differ materially from those described in the forward-looking statements, including, but not limited to, risks resulting from the regulatory environment in which we operate, economic and market conditions, competition, other business conditions, accounting estimates, the concentration of profits generated from commercial payor plans, continued downward pressure on average realized payment rates from commercial payors, which may result in the loss of revenue or patients, a reduction in the number of patients under higher-paying commercial plans, changes in government payment rates or the structure of payments under the Medicare ESRD program may result in lower reimbursement for services we provide to Medicare patients and could have a material impact on our overall profitability, changes in pharmaceutical or anemia management practice patterns, payment policies, or pharmaceutical pricing, our ability to maintain contracts with physician medical directors, legal compliance risks, including our continued compliance with complex government regulations and compliance with the corporate integrity agreement applicable to the dialysis centers acquired from Gambro Healthcare and assumed in connection with such acquisition, the resolution of ongoing investigations by various federal and state government agencies, and the risk factors set forth in this Quarterly Report on Form 10-Q. We base our forward-looking statements on information currently available to us, and we undertake no obligation to update or revise these statements, whether as a result of changes in underlying factors, new information, future events or otherwise.*

**Results of operations**

We operate principally as a dialysis and related lab services business but also operate other ancillary services and strategic initiatives. These ancillary services and strategic initiatives consists of infusion therapy services, pharmacy services, vascular access services, physician services, disease management services and full-service special needs plans, as well as clinical research programs. The dialysis and related lab services business qualifies under SFAS No. 131 as a reportable segment and all of the other ancillary services and strategic initiatives have been combined and disclosed in the other segments category.

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Our consolidated operating results for the third quarter of 2008 compared with the prior sequential quarter and the same quarter of last year and the nine months ended September 30, 2008 compared to the nine months ended September 30, 2007 were as follows:

Consolidated Operations	September 30, 2008		Quarter ended June 30, 2008		September 30, 2007		September 30, 2008		Nine months ended September 30, 2007						
(dollar amounts rounded to nearest million, except per treatment data)															
Net operating revenues	\$	1,447	100%	\$	1,407	100%	\$	1,318	100%	\$	4,199	100%	\$	3,909	100%
Operating expenses and charges:															
Patient care costs		1,006	70%		973	69%		890	68%		2,909	69%		2,663	68%
General and administrative		129	9%		125	9%		121	9%		375	9%		356	9%
Depreciation and amortization		55	4%		53	4%		49	4%		161	4%		142	4%
Provision for uncollectible		37	3%		37	3%		34	3%		109	3%		102	3%
Minority interest and equity income, net		13	1%		13	1%		12	1%		35	1%		35	1%
Valuation gain on Product Supply Agreement			0%			0%			0%			0%		(55)	(1)%
Total operating expenses and charges		1,239	86%		1,202	85%		1,106	80%		3,589	86%		3,242	83%
Operating income	\$	208		\$	206		\$	212		\$	610		\$	667	
Dialysis treatments		4,091,099			4,018,763			3,842,763			12,044,639			11,335,453	
Average dialysis treatments per treatment day		51,786			51,523			49,266			51,385			48,567	
Average dialysis revenue per dialysis treatment (including lab services)	\$	336		\$	336		\$	334		\$	334		\$	336	

The following table summarizes consolidated net operating revenues:

	September 30, 2008		Three months ended June 30, 2008		September 30, 2007		Nine months ended September 30, 2008		September 30, 2007	
(dollar amounts rounded to nearest million)										
Dialysis and related lab services		\$ 1,378		\$ 1,351		\$ 1,285		\$ 4,026		\$ 3,820
Other Ancillary services and strategic initiatives		69		56		33		173		89
Consolidated net operating revenues		\$ 1,447		\$ 1,407		\$ 1,318		\$ 4,199		\$ 3,909

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The following table summarizes consolidated operating income:

	Three months ended			Nine months ended	
	September 30, 2008	June 30, 2008	September 30, 2007 <sup>(1)</sup>	September 30, 2008	September 30, 2007 <sup>(1)</sup>
	(dollar amounts rounded to nearest million)				
Dialysis and related lab services	\$ 236	\$ 238	\$ 247	\$ 702	\$ 762
Other Ancillary services and strategic initiatives loss	(5)	(10)	(14)	(27)	(35)
<b>Total segment margin</b>	<b>231</b>	<b>228</b>	<b>233</b>	<b>675</b>	<b>727</b>
Reconciling items:					
Stock-based compensation	(11)	(9)	(9)	(30)	(25)
Minority interests and equity income, net	(13)	(13)	(12)	(35)	(35)
<b>Consolidated operating income</b>	<b>208</b>	<b>206</b>	<b>212</b>	<b>610</b>	<b>667</b>
Reconciliation of non-GAAP measures:					
Less: Gains on insurance settlements			(7)		(7)
Valuation gain on the Product Supply Agreement					(55)
<b>Non-GAAP consolidated operating income</b>	<b>\$ 208</b>	<b>\$ 206</b>	<b>\$ 205</b>	<b>\$ 610</b>	<b>\$ 605</b>

<sup>(1)</sup> We have excluded valuation gains on the Product Supply Agreement and gains on insurance settlements from Hurricane Katrina from non-GAAP adjusted consolidated operating income in 2007 because management believes that this presentation enhances a user's understanding of our normal consolidated operating income as it excludes a non-recurring non-cash gain that resulted from the termination of our purchase obligation for dialysis machines from Gambro Renal Products Inc. under the Product Supply Agreement as well as an unusual insurance gain, and therefore is more meaningful and comparable to our current and prior period results and is indicative of our normal consolidated operating income.

*Consolidated net operating revenues*

Consolidated net operating revenues for the third quarter of 2008 increased by approximately \$40 million or approximately 2.8% as compared to the second quarter of 2008. The increase in consolidated net operating revenues was primarily due to an increase in Dialysis and Related Lab Services net revenues of approximately \$27 million, principally due to increased treatments and an increase of approximately \$13 million in the Ancillary Services and Strategic Initiatives net revenues primarily from growth in our pharmacy and in our VillageHealth special needs plans.

The increases in consolidated net operating revenues of approximately 9.8% and 7.4% for the three and nine months ended September 30, 2008, respectively, as compared to the same periods in 2007, were primarily due to an increase in Dialysis and Related Lab Services net revenues of 7.2% and 5.4%, respectively, which were primarily due to an increase in the number of treatments, with the balance of the increase from the Ancillary Services and Strategic Initiatives.

*Consolidated operating income*

Consolidated operating income for the third quarter of 2008 increased by approximately \$2 million or approximately 1.1% as compared to the second quarter of 2008. The increase in consolidated operating income was primarily due to lower operating losses in the Ancillary Services and Strategic Initiatives, due to growth in revenue combined with lower direct general and administrative expenses. These lower operating losses were offset by a decrease in the Dialysis and Related Lab Services operating income, which decreased primarily due to an increase in labor, the effects of two hurricanes that occurred during the third quarter of 2008, an increase in pharmaceutical costs and the timing of certain operating center costs.



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Consolidated operating income was \$208 million for the third quarter of 2008 as compared to \$212 million for the third quarter of 2007. The third quarter of 2007 included a \$7 million insurance settlement from Hurricane Katrina, and excluding this item consolidated operating income for the third quarter of 2007 would have been approximately \$205 million. This slight increase of \$3 million as adjusted in consolidated operating income was primarily related to the same factors discussed above. See reconciliation above.

Consolidated operating income was \$610 million for the nine months ended September 30, 2008, as compared to \$667 million for the nine months ended September 30, 2007. The nine months ended September 30, 2007 included a valuation gain of \$55 million on the alliance and product supply agreement we entered into with Gambro Renal Products in connection with the acquisition of Gambro Healthcare (the Product Supply Agreement) and the \$7 million insurance settlement related to Hurricane Katrina. Excluding the valuation gain on the Product Supply Agreement and the insurance settlement, our consolidated operating income for the nine months ended September 30, 2008 would have increased by approximately \$5 million compared to the nine months ended September 30, 2007. The increase was primarily due to treatment growth in revenue combined with growth in revenue in the Ancillary Services and Strategic Initiatives outpacing increases in our operating expenses. However, our consolidated operating income for the nine months ended September 30, 2008 was negatively affected by the events and factors that occurred in the Dialysis and Related Lab Services in the third quarter of 2008, as discussed above. See reconciliation above.

**Operating segments*****Dialysis and Related Lab Services***

	Three months ended			Nine months ended	
	September 30, 2008	June 30, 2008 (in millions)	September 30, 2007	September 30, 2008	September 30, 2007
Revenues	\$ 1,378	\$ 1,351	\$ 1,285	\$ 4,026	\$ 3,820
Segment margin	\$ 236	\$ 238	\$ 247	\$ 702	\$ 762

***Net Operating Revenues***

Dialysis and Related Lab Services net operating revenues for the third quarter of 2008 increased by approximately \$27 million or approximately 1.9% compared with the second quarter of 2008. The increase in net operating revenues was primarily due to an increase in the number of treatment days in the third quarter of 2008, as well as growth in the number of treatments driven primarily by non-acquired treatment growth at existing and new centers, a slight increase in the average dialysis revenue per treatment, partially offset by a decrease in the number of treatments due to the impact of Hurricanes Gustav and Ike. The increase in the average dialysis revenue per treatment in the third quarter of 2008, as compared to the second quarter of 2008, was primarily due to changes in mix and rates of our non-government payors, and improved collection performance.

Dialysis and Related Lab Services net operating revenues increased by approximately \$92 million or 7.2% in the third quarter of 2008 as compared to the same period in 2007. The increase in net operating revenues in the third quarter of 2008 was principally due to an increase in the number of treatments of approximately 6.2% and an increase in the average revenue per treatment of approximately 1%. The increase in the number of treatments was primarily attributable to an increase in the number of treatment days in the third quarter of 2008, as well as growth in the number of treatments primarily by non-acquired annual treatment growth at existing and new centers and growth through acquisitions, partially offset by a decrease in the number of treatments due to the impact of the Hurricanes Gustav and Ike. The increase in the average dialysis revenue per treatment in the third quarter of 2008 as compared to the third quarter of 2007 was due primarily to an increase in our non-government payment rates partially offset by decreases in the intensity of physician-prescribed pharmaceuticals and changes in the mix of our non-government payors.

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Dialysis and Related Lab Services net operating revenues increased by approximately \$205 million or 5.4% for the nine months ended September 30, 2008 as compared to the same period in 2007. The increase in net operating revenues for the nine months ended September 30, 2008 was principally due to an increase in the number of treatments of approximately 6.2%, partially offset by a decrease in the average revenue per treatment of approximately 0.8%. The increase in the number of treatments was primarily attributable to the same factors discussed above. The decrease in the average dialysis revenue per treatment for the nine months ended September 30, 2008 as compared to the same period of 2007 was primarily due to changes in the mix of our non-government reimbursement rates, decreases in the intensity of physician-prescribed pharmaceuticals, partially offset by an increase in the Medicare composite rate.

*Operating Expenses and Charges*

*Patient care costs.* Dialysis and Related Lab Services patient care costs on a per treatment basis increased by approximately \$2 in the third quarter of 2008, as compared to the second quarter of 2008. The increase in the per treatment costs in the third quarter of 2008 as compared to the second quarter of 2008 was primarily attributable to an increase in labor rates and additional labor hours as a result of lower productivity during the quarter, the effects of Hurricanes Gustav and Ike, an increase in pharmaceutical costs and the timing of certain operating center costs.

Dialysis and related Lab Services patient care costs on a per treatment basis increased by approximately \$9 and \$2 in the third quarter of 2008 and for the nine months ended September 30, 2008, respectively, as compared to the same periods in 2007. The increases in the per treatment costs in both periods were primarily attributable to the same factors as discussed above. In addition, we experienced an increase in the operating costs of our dialysis centers due to a large number of new centers that have opened during these periods, an increase as a result of the third quarter of 2007 benefiting from the insurance settlements from Hurricane Katrina, partially offset by decreases in the intensity of physician-prescribed pharmaceuticals.

*General and administrative expenses.* Dialysis and Related Lab Services general and administrative expenses for the third quarter of 2008 increased in absolute dollars by approximately \$1.9 million from the second quarter of 2008. The increase in the third quarter of 2008 compared to the second quarter of 2008 was due to increases in labor costs and the timing of certain other expenditures. In absolute dollars, general and administrative expenses increased by approximately \$4.4 million and \$2.2 million, respectively, in the third quarter of 2008 and for the nine months ended September 30, 2008 as compared to the same periods in 2007. The increases were primarily due to higher labor and benefit costs, partially offset by lower integration expenditures that were completed by the end of 2007.

*Depreciation and amortization.* The increase in depreciation and amortization for Dialysis and Related Lab Services in the third quarter of 2008 as compared to the second quarter of 2008 and the third quarter of 2007 was primarily due to growth through new center developments and expansions. The increase in depreciation and amortization for the nine months ended September 30, 2008, as compared to the nine months ended September 30, 2007 was primarily due to growth through new center developments and expansions and an increase in the amortization expense as a result of reductions in the intangible liability associated with the Product Supply Agreement.

*Provision for uncollectible accounts receivable.* The provision for uncollectible accounts receivable for Dialysis and Related Lab Services was 2.6% for all quarters presented. The current provision level of 2.6% may increase if we encounter problems with the upgrade of our billing systems and the recently completed integration of our billing and collecting systems.

*Operating income.*

Dialysis and Related Lab Services operating income for the third quarter of 2008 decreased by approximately \$2 million and \$11 million as compared to the second quarter of 2008 and as compared to the third quarter of 2007, respectively. The third quarter of 2007 included \$7 million of insurance settlements

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relating to Hurricane Katrina, and excluding this item operating income for the third quarter of 2008 would have decreased by approximately \$4 million. The third quarter of 2008 was significantly affected by several events that resulted in an overall reduction to operating income. Although operating revenues increased during the third quarter of 2008, other events and factors resulted in a decrease in our operating income for this period. These events and factors included (i) an increase in labor rates, and additional labor hours as a result of lower productivity during the quarter, (ii) the impact of Hurricanes Gustav and Ike that resulted in fewer treatments during the third quarter of 2008, and consequently, lower revenues, and (iii) the timing of certain operating center costs incurred during the third quarter of 2008.

**Other Ancillary Services and Strategic Initiatives**

	September 30, 2008	Three months ended June 30, 2008	September 30, 2007	Nine months ended September 30, 2008	2007
Revenues	\$ 69	\$ 56	\$ 33	\$ 173	\$ 89
Segment loss	\$ (5)	\$ (10)	\$ (14)	\$ (27)	\$ (35)

*Net operating revenues*

The Ancillary Services and Strategic Initiatives net operating revenues for the third quarter of 2008 increased by approximately \$13 million or 24% as compared to the second quarter of 2008, primarily from growth in our pharmacy business, VillageHealth and in our physician services business.

The increase in net operating revenues in the third quarter of 2008 and for the nine months ended September 30, 2008 of approximately \$36 million and \$84 million, respectively, as compared to the same periods in 2007, was primarily due to growth in our pharmacy business, the acquisition of HomeChoice Partners which provides infusion therapy services, and growth in our VillageHealth special needs plans.

*Operating expenses*

Ancillary Services and Strategic Initiatives operating expenses for the third quarter of 2008 increased by approximately \$9 million as compared to the second quarter of 2008, primarily due to an increase in volume in our pharmacy business, an increase in fixed operating expenses and an increase in impairment charges.

Ancillary Services and Strategic Initiatives operating expenses for the third quarter of 2008 and for the nine months ended September 30, 2008, increased as compared to the same periods in 2007, primarily due to the acquisition of HomeChoice Partners, volume growth in our pharmacy business, additional operating expenses associated with the VillageHealth special need plans becoming effective in early 2008 and higher labor and benefit costs, partially offset by lower professional fees for legal and consulting services that were incurred in 2007 to establish the special need plans.

*Operating loss*

Ancillary and Strategic Initiatives operating losses for the third quarter of 2008 decreased by approximately \$5 million and \$9 million as compared to the second quarter of 2008, and the third quarter of 2007, respectively. The decrease in operating losses was primarily due to growth in revenues outpacing increases in operating expenses.

**Corporate level charges**

*Stock-based compensation.* Stock-based compensation of approximately \$10.8 million in the third quarter of 2008 was relatively flat as compared to the second quarter of 2008 and increased by approximately \$1.8 million, as compared to the third quarter of 2007, primarily due to additional stock grants awarded during the period.



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Stock-based compensation of approximately \$30 million for the nine months ended September 30, 2008 increased by approximately \$5 million, as compared to the nine months ended September 30, 2007, also primarily due to additional stock grants awarded during the period.

*Minority interests and equity income, net.* Minority interests and equity income, net was \$12.7 million for the third quarter of 2008, a net decrease of approximately \$0.2 million and a net increase of approximately \$1.0 million as compared to the second quarter of 2008 and the third quarter of 2007, respectively. The increase in the third quarter of 2008 as compared to the third quarter of 2007 was primarily due to an increase in the profitability of our joint ventures in the third quarter of 2008, as well as an increase in the number of joint ventures. Minority interests and equity income, net increased by approximately \$0.4 million for the nine months ended September 30, 2008 as compared to the same period in 2007.

*Debt expense.* Debt expense of \$54.5 million in the third quarter of 2008 decreased by approximately \$1 million from the second quarter of 2008. The decrease was primarily due to reductions in the LIBOR-based variable interest rates on the unhedged portion of our debt. The overall average effective interest rate for the third quarter of 2008 was 5.66% compared to 5.75% for the second quarter of 2008.

For the three and nine months ended September 30, 2008, debt expense decreased by approximately \$8.2 million and \$25.6 million, respectively, as compared to the same periods in 2007. Debt expense for the nine months ended September 30, 2007 included write-offs of deferred financing costs of approximately \$4.4 million, associated with principal payments on our term loans. The decreases were attributable to lower interest rates as a result of reductions in the LIBOR-based variable interest rates on the unhedged portion of our debt.

### **Accounts receivable**

Our accounts receivable balances at September 30, 2008 and June 30, 2008 were \$1,057 million and \$1,047 million, respectively, which represented approximately 70 days of revenue in both periods, net of bad debt provision. Our DSO calculation is based on the current quarter's average revenue per day. There were no significant changes during the third quarter of 2008 from the second quarter of 2008 in the amount of unreserved accounts receivable over one year old or the amounts pending approval from third-party payors.

### **Outlook**

*Outlook for 2008 and 2009.* We expect our operating income results for 2008 to be near the middle of the range of our previously provided guidance of \$800-\$840 million. We still expect to generate approximately \$480 million to \$530 million of operating cash flow in 2008. Our operating income guidance for 2009 remains unchanged at a range of \$820-\$880 million. These projections and the underlying assumptions involve significant risks and uncertainties, and actual results may vary significantly from these current projections. These risks, among others, include those relating to the concentration of profits generated from commercial payor plans, continued downward pressure on average realized payment rates from commercial payors, which may result in the loss of revenue or patients, a reduction in the number of patients under higher-paying commercial plans, changes in government payment rates or the structure of payments under Medicare ESRD Program may result in lower reimbursement for services we provide to Medicare patients and could have a material impact on our overall profitability, changes in pharmaceutical or anemia management practice patterns, payment policies or pharmaceutical pricing, our ability to maintain contracts with physician medical directors, legal compliance risks, including our continued compliance with complex government regulations and compliance with the corporate integrity agreement applicable to the dialysis centers acquired from Gambro Healthcare and assumed in connection with such acquisition, and the resolution of ongoing investigations by various federal and state government agencies. You should read **Risk Factors** in this Quarterly Report on Form 10-Q and the cautionary language contained in the forward looking statements and associated risks as discussed under **Forward-looking statements** on page 21 for more information about these and other potential risks. We undertake no obligation to update or revise these projections, whether as a result of changes in underlying factors, new information, future events or otherwise.

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**Table of Contents****Liquidity and Capital Resources**

*Liquidity and capital resources.* Cash flow from operations during the third quarter of 2008 was \$146 million, compared to \$96 million during the third quarter of 2007. Non-operating cash outflows for the third quarter of 2008 included capital asset expenditures of \$79 million, of which \$52 million was for new center developments and relocations, and an additional \$32 million for acquisitions. Non-operating cash outflows for the third quarter of 2007 included capital asset expenditures of approximately \$71 million, of which \$49 million was for new center developments and relocations, and an additional \$76 million for acquisitions. We also repurchased 0.1 million shares of common stock for approximately \$6.4 million. During the third quarter of 2007, we sold investments in mutual funds and NxStage, Inc. common stock totaling \$6.7 million. During the third quarter of 2008, we acquired 6 dialysis centers, opened 22 new dialysis centers, closed 1 center, merged the operations of 2 centers into 2 other existing centers, and divested one center. During the third quarter of 2007, we acquired 6 centers, opened 18 new dialysis centers, closed one center, and provided administrative services to one additional center.

Cash flow from operations during the first nine months of 2008 was \$372 million, compared to \$310 million during the first nine months of 2007. Non-operating cash outflows for the first nine months of 2008 included capital asset expenditures of \$224 million, including \$158 million for new center developments and relocations, and an additional \$101 million for acquisitions. During the nine months ended September 30, 2008, we sold investments in mutual funds totaling \$5.3 million, and recognized a pre-tax gain of \$0.1 million. We also repurchased 3.5 million shares of our common stock for \$169.7 million, as discussed below. Non-operating cash outflows for the first nine months of 2007 included capital asset expenditures of approximately \$176 million, including \$102 million for new center developments and relocations, and an additional \$82 million for acquisitions. During the nine months ended September 30, 2007, we sold investments in mutual funds and NxStage, Inc. common stock totaling \$32.1 million. During the first nine months of 2008, we acquired 16 centers, opened 61 new dialysis centers, closed 6 centers, merged the operations of 4 centers into other existing centers, discontinued providing administrative services to one third-party owned center, provided administrative services to one additional center and divested 1 center. During the first nine months of 2007, we acquired 10 dialysis centers, opened 39 new dialysis centers, closed two centers, divested one center and provided administrative services to one third-party owned center.

We expect to spend approximately \$110 million to \$120 million in 2008 for capital asset expenditures related to routine maintenance items and information technology equipment, and have increased our expected expenditures for new center development, relocations and acquisitions to approximately \$300 million to \$350 million in 2008. We continue to expect to generate approximately \$480 million to \$530 million of operating cash flow in 2008.

During the third quarter of 2008 we made a mandatory principle payment of approximately \$1.8 million on the term loan A.

During the first nine months of 2008, we repurchased a total of 3,461,353 shares of our common stock for \$169.7 million, or an average price of \$49.02 per share, pursuant to previously announced authorizations by the Board of Directors. On May 1, 2008, our Board of Directors authorized an increase of an additional \$143.5 million of share repurchases of our common stock. We did not repurchase any additional shares of our common stock during the third quarter of 2008. However, during October 2008, we repurchased 1,027,502 shares of our common stock for \$50 million, or an average price of \$48.66 per share. As a result of these transactions, the total outstanding authorization for share repurchases is currently \$166.6 million. This stock repurchase program has no expiration date.

As of September 30, 2008, we maintained a total of ten interest rate swap agreements with amortizing notional amounts totaling \$834 million. These agreements had the economic effect of modifying the LIBOR-based variable interest rate on an equivalent amount of our debt to fixed rates ranging from 3.08% to 4.70%, resulting in a weighted average effective interest rate of 5.51% on the hedged portion of our Senior Secured

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Credit Facilities, including the term loan B margin of 1.50%. The swap agreements expire in 2008 through 2010 and require quarterly interest payments. During the nine months ended September 30, 2008, we accrued net charges of \$3.7 million from these swaps which is included in debt expense. As of September 30, 2008, the total fair value of these swaps was a liability of \$9.3 million. During the nine months ended September 30, 2008, we recorded \$1.7 million, net of tax, as a reduction to other comprehensive income for valuation losses, net of amounts reclassified into income.

As of September 30, 2008, the interest rates were economically fixed on approximately 43% of our variable rate debt and approximately 70% of our total debt.

As a result of the swap agreements, the overall effective weighted average interest rate on the Senior Secured Credit Facilities was 5.39%, based upon the current margins in effect of 1.50%, as of September 30, 2008.

Our overall average effective interest rate during the third quarter of 2008 was 5.66% and as of September 30, 2008 was 6.09%.

As of September 30, 2008, we have undrawn revolving credit facilities totaling \$250 million of which approximately \$47 million was committed for outstanding letters of credit. We also have undrawn revolving credit facilities totaling \$10.0 million associated with several of our joint ventures. These revolving credit facilities are typically guaranteed by DaVita Inc. or one of its wholly-owned subsidiaries based upon its proportional ownership percentage.

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

*Stock-based compensation*

Under SFAS No. 123(R) stock-based compensation recognized during a period is based on the estimated grant-date fair value of the portion of the stock-based awards vesting during that period, adjusted for expected forfeitures. Stock-based compensation recognized in these condensed consolidated financial statements for the nine months ended September 30, 2008 and 2007 includes compensation cost for stock-based awards granted prior to, but not fully vested as of, December 31, 2005 and subsequent stock-based awards granted through September 30, 2008 and 2007, respectively. Shares issued upon exercise of stock awards are generally issued from shares in treasury. We have used the Black-Scholes-Merton valuation model for estimating the grant-date fair value of stock options and stock-settled stock appreciation rights granted in all periods. During the nine months ended September 30, 2008, we granted 4.5 million stock-settled stock appreciation rights with a grant date fair value of \$49 million and with a weighted-average expected life of approximately 3.35 years and also granted 32,983 stock units with a fair value of \$1.7 million and a weighted average expected life of approximately 1.24 years.

For the nine months ended September 30, 2008 and September 30, 2007, we recognized \$30 million and \$25.3 million, respectively, in stock-based compensation expense for stock options, stock-settled stock appreciation rights, stock units and discounted employee stock plan purchases, which are primarily included in general and administrative expenses. The estimated tax benefit recorded for stock-based compensation through September 30, 2008 and 2007 was \$11.3 million and \$9.5 million, respectively. As of September 30, 2008, there was \$90 million of total estimated unrecognized compensation cost related to nonvested stock-based compensation arrangements under our equity compensation and stock purchase plans. We expect to recognize this cost over a weighted average remaining period of 1.5 years.

During the nine months ended September 30, 2008 and 2007, we received \$30 million and \$41.3 million, respectively, in cash proceeds from stock option exercises and \$10.2 million and \$27.0 million, respectively, in actual tax benefits upon the exercise of stock awards.

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### **Recent developments**

In July 2008, the Medicare Improvements for Patients and Providers Act for 2008 was passed by Congress. This legislation provides for an increase in the composite rate in the amount of 1% in 2009 and in 2010. In addition this legislation introduces a new payment system for dialysis services beginning in January 2011 whereby ESRD payments will be made under a bundled payment rate which will provide for a fixed rate for all goods and services provided during the dialysis treatment, including laboratory services and the administration of pharmaceuticals. The initial 2011 bundled rate will be set 2% below the payment rate that providers would have received under the historical fee for service payment methodology. The new payment system will provide for a single bundled payment base rate with an annual inflation adjustment based upon a market basket index, less 1% of such index, beginning in 2012. The bundled payment rate will be determined by the Secretary of Health and Human Services, who will have discretion to determine the base payment rate based on the goods and services included in the bundled rate. Dialysis providers will have the option to move fully to the bundled payment system in 2011 or to phase in the payment system over three years.

In February 2008, Baxter Healthcare Corporation proceeded with a recall of heparin, a pharmaceutical used in the treatment of dialysis patients and ceased further sales. As a result of the recall, there is only one remaining supplier of heparin and the cost to purchase heparin has significantly increased. It is possible that our heparin costs may continue to increase and since there is no separate reimbursement for this drug under Medicare, cost increases have a direct impact on our profitability. An affiliate of Fresenius Medical Care acquired the sole provider of heparin for the U.S. dialysis market. This could negatively impact our access to and pricing for this critical product.

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

In addition to the debt obligations reflected on our balance sheet, we have commitments associated with operating leases, letters of credit and our investments in third-party dialysis businesses. Substantially all of our facilities are leased. We have potential acquisition obligations for several jointly-owned centers and for some of our non-wholly-owned subsidiaries in the form of put provisions, which are exercisable at the third-party owners' future discretion within specified periods as outlined in each specific put provision. These put provisions, if exercised, would require us to purchase the third-party owners' interests at either the appraised fair market value or a predetermined multiple of earnings or cash flow attributable to the equity interest put to us, which is intended to approximate fair value. During the second quarter of 2008 we updated our methodology used to estimate the fair value of these put provisions. The revised methodology now used to estimate the fair value of the put provisions assumes either a predetermined multiple of earnings, or the higher of a liquidation value or an average multiple of earnings, based on historical earnings, patient mix and other performance indicators, as well as other factors. The estimate of the fair values of these put provisions is a critical accounting estimate that involves significant judgments and assumptions that were used in the calculation of estimating the overall fair values of these put provisions as of September 30, 2008. The methodology we used to estimate the fair values of these put provisions, as described above, may not be indicative of the actual methodology that will be used to ultimately settle these amounts on the settlement date, and therefore the fair values of these put provisions could vary significantly from our current estimates. The estimated fair values of these put provisions can also fluctuate and the implicit multiple of earnings at which these amounts are settled will vary depending upon market conditions including the credit and capital markets, which can impact the level of competition for dialysis and non-dialysis related businesses, the economic performance of these businesses and the restricted marketability of the third-party owners' interests. For additional information, see Note 6 to the condensed consolidated financial statements.

We also have potential cash commitments to provide operating capital advances as needed to several other third-party owned centers, nonconsolidated investments and physician owned vascular access clinics that we operate under administrative services agreements.

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The following is a summary of these contractual obligations and commitments as of September 30, 2008 reflecting changes that have occurred with our debt instruments during the first nine months of 2008 (in millions):

	Less Than 1 Year	1-3 Years	3-5 Years	After 5 Years	Total
<b>Scheduled payments under contractual obligations:</b>					
Long-term debt	\$ 17	\$ 157	\$ 1,773	\$ 1,751	\$ 3,698
Interest payments on senior and senior subordinated notes		243	243	183	669
Capital lease obligations	1	1	1	3	6
Operating leases	49	346	278	464	1,137
	\$ 67	\$ 747	\$ 2,295	\$ 2,401	\$ 5,510
<b>Potential cash requirements under existing commitments:</b>					
Letters of credit	\$ 47	\$	\$	\$	\$ 47
Acquisition of dialysis centers	121	62	72	41	296
Pay-fixed swaps potential obligations	2	7			9
Working capital advances to nonconsolidated investments and third-party-owned centers and clinics under administrative services agreements	26				26
	\$ 196	\$ 69	\$ 72	\$ 41	\$ 378

Not included above are interest payments related to our senior secured credit facilities. Our senior secured credit facilities as of September 30, 2008 bear interest at LIBOR plus margins of 1.50%. The term loan A and the revolving line of credit is adjustable depending upon our achievement of certain financial ratios. At September 30, 2008 our senior secured credit facilities had an overall effective weighted average interest rate of 5.39% including the effects of our swap agreements. Interest payments are due at the maturity of specific debt tranches within each term loan, which can range in maturity from one month to twelve months. Future interest payments will depend upon the amount of mandatory principal payments and principal prepayments, changes in the LIBOR-based interest rates that can fluctuate significantly depending upon market conditions including the credit and capital markets, as well as changes in the interest rate margins. Assuming no principal prepayments on our senior secured credit facilities during the next year and no changes in the effective interest rates, we would pay approximately \$105 million of interest over the next twelve months.

In addition to the above commitments, we are obligated to purchase a significant majority of our hemodialysis products and supplies at fixed prices through 2015 from Gambro Renal Products, Inc. in connection with an Alliance and Product Supply Agreement. Our total expenditures for the nine months ended September 30, 2008 on such products were approximately 2% of our total operating costs. The actual amount of purchases in future years under the Alliance and Product Supply Agreement will depend upon a number of factors, including the operating requirements of our centers, the number of centers we acquire, growth of our existing centers, and Gambro Renal Products' ability to meet our needs.

The pay-fixed swap obligations represent the estimated fair market values of our interest rate swap agreements as reported by various broker dealers that are based upon relevant observable market inputs as well as other current market conditions that exist as of September 30, 2008, and represent the estimated potential obligation that we would be required to pay based upon future settlement of each specific tranche within the swap agreements. The actual amount of our obligation associated with these swaps in the future will depend upon changes in interest rates that can fluctuate significantly depending upon market conditions, and other relevant factors that can affect the fair market value of these swap agreements.

The settlements of approximately \$12 million of existing FIN 48 liabilities are excluded from the above table as reasonably reliable estimates of the timing cannot be made.

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**Table of Contents****Significant New Accounting Standards**

In March 2008, the Financial Statement Accounting Board, or FASB, issued statement No. 161 *Disclosures about Derivative Instruments and Hedging Activities*, which amends SFAS No. 133 *Accounting for Derivative Instruments and Hedging Activities*. This standard requires enhanced disclosures about an entity's derivative and hedging activities. Entities will be required to provide additional disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under SFAS No. 133, and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. This standard is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, and encourages but does not require comparative disclosures for earlier periods at the initial adoption. We are currently in the process of assessing the expected impact of this standard on our consolidated financial statements.

On January 1, 2008, we adopted SFAS No. 157 *Fair Value Measurements*, except for the nonfinancial assets and liabilities that are subject to a one-year deferral allowed by FASB Staff Position (FSP) FAS 157-2 *Effective Date of FASB Statement No. 157*. This standard establishes a framework for measuring assets and liabilities at fair value and also requires additional disclosures about fair value measurements. The standard applies to assets and liabilities that are carried at fair value on a recurring basis. On February 12, 2008, FSP FAS157-2 was issued delaying the effective date of SFAS No. 157 until fiscal years beginning after November 15, 2008 for nonfinancial assets and liabilities that are not recognized or disclosed at fair value in the financial statements on a recurring basis at least annually. See Notes 6 and 8 to the condensed consolidated financial statements for further discussions.

On January 1, 2008, we adopted SFAS No. 159 *Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of SFAS No. 115*. This standard allows companies the alternative to measure certain financial assets and liabilities at fair value on an instrument-by-instrument basis that are currently not required to be measured at fair value. The standard is also designed to reduce the volatility in earnings caused by measuring related assets and liabilities differently and establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. The implementation of this standard did not have an impact on our consolidated financial statements.

In December 2007, the FASB issued Statement No. 141(R) *Business Combinations*, which replaces SFAS No. 141 *Business Combinations*. This standard requires all business combinations to be accounted for under the acquisition method (previously referred to as the purchase method). Under the acquisition method, the acquirer recognizes the assets acquired, the liabilities assumed, contractual contingencies, as well as any noncontrolling interest in the acquiree at their fair values at the acquisition date. Noncontractual contingencies are recognized at the acquisition date at their fair values only if it is more likely than not that they meet the definition of an asset or a liability in FASB Concepts Statement No. 6 *Elements of Financial Statements*. Transaction costs are excluded from the acquisition accounting and will be expensed as incurred. Any contingent consideration included by the acquirer as part of the purchase price must also be measured at fair value at the acquisition date and will be classified as either equity or a liability. This standard also requires a company that obtains control but acquires less than 100% of an acquiree to record 100% of the fair value of the acquiree assets, liabilities, and noncontrolling interests at the acquisition date. This standard is effective for periods beginning on or after December 15, 2008. We are currently in the process of assessing the expected impact of this standard on our consolidated financial statements.

In December 2007, the FASB issued Statement No. 160 *Noncontrolling Interests in Consolidated Financial Statements*, which amends Accounting Research Bulletin No. 51 *Consolidated Financial Statements*. This standard requires noncontrolling interests to be treated as a separate component of equity, but apart from the parent's equity and not as a liability, or as an item outside of equity. This will eliminate diversity that currently exists in accounting for transactions between an entity and its noncontrolling interests. This standard also

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specifies that consolidated net income attributable to the parent and to the noncontrolling interest be clearly identified and presented on the face of the consolidated statement of income, and that changes in the parent's ownership interest while it retains a controlling financial interest should be accounted for as equity transactions. This standard also expands disclosures in the financial statements to include a reconciliation of the beginning and ending balances of the equity attributable to the parent and the noncontrolling owners and a schedule showing the effects of changes in a parent's ownership interest in a subsidiary on the equity attributable to the parent. This standard is effective for periods beginning on or after December 15, 2008. We are currently in the process of assessing the expected impact of this standard on our consolidated financial statements.

**Table of Contents****Item 3. Quantitative and Qualitative Disclosures about Market Risk***Interest rate sensitivity*

The table below provides information, as of September 30, 2008, about our financial instruments that are sensitive to changes in interest rates.

	Expected maturity date					2013	Thereafter	Total	Average interest rate	Fair value
	2008	2009	2010	2011	2012					
(dollars in millions)										
Long term debt:										
Fixed rate	\$ 1	\$ 2	\$ 1	\$ 1	\$ 1	\$ 901	\$ 853	\$ 1,760	6.88%	\$ 1,688
Variable rate	\$ 17	\$ 67	\$ 88	\$ 66	\$ 1,706	\$	\$	\$ 1,944	5.38%	\$ 1,755

	Notional amount	Contract maturity date					Pay fixed	Receive variable	Fair value
		2008	2009	2010	2011	2012			
(dollars in millions)									
Swaps:									
Pay-fixed rate	\$ 834	\$ 44	\$ 401	\$ 389	\$	\$	3.08% to 4.70%	LIBOR	\$ (9.3)

Our Senior Secured Credit Facilities, which include the term loan A and the term loan B, consist of various individual tranches that can range in maturity from one month to twelve months and each specific tranche bears interest at a LIBOR rate that is determined by the maturity of that specific tranche. LIBOR-based interest rates are reset as each specific tranche matures and can fluctuate significantly depending upon market conditions including the credit and capital markets. Any increase in the LIBOR-based interest rates on the unhedged portion of our Senior Secured Credit Facilities, which totaled approximately \$1.1 billion as of September 30, 2008 will have a negative impact on our overall earnings.

As of September 30, 2008, we maintained a total of ten interest rate swap agreements with amortizing notional amounts totaling \$834 million. These agreements had the economic effect of modifying the LIBOR-based variable interest rate on an equivalent amount of our debt to fixed rates ranging from 3.08% to 4.70%, resulting in a weighted average effective interest rate of 5.51% on the hedged portion of our Senior Secured Credit Facilities, including the term loan B margin of 1.50%. The swap agreements expire in 2008 through 2010 and require quarterly interest payments. During the nine months ended September 30, 2008, we accrued net charges of \$3.7 million from these swaps which is included in debt expense. As of September 30, 2008, the total fair value of these swaps was a liability of \$9.3 million. During the nine months ended September 30, 2008, we recorded \$1.7 million, net of tax, as a reduction to other comprehensive income for valuation losses, net of amounts reclassified into income.

As of September 30, 2008, the interest rates were economically fixed on approximately 43% of our variable rate debt and approximately 70% of our total debt.

As a result of the swap agreements, the overall effective weighted average interest rate on the Senior Secured Credit Facilities was 5.39%, based upon the current margins in effect of 1.50% as of September 30, 2008.

Our overall average effective interest rate during the third quarter of 2008 was 5.66% and as of September 30, 2008 was 6.09%.

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

Management has established and maintains disclosure controls and procedures designed to ensure that information required to be disclosed in the reports that it files or submits pursuant to the Securities Exchange Act of 1934, as amended, or Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate to allow for timely decisions regarding required disclosures.

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

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

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**PART II**

**OTHER INFORMATION**

**Item 1. Legal Proceedings**

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

**Item 1A. Risk Factors**

*A restated description of the risk factors associated with our business is set forth below. This description includes any material changes to and supersedes the description of the risk factors associated with our business previously disclosed in Part I Item 1A of our Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2008. The risks discussed below are not the only ones facing our business. Please read the cautionary notice regarding forward-looking statements under the heading Management's Discussion and Analysis of Financial Condition and Results of Operations .*

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

Approximately 35% of our dialysis revenue for the nine months ended September 30, 2008 was generated from patients who have commercial payors as the primary payor. The majority of these patients have insurance policies that pay us on terms and at rates that are generally significantly higher than Medicare rates. The payments we receive from commercial payors generate nearly all of our profit. We are experiencing a decrease in some of our commercial payment rates and it is possible that commercial payment rates could be materially lower in the future. The downward pressure on commercial payment rates is a result of general conditions in the market, recent and future consolidations among commercial payors, increased focus on dialysis services and other factors.

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

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

Our revenue levels are sensitive to the percentage of our patients with higher-paying commercial insurance coverage. A patient's insurance coverage may change for a number of reasons, including as a result of changes in the patient's or a family member's employment status. Currently, for a patient covered by an employer group health plan, Medicare generally becomes the primary payor after 33 months, or earlier, if the patient's employer group health plan coverage terminates. When Medicare becomes the primary payor, the payment rate we receive for that patient shifts from the employer group health plan rate to the lower Medicare payment rate. In addition,

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our continued negotiations with commercial payors could result in a decrease in the number of patients under commercial plans. If there is a significant reduction in the number of patients under higher-paying commercial plans relative to government-based programs that pay at lower rates, it would have a material adverse effect on our revenues, earnings and cash flows.

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

Approximately one-half of our dialysis revenue for the nine months ended September 30, 2008 was generated from patients who have Medicare as their primary payor. Currently, the Medicare End Stage Renal Disease, or ESRD, program pays us for dialysis treatment services at a fixed composite rate. The Medicare composite rate is the payment rate for a dialysis treatment including the supplies used in those treatments, specified laboratory tests and certain pharmaceuticals. Other services and certain pharmaceuticals, including EPO (a pharmaceutical used to treat anemia, a common complication associated with ESRD), vitamin D analogs and iron supplements, are separately billed.

In July 2008, the Medicare Improvements for Patients and Providers Act for 2008 was passed by Congress. This legislation provides for an increase in the composite rate in the amount of 1% in 2009 and in 2010. In addition this legislation introduces a new payment system for dialysis services beginning in January 2011 whereby ESRD payments will be made under a bundled payment rate which will provide for a fixed rate for all goods and services provided during the dialysis treatment, including laboratory services and the administration of pharmaceuticals. The initial 2011 bundled rate will be set 2% below the payment rate that providers would have received under the historical fee for service payment methodology. The new payment system will provide for a single bundled payment base rate with an annual inflation adjustment based upon a market basket index, less 1% of such index, beginning in 2012. The bundled payment rate will be determined by the Secretary of Health and Human Services, who will have discretion to determine the base payment rate based on the goods and services included in the bundled rate. Dialysis providers will have the option to move fully to the bundled payment system in 2011 or to phase in the payment system over three years.

We experience increases in operating costs that are subject to inflation, such as labor and supply costs, regardless of whether there is a compensating inflation-based increase in Medicare payment rates. The composite rate adjustment provided for in 2009 and 2010 is not sufficient to compensate for the increases that we experience in operating costs that are subject to inflation. Because the bundled rates that will take effect in 2011 have not been set, we cannot predict whether the established rates, combined with the proposed negative adjustments, will be sufficient to compensate for increases in our operating costs that are subject to inflation. To the extent the Medicare bundled rates are established at levels that result in lower overall reimbursement for services we provide to Medicare patients, it could have a material adverse effect on our revenues, earnings and cash flows.

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

Approximately 4% of our dialysis revenue for the nine months ended September 30, 2008 was generated from patients who have Medicaid as their primary coverage. As state governments face increasing budgetary pressure, they may propose reductions in payment rates, delays in the timing of payments, limitations on eligibility or other changes to Medicaid programs. In addition Medicaid eligibility requirements mandate that citizen enrollees in Medicaid programs provide documented proof of citizenship. Our revenues, earnings and cash flows could be negatively impacted to the extent that we are not paid by Medicaid or other state programs for services provided to patients that are unable to satisfy the revised eligibility requirements, including undocumented patients living in the U.S. If state governments reduce the rates paid by Medicaid programs for dialysis and related services, delay the timing of payment for services provided, further limit eligibility for Medicaid coverage or adopt changes to the Medicaid payment structure which reduces our overall payments from Medicaid, then our revenues, earnings and cash flows could be adversely affected.

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

The administration of EPO and other pharmaceuticals accounted for approximately 30% of our dialysis revenue for the nine months ended September 30, 2008, with EPO accounting for approximately 20% of our dialysis revenue. Since late 2006, there has been significant media discussion and government scrutiny regarding anemia management practices in the United States which has created confusion and concern in the nephrology community. In late 2006, the House Ways and Means Committee held a hearing on the issue of EPO utilization and in 2007, the FDA required changes to the labeling of EPO and Aranesp® to include a black box warning, the FDA's strongest form of warning label. The FDA has held additional hearings to revisit these label changes as they apply to ESRD and continues to examine the issue. CMS also reviewed its EPO reimbursement policies and in January 2008, changes to the EPO monitoring policy went into effect which further limit reimbursement and which have negatively impacted the prescribing habits of our physicians. Commercial payors have also increasingly examined their administration policies for EPO and, in some cases have modified those policies. As a result, we experience variability in EPO utilization by prescribing physicians. Further changes in physician practice patterns and accepted clinical practices, changes in labeling of other pharmaceuticals in a manner that alters physician practice patterns or accepted clinical practices, changes in private and governmental payment criteria, including the introduction of EPO administration policies, the conversion to alternate types of administration of EPO or other pharmaceuticals that result in further decreases in utilization or reimbursement for EPO could have a material adverse effect on our revenues, earnings and cash flows.

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

Amgen Inc. is the sole supplier of EPO and may unilaterally decide to increase its price for EPO during the term of our contract. Future changes in the cost of EPO could have a material adverse effect on our earnings and cash flows and ultimately reduce our income. Although our agreement with Amgen for EPO includes potential pricing discounts which depend upon the achievement of certain criteria, we cannot predict whether we will continue to receive the discount structure for EPO that we currently receive, or whether we will continue to achieve the same levels of discounts within that structure as we have historically achieved. Our agreement with Amgen also provides for specific rebates off of list price based on process improvement and data submission and some combination of these factors. Factors that could impact our ability to qualify for the discounts and rebates provided for in our agreement with Amgen in the future include our ability to develop and implement certain process improvements and track certain data elements. Failure to qualify for discounts or meet certain targets and earn the specified rebates could have a material adverse effect on our earnings and cash flows.

Amgen has developed and obtained FDA approval for Aranesp®, a pharmaceutical used to treat anemia that may replace EPO or reduce its use with dialysis patients. Unlike EPO, which is generally administered in conjunction with each dialysis treatment, Aranesp is administered less frequently. In the event that alternatives to EPO are marketed for the treatment of dialysis patients, we may realize lower margins on the administration of such pharmaceuticals than are currently realized with EPO. A significant increase in the development and use of similar alternatives to EPO, or a change in administration practices, could have a material adverse impact on our revenues, earnings and cash flows.

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

In response to clinical studies which identified risks in certain patient populations related to the utilization of EPO and other erythropoiesis-stimulating agents, i.e., Aranesp®, and in response to changes in the labeling of EPO and Aranesp®, there has been substantial media attention and government scrutiny resulting in hearings and

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legislation regarding utilization and reimbursement. Although we believe our anemia management practices have been compliant with existing laws and regulations, as a result of the current high level of scrutiny and controversy, we may be subject to increased inquiries from a variety of governmental bodies and claims by third parties. For example, the subpoena from the U.S. Attorney's Office in the Eastern District of Missouri includes requests for documents regarding the administration of, and billing for, EPO. In August 2007, we received a subpoena from the Office of Inspector General in Houston, Texas for records relating to EPO claims submitted to Medicare. In addition, in August 2007, a complaint was filed against us, Amgen and Fresenius Medical Care Holdings by Sheet Metal Workers National Health Fund and Glenn Randle alleging claims related to the administration and use of EPO. In February 2008 the Attorney General's Office for the State of Nevada notified us that Nevada Medicaid intends to conduct audits of ESRD providers in Nevada relating to the billing of pharmaceuticals, including EPO and on November 4, 2008, we received a verbal notice of a forthcoming civil inquiry from the Department of Justice and the U.S. Attorney's Office for the Northern District of Georgia relating to the administration of iron and vitamin D pharmaceuticals. We expect to receive a request to produce documents and other information and such request may come in the form of a subpoena. We intend to cooperate with any such request. Additional inquiries from various agencies and claims by third parties with respect to this issue would continue to require management's attention and significant legal expense and any negative findings could result in substantial financial penalties against us or exclusion from future participation in the Medicare and Medicaid programs, and could substantially reduce our revenues, earnings and cash flows.

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

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

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

We are voluntarily cooperating with the U.S. Attorney's Office for the Eastern District of New York and the OIG with respect to the subpoena we received in October 2004, which requires production of a wide range of documents relating to our operations, including DaVita Laboratory Services. The subpoena also includes specific requests for documents relating to testing for PTH and to products relating to vitamin D therapies. DVA Renal Healthcare (formerly Gambro Healthcare Inc.) received a similar subpoena in November 2004. It is possible that criminal proceedings may be initiated against us in connection with this inquiry. Any negative findings could result in substantial financial penalties against us, exclusion from future participation in the Medicare and Medicaid programs and criminal penalties. To our knowledge, no proceedings have been initiated against us at this time. Although we cannot predict whether or when proceedings might be initiated or when these matters may be resolved, it is not unusual for investigations such as this to continue for a considerable period of time. Responding to the subpoenas may require management's attention and significant legal expense.

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

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

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

We endeavor to comply with all of the requirements for receiving Medicare and Medicaid payments and to structure all of our relationships with referring physicians to comply with state and federal anti-kickback laws and the Stark II physician self-referral law. However, the laws and regulations in this area are complex and subject to varying interpretations. For example, if an enforcement agency were to challenge the level of compensation that we pay our medical directors, we could be required to change our practices, face criminal or civil penalties, pay substantial fines or otherwise experience a material adverse effect as a result of a challenge to these arrangements.

Because of regulatory considerations unique to New York, all of our dialysis operations in New York are conducted by privately-owned companies to which we provide a broad range of administrative services. These operations accounted for approximately 5% of our dialysis revenue for the nine months ended September 30, 2008. In 2007, changes to New York law were adopted that will permit us to hold licenses to conduct dialysis business directly, but until these changes are implemented and we transfer these operating licenses, we can give no assurances that these arrangements will not be challenged.

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

Suspension or termination of our participation in government payment programs;

Refunds of amounts received in violation of law or applicable payment program requirements;

Loss of required government certifications or exclusion from government payment programs;

Loss of licenses required to operate healthcare facilities in some of the states in which we operate;

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

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

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



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Mandated practice changes that significantly increase operating expenses; and

Termination of relationships with medical directors.

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

As of September 30, 2008 we owned a controlling interest in numerous dialysis related joint ventures, which represented approximately 15% of our dialysis revenue. In addition, we also owned a noncontrolling interest in several other dialysis related joint ventures. We anticipate that we will continue to increase the number of our joint ventures. Many of our joint ventures with physicians or physician groups also have the physician owners providing medical director services to those centers or other centers we own and operate. Because our relationships with physicians are governed by the anti-kickback statute contained in the Social Security Act, we have sought to structure our joint venture arrangements to satisfy as many safe harbor requirements as we believe are reasonably possible. However, our joint venture arrangements do not satisfy all elements of any safe harbor under the federal anti-kickback statute. The subpoena we received from the United States Attorney's Office for the Eastern District of Missouri in March 2005, and the related request for additional documents received in October 2005, included requests for documents related to our joint ventures.

If our joint ventures are found to be in violation of the anti-kickback statute or the Stark provisions, we could be required to restructure the joint ventures or refuse to accept referrals for designated health services from the physicians with whom the joint venture centers have a financial relationship.

We also could be required to repay amounts received from Medicare and certain other payors by the joint ventures pursuant to prohibited referrals, and we could be subject to monetary penalties and exclusion from government healthcare programs. If our joint venture centers are subject to any of these penalties, we could suffer severe consequences that would have a material adverse effect on our revenues, earnings and cash flows.

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

There are significant estimating risks associated with the amount of dialysis revenue that we recognize in a reporting period. Ongoing insurance coverage changes, geographic coverage differences, differing interpretations of contract coverage, and other payor issues complicate the billing and collection process. Determining applicable primary and secondary coverage for approximately 111,000 patients at any point in time, together with the changes in patient coverage that occur each month, requires complex, resource-intensive processes and errors in determining the correct coordination of benefits may result in refunds to payors. Revenues associated with Medicare and Medicaid programs are also subject to estimating risk related to the amounts not paid by the primary government payor that will ultimately be collectible from other government programs paying secondary coverage, the patient's commercial health plan secondary coverage or the patient. Collections, refunds and payor retractions typically continue to occur for up to three years and longer after services are provided. If our estimates of dialysis revenue are materially inaccurate, it could impact the timing of our revenue recognition and have a significant impact on our operating results.

**The ancillary services we provide or the strategic initiatives we invest in may generate losses and may ultimately be unsuccessful. In the event that one or more of these activities is unsuccessful, we may have to write off our investment and incur other exit costs.**

Our ancillary services and strategic initiatives include pharmacy services, vascular access services, disease management services, ESRD clinical research programs, ESRD full capitation demonstration projects, ESRD special needs plans, and administrative services provided to noncontrolling owned and third-party owned centers

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and clinics, each of which is related to our core business of providing dialysis services, as well as the provision of home infusion therapy services which is related to our core competencies. Many of these initiatives require investments of both management and financial resources and can generate significant losses for a substantial period of time prior to becoming profitable. There can be no assurance that any such strategic initiative will ultimately be successful. (For example, during 2007 and for the nine months ended September 30, 2008, our VillageHealth and pharmacy initiatives generated net operating losses and are expected to generate net operating losses for the remainder of 2008.) If any of our ancillary services or strategic initiatives do not perform as planned, we may incur a material write-off of our investment in one or more of these activities.

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

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

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

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

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

**Current economic conditions, including the possibility of a severe recession in the United States and a worldwide economic slowdown, as well as disruptions in the financial markets could result in substantial declines in our revenues, earnings, cash flows and financial condition.**

The possibility of a severe recession in the United States and a worldwide economic slowdown, could adversely affect our business and our profitability. Among other things, the potential decline in Federal and state revenues that may result from such conditions may create additional pressures to contain or reduce reimbursements for our services from Medicare, Medicaid and other government sponsored programs. The

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potential increase in job losses in the United States which may occur in the near future if the economy continues to decline could result in a smaller percentage of our patients being covered by an employer group health plan and a larger percentage being covered by lower paying Medicare and Medicaid programs. In addition, if the current turmoil in the financial markets continues, the interest rates payable under our credit facilities could be adversely affected or it could be more difficult to obtain or renew such facilities in the future. Any or all of these factors, as well as other consequences of the current economic conditions which cannot currently be anticipated, could substantially reduce our revenues, earnings and cash flows and otherwise adversely affect our financial condition.

**If we are not able to continue to make acquisitions on reasonable terms, or maintain an acceptable level of non-acquired growth, or if we face significant patient attrition to our competitors, it could adversely affect our business.**

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

**Increases in interest rates may increase our interest expense and adversely affect our profitability and cash flow and our ability to service our indebtedness.**

We are subject to interest rate risk associated with the portions of our borrowings that bear interest at a variable rate. As of September 30, 2008, we had approximately \$1.9 billion outstanding under the Senior Secured Credit Facilities, of which approximately \$1.1 billion bore interest at a LIBOR-based variable rate, without giving effect to any interest rate swaps. The variable rate debt outstanding under our Senior Secured Credit Facilities had a weighted average interest rate of approximately 5.39% at September 30, 2008. In addition, we have approximately \$203 million of available borrowings under our Senior Secured Credit Facilities that would bear interest at the LIBOR-based variable rate. We may also incur additional variable rate debt in the future.

Increases in interest rates would increase our interest expense for the variable portion of our indebtedness, which could negatively impact our earnings and cash flow. In addition, if we seek to refinance our existing indebtedness under our Senior Secured Credit Facilities, we may not be able to do so on acceptable terms and conditions, which could increase our interest expense or impair our ability to service our indebtedness and fund our operations.

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

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

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

increase our vulnerability to general adverse economic and industry conditions;

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

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

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



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

limit our ability to borrow additional funds.

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

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

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

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

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

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

**Our business is labor intensive and could be adversely affected if we were unable to maintain satisfactory relations with our employees or if union organizing activities were to result in significant increases in our operating costs or decreases in productivity.**

Our business is labor intensive, and our results are subject to variations in labor-related costs and productivity. If the recent national and local elections to result in actions or proposals that increased the likelihood of union organizing activities at our facilities, our operating costs could increase and our employee relations, productivity, earnings and cash flows could be adversely affected.

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

Our obligations under our alliance and product supply agreement with Gambro Renal Products to purchase dialysis equipment, dialyzers and certain other products, may limit our ability to realize future cost savings in regard to certain products. For the nine months ended September 30, 2008, our total spending on hemodialysis products, supplies and equipment with Gambro Renal Products was approximately 2% of our total operating costs.

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**Upgrades to our billing and collections systems and complications associated with the integration of our billing and collections systems could have a material adverse effect on our revenues, cash flows and operating results.**

In 2007, we completed the integration of our billing systems into one system and system upgrades continue in 2008. We may experience difficulties in our ability to successfully bill and collect for services rendered as a result of these changes, including a slow-down of collections, a reduction in the amounts we expect to collect, increased risk of retractions from and refunds to commercial and government payors and noncompliance with reimbursement regulations. These changes could also have an adverse impact on the claims review required by the corporate integrity agreement applicable to the centers acquired from Gambro Healthcare, described below. The failure to successfully implement the upgrades to the billing and collection systems could have a material adverse effect on our revenues, cash flows and operating results.

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

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

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

We have significant suppliers that are either the sole or primary source of products critical to the services we provide or to which we have committed obligations to make purchases, including Amgen, Fresenius Medical Care, Gambro Renal Products, Baxter Healthcare Corporation, NxStage, as well as others. If any of these suppliers are unable to meet our needs for the products they supply, including in the event of a product recall, and we are not able to find adequate alternative sources, our revenues, earnings and cash flows could be substantially reduced. For example, in February 2008, Baxter Healthcare Corporation proceeded with a recall of heparin, a pharmaceutical used in the treatment of dialysis patients and ceased further sales. As a result of the recall, there is only one remaining supplier of heparin and the cost to purchase heparin has significantly increased. It is possible that our heparin costs may continue to increase and since there is no separate reimbursement for this drug under Medicare, cost increases have a direct impact on our profitability. An affiliate of Fresenius Medical Care acquired the sole provider of heparin for the U.S. dialysis market. This could negatively impact our access to and pricing for this critical product. In addition, the technology related to the products critical to the services we provide is subject to new developments and may result in superior products. If we are not able to access superior products on a cost-effective basis or if suppliers are not able to fulfill our requirements for such products, we could face patient attrition which could substantially reduce our revenues, earnings and cash flows.

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

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

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

further increases in premiums and deductibles;

increases in the number of liability claims against us or the cost of settling or trying cases related to those claims; and

an inability to obtain one or more types of insurance on acceptable terms.

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

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

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

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

Most of our outstanding employee stock options include a provision accelerating the vesting of the options in the event of a change of control. We also maintain a change of control protection program for our employees who do not have a significant number of stock awards, which provides for cash bonuses to the employees in the

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event of a change of control which has been in place since September 2001. Based on the shares of our common stock outstanding and the market price of our stock on September 30, 2008, these cash bonuses would total approximately \$231 million if a change of control transaction occurred at that price and our Board of Directors did not modify this program. These compensation programs may affect the price an acquirer would be willing to pay for our Company.

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

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

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds***(c) Stock Repurchases*

The following table summarizes the Company's repurchases of its common stock during the third quarter of 2008:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs <sup>(1)</sup>	Approximate Dollar Value of Shares that may Yet Be Purchased Under the Plans or Programs (in millions) <sup>(2)</sup>
July 1-31, 2008				\$ 216.6
August 1-31, 2008				216.6
September 1-30, 2008				216.6
Total				\$ 216.6

<sup>(1)</sup> On September 11, 2003, we announced that the Board of Directors authorized the repurchase of up to \$200 million of our common stock, with no expiration date. On November 2, 2004, we announced that the Board of Directors approved an increase in our authorization to repurchase shares of our common stock by an additional \$200 million. For the first nine months of 2008, we repurchased 3,461,353 shares of our common stock for a total of \$169.7 million, or an average of \$49.02 per share. On May 1, 2008, our Board of Directors authorized an increase of an additional \$143.5 million of share repurchases of our common stock. We did not repurchase any additional shares of our common stock during the third quarter of 2008.

<sup>(2)</sup> During October 2008, we repurchased 1,027,502 shares of our common stock for \$50 million, or an average price of \$48.66 per share. As a result, the total outstanding authorization for share repurchases is currently \$166.6 million. This stock repurchase program has no expiration date. We are authorized to make purchases from time to time in the open market or in privately negotiated transactions, depending upon market conditions and other considerations. However, we are subject to share repurchase limitations under the terms of the Senior Secured Credit Facilities and the indentures governing our senior and senior subordinated notes.

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



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**Item 6. Exhibits**

*(a) Exhibits*

**Exhibit  
Number**

10.1	Employment Agreement between the Company and Kent J. Thiry effective July 25, 2008. <sup>*(1)</sup>
10.2	Employment Agreement between the Company and Allen Nissenson effective August 1, 2008. <sup>ü*</sup>
10.3	Form of Stock Appreciation Rights Agreement Board (Davita Inc. 2002 Equity Compensation Plan). <sup>ü*</sup>
10.4	Form of Restricted Stock Units Agreement Board (Davita Inc. 2002 Equity Compensation Plan). <sup>ü*</sup>
10.5	Form of Non-qualified Stock Option Agreement Board (Davita Inc. 2002 Equity Compensation Plan). <sup>ü*</sup>
12.1	Ratio of earnings to fixed charges. <sup>ü</sup>
31.1	Certification of the Chief Executive Officer, dated November 5, 2008, pursuant to Rule 13a-14(a) or 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. <sup>ü</sup>
31.2	Certification of the Chief Financial Officer, dated November 5, 2008, pursuant to Rule 13a-14(a) or 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. <sup>ü</sup>
32.1	Certification of the Chief Executive Officer, dated November 5, 2008, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. <sup>ü</sup>
32.2	Certification of the Chief Financial Officer, dated November 5, 2008, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. <sup>ü</sup>

<sup>ü</sup> Filed herewith.

\* Management contract or executive compensation plan or arrangement.

(1) Filed on July 31, 2008 as an exhibit to the Company's current report on Form 8-K.

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**SIGNATURE**

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

DAVITA INC.

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

Date: November 5, 2008

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

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**INDEX TO EXHIBITS**

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