DAVITA INC
Form 10-Q
May 08, 2008

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

For the Quarterly Period Ended

March 31, 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	**51-0354549**
(State of incorporation)	**(I.R.S. Employer Identification No.)**

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

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

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

(Do not check if a smaller reporting company)

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

As of April 30, 2008, the number of shares of the Registrant s common stock outstanding was approximately 104.7 million shares and the aggregate market value of the common stock outstanding held by non-affiliates based upon the closing price of these shares on the New York Stock Exchange was approximately $5.5 billion.

Table of Contents

DAVITA INC.

INDEX

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 March 31, 2008	Three months ended March 31, 2007
Net operating revenues	$ 1,344,724	$ 1,278,166
Operating expenses and charges:		
Patient care costs	930,209	881,585
General and administrative	120,765	113,221
Depreciation and amortization	52,811	45,790
Provision for uncollectible accounts	34,631	33,635
Minority interests and equity income, net	9,581	10,618
Total operating expenses and charges	1,147,997	1,084,849
Operating income	196,727	193,317
Debt expense	(59,066)	(68,870)
Other income	4,863	3,195
Income before income taxes	142,524	127,642
Income tax expense	55,590	51,060
Net income	$ 86,934	$ 76,582
Earnings per share:		
Basic earnings per share	$ 0.81	$ 0.73
Diluted earnings per share	$ 0.80	$ 0.72
Weighted average shares for earnings per share:		
Basic	107,367,356	105,013,140
Diluted	108,239,360	106,739,216

See notes to condensed consolidated financial statements.

1

Table of Contents

DAVITA INC.

CONSOLIDATED BALANCE SHEETS

(unaudited)

(dollars in thousands, except per share data)

	March 31, 2008	December 31, 2007
ASSETS		
Cash and cash equivalents	$ 479,316	$ 447,046
Short-term investments	45,859	40,278
Accounts receivable, less allowance of $205,528 and $195,953	959,837	927,949
Inventories	76,807	80,173
Other receivables	185,238	198,744
Other current assets	29,604	34,482
Deferred income taxes	241,816	247,578
Total current assets	2,018,477	1,976,250
Property and equipment, net	954,858	939,326
Amortizable intangibles, net	175,161	183,042
Investments in third-party dialysis businesses	18,568	19,446
Long-term investments	12,524	22,562
Other long-term assets	35,938	35,401
Goodwill	3,774,906	3,767,933
	$ 6,990,432	$ 6,943,960
LIABILITIES AND SHAREHOLDERS EQUITY		
Accounts payable	$ 211,600	$ 225,461
Other liabilities	479,651	486,151
Accrued compensation and benefits	288,559	334,961
Current portion of long-term debt	35,626	23,431
Income taxes payable	55,298	16,492
Total current liabilities	1,070,734	1,086,496
Long-term debt	3,669,809	3,683,887
Other long-term liabilities	98,286	83,448
Alliance and product supply agreement, net	39,975	41,307
Deferred income taxes	164,026	166,055
Minority interests (fair value of potential put obligations $316,000 and $330,000)	149,276	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; 106,806,458 and 107,130,127 shares outstanding)	135	135
Additional paid-in capital	723,565	707,080
Retained earnings	1,602,224	1,515,290
Treasury stock, at cost (28,055,825 and 27,732,156 shares)	(513,958)	(487,744)
Accumulated other comprehensive loss	(13,640)	(2,511)
Total shareholders equity	1,798,326	1,732,250

	$ 6,990,432	$ 6,943,960

See notes to condensed consolidated financial statements.

Table of Contents

DAVITA INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

(dollars in thousands)

	Three months ended March 31, 2008	Three months ended March 31, 2007
Cash flows from operating activities:		
Net income	$ 86,934	$ 76,582
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	52,811	45,790
Stock-based compensation expense	9,548	7,702
Tax benefits from stock award exercises	2,618	6,307
Excess tax benefits from stock award exercises	(1,411)	(5,426)
Deferred income taxes	(7,439)	(2,194)
Minority interests in income of consolidated subsidiaries	9,054	10,828
Distributions to minority interests	(16,888)	(10,106)
Equity investment losses (income)	527	(210)
Loss on disposal of assets	1,355	1,552
Non-cash debt and non-cash rent charges	4,074	6,946
Changes in operating assets and liabilities, other than from acquisitions and divestitures:		
Accounts receivable	(33,168)	25,875
Inventories	3,499	19,667
Other receivables and other current assets	16,846	(4,471)
Other long-term assets	(537)	(1,873)
Accounts payable	(39,217)	(46,387)
Accrued compensation and benefits	(47,571)	(33,988)
Other current liabilities	(6,500)	(31,636)
Income taxes	56,673	26,389
Other long-term liabilities	(184)	(3,316)
Net cash provided by operating activities	91,024	88,031
Cash flows from investing activities:		
Additions of property and equipment, net	(64,673)	(49,444)
Acquisitions and purchases of other ownership interests	(8,838)	(189)
Proceeds from divestitures and asset sales	23	98
Purchase of investments available for sale	(839)	(20,960)
Purchase of investments held-to-maturity	(109)	(15)
Proceeds from sale of investments available for sale	4,955	6,236
Proceeds from maturities of investments held-to-maturity	73	
Contributions from minority owners	9,759	4,650
Purchase of intangible assets	(64)	(55)
Net cash used in investing activities	(59,713)	(59,679)
Cash flows from financing activities:		
Borrowings	4,050,363	3,898,955
Payments on long-term debt	(4,052,066)	(3,894,640)
Deferred financing costs	(130)	(4,048)

Purchase of treasury stock	(7,144)	
Excess tax benefits from stock award exercises	1,411	5,426
Stock award exercises and other share issuances, net	8,525	12,137
Net cash provided by financing activities	959	17,830
Net increase in cash and cash equivalents	32,270	46,182
Cash and cash equivalents at beginning of period	447,046	310,202
Cash and cash equivalents at end of period	$ 479,316	$ 356,384

See notes to condensed consolidated financial statements.

Table of Contents

DAVITA INC.

CONSOLIDATED STATEMENT OF SHAREHOLDERS EQUITY

AND

COMPREHENSIVE INCOME

(unaudited)

(dollars and shares in thousands)

	Common stock				Treasury stock			
	Shares	Amount	Additional paid-in capital	Retained earnings	Shares	Amount	Accumulated other comprehensive income	Total
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 reclassifications 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				86,934				86,934
Unrealized losses on interest rate swaps, net of tax							(10,030)	(10,030)
Less reclassification of net swap realized gains into net income, net of tax							(787)	(787)
Unrealized losses on investments, net of tax							(243)	(243)
Less reclassifications of net investment realized gains into net income, net of tax							(69)	(69)
Total comprehensive income								75,805
Stock purchase shares issued			2,981		98	1,730		4,711
Stock unit shares issued			237		1	13		250
Stock options and SSARs exercised			2,157		260	4,569		6,726
Stock-based compensation expense			9,548					9,548
Excess tax benefits from stock awards exercised			1,562					1,562
Purchase of treasury stock					(683)	(32,526)		(32,526)
Balance at March 31, 2008	134,862	$ 135	$ 723,565	$ 1,602,224	(28,056)	$ (513,958)	$ (13,640)	$ 1,798,326

See notes to condensed consolidated financial statements

Table of Contents

DAVITA INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

(dollars and shares in thousands)

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

1. Condensed consolidated interim financial statements

The condensed consolidated interim financial statements included in this report are prepared by the Company without audit. In the opinion of management, all adjustments consisting only of normal recurring items necessary for a fair presentation of the results of operations are reflected in these consolidated interim financial statements. All significant intercompany accounts and transactions have been eliminated. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. The most significant estimates and assumptions underlying these financial statements and accompanying notes generally involve revenue recognition and provisions for uncollectible accounts, impairments and valuation adjustments, fair value estimates, accounting for income taxes, variable compensation accruals, purchase accounting valuation estimates and stock-based compensation. The results of operations for the three months ended March 31, 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.

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 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:

	Three months ended March 31,	
	2008	**2007**
	(shares in thousands)	
Basic:		
Net income	$ 86,934	$ 76,582
Weighted average shares outstanding during the period	107,340	104,995
Vested stock units	27	18
Weighted average shares for basic earnings per share calculation	107,367	105,013
Basic net income per share	$ 0.81	$ 0.73
Diluted:		
Net income for diluted earnings per share calculation	$ 86,934	$ 76,582

Weighted average shares outstanding during the period	107,340	104,995
Vested stock units	27	18
Assumed incremental shares from stock plans	872	1,726
Weighted average shares for diluted earnings per share calculation	108,239	106,739
Diluted net income per share	$ 0.80	$ 0.72

5

Table of Contents

DAVITA INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(unaudited)

(dollars and shares in thousands)

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

	Three months ended March 31, 2008	Three months ended March 31, 2007
Stock award shares not included in computation (shares in 000 s)	4,574	1,066
Exercise price range of shares not included in computation:		
Low	$ 51.24	$ 54.15
High	$ 64.21	$ 60.21

3. Stock-based compensation and other equity transactions

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 months ended March 31, 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 March 31, 2008 and 2007, respectively. Shares issued upon exercise of stock awards are generally issued from shares in treasury. The Company has utilized the Black-Scholes-Merton valuation model for estimating the grant-date fair value of stock options and stock-settled stock appreciation rights granted in all periods. During the first quarter of 2008, the Company granted 3,725 stock-settled stock appreciation rights with a grant-date fair value of $40,209, and with a weighted-average expected life of approximately 3.36 years. The Company also granted 2 stock units with a fair value of $79 in the first quarter of 2008.

For the three months ended March 31, 2008 and March 31, 2007, the Company recognized $9,548 and $7,702, 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 in continuing operations. The estimated tax benefit recorded for stock-based compensation through March 31, 2008 and 2007 was $3,599 and $2,889, respectively. As of March 31, 2008, there was $103,572 of total estimated unrecognized compensation cost related to nonvested stock-based compensation arrangements under our equity compensation and stock purchase plans. The Company expects to recognize this cost over a weighted average remaining period of 1.7 years.

During the three months ended March 31, 2008 and 2007, the Company received $6,726 and $7,334, respectively in cash proceeds from stock option exercises and $2,618 and $6,307, respectively, in actual tax benefits upon the exercise of stock awards.

During the first quarter of 2008, the Company repurchased a total of 683 shares of its common stock for $32,526, or an average price of $47.66 per share, pursuant to previously announced authorizations by the Board of Directors. Through April 30, 2008, the Company repurchased an additional 2,121 shares of its common stock for a total of $103,705, or an average price of $48.89 per share. After these share repurchases, the remaining Board of Directors authorization was approximately $106,500. 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. As a result, the total outstanding authorization for share repurchases is currently $250,000. This stock repurchase program has no expiration date.

DAVITA INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(unaudited)

(dollars and shares in thousands)

4. Long-term debt

Long-term debt was comprised of the following:

	March 31, 2008	December 31, 2007
Senior Secured Credit Facilities:		
Term loan A	$ 229,250	$ 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	9,627	11,047
Capital lease obligations	6,385	6,667
Total principal debt outstanding	3,701,137	3,702,839
Premium on the 6 5/8% senior notes	4,298	4,479
	3,705,435	3,707,318
Less current portion	(35,626)	(23,431)
	$ 3,669,809	$ 3,683,887

Scheduled maturities of long-term debt at March 31, 2008 were as follows:

2008	$ 21,782
2009	63,862
2010	89,034
2011	66,570
2012	1,706,542
2013	900,767
Thereafter	852,580

As of March 31, 2008, the Company maintained a total of nine interest rate swap agreements with amortizing notional amounts totaling $896,000. 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 4.27%, resulting in an overall weighted average effective interest rate of 5.39% 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 and 2010 and require quarterly interest payments. In addition, the Company maintains two forward interest rate swap agreements with notional amounts totaling $200,000. These forward interest rate swaps will have the economic effect of modifying the LIBOR-based interest rates to fixed rates of 4.05% and 4.70% on the Company s term loan B outstanding debt. These forward interest rate swaps take effect on September 30, 2008, require quarterly interest payments beginning in December 2008, and expire in 2010. During the first quarter of 2008, the Company accrued net benefits of $1,288 from these swaps which is included in debt expense. As of March 31, 2008, the total fair value of these swaps was a liability of $20,249 and is principally included in other long term liabilities.

Total comprehensive income for the quarter ended March 31, 2008 was $75,805, including reductions to other comprehensive income for valuation losses on interest rate swaps net of amounts reclassified into income of $10,817, net of tax, and decreases in other comprehensive income for unrealized losses on investments net of amounts reclassified into income of $312, net of tax.

Table of Contents

DAVITA INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(unaudited)

(dollars and shares in thousands)

Total comprehensive income for the quarter ended March 31, 2007 was $77,352, including reductions to other comprehensive income for valuation of losses on interest rate swaps net of amounts reclassified into income of $3,476, net of tax, and increases in other comprehensive income for unrealized gains on investments of $4,246, net of tax.

As of March 31, 2008, the interest rates were economically fixed on approximately 46% of the Company s variable rate debt and approximately 72% 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 4.80%, based upon the current margins in effect of 1.50%, as of March 31, 2008.

The Company s overall average effective interest rate during the first quarter of 2008 was 6.10% and as of March 31, 2008 was 5.79%.

As of March 31, 2008, the Company has undrawn revolving credit facilities totaling $250,000 of which approximately $41,000 was committed for outstanding letters of credit. The Company also has undrawn revolving credit facilities totaling $7,200 associated with several of its joint ventures.

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®, 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. To the Company s knowledge, no proceedings have been initiated against the Company at this time. Although the Company cannot predict whether or when proceedings might be initiated or when these matters may be resolved, it is not unusual for investigations such as these to continue for a considerable period of time. Responding to the subpoena will 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.

Table of Contents

DAVITA INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(unaudited)

(dollars and shares in thousands)

In March 2005, the Company received a subpoena from the U.S. Attorney s Office for the Eastern District of Missouri in St. Louis. The subpoena requires production of a wide range of documents relating to our operations, including documents related to, among other things, pharmaceutical and other services provided to patients, relationships with pharmaceutical companies, and financial relationships with physicians and joint ventures. The subpoena covers the period from December 1, 1996 through the present. In October 2005, the Company received a follow-up request for additional documents related to specific medical director and joint venture arrangements. In February 2006, the Company received an additional subpoena for documents, including certain patient records relating to the administration and billing of EPO. In May 2007, the Company received a request for documents related to durable medical equipment and supply companies owned and operated by the Company. The Company is 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 settlement agreement with the Department of Justice. At least one commercial payor has filed an arbitration demand against the Company, as described below, and additional commercial payors have threatened litigation. The Company intends to defend against these claims vigorously; however, the Company may not be successful and these claims may lead to litigation and any such litigation may be resolved unfavorably. Although the ultimate outcome of these claims cannot be predicted at this time, an adverse result in excess of the Company s established reserves, with respect to one or more of these claims could have a material adverse effect on the Company s business, financial condition, results of operations and liquidity.

DAVITA INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(unaudited)

(dollars and shares in thousands)

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 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. On February 8, 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

Table of Contents

DAVITA INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(unaudited)

(dollars and shares in thousands)

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.

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 are exercised, the Company would be required to purchase the third-party owners interests at either the appraised fair market value or a predetermined multiple of cash flow or earnings, which is intended to approximate fair value. The methodology used to estimate the fair values of the put provisions assumes either a multiple of earnings based on recent prior Company acquisitions or a predetermined multiple of earnings. The estimated fair values of these put provisions can fluctuate and the ultimate multiple of earnings used to settle these amounts 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 provisions obligations during the first quarter of 2008:

	Fair value estimates using significant unobservable inputs (Level 3)
Beginning balance January 1, 2008	$ 330,000
Changes in fair value	$ (16,000)
New agreements	$ 5,000
Purchase and exercises of put obligation	$ (3,000)
Balance at March 31, 2008	$ 316,000

Additionally, the Company has certain other potential commitments to provide operating capital to several noncontrolling-owned centers and to third-party centers that the Company operates under administrative service agreements of approximately $28,000.

The Company is obligated under mandatorily redeemable instruments in connection with certain consolidated joint ventures. Future distributions may be required for the minority partners   interests in limited-

Table of Contents

DAVITA INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(unaudited)

(dollars and shares in thousands)

life entities which dissolve after terms of ten to fifty years. As of March 31, 2008, such distributions would be valued below the related minority interests balances in the consolidated balance sheet.

7. Investments

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

The Company s investments consist of the following:

	March 31, 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	$ 19,859	$	$ 19,859	$ 19,804	$	$ 19,804
Investments in mutual funds		38,524	38,524		43,036	43,036
	$ 19,859	$ 38,524	$ 58,383	$ 19,804	$ 43,036	$ 62,840
Short-term investments	$ 19,859	$ 26,000	$ 45,859	$ 19,804	$ 20,474	$ 40,278
Long-term investments		12,524	12,524		22,562	22,562
	$ 19,859	$ 38,524	$ 58,383	$ 19,804	$ 43,036	$ 62,840

The cost of the certificates of deposit and U.S. treasury notes at March 31, 2008 and December 31, 2007 approximates their fair value. As of March 31, 2008 and December 31, 2007 the available for sale investments included $341 and $850 of gross pre-tax unrealized gains, respectively. During the three months ended March 31, 2008, the Company recorded gross pre-tax unrealized losses of $396, or $243, after tax, in other comprehensive income associated with changes in the fair value of the these investments. During the first quarter of 2008, the Company sold investments in mutual funds for net proceeds of $4,955, and recognized a pre-tax gain of $113, or $69 after tax, that was previously recorded in other comprehensive income. This pre-tax gain is included in other income.

The certificates of deposit and U.S. treasury notes classified as held to maturity are investments used to 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 Da*