

The first part of the paper discusses the importance of understanding the underlying mechanisms of the observed phenomena. This is followed by a detailed analysis of the data, which reveals several key findings. The results indicate that the proposed model is highly effective in capturing the essential features of the system under study. Furthermore, the analysis shows that the model's performance is robust across different parameter settings and data distributions. The final section of the paper concludes with a summary of the findings and suggests directions for future research.

In the second part of the paper, we explore the implications of the findings for practical applications. The results suggest that the proposed model can be used to predict the behavior of the system with high accuracy. This has significant implications for the design and optimization of the system. The paper also discusses the limitations of the current study and provides recommendations for future work. The authors express their gratitude to the funding agencies and the reviewers for their support and constructive comments. The paper is organized as follows: Section 1 introduces the problem and the proposed model. Section 2 presents the data analysis and the results. Section 3 discusses the implications of the findings. Section 4 concludes the paper and suggests future research directions.

The authors would like to thank the following individuals for their assistance and support: [Names of individuals]. The paper is a result of the collaborative effort of the authors and the funding agencies. The authors declare that they have no conflict of interest. The paper is published in the [Journal Name] and is available online at [URL].



Dear Stakeholders:

2009 represents the last year in DaVita's first decade. I will first discuss our 2009 results and then provide a few thoughts on the future.

We had a strong year in 2009.

- Clinical outcomes were once again among the best or were the best in virtually every category compared to national averages and we significantly advanced our clinical care initiatives,
- We delivered strong growth in operating profits, earnings and cash flows,
- We successfully completed the five year term of the Gambro Corporate Integrity Agreement and are no longer subject to its restrictions,
- We continued to lead the dialysis community in working with CMS on the rules for the bundled reimbursement set to begin in 2011, and
- We strengthened our senior team, including the addition of Dr. Mahesh Krishnan as Vice President of DaVita Clinical Research and Dr. John Moran as Vice President of Clinical Affairs–Home Modalities.

**Clinical Outcomes and
Clinical Care Initiatives:**

DaVita and its affiliated physicians collaborated to achieve outstanding clinical outcomes in 2009. For the 9th straight year these were the best patient outcomes in our history. At the end of the year:

- 65% of our patients had an arteriovenous fistula placed for dialysis,
- 84% of our patients achieved an albumin level of 3.5 or better,
- 95% of our patients achieved a Kt/V of 1.2 or better,
- 64% of our patients had a 90-day hemoglobin level between 10 and 12, and
- 76% of our patients achieved a calcium phosphorus product <55, the best results ever for management of metabolic bone disease.

Our patients' 2008 gross mortality rate improved for the third straight year to 16.5%, an 11% improvement from our 2005 mortality rate of 18.5%.

These results compare quite favorably to those reported publicly for other providers.

In 2010 we will continue our *Relentless Pursuit of Quality* with an intense focus on further improving vascular access and survival, while continuing to improve outcomes in all important areas of patient care.

Financial:

Net income was \$423 million and earnings per share were \$4.06, representing a 13% increase in net income and a 15% increase in earnings per share as compared to 2008. Our year-end stock price of \$58.74 was an 18% increase over our closing price on December 31, 2008.

Cash flow from operations was \$667 million and free cash flow was \$485 million⁽¹⁾. These strong cash flows allowed us to repurchase 2.9 million shares of common stock for \$153 million and spend \$248 million for center developments and acquisitions. Our balance sheet is strong with an end of year leverage ratio of 2.56 times debt to trailing 12 month earnings before interest and taxes⁽¹⁾.

Growth:

We provided 17 million dialysis treatments this year, a 4.9% increase from 2008. Our 2009 non-acquired growth was 4.6% year-over-year.

Public Policy:

The implementation of a bundled Medicare payment system in January 2011 represents the biggest change to dialysis reimbursement in recent history. The preliminary rules proposed by CMS in September 2009 represent a payment reduction significantly greater than the 2% Congress intended in its 2008 MIPPA legislation. The dialysis community continues to work with CMS to ensure that the final bundling rules provide adequate reimbursement for the dialysis community, and we await the release of the final rules in 2010.

While adapting to the new reimbursement rules creates some short term pressure, MIPPA provides for a much needed annual inflation adjustment for payments beginning in 2012. Additionally, we will work hard to innovate in the \$1.1 billion dollars of cost that is moving to the bundle, to find ways to reduce costs while maintaining or improving clinical quality.

As in the past, we continue to seek to build strong relationships with key government stakeholders, including CMS and within Congress, and develop alternative reform proposals for consideration. In 2010, we will continue to seek to improve the care we deliver to our patients while seeking to partner with the government to enhance the longevity of the Medicare Trust Fund.

Corporate Citizenship:

Being a leader in American healthcare means being a responsible corporate community. Community Care, DaVita's vision for social responsibility, is our philosophy for balancing our business responsibilities with our social, economic and environmental ones. Over the past decade, DaVita has had a vision for creating a true community—one that cares for our teammates as well as our patients. This investment in creating a community has inspired our teammates to realize their full potential and to deliver superior quality care to our patients.

Our Community Care programs, including several examples below, enrich the lives of our more than 118,000 patients and 34,000 teammates and their families.

- Bridge of Life—DaVita Medical Missions works with DaVita teammates who volunteer to provide quality dialysis and kidney care to underserved parts of the world.
- Tour DaVita and DaVita Kidney Awareness Run/Walks raise money and awareness to support the Kidney TRUST in its mission to increase kidney disease education and testing.

- DaVita and our teammates reach out to support underprivileged communities at home through Village Service Days and investment in our Minority Bank Initiative.
- DaVita's Village Green program focuses on reducing waste in our centers and corporate offices, as we strive to be strong stewards of the natural world around us.

We invite you to review our work and be inspired to help change your community. Our 2009 Community Care Responsibility Report will be available on DaVita.com later this quarter.

Outlook:

In 2009, the last year of DaVita's first decade, we delivered strong performance to all our stakeholders.

Looking forward to our next decade, we face significant challenges and opportunities.

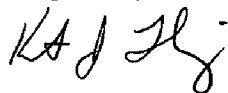
If the final Medicare bundling rules are unfavorable, this would lead us and other providers to close dialysis centers in locations where there is not sufficient commercial insurance reimbursement to subsidize the losses we face from Medicare patients. We, along with the dialysis community, continue to work with CMS to ensure that this scenario does not happen.

Bundling implementation poses short term challenges as we adapt, but it also provides a longer term incentive to innovate to reduce the cost of care while maintaining or even increasing clinical quality—providing value for patients, taxpayers, and our shareholders.

In the coming years, our suite of value-added businesses including DaVita Rx, Lifeline, and Village Health positions us for a world with increasingly integrated care. Congress and CMS have been looking to create programs to improve care for chronic conditions. The establishment of Accountable Care Organizations (ACOs) in the 2010 healthcare reform legislation provides such an opportunity. Our developed capabilities will hopefully allow us to be a significant player in the collective efforts to improve care and generate savings for taxpayers.

Once again, I offer heartfelt thanks to our 34,000 teammates for your accomplishments. Your resilience and tenacity in simultaneously meeting the needs of so many diverse constituencies is remarkable.

Respectfully submitted,



Kent J. Thiry
Chairman and CEO

⁽¹⁾ These are Non-GAAP amounts. For a reconciliation of non-GAAP financial measures to comparable GAAP measures, see our press release for the fourth Quarter and Year Ended 2009 Results, which is on our Website at www.davita.com

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In the interest of our Stakeholders, we have kept the cost of this Annual Report to a minimum. For additional information about the Company, please visit our website at www.davita.com or contact Jim Gustafson at DaVita’s corporate address.

Management's Discussion and Analysis of Financial Condition and Results of Operations.

Forward-looking statements

This Management's Discussion and Analysis of Financial Condition and Results of Operations contain 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, government and commercial payment rates, revenue estimating risk and the impact of our related level of indebtedness on our financial performance, including earnings per share. These statements involve substantial known and unknown risks and uncertainties that could cause our actual results to differ materially from those described in the forward-looking statements, including, but not limited to, risks resulting from the regulatory environment in which we operate, economic and market conditions, competitive activities, other business conditions, accounting estimates, the variability of our cash flows, 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, a reduction in government payment rates or changes to the structure of payments under the Medicare ESRD program or other government-based programs, including, for example, the implementation of a bundled payment rate system which will lower reimbursement for services we provide to Medicare patients, 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, the resolution of ongoing investigations by various federal and state government agencies, and the risk factors set forth in this Annual Report. 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.

The following should be read in conjunction with our consolidated financial statements.

Overview

We are a leading provider of dialysis services in the United States through a network of approximately 1,530 outpatient dialysis centers and approximately 720 hospitals, serving approximately 118,000 patients in 43 states. In 2009, our overall network of dialysis centers increased by 81 centers primarily as a result of opening new centers and acquisitions and the overall number of patients that we serve increased by approximately 5.5%.

Our stated mission is to be the provider, partner and employer of choice. We believe our attention to these three stakeholders—our patients, our business partners, and our teammates—represents the major driver of our long-term performance, although we are subject to the impact of external factors such as government policy and physician practice patterns. Accordingly, two principal non-financial metrics we track are quality clinical outcomes and teammate turnover. We have developed our own composite index for measuring improvements in our clinical outcomes, which we refer to as the DaVita Quality Index, or DQI. Our clinical outcomes as measured by DQI have improved over each of the past three years. Although it is difficult to reliably measure clinical performance across our industry, we believe our clinical outcomes compare favorably with other dialysis providers in the United States. In addition, over the past several years our teammate turnover has remained relatively constant, although in 2009 we did experience a decrease in our overall teammate turnover. We believe this was a major contributor to our continued clinical performance improvements and also a major driver in our ability to improve productivity in 2009. We will continue to focus on these stakeholders and our clinical outcomes as we believe these are fundamental long-term value drivers.

Approximately 95% of our 2009 consolidated net operating revenues were derived directly from our dialysis and related lab services business. Approximately 84% of our 2009 dialysis and related lab services revenues were derived from outpatient hemodialysis services in the 1,498 centers that we consolidate, which are either wholly-owned or majority-owned. Other dialysis services, which are operationally integrated with our dialysis operations, are peritoneal dialysis, home-based hemodialysis, and hospital inpatient hemodialysis services. These services collectively accounted for the balance of our 2009 dialysis and related lab services revenues. We also generate management fees from management and administrative services to certain third-party-owned dialysis centers and dialysis centers that we own an equity investment in. These management fees represent less than 1% of our dialysis and related lab services revenues.

Our other business operations include ancillary services and strategic initiatives which are primarily aligned with our core business of providing dialysis services to our network of patients. These consist primarily of pharmacy services, infusion therapy services, disease management services, vascular access services, ESRD clinical research programs and physician services. These services generated approximately \$317 million of net operating revenues in 2009, or approximately 5% of our consolidated net operating revenues. Overall our ancillary services and strategic initiatives decreased their operating losses from \$30 million in 2008 to \$18 million in 2009, primarily as a result of improved profitability in our pharmacy and disease management businesses. We currently expect to continue to invest in our ancillary services and strategic initiatives as we work to develop successful new business operations. However, any significant change in market conditions, business performance or in the regulatory environment may impact the economic viability of any of these strategic initiatives. Any unfavorable changes could result in a write-off or an impairment of some or all of our investments, including goodwill, in these strategic initiatives, or could also result in significant termination costs if we were to exit a certain line of business.

The principal drivers of our dialysis and related lab services revenues are:

- the number of treatments, which is primarily a function of the number of chronic patients requiring approximately three treatments per week, as well as, to a lesser extent, the number of treatments for peritoneal dialysis services and home-based dialysis and hospital inpatient dialysis services;
- average dialysis revenue per treatment; and
- the number of laboratory patient tests.

The total patient base is a relatively stable factor, which we believe is influenced by a demographically growing need for dialysis services, our relationships with referring physicians together with the quality of our clinical care, and our ability to open and acquire new centers. Our year-over-year treatment volume growth was 4.9% in 2009.

Average dialysis and related lab services revenue per treatment is primarily driven by our mix of commercial and government (principally Medicare and Medicaid) patients, the mix and intensity of physician-prescribed pharmaceuticals, commercial and government payment rates, and our billing and collecting operations performance.

On average, payment rates from commercial payors are significantly higher than Medicare, Medicaid and other government program payment rates, and therefore the percentage of commercial patients to total patients represents a major driver of our total average dialysis revenue per treatment. The percentage of commercial patients covered under contracted plans as compared to commercial patients with out-of-network providers can also significantly affect our average dialysis revenue per treatment. In 2009, the growth of our government-based patients, driven primarily by growth in Medicare-assigned plans, which we believe is largely as a result of improved mortality and the current economic recession, outpaced the growth in our commercial patients, which negatively impacted our average dialysis revenue per treatment as a result of receiving lower payment rates associated with these additional government-based patients.

The following table summarizes our dialysis and related lab services revenues for the year ended December 31, 2009:

	<u>Revenues</u>
Medicare and Medicare-assigned plans	57%
Medicaid and Medicaid-assigned plans	6%
Other government-based programs	<u>2%</u>
Total government-based programs	65%
Commercial (including hospital dialysis services)	<u>35%</u>
Total dialysis and related lab services revenues	<u>100%</u>

Government payment rates are principally determined by federal Medicare and state Medicaid policy. These payment rates have historically had limited potential for rate increases and are sometimes at risk of reduction as federal and state governments face increasing budget pressures. Medicare payment rates for dialysis services through 2008 have not been routinely increased to compensate for the impact of inflation. In July 2008, MIPPA was passed by Congress which introduced 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. The legislation also provided for an increase in the composite rate of 1% effective January 1, 2009 and an additional 1% effective January 1, 2010. On September 15, 2009, CMS released the proposed rule regarding the new bundled payment rate system. The initial 2011 bundled rate is required to be set based on a 2% reduction in the payment rate that providers would have received under the historical fee for service payment methodology and based on the lowest average industry pharmaceutical utilization from 2007 to 2009. The combined effect of the adjustments provided in the proposed rule would result in a bundled rate that represents a significantly greater than 2% reduction in the payment rate that we would have received for our services prior to bundling. The proposed rule also requires, among other things, the new single bundled payment base rate to be adjusted annually for inflation based upon a market basket index, less 1% of such index, beginning in 2012. Dialysis providers have the option to move fully to the bundled payment system in 2011 or to phase in the payment system over three years.

Dialysis payment rates from commercial payors can vary significantly and a major portion of our commercial rates are set at contracted amounts with large payors and are subject to intense negotiation pressure. In 2009, we were successful in maintaining and in some instances increasing average payment rates, resulting in an aggregate increase in average payment rates for patients with commercial plans. However, we are continuously in the process of negotiating agreements with our commercial payors and payors are aggressive in their negotiations. If our negotiations result in overall commercial rate reductions in excess of overall commercial rate increases, this would have a material adverse effect on our operating results. In addition, if there are sustained or increased job losses in the United States as a result of current economic conditions, or depending upon changes to the healthcare regulatory system, we could experience a decrease in the number of patients under commercial plans. We also 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, payors have been attempting to impose restrictions and limitations on non-contracted or out-of-network providers, which could further decrease our commercial rate revenues since rates for out-of-network providers are on average higher than rates for in-network providers.

Approximately 30% of our dialysis and related lab services revenues for the year ended December 31, 2009 were from physician-prescribed pharmaceuticals, with EPO accounting for approximately 20% of our dialysis and related lab services revenues. Therefore, changes in physician practice patterns, pharmaceutical protocols, pharmaceutical intensities and changes in commercial and governmental payment rates for EPO significantly influence our revenue. For example, effective January 2008, changes

to the EPO monitoring policy went into effect which further limited reimbursements and impacted the prescribing habits of our physicians, which resulted in lower pharmaceutical intensities during 2008. In 2009, the intensities of physician-prescribed pharmaceuticals increased slightly from 2008, which helped contribute to an increase in our average dialysis and related lab services revenue per treatment.

Our operating performance with respect to dialysis services billing and collection can also be a significant factor in how much average dialysis and related lab services revenue per treatment we actually realize. Over the past several years we have invested heavily in new systems and processes that we believe have helped improve our operating performance and reduced our regulatory compliance risks and we expect to continue to improve these systems. In 2009, we continued to upgrade our systems and implemented process changes and will continue to do so in 2010 as necessary to improve our billing and collection performance. However, as we implement these system upgrades, our collection performance as well as our dialysis and related lab services revenue per treatment could be negatively impacted.

Our revenue recognition involves significant estimation risks. Our estimates are developed based on the best information available to us and our best judgment as to the reasonably assured collectibility of our billings as of the reporting date based upon our actual historical collection experience. Changes in estimates are reflected in the then-current period financial statements based upon on-going actual experience trends, or subsequent settlements and realizations depending on the nature and predictability of the estimates and contingencies.

Our annual average dialysis and related lab services revenue per treatment was approximately \$340, \$334 and \$334 for 2009, 2008 and 2007, respectively. In 2009, the increase in our average dialysis and related lab services revenue per treatment was primarily due to a 1% increase in the Medicare composite rate, an increase in our commercial payment rates, an increase in our reimbursement rates for EPO and other pharmaceuticals and an increase in the intensities of physician-prescribed pharmaceuticals, partially offset by changes in the mix of our commercial payors. In 2008, the average dialysis and related lab services revenue per treatment was flat as compared to 2007, but was impacted by some commercial rate compression that occurred in late 2007, a decrease in the intensities of physician-prescribed pharmaceuticals offset by changes in mix and rates of some of our other commercial payors. Our ability to negotiate acceptable payment rates with commercial payors, changes in the mix and intensities of physician-prescribed pharmaceuticals, government payment policies regarding reimbursement amounts for dialysis treatments and pharmaceuticals, including the bundling of such services, and changes in the mix of government and commercial payors may materially impact our average dialysis and related lab services revenue per treatment in the future.

The principal drivers of our dialysis and related lab services patient care costs are clinical hours per treatment, labor rates, vendor pricing of pharmaceuticals, utilization levels of pharmaceuticals and business infrastructure, including the operating costs of our dialysis centers, and compliance costs. However, other cost categories can also represent significant cost variability, such as employee benefit costs and insurance costs. Our average clinical hours per treatment have remained relatively stable over the past few years primarily because of improved efficiencies driven by reduced clinical teammate turnover and improved training and processes. In 2009, we were able to reduce our average clinical hours per treatment from 2008 as a result of continued productivity improvements primarily through reduced teammate turnover and the fact that 2008 was negatively impacted by the implementation of new federal guidelines. We continue to strive for improved productivity levels, however we may not be able to sustain our 2009 performance as changes in federal and state policies can adversely impact our ability to achieve optimal productivity levels, as would improvements in the U.S. economy, which could stimulate additional competition for skilled clinical personnel, and result in higher teammate turnover. In 2009 and 2008, we also experienced an increase in our labor rates of approximately 2.5% and 3.5%, respectively, as labor rates have increased consistent with general industry trends, mainly due to the demand for skilled clinical personnel, along with general inflation increases. In 2009, we experienced an increase in our pharmaceutical costs, mainly related

to EPO, which increased by approximately 2%. In addition, our agreement with Amgen for the purchase of EPO provides for specific rebates based on a combination of factors, including process improvement and data submission, which could negatively impact our earnings if we are unable to continue to qualify for these rebates. In 2009, we experienced increases in our infrastructure and operating costs of our dialysis centers, primarily due to the number of new centers opened, and general increases in rent, utilities and repairs and maintenance.

General and administrative expenses have remained relatively constant as a percent of consolidated revenues over the past three years. However, this reflects a substantial increase in the dollar amount of spending related to strengthening our dialysis business, improving our regulatory compliance and other operational processes, responding to certain legal matters and supporting the growth in our ancillary services and strategic initiatives. We expect that the level of general and administrative expenses will be sustained and may vary depending upon the level of investment we make in our long-term initiatives, including further investments in our ancillary services and strategic initiatives, and to support our regulatory compliance efforts.

Outlook for 2010. Currently, we still expect our operating income for 2010 to be in the range of \$950 million to \$1,020 million and we also expect our operating cash flows for 2010 to be in the range of \$675 million to \$725 million. These projections and the underlying assumptions involve significant risks and uncertainties, and actual results may vary significantly from these current projections. These risks and uncertainties, 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, a reduction in government payment rates or changes to the structure of payments under the Medicare ESRD program or other government-based programs, including, for example, the implementation of a bundled payment rate system which will lower reimbursement for services we provide to Medicare patients, 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 the resolution of ongoing investigations by various federal and state government agencies. You should read “Risk Factors” in this Annual Report and the cautionary language contained in the forward-looking statements and associated 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.

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 consist primarily of pharmacy services, infusion therapy services, disease management services (VillageHealth), vascular access services, ESRD clinical research programs and physician services. The dialysis and related lab services business qualifies as a separately reportable segment and all of the other ancillary services and strategic initiatives have been combined and disclosed in the other segments category.

Following is a summary of consolidated operating results for reference in the discussion that follows.

	Year ended December 31,					
	2009		2008		2007	
	(dollar amounts rounded to nearest million)					
Net operating revenues:						
Current period services	\$6,109	100%	\$5,660	100%	\$5,264	100%
Operating expenses and charges:						
Patient care costs	4,249	70%	3,920	69%	3,590	68%
General and administrative	532	9%	508	9%	491	9%
Depreciation and amortization	229	4%	217	4%	193	4%
Provision for uncollectible accounts	162	3%	146	3%	137	3%
Equity investment income	(2)	—	(1)	—	(1)	—
Valuation gain on alliance and product supply agreement	—	—	—	—	(55)	(1)%
Total operating expenses and charges	5,169	85%	4,791	85%	4,355	83%
Operating income	<u>\$ 940</u>	<u>15%</u>	<u>\$ 869</u>	<u>15%</u>	<u>\$ 909</u>	<u>17%</u>

The following table summarizes consolidated net operating revenues:

	Year ended		
	2009	2008	2007
	(dollar amounts rounded to nearest million)		
Dialysis and related lab services	\$5,792	\$5,415	\$5,130
Other—ancillary services and strategic initiatives	317	245	134
Consolidated net operating revenues	<u>\$6,109</u>	<u>\$5,660</u>	<u>\$5,264</u>

The following table summarizes consolidated operating income:

	Year ended		
	2009	2008(2)	2007(1)(2)
	(dollar amounts rounded to nearest million)		
Dialysis and related lab services	\$1,000	\$939	\$990
Other—ancillary services and strategic initiatives loss	(18)	(30)	(48)
Total segment operating income	982	910	942
Reconciling items:			
Stock-based compensation	(44)	(41)	(34)
Equity investment income	2	1	1
Consolidated operating income	940	869	909
Reconciliation of non-GAAP measures:			
Less: Gains on insurance settlements	—	—	(7)
Valuation gain on the alliance and product supply agreement	—	—	(55)
Non-GAAP consolidated operating income	<u>\$ 940</u>	<u>\$869</u>	<u>\$847</u>

- (1) In 2007, we have excluded valuation gains on the alliance and product supply agreement with Gambro Renal Products Inc. (the Product Supply Agreement) as well as 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 by excluding 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 as a result is both more meaningful and comparable to our current and prior period results, and more indicative of our normal consolidated operating income.

- (2) Certain costs previously reported in ancillary services and strategic initiatives have been reclassified to dialysis and related lab services to conform to the current year presentation.

Consolidated net operating revenues

Consolidated net operating revenues for 2009 increased by approximately \$449 million or approximately 7.9% from 2008. This increase was primarily due to an increase in dialysis and related lab services net revenues of approximately \$377 million, principally due to increased treatments, and an increase of approximately \$72 million in the ancillary services and strategic initiatives net revenues primarily from growth in our pharmacy services, VillageHealth services and from our infusion therapy services.

Consolidated net operating revenues for 2008 increased by approximately \$396 million or approximately 7.5% from 2007. This increase was primarily due to an increase in dialysis and related lab services net revenues of approximately \$285 million, principally due to increased treatments, and an increase of approximately \$111 million in the ancillary services and strategic initiatives net revenues primarily from growth in our pharmacy services, VillageHealth services and from our infusion therapy services.

Consolidated operating income

Consolidated operating income of \$940 million for 2009 increased by approximately \$71 million from 2008. This increase was primarily attributable to an increase in revenue as a result of non-acquired treatment growth in dialysis and related lab services, as well as an increase in our dialysis revenue per treatment of approximately \$6 as described below. Operating income also increased as a result of cost control initiatives, improved productivity and lower operating losses in our ancillary services and strategic initiatives, which losses were reduced by approximately \$12 million in 2009, partially offset by the negative impact of higher pharmaceutical, labor and benefit costs, and increases in other operating costs of our dialysis centers.

Consolidated operating income was \$869 million for 2008, as compared to \$909 million for 2007. Consolidated operating income in 2007 included a valuation gain of \$55 million on 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 in 2007, our consolidated operating income for 2008 would have increased by approximately \$22 million, compared to the adjusted operating income for 2007. This increase in consolidated operating income for 2008 as compared to adjusted operating income for 2007 was primarily due to treatment growth in dialysis and related lab services revenues, combined with growth in revenue in ancillary services and strategic initiatives outpacing increases in our operating expenses. Our ancillary services and strategic initiatives net operating losses were reduced by approximately \$18 million in 2008. However, our consolidated operating income for 2008 was negatively affected by rising labor costs, the absence of a Medicare rate increase, the impact of some commercial rate compression that occurred in late 2007, decreases in intensities of physician-prescribed pharmaceuticals, an increase in the operating costs of our dialysis centers, driven in part by the number of new dialysis centers opened and from centers constructed but pending state and/or federal certification, an increase in pharmaceutical costs (primarily heparin) and an increase in stock-based compensation costs.

Operating segments

Dialysis and Related Lab Services

	Year ended		
	2009	2008	2007
	(dollar amounts rounded to nearest million, except per treatment data)		
Revenues	\$ 5,792	\$ 5,415	\$ 5,130
Segment operating income	\$ 1,000	\$ 939	\$ 990
Dialysis treatments	17,010,450	16,217,107	15,318,995
Average dialysis treatments per treatment day ...	54,433	51,663	48,942
Average dialysis and related lab services revenue per treatment	\$ 340	\$ 334	\$ 334

Net operating revenues

Dialysis and related lab services net operating revenues for 2009 increased by approximately \$377 million or approximately 6.9% from 2008. The increase in net operating revenues was primarily due to an increase in the number of treatments of approximately 4.7%, and an increase in the average dialysis revenue per treatment of approximately \$6, or 1.9%. The increase in the number of treatments was primarily due to an increase in non-acquired treatment growth at existing and new centers and growth through acquisitions. The increase in the average dialysis revenue per treatment in 2009, as compared to 2008, was primarily due to a 1% Medicare increase in the Medicare composite rate, an increase in our commercial payment rates, an increase in our reimbursement rates for EPO and other pharmaceuticals, and an increase in the intensities of physician-prescribed pharmaceuticals, partially offset by changes in the mix of our commercial payors.

Dialysis and related lab services net operating revenues for 2008 increased by approximately \$285 million or approximately 5.6% from 2007. The increase in net operating revenues was primarily due to an increase in the number of treatments of approximately 5.7%, offset by a slight decrease in the average dialysis revenue per treatment. The increase in number of treatments was primarily due to an increase in the number of treatment days in 2008, as compared to 2007, and non-acquired treatment growth at existing and new centers and growth through acquisitions. The decrease in the average dialysis revenue per treatment in 2008, as compared to 2007, was primarily due to the impact of some commercial rate compression that occurred in late 2007, decreases in intensity of physician-prescribed pharmaceuticals, partially offset by changes in the mix and rates of some of our other commercial payors.

The following table summarizes our dialysis and related lab services revenues by modality for the year ended December 31, 2009:

	<u>Revenue percentages</u>
Outpatient hemodialysis centers	84%
Peritoneal dialysis and home-based hemodialysis	11%
Hospital inpatient hemodialysis	5%
Total dialysis and related lab services revenues	<u>100%</u>

In addition to reimbursements for dialysis treatments, the other major component of dialysis and related lab services revenues is the administration of EPO and other pharmaceuticals as part of the dialysis treatment, which represents slightly more than 30% of total dialysis and related lab services revenues for the year ended December 31, 2009.

Approximately 65% of our total dialysis and related lab services revenues for the year ended December 31, 2009 were from government-based programs, principally Medicare, Medicaid, and Medicare-assigned plans, representing approximately 88% of our total patients. Approximately 35% of our dialysis and related lab services revenues and 12% of our patients are associated with commercial payors. Less than 1% of our dialysis and related lab services payments are due directly from patients. No single commercial payor accounted for more than 5% of total dialysis and related lab services revenues for the year ended December 31, 2009.

On average we are paid significantly more for services provided to patients covered by commercial healthcare plans than we are for patients covered by Medicare, Medicaid or other government plans such as Medicare-assigned plans. Patients covered by commercial health plans transition to Medicare coverage after a maximum of 33 months. As a patient transitions from commercial coverage to Medicare or Medicaid coverage, the payment rates normally decline substantially. As of December 31, 2009, the Medicare ESRD dialysis treatment rates for our patients were between \$150 and \$167 per treatment, or an overall average of \$159 per treatment, excluding the administration of separately billed pharmaceuticals. Medicare payment rates are insufficient to cover our costs associated with providing dialysis treatments, and therefore we lose money on each Medicare treatment.

Nearly all of our net earnings from dialysis and related lab services are derived from commercial payors, some of which pay at negotiated payment rates as established by contract and others of which pay based on our usual and customary fee schedule. We are continuously in negotiations with commercial payors for contracted rates and some of these payment rates are under downward pressure as we negotiate these rates with large HMOs and insurance carriers and we expect this trend to continue. We also expect that we may experience decreases in patient volume as our negotiations with commercial payors continue. In addition, payors have been attempting to impose restrictions and limitations on non-contracted or out-of-network providers, in which we receive higher payment rates than for in-network providers. If we experience a net overall reduction in our contracted and non-contracted commercial rates as a result of these negotiations or restrictions, it could have a material adverse effect on our operating results.

Our average dialysis and related lab services revenue per treatment can be significantly impacted by several major factors, including our ability to negotiate acceptable payment rates with contracted and non-contracted commercial payors, changes in the mix and intensities of physician-prescribed pharmaceuticals, government payment policies regarding reimbursement amounts for dialysis treatments and pharmaceuticals, including the bundling of such services and changes in the mix of government and non-government payments.

Operating expenses and charges

Patient care costs. Dialysis and related lab services patient care costs are those costs directly associated with operating and supporting our dialysis centers and consist principally of labor, pharmaceuticals, medical supplies and operating costs of the dialysis centers. The dialysis and related lab services patient care costs on a per treatment basis were \$234, \$230 and \$227 for 2009, 2008, and 2007, respectively. The \$4 increase in the per treatment costs in 2009 as compared to 2008 was primarily attributable to higher labor rates and benefit costs, an increase in pharmaceutical costs, an increase in other operating costs of our dialysis centers and a increase in the intensities of physician-prescribed pharmaceuticals, partially offset by improved productivity.

Dialysis and related lab services patient care costs on a per treatment basis increased by approximately \$3 in 2008 as compared to 2007. The increase in the per treatment costs was primarily attributable to an increase in labor rates as well as the negative impact on productivity during the year as we implemented new federal guidelines. Additionally, we experienced an increase in the operating costs of our dialysis centers driven in part by the number of new centers opened and from centers constructed but

pending state and/or federal certification, and an increase in pharmaceutical costs, partially offset by a decrease in the intensities of physician-prescribed pharmaceuticals.

General and administrative expenses. Dialysis and related lab services general and administrative expenses for the years ended 2009, 2008 and 2007 were approximately \$427 million, \$402 million and \$400 million, respectively. The increase of approximately \$25 million in 2009 as compared to 2008 was primarily due to increases in labor and benefit costs, partially offset by the timing of certain other expenditures. The increase in general and administrative expenses of approximately \$2 million in 2008 as compared to 2007, was primarily due to increases in labor costs and the timing of certain other expenditures, mainly offset by lower integration costs and lower professional fees.

Depreciation and amortization. Dialysis and related lab services depreciation and amortization expenses for 2009, 2008 and 2007 were approximately \$222 million, \$210 million and \$189 million, respectively. The increase of approximately \$12 million in depreciation and amortization for dialysis and related lab services in 2009 as compared to 2008 was primarily due to growth through new center developments and expansions. The increase in depreciation and amortization of approximately \$21 million in 2008, as compared to 2007, was primarily due to growth through new center developments and expansions and a change in amortization associated with amendments to the Product Supply Agreement.

Provision for uncollectible accounts receivable. The provision for uncollectible accounts receivable for dialysis and related lab services was 2.7% for 2009 and 2.6% for 2008 and 2007. The increase in the provision for uncollectible accounts in 2009 was primarily to reflect a slowdown in the timing of payments from some of our non-government payors. The current provision level of 2.7% may increase if we encounter problems with our billing and collection process as a result of sustained weakness in the U.S. economy.

Operating income

Dialysis and related lab services operating income for 2009 increased by approximately \$61 million as compared to 2008. The increase in the operating income for 2009 as compared to 2008 was primarily due to growth in the number of dialysis treatments, an increase in the dialysis revenue per treatment of approximately \$6 as described above. The dialysis and related lab services operating income also increased as a result of certain cost control initiatives and improved productivity, but was negatively impacted primarily by higher labor and benefit costs, an increase in pharmaceutical costs and an increase in other operating costs of our dialysis centers.

Dialysis and related lab services operating income for 2008 decreased by approximately \$51 million as compared to 2007. Operating income in 2007 included a valuation gain of \$55 million on the Product Supply Agreement and \$7 million of insurance settlements relating to Hurricane Katrina as discussed above. Excluding these items, operating income for 2008 would have increased by approximately \$11 million as compared to adjusted operating income for 2007. The increase in the operating income for 2008 as compared to adjusted operating income for 2007 was primarily due to growth in the volume of revenue outpacing increases in certain expenditures. However, operating income for 2008 was negatively affected by certain significant items such as a decrease in our dialysis revenue per treatment, lower intensities of physician-prescribed pharmaceuticals, an increase in labor costs and higher operating costs of our dialysis centers primarily associated with the number of new centers that were opened and from centers constructed but pending state and/or federal certification, an increase in pharmaceutical costs (primarily heparin), and the absence of a Medicare rate increase.

Other—Ancillary services and strategic initiatives

	Year ended		
	2009	2008	2007
	(dollar amounts rounded to nearest million)		
Revenues	\$317	\$245	\$134
Segment operating loss	<u>\$ (18)</u>	<u>\$ (30)</u>	<u>\$ (48)</u>

Net operating revenues

The ancillary services and strategic initiatives net operating revenues for 2009 increased by approximately \$72 million or 29.5% as compared to 2008, primarily from growth in pharmacy services, VillageHealth services and from our infusion therapy services.

The ancillary services and strategic initiatives net operating revenues for 2008 increased by approximately \$111 million or 82.7% as compared to 2007, primarily from growth in pharmacy services, VillageHealth services, vascular access services and a full year of operations of our infusion therapy services which we acquired in the third quarter of 2007.

Operating expenses

Ancillary services and strategic initiatives operating expenses for 2009 increased by approximately \$60 million from 2008, primarily due to an increase in volume in our pharmacy business, an increase in labor and benefit costs, partially offset by lower professional fees.

Ancillary services and strategic initiatives operating expenses for 2008 increased by approximately \$93 million from 2007, primarily due to an increase in volume in our pharmacy business, an increase in fixed operating expenses, an increase in labor costs and a full year of operations of our infusion therapy services, partially offset by lower professional fees in our VillageHealth business.

Operating loss

Ancillary services and strategic initiatives operating losses for 2009 decreased by approximately \$12 million from 2008. The decrease in operating losses was primarily due to volume growth in revenues outpacing increases in operating expenses, primarily associated with our pharmacy business and our VillageHealth business, partially offset by an increase in operating losses associated with certain new initiatives.

Ancillary services and strategic initiatives operating losses for 2008 decreased by approximately \$18 million from 2007. The decrease in operating losses was primarily due to growth in revenues outpacing increases in operating expenses, primarily associated with our pharmacy business and our vascular access services.

Corporate level charges

Stock-based compensation. Stock-based compensation of approximately \$44 million for 2009 increased by approximately \$3 million from 2008. Stock-based compensation for 2008 increased by approximately \$7 million from 2007. The increases in both periods resulted from an increase in the aggregate quantity of grants that contributed expense to each of these years.

Debt expense. Debt expense for 2009, 2008, and 2007 consisted of interest expense of approximately \$176 million, \$215 million, and \$243 million, respectively, and amortization of deferred financing costs of

approximately \$10 million for each year presented. Debt expense for 2007 also included the write-off of approximately \$4 million of deferred financing costs associated with the principal prepayments on our term loans. The decrease in interest expense in 2009 as compared to 2008 was primarily attributable to decreases in the LIBOR-based variable interest rates on the unhedged portion of our debt and the result of lower notional amounts of fixed rate swap agreements that contained higher rates. As of December 31, 2009, the notional amounts of our fixed rate swaps were approximately \$389 million as compared to approximately \$790 million at December 31, 2008. Our overall weighted average effective interest rate in 2009 was 4.86% as compared to 5.82% in 2008. The decrease in interest expense in 2008 as compared to 2007 was primarily attributable to decreases in the LIBOR-based variable interest rates on the unhedged portion of our debt. Our overall weighted average interest rate in 2008 was 5.82% as compared to 6.49% in 2007.

Equity investment income. Equity investment income was approximately \$2.4 million in 2009 as compared to \$0.8 million in 2008. The increase in equity investment income in 2009 was primarily due to an increase in the number of equity investments and improved profitability at several joint ventures. Equity investment income in 2008 remained flat as compared to 2007.

Other income. Other income was approximately \$4 million, \$12 million, and \$22 million in 2009, 2008, and 2007, respectively, and consisted principally of interest income. The decrease in other income in 2009 was primarily the result of lower average interest rates, partially offset by higher average cash balances. The decrease in other income in 2008 as compared to 2007, was primarily due to the fact that 2007 included gains on the sale of investments of approximately \$6 million resulting from the sale of our investment in NxStage Medical Inc. and a decrease in interest rates as well as lower average cash and investment balances.

Provision for income taxes. The provision for income taxes for 2009 represented an effective annualized tax rate of 36.7%, compared with 35.9% and 36.4% in 2008 and 2007, respectively. The effective tax rate in 2008 was lower primarily due to nonrecurring tax benefits associated with transactions occurring in 2008. We currently project the effective income tax rate for 2010 to be in the range of 36.5% to 37.5%.

Impairments and valuation adjustments. We perform impairment or valuation reviews for our property and equipment, amortizable intangible assets with finite useful lives, equity investments in non-consolidated businesses, and our investments in ancillary services and strategic initiatives at least annually and whenever a change in condition indicates that an impairment review is warranted. Such changes include shifts in our business strategy or plans, the quality or structure of our relationships with our partners, or when a center experiences deteriorating operating performance. Goodwill is also assessed at least annually for possible valuation impairment using fair value methodologies. These types of adjustments are charged directly to the corresponding operating segment that incurred the charge. No significant impairments or valuation adjustments were recognized during the periods presented.

Noncontrolling interests

Net income attributable to noncontrolling interests for 2009, 2008 and 2007 were approximately \$57 million, \$47 million and \$47 million, respectively. The increase in noncontrolling interests in 2009 was primarily due to an increase in new dialysis centers having minority partners and growth in the earnings of our existing dialysis joint ventures. The percentage of dialysis and related lab services net operating revenues generated from dialysis related joint ventures was approximately 16% in 2009 compared to 15% in 2008.

Accounts receivable

Our accounts receivable balances at December 31, 2009 and 2008 represented approximately 68 and 70 days of revenue, respectively, net of bad debt allowance. The relative decrease in the days of net revenue in accounts receivable as of December 31, 2009 was a result of improved cash collections on current outstanding balances. Accounts receivable balances of approximately 70 days of revenue is more consistent with our past experience levels and expected trends.

As of December 31, 2009 and 2008, approximately \$201 million and \$102 million in unreserved accounts receivable, respectively, representing approximately 18% and 9% of our total accounts receivable balance, respectively, were more than six months old. During 2009, we experienced delays in cash collections from certain government payors and certain commercial payors. We anticipate that we will collect these outstanding balances since we believe the delays in collections relate primarily to the timing of payors processing our claims for payment. There were no significant unreserved balances over one year old. Less than 2% of our treatments are classified as “patient pay”. Substantially all revenue realized is from government and commercial payors, as discussed above.

Amounts pending approval from third-party payors as of December 31, 2009 and 2008, other than the standard monthly billing, consisted of approximately \$46 million and \$39 million, respectively, associated with Medicare bad debt claims, classified as “other receivables”. Currently, our Medicare bad debt claims are typically paid to us before the Medicare fiscal intermediary audits the claims. However, the payment received from Medicare is subject to adjustment based upon the actual results of the audits. Such audits typically occur one to four years after the claims are filed. As a kidney dialysis provider, our revenue is not subject to cost report settlements, except for potentially limiting the collectibility of these Medicare bad debt claims.

Liquidity and capital resources

Available liquidity. As of December 31, 2009, our cash balance was \$539 million and we had undrawn credit under our Senior Secured Credit Facilities totaling \$250 million, of which approximately \$52 million was committed for outstanding letters of credit. We believe that we will have sufficient liquidity, operating cash flows and access to borrowings to fund our scheduled debt service and other obligations for the foreseeable future. Our primary sources of liquidity are cash from operations and cash from borrowings.

Cash flow from operations during 2009 amounted to \$667 million, compared with \$614 million for 2008. Cash flow from operations in 2009 included cash interest payments of approximately \$186 million and cash tax payments of \$162 million. Cash flow from operations in 2008 included cash interest payments of \$223 million and cash tax payments of \$163 million.

Non-operating cash outflows in 2009 included \$275 million for capital asset expenditures, including \$161 million for new center developments and relocations, and \$114 million for maintenance and information technology. We also spent an additional \$88 million for acquisitions. During 2009, we also received \$33 million from the maturity and sale of investments. However, these proceeds were either used to repurchase other investments or were used to fund distributions from our deferred compensation plans. In addition, we received \$75 million associated with stock option exercises and other share issuances and the related excess tax benefits. We also made distributions to noncontrolling interests of \$68 million, and received contributions from noncontrolling interests of \$13 million associated with new joint ventures and from additional equity contributions. We also repurchased 2.9 million shares of our common stock for approximately \$154 million.

Non-operating cash outflows in 2008 included \$318 million for capital asset expenditures, including \$213 million for new center developments and relocations and \$105 million for maintenance and

information technology. We also spent an additional \$102 million for acquisitions. During 2008, we also received \$43 million from the maturity and sale of investments. However, these proceeds were either used to repurchase other investments or were used to fund distributions from our deferred compensation plans. In addition, we received \$48 million associated with stock option exercises and other share issuances and related excess tax benefits. We also made distributions to noncontrolling interests of \$59 million and received contributions from noncontrolling interests of \$19 million associated with new joint ventures and from additional equity contributions. We also repurchased 4.8 million shares of our common stock for approximately \$233 million.

During 2009, we acquired a total of 19 dialysis centers, opened 78 new dialysis centers, sold or closed eight centers, merged 16 centers into other existing centers, made equity investments in six centers and added two centers under management and administrative service agreements. During 2008, we acquired a total of 20 dialysis centers, opened 86 new dialysis centers, sold or closed nine centers, merged eight centers into other existing centers, ceased operations at one joint venture in which we owned an equity investment and added a net two centers under management and administrative service agreements.

We currently expect to spend approximately \$125 million for general maintenance capital asset expenditures in 2010, and approximately \$250 million for new center development, relocations and center acquisitions depending upon the availability of certain projects and sufficient project returns which does not include any potential expenditures for our new corporate headquarters. We expect to generate approximately \$675 million to \$725 million of operating cash flow in 2010. Our actual expenditures for growth and cash flows in 2010 could vary significantly from these expected amounts.

2009 capital structure changes and other items

Our Senior Secured Credit Facilities are guaranteed by substantially all of our direct and indirect wholly-owned subsidiaries and are secured by substantially all of our and our subsidiary guarantors' assets. The Senior Secured Credit Facilities also contain customary affirmative and negative covenants and require compliance with financial covenants, including an interest rate coverage ratio and a leverage ratio that determines the interest rate margins on our term loan A and our revolving line of credit. The Senior Secured Credit Facilities in general also contain limits on the general amount of capital expenditures for internal growth, acquisitions and capital improvements, as described below, as well as limits on the amount of tangible net assets in non-guarantor subsidiaries.

Term Loan A

During 2009, we made mandatory principal payments totaling \$61.3 million on our term loan A. As a result of these principal payments, the outstanding balance on term loan A as of December 31, 2009 was \$153.1 million and bore interest at LIBOR plus a margin of 1.50%, for an overall weighted average effective rate of 1.74%. The interest rate margin is subject to adjustment depending upon certain financial conditions and could range from 1.50% to 2.25%. Term loan A matures in October 2011 and requires annual principal payments of \$87.5 million in 2010 and \$65.6 million in 2011, respectively.

Term Loan B

As of December 31, 2009, the outstanding balance of our term loan B was \$1.7 billion and bore interest at LIBOR plus a margin of 1.50% for an overall weighted average effective rate of 2.66%, including the impact of our swap agreements. We did not make any principal payments on term loan B during 2009, nor were we required to. Term loan B matures in October 2012 and requires principal payments of \$1.7 billion in 2012.

Senior and Senior Subordinated Notes

Our senior and senior subordinated notes, as of December 31, 2009, consisted of \$900 million of 6⁵/₈% senior notes due 2013 and \$850 million of 7¹/₄% senior subordinated notes due 2015. The notes are guaranteed by substantially all of our direct and indirect wholly-owned subsidiaries and require semi-annual interest payments in March and September. We may redeem some or all of the senior notes at any time on or after March 15, 2009 and some or all of the senior subordinated notes at any time on or after March 15, 2010.

Interest rate swaps

As of December 31, 2009, we maintained a total of eight interest rate swap agreements, with amortizing notional amounts totaling \$389 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 3.88% to 4.70%, resulting in an overall weighted average effective interest rate of 5.78% on the hedged portion of our Senior Secured Credit Facilities, including the term loan B margin of 1.50%. The swap agreements expire in 2010 and require quarterly interest payments. During 2009, 2008, and 2007 we accrued net cash (obligations) benefits of approximately (\$17.3) million, \$(4.2) million, and \$14.5 million, respectively, from these swaps, which are included in debt expense. We estimate that approximately \$8.9 million of existing unrealized pre-tax losses in other comprehensive income at December 31, 2009 will be reclassified into income in 2010. As of December 31, 2009 and 2008, the total fair value of these swaps were liabilities of \$10.8 million and \$21.9 million, respectively. The 2009 amount was included in other current liabilities. The 2008 amount was primarily included in other long-term liabilities. Also during 2009, we recorded approximately \$8.0 million, net of tax, as an increase to other comprehensive income for amounts reclassified into income, net of swap valuation losses. In 2008, we recorded \$10.4 million, net of tax, as reductions to other comprehensive income for swap valuation losses, net of amounts reclassified into income.

As of December 31, 2009, the interest rates were economically fixed on approximately 21% of our variable rate debt and approximately 59% of our total debt.

As a result of the swap agreements, our overall weighted average effective interest rate on the Senior Secured Credit Facilities was 2.63%, based upon the current margins in effect of 1.50%, as of December 31, 2009.

Our overall weighted average effective interest rate in 2009 was 4.86% and as of December 31, 2009 was 4.68%.

Stock repurchases

During 2009, we repurchased a total of 2,902,619 shares of our common stock for \$153.5 million, or an average price of \$52.88 per share, pursuant to previously announced authorizations by the Board of Directors. On November 3, 2009, we announced that our Board of Directors authorized an increase of an additional \$500 million of share repurchases of our common stock. As a result of these transactions the total outstanding authorization for share repurchases as of December 31, 2009 was \$500 million. We have not repurchased any additional shares of our common stock from January 1, 2010 through February 25, 2010. This stock repurchase program has no expiration date.

Stock-based compensation

Stock-based compensation recognized in a period represents the amortization during that period of the estimated grant-date fair value of stock-based awards over their vesting terms, adjusted for expected forfeitures. Shares issued upon exercise of stock awards are generally issued from shares in treasury. We

have utilized the Black-Scholes-Merton valuation model for estimating the grant date fair value of stock options and stock-settled stock appreciation rights granted in all prior periods. During 2009, we granted 4,211,840 stock-settled stock appreciation rights with a grant-date fair value of \$50.9 million and a weighted-average expected life of approximately 3.5 years, and also granted 48,135 stock units with a grant-date fair value of \$2.6 million and a weighted-average expected life of approximately 2.5 years.

For the years ended December 31, 2009 and 2008, we recognized \$44.4 million and \$41.2 million, respectively, in stock-based compensation expense for stock options, stock-settled stock appreciation rights, stock units and discounted employee stock plan purchases, which is primarily included in general and administrative expenses. The estimated tax benefits recorded for this stock-based compensation in 2009 and 2008 were \$16.8 million and \$15.6 million, respectively. As of December 31, 2009, there was \$80.0 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 1.4 years.

During the years ended December 31, 2009 and 2008, we received \$63.7 million and \$35.6 million, respectively, in cash proceeds from stock option exercises and \$18.2 million and \$14.0 million, respectively, in total actual tax benefits upon the exercise of stock awards.

2008 capital structure changes

Term Loan A

During 2008, we made mandatory principal payments totaling \$14.9 million on our term loan A. As a result of these principal payments, the outstanding balance on term loan A as of December 31, 2008 was \$214.4 million and bore interest at LIBOR plus a margin of 1.50%, for an overall weighted average effective rate of 1.97%. The interest rate margin is subject to adjustment depending upon certain financial conditions and could range from 1.50% to 2.25%.

Term Loan B

As of December 31, 2008, the outstanding balance of our term loan B was \$1.7 billion and bore interest at LIBOR plus a margin of 1.50% for an overall weighted average effective rate of 3.63%, including the impact of our swap agreements. We did not make any principal payments on term loan B during 2008, nor were we required to.

Senior and Senior Subordinated Notes

Our senior and senior subordinated notes, as of December 31, 2008, consisted of \$900 million of 6⁵/₈% senior notes due 2013 and \$850 million of 7¹/₄% senior subordinated notes due 2015. The notes are guaranteed by substantially all of our direct and indirect wholly-owned subsidiaries and require semi-annual interest payments in March and September. We may redeem some or all of the senior notes at any time on or after March 15, 2009 and some or all of the senior subordinated notes at any time on or after March 15, 2010.

Stock repurchases

During 2008, we repurchased a total of 4,788,881 shares of our common stock for \$232.7 million, or an average price of \$48.59 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. As a result of these transactions the total outstanding authorization for share repurchases as of December 31, 2008 was \$153.5 million. This stock repurchase program had no expiration date.

Interest rate swaps

As of December 31, 2008, we maintained a total of nine interest rate swap agreements, with amortizing notional amounts totaling \$790 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 4.27%, resulting in a weighted average effective interest rate of 5.54%, on the hedged portion of our Senior Secured Credit Facilities, including the term loan B margin of 1.50%.

As of December 31, 2008, the interest rates were economically fixed on approximately 41% of our variable rate debt and approximately 69% of our total debt.

As a result of the swap agreements our overall weighted average effective interest rate on our Senior Secured Credit Facilities was 3.48%, based upon the current margins in effect of 1.50%, as of December 31, 2008.

At December 31, 2008 our overall weighted average effective interest rate was 5.10%.

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 and letters of credit as well as potential obligations associated with our equity investments and to dialysis centers that are wholly-owned by third parties. Substantially all of our facilities are leased. We have potential acquisition obligations for several joint ventures and for some of our non-wholly-owned subsidiaries in the form of put provisions. These put provisions, if exercised, would require us to purchase the third-party owners' noncontrolling interests at either the appraised fair market value or a predetermined multiple of earnings or cash flow attributable to the noncontrolling interests put to us, which is intended to approximate fair value. The methodology we use to estimate the fair value of the noncontrolling interests subject to put provisions assumes either the higher of a liquidation value of net assets or an average multiple of earnings, based on historical earnings, patient mix and other performance indicators, as well as other factors. The estimate of the fair values of the noncontrolling interests subject to put provisions is a critical accounting estimate that involves significant judgments and assumptions and may not be indicative of the actual values at which the noncontrolling interests may ultimately be settled, which could vary significantly from our current estimates. The estimated fair values of noncontrolling interests subject to put provisions can also fluctuate and the implicit multiple of earnings at which these noncontrolling interests obligations may be settled will vary depending upon market conditions including potential purchasers' access to the capital markets, which can impact the level of competition for dialysis and non-dialysis related businesses, the economic performance of these businesses and the restricted marketability of the third-party owners' noncontrolling interests. The amount of noncontrolling interests subject to put provisions that contractually employ a predetermined multiple of earnings rather than fair value are immaterial. For additional information see Note 22 to our consolidated financial statements.

We also have potential cash commitments to provide operating capital advances as needed to several other dialysis centers that are wholly-owned by third parties or centers in which we own an equity investment, as well as to physician-owned vascular access clinics that we operate under management and administrative services agreements.

The following is a summary of these contractual obligations and commitments as of December 31, 2009 (in millions):

	<u>Less Than 1 year</u>	<u>2-3 years</u>	<u>4-5 years</u>	<u>After 5 years</u>	<u>Total</u>
Scheduled payments under contractual obligations:					
Long-term debt	\$100	\$1,774	\$ 901	\$ 850	\$3,625
Interest payments on senior and senior subordinated notes	121	243	153	31	548
Capital lease obligations	—	2	1	2	5
Operating leases	216	374	283	439	1,312
	<u>\$437</u>	<u>\$2,393</u>	<u>\$1,338</u>	<u>\$1,322</u>	<u>\$5,490</u>
Potential cash requirements under existing commitments:					
Letters of credit	\$ 52	\$ —	\$ —	\$ —	\$ 52
Noncontrolling interests subject to put provisions	169	56	52	55	332
Pay-fixed swaps potential obligations	11	—	—	—	11
Operating capital advances	7	—	—	—	7
Income tax liabilities for unrecognized tax benefits	19	—	—	—	19
	<u>\$258</u>	<u>\$ 56</u>	<u>\$ 52</u>	<u>\$ 55</u>	<u>\$ 421</u>

Not included above are interest payments related to our Senior Secured Credit Facilities. Our Senior Secured Credit Facilities as of December 31, 2009 bear interest at LIBOR plus current margins of 1.50%. The term loan A and the revolving line of credit are adjustable depending upon our achievement of certain financial ratios. At December 31, 2009, our Senior Secured Credit Facilities had an overall weighted average effective interest rate of 2.63%, including the effects of our swap agreements. Interest payments are due at the maturity of specific debt tranches within each term loan, which can range in maturity from one month to twelve months. Future interest payments will depend upon the amount of mandatory principal payments and principal prepayments, as well as changes in the LIBOR-based interest rates and changes in the interest rate margins. Assuming no principal prepayments on our Senior Secured Credit Facilities during 2010 and no changes in the effective interest rate, including the interest rate margin, approximately \$49 million of interest would be required to be paid in 2010.

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 existed as of December 31, 2009, and represent the estimated potential obligation that we would be required to pay based upon the estimated 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 the LIBOR-based 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.

In addition to the above commitments, we are obligated to purchase a certain amount of our hemodialysis products and supplies at fixed prices through 2015 from Gambro Renal Products, Inc. in connection with the Product Supply Agreement. Our total expenditures for the years ended December 31, 2009 and 2008 on such products were approximately 2% of our total operating costs in each year. In January 2010, we entered into an agreement with Fresenius which committed us to purchase a certain amount of dialysis equipment, parts and supplies from them through 2013.

The actual amount of purchases in future years from Gambro Renal Products and Fresenius 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 in the case of the Product Supply Agreement, Gambro Renal Products' ability to meet our needs.

Settlements of approximately \$15 million of existing income tax liabilities for unrecognized tax benefits are excluded from the above table as reasonably reliable estimates of their timing cannot be made.

Contingencies

The information in Note 16 of the Notes to Consolidated Financial Statements of this report is incorporated by reference in response to this item.

Critical accounting estimates and judgments

Our consolidated financial statements and accompanying notes are prepared in accordance with United States generally accepted accounting principles. These accounting principles require us to make estimates, judgments and assumptions that affect the reported amounts of revenues, expenses, assets, liabilities, and contingencies. All significant estimates, judgments and assumptions are developed based on the best information available to us at the time made and are regularly reviewed and updated when necessary. Actual results will generally differ from these estimates. Changes in estimates are reflected in our financial statements in the period of change based upon on-going actual experience trends, or subsequent settlements and realizations depending on the nature and predictability of the estimates and contingencies. Interim changes in estimates are applied prospectively within annual periods. Certain accounting estimates, including those concerning revenue recognition and accounts receivable, impairments of long-lived assets, accounting for income taxes, quarterly variable compensation accruals, purchase accounting valuation estimates, fair value estimates and stock-based compensation are considered to be critical to evaluating and understanding our financial results because they involve inherently uncertain matters and their application requires the most difficult and complex judgments and estimates.

Revenue recognition and accounts receivable. There are significant estimating risks associated with the amount of revenue that we recognize in a given reporting period. Payment rates are often subject to significant uncertainties related to wide variations in the coverage terms of the commercial healthcare plans under which we receive payments. In addition, ongoing insurance coverage changes, geographic coverage differences, differing interpretations of contract coverage, and other payor issues complicate the billing and collection process. Net revenue recognition and allowances for uncollectible billings require the use of estimates of the amounts that will ultimately be realized considering, among other items, retroactive adjustments that may be associated with regulatory reviews, audits, billing reviews and other matters.

Revenues associated with Medicare and Medicaid programs are recognized based on (a) the payment rates that are established by statute or regulation for the portion of the payment rates paid by the government payor (e.g., 80% for Medicare patients) and (b) for the portion not paid by the primary government payor, the estimated amounts that will ultimately be collectible from other government programs paying secondary coverage (e.g., Medicaid secondary coverage), the patient's commercial health plan secondary coverage, or the patient.

Commercial healthcare plans, including contracted managed-care payors, are billed at our usual and customary rates; however, revenue is recognized based on estimated net realizable revenue for the services provided. Net realizable revenue is estimated based on contractual terms for the patients under healthcare plans with which we have formal agreements, non-contracted healthcare plan coverage terms if known, estimated secondary collections, historical collection experience, historical trends of refunds and payor payment adjustments (retractions), inefficiencies in our billing and collection processes that can result in denied claims for payments, slow down in collections, a reduction in the amounts that we expect to collect

and regulatory compliance issues. Determining applicable primary and secondary coverage for our more than 118,000 patients at any point in time, together with the changes in patient coverages that occur each month, requires complex, resource-intensive processes. Collections, refunds and payor retractions typically continue to occur for up to three years or longer after services are provided.

We generally expect our range of dialysis and related lab services revenues estimating risk to be within 1% of its revenue, which can represent as much as 6% of consolidated operating income. Changes in estimates are reflected in the then-current financial statements based on on-going actual experience trends, or subsequent settlements and realizations depending on the nature and predictability of the estimates and contingencies. Changes in revenue estimates for prior periods are separately disclosed and reported if material to the current reporting period and longer term trend analyses, and have not been significant.

Lab service revenues for current period dates of services are recognized at the estimated net realizable amounts to be received.

Impairments of long-lived assets. We account for impairments of long-lived assets, which include property and equipment, equity investments in non-consolidated businesses, amortizable intangible assets with finite useful lives and goodwill, in accordance with the provisions of applicable accounting guidance. Impairment reviews are performed at least annually and whenever a change in condition occurs which indicates that the carrying amounts of assets may not be recoverable.

Such changes include changes in our business strategies and plans, changes in the quality or structure of our relationships with our partners and deteriorating operating performance of individual dialysis centers or other operations. We use a variety of factors to assess the realizable value of assets depending on their nature and use. Such assessments are primarily based upon the sum of expected future undiscounted net cash flows over the expected period the asset will be utilized, as well as market values and conditions. The computation of expected future undiscounted net cash flows can be complex and involves a number of subjective assumptions. Any changes in these factors or assumptions could impact the assessed value of an asset and result in an impairment charge equal to the amount by which its carrying value exceeds its actual or estimated fair value.

Accounting for income taxes. We estimate our income tax provision to recognize our tax expense for the current year, and our deferred tax liabilities and assets for future tax consequences of events that have been recognized in our financial statements, measured using enacted tax rates and laws expected to apply in the periods when the deferred tax liabilities or assets are expected to be realized. We are required to assess our tax positions on a more-likely-than-not criteria and to also determine the actual amount of benefit to recognize in the financial statements. Deferred tax assets are assessed based upon the likelihood of recoverability from future taxable income and, to the extent that recovery is not likely, a valuation allowance is established. The allowance is regularly reviewed and updated for changes in circumstances that would cause a change in judgment about the realizability of the related deferred tax assets. These calculations and assessments involve complex estimates and judgments because the ultimate tax outcome can be uncertain and future events unpredictable.

Variable compensation accruals. We estimate variable compensation accruals quarterly based upon the annual amounts expected to be earned and paid out resulting from the achievement of certain teammate-specific and/or corporate financial and operating goals. Our estimates, which include compensation incentives for bonuses, and other awards, are updated periodically based on changes in our economic condition or cash flows that could ultimately impact the actual final award. Actual results reflected in each fiscal quarter may vary due to the subjectivity involved in anticipating fulfillment of specific and/or corporate goals, as well as the final determination and approval of amounts by our Board of Directors.

Purchase accounting valuation estimates. We make various assumptions and estimates regarding the valuation of tangible and intangible assets, liabilities and contractual as well as non-contractual contingencies associated with our acquisitions. These assumptions can have a material effect on our balance sheet valuations and the related amount of depreciation and amortization expense that will be recognized in the future. Long-lived tangible and intangible assets are subject to our regular ongoing impairment assessments.

Fair value estimates. We have recorded certain assets, liabilities and noncontrolling interests subject to put provisions at fair value. The FASB defines fair value which is measured based upon certain valuation techniques that include inputs and assumptions that market participants would use in pricing assets, liabilities and noncontrolling interests subject to put provisions. We have measured the fair values of our applicable assets, liabilities and noncontrolling interests subject to put provisions based upon certain market inputs and assumptions that are either observable or unobservable in determining fair values and have also classified these assets, liabilities and noncontrolling interests subject to put provisions into the appropriate fair value hierarchy levels. The fair value of our investments available for sale are based upon quoted market prices from active markets and the fair value of our swap agreements are 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. For our noncontrolling interests subject to put provisions we have estimated the fair values of these based upon either the higher of a liquidation value of net assets or an average multiple of earnings based on historical earnings, patient mix and other performance indicators, as well as other factors. The estimate of the fair values of the noncontrolling interests subject to put provisions involves significant judgments and assumptions and may not be indicative of the actual values at which the noncontrolling interests may ultimately be settled, which could vary significantly from our current estimates. The estimated fair values of the noncontrolling interests subject to put provisions can also fluctuate and the implicit multiple of earnings at which these noncontrolling interests obligations may be settled will vary depending upon market conditions including potential purchasers' access to the capital markets, which can impact the level of competition for dialysis and non-dialysis related businesses, the economic performance of these businesses and the restricted marketability of the third-party owners' noncontrolling interests.

Stock-based compensation. Stock-based compensation recognized in a period represents the amortization during that period of the estimated grant-date fair value of stock-based awards over their vesting terms, adjusted for expected forfeitures. Stock-based compensation recognized in our consolidated financial statements for the years ended December 31, 2009, 2008 and 2007 include compensation costs for stock-based awards granted prior to, but not fully vested as of December 31, 2006, and stock-based awards granted thereafter. We estimate the grant-date fair value of stock awards using complex option pricing models that rely heavily on estimates from us about uncertain future events, including the expected term of the awards, the expected future volatility of our stock price, and expected future risk-free interest rates.

Significant new accounting standards

On June 29, 2009, the Financial Accounting Standards Board (FASB) established the FASB Accounting Standards Codification (Codification) as the single source of authoritative U.S. generally accepted accounting principles (GAAP) for all nongovernmental entities. Rules and interpretive releases of the Securities and Exchange Commission (SEC) are also sources of authoritative U.S. GAAP for SEC registrants. The Codification does not change U.S. GAAP but takes previously issued FASB standards and other U.S. GAAP authoritative pronouncements, changes the way the standards are referred to, and includes them in specific topic areas. The Codification is effective for financial statements issued for interim and annual periods ending after September 15, 2009. The adoption of the Codification did not have any impact on our consolidated financial statements.

Effective for our first annual reporting period that begins after November 15, 2009, the FASB is eliminating the quantitative approach previously required for determining the primary beneficiary of a variable interest entity, and requiring additional disclosures about an enterprise's involvement in variable interest entities. An enterprise will be required to perform an analysis to determine whether the enterprise's variable interest or interests give it a controlling financial interest in a variable interest entity by having both the power to direct the activities of a variable interest entity that most significantly impact the entity's economic performance and the obligation to absorb losses of the entity, or the right to receive benefits from the entity. In addition, the FASB is establishing new guidance for determining whether an entity is a variable interest entity, requiring an ongoing reassessment of whether an enterprise is the primary beneficiary of a variable interest entity, and adding an additional reconsideration event for determining whether an entity is a variable interest entity when any changes in facts and circumstances occur such that the holders of the equity investment at risk, as a group, lose the power from voting rights or similar rights concerning those investments to direct the activities of the entity that most significantly impact the entity's economic performance. We are currently in the process of assessing the expected impact of this standard on our consolidated financial statements.

Effective May 28, 2009, the FASB issued requirements relating to the accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. These requirements set forth the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements, the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements, and the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. These requirements do not apply to subsequent events or transactions that are within the scope of other applicable principles of GAAP that provide different guidance on the accounting treatment for subsequent events or transactions. These requirements were effective for interim and annual periods ending after June 15, 2009. See Note 1 to the consolidated financial statements for further details.

Effective January 1, 2009, we are required to provide enhanced disclosures about our derivative and hedging activities. We are required to provide additional disclosures about (a) how and why we use derivative instruments, (b) how derivative instruments and related hedged items are accounted for, and (c) how derivative instruments and related hedged items affect our financial position, financial performance, and cash flows. These requirements did not have a material impact on our consolidated financial statements. See Note 13 to the consolidated financial statements for the disclosure of these items.

Effective January 1, 2009, we are required to treat noncontrolling interests as a separate component of equity, but apart from our equity, and not as a liability or other item outside of equity. We are also required to identify and present consolidated net income attributable to us and to noncontrolling interests on the face of the consolidated statement of income. Previously, we had reported minority interests (noncontrolling interests) as a reduction to operating income. In addition, changes in our ownership interest while we retain a controlling financial interest should be accounted for as equity transactions. We were also required to expand disclosures in the financial statements to include a reconciliation of the beginning and ending balances of the equity attributable to us and the noncontrolling owners and a schedule showing the effects of changes in our ownership interest in a subsidiary on the equity attributable to us. This change did not have a material impact on our consolidated financial statements; however, it did change the presentation of minority interests (noncontrolling interests) in our consolidated financial statements. In conjunction with adopting these requirements, we are required to classify securities with redemption features that are not solely within our control such as our noncontrolling interests that are subject to put provisions outside of permanent equity and to measure these noncontrolling interests at fair value. See Note 22 to our consolidated financial statements for further details. The consolidated financial statements have been recast for all prior periods presented for the retrospective application of these presentation and disclosure requirements.

All business combinations consummated after January 1, 2009, are required 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 interests 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. Transaction costs are excluded from the acquisition cost and are 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 is classified as either equity or a liability. A company that obtains control but acquires less than 100% of an acquiree is required to record 100% of the fair value of the acquiree assets, liabilities, and noncontrolling interests at the acquisition date. The adoption of these requirements did not have a material impact on our consolidated financial statements.

In December 2008, the FASB required public entities to provide additional disclosures about transfers of financial assets and required public enterprises to provide additional disclosures about their involvement in variable interest entities and certain special purpose entities. Because these requirements impact disclosures and not the accounting treatment for transfers of financial assets and interests in variable interest entities, these requirements did not impact our financial condition or results of operations.

Effective January 1, 2008, the FASB established a framework for measuring fair value and also required additional disclosures about fair value measurements. These requirements applied to assets and liabilities that are carried at fair value on a recurring basis. Effective January 1, 2009 the FASB issued additional requirements relating to 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 note 23 to our consolidated financial statements for the impact of these requirements. The adoption of these requirements relating to nonfinancial assets and liabilities did not have a material impact on our consolidated financial statements.

Effective January 1, 2008, the FASB 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. This provision 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 adoption of this provision did not have a material impact on our consolidated financial statements.

Management's Report on Internal Control over Financial Reporting

Management is responsible for establishing and maintaining an adequate system of internal control over financial reporting designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles and which includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on the financial statements.

During the last fiscal year, the Company conducted an evaluation, under the oversight of the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's internal control over financial reporting. This evaluation was completed based on the criteria established in the report titled "Internal Control—Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

Based upon our evaluation under the COSO framework, we have concluded that the Company's internal control over financial reporting was effective as of December 31, 2009.

The Company's independent registered public accounting firm, KPMG LLP, has issued an attestation report on the Company's internal control over financial reporting, which report is included in this Annual Report.

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders
DaVita Inc.:

We have audited DaVita Inc.'s internal control over financial reporting as of December 31, 2009, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). DaVita Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying "Management's Report on Internal Control Over Financial Reporting". Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, DaVita Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2009, based on criteria established in *Internal Control—Integrated Framework* issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of DaVita Inc. and subsidiaries as of December 31, 2009 and 2008, and the related consolidated statements of income, equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2009, and our report dated February 25, 2010 expressed an unqualified opinion on those consolidated financial statements.

KPMG LLP

Seattle, Washington
February 25, 2010

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders
DaVita Inc.:

We have audited the accompanying consolidated balance sheets of DaVita Inc. and subsidiaries as of December 31, 2009 and 2008, and the related consolidated statements of income, equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2009. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of DaVita Inc. and subsidiaries as of December 31, 2009 and 2008, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2009, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the consolidated financial statements, the Company adopted Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 160, Noncontrolling Interests in Consolidated Financial Statements (included in FASB ASC Topic 810, Consolidation), on a prospective basis except for the presentation and disclosure requirements which were applied retrospectively for all periods presented effective January 1, 2009.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), DaVita Inc.'s internal control over financial reporting as of December 31, 2009, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 25, 2010 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

KPMG LLP

Seattle, Washington
February 25, 2010

Consolidated Statements of Income

(dollars in thousands, except per share data)

	Year ended December 31,		
	2009	2008	2007
Net operating revenues	\$ 6,108,800	\$ 5,660,173	\$ 5,264,151
Operating expenses and charges:			
Patient care costs	4,248,668	3,920,487	3,590,344
General and administrative	531,531	508,240	491,236
Depreciation and amortization	228,986	216,917	193,470
Provision for uncollectible accounts	161,786	146,229	136,682
Equity investment income	(2,442)	(796)	(1,217)
Valuation gain on alliance and product supply agreement	—	—	(55,275)
Total operating expenses and charges	5,168,529	4,791,077	4,355,240
Operating income	940,271	869,096	908,911
Debt expense	(185,755)	(224,716)	(257,147)
Other income, net	3,708	12,411	22,460
Income before income taxes	758,224	656,791	674,224
Income tax expense	278,465	235,471	245,581
Net income	479,759	421,320	428,643
Less: Net income attributable to noncontrolling interests	(57,075)	(47,160)	(46,865)
Net income attributable to DaVita Inc.	\$ 422,684	\$ 374,160	\$ 381,778
Earnings per share:			
Basic earnings per share attributable to DaVita Inc.	\$ 4.08	\$ 3.56	\$ 3.61
Diluted earnings per share attributable to DaVita Inc.	\$ 4.06	\$ 3.53	\$ 3.55
Weighted average shares for earnings per share:			
Basic	103,603,885	105,149,448	105,893,052
Diluted	104,167,685	105,939,725	107,418,240

See notes to consolidated financial statements.

Consolidated Balance Sheets
(dollars in thousands, except per share data)

	December 31,	
	2009	2008
ASSETS		
Cash and cash equivalents	\$ 539,459	\$ 410,881
Short-term investments	26,475	35,532
Accounts receivable, less allowance of \$229,317 and \$211,222	1,105,903	1,075,457
Inventories	70,041	84,174
Other receivables	263,456	239,165
Other current assets	40,234	33,761
Income tax receivable	—	32,130
Deferred income taxes	256,953	217,196
Total current assets	2,302,521	2,128,296
Property and equipment, net	1,104,925	1,048,075
Amortizable intangibles, net	136,732	160,521
Equity investments	22,631	19,274
Long-term investments	7,616	5,656
Other long-term assets	32,615	47,330
Goodwill	3,951,196	3,876,931
	<u>\$7,558,236</u>	<u>\$7,286,083</u>
LIABILITIES AND EQUITY		
Accounts payable	\$ 176,657	\$ 282,883
Other liabilities	461,092	495,239
Accrued compensation and benefits	286,121	312,216
Current portion of long-term debt	100,007	72,725
Income taxes payable	23,064	—
Total current liabilities	1,046,941	1,163,063
Long-term debt	3,532,217	3,622,421
Other long-term liabilities	87,692	101,442
Alliance and product supply agreement, net	30,647	35,977
Deferred income taxes	334,855	244,884
Total liabilities	5,032,352	5,167,787
Commitments and contingencies		
Noncontrolling interests subject to put provisions	331,725	291,397
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; 103,062,698 and 103,753,673 shares outstanding)	135	135
Additional paid-in capital	621,685	584,358
Retained earnings	2,312,134	1,889,450
Treasury stock, at cost (31,799,585 and 31,108,610 shares)	(793,340)	(691,857)
Accumulated other comprehensive loss	(5,548)	(14,339)
Total DaVita Inc. shareholders' equity	2,135,066	1,767,747
Noncontrolling interests not subject to put provisions	59,093	59,152
Total equity	<u>2,194,159</u>	<u>1,826,899</u>
	<u>\$7,558,236</u>	<u>\$7,286,083</u>

See notes to consolidated financial statements.

Consolidated Statements of Cash Flow

(dollars in thousands)

	Year ended December 31,		
	2009	2008	2007
Cash flows from operating activities:			
Net income.	\$ 479,759	\$ 421,320	\$ 428,643
Adjustments to reconcile net income to cash provided by operating activities:			
Depreciation and amortization	228,986	216,917	193,470
Valuation gain on alliance and product supply agreement	—	—	(55,275)
Stock-based compensation expense	44,422	41,235	34,149
Tax benefits from stock award exercises	18,241	13,988	32,788
Excess tax benefits from stock award exercises	(6,950)	(8,013)	(25,541)
Deferred income taxes	50,869	94,912	18,601
Equity investment income, net	(204)	(796)	(1,217)
Loss (gain) on disposal of assets	9,761	15,216	(2,825)
Non-cash debt expense and non-cash rent charges	11,184	11,794	12,713
Changes in operating assets and liabilities, net of effect of acquisitions and divestitures:			
Accounts receivable	(32,313)	(149,939)	15,911
Inventories	15,115	(2,715)	11,271
Other receivables and other current assets	(35,104)	(40,960)	(61,049)
Other long-term assets	7,288	(11,929)	(14,528)
Accounts payable	(104,879)	57,422	(9,216)
Accrued compensation and benefits	(9,138)	(31,602)	9,691
Other current liabilities	(43,543)	8,871	657
Income taxes	44,578	(30,087)	(12,942)
Other long-term liabilities	(11,362)	8,067	5,764
Net cash provided by operating activities	666,710	613,701	581,065
Cash flows from investing activities:			
Additions of property and equipment	(274,605)	(317,962)	(272,212)
Acquisitions	(87,617)	(101,959)	(127,094)
Proceeds from asset sales	7,697	530	12,289
Purchase of investments available-for-sale	(2,062)	(2,009)	(52,085)
Purchase of investments held-to-maturity	(22,664)	(21,048)	(23,061)
Proceeds from the sale of investments available-for-sale	16,693	21,291	32,274
Proceeds from maturities of investments held-to-maturity	16,380	21,355	4,795
Purchase of equity investments	(2,100)	—	(17,550)
Distributions received on equity investments	2,547	908	1,134
Purchase of intangible assets	(329)	(65)	(2,291)
Other investment activity	—	1,220	(2,942)
Net cash used in investing activities	(346,060)	(397,739)	(446,743)
Cash flows from financing activities:			
Borrowings	18,767,592	17,089,018	13,113,640
Payments on long-term debt	(18,828,824)	(17,102,569)	(13,160,942)
Deferred financing costs	(42)	(130)	(4,511)
Purchase of treasury stock	(153,495)	(232,715)	(6,350)
Excess tax benefits from stock award exercises	6,950	8,013	25,541
Stock award exercises and other share issuances, net	67,908	40,247	62,902
Distributions to noncontrolling interests	(67,748)	(59,357)	(48,029)
Contributions from noncontrolling interests	13,071	19,074	14,735
Proceeds from sales of additional noncontrolling interests	9,375	10,701	5,536
Purchases from noncontrolling interests	(6,859)	(24,409)	—
Net cash (used in) provided by financing activities	(192,072)	(252,127)	2,522
Net increase (decrease) in cash and cash equivalents	128,578	(36,165)	136,844
Cash and cash equivalents at beginning of year	410,881	447,046	310,202
Cash and cash equivalents at end of year	\$ 539,459	\$ 410,881	\$ 447,046

See notes to consolidated financial statements.

Consolidated Statements of Equity and Comprehensive Income

(dollars and shares in thousands)

		DaVita Inc. Shareholders' Equity									
	Non-controlling interests subject to put provisions	Common stock		Additional paid-in capital	Retained earnings	Treasury stock		Accumulated other comprehensive income (loss)	Total	Non-controlling interests not subject to put provisions	Comprehensive income
		Shares	Amount			Shares	Amount				
Balance at December 31, 2006	\$191,871	134,862	\$135	\$ 523,500	\$1,129,621	(30,226)	\$(526,920)	\$ 12,997	\$1,139,333	\$ 37,079	
Comprehensive income:											
Net income	30,157				381,778				381,778	16,708	\$428,643
Unrealized losses on interest rate swaps, net of tax								(7,169)	(7,169)		(7,169)
Less reclassification of net swap realized gains into net income, net of tax ..								(8,858)	(8,858)		(8,858)
Unrealized gains on investments, net of tax								4,211	4,211		4,211
Less reclassification of net investment realized gains into net income, net of tax								(3,692)	(3,692)		(3,692)
Total comprehensive income											<u>\$413,135</u>
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		
Distributions to noncontrolling interests ...	(28,553)									(19,476)	
Contributions from noncontrolling interests ...	9,124									5,611	
Sales and assumptions of additional noncontrolling interests	6,061									7,281	
Changes in fair value of noncontrolling interests ...	121,374			(121,374)					(121,374)	—	
Other adjustments to noncontrolling interests ...	433									975	
Purchase of treasury stock ...						(111)	(6,350)		(6,350)		
Balance at December 31, 2007	\$330,467	134,862	\$135	\$ 479,115	\$1,515,290	(27,732)	\$(487,744)	\$ (2,511)	\$1,504,285	\$ 48,178	
Comprehensive income:											
Net income	30,401				374,160				374,160	16,759	\$421,320
Unrealized losses on interest rate swaps, net of tax								(12,947)	(12,947)		(12,947)
Less reclassification of net swap realized losses into net income, net of tax ..								2,590	2,590		2,590
Unrealized losses on investments, net of tax								(1,174)	(1,174)		(1,174)
Less reclassification of net investment realized gains into net income, net of tax								(297)	(297)		(297)
Total comprehensive income											<u>\$409,492</u>

Consolidated Statements of Equity and Comprehensive Income—(Continued)

(dollars and shares in thousands)

		DaVita Inc. Shareholders' Equity										
		Non-controlling interests subject to put provisions	Common stock		Additional paid-in capital	Retained earnings	Treasury stock		Accumulated other comprehensive income (loss)	Total	Non-controlling interests not subject to put provisions	Comprehensive income
			Shares	Amount			Shares	Amount				
Stock purchase shares issued					2,981		98	1,730		4,711		
Stock unit shares issued					(2,670)		181	3,544		874		
Stock options and SSARs exercised					12,278		1,133	23,328		35,606		
Stock-based compensation expense					41,235					41,235		
Excess tax benefits from stock awards exercised					8,165					8,165		
Distributions to noncontrolling interests ...		(40,016)									(19,341)	
Contributions from noncontrolling interests ...		7,305									11,769	
Sales and assumptions of additional noncontrolling interests		9,389									4,726	
Purchases from noncontrolling interests ...		(2,347)									(2,334)	
Changes in fair value of noncontrolling interests ...		(43,254)			43,254					43,254	—	
Other adjustments to noncontrolling interests ...		(548)									(605)	
Purchase of treasury stock ...							(4,789)	(232,715)		(232,715)		
Balance at December 31, 2008		\$291,397	134,862	\$135	\$584,358	\$1,889,450	(31,109)	\$(691,857)	\$(14,339)	\$1,767,747	\$ 59,152	
Comprehensive income:												
Net income		38,381				422,684				422,684	18,694	\$479,759
Unrealized losses on interest rate swaps, net of tax									(2,578)	(2,578)		(2,578)
Less reclassification of net swap realized losses into net income, net of tax ...									10,542	10,542		10,542
Unrealized gains on investments, net of tax ..									986	986		986
Less reclassification of net investment realized gains into net income, net of tax									(159)	(159)		(159)
Total comprehensive income												\$488,550
Stock purchase shares issued					2,135		107	2,387		4,522		
Stock unit shares issued					(1,570)		69	1,570		—		
Stock options and SSARs exercised					15,598		2,036	48,055		63,653		
Stock-based compensation expense					44,422					44,422		
Excess tax benefits from stock awards exercised					6,150					6,150		
Distributions to noncontrolling interests ...		(44,277)									(23,471)	
Contributions from noncontrolling interests ...		10,502									2,569	
Sales and assumptions of additional noncontrolling interests		13,483			(529)					(529)	4,039	
Purchases from noncontrolling interests ...		(2,594)			(3,721)					(3,721)	(544)	
Changes in fair value of noncontrolling interests ...		24,819			(24,819)					(24,819)	—	
Other adjustments		14			(339)					(339)	(1,346)	
Purchase of treasury stock ...							(2,903)	(153,495)		(153,495)		
Balance at December 31, 2009		\$331,725	134,862	\$135	\$621,685	\$2,312,134	(31,800)	\$(793,340)	\$ (5,548)	\$2,135,066	\$ 59,093	

See notes to consolidated financial statements.

Notes to Consolidated Financial Statements

(dollars in thousands, except per share data)

1. Organization and summary of significant accounting policies

Organization

DaVita Inc. principally operates kidney dialysis centers and provides related lab services primarily in dialysis centers and in contracted hospitals across the United States. The Company also operates other ancillary services and strategic initiatives which relate primarily to its core business of providing renal care services. As of December 31, 2009, the Company operated or provided administrative services to 1,530 outpatient dialysis centers located in 43 states and the District of Columbia, serving approximately 118,000 patients. The Company's dialysis and related lab services business qualifies as a separately reportable segment and all other ancillary services and strategic initiatives have been combined and disclosed in the other segments category.

Basis of presentation

These consolidated financial statements are prepared in accordance with United States generally accepted accounting principles. The financial statements include DaVita and its subsidiaries, partnerships and other entities in which it maintains a 100%, majority voting, or other controlling financial interest (collectively, the Company). All significant intercompany transactions and balances have been eliminated. Non-marketable equity investments are recorded under the equity or cost method of accounting based upon whether the Company has significant influence over the investee. The Company has evaluated subsequent events through February 25, 2010, which is the date these consolidated financial statements were issued.

Use of estimates

The preparation of financial statements in conformity with United States generally accepted accounting principles requires the use of estimates and assumptions that affect the reported amounts of revenues, expenses, assets, liabilities and contingencies. Although actual results in subsequent periods will differ from these estimates, such estimates are developed based on the best information available to management and management's best judgments at the time made. All significant assumptions and estimates underlying the amounts reported in the financial statements and accompanying notes are regularly reviewed and updated. Changes in estimates are reflected in the financial statements based upon on-going actual experience trends, or subsequent settlements and realizations depending on the nature and predictability of the estimates and contingencies. Interim changes in estimates related to annual operating costs are applied prospectively within annual periods.

The most significant assumptions and estimates underlying these financial statements and accompanying notes involve revenue recognition and provisions for uncollectible accounts, impairments and valuation adjustments, accounting for income taxes, quarterly variable compensation accruals, purchase accounting valuation estimates, fair value estimates and stock-based compensation. Specific estimating risks and contingencies are further addressed within these notes to the consolidated financial statements.

Net operating revenues and accounts receivable

Revenues associated with Medicare and Medicaid programs are recognized based on: (a) the payment rates that are established by statute or regulation for the portion of the payment rates paid by the government payor (e.g., 80% for Medicare patients) and (b) for the portion not paid by the primary government payor, estimates of the amounts ultimately collectible from other government programs

paying secondary coverage (e.g., Medicaid secondary coverage), the patient's commercial health plan secondary coverage, or the patient. Revenues associated with commercial health plans are estimated based on contractual terms for the patients under healthcare plans with which the Company has formal agreements, non-contracted health plan coverage terms if known, estimated secondary collections, historical collection experience, historical trends of refunds and payor payment adjustments (retractions), inefficiencies in the Company's billing and collection processes that can result in denied claims for payments, and regulatory compliance issues.

Operating revenues are recognized in the period services are provided. Revenues consist primarily of payments from Medicare, Medicaid and commercial health plans for dialysis and ancillary services provided to patients. A usual and customary fee schedule is maintained for the Company's dialysis treatments and other patient services; however, actual collectible revenue is normally recognized at a discount from the fee schedule.

Commercial revenue recognition involves significant estimating risks. With many larger, commercial insurers the Company has several different contracts and payment arrangements, and these contracts often include only a subset of the Company's centers. It is often not possible to determine which contract, if any, should be applied prior to billing. In addition, for services provided by non-contracted centers, final collection may require specific negotiation of a payment amount, typically at a significant discount from the Company's usual and customary rates.

Services covered by Medicare and Medicaid are less subject to estimating risk. Both Medicare and Medicaid rates use prospective payment methods established in advance with definitive terms. Medicare payments for bad debt claims are subject to individual center profitability, as established by cost reports, and require evidence of collection efforts. As a result, billing and collection of Medicare bad debt claims are often delayed significantly, and final payment is subject to audit.

Medicaid payments, when Medicaid coverage is secondary, can also be difficult to estimate. For many states, Medicaid payment terms and methods differ from Medicare, and may prevent accurate estimation of individual payment amounts prior to billing.

Net revenue recognition and allowances for uncollectible billings require the use of estimates of the amounts that will ultimately be realized considering, among other items, retroactive adjustments that may be associated with regulatory reviews, audits, billing reviews and other matters.

The Company's range of revenue estimating risk for the dialysis and related lab services segment is generally expected to be within 1% of its revenue. Changes in revenue estimates for prior periods are separately disclosed, if material.

Management and administrative support services are provided to dialysis centers and physician practices and clinics that the Company does not own or in which the Company does not maintain a controlling ownership interest. The management fees are principally determined as a percentage of the managed operations' revenues or cash collections and in some cases an additional component based upon a percentage of operating income. Management fees are included in net operating revenues as earned, and represent less than 1% of total consolidated operating revenues.

Other income, net

Other income includes interest income on cash investments and other non-operating gains and losses from investment transactions.

Notes to Consolidated Financial Statements (Continued)

(dollars in thousands, except per share data)

Cash and cash equivalents

Cash equivalents are highly liquid investments with maturities of three months or less at date of purchase.

Inventories

Inventories are stated at the lower of cost (first-in, first-out) or market and consist principally of pharmaceuticals and dialysis-related supplies. Rebates related to inventory purchases are recorded when earned and are based on certain achievement factors such as process improvements, data submission and some combination of these factors.

Property and equipment

Property and equipment is stated at cost less accumulated depreciation and amortization and is further reduced by any impairments. Maintenance and repairs are charged to expense as incurred. Depreciation and amortization expenses are computed using the straight-line method over the useful lives of the assets estimated as follows: buildings, 20 to 40 years; leasehold improvements, the shorter of their economic useful life or the expected lease term; and equipment and information systems, principally 3 to 8 years. Disposition gains and losses are included in current operating expenses.

Investments

Based upon the Company's intentions and ability to hold certain assets until maturity, the Company classifies certain debt securities as held-to-maturity and measures them at amortized cost. Based upon the Company's other strategies involving investments, the Company classifies equity securities that have readily determinable fair values and certain other debt securities as available for sale and measures them at fair value. Unrealized gains or losses from available for sale investments are recorded in other comprehensive income until realized.

Amortizable intangibles

Amortizable intangible assets and liabilities include non-competition and similar agreements, lease agreements, hospital acute services contracts, deferred debt issuance costs and the Alliance and Product Supply Agreement, each of which have finite useful lives. Non-competition and similar agreements are amortized over the terms of the agreements, typically ten years, using the straight-line method. Lease agreements and hospital acute service contracts are amortized straight-line over the term of the lease and the contract period, respectively. Deferred debt issuance costs are amortized to debt expense over the term of the related debt using the effective interest method. The Alliance and Product Supply Agreement intangible liability is being amortized using the straight-line method over the term of the agreement, which is ten years.

Goodwill

Goodwill represents the difference between the fair value of acquired businesses and the fair value of the identifiable tangible and intangible net assets acquired. Goodwill is not amortized, but is assessed for valuation impairment as circumstances warrant and at least annually. An impairment charge would be recorded to the extent the book value of goodwill exceeds its fair value. The Company operates several reporting units for goodwill impairment assessments.

Impairment of long-lived assets

Long-lived assets, including property and equipment, equity investments in non-consolidated businesses, and amortizable intangible assets with finite useful lives, are reviewed for possible impairment

at least annually and whenever significant events or changes in circumstances indicate that an impairment may have occurred, including changes in our business strategy and plans, changes in the quality or structure of our relationships with our partners and deteriorating operating performance of individual dialysis centers or other operations. An impairment is indicated when the sum of the expected future undiscounted net cash flows identifiable to an asset or asset group is less than its carrying value. Impairment losses are determined from actual or estimated fair values, which are based on market values, net realizable values or projections of discounted net cash flows, as appropriate. Impairment charges are included in operating expenses.

Income taxes

Federal and state income taxes are computed at current enacted tax rates, less tax credits using the asset and liability method. Deferred taxes are adjusted both for items that do not have tax consequences and for the cumulative effect of any changes in tax rates from those previously used to determine deferred tax assets or liabilities. Tax provisions include amounts that are currently payable, changes in deferred tax assets and liabilities that arise because of temporary differences between the timing of when items of income and expense are recognized for financial reporting and income tax purposes, changes in the recognition of tax positions and any changes in the valuation allowance caused by a change in judgment about the realizability of the related deferred tax assets. A valuation allowance is established when necessary to reduce deferred tax assets to amounts expected to be realized.

The Company uses a recognition threshold of more-likely-than not and a measurement attribute on all tax positions taken or expected to be taken in a tax return in order to be recognized in the financial statements. Once the recognition threshold is met, the tax position is then measured to determine the actual amount of benefit to recognize in the financial statements.

Self insurance

The Company maintains insurance reserves for professional and general liability and workers' compensation in excess of certain individual and or aggregate amounts not covered by third-party carriers. The Company estimates the self-insured retention portion of professional and general liability and workers' compensation risks using third-party actuarial calculations that are based upon historical claims experience and expectations for future claims.

Noncontrolling interests

Noncontrolling interests represent the equity interests of third-party owners in consolidated entities which are majority-owned. As of December 31, 2009, third parties held noncontrolling ownership interests in 137 consolidated entities. See discussion below on the retrospective application of adopting the presentation and disclosure requirements relating to noncontrolling interests.

Stock-based compensation

The Company's stock-based compensation awards are measured at their estimated fair value on the date of grant and recognized as compensation expense on the straight-line method over their individual requisite service periods. The Company implemented these requirements for all stock-based awards using the modified prospective transition method.

Interest rate swap agreements

The Company has entered into several interest rate swap agreements as a means of hedging its exposure to and volatility from variable-based interest rate changes. These agreements are designated as

Notes to Consolidated Financial Statements (Continued)

(dollars in thousands, except per share data)

cash flow hedges and are not held for trading or speculative purposes, and have the economic effect of converting portions of the Company's variable rate debt to a fixed rate. See Note 13 to the consolidated financial statements for further details.

Fair value estimates

The Company measures the fair value of certain assets, liabilities and noncontrolling interests subject to put provisions based upon certain valuation techniques that include observable or unobservable market inputs and assumptions that market participants would use in pricing these assets, liabilities and noncontrolling interests subject to put provisions. The Company also has classified its assets, liabilities and noncontrolling interests subject to put provisions into the appropriate fair value hierarchy levels as defined by the FASB. See Note 23 to the consolidated financial statements for further details.

New accounting standards

On June 29, 2009, the Financial Accounting Standards Board (FASB) established the FASB Accounting Standards Codification (Codification) as the single source of authoritative U.S. generally accepted accounting principles (GAAP) for all nongovernmental entities. Rules and interpretive releases of the Securities and Exchange Commission (SEC) are also sources of authoritative U.S. GAAP for SEC registrants. The Codification does not change U.S. GAAP but takes previously issued FASB standards and other U.S. GAAP authoritative pronouncements, changes the way the standards are referred to, and includes them in specific topic areas. The Codification is effective for financial statements issued for interim and annual periods ending after September 15, 2009. The adoption of the Codification did not have any impact on the Company's consolidated financial statements.

Effective January 1, 2009, the Company is required to treat noncontrolling interests as a separate component of equity, but apart from the Company's equity, and not as a liability or other item outside of equity. The Company is also required to identify and present consolidated net income attributable to the Company and to noncontrolling interests on the face of the consolidated statement of income. Previously, the Company had reported minority interests (noncontrolling interests) as a reduction to operating income. In addition, changes in the Company's ownership interest while the Company retains a controlling financial interest should be accounted for as equity transactions. The Company was also required to expand disclosures in the financial statements to include a reconciliation of the beginning and ending balances of the equity attributable to the Company and the noncontrolling owners and a schedule showing the effects of changes in the Company's ownership interest in a subsidiary on the equity attributable to the Company. This change did not have a material impact on the Company's consolidated financial statements; however, it did change the presentation of minority interests (noncontrolling interests) in the Company's consolidated financial statements. In conjunction with adopting these requirements, the Company was required to classify securities with redemption features that are not solely within the Company's control such as the Company's noncontrolling interests that are subject to put provisions outside of permanent equity and to measure these noncontrolling interests at fair value. See Note 22 to the Company's consolidated financial statements for further details. These consolidated financial statements have been recast for all prior periods presented for the retrospective application of these presentation and disclosure requirements.

The effects of the change upon the retrospective application of these presentation and disclosure requirements were as follows:

Consolidated income statements:

	2008	2007
Operating income:		
Operating income as previously reported	\$821,765	\$862,209
Reclassification of noncontrolling interests	47,331	46,702
Operating income as adjusted	<u>\$869,096</u>	<u>\$908,911</u>
Income taxes:		
Income taxes as previously reported	\$235,300	\$245,744
Income taxes associated with noncontrolling interests	171	(163)
Income taxes as adjusted	<u>\$235,471</u>	<u>\$245,581</u>

Consolidated balance sheet:

	2008				
	Income tax receivable	Minority interest	Noncontrolling interests not subject to put provisions	Noncontrolling interests subject to put provisions	Additional paid in capital
Balances as previously reported	\$32,138	\$ 165,846	\$ —	\$ —	\$ 769,069
Net change	(8)	(165,846)	59,152	291,397	(184,711)
Balances as adjusted	<u>\$32,130</u>	<u>\$ —</u>	<u>\$59,152</u>	<u>\$291,397</u>	<u>\$ 584,358</u>

Consolidated statements of cash flow:

	2008	2007
Cash flows from operating activities:		
Net cash provided by operating activities as previously reported	\$555,931	\$533,036
Reclassification of distributions to noncontrolling interests to cash flows from financing activities	57,770	48,029
Net cash provided by operating activities as adjusted	<u>\$613,701</u>	<u>\$581,065</u>

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 stock options, stock-settled stock appreciation rights and unvested stock units under the treasury stock method.

Notes to Consolidated Financial Statements (Continued)

(dollars in thousands, except per share data)

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

	Year ended December 31,		
	2009	2008	2007
	(shares in thousands)		
Basic:			
Net income attributable to DaVita Inc.	\$422,684	\$374,160	\$381,778
Weighted average shares outstanding during the year	103,595	105,140	105,848
Vested stock units	9	9	45
Weighted average shares for basic earnings per share calculation	103,604	105,149	105,893
Basic net income per share attributable to DaVita Inc	<u>\$ 4.08</u>	<u>\$ 3.56</u>	<u>\$ 3.61</u>
Diluted:			
Net income attributable to DaVita Inc.	\$422,684	\$374,160	\$381,778
Weighted average shares outstanding during the year	103,595	105,140	105,848
Vested stock units	9	9	45
Assumed incremental shares from stock plans	564	791	1,525
Weighted average shares for diluted earnings per share calculation	104,168	105,940	107,418
Diluted net income per share attributable to DaVita Inc	<u>\$ 4.06</u>	<u>\$ 3.53</u>	<u>\$ 3.55</u>
Shares subject to anti-dilutive awards excluded from calculation(1)	<u>9,912</u>	<u>10,053</u>	<u>260</u>

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

3. Accounts receivable

Approximately 18% and 9% of the accounts receivable balances as of December 31, 2009 and 2008, respectively, were more than six months old, and there were no significant balances over one year old. Approximately 2% and 1% of our accounts receivable as of December 31, 2009 and 2008, respectively, relate to amounts due from patients. Accounts receivable are principally from Medicare and Medicaid programs and commercial insurance plans.

4. Other receivables

Other receivables were comprised of the following:

	December 31,	
	2009	2008
Supplier rebates and other non-trade receivables	\$195,753	\$172,604
Medicare bad debt claims	45,600	38,700
Operating advances under management and administrative services agreements ...	22,103	27,861
	<u>\$263,456</u>	<u>\$239,165</u>

Operating advances under management and administrative services agreements are generally unsecured.

5. Other current assets

Other current assets consist principally of prepaid expenses and operating deposits.

6. Property and equipment

Property and equipment were comprised of the following:

	December 31,	
	2009	2008
Land	\$ 11,771	\$ 11,771
Buildings	34,294	33,833
Leasehold improvements	997,668	873,306
Equipment and information systems	999,305	928,795
New center and capital asset projects in progress	32,280	36,875
	2,075,318	1,884,580
Less accumulated depreciation and amortization	(970,393)	(836,505)
	<u>\$1,104,925</u>	<u>\$1,048,075</u>

Depreciation and amortization expense on property and equipment was \$214,515, \$201,006 and \$178,990 for 2009, 2008 and 2007, respectively.

Interest on debt incurred during the development of new centers and other capital asset projects is capitalized as a component of the asset cost based on the respective in-process capital asset balances. Interest capitalized was \$3,627, \$4,189 and \$3,878 for 2009, 2008 and 2007, respectively.

7. Amortizable intangibles

Amortizable intangible assets were comprised of the following:

	December 31,	
	2009	2008
Noncompetition and other agreements	\$ 291,022	\$ 285,270
Lease agreements	8,156	8,637
Deferred debt issuance costs	72,656	72,748
	371,834	366,655
Less accumulated amortization	(235,102)	(206,134)
Total amortizable intangible assets	<u>\$ 136,732</u>	<u>\$ 160,521</u>

Amortizable intangible liabilities were comprised of the following:

	December 31,	
	2009	2008
Alliance and product supply agreement commitment (See Note 22)	\$ 68,200	\$ 68,200
Less accumulated amortization	(37,553)	(32,223)
	<u>\$ 30,647</u>	<u>\$ 35,977</u>

Net amortization expense from noncompetition and other agreements and the amortizable intangible liabilities was \$14,471, \$15,911 and \$14,480 for 2009, 2008 and 2007, respectively. Lease agreements which are amortized to rent expense were \$565 in 2009, \$1,420 in 2008 and \$2,240 in 2007, respectively.

Notes to Consolidated Financial Statements (Continued)

(dollars in thousands, except per share data)

Deferred debt issuance costs are amortized to debt expense as described in Note 13 to the consolidated financial statements.

Scheduled amortization charges from intangible assets and liabilities as of December 31, 2009 were as follows:

	Noncompetition and other agreements	Deferred debt issuance costs	Alliance and Product Supply Agreement liability
2010	\$20,100	\$9,390	\$(5,330)
2011	19,660	8,922	(5,330)
2012	18,935	6,423	(5,330)
2013	16,817	2,741	(5,330)
2014	15,133	2,290	(5,330)
Thereafter	15,844	477	(3,997)

8. Equity investments

Equity investments in non-consolidated businesses were \$22,631 and \$19,274 at December 31, 2009 and 2008, respectively. During 2009, 2008 and 2007, the Company recognized income of \$2,442, \$796 and \$1,217, respectively, relating to equity investments in non-consolidated businesses under the equity method of accounting. See Note 17, section *Changes in DaVita Inc.'s ownership interest in consolidated subsidiaries* to the consolidated financial statements for additional information regarding equity investment transactions.

In 2009, the Company also contributed \$1,100 to an existing joint venture in which the Company owns a 50% equity investment. On December 31, 2007, the Company acquired a 50% equity investment in a joint venture that operated six dialysis centers for \$17,550.

9. Investments in debt and equity securities

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 other debt securities classified as available for sale are recorded at fair value.

The Company's investments consist of the following:

	December 31, 2009			December 31, 2008		
	Held to maturity	Available for sale	Total	Held to maturity	Available for sale	Total
Certificates of deposit, money market funds and U.S. treasury notes due within one year	\$25,275	\$ —	\$25,275	\$19,355	\$ —	\$19,355
Investments in mutual funds	—	8,816	8,816	—	21,833	21,833
	<u>\$25,275</u>	<u>\$8,816</u>	<u>\$34,091</u>	<u>\$19,355</u>	<u>\$21,833</u>	<u>\$41,188</u>
Short-term investments	\$25,275	\$1,200	\$26,475	\$19,355	\$16,177	\$35,532
Long-term investments	—	7,616	7,616	—	5,656	5,656
	<u>\$25,275</u>	<u>\$8,816</u>	<u>\$34,091</u>	<u>\$19,355</u>	<u>\$21,833</u>	<u>\$41,188</u>

The cost of the certificates of deposit, money market funds and U.S. treasury notes at December 31, 2009 and 2008 approximates fair value. As of December 31, 2009 and 2008, the available for sale investments included \$205 and \$1,558, respectively, of gross pre-tax unrealized losses. During 2009 and 2008 the Company recorded gross pre-tax unrealized gains (losses) of \$1,614 and \$(1,922), respectively, in other comprehensive income associated with changes in the fair value of these investments. During 2009, the Company sold investments in mutual funds for net proceeds of \$16,693, and recognized a pre-tax gain of \$261, or \$159 after tax, that was previously recorded in other comprehensive income. In 2009, the Company also purchased approximately \$6,300 of investments that are classified as held to maturity, net of investments routinely reinvested as required for VillageHealth, see discussion below. During 2008, the Company sold investments in mutual funds for net proceeds of \$21,291 and recognized a pre-tax gain of \$486, or \$297 after-tax, that was also previously recorded in other comprehensive income. These pre-tax gains are included in other income. See Note 18 to the consolidated financial statements for further details.

As of December 31, 2009, investments totaling \$22,275 classified as held to maturity are used to maintain certain capital requirements of the special needs plans of VillageHealth, which is a wholly-owned subsidiary of the Company. As of December 31, 2009, the Company discontinued the VillageHealth special needs plans and is in process of paying out all incurred claims. The Company also expects to liquidate its investments that are currently held to maintain certain capital requirements as soon as all of the claims are paid and the various state regulatory agencies approve the release of these investments. The investments in mutual funds classified as available for sale are held within a trust to fund existing obligations associated with several of the Company's non-qualified deferred compensation plans.

During 2007, the Company sold its investment of \$20,000, or two million shares in NxStage Medical, Inc., for net proceeds of \$25,868 and recognized a pre-tax gain of \$5,868, or \$3,628 after tax, that was previously recorded in other comprehensive income. The pre-tax gain is included in other income.

10. Goodwill

Changes in the book value of goodwill were as follows:

	Year ended December 31,	
	2009	2008
Balance at January 1	\$3,876,931	\$3,767,933
Acquisitions	78,199	89,234
Sales of and purchases from noncontrolling interests	(3,293)	20,141
Divestitures	(641)	—
DVA Renal Healthcare income tax adjustments	—	(642)
Other adjustments	—	265
Balance at December 31	<u>\$3,951,196</u>	<u>\$3,876,931</u>

As of December 31, 2009, there was \$3,882,254 and \$68,942 of goodwill associated with the dialysis and related lab services business and the ancillary services and strategic initiatives, respectively.

As of December 31, 2008, there was \$3,808,942 and \$67,989 of goodwill associated with the dialysis and related lab services business and the ancillary services and strategic initiatives, respectively.

Notes to Consolidated Financial Statements (Continued)

(dollars in thousands, except per share data)

11. Other liabilities

Other accrued liabilities were comprised of the following:

	December 31,	
	2009	2008
Payor refunds and retractions	\$320,187	\$361,205
Insurance and self-insurance accruals	59,734	55,844
Accrued interest	36,881	44,308
Accrued non-income tax liabilities	11,581	8,920
Interest rate swaps	10,792	18
Other	21,917	24,944
	<u>\$461,092</u>	<u>\$495,239</u>

12. Income taxes

A reconciliation of the beginning and ending liability for unrecognized tax benefits that do not meet the more-likely-than-not threshold were as follows:

	Year ended December 31,	
	2009	2008
Balance beginning	\$10,887	\$ 25,744
Additions for tax positions related to current year	6,939	1,934
Additions for tax positions related to prior years	14,941	463
Reductions for tax positions related to prior years	(1,738)	(17,254)
Settlements	(336)	—
Balance ending	<u>\$30,693</u>	<u>\$ 10,887</u>

As of December 31, 2009, it is reasonably possible that \$18,342 of unrecognized tax benefits may be recognized within the next 12 months, primarily related to the filing of tax accounting method changes. These changes will have no impact on the Company's effective tax rate. As of December 31, 2009, unrecognized tax benefits totaling \$12,351 would affect the Company's effective tax rate, if recognized.

The Company recognizes accrued interest and penalties related to unrecognized tax benefits in its income tax expense. At December 31, 2009 and 2008, the Company had approximately \$3,226 and \$1,402, respectively, accrued for interest and penalties related to unrecognized tax benefits, net of federal tax benefits.

The Company and its subsidiaries file U.S. federal income tax returns and various state returns. The Company is no longer subject to U.S. federal, state and local examinations by tax authorities for years before 2004.

Income tax expense consisted of the following:

	Year ended December 31,		
	2009	2008	2007
Current:			
Federal	\$193,181	\$118,764	\$196,556
State	34,415	20,595	30,424
Deferred:			
Federal	44,376	81,306	14,945
State	6,493	14,806	3,656
	<u>\$278,465</u>	<u>\$235,471</u>	<u>\$245,581</u>

Deferred tax assets and liabilities arising from temporary differences were as follows:

	December 31,	
	2009	2008
Receivables	\$ 142,315	\$ 108,275
Alliance and product supply agreement	11,922	13,995
Accrued liabilities	125,992	117,474
Other	62,208	65,635
Deferred tax assets	342,437	305,379
Valuation allowance	(14,191)	(12,588)
Net deferred tax assets	328,246	292,791
Intangible assets	(317,306)	(262,029)
Property and equipment	(84,041)	(55,747)
Other	(4,801)	(2,703)
Deferred tax liabilities	(406,148)	(320,479)
Net deferred tax liabilities	<u>\$ (77,902)</u>	<u>\$ (27,688)</u>

At December 31, 2009, the Company had state net operating loss carryforwards of approximately \$169,497 that expire through 2029, and federal net operating loss carryforwards of \$10,657 that expire through 2029. The utilization of these losses may be limited in future years based on the profitability of certain separate-return entities. The valuation allowance increase of \$1,603 relates to changes in the estimated tax benefit of federal and state operating losses of separate-return entities.

The reconciliation between our effective tax rate from continuing operations and the U.S. federal income tax rate is as follows:

	Year ended December 31,		
	2009	2008	2007
Federal income tax rate	35.0%	35.0%	35.0%
State taxes, net of federal benefit	3.7	3.7	3.5
Changes in deferred tax valuation allowances	0.2	0.3	0.2
Other	0.8	(0.3)	0.4
Impact of noncontrolling interests primarily attributable to non-tax paying entities	(3.0)	(2.8)	(2.7)
Effective tax rate	<u>36.7%</u>	<u>35.9%</u>	<u>36.4%</u>

Notes to Consolidated Financial Statements (Continued)

(dollars in thousands, except per share data)

13. Long-term debt

Long-term debt was comprised of the following:

	December 31,	
	2009	2008
Senior Secured Credit Facilities:		
Term loan A	\$ 153,125	\$ 214,375
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	15,891	15,266
Capital lease obligations	4,635	5,873
Total principal debt outstanding	3,629,526	3,691,389
Premium on the 6 ⁵ / ₈ % senior notes	2,698	3,757
	3,632,224	3,695,146
Less current portion	(100,007)	(72,725)
	<u>\$3,532,217</u>	<u>\$3,622,421</u>

Scheduled maturities of long-term debt at December 31, 2009 were as follows:

2010	100,007
2011	67,589
2012	1,707,625
2013	901,374
2014	495
Thereafter	852,436

Senior Secured Credit Facility

The Senior Secured Credit Facilities are guaranteed by substantially all of the Company's direct and indirect wholly-owned subsidiaries and are secured by substantially all of the Company's and its subsidiary guarantors' assets. The Senior Secured Credit Facilities also contain customary affirmative and negative covenants and require compliance with financial covenants, including an interest rate coverage ratio, and a leverage ratio that determines the interest rate margins on term loan A and the revolving line of credit. The Senior Secured Credit Facilities in general also contain limits on the general amount of capital expenditures for internal growth, acquisitions and capital improvements, redemptions or acquisitions of capital stock, the payment of dividends and distributions in cash as well as limits on the amount of tangible net assets in non-guarantor subsidiaries. However, the limitations on capital expenditures for internal growth will not apply during the periods in which the Company's leverage ratio is less than 3.5:1. The Company's leverage ratio at December 31, 2009 was less than 3.5:1.

Term Loans

Term loan A and term loan B total outstanding borrowings each consist of various individual tranche amounts that can range in maturity from one month to twelve months. Each specific tranche bears interest at a LIBOR rate determined by the maturity of that specific tranche and the interest rates are reset as each specific tranche matures. The overall weighted average interest rate for each term loan is determined based upon the LIBOR interest rates in effect for all of the individual tranches plus the interest rate margin.

Term Loan A

Term loan A currently bears interest at LIBOR plus a margin of 1.50%, for an overall weighted average effective rate of 1.74% at December 31, 2009. The interest rate margin is subject to adjustment depending upon certain financial conditions and could range from 1.50% to 2.25%. Term loan A matures in October 2011 and requires annual principal payments of \$87,500 in 2010 and \$65,625 in 2011, respectively.

During 2009 and 2008, the Company made principal payments totaling \$61,250 and \$14,875, respectively, on term loan A.

Term Loan B

Term loan B bears interest at LIBOR plus a margin of 1.50% for an overall weighted average effective rate of 2.66%, including the impact of the Company's swap agreements at December 31, 2009. Term loan B matures in October 2012 and requires principal payments of \$1,705,875 in year 2012. During 2009 and 2008, the Company did not make, nor was the Company required to make, any principal payments on Term loan B.

Revolving Lines of Credit

The Company has an undrawn revolving line under the Senior Secured Credit Facilities totaling \$250,000, of which approximately \$51,889 was committed for outstanding letters of credit. The Company also has other undrawn revolving lines of credit totaling \$3,300 associated with several of its joint ventures.

Senior and Senior Subordinated Notes

The Company's senior and senior subordinated notes, as of December 31, 2009 and 2008, consisted of \$900,000 of 6⁵/₈% senior notes due 2013 and \$850,000 of 7¹/₄% senior subordinated notes due 2015. The effective interest rate for \$400,000 of the 6⁵/₈% senior notes is 6.45%. The notes are guaranteed by substantially all of the Company's direct and indirect wholly-owned subsidiaries and require semi-annual interest payments in March and September. The Company may redeem some or all of the senior notes at any time on or after March 15, 2009 and some or all of the senior subordinated notes at any time on or after March 15, 2010.

Interest rate swaps

Effective January 1, 2009, the Company was required to provide enhanced disclosures about the Company's derivative and hedging activities. The Company is required to provide additional disclosures about (a) how and why the Company uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for, and (c) how derivative instruments and related hedged items affect the Company's financial position, financial performance, and cash flows. These requirements did not have a material impact on the Company's consolidated financial statements. The Company has elected to provide comparative disclosures for the prior period presented.

The Company has entered into several interest rate swap agreements as a means of hedging its exposure to and volatility from variable-based interest rate changes as part of its overall risk management strategy. These agreements are not held for trading or speculative purposes, and have the economic effect of converting portions of our variable rate debt to a fixed rate. These agreements are designated as cash flow hedges, and as a result, hedge-effective gains or losses resulting from changes in the fair values of these swaps are reported in other comprehensive income until such time as each specific swap tranche is realized, at which time the amounts are reclassified into net income. Net amounts paid or received for each specific swap tranche that have settled have been reflected as adjustments to debt expense. These agreements do not contain credit-risk contingent features.

Notes to Consolidated Financial Statements (Continued)

(dollars in thousands, except per share data)

As of December 31, 2009, the Company maintained a total of eight interest rate swap agreements with amortizing notional amounts totaling \$388,900. 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 3.88% to 4.70%, resulting in an overall weighted average effective interest rate of 5.78% 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 2010 and require quarterly interest payments. The Company estimates that approximately \$8,900 of existing unrealized pre-tax losses in other comprehensive income at December 31, 2009 will be reclassified into income over the next twelve months.

The following table summarizes our derivative instruments as of December 31, 2009 and 2008:

	Interest rate swap liabilities			
	December 31, 2009		December 31, 2008	
	Balance sheet location	Fair value	Balance sheet location	Fair value
Derivatives designated as hedging instruments				
Current settlement of interest rate swap agreements	Other current liabilities	\$10,792	Other current liabilities	\$ 18
Interest rate swap agreements	Other long-term liabilities	—	Other long-term liabilities	21,886
Total		<u>\$10,792</u>		<u>\$21,904</u>

The following table summarizes the effects of our interest rate swap agreements for the years ended December 31, 2009, 2008 and 2007:

	Amount of gains (losses) recognized in OCI on interest rate swap agreements			Location of (losses) gains reclassified from accumulated OCI into income	Amount of gains (losses) reclassified from accumulated OCI into income		
	Years ended December 31,				Years ended December 31,		
	2009	2008	2007		2009	2008	2007
Derivatives designated as cash flow hedges							
Interest rate swap agreements	\$(4,220)	\$(21,190)	\$(11,733)	Debt expense	\$(17,253)	\$(4,239)	\$14,498
Tax expense benefit (expense)	1,642	8,243	4,564		6,711	1,649	(5,640)
Total	\$(2,578)	\$(12,947)	\$ (7,169)		\$(10,542)	\$(2,590)	\$ 8,858

As of December 31, 2009, the Company's interest rates were economically fixed on approximately 21% of its variable rate debt and approximately 59% of its total debt.

As a result of the swap agreements, the Company's overall weighted average effective interest rate on the Senior Secured Credit Facilities was 2.63%, based upon the current margins in effect of 1.50%, as of December 31, 2009.

The Company's overall weighted average effective interest rate in 2009 was 4.86% and as of December 31, 2009 was 4.68%.

Debt expense

Debt expense consisted of interest expense of \$176,100, \$214,944 and \$242,720, amortization of deferred financing costs of \$9,655, \$9,772 and \$9,808 for 2009, 2008 and 2007, respectively, and in 2007 included the write-off of \$4,371 of deferred financing costs. Debt expense in 2007 also included \$248 of other costs associated with the amendment and reinstatement of the Senior Secured Credit Facilities. The interest expense amounts are net of capitalized interest.

14. Leases

The majority of the Company's facilities are leased under non-cancelable operating leases, ranging in terms from five to 15 years, which contain renewal options of five to ten years at the fair rental value at the time of renewal. The Company leases are generally subject to periodic consumer price index increases or contain fixed escalation clauses. The Company also leases certain equipment under capital leases.

Future minimum lease payments under non-cancelable operating leases and capital leases are as follows:

	Operating leases	Capital leases
2010	\$ 215,993	\$ 851
2011	197,042	852
2012	176,378	870
2013	152,512	835
2014	130,718	579
Thereafter	439,217	2,801
	<u>\$1,311,860</u>	<u>6,788</u>
Less portion representing interest		(2,153)
Total capital lease obligations, including current portion		<u>\$ 4,635</u>

Rent expense under all operating leases for 2009, 2008, and 2007 was \$248,792, \$225,531 and \$200,626, respectively. Rent expense is recorded on a straight-line basis, over the term of the lease, for leases that contain fixed escalation clauses or include abatement provisions. Leasehold improvement incentives are deferred and amortized to rent expense over the term of the lease. The net book value of property and equipment under capital leases was \$5,432, \$6,612 and \$7,191 at December 31, 2009, 2008 and 2007, respectively. Capital lease obligations are included in long-term debt. See Note 13 to the consolidated financial statements.

15. Employee benefit plans

The Company has a savings plan for substantially all employees which has been established pursuant to the provisions of Section 401(k) of the Internal Revenue Code, or IRC. The plan allows for employees to contribute a percentage of their base annual salaries on a tax-deferred basis not to exceed IRC limitations. The Company does not provide any matching contributions.

The Company also maintains a voluntary compensation deferral plan, the DaVita Voluntary Deferral Plan. This plan is non-qualified and permits certain employees whose annualized base salary equals or exceeds a minimum annual threshold amount as set by the Company to elect to defer all or a portion of their annual bonus payment and up to 50% of their base salary into a deferral account maintained by the Company. Total contributions to this plan in 2009 and 2008 were \$2,062, and \$1,993, respectively. Deferred amounts are generally paid out in cash at the participant's election either in the first or second year following retirement or in a specified future period at least three to four years after the deferral election was effective. During 2009 and 2008, the Company distributed \$601 and \$764, respectively, to participants. Participants are credited with their proportional amount of annual earnings from the plan. The assets of this plan are held in a "rabbi trust" and as such are subject to the claims of the Company's general creditors in the event of its bankruptcy. As of December 31, 2009 and 2008, the total fair value of assets held in trust were \$7,246 and \$4,556, respectively.

Notes to Consolidated Financial Statements (Continued)

(dollars in thousands, except per share data)

As part of the acquisition of DVA Renal Healthcare on October 5, 2005, the Company acquired an Executive Retirement Plan for certain members of management. This plan is non-qualified and contributions to the plan were made at the discretion of DVA Renal Healthcare based upon a pre-determined percentage of a participant's base salary. Effective November 2005, all contributions to this plan were discontinued and the balance of the plan assets will be paid out upon termination of each individual participant. During 2009 and 2008, the Company distributed \$241 and \$142, respectively, to participants. As of December 31, 2009 and 2008, the total fair value of assets held in trust was \$1,570 and \$1,490, respectively.

The Company maintained a non-qualified deferred compensation plan for key employees. Company contributions were discretionary and were deposited into a rabbi trust. Participants in the plan were subject to a vesting period and typically receive annual distributions from the plan commencing one year after grant date, although in certain situations distributions are paid upon termination or retirement. Participants also had the option to direct their balances into certain investment funds and were credited with their proportional amount of earnings from the investments. The assets of this plan were held in the rabbi trust and were subject to the claims of the Company's general creditors in the event of its bankruptcy. There were no contributions to this plan in 2009. In 2008, the Company contributed \$16 to this plan. During 2009, the Company distributed \$15,851, including earnings, to eligible participants, which were the total assets held in trust. In 2008, the Company distributed \$5,263 to eligible participants.

The Company also maintained another non-qualified deferred compensation plan for certain employees. Company contributions to the plan were discretionary and were deposited into a rabbi trust that was not subject to general creditors claims in the event of bankruptcy by the Company. Participants in the plan were subject to a vesting period and were credited with their proportional amount of earnings from the investments within the plan. In 2008, the Company distributed \$15,122, including earnings to all eligible participants. The distribution was the total assets held by trust.

The fair value of all of the assets held in plan trusts as of December 31, 2009, and 2008 totaled \$8,816 and \$21,833, respectively. These assets are available for sale and as such are recorded at fair market value with changes in the fair market values being recorded in other comprehensive income. Any fair market value changes to the corresponding liability balance will be recorded as compensation expense. See Note 9 to the consolidated financial statements.

Most of the Company's outstanding employee stock plan awards include a provision accelerating the vesting of the award in the event of a change of control. The Company also maintains a change of control protection program for its employees who do not have a significant number of stock awards, which has been in place since 2001, and which provides for cash bonuses to employees in the event of a change of control. Based on the market price of the Company's common stock and shares outstanding on December 31, 2009, these cash bonuses would total approximately \$235,000 if a control transaction occurred at that price and the Company's Board of Directors did not modify the program. This amount has not been accrued at December 31, 2009, and would only be accrued upon a change of control. These change of control provisions may affect the price an acquirer would be willing to pay for the Company.

16. Contingencies

The majority of the Company's revenues are from government programs and may be subject to adjustment as a result of: (1) examination by government agencies or contractors, for which the resolution of any matters raised may take extended periods of time to finalize; (2) differing interpretations of government regulations by different fiscal intermediaries or regulatory authorities; (3) differing opinions

regarding a patient's medical diagnosis or the medical necessity of services provided; and (4) retroactive applications or interpretations of governmental requirements. In addition, the Company's revenues from commercial payors may be subject to adjustment as a result of potential claims for refunds, as a result of government actions or as a result of other claims by commercial payors.

Inquiries by the Federal Government

In December 2008, the Company received a subpoena for documents from the Office of Inspector General, U.S. Department of Health and Human Services, or OIG, relating to the pharmaceutical products Zemplar, Hectorol, Venofer, Ferrlecit and Epogen®, or EPO, as well as other related matters. The subpoena covers the period from January 2003 to the present. The Company has been in contact with the United States Attorney's Office, or U.S. Attorney's Office, for the Northern District of Georgia and the U.S. Department of Justice in Washington, DC, since November 2008 relating to this matter, and has been advised that this is a civil inquiry. On June 17, 2009, the Company learned that the allegations were made as part of a civil qui tam complaint filed by individuals and brought pursuant to the federal False Claims Act. The case remains under seal in the United States District Court for the Northern District of Georgia. The Company is cooperating with the inquiry and is producing the requested records. To the Company's knowledge, no proceedings have been initiated by the federal government 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.

In February 2007, the Company received a request for information from the OIG for records relating to EPO claims submitted to Medicare. In August 2007, the Company received a subpoena from the OIG seeking similar documents. The requested documents relate to services provided from 2001 to 2004 by a number of the Company's centers. The request and subpoena were sent from the OIG's offices in Houston and Dallas, Texas. The Company is cooperating with the inquiry and is producing the requested records. The Company has been in contact with the U.S. Attorney's Office for the Eastern District of Texas, which has stated that this is a civil inquiry related to EPO claims. On July 6, 2009, the United States District Court for the Eastern District of Texas lifted the seal on the civil qui tam complaint related to these allegations and the Company was subsequently served with a complaint by the relator. We believe that there is some overlap between this issue and the ongoing review of EPO utilization and claims by the U.S. Attorney's Office, for the Eastern District of Missouri in St. Louis described below. To the Company's knowledge, no proceedings have been initiated by the federal government 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 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 request for documents related to durable medical equipment and supply companies owned and operated by the Company. The Company is cooperating

Notes to Consolidated Financial Statements (Continued)

(dollars in thousands, except per share data)

with the inquiry and is producing the requested records. The subpoenas have been issued in connection with a joint civil and criminal investigation. It is possible that criminal proceedings may be initiated against the Company in connection with this inquiry. 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 subpoenas will continue to require management's attention and significant legal expense. Any negative findings could result in substantial financial penalties against the Company, exclusion from future participation in the Medicare and Medicaid programs and criminal penalties.

Other

The Company has received several notices of claims from commercial payors and other third parties related to historical billing practices and claims against DVA Renal Healthcare (formerly known as Gambro Healthcare) 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.

Several wage and hour claims have been filed against the Company in the Superior Court of California, each of which has been styled as a class action. In February 2007, June 2008, October 2008 and December 2008, the Company was served with five separate complaints, including two in October 2008, by various former employees, each of which alleges, among other things, that the Company failed to provide rest and meal periods, failed to pay compensation in lieu of providing such rest or meal periods, failed to pay the correct amount of overtime, failed to pay the rate on the "wage statement," and failed to comply with certain other California labor code requirements. The Company has reached a tentative settlement in the complaints served in February 2007 and December 2008 and one of the complaints served in October 2008. That settlement has been partially approved by the court and the Company is waiting for final court approval of the last part of the settlement. The Company intends to vigorously defend against the remaining claims and to vigorously oppose the certification of the remaining matters as class actions.

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. On December 17, 2008, the Court dismissed the complaint and allegations in their entirety with permission of plaintiffs to amend the complaint. The Company was not named as a defendant in plaintiffs' amended complaint. In June 2009, the Court dismissed the remainder of the case. Following the dismissal, plaintiffs filed a notice of appeal. The notice of appeal seeks review by the U. S. Court of Appeals for the Ninth Circuit of all of the district court's dismissal rulings, including the ruling dismissing the Company as a defendant. The Company intends to continue to vigorously defend this claim.

In October 2007, the Company was contacted by the Attorney General's Office for the State of Nevada. The Attorney General's Office informed the Company that it was conducting a civil and criminal

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

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

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

17. DaVita Inc. stock-based compensation and shareholders' equity

Stock-based compensation

Stock-based compensation recognized in a period represents the amortization during that period of the estimated grant-date fair value of stock-based awards over their vesting terms, adjusted for expected forfeitures. Shares issued upon exercise of stock awards are generally issued from shares held in treasury.

Stock-based compensation plans and agreements

On May 29, 2007, the Company's stockholders approved an amendment and restatement of the Company's Employee Stock Purchase Plan to increase the number of shares of common stock available for issuance under that plan by 800,001 shares, and approved an amendment and restatement of the Company's 2002 Equity Compensation Plan to increase the number of shares of common stock available for issuance under that plan by 6,000,000 shares and, among other things, to remove certain available share recycling features, to change the limit on the maximum number of shares of common stock that may

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(dollars in thousands, except per share data)

be subject to awards granted to any single recipient in any consecutive twenty-four month period so that such limit applies only to awards of stock options and stock appreciation rights, and to provide additional exceptions from the three year minimum vesting period generally applicable to grants of restricted stock units and other full share awards.

The Company's stock-based compensation plans and agreements are described below.

2002 Plan. The DaVita Inc. 2002 Equity Compensation Plan (the 2002 Plan) is the Company's omnibus equity compensation plan and provides for grants of stock-based awards to employees, directors and other individuals providing services to the Company, except that incentive stock options may only be awarded to employees. The 2002 Plan mandates a maximum award term of five years, and stipulates that stock options and stock appreciation rights be granted with prices not less than the fair market value on the date of grant. The 2002 Plan further requires that full share awards such as restricted stock units reduce shares available under the 2002 Plan at a rate of 3.0:1. The Company's nonqualified stock options, stock appreciation rights and stock units awarded under the 2002 Plan generally vest over 48 to 60 months from the date of grant. At December 31, 2009, there were 13,316,104 stock options and stock-settled stock appreciation rights and 69,696 stock units outstanding and 4,041,592 shares available for future grants under the 2002 Plan.

Predecessor plans. Various prior stock-based compensation plans were terminated upon shareholder approval of the 2002 Plan in 2002, and the 1999 Non-Executive Officer and Non-Director Equity Compensation Plan (the 1999 Plan) expired in 2009, both except with respect to option awards then outstanding. Stock options granted under these terminated plans were generally issued with exercise prices equal to the market price of the stock on the date of grant, vested over four years from the date of grant, and bore maximum award terms of five to 10 years. For these terminated plans, there were only 20,084 stock options remaining outstanding under the 1999 Plan as of December 31, 2009.

Deferred stock unit agreements. During 2001 through 2003, the Company made nonqualified stock unit awards to members of the Board of Directors and certain key executive officers under stand-alone contractual deferred stock unit agreements. These awards vested over one to four years and were settled in stock when they vested or at a later date at the election of the recipient. The last 63,636 shares subject to these agreements were issued to their recipients in 2008.

A combined summary of the status of awards under these stock-based compensation plans and agreements, including base shares for stock appreciation rights and shares subject to stock option and stock unit awards, is as follows:

Year ended December 31, 2009					
	Stock options and stock appreciation rights			Stock units	
	Awards	Weighted average exercise price	Weighted average remaining contractual life	Awards	Weighted average remaining contractual life
Outstanding at beginning of year	12,739,134	\$47.75		104,085	
Granted	4,211,840	46.97		48,135	
Exercised	(2,621,042)	37.31		(73,801)	
Forfeited	(993,744)	49.74		(8,723)	
Outstanding at end of period	13,336,188	\$49.41	3.0	69,696	4.1
Awards exercisable at end of period	4,473,520	\$50.93	2.0	8,810	4.8
Weighted-average fair value of awards granted during 2009	\$ 12.08			\$ 54.31	
Weighted-average fair value of awards granted during 2008	\$ 11.01			\$ 51.13	
Weighted-average fair value of awards granted during 2007	\$ 13.89			\$ 54.69	

Range of exercise prices	Awards outstanding	Weighted average exercise price	Awards exercisable	Weighted average exercise price
\$ 0.00–\$ 0.00	69,696	\$ —	8,810	\$ —
\$30.01–\$40.00	250	32.20	250	32.20
\$40.01–\$50.00	7,324,263	46.52	1,844,556	47.94
\$50.01–\$60.00	5,957,175	52.85	2,603,091	52.94
\$60.01–\$70.00	54,500	61.12	25,623	61.02
Total	13,405,884	\$49.15	4,482,330	\$50.83

For the years ended December 31, 2009, 2008, and 2007, the aggregate intrinsic value of stock awards exercised was \$46,896, \$35,957 and \$86,283, respectively. At December 31, 2009, the aggregate intrinsic value of stock awards outstanding was \$128,668 and the aggregate intrinsic value exercisable was \$35,533.

Estimated fair value of stock-based compensation awards

The Company has estimated the grant-date fair value of stock option and stock-settled stock appreciation rights awards using the Black-Scholes-Merton valuation model and stock unit awards at intrinsic value on the date of grant. The following assumptions were used in estimating these values and determining the total stock-based compensation attributable to the current period:

Expected term of the awards: The expected term of awards granted represents the period of time that they are expected to remain outstanding from the date of grant. The Company determines the expected term of its stock awards based on its historical experience with similar awards, considering the Company's historical exercise and post-vesting termination patterns, and the terms expected by peer companies in near industries.

Notes to Consolidated Financial Statements (Continued)

(dollars in thousands, except per share data)

Expected volatility: Expected volatility represents the volatility anticipated over the expected term of the award. The Company determines the expected volatility for its awards based on the volatility of the price of its common stock over the most recent retrospective period commensurate with the expected term of the award, considering the volatility expectations implied by the market price of its exchange-traded options and the volatilities expected by peer companies in near industries.

Expected dividend yield: The Company has not paid dividends on its common stock and does not currently expect to pay dividends during the term of stock awards granted.

Risk-free interest rate: The Company bases the expected risk-free interest rate on the implied yield currently available on stripped interest coupons of U.S. Treasury issues with a remaining term equivalent to the expected term of the award.

A summary of the weighted average valuation inputs described above used for estimating the grant-date fair value of stock options and stock-settled stock appreciation rights granted in the periods indicated is as follows:

	Year ended December 31,		
	2009	2008	2007
Expected term	3.5 years	3.4 years	3.7 years
Expected volatility	32%	27%	25%
Expected dividend yield	0.0%	0.0%	0.0%
Risk-free interest rate	1.8%	2.4%	4.4%

The Company estimates expected forfeitures based upon historical experience with separate groups of employees that have exhibited similar forfeiture behavior in the past. Stock-based compensation expense is recorded only for awards that are expected to vest.

Employee stock purchase plan

The Employee Stock Purchase Plan entitles qualifying employees to purchase up to \$25 of the Company's common stock during each calendar year. The amounts used to purchase stock are accumulated through payroll withholdings or through optional lump sum payments made in advance of the first day of the purchase right period. This compensatory plan allows employees to purchase stock for the lesser of 100% of the fair market value on the first day of the purchase right period or 85% of the fair market value on the last day of the purchase right period. Purchase right periods begin on January 1 and July 1, and end on December 31. Payroll withholdings and lump-sum payments related to the plan, included in accrued compensation and benefits that were used to purchase the Company's common stock were \$4,280, \$4,522, and \$4,711 at December 31, 2009, 2008 and 2007, respectively. Subsequent to December 31, 2009, 2008 and 2007, 86,213, 107,340 and 98,353 shares, respectively, were issued to satisfy obligations under the plan. At December 31, 2009, there were 962,752 shares available for future grants under this plan.

The fair value of employees' purchase rights was estimated as of the beginning dates of the purchase right periods using the Black-Scholes-Merton valuation model with the following weighted average assumptions for purchase right periods in 2009, 2008 and 2007, respectively: expected volatility of 34%, 24% and 23%; risk-free interest rate of 0.2%, 2.5% and 4.9%, and no dividends. Using these assumptions, the weighted average estimated fair value of these purchase rights was \$13.90, \$13.65 and \$13.96 for 2009, 2008 and 2007, respectively.

Stock-based compensation expense and proceeds

For the years ended December 31, 2009, 2008 and 2007, the Company recognized \$44,422, \$41,235 and \$34,149, respectively, in stock-based compensation expense for stock options, stock settled stock appreciation rights, stock units and discounted employee stock plan purchases, which is primarily included in general and administrative expenses. The estimated tax benefits recorded for this stock-based compensation in 2009, 2008 and 2007 were \$16,810, \$15,609 and \$12,820, respectively. As of December 31, 2009, there was \$79,957 of total estimated unrecognized compensation cost related to nonvested stock-based compensation arrangements under the Company's equity compensation and stock purchase plans. The Company expects to recognize this cost over a weighted average remaining period of 1.4 years.

During the years ended December 31, 2009, 2008 and 2007, the Company received \$63,653, \$35,606 and \$54,697 in cash proceeds from stock option exercises and \$18,241, \$13,988 and \$32,788 in total actual tax benefits upon the exercise of stock awards, respectively.

Stock repurchases

During 2009 and 2008, the Company repurchased a total of 2,902,619 and 4,788,881 shares of its common stock for \$153,495 and \$232,715, or an average price of \$52.88 and \$48.59 per share respectively, pursuant to previously announced authorizations by the Board of Directors. On November 3, 2009, the Company announced that its Board of Directors authorized an increase of an additional \$500,000 of share repurchases of its common stock. As a result of these transactions the total outstanding authorization for share repurchases as of December 31, 2009 was \$500,000. The Company has not repurchased any additional shares of its common stock through February 25, 2010. This stock repurchase program has no expiration date.

Shareholder rights plan

The Company's Board of Directors approved a shareholder rights plan on November 14, 2002. This plan is designed to assure that DaVita's shareholders receive fair treatment in the event of any proposed takeover of DaVita.

Pursuant to this plan, the Board approved the declaration of a dividend distribution of one common stock purchase right for each outstanding share of its common stock payable on December 10, 2002 to holders of record of DaVita common stock on November 29, 2002. This rights distribution was not taxable to DaVita shareholders. As a result of the stock split that occurred during the second quarter of 2004, two-thirds of a right are now attached to each share of the Company's common stock. Two-thirds of a right will also attach to each newly issued or reissued share of common stock. These rights will become exercisable if a person or group acquires, or announces a tender offer for, 15% or more of DaVita's outstanding common stock. The triggering person's stock purchase rights will become void at that time and will not become exercisable.

Each right initially entitles its holder to purchase one share of common stock from the Company at a price of \$125.00. If the rights become exercisable, and subject to adjustment for authorized shares available, each purchase right will then entitle its holder to purchase \$125.00 of common stock at a price per share equal to 50% of the average daily closing price of the Company's common stock for the immediately preceding 30 consecutive trading days. If DaVita is acquired in a merger or other business combination transaction after the rights become exercisable, provisions will be made to allow the holder of each right to purchase \$125.00 of common stock from the acquiring company at a price equal to 50% of the average daily closing price of that company's common stock for the immediately preceding 30 consecutive trading days.

Notes to Consolidated Financial Statements (Continued)

(dollars in thousands, except per share data)

The Board of Directors may elect to redeem the rights at \$0.01 per purchase right at any time prior to, or exchange common stock for the rights at an exchange ratio of one share per right at any time after, a person or group acquires or announces a tender offer for 15% or more of DaVita's outstanding common stock. The exercise price, number of shares, redemption price or exchange ratio associated with each right may be adjusted as appropriate upon the occurrence of certain events, including any stock split, stock dividend or similar transaction. These purchase rights will expire no later than November 14, 2012.

Charter documents & Delaware law

The Company's charter documents include provisions that may deter hostile takeovers, delay or prevent changes of control or changes in management, or limit the ability of stockholders to approve transactions that they may otherwise determine to be in their best interests. These include provisions prohibiting stockholders from acting by written consent, requiring 90 days advance notice of stockholder proposals or nominations to the Board of Directors and granting the Board of Directors the authority to issue up to five million shares of preferred stock and to determine the rights and preferences of the preferred stock without the need for further stockholder approval.

The Company is also subject to Section 203 of the Delaware General Corporation Law that, subject to exceptions, would prohibit the Company 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 restrictions may discourage, delay or prevent a change in the control of the Company.

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

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

	<u>Year ended December 31, 2009</u>
Net income attributable to DaVita Inc.	<u>\$422,684</u>
Decrease in paid-in capital for sales of noncontrolling interest in eleven joint ventures, respectively	(529)
Decrease in paid-in capital for the purchase of a noncontrolling interest in six joint ventures, respectively	<u>(3,721)</u>
Net transfer from noncontrolling interests	<u>(4,250)</u>
Change from net income attributable to DaVita Inc. and transfers (to) from noncontrolling interests	<u><u>\$418,434</u></u>

During 2009, the Company contributed cash and assets in two centers that were previously wholly-owned in exchange for an equity investment of 40% in a newly formed joint venture valued at \$3,600. The Company recognized a pre-tax loss of \$1,928 and deconsolidated these centers as a result of the transaction. In 2009, the Company also sold its controlling financial interest in one entity that contained one center which was previously wholly-owned to an existing joint venture in which the Company owns a 50% equity investment for \$1,750 and recognized a pre-tax loss of \$1,408. The Company deconsolidated this entity as a result of this transaction. The Company was also required to contribute \$1,000 to the joint venture. The estimated fair values of the retained equity investments for both of these transactions were based upon valuation techniques as determined by an outside appraiser. The recognized pre-tax losses for both transactions were recorded in patient care costs in the consolidated statement of income.

18. Other comprehensive income

Charges and credits to other comprehensive income have been as follows:

	2007		
	Before tax amount	Tax (expense) benefit	Net-of-tax amount
Unrealized losses on interest rate swaps	\$(11,733)	\$ 4,564	\$ (7,169)
Less reclassification of net swap realized gains into net income	(14,498)	5,640	(8,858)
Net swap activity	(26,231)	10,204	(16,027)
Unrealized gains on investments	6,892	(2,681)	4,211
Less reclassification of net investment realized gains into net income	(6,042)	2,350	(3,692)
Net investment activity	850	(331)	519
Total	<u>\$(25,381)</u>	<u>\$ 9,873</u>	<u>\$(15,508)</u>

	2008		
	Before tax amount	Tax (expense) benefit	Net-of-tax amount
Unrealized losses on interest rate swaps	\$(21,190)	\$ 8,243	\$(12,947)
Less reclassification of net swap realized losses into net income	4,239	(1,649)	2,590
Net swap activity	(16,951)	6,594	(10,357)
Unrealized losses on investments	(1,922)	748	(1,174)
Less reclassification of net investment realized gains into net income	(486)	189	(297)
Net investment activity	(2,408)	937	(1,471)
Total	<u>\$(19,359)</u>	<u>\$ 7,531</u>	<u>\$(11,828)</u>

	2009		
	Before tax amount	Tax (expense) benefit	Net-of-tax amount
Unrealized losses on interest rate swaps	\$ (4,220)	\$ 1,642	\$ (2,578)
Less reclassification of net swap realized losses into net income	17,253	(6,711)	10,542
Net swap activity	13,033	(5,069)	7,964
Unrealized gains on investments	1,614	(628)	986
Less reclassification of net investment realized gains into net income	(261)	102	(159)
Net investment activity	1,353	(526)	827
Total	<u>\$ 14,386</u>	<u>\$ (5,595)</u>	<u>\$ 8,791</u>

Notes to Consolidated Financial Statements (Continued)

(dollars in thousands, except per share data)

Changes in accumulated other comprehensive income (loss) has been as follows:

	Interest rate swaps	Investment securities	Accumulated other comprehensive income
Balance December 31, 2007	(3,030)	519	(2,511)
Net activity	(10,357)	(1,471)	(11,828)
Balance December 31, 2008	\$(13,387)	\$ (952)	\$(14,339)
Net activity	7,964	827	8,791
Balance December 31, 2009	<u>\$ (5,423)</u>	<u>\$ (125)</u>	<u>\$ (5,548)</u>

19. Acquisitions and divestitures

Acquisitions

All business combinations consummated after January 1, 2009, are required 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 interests 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. Transaction costs are excluded from the acquisition cost and are 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 is classified as either equity or a liability. A Company that obtains control but acquires less than 100% of an acquiree is required to record 100% of the fair value of the acquiree assets, liabilities, and noncontrolling interests at the acquisition date. The adoption of these requirements did not have a material impact on the Company's consolidated financial statements.

The total acquisition amounts were as follows:

	Year ended December 31,		
	2009	2008	2007
Cash paid, net of cash acquired	\$87,617	\$101,959	\$127,094
Deferred purchase price and other acquisition obligations	338	2,286	1,195
Aggregate purchase cost	<u>\$87,955</u>	<u>\$104,245</u>	<u>\$128,289</u>
Number of chronic dialysis centers acquired	<u>19</u>	<u>20</u>	<u>16</u>

During 2009, 2008, and 2007, the Company acquired dialysis businesses consisting of 19 centers, 20 centers and 16 centers for a total of \$87,955, \$93,024 and \$57,783, respectively, in cash and deferred purchase price obligations. In 2009, the Company also acquired additional ownership interests in several existing majority-owned joint ventures for \$6,859. In 2008, the Company also acquired an 80% ownership interest in one vascular access clinic for \$11,221 and in addition, purchased additional ownership interests in several existing majority-owned joint ventures for \$24,409. In 2007, the Company also acquired an 85% ownership interest in HomeChoice Partners for \$70,506 in cash and deferred purchase price obligations. HCP provides infusion therapy services to patients with acute or chronic conditions that can be treated at home or at an ambulatory infusion site. The assets and liabilities for all acquisitions were recorded at their estimated fair values at the dates of the acquisitions and are included in the Company's financial statements and operating results from the designated effective dates of the acquisitions.

The initial purchase cost allocations for acquired businesses are recorded at fair values based upon the best information available to management and are finalized when identified pre-acquisition contingencies have been resolved and other information arranged to be obtained has been received, but in no case in excess of one year from the acquisition date. Adjustments to purchase accounting for prior acquisitions and payments for acquisitions in process have been included in the periods recognized.

The aggregate purchase cost allocations for dialysis and other related businesses were as follows:

	Year ended December 31,		
	2009	2008	2007
Tangible assets, principally leasehold improvements and equipment	\$11,140	\$ 7,972	\$ 20,085
Amortizable intangible assets	6,703	9,988	12,271
Goodwill	78,199	89,234	105,609
Noncontrolling interest, net purchased (assumed)	(7,567)	(2,732)	(7,987)
Liabilities assumed	(520)	(217)	(1,689)
Aggregate purchase cost	<u>\$87,955</u>	<u>\$104,245</u>	<u>\$128,289</u>

Amortizable intangible assets acquired during 2009, 2008 and 2007 had weighted-average estimated useful lives of seven, nine and eight years, respectively. The total amount of goodwill deductible for tax purposes associated with these acquisitions for 2009, 2008, and 2007 was approximately \$72,000, \$109,000 and \$106,000, respectively.

Pro forma financial information

The following summary, prepared on a pro forma basis, combines the results of operations as if all acquisitions in 2009 and 2008 had been consummated as of the beginning of 2008, after including the impact of certain adjustments such as amortization of intangibles, interest expense on acquisition financing and income tax effects.

	Year ended December 31,	
	2009	2008
	(unaudited)	
Pro forma net revenues	\$6,141,217	\$5,761,318
Pro forma net income attributable to DaVita Inc.	424,493	379,132
Pro forma income from continuing operations attributable to DaVita Inc.	424,493	379,132
Pro forma basic net income per share attributable to DaVita Inc.	4.10	3.61
Pro forma diluted net income per share attributable to DaVita Inc.	4.08	3.58

20. Variable interest entities

Effective for the Company's first annual reporting period that begins after November 15, 2009, the FASB is eliminating the quantitative approach previously required for determining the primary beneficiary of a variable interest entity, and requiring additional disclosures about an enterprise's involvement in variable interest entities. An enterprise will be required to perform an analysis to determine whether the enterprise's variable interest or interests give it a controlling financial interest in a variable interest entity by having both the power to direct the activities of a variable interest entity that most significantly impact the entity's economic performance and the obligation to absorb losses of the entity, or the right to receive benefits from the entity. In addition, the FASB is establishing new guidance for determining whether an entity is a variable interest entity, requiring an ongoing reassessment of whether an enterprise is the primary beneficiary of a variable interest entity, and adding an additional reconsideration event for determining whether an entity is a variable interest entity when any changes in facts and circumstances occur such that the holders of the equity investment at risk, as a group, lose the power from voting rights

Notes to Consolidated Financial Statements (Continued)

(dollars in thousands, except per share data)

or similar rights concerning those investments to direct the activities of the entity that most significantly impact the entity's economic performance. The Company is currently in the process of assessing the expected impact of this standard on its consolidated financial statements.

In December 2008, the FASB required public entities to provide additional disclosures about transfers of financial assets and required public enterprises to provide additional disclosures about their involvement in variable interest entities and certain special purpose entities. Because these requirements impact disclosures and not the accounting treatment for transfers of financial assets and interests in variable interest entities, these requirements did not impact the Company's consolidated financial condition or results of operations.

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

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

Total assets of these consolidated operating VIEs were approximately \$21,000 and their liabilities to unrelated third parties were approximately \$18,000 at December 31, 2009.

The Company also sponsors certain deferred compensation plans whose trusts qualify as VIEs and as their primary beneficiary the Company consolidates each of these plans. The assets of these plans are recorded in short-term or long-term investments with matching offsetting liabilities in accrued compensation and benefits and other long-term liabilities. See Note 9 to the consolidated financial statements for disclosures on the assets of these consolidated non-qualified deferred compensation plans.

21. Concentrations

Approximately 65% of the Company's total dialysis and related lab services revenues in 2009, 65% in 2008 and 64% in 2007 are from government-based programs, principally Medicare and Medicaid. Accounts receivable, and other receivables, from Medicare and Medicaid-assigned plans were approximately \$467,900 and \$467,400, respectively as of December 31, 2009 and 2008. No other single payor accounted for more than 5% of total accounts receivable.

A significant physician-prescribed pharmaceutical administered during dialysis, EPO, is provided by a sole supplier and accounted for approximately 20% of net operating revenues. Although the Company currently receives discounted prices for EPO, the supplier has unilateral pricing discretion and in the future the Company may not be able to achieve the same cost levels historically obtained.

22. Noncontrolling interests subject to put provisions and other commitments

Noncontrolling interests subject to put provisions

The Company has potential 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' noncontrolling interests at either the appraised fair market value or a predetermined multiple of earnings or cash flow attributable to the noncontrolling interests put to the Company, which is intended to approximate fair value. The methodology the Company uses to estimate the fair values of the noncontrolling interests subject to put provisions assumes either the higher of a liquidation value of net assets or an average multiple of earnings, based on historical earnings, patient mix and other performance indicators, as well as other factors. The estimated fair values of the noncontrolling interests subject to put provisions can fluctuate and the implicit multiple of earnings at which these noncontrolling interest obligations may be settled will vary significantly depending upon market conditions including potential purchasers' access to the capital markets, which can impact the level of competition for dialysis and non-dialysis related businesses, the economic performance of these businesses and the restricted marketability of the third-party owners' noncontrolling interests. The amounts of noncontrolling interests subject to put provisions that contractually employ a predetermined multiple of earnings rather than fair value are immaterial.

Additionally, the Company has certain other potential commitments to provide operating capital to several dialysis centers that are wholly-owned by third parties or centers in which the Company owns an equity investment as well as to physician-owned vascular access clinics that the Company operates under management and administrative service agreements of approximately \$7,200.

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

Other commitments

In conjunction with the acquisition of DVA Renal Healthcare, Inc., formerly known as Gambro Healthcare, Inc., which occurred in October 2005, the Company entered into an Alliance and Product Supply Agreement (the Product Supply Agreement) with Gambro AB and Gambro Renal Products, Inc (Gambro Renal Products). The Product Supply Agreement has an initial term of seven years and will automatically renew for three additional one-year periods if the Company has not negotiated the terms of an extension during the initial term. Because the Product Supply Agreement results in higher costs for most of the products covered by the Product Supply Agreement than would otherwise be available to the Company, the Product Supply Agreement represented an intangible liability initially valued at \$162,100 as of the acquisition date.

The Product Supply Agreement committed the Company to purchase a significant majority of its hemodialysis products, supplies and equipment at fixed prices through 2015. The agreement was amended in 2006 (the Amended Product Supply Agreement) to reduce the Company's purchase obligations for certain hemodialysis product supplies and equipment, and in 2007, the Company terminated its obligation to purchase certain dialysis machines under the Amended Product Supply Agreement. As a result of this termination the Company recorded a net valuation gain of \$55,275 in 2007. This valuation gain represents the difference in the amortized original fair value of the Amended Product Supply Agreement and that of the Amended Product Supply Agreement as adjusted for the termination of the obligation to purchase certain dialysis machines as of June 30, 2007. We continue to be subject to the Product Supply

Notes to Consolidated Financial Statements (Continued)

(dollars in thousands, except per share data)

Agreement's requirements to purchase a significant majority of our hemodialysis non-equipment product supplies, such as dialyzers, from Gambro at fixed prices.

During 2009, 2008 and 2007, the Company purchased \$87,983, \$83,360 and \$90,696 of hemodialysis product supplies from Gambro Renal Products, representing 2% of the Company's total operating costs, for all years presented.

The centers acquired from Gambro Healthcare were subject to a five-year Corporate Integrity Agreement in connection with its December 2004 settlement with the U.S. Government that imposed significant specific compliance operating and reporting requirements, and requires an annual audit by an independent reporting organization. The corporate integrity agreement expired on November 30, 2009. The Company submitted its final annual report to the Office of the Inspector General, U.S. Department of Health and Human Services on January 14, 2010. On February 16, 2010, the Company was informed by the OIG that it has received the Company's final annual report and determined that DVA Renal Healthcare, a wholly-owned subsidiary of the Company, complied with the terms of the corporate integrity agreement during the final reporting period and that the Fifth Annual Report is complete. The five year term of the corporate integrity agreement has now concluded and DVA Renal Healthcare is no longer subject to its terms.

In January 2010, the Company entered into an agreement with Fresenius which committed the Company to purchase a certain amount of dialysis equipment, parts and supplies from them through 2013.

Other than operating leases, disclosed in Note 14 to the consolidated financial statements, and the letters of credit and the interest rate swap agreements, disclosed in Note 13 to the consolidated financial statements, or as described above the Company has no off balance sheet financing arrangements as of December 31, 2009.

23. Fair values of financial instruments

Effective January 1, 2008, the FASB established a framework for measuring assets and liabilities at fair value and also required additional disclosures about fair value measurements. These requirements applied to assets and liabilities that are carried at fair value on a recurring basis. Effective January 1, 2009 the FASB issued additional requirements relating to nonfinancial assets and liabilities that are not recognized or disclosed at fair value in the financial statements on a recurring basis at least annually. The adoption of these requirements relating to nonfinancial assets and liabilities did not have a material impact on the Company's consolidated financial statements.

The following table summarizes the Company's assets and liabilities measured at fair value on a recurring basis as of December 31, 2009:

	Total	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets				
Available for sale securities	\$ 8,816	\$8,816	\$ —	\$ —
Liabilities				
Interest rate swap agreements	\$ 10,792	\$ —	\$10,792	\$ —
Temporary equity				
Noncontrolling interests subject to put provisions	\$331,725	\$ —	\$ —	\$331,725

The available for sale securities represent investments in various open-ended registered investment companies, or mutual funds, and are recorded at fair value based upon the quoted market prices as reported by each mutual fund. See Note 9 to the 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 currently reported. See Note 13 to the consolidated financial statements for further discussion.

See Note 22 to the consolidated financial statements for a discussion of the Company's methodology for estimating the fair value of noncontrolling interests subject to put obligations.

Effective January 1, 2008, the FASB allowed 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. This provision was also designed to reduce the volatility in earnings caused by measuring related assets and liabilities differently and established presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. The Company did not elect to measure certain assets and liabilities at fair value on an instrument-by-instrument basis.

Other financial instruments consist primarily of cash, accounts receivable, notes receivable, accounts payable, other accrued liabilities and debt. The balances of the non-debt financial instruments are presented in the consolidated financial statements at December 31, 2009 and 2008 at their approximate fair values due to the short-term nature of their settlements. Borrowings under the Company's Senior Secured Credit Facilities totaled \$1,859,000 as of December 31, 2009, and the fair value was \$1,817,173 based upon quoted market prices. The fair value of the Company's senior and senior subordinated notes was approximately \$1,756,625 at December 31, 2009 based upon quoted market prices, as compared to the carrying amount of \$1,750,000.

24. Segment reporting

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

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

Notes to Consolidated Financial Statements (Continued)

(dollars in thousands, except per share data)

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

	Years ended December 31,		
	2009	2008(2)	2007(2)
Segment revenues:			
Dialysis and related lab services(1)	\$5,791,698	\$5,415,363	\$5,130,181
Other—Ancillary services and strategic initiatives	317,102	244,810	133,970
Consolidated revenues	<u>\$6,108,800</u>	<u>\$5,660,173</u>	<u>\$5,264,151</u>
Segment operating margin (loss):			
Dialysis and related lab services	\$ 999,961	\$ 939,391	\$ 990,049
Other—Ancillary services and strategic initiatives	(17,710)	(29,856)	(48,206)
Total segment margin	982,251	909,535	941,843
Reconciliation of segment margin to income before income taxes:			
Stock-based compensation	(44,422)	(41,235)	(34,149)
Equity investment income	2,442	796	1,217
Consolidated operating income	940,271	869,096	908,911
Debt expense	(185,755)	(224,716)	(257,147)
Other income	3,708	12,411	22,460
Consolidated income before income taxes	<u>\$ 758,224</u>	<u>\$ 656,791</u>	<u>\$ 674,224</u>

- (1) Includes management fees for providing management and administrative services to dialysis centers in which the Company either owns an equity investment or are wholly-owned by third parties.
- (2) Certain costs previously reported in the Ancillary Services and Strategic Initiatives have been reclassified to the dialysis and related lab services to conform to the current year presentation.

Depreciation and amortization expense for the dialysis and related lab services for 2009, 2008 and 2007 were \$221,907, \$210,143 and \$189,215, respectively, and were \$7,079, \$6,774 and \$4,255, respectively, for the ancillary services and strategic initiatives.

Summary of assets by segment is as follows:

	December 31,	
	2009	2008
Segment assets		
Dialysis and related lab services	\$7,334,235	\$7,031,550
Other—Ancillary services and strategic initiatives	224,001	254,533
Consolidated assets	<u>\$7,558,236</u>	<u>\$7,286,083</u>

In 2009 and 2008, the total amount of expenditures for property and equipment for the dialysis and related lab services were \$271,817 and \$313,414, respectively, and were \$2,788 and \$4,548, respectively, for the ancillary services and strategic initiatives.

25. Supplemental cash flow information

The table below provides supplemental cash flow information:

	Year ended December 31,		
	2009	2008	2007
Cash paid:			
Income taxes	\$161,671	\$163,147	\$205,955
Interest	186,280	222,558	245,325
Non-cash investing and financing activities:			
Fixed assets acquired under capital lease obligations	—	—	2,769
Liabilities assumed in conjunction with common stock acquisitions	—	—	1,653
Assets exchanged for equity investments	2,618	—	—
Assets received for additional noncontrolling interests	51	—	—

26. Selected quarterly financial data (unaudited)

	2009				2008			
	December 31	September 30	June 30	March 31	December 31	September 30	June 30	March 31
Net operating revenues	\$1,568,204	\$1,573,915	\$1,519,041	\$1,447,640	\$1,461,010	\$1,447,135	\$1,407,304	\$1,344,724
Operating income	238,712	245,001	235,954	220,604	223,109	221,772	218,434	205,781
Income before income taxes	194,563	200,465	190,139	173,057	169,364	169,748	166,101	151,578
Net income attributable to DaVita Inc.	109,724	110,930	105,819	96,211	98,365	93,910	94,951	86,934
Basic earnings per share attributable to DaVita Inc. ...	1.07	1.07	1.02	0.93	0.95	0.90	0.91	0.81
Diluted earnings per share attributable to DaVita Inc. ...	\$ 1.06	\$ 1.06	\$ 1.02	\$ 0.92	\$ 0.94	\$ 0.89	\$ 0.90	\$ 0.80

27. Condensed consolidating financial statements

The following information is presented in accordance with Rule 3-10 of Regulation S-X. The operating and investing activities of the separate legal entities included in the Company's consolidated financial statements are fully interdependent and integrated. Revenues and operating expenses of the separate legal entities include intercompany charges for management and other services. The senior notes and the senior subordinated notes were issued by the Company and are guaranteed by substantially all of its 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 ventures, partnerships and third parties are not guarantors of these obligations.

Notes to Consolidated Financial Statements (Continued)
(dollars in thousands, except per share data)

Condensed Consolidating Statements of Income

	DaVita Inc.	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Consolidating Adjustments	Consolidated Total
For the year ended December 31, 2009					
Net operating revenues	\$ 401,058	\$5,100,716	\$1,032,676	\$(425,650)	\$6,108,800
Operating expenses	246,578	4,484,083	863,518	(425,650)	5,168,529
Operating income	154,480	616,633	169,158	—	940,271
Debt (expense)	(188,109)	(179,294)	(1,304)	182,952	(185,755)
Other income, net	186,189	—	471	(182,952)	3,708
Income tax expense	60,414	212,571	5,480	—	278,465
Equity earnings in subsidiaries	330,538	103,430	—	(433,968)	—
Net income	422,684	328,198	162,845	(433,968)	479,759
Less: Net income attributable to noncontrolling interests	—	—	—	(57,075)	(57,075)
Net income attributable to DaVita Inc.	<u>\$ 422,684</u>	<u>\$ 328,198</u>	<u>\$ 162,845</u>	<u>\$(491,043)</u>	<u>\$ 422,684</u>
For the year ended December 31, 2008					
Net operating revenues	\$ 363,112	\$4,808,324	\$ 881,810	\$(393,073)	\$5,660,173
Operating expenses	228,729	4,208,769	746,652	(393,073)	4,791,077
Operating income	134,383	599,555	135,158	—	869,096
Debt (expense)	(227,535)	(189,506)	(2,520)	194,845	(224,716)
Other income, net	206,527	—	729	(194,845)	12,411
Income tax expense	43,763	188,888	2,820	—	235,471
Equity earnings in subsidiaries	304,548	81,459	—	(386,007)	—
Net income	374,160	302,620	130,547	(386,007)	421,320
Less: Net income attributable to noncontrolling interests	—	—	—	(47,160)	(47,160)
Net income attributable to DaVita Inc.	<u>\$ 374,160</u>	<u>\$ 302,620</u>	<u>\$ 130,547</u>	<u>\$(433,167)</u>	<u>\$ 374,160</u>
For the year ended December 31, 2007					
Net operating revenues	\$ 365,728	\$4,534,153	\$ 754,163	\$(389,893)	\$5,264,151
Operating expenses	208,042	3,919,932	617,159	(389,893)	4,355,240
Operating income	157,686	614,221	137,004	—	908,911
Debt (expense)	(259,745)	(256,050)	(4,002)	262,650	(257,147)
Other income, net	284,038	—	1,072	(262,650)	22,460
Income tax expense (benefit)	70,972	175,691	(1,082)	—	245,581
Equity earnings in subsidiaries	270,771	87,185	—	(357,956)	—
Net income	381,778	269,665	135,156	(357,956)	428,643
Less: Net income attributable to noncontrolling interests	—	—	—	(46,865)	(46,865)
Net income attributable to DaVita Inc.	<u>\$ 381,778</u>	<u>\$ 269,665</u>	<u>\$ 135,156</u>	<u>\$(404,821)</u>	<u>\$ 381,778</u>

Condensed Consolidating Balance Sheets

	DaVita Inc.	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Consolidating Adjustments	Consolidated Total
As of December 31, 2009					
Cash and cash equivalents	\$ 534,550	\$ —	\$ 4,909	\$ —	\$ 539,459
Accounts receivable, net	—	961,946	143,957	—	1,105,903
Other current assets	15,619	597,086	44,454	—	657,159
Total current assets	550,169	1,559,032	193,320	—	2,302,521
Property and equipment, net	11,232	900,969	192,724	—	1,104,925
Amortizable intangible assets, net	30,212	101,931	4,589	—	136,732
Investments in subsidiaries	5,130,035	509,733	—	(5,639,768)	—
Receivables from subsidiaries	293,062	—	138,482	(431,544)	—
Other long-term assets and investments	7,700	19,528	35,634	—	62,862
Goodwill	—	3,622,885	328,311	—	3,951,196
Total assets	<u>\$6,022,410</u>	<u>\$6,714,078</u>	<u>\$893,060</u>	<u>\$(6,071,312)</u>	<u>\$7,558,236</u>
Current liabilities	\$ 170,061	\$ 781,870	\$ 95,010	\$ —	\$1,046,941
Payables to parent	—	418,529	13,015	(431,544)	—
Long-term debt and other long-term liabilities	3,507,753	458,779	18,879	—	3,985,411
Noncontrolling interests subject to put provisions	209,530	—	—	122,195	331,725
Total DaVita Inc. shareholders' equity	2,135,066	5,054,900	584,868	(5,639,768)	2,135,066
Noncontrolling interest not subject to put provisions	—	—	181,288	(122,195)	59,093
Total equity	2,135,066	5,054,900	766,156	(5,761,963)	2,194,159
Total liabilities and equity	<u>\$6,022,410</u>	<u>\$6,714,078</u>	<u>\$893,060</u>	<u>\$(6,071,312)</u>	<u>\$7,558,236</u>
As of December 31, 2008					
Cash and cash equivalents	\$ 397,576	\$ —	\$ 13,305	\$ —	\$ 410,881
Accounts receivable, net	—	933,906	141,551	—	1,075,457
Other current assets	22,112	573,070	46,776	—	641,958
Total current assets	419,688	1,506,976	201,632	—	2,128,296
Property and equipment, net	15,175	864,725	168,175	—	1,048,075
Amortizable intangible assets, net	39,990	114,237	6,294	—	160,521
Investments in subsidiaries	4,866,399	464,377	—	(5,330,776)	—
Receivables from subsidiaries	320,338	—	90,754	(411,092)	—
Other long-term assets and investments	13,320	14,815	44,125	—	72,260
Goodwill	—	3,571,669	305,262	—	3,876,931
Total assets	<u>\$5,674,910</u>	<u>\$6,536,799</u>	<u>\$816,242</u>	<u>\$(5,741,868)</u>	<u>\$7,286,083</u>
Current liabilities	\$ 106,370	\$ 990,024	\$ 66,669	\$ —	\$1,163,063
Payables to parent	—	386,460	24,632	(411,092)	—
Long-term debt and other long-term liabilities	3,616,082	368,774	19,868	—	4,004,724
Noncontrolling interests subject to put provisions	184,711	—	—	106,686	291,397
Total DaVita Inc. shareholders' equity	1,767,747	4,791,541	539,235	(5,330,776)	1,767,747
Noncontrolling interest not subject to put provisions	—	—	165,838	(106,686)	59,152
Total equity	1,767,747	4,791,541	705,073	(5,437,462)	1,826,899
Total liabilities and equity	<u>\$5,674,910</u>	<u>\$6,536,799</u>	<u>\$816,242</u>	<u>\$(5,741,868)</u>	<u>\$7,286,083</u>

Notes to Consolidated Financial Statements (Continued)

(dollars in thousands, except per share data)

Condensed Consolidating Statements of Cash Flows

	DaVita Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Consolidated Total
For the year ended December 31, 2009					
Cash flows from operating activities					
Net income.	\$ 422,684	\$ 328,198	\$ 162,845	\$(433,968)	\$ 479,759
Changes in operating assets and liabilities and non cash items included in net income	(115,305)	(72,610)	(59,102)	433,968	186,951
Net cash provided by operating activities	307,379	255,588	103,743	—	666,710
Cash flows from investing activities					
Additions of property and equipment	(1,748)	(213,046)	(59,811)	—	(274,605)
Acquisitions	—	(87,617)	—	—	(87,617)
Proceeds from asset sales	—	7,697	—	—	7,697
Other items	11,631	(3,166)	—	—	8,465
Net cash provided by (used in) by investing activities	9,883	(296,132)	(59,811)	—	(346,060)
Cash flows from financing activities					
Long-term debt	(60,619)	(1,512)	899	—	(61,232)
Intercompany borrowing	(41,032)	100,429	(59,397)	—	—
Other items	(78,637)	(58,373)	6,170	—	(130,840)
Net cash (used in) provided by financing activities	(180,288)	40,544	(52,328)	—	(192,072)
Net increase (decrease) in cash and cash equivalents	136,974	—	(8,396)	—	128,578
Cash and cash equivalents at beginning of the year	397,576	—	13,305	—	410,881
Cash and cash equivalents at the end of the year	\$ 534,550	\$ —	\$ 4,909	\$ —	\$ 539,459
For the year ended December 31, 2008					
Cash flows from operating activities					
Net income.	\$ 374,160	\$ 302,620	\$ 130,547	\$(386,007)	\$ 421,320
Changes in operating assets and liabilities and non cash items included in net income	(614,540)	431,232	(10,318)	386,007	192,381
Net cash (used in) provided by operating activities	(240,380)	733,852	120,229	—	613,701
Cash flows from investing activities					
Additions of property and equipment	(2,546)	(271,561)	(43,855)	—	(317,962)
Acquisitions	(439)	(92,299)	(9,221)	—	(101,959)
Proceeds from asset sales	—	530	—	—	530
Other items	19,281	2,371	—	—	21,652
Net cash provided by (used in) investing activities	16,296	(360,959)	(53,076)	—	(397,739)
Cash flows from financing activities					
Long-term debt	(17,675)	(424)	4,548	—	(13,551)
Intercompany borrowing	380,763	(358,761)	(22,002)	—	—
Other items	(184,585)	(13,708)	(40,283)	—	(238,576)
Net cash provided by (used in) financing activities	178,503	(372,893)	(57,737)	—	(252,127)
Net (decrease) increase in cash and cash equivalents	(45,581)	—	9,416	—	(36,165)
Cash and cash equivalents at beginning of the year	443,157	—	3,889	—	447,046
Cash and cash equivalents at the end of the year	\$ 397,576	\$ —	\$ 13,305	\$ —	\$ 410,881
For the year ended December 31, 2007					
Cash flows from operating activities					
Net income	\$ 381,778	\$ 269,665	\$ 135,156	\$(357,956)	\$ 428,643
Changes in operating assets and liabilities and non cash items included in net income	(283,596)	108,534	(30,472)	357,956	152,422
Net cash provided by operating activities	98,182	378,199	104,684	—	581,065
Cash flows from investing activities					
Additions of property and equipment	(3,501)	(220,264)	(48,447)	—	(272,212)
Acquisitions	(69,701)	(57,393)	—	—	(127,094)
Proceeds from asset sales	—	12,289	—	—	12,289
Other items	(19,811)	(39,915)	—	—	(59,726)
Net cash used in investing activities	(93,013)	(305,283)	(48,447)	—	(446,743)
Cash flows from financing activities					
Long-term debt	(49,961)	2,212	447	—	(47,302)
Intercompany borrowing	110,937	(80,664)	(30,273)	—	—
Other items	77,582	5,536	(33,294)	—	49,824
Net cash provided by (used in) financing activities	138,558	(72,916)	(63,120)	—	2,522
Net increase (decrease) in cash and cash equivalents	143,727	—	(6,883)	—	136,844
Cash and cash equivalents at the beginning of the year	299,430	—	10,772	—	310,202
Cash and cash equivalents at the end of the year	\$ 443,157	\$ —	\$ 3,889	\$ —	\$ 447,046

Risk Factors

This Annual Report contains statements that are forward-looking statements within the meaning of the federal securities laws. These statements involve known and unknown risks and uncertainties including the risks discussed below. 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 and related lab services revenues for the year ended December 31, 2009 were 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 and all of our nonacute dialysis profits come from commercial payors. We continue to experience downward pressure on 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 payors are 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. Our negotiations with payors are also influenced by competitive pressures. We expect that some of our contracted rates with commercial payors may decrease or that 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. In some circumstances for some commercial payors, our centers are designated as out-of-network providers. Rates for out-of-network providers are on average higher than rates for in-network providers. Commercial payors may restructure their benefits to create disincentives for patients to select or remain with out-of-network providers or may decrease payment rates for out-of-network providers. We, along with others in the kidney care community, are resisting attempts to limit access to out-of-network providers 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 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. We have seen an increase in the number of patients who have government-based programs as their primary payors which we believe is largely as a result of improved mortality and the current economic recession which has a negative impact on the percentage of patients covered under

Risk Factors (continued)

commercial insurance plans. To the extent there are sustained or increased job losses in the United States as a result of current economic conditions, we could experience a decrease in the number of patients under commercial plans. We could also experience a further decrease if changes to the healthcare regulatory system result in fewer patients covered under commercial plans. In addition, our continued negotiations with commercial payors could result in a decrease in the number of patients under commercial plans to the extent that we cannot reach agreement with commercial payors on rates and other terms. 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, including the implementation of a bundled payment system under MIPPA and other healthcare reform initiatives, could substantially reduce our revenues, earnings and cash flows.

Approximately one-half of our dialysis and related lab services revenues for the year ended December 31, 2009 was generated from patients who have Medicare as their primary payor. Currently, the Medicare 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. Certain other pharmaceuticals, including EPO, vitamin D analogs and iron supplements, as well as certain specialized laboratory tests, are separately billed.

In July 2008, MIPPA was passed by Congress. This legislation introduced 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. On September 15, 2009, CMS released the proposed rule regarding the new bundled payment rate system. If the new bundled payment rate system is implemented as proposed, it could have a material adverse effect on our revenues, earnings and cash flows. The initial 2011 bundled rate is required to be set based on a 2% reduction in the payment rate that providers would have received under the historical fee for service payment methodology and based on the lowest average industry pharmaceutical utilization from 2007 to 2009. Among other things, the proposed rule requires dialysis facilities to provide certain oral medications but does not provide funding sufficient to cover our costs for those medications. In addition, all laboratory tests ordered by nephrologists would be included in the bundle, whether or not the laboratory tests are related to ESRD treatment, without funding sufficient to cover our costs for those tests. The proposed rule also includes an expanded list of case-mix adjusters, many of which may be difficult or impossible for dialysis clinics to track, consequently reducing the payment rate for ESRD treatments. The proposed rule also introduced a transition adjustment that would reduce payments to providers by 3%. The combined effect of the adjustments provided in the proposed rule would result in a bundled rate that represents a significantly greater than 2% reduction in the payment rate that we would have received for our services prior to bundling. The proposed rule also requires the new single bundled payment base rate to be adjusted annually for inflation based upon a market basket index, less 1% of such index, beginning in 2012. Also, beginning in 2012, the proposed rule provides that 2% of payments due to providers will be set aside subject to provider satisfaction of certain quality standards. A failure to achieve the required quality standards will result in the forfeiture of the 2% reserve. Dialysis providers have the option to move fully to the bundled payment system in 2011 or to phase in the payment system over three years. Because the bundled rates that will take effect in 2011 have not been set, we cannot predict whether we will be able to reduce our operating costs at a level that will offset any reduction in overall reimbursement for services we provide to Medicare patients. In addition, we experience increases in operating costs that are subject to inflation, such as labor and supply costs, regardless of whether there is a compensating inflation-based increase in Medicare payment rates. To the extent 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. We also cannot predict whether we will be able to implement the requirements of the final rule within the time frames set in the final rule or whether we will be able to satisfy our Medicare and Medicaid regulatory compliance obligations as processes and systems are modified to comply with the final rule.

In addition, ongoing public policy debates regarding healthcare reform and the extension of coverage to uninsured individuals has recently intensified. While we cannot predict whether the federal government will enact changes to the healthcare regulatory system in response to the current debate or the potential impact of any such changes, to the extent that any changes to the current healthcare regulatory system result in a reduction in patients covered by commercial insurance or a reduction in reimbursement rates for our services from commercial and/or government payors, our revenues, earnings and cash flows could be adversely affected.

Changes in state Medicaid or other non-Medicare government-based programs or payment rates could reduce our revenues, earnings and cash flows.

Approximately 15% of our dialysis and related lab services revenues for the year ended December 31, 2009, was generated from patients who have state Medicaid or other non-Medicare government-based programs, such as Medicare-assigned plans or the Veterans Health Administration, as their primary coverage. As state governments and governmental organizations face increasing budgetary pressure, they may propose reductions in payment rates, delays in the timing of payments, limitations on eligibility or other changes to their related programs. For example, some programs, such as certain state Medicaid programs and the Veterans Health Administration, have recently considered, proposed or implemented rate reductions. In January 2009, the Department of Veterans Affairs informally adopted a policy to reduce payment rates for dialysis services to Medicare rates. The informal policy was subsequently withdrawn in July 2009. On February 17, 2010, the Department of Veterans Affairs formally proposed a rule which would materially reduce their payment rates for dialysis services to equal Medicare rates. The proposed rule is subject to a 60 day comment period and we expect to participate in the comment process. We cannot predict when or if the final rule will be effective or what will be included in the final rule. If the proposed rule is implemented in its current form, it will have a significant negative impact on our revenues, earnings and cash flows as a result of the reduction in rates or as a result of a decrease in the number of patients covered by the Veterans Health Administration that we service. Approximately 2% of our dialysis and related lab services revenues for the year ended December 31, 2009 was generated by the Veterans Health Administration. While we cannot predict whether the Department of Veterans Affairs or any other government programs will be successful in reducing their payment rates or the timing of potential reductions, any such reduction could have a material adverse effect on our revenues, earnings and cash flows.

In addition, some state Medicaid program eligibility requirements mandate that citizen enrollees in such programs provide documented proof of citizenship. If our patients cannot meet these proof of citizenship documentation requirements, they may be denied coverage under these programs. If state Medicaid or other non-Medicare government programs reduce the rates paid by these programs for dialysis and related services, delay the timing of payment for services provided, further limit eligibility for coverage or adopt changes to their payment structure which reduces our overall payments from these state Medicaid or non-Medicare government programs, then our revenues, earnings and cash flows could be adversely affected.

Changes in clinical practices, payment rates or regulations impacting 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 and related lab services revenues for the year ended December 31, 2009, with EPO accounting for

Risk Factors (continued)

approximately 20% of our dialysis and related lab services revenues for the same period. Changes in clinical practices that result in further decreased utilization of prescribed pharmaceuticals or changes in payment rates for those pharmaceuticals could substantially reduce our revenues, earnings and cash flows.

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 the utilization of erythropoiesis stimulating agents, or ESAs, which include EPO, 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 held additional hearings to revisit these label changes as they apply to ESRD and has indicated that they will convene in 2010 to further review ESA labeling. CMS also reviewed its EPO reimbursement policies and in January 2008, changes to the EPO monitoring policy went into effect which further limited reimbursement and which impacted the prescribing habits of our physicians and which has in the past and may in the future result in lower pharmaceutical intensities. Most recently, HHS and CMS have given notice that a meeting of the Medicare Evidence Development & Coverage Advisory Committee, or MedCAC, will be convened on March 24, 2010 to review policies around the administration of ESAs, including, among other things, an evaluation of the efficacy of certain hemoglobin targets in CKD patients. These meetings could result in further restrictions on the utilization and reimbursement for ESAs which could result in decreased EPO utilization. Commercial payors have also increasingly examined their administration policies for EPO and, in some cases have modified those policies. Further changes in labeling of EPO and 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 or the conversion to alternate types of administration of EPO or other pharmaceuticals that result in further decreases in utilization or reimbursement for EPO and other pharmaceuticals could have a material adverse effect on our revenues, earnings and cash flows.

Changes in EPO pricing 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 at any time during the term of our agreement with Amgen. Future increases in the cost of EPO without corresponding increases in payment rates for EPO could have a material adverse effect on our earnings and cash flows and ultimately reduce our income. Our agreement with Amgen for EPO includes potential rebates which depend upon the achievement of certain criteria. We cannot predict whether we will continue to receive the rebates for EPO that we currently receive, or whether we will continue to achieve the same levels of rebates within that structure as we have historically achieved. Our agreement with Amgen provides for specific rebates off of list price based on a combination of factors, including process improvement and data submission. Factors that could impact our ability to qualify for 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 meet certain targets and earn the specified rebates could have a material adverse effect on our earnings and cash flows. Our agreement with Amgen terminates on December 31, 2010. We cannot predict whether any new agreement with Amgen will include the same or similar rebates as provided in our current agreement.

We are the subject of a number of inquiries by the federal government, any of which could result in substantial penalties against us.

We are the subject of a number of inquiries by the federal government. We have received subpoenas from the U.S. Attorney's Office for the Northern District of Georgia, the U.S. Attorney's Office for the

Eastern District of Missouri and the U.S. Attorney's Office for the Eastern District of Texas. We are cooperating with the U.S. Attorney's Offices with respect to each of the subpoenas and producing the requested records. Any negative findings could result in substantial financial penalties against us, exclusion from future participation in the Medicare and Medicaid programs and, in certain cases, criminal penalties. To our knowledge, no proceedings have been initiated by the federal government against us at this time. Although we cannot predict whether or when proceedings might be initiated by the federal government or when these matters may be resolved, it is not unusual for investigations such as these to continue for a considerable period of time. Responding to the subpoenas will continue to require management's attention and significant legal expense. See Note 16 to our consolidated financial statements for additional information regarding these inquiries and subpoenas.

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 have a material adverse effect on 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 ESAs, 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 legislation regarding pharmaceutical utilization and reimbursement. Although we believe our anemia management practices and other pharmaceutical administration 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 for the Northern District of Georgia relates to the pharmaceutical products Zemiplar, Hectorol, Venofer, Ferrlecit, EPO and other related matters. 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. The subpoena from the Office of Inspector General in Houston, Texas requests records relating to EPO claims submitted to Medicare. In addition, in February 2008 the Attorney General's Office for the State of Nevada notified us that Nevada Medicaid intends to conduct audits of ESRD dialysis providers in Nevada relating to the billing of pharmaceuticals, including EPO. 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 have a material adverse effect on our revenues, earnings and cash flows. See Note 16 to our consolidated financial statements for additional information regarding these inquiries and subpoenas.

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 Law physician self-referral prohibition and analogous state referral statutes, the federal False Claims Act, or FCA, 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. A violation or departure from any of these requirements may result in government audits, lower reimbursements, significant fines and penalties, the potential loss of certification and recoupments or voluntary repayments.

Risk Factors (continued)

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 physician self-referral law (Stark 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. In addition, recent amendments to the FCA impose severe penalties for the knowing and improper retention of overpayments collected from government payors. These amendments could subject our procedures for identifying and processing overpayments to greater scrutiny. We have made significant investments in additional resources to accelerate the time it takes to identify and process overpayments and we may be required to make additional investments in the future. An acceleration in our ability to identify and process overpayments could result in us refunding overpayments to government or other payors sooner than we have in the past. A significant acceleration of these refunds could have a material adverse affect on our operating cash flows.

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 Law violations, FCA violations, civil or criminal liability based on violations of law, or other failures to meet regulatory requirements;
- Claims for monetary damages from patients who believe their protected health information has been used or disclosed in violation of federal or state patient privacy laws;
- Mandated practice changes that significantly increase operating expenses; and
- Termination of relationships with medical directors.

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 are having difficulty certifying dialysis centers in the normal course resulting in significant delays in certification. If state governments continue to have difficulty certifying new centers in the normal course and we continue to experience significant delays in our ability to treat and bill for services provided to patients covered under government programs, it could cause us to incur write-offs of investments or

accelerate the recognition of lease obligations in the event we have to close centers or our centers' operating performance deteriorates, and it could have an adverse effect on our revenues, earnings and cash flows.

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 December 31, 2009, we owned a controlling interest in numerous dialysis related joint ventures, which represented approximately 16% of our dialysis and related lab services revenues for the year ended December 31, 2009. In addition, we also owned equity interests 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 federal anti-kickback statute, 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 and related requests for documents we received from the United States Attorney's Office for the Eastern District of Missouri included requests for documents related to our joint ventures. See Note 16 to our consolidated financial statements for additional information regarding these inquiries and subpoenas.

If our joint ventures are found to be in violation of the anti-kickback statute or the Stark Law 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 by the joint ventures from Medicare and certain other payors to the extent that these arrangements are found to give rise 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 and related refund liabilities that we recognize and if we are unable to accurately estimate our revenue and related refund liabilities, 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 and related lab services revenues and related refund liabilities that we recognize in a reporting period. The billing and collection process is complex due to ongoing insurance coverage changes, geographic coverage differences, differing interpretations of contract coverage, and other payor issues. Determining applicable primary and secondary coverage for approximately 118,000 patients at any point in time, together with the changes in patient coverage that occur each month, requires complex, resource-intensive processes. 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. We generally expect our range of dialysis and related lab services revenues estimating risk to be within 1% of revenues for the segment, which can represent as much as 6% of consolidated operating income. If our estimates of dialysis and related lab services revenues and related refund liabilities are materially inaccurate, it could impact the timing of our revenue recognition and have a significant impact on our operating results.

Risk Factors (continued)

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, infusion therapy services, disease management services, vascular access services, ESRD clinical research programs and physician services. Many of these initiatives require investments of both management and financial resources and can generate significant losses for a substantial period of time and may not become profitable. There can be no assurance that any such strategic initiative will ultimately be successful. Any significant change in market conditions, business performance or in the regulatory environment may impact the economic viability of any of these strategic initiatives. For example, during 2009 and 2008, several of our strategic initiatives generated net operating losses and are expected to generate net operating losses in 2010. If any of our ancillary services or strategic initiatives do not perform as planned, we may incur a material write-off or an impairment of our investment, including goodwill, in one or more of these activities or we could incur significant termination costs if we were to exit a certain line of business.

If a significant number of physicians were to cease referring patients to our dialysis centers, whether due to regulatory or other reasons, it would have a material adverse effect on our revenues, earnings and cash flows.

We believe that 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 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 dialysis 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.

Current economic conditions, including the current recession, as well as further disruptions in the financial markets could result in substantial declines in our revenues, earnings, cash flows and financial condition.

The current economic recession 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. Increasing job losses in the United States as a result of current

economic conditions has and may continue to 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. Employers may also begin to select more restrictive commercial plans with lower reimbursement rates. To the extent that payors are negatively impacted by a decline in the economy, we may experience further pressure on commercial rates, a further slow down in collections and a reduction in the amounts we expect to collect. In addition, if the current uncertainty in the financial markets continues, the variable interest rates payable under our credit facilities could be adversely affected or it could be more difficult to obtain or renew such facilities or to obtain other forms of financing 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 have a material adverse effect on 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.

The dialysis industry is highly competitive, particularly in terms of acquiring existing dialysis centers. We continue to face 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. Because of the ease of entry into the dialysis business and the ability of physicians to be medical directors for their own centers, competition for growth in existing and expanding markets is not limited to large competitors with substantial financial resources. Occasionally, we have experienced competition from former medical directors or referring physicians who have opened their own dialysis centers. In addition, Fresenius, our largest competitor, manufactures a full line of dialysis supplies and equipment in addition to owning and operating dialysis centers. This may give them cost advantages over us because of their ability to manufacture their own products. 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.

The level of our current and future debt could have an adverse impact on our business and our ability to generate cash to service our indebtedness depends on many factors beyond our control.

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;
- limit our flexibility in planning for, or reacting to, changes in our business and the markets in which we operate;
- place us at a competitive disadvantage compared to our competitors that have less debt; and
- limit our ability to borrow additional funds.

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.

Risk Factors (continued)

We cannot provide assurance 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 or to fund other liquidity needs. Our Senior Secured Credit Facilities are secured by substantially all of our and our wholly-owned 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 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.

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 volatility associated with the portions of our borrowings that bear interest at variable rates. As of December 31, 2009, we had approximately \$1.9 billion outstanding borrowings under our Senior Secured Credit Facilities, which bears interest at a variable rate. Approximately \$0.4 billion of this outstanding debt is subject to interest rate swaps which have the economic effect of fixing the interest rate on an equivalent portion of our debt. The remaining variable rate debt outstanding under our Senior Secured Credit Facilities had a weighted average interest rate of 1.74% at December 31, 2009. As of December 31, 2009, the interest rates were economically fixed on approximately 21% of our variable rate debt and approximately 59% of our total debt. In addition, we have approximately \$198 million of available borrowings under our Senior Secured Credit Facilities that would bear interest at the LIBOR-based variable rate plus an interest rate margin of 1.50%. 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. For example, it is estimated that a hypothetical increase in interest rates of 100 basis points across all variable rate maturities would reduce net income by approximately \$9.9 million, for the next twelve months given our current interest rates in effect at December 31, 2009. See "Quantitative and Qualitative Disclosures about Market Risk" for more information. 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.

If there are shortages of skilled clinical personnel 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. In addition, changes in certification requirements for skilled clinical personnel can impact our ability to maintain sufficient staff levels to the extent our teammates are not able to meet new requirements or competition for qualified individuals increases. 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 political efforts at the national and local level result in actions or proposals that increase the likelihood of union organizing activities at our facilities or if union organizing activities increase for other reasons, our operating costs could increase and our employee relations, productivity, earnings and cash flows could be adversely affected.

Upgrades to our billing and collections systems and complications associated with upgrades and other improvements to our billing and collections systems could have a material adverse effect on our revenues, cash flows and operating results.

We are continuously performing upgrades to our billing systems and expect to continue to do so during 2010. In addition, we continuously work to improve our billing and collections performance through process upgrades, organizational changes and other improvements. 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, an increase in our provision for uncollectible accounts receivable and noncompliance with reimbursement regulations. The failure to successfully implement the upgrades to the billing and collection systems and other improvements could have a material adverse effect on our revenues, cash flows and operating results.

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, including Amgen, Fresenius Medical Care, Baxter Healthcare Corporation, NxStage Medical, Inc. and others or to which we have committed obligations to make purchases including Gambro Renal Products. 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, a recall of heparin by Baxter Healthcare Corporation in 2008 resulted in only one remaining supplier of heparin and the cost to purchase heparin significantly increased. While an alternative supplier has entered the market, 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. 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.

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 adverse patient events, 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

Risk Factors (continued)

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:

- the collapse or insolvency of our insurance carriers;
- 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 originally 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 has been in place since 2001, and which provides for cash bonuses to the employees in the event of a change of control. Based on the market price of our common stock and shares outstanding on December 31, 2009, these cash bonuses would total approximately \$235 million if a change of control transaction occurred at that price and our Board of Directors did not modify this program. These change of control provisions 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.

Selected Financial Data

The following table presents selected consolidated financial and operating data for the periods indicated. Effective January 1, 2009, we were required to present consolidated net income attributable to us and to noncontrolling interests on the face of the consolidated statement of income, which changed the presentation of minority interests (noncontrolling interests) in our consolidated statements of income. These consolidated financial results have been recast for all prior periods presented to reflect the retrospective application of adopting these new presentation and disclosure requirements for noncontrolling interests. The operating results of DVA Renal Healthcare are included in our operating results from October 1, 2005, and the operating results of the historical DaVita divested centers are reflected as discontinued operations in our consolidated statements of income for 2005.

	Year ended December 31,				
	2009	2008	2007	2006	2005
	(in thousands, except share data)				
Income statement data:					
Net operating revenues ⁽¹⁾	\$ 6,108,800	\$ 5,660,173	\$ 5,264,151	\$ 4,880,662	\$ 2,973,918
Operating expenses and charges ⁽²⁾	5,168,529	4,791,077	4,355,240	4,103,089	2,485,052
Operating income	940,271	869,096	908,911	777,573	488,866
Debt expense ⁽³⁾	(185,755)	(224,716)	(257,147)	(276,706)	(139,586)
Swap valuations gain, net ⁽⁴⁾	—	—	—	—	4,548
Refinancing charges ⁽⁵⁾	—	—	—	—	(8,170)
Other income, net ⁽⁶⁾	3,708	12,411	22,460	13,033	8,934
Income from continuing operations before income taxes	758,224	656,791	674,224	513,900	354,592
Income tax expense	278,465	235,471	245,581	186,430	123,675
Income from continuing operations	479,759	421,320	428,643	327,470	230,917
Income from discontinued operations, net of tax ⁽⁷⁾	—	—	—	1,747	14,376
Gain on disposal of discontinued operations, net of tax ⁽⁷⁾	—	—	—	362	8,064
Net income	\$ 479,759	\$ 421,320	\$ 428,643	\$ 329,579	\$ 253,357
Less: Net income attributable to noncontrolling interests ⁽⁸⁾	\$ (57,075)	\$ (47,160)	\$ (46,865)	\$ (39,888)	\$ (24,714)
Net income attributable to DaVita Inc.	\$ 422,684	\$ 374,160	\$ 381,778	\$ 289,691	\$ 228,643
Basic earnings per common share from continuing operations attributable to DaVita Inc. ⁽⁷⁾	\$ 4.08	\$ 3.56	\$ 3.61	\$ 2.79	\$ 2.06
Diluted earnings per common share from continuing operations attributable to DaVita Inc. ⁽⁷⁾	\$ 4.06	\$ 3.53	\$ 3.55	\$ 2.73	\$ 1.99
Weighted average shares outstanding: ⁽¹⁰⁾					
Basic	103,604,000	105,149,000	105,893,000	103,520,000	100,762,000
Diluted	104,168,000	105,940,000	107,418,000	105,793,000	104,068,000
Ratio of earnings to fixed charges ⁽⁹⁾	3.58:1	3.01:1	2.92:1	2.38:1	2.86:1
Balance sheet data:					
Working capital	\$ 1,255,580	\$ 965,233	\$ 889,917	\$ 597,324	\$ 664,675
Total assets	7,558,236	7,286,083	6,943,960	6,491,816	6,279,762
Long-term debt	3,532,217	3,622,421	3,683,887	3,730,380	4,085,435
Total DaVita Inc. shareholders' equity ⁽¹⁰⁾	2,135,066	1,767,747	1,504,285	1,139,333	740,122

- (1) Net operating revenues include \$3,771 in 2005 of Medicare lab recoveries relating to prior years' services.
(2) Operating expenses and charges include \$55,275 in 2007 and \$37,968 in 2006 of valuation gains on the alliance and product supply agreement with Gambro Renal Products, Inc. Operating expenses and charges in 2007 also includes \$6,779 of gains from insurance settlements related to Hurricane Katrina and a fire that destroyed one center.

- (3) Debt expense in 2007 and 2006 includes the write-off of approximately \$4.4 million and \$3.3 million, respectively, of deferred financing costs associated with our principal prepayments on our term loans.
- (4) The swap valuation net gains of \$4,548 in 2005 represented the accumulated fair value on several swap instruments that were ineffective as cash flow hedges, as a result of the repayment of our prior senior secured credit facilities, as well as changes in the fair values of these swaps until they were redesignated as hedges, and represent changes in the fair value of the swaps during periods in which there was no matching variable rate LIBOR-based interest payments.
- (5) Refinancing charges of \$8,170 in 2005 represented the write-off of deferred financing costs associated with the extinguishment of our prior senior secured credit facilities.
- (6) Other income, net, includes \$5,868 in 2007 of gains from the sale of investment securities.
- (7) During 2005, we divested a total of 71 outpatient dialysis centers in conjunction with a consent order issued by the Federal Trade Commission on October 4, 2005 in order for us to complete the acquisition of DVA Renal Healthcare. In addition, we completed the sale of three additional centers that were previously pending state regulatory approval in January 2006. The operating results of the historical DaVita divested and held for sale centers were reflected as discontinued operations in our consolidated financial statements for 2005.
- (8) Net income attributable to noncontrolling interests includes \$1,747 in 2006, and \$1,219 in 2005 of income from discontinued operations.
- (9) The ratio of earnings to fixed charges was computed by dividing earnings by fixed charges. Earnings for this purpose is defined as pretax income from continuing operations adjusted by adding back fixed charges expensed during the period. Fixed charges include debt expense (interest expense and the write-off and amortization of deferred financing costs), the estimated interest component of rental expense on operating leases, and capitalized interest.
- (10) Share repurchases consisted of 2,902,619 shares of common stock for \$153,495 in 2009, 4,788,881 shares of common stock for \$232,715 in 2008 and 111,300 shares of common stock for \$6,350 in 2007. Shares issued in connection with stock awards amounted to 2,104,304 in 2009, 1,314,074 in 2008, 2,480,899 in 2007, 2,620,125 in 2006 and 3,303,451 in 2005.

Market for the Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Our common stock is traded on the New York Stock Exchange under the symbol "DVA". The following table sets forth, for the periods indicated, the high and low closing prices for our common stock as reported by the New York Stock Exchange.

	<u>High</u>	<u>Low</u>
Year ended December 31, 2009:		
1st quarter	\$53.04	\$42.34
2nd quarter	49.56	42.36
3rd quarter	56.64	47.78
4th quarter	61.55	53.03
Year ended December 31, 2008:		
1st quarter	\$59.23	\$42.48
2nd quarter	53.86	47.79
3rd quarter	60.01	52.64
4th quarter	56.75	42.66

The closing price of our common stock on January 29, 2010 was \$59.76 per share. According to The Bank of New York, our registrar and transfer agent, as of January 29, 2010, there were 8,315 holders of record of our common stock. We have not declared or paid cash dividends to holders of our common stock since 1994. We have no current plans to pay cash dividends and we are restricted from paying dividends under the terms of our Senior Secured Credit Facilities and the indentures governing our senior and senior subordinated notes. Also, see the heading "Liquidity and capital resources" under "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" and the notes to our consolidated financial statements.

Stock Repurchases

The following table summarizes our repurchases of our common stock during 2009:

<u>Period</u>	<u>Total Number of Shares Purchased</u>	<u>Average Price Paid per Share</u>	<u>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs(1)</u>	<u>Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (in millions)</u>
March 1–31, 2009	744,400	\$43.01	744,400	\$121.5
September 1–30, 2009	1,108,784	56.25	1,108,784	59.1
October 1–31, 2009	1,049,435	56.32	1,049,435	500.0
Total	<u>2,902,619</u>	<u>\$52.88</u>	<u>2,902,619</u>	

- (1) On September 11, 2003, we announced that the Board of Directors authorized the repurchase of up to \$200 million of our common stock, with no expiration date. On November 2, 2004, we announced that the Board of Directors approved an increase in our authorization to repurchase shares of our common stock by an additional \$200 million. On May 1, 2008, our Board of Directors authorized an increase of an additional \$143.5 million of repurchases of our common stock. On November 3, 2009, we announced that the Board of Directors authorized an increase of an additional \$500 million for repurchases of our common stock.

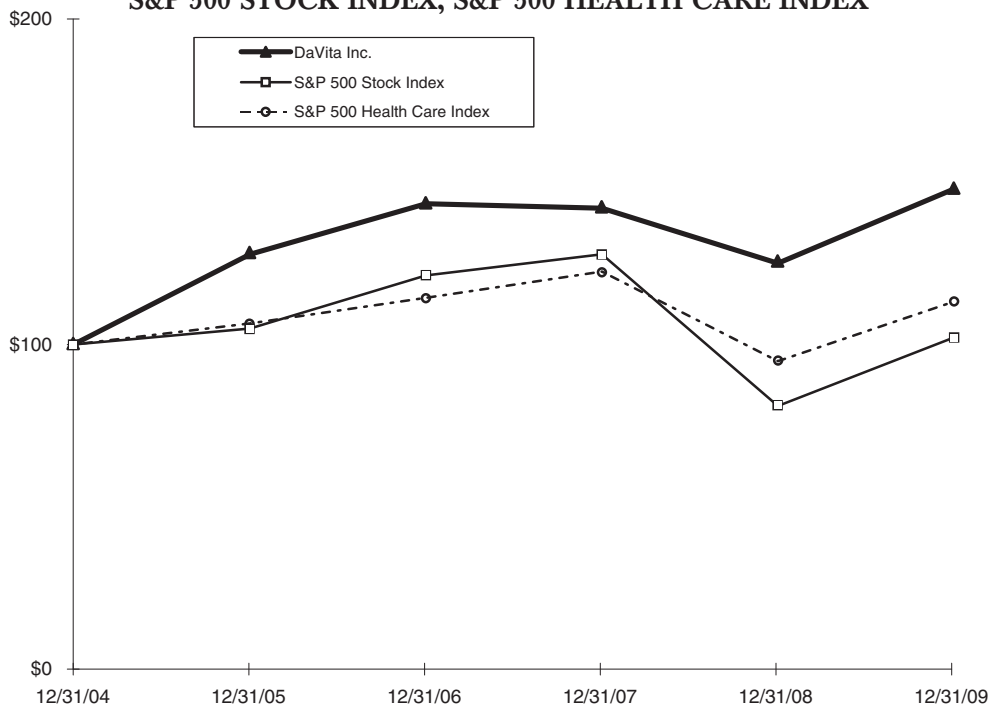
This stock repurchase program has no expiration date. We are authorized to make purchases from time to time in the open market or in privately negotiated transactions, depending upon market conditions and other considerations. However, we are subject to share repurchase limitations under the terms of the Senior Secured Credit Facilities and the indentures governing our senior and senior subordinated notes.

Stock Price Performance

The following graph shows a comparison of our cumulative total returns, the Standard & Poor's 500 Stock Index and the S&P 500 Health Care Index. The graph assumes that the value of an investment in our common stock and in each such index was \$100.00 on December 31, 2004 and that all dividends have been reinvested.

The comparison in the graph below is based solely on historical data and is not intended to forecast the possible future performance of our common stock.

COMPARISON OF FIVE-YEAR CUMULATIVE TOTAL RETURN AMONG DAVITA INC, S&P 500 STOCK INDEX, S&P 500 HEALTH CARE INDEX



	12/31/04	12/31/05	12/31/06	12/31/07	12/31/08	12/31/09
DaVita Inc.	\$100.0	\$128.1	\$143.9	\$142.5	\$125.4	\$148.6
S&P 500 Stock Index	\$100.0	\$104.9	\$121.5	\$128.2	\$ 80.7	\$102.1
S&P 500 Health Care Index	\$100.0	\$106.5	\$114.5	\$122.7	\$ 94.7	\$113.3

Quantitative and Qualitative Disclosures about Market Risk

Interest rate sensitivity

The tables below provide information about our financial instruments that are sensitive to changes in interest rates. For our debt obligations the table presents principal repayments and current weighted average interest rates on our debt obligations as of December 31, 2009. The variable rates presented reflect the weighted average LIBOR rates in effect for all debt tranches plus margins in effect at the end of 2009 including the economic effects of our swap agreements. Term loan A and revolving line of credit interest rate margins are subject to adjustment depending upon changes in certain of our financial ratios including a leverage ratio. The margins currently in effect at December 31, 2009 were 1.50% on all of the outstanding balances under our Senior Secured Credit Facilities. For our interest rate swap agreements, the table below presents the notional amounts by contract maturity date and the related interest rate terms of the agreements (to pay fixed rates, and to receive LIBOR).

	Expected maturity date						Total	Fair Value	Average interest rate
	2010	2011	2012	2013	2014	Thereafter			
	(dollars in millions)								
Long-term debt:									
Fixed rate	\$ 2	\$ 1	\$ 1	\$901	\$ 1	\$852	\$ 1,758	\$ 1,765	6.88%
Variable rate	\$ 98	\$ 67	\$1,707	\$ —	\$—	\$ —	\$ 1,872	\$ 1,829	2.62%
	Notional amount	Contract maturity date					Pay fixed	Receive variable	Fair value
		2010	2011	2012	2013	2014			
		(dollars in millions)							
Swaps:									
Pay-fixed swaps	\$389	\$389	\$ —	\$ —	\$—	\$ —	3.88% to 4.70%	LIBOR	\$(10.8)

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 plus an interest rate margin, which is currently 1.50% at December 31, 2009. LIBOR-based interest rates are reset as each specific tranche matures and a new tranche is re-established 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 \$1.5 billion as of December 31, 2009 will have a negative impact on our overall earnings.

As of December 31, 2009, we maintained a total of eight interest rate swap agreements, with amortizing notional amounts totaling \$389 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 3.88% to 4.70%, resulting in an overall weighted average effective interest rate of 5.78% on the hedged portion of our Senior Secured Credit Facilities, including the term loan B margin of 1.50%. The swap agreements expire in 2010 and require quarterly interest payments. During 2009, we accrued net cash obligations of \$17.3 million from these swaps, which are included in debt expense. As of December 31, 2009, the total fair value of these swaps was a liability of \$10.8 million. During 2009, we recorded \$8.0 million, net of tax, as an increase to other comprehensive income for amounts reclassified into income, net of swap valuation losses.

As of December 31, 2009, the interest rates were economically fixed on approximately 21% of our variable rate debt and approximately 59% of our total debt.

As a result of the swap agreements, our overall weighted average effective interest rate on the Senior Secured Credit Facilities was 2.63%, based upon the current margins in effect of 1.50% as of December 31, 2009.

Our overall weighted average effective interest rate in 2009 was 4.86% and as of December 31, 2009 was 4.68%.

One means of assessing exposure to debt-related interest rate changes is a duration-based analysis that measures the potential loss in net income resulting from a hypothetical increase in interest rates of 100 basis points across all variable rate maturities (referred to as a “parallel shift in the yield curve”). Under this model, with all else constant, it is estimated that such an increase would have reduced net income by approximately \$8.5 million, \$7.1 million, and \$5.5 million, net of tax, for the years ended December 31, 2009, 2008, and 2007, respectively.

Exchange rate sensitivity

We are currently not exposed to any foreign currency exchange rate risk.



CORPORATE INFORMATION

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Annual Meeting of Stockholders
Monday, June 7, 2010
DaVita Inc.
1627 Cole Boulevard
Lakewood, CO 80401

Common Stock Listing
New York Stock Exchange (NYSE)
Symbol: DVA

Form 10-K Request
For a free copy of DaVita's annual report on
Form 10-K for the year ended December 31,
2009 please send a written request to Jim
Gustafson, Vice President, Investor Relations at
DaVita's corporate address.

Corporate Governance Guidelines
DaVita's corporate governance guidelines, Code
of Ethics and Board Committee Charters are
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Lincoln Financial Group

Kent J. Thiry
Chairman of the Board and
Chief Executive Officer
DaVita Inc.

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