

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q/A

(AMENDMENT NO. 1)

(Mark One)

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

For the quarterly period ended March 31, 1999

OR

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

For the transition period from to

Commission File Number: 1-4034

TOTAL RENAL CARE HOLDINGS, INC.  
(Exact name of registrant as specified in its charter)

FOR THE QUARTER ENDED MARCH 31, 1999

Delaware  
(State or other jurisdiction of  
incorporation or organization)

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

21250 Hawthorne Blvd., Suite 800  
Torrance, California  
(Address of principal executive offices)

90503-5517  
(Zip Code)

Registrant's telephone number, including area code: (310) 792-2600

Not Applicable  
(Former name or former address, if changed since last report)

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

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY  
PROCEEDINGS DURING THE PRECEDING FIVE YEARS:

Indicate by check mark whether the Registrant has filed all documents and  
reports required to be filed by Sections 12, 13 or 15(d) of the Securities  
Exchange Act of 1934 subsequent to the distribution of securities under a plan  
confirmed by a court. Yes ☐ No ☐

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of  
common stock as of the latest practicable date.

Class	Outstanding at May 1, 1999
Common Stock, Par Value \$0.001.....	81,172,370 shares

TOTAL RENAL CARE HOLDINGS, INC.

Unless otherwise indicated in this Form 10-Q, "we," "us," "our" and similar terms refer to Total Renal Care Holdings, Inc. and its subsidiaries.

INTRODUCTORY STATEMENT

We are filing this Amendment No. 1 on Form 10-Q/A for the quarterly period ended March 31, 1999 to restate the financial information to correct for previously unrecorded amounts due to suppliers. Our operating expenses and other current liabilities for the three months ended March 31, 1999 increased by \$13,150,000 and net income for the same period decreased by \$7,943,000, net of tax of \$5,207,000.

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Note: Items 1, 2, 3, 4 and 5 of Part II are omitted because they are not applicable.

## TOTAL RENAL CARE HOLDINGS, INC.

## CONDENSED CONSOLIDATED BALANCE SHEETS

	March 31, 1999	December 31, 1998
	-----	-----
ASSETS		
-----		
Current assets:		
Cash and cash equivalents.....	\$ 39,905,000	\$ 41,487,000
Patient accounts receivable, less allowance for doubtful accounts of \$68,828,000 and \$61,848,000, respectively.....	441,810,000	416,472,000
Deferred income taxes.....	34,320,000	31,917,000
Other current assets.....	58,122,000	50,395,000
	-----	-----
Total current assets.....	574,157,000	540,271,000
Property and equipment, net.....	261,189,000	233,337,000
Notes receivable and other long-term assets ...	94,743,000	57,578,000
Intangible assets, net of accumulated amortization of \$130,936,000 and \$114,982,000, respectively.....	1,117,315,000	1,084,395,000
	-----	-----
Total assets.....	\$2,047,404,000	\$1,915,581,000
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY		
-----		
Current liabilities:		
Current portion of long-term obligations.....	\$ 19,435,000	\$ 21,847,000
Other current liabilities.....	157,474,000	152,617,000
	-----	-----
Total current liabilities.....	176,909,000	174,464,000
Long term debt and other.....	1,324,754,000	1,227,671,000
Deferred income taxes.....	15,301,000	8,212,000
Minority interests.....	26,545,000	23,422,000
Stockholders' equity:		
Preferred stock, (\$.001 par value; 5,000,000 shares authorized; none outstanding).....		
Common stock, voting, (\$.001 par value; 195,000,000 shares authorized; 81,153,000 and 81,030,000 shares issued and outstanding, respectively).....	81,000	81,000
Additional paid-in capital.....	415,581,000	413,095,000
Notes receivable from stockholders.....	(364,000)	(356,000)
Accumulated other comprehensive income.....	(336,000)	
Retained earnings.....	88,933,000	68,992,000
	-----	-----
Total stockholders' equity.....	503,895,000	481,812,000
	-----	-----
Total liabilities and stockholders' equity.....	\$2,047,404,000	\$1,915,581,000
	=====	=====

See accompanying Notes to Condensed Consolidated Financial Statements and Management's Discussion and Analysis of Financial Condition and Results of Operations.

## TOTAL RENAL CARE HOLDINGS, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

Three months ended March 31, 1999 and 1998

	Three Months	
	1999	1998
<b>STATEMENTS OF INCOME</b>		
Net operating revenues.....	\$ 352,244,000	\$258,749,000
Operating expenses:		
Facilities.....	233,983,000	166,995,000
General and administrative.....	23,987,000	16,910,000
Provision for doubtful accounts.....	10,478,000	6,763,000
Depreciation and amortization.....	27,025,000	19,594,000
Merger and related costs.....		79,435,000
	-----	-----
Total operating expenses.....	295,473,000	289,697,000
Operating income (loss).....	56,771,000	(30,948,000)
Interest expense, net of capitalized interest.....	(22,767,000)	(14,517,000)
Interest income.....	1,330,000	1,642,000
	-----	-----
Income (loss) before income taxes, minority interests, extraordinary item and cumulative effect of change in accounting principle.....	35,334,000	(43,823,000)
Income taxes.....	13,075,000	872,000
	-----	-----
Income (loss) before minority interests, extraordinary item and cumulative effect of change in accounting principle.....	22,259,000	(44,695,000)
Minority interests in income of consolidated subsidiaries.....	2,318,000	1,393,000
	-----	-----
Income (loss) before extraordinary item and cumulative effect of change in accounting principle.....	19,941,000	(46,088,000)
Extraordinary loss, net of tax of \$1,580,000.....		2,812,000
Cumulative effect of change in accounting principle, net of tax of \$4,300,000.....		6,896,000
	-----	-----
Net income (loss).....	\$ 19,941,000	\$ (55,796,000)
	=====	=====
<b>Earnings (loss) per common share:</b>		
Income (loss) before extraordinary item and cumulative effect of change in accounting principle.....	\$ 0.25	\$ (0.59)
Extraordinary loss, net of tax.....		(0.03)
Cumulative effect of change in accounting principle, net of tax.....		(0.09)
	-----	-----
Net income (loss).....	\$ 0.25	\$ (0.71)
	=====	=====
Weighted average number of common shares outstanding.....	81,102,000	78,926,000
	=====	=====
<b>Earnings (loss) per common share--assuming dilution:</b>		
Income (loss) before extraordinary item and cumulative effect of change in accounting principle.....	\$ 0.24	\$ (0.59)
Extraordinary loss, net of tax.....		(0.03)
Cumulative effect of change in accounting principle, net of tax.....		(0.09)
	-----	-----
Net income (loss).....	\$ 0.24	\$ (0.71)
	=====	=====
Weighted average number of common shares and equivalents outstanding--assuming dilution.....	86,458,000	78,926,000

STATEMENTS OF COMPREHENSIVE INCOME	=====	=====
Net income (loss).....	\$ 19,941,000	\$ (55,796,000)
Other comprehensive income:		
Foreign currency translation.....	(336,000)	
	-----	-----
Comprehensive income (loss).....	\$ 19,605,000	\$ (55,796,000)
	=====	=====

See accompanying Notes to Condensed Consolidated Financial Statements and Management's Discussion and Analysis of Financial Condition and Results of Operations.

## TOTAL RENAL CARE HOLDINGS, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

Three months ended March 31, 1999 and 1998

	Three Months	
	1999	1998
Cash flows from operating activities:		
Net income (loss) .....	\$ 19,941,000	\$ (55,796,000)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization.....	27,025,000	19,594,000
Extraordinary item, net of tax.....		2,812,000
Provision for doubtful accounts.....	10,478,000	6,763,000
Change in accounting principle, net of tax...		6,896,000
Compensation expense from stock option exercise.....		16,000,000
Changes in working capital.....	(19,127,000)	(31,825,000)
Total adjustments.....	18,376,000	20,240,000
Net cash provided by (used in) operating activities.....	38,317,000	(35,556,000)
Cash flows from investing activities:		
Purchases of property and equipment.....	(38,638,000)	(12,937,000)
Cash paid for acquisitions, net of cash acquired.....	(77,417,000)	(64,160,000)
Other.....	(17,666,000)	(18,930,000)
Net cash used in investing activities....	(133,721,000)	(96,027,000)
Cash flows from financing activities:		
Borrowings from bank credit facility.....	84,500,000	494,000,000
Principal payments on long-term obligations....		(325,121,000)
Net proceeds from sale of common stock.....	1,992,000	17,441,000
Other.....	7,330,000	4,628,000
Net cash provided by financing activities.....	93,822,000	190,948,000
Net (decrease) increase in cash.....	(1,582,000)	59,365,000
Cash at beginning of period.....	41,487,000	6,143,000
Cash at end of period.....	\$ 39,905,000	\$ 65,508,000

See accompanying Notes to Condensed Consolidated Financial Statements and Management's Discussion and Analysis of Financial Condition and Results of Operations.

TOTAL RENAL CARE HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. In our opinion the interim financial information reflects all normal recurring adjustments which are necessary to state fairly our consolidated financial position, results of operations, and cash flows as of and for the periods indicated. We presume that users of the interim financial information herein have read or have access to our audited consolidated financial statements and Management's Discussion and Analysis of Financial Condition and Results of Operations for the preceding fiscal year and that the adequacy of additional disclosure needed for a fair presentation, except in regard to material contingencies or recent significant events, may be determined in that context. Accordingly, we have omitted footnote and other disclosures which would substantially duplicate the disclosures contained in our Form 10-K for the year ended December 31, 1998. We have made certain reclassifications of prior period amounts to conform to current period classifications. The interim financial information herein is not necessarily representative of a full year's operations.

The information related to the activity for the three months ended March 31, 1999 has been restated for adjustments to correct for previously unrecorded amounts due to suppliers. Facility operating expenses and general and administrative expenses have increased by \$11,900,000 and \$1,250,000, respectively, and adjustments to other accrued liabilities and income tax liabilities have been recorded and are reflected in this Form 10-Q. The following summarizes the impact of these adjustments to net income for the three months ended March 31, 1999.

	For the three months ended March 31, 1999	
	-----	
	As	
	originally	
	reported	As restated
	-----	-----
Operating expense.....	\$282,323,000	\$295,473,000
Income from operations.....	69,921,000	56,771,000
Income taxes.....	18,282,000	13,075,000
Net income.....	27,884,000	19,941,000
Earnings per share.....	0.34	0.25
Earnings per share--assuming dilution.....	0.34	0.24

The information related to the activity for the three months ended March 31, 1998 has been restated for certain reclassifications and adjustments. The accrued merger and related costs initially reported by us in the first quarter of 1998 amounted to \$92,835,000. We have revised our financial reporting relating to certain costs initially included in our merger and related costs and accrual resulting in a decrease in merger and related costs of \$13,400,000, partially offset by an increase to facilities operating costs of \$1,700,000 and an increase to depreciation and amortization of \$590,000 for a net decrease to our first quarter 1998 operating expenses of \$11,110,000. These reclassifications and adjustments are more fully described in our Form 10-K for the year ended December 31, 1998.

TOTAL RENAL CARE HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

2. On February 27, 1998, we acquired Renal Treatment Centers, Inc., or RTC, in a merger transaction. The merger was accounted for as a pooling of interests. As a result, we restated our condensed consolidated financial statements to include RTC for all periods presented. We had no transactions with RTC prior to the combination and no adjustments were necessary to conform RTC's accounting policies to ours. The results of operations for the separate companies and the combined results presented in the condensed consolidated financial statements follow:

	Three months ended March 31, 1998 -----
Net operating revenues	
TRCH.....	\$144,088,000
RTC.....	114,661,000
	-----
	\$258,749,000
	=====
Loss before extraordinary item and cumulative effect of change in accounting principle	
TRCH.....	\$ (18,773,000)
RTC.....	(27,315,000)
	-----
	\$ (46,088,000)
	=====
Net loss	
TRCH.....	\$ (21,677,000)
RTC.....	(34,119,000)
	-----
	\$ (55,796,000)
	=====

Merger and related costs recorded during the first quarter of 1998 in connection with our merger with RTC included costs associated with certain of the integration activities, transaction costs and costs of employee severance and amounts due under employment agreements and other compensation programs. A summary of merger and related costs and accrual activity through March 31, 1999 is as follows:

	Direct Transaction Costs	Severance and Employment Costs	Costs to Integrate Operations	Total
Initial expense.....	\$21,580,000	\$ 41,960,000	\$ 15,895,000	\$ 79,435,000
Amounts utilized in 1998.....	(22,885,000)	(37,401,000)	(13,137,000)	(73,423,000)
Adjustment of estimates.....	1,305,000	(959,000)	(1,593,000)	(1,247,000)
	-----	-----	-----	-----
Accrual, December 31, 1998.....	\$	3,600,000	1,165,000	4,765,000
	=====			
Amounts utilized--1st quarter 1999.....		(600,000)	(90,000)	(690,000)
		-----	-----	-----
Accrual, March 31, 1999.....		\$ 3,000,000	\$ 1,075,000	\$ 4,075,000
		=====	=====	=====

The remaining balance of severance and employment costs represents tax gross-up payments expected to be paid in the second quarter of 1999. The remaining balance of costs to integrate operations represents remaining lease payments on RTC's vacant laboratory lease space.



In February 1998, in conjunction with our merger with RTC, we terminated RTC's revolving credit agreement, and recorded all of the remaining unamortized deferred financing costs as an extraordinary loss of \$2,812,000, net of income tax effect.

TOTAL RENAL CARE HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

3. During the quarter ended March 31, 1999, we purchased 23 centers and additional interests from minority partners in certain of our partnerships. Total cash consideration for these transactions was approximately \$77.4 million.

We accounted for these transactions under the purchase method. The cost of these acquisitions is allocated primarily to intangible assets such as patient charts, noncompete agreements and goodwill to the extent the purchase price exceeds the value of the tangible assets, primarily capital equipment.

The results of operations on a pro forma basis, as though the above acquisitions had been combined with us at the beginning of each period presented for the three months ended March 31, are as follows:

	1999	1998
	-----	-----
Pro forma net operating revenues.....	\$357,614,000	\$270,325,000
Pro forma income (loss) before extraordinary item and cumulative effect of change in accounting principle.....	\$ 20,834,000	\$(44,673,000)
Pro forma net income (loss) .....	\$ 20,834,000	\$(54,381,000)
Pro forma earnings (loss) per share before extraordinary item and cumulative effect of change in accounting principle:		
Basic.....	\$ 0.26	\$(0.57)
Assuming dilution.....	\$ 0.25	\$(0.57)

4. In March 1998, Statement of Position No. 98-1, Accounting for the Cost of Computer Software Developed or Obtained for Internal Use, or SOP 98-1, was issued and we adopted SOP 98-1 in the first quarter of 1999, effective January 1, 1999. SOP 98-1 defines internal-use software and identifies whether internal-use software costs that we incur must be expensed or capitalized. Costs that should be capitalized include external direct costs of materials and services, payroll and payroll related costs for employees directly associated with the internal-use software projects and certain interest costs incurred in the application development stage. All other internal-use software costs are expensed as incurred.

As a result of the adoption of SOP 98-1, we capitalized certain direct costs of materials and payroll and payroll related costs related to software projects currently in their application development stage. The capitalized costs of these projects are included in projects under development as a component of property, plant and equipment, as of March 31, 1999. The impact of the adoption is not material to our operations.

In April 1998, Statement of Position No. 98-5, Reporting on the Costs of Start-up Activities, or SOP 98-5, was issued. We adopted SOP 98-5 effective January 1, 1998. SOP 98-5 requires that pre-opening and organization costs, incurred in conjunction with facility pre-opening activities, which previously had been treated as deferred costs and amortized over five years, should be expensed as incurred. As a result of the adoption of SOP 98-5, all remaining unamortized pre-opening, development and organizational costs existing prior to January 1, 1998 of \$11,196,000 were recognized, net of tax of \$4,300,000, as the cumulative effect of a change in accounting principle in the first quarter of 1998.

TOTAL RENAL CARE HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

5. The reconciliation of the numerators and denominators used to calculate earnings (loss) per common share for all periods presented is as follows:

	Three months ended March 31,	
	1999	1998
Income (loss) before extraordinary item and cumulative effect of change in accounting principle.....	\$19,941,000	\$ (46,088,000)
Interest, net of tax resulting from dilutive effect of convertible debt.....	1,088,000	
Adjusted income (loss).....	21,029,000	(46,088,000)
Extraordinary loss, net of tax.....		(2,812,000)
Cumulative effect of change in accounting principle, net of tax.....		(6,896,000)
Income (loss)--assuming dilution.....	\$21,029,000	\$ (55,796,000)
Applicable Common Shares		
Average outstanding during the period.....	81,123,000	79,031,000
Reduction in shares in connection with notes receivable from employees.....	(21,000)	(105,000)
Weighted average number of shares outstanding for use in computing earnings per share.....	81,102,000	78,926,000
Dilutive effect of outstanding stock options.....	477,000	
Dilutive effect of convertible debt.....	4,879,000	
Weighted average number of shares and equivalents outstanding for use in computing earnings per share--assuming dilution.....	86,458,000	78,926,000
Earnings (loss) per common share:		
Income (loss) per common share before extraordinary item and cumulative effect of change in accounting principle.....	\$ 0.25	\$ (0.59)
Extraordinary loss, net of tax.....		(0.03)
Cumulative effect of change in accounting principle, net of tax.....		(0.09)
Net income (loss) per common share.....	\$ 0.25	\$ (0.71)
Earnings (loss) per common share--assuming dilution:		
Income (loss) before extraordinary item and cumulative effect of change in accounting principle.....	\$ 0.24	\$ (0.59)
Extraordinary loss, net of tax.....		(0.03)
Cumulative effect of change in accounting principle, net of tax.....		(0.09)
Net income (loss) per common share--assuming dilution.....	\$ 0.24	\$ (0.71)

Included in the above calculation for the three months ended March 31, 1999, is the effect of RTC's 5 5/8% convertible subordinated notes due 2006 treated on an "as converted" basis; however, the effect is not included for the three months ended March 31, 1998 because it was anti-dilutive. Our 7% convertible notes due 2009 were also antidilutive.

6. During the quarter ended June 30, 1998, we entered into forward interest rate cancelable swap agreements, with a combined notional amount of \$800,000,000. The lengths of the agreements are between three and ten years with cancellation clauses at the swap holders' option from one to seven years. The underlying blended rate is fixed at approximately 5.65% plus an applicable margin based upon our current leverage ratio. At March 31, 1999, the effective interest rate for borrowings under the swap agreements was 7.2%.



TOTAL RENAL CARE HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

7. In June 1996, RTC issued \$125,000,000 of 5 5/8% convertible subordinated notes due 2006. These notes are convertible, at the option of the holder, at any time after August 12, 1996 through maturity, unless previously redeemed or repurchased, into our common stock at a conversion price of \$25.62 principal amount per share, subject to certain adjustments. At any time on or after July 17, 1999, all or any part of these notes will be redeemable at our option on at least 15 and not more than 60 days' notice as a whole or, from time to time, in part at redemption prices ranging from 103.94% to 100% of the principal amount thereof, depending on the year of redemption, together with accrued interest to, but excluding, the date fixed for redemption. TRCH has guaranteed these notes.

The following is summarized financial information of RTC:

	March 31, 1999	December 31, 1998
Cash and cash equivalents.....	\$ 0	\$ 5,396,000
Accounts receivable, net.....	127,355,000	130,129,000
Other current assets.....	18,906,000	19,106,000
Total current assets.....	146,261,000	154,631,000
Property and equipment, net.....	86,734,000	75,641,000
Intangible assets, net.....	421,469,000	406,562,000
Other assets.....	3,159,000	9,249,000
Total assets.....	\$657,623,000	\$646,083,000
Current liabilities (includes \$311,843,000 and \$306,628,000 intercompany payable to TRCH at March 31, and December 31, 1998, respectively)..	\$352,255,000	\$352,753,000
Long-term debt.....	134,553,000	125,199,000
Stockholder's equity.....	170,815,000	168,131,000
Total liabilities and stockholders' equity.....	\$657,623,000	\$646,083,000

	Three months ended March 31,	
	1999	1998
Net operating revenues.....	\$120,402,000	\$114,661,000
Total operating expenses.....	114,258,000	136,407,000
Operating income (loss).....	6,144,000	(21,746,000)
Interest expense, net.....	1,802,000	3,588,000
Income before income taxes.....	4,342,000	(25,334,000)
Income taxes.....	1,658,000	1,981,000
Net income (loss) before extraordinary item and cumulative effect of change in accounting principle.....	\$ 2,684,000	\$ (27,315,000)

8. In November 1998, we issued \$345,000,000 of 7% convertible subordinated notes due 2009, or the 7% notes, in a private placement offering. The 7% notes are convertible, at the option of the holder, at any time into our common stock at a conversion price of \$32.81 per share. We may redeem the 7% notes on or after November 15, 2001. The 7% notes are general, unsecured obligations junior to all of our existing and future senior debt and, effectively, all existing and future liabilities of us and our subsidiaries.

We subsequently filed a registration statement covering the resale of the 7% notes which has not yet been declared effective by the SEC. As further described in the registration statement, commencing May 18, 1999, we will accrue certain monetary penalties on a weekly basis until the registration

statement is declared effective, as follows:

Days following 180 days after closing -----	Weekly Penalty -----	Cumulative Penalty -----
0-90	\$17,250	\$ 207,000
91-180	34,500	656,000
181-270	51,750	1,328,000
271-360	69,000	2,225,000
Thereafter	86,250	

Payment of these penalties is due upon the next interest due date.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

## 9. Contingencies

Our Florida-based laboratory subsidiary is the subject of a third-party carrier review relating to certain claims submitted by us for Medicare reimbursement. We understand that similar reviews have been undertaken with respect to other providers' laboratory activities in Florida and elsewhere. The carrier has alleged that 99.3% of the tests performed by this laboratory for the review period it initially identified, from January 1995 to April 1996, were not properly supported by the prescribing physicians' medical justification. The carrier subsequently requested billing records with respect to the additional period from May 1996 to March 1998. The carrier has issued a formal overpayment determination in the amount of \$5.6 million and has suspended all payments of claims related to this laboratory. The carrier has withheld approximately \$18 million as of March 31, 1999. In addition the carrier has informed the local offices of the Department of Justice, or DOJ, and the Department of Health and Human Services, or HHS, of this matter.

We have consulted with outside counsel, reviewed our records, are disputing the overpayment determination vigorously and have provided extensive supporting documentation of our claims. We have cooperated with the carrier to resolve this matter and have initiated the process of a formal review of the carrier's determination. The first step in this formal review process is a hearing before a hearing officer at the carrier, which is scheduled to begin in June 1999. We have received minimal responses from the carrier to our repeated requests for clarification and information regarding the continuing payment suspension. In February 1999, our Florida-based laboratory subsidiary filed a complaint against the carrier and HHS seeking a court order to lift the payment suspension. We initiated this action only after serious consideration and the unanimous approval of our board of directors, and we believe it is necessary to bring a prompt resolution to this payment dispute. We are unable to determine at this time:

- . When this matter will be resolved or when the laboratory's payment suspension will be lifted;
- . What, if any, of the laboratory claims will be disallowed;
- . What action the carrier, DOJ or HHS may take with respect to this matter;
- . What the outcome of the carrier's review of the periods from May 1996 through March 1998 will be and whether it will include the initiation of another payment suspension;
- . Whether additional periods may be reviewed by the carrier; or
- . Any other outcome of this investigation or our lawsuit.

Any determination adverse to us could have an adverse impact on our business, results of operations, financial condition or cash flows.

Following the announcement on February 18, 1999 of our preliminary results for the fourth quarter of fiscal 1998 and the full year then ended, several class action lawsuits were filed against us and certain of our officers in the U.S. District Court for the Central District of California. The complaints are similar and allege violations of federal securities laws arising from alleged false and misleading statements primarily regarding our accounting for the integration of RTC into TRCH and request unspecified monetary damages. We believe that all of the claims are without merit and we intend to defend ourselves vigorously. We anticipate that the attorneys' fees and related costs of defending these lawsuits should be covered primarily by our directors and officers insurance policies and we believe that any additional costs will not have a material impact on our financial condition, results of operations or cash flows.

TOTAL RENAL CARE HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

In addition, we are subject to claims and suits in the ordinary course of business for which we believe we will be covered by insurance. We do not believe that the ultimate resolution of these additional pending proceedings, whether the underlying claims are covered by insurance or not, will have a material adverse effect on our financial condition, results of operations or cash flows.

10. Subsequent to March 31, 1999, we completed acquisitions of 11 dialysis facilities for consideration of approximately \$50.5 million, which has been funded by additional borrowings under our credit facilities.



Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

As described in Note 2 to our condensed consolidated financial statements, we acquired Renal Treatment Centers, Inc., or RTC, on February 27, 1998 in a merger accounted for as a pooling of interests. Accordingly, our condensed consolidated financial statements have been restated to include RTC for all periods presented.

The information related to the activity for the three months ended March 31, 1999 has been restated for adjustments to correct for previously unrecorded amounts due to suppliers. Facility operating expenses and general and administrative expenses have increased by \$11,900,000 and \$1,250,000, respectively, and adjustments to other accrued liabilities and income tax liabilities have been recorded and are reflected in this Form 10-Q. The following summarizes the impact of these adjustments to net income for the three months ended March 31, 1999.

	For the three months ended March 31, 1999	
	-----	
	As	
	originally	
	reported	As restated
	-----	-----
Operating expense.....	\$282,323,000	\$295,473,000
Income from operations.....	69,921,000	56,771,000
Income taxes.....	18,282,000	13,075,000
Net income.....	27,884,000	19,941,000
Earnings per share.....	0.34	0.25
Earnings per share--assuming dilution.....	0.34	0.24

The information related to the activity for the three months ended March 31, 1998 has been restated for certain reclassifications and adjustments. The accrued merger and related costs initially reported by us in the first quarter of 1998 amounted to \$92,835,000. We have revised our financial reporting relating to certain costs initially included in our merger and related costs and accrual resulting in a decrease in merger and related costs of \$13,400,000, partially offset by an increase to facilities operating costs of \$1,700,000 and an increase to depreciation and amortization of \$590,000 for a net decrease to our first quarter 1998 operating expenses of \$11,110,000. These reclassifications and adjustments are more fully described in our Form 10-K for the year ended December 31, 1998.

#### Results of operations

Three months ended March 31, 1999 compared to the three months ended March 31, 1998

Net operating revenues. Net operating revenues are derived primarily from five sources: (a) outpatient facility hemodialysis services; (b) ancillary services, including the administration of EPO and other intravenous pharmaceuticals, clinical laboratory services, oral pharmaceutical products and other ancillary services; (c) home dialysis services and related products; (d) inpatient hemodialysis services provided to hospitalized patients pursuant to arrangements with hospitals; and (e) international operations. Additional revenues are derived from the provision of dialysis facility management services to certain subsidiaries and affiliated and unaffiliated dialysis centers. Our dialysis and ancillary services are reimbursed primarily under the Medicare ESRD program in accordance with rates established by HCFA. Payments are also provided by other third party payors, generally at rates higher than those reimbursed by Medicare for up to the first 33 months of treatment as mandated by law. Rates paid for services provided to hospitalized patients are negotiated with individual hospitals.

We maintain a usual and customary fee schedule for our dialysis treatment and other patient services. We often do not realize our usual and customary rates, however, because of limitations on the amounts we can bill to or collect from the payors for our services. We generally bill the Medicare and Medicaid programs at net realizable rates determined by applicable fee schedules for these programs, which are established by statute or regulation. We bill most non-governmental payors, including managed care payors with which we have

contracted, at our usual and customary rates. Since we bill most non-governmental payors at our usual and customary rates, but often expect to receive payments at the lower contracted rates, we also record a contractual allowance in order to record expected net realizable revenue for services provided. This process involves estimates and we record revisions to these estimates in subsequent periods as they are determined to be necessary.

Net operating revenues increased \$93,495,000 to \$352,244,000 in the first quarter of 1999 from \$258,749,000 in the first quarter of 1998, representing a 36.1% increase. Of this increase, \$68,649,000 was due to increased treatments, of which \$57,734,000 was from acquisitions consummated after the first quarter of 1998, \$7,829,000 was from de novo developments commencing operations after the first quarter of 1998 and \$3,086,000 was from existing facilities as of March 31, 1998. The remaining increase of \$24,846,000 resulted from an increase in net operating revenues per treatment which increased from \$235.31 in the first quarter of 1998 to \$253.16 in the first quarter of 1999. The increase in net operating revenue per treatment was mainly attributable to an increase in ancillary services intensity and pricing of \$13,339,000, primarily in the administration of EPO of \$9,979,000, an increase in services reimbursed by private payors of \$6,846,000, who pay at higher rates, stemming from the extension of the period during which Medicare is secondary payor and private payors are primary payor for an additional twelve-month period, and an increase in corporate and ancillary program fees of \$4,661,000, primarily from the expansion of laboratory services to former RTC facilities of \$3,251,000.

Facility operating expenses. Facility operating expenses consist of costs and expenses specifically attributable to the operation of dialysis facilities, including operating and maintenance costs of such facilities, equipment, direct labor, and supply and service costs relating to patient care. Facility operating expenses increased \$66,988,000 to \$233,983,000 in the first quarter of 1999 from \$166,995,000 in the first quarter of 1998 and as a percentage of net operating revenues, facility operating expenses increased to 66.4% in the first quarter of 1999 from 64.5% in the first quarter of 1998. This increase was attributable to higher operating costs, primarily in medical supplies and EPO.

General and administrative expenses. General and administrative expenses include headquarters expense and administrative, legal, quality assurance, information systems and centralized accounting support functions. General and administrative expenses increased \$7,077,000 to \$23,987,000 in the first quarter of 1999 from \$16,910,000 in the first quarter of 1998 and as a percentage of net operating revenues, general and administrative expenses increased to 6.8% in the first quarter of 1999 from 6.5% in the first quarter of 1998.

Provision for doubtful accounts. The provision for doubtful accounts is influenced by the amount of net operating revenues generated from non-governmental payor sources in addition to the relative percentage of accounts receivable by aging category. The provision for doubtful accounts increased \$3,715,000 to \$10,478,000 in the first quarter of 1999 from \$6,763,000 in the first quarter of 1998. As a percentage of net operating revenues, the provision for doubtful accounts increased to 3.0% in the first quarter of 1999 from 2.6% in the first quarter of 1998. This increase was due to an increase in the non-governmental payor mix caused by the Medicare as secondary payor extension.

Depreciation and amortization. Depreciation and amortization increased \$7,431,000 to \$27,025,000 in the first quarter of 1999 from \$19,594,000 in the first quarter of 1998. As a percentage of net operating revenues, depreciation and amortization increased to 7.7% in the first quarter of 1999 from 7.6% in the first quarter of 1998. The increase is primarily attributable to an increase over the prior period in the relative number of international acquisitions which generate goodwill with a shorter amortization period as compared to domestic acquisitions.

## Merger and related costs.

Merger and related costs recorded during the first quarter of 1998 include costs associated with certain integration activities, transaction costs and costs of employee severance and amounts due under employment agreements and other compensation programs, in connection with our merger with RTC.

A summary of merger and related costs and accrual activity through March 31, 1999 is as follows:

	Direct Transaction Costs	Severance and Employment Costs	Costs to Integrate Operations	Total
	-----	-----	-----	-----
Initial expense.....	\$ 21,580,000	\$ 41,960,000	\$ 15,895,000	\$ 79,435,000
Amounts utilized in 1998.....	(22,885,000)	(37,401,000)	(13,137,000)	(73,423,000)
Adjustment of estimates.....	1,305,000	(959,000)	(1,593,000)	(1,247,000)
	-----	-----	-----	-----
Accrual, December 31, 1998.....	\$ =====	3,600,000	1,165,000	4,765,000
Amounts utilized--1st quarter 1999.....		(600,000)	(90,000)	(690,000)
		-----	-----	-----
Accrual, March 31, 1999.....		\$ 3,000,000 =====	\$ 1,075,000 =====	\$ 4,075,000 =====

The remaining balance of severance and employment costs represents tax gross-up payments expected to be paid in the second quarter of 1999. The remaining balance of costs to integrate operations represents remaining lease payments on RTC's vacant laboratory lease space.

Operating income. Operating income increased \$87,719,000 to \$56,771,000 in the first quarter of 1999 from an operating loss of \$30,948,000 in the first quarter of 1998. Operating income before merger and related costs increased \$8,284,000 to \$56,771,000 from \$48,487,000 in the first quarter of 1998. As a percentage of net operating revenues, operating income before merger and related costs decreased to 16.1% in the first quarter of 1999 from 18.7% in the first quarter of 1998 primarily due to increases in facility operating expenses, general and administrative expenses, the provision for doubtful accounts and depreciation and amortization expense.

Interest expense. Interest expense increased \$8,250,000 to \$22,767,000 in the first quarter of 1999 from \$14,517,000 in the first quarter of 1998. The increase in interest expense was due to an increase in borrowings made under our credit facilities to fund acquisitions.

Interest income. Interest income is generated as a result of the short-term investment of surplus cash from operations and excess proceeds from borrowings under our credit facilities. Interest income decreased \$312,000 to \$1,330,000 in the first quarter of 1999 from \$1,642,000 in the first quarter of 1998 and as a percentage of net operating revenues, interest income decreased to 0.4% in the first quarter of 1999 from 0.6% in the first quarter of 1998. This decrease is primarily the result of lower average balances of cash and cash equivalents during the first quarter of 1999 as compared to the first quarter of 1998.

Provision for income taxes. Provision for income taxes increased \$12,203,000 to \$13,075,000 for the first quarter of 1999 from \$872,000 in the first quarter of 1998. The effective tax rate was 39.6% for the first quarter of 1999 compared to 39.8% in the first quarter of 1998, after minority interest but before merger and related costs. The decrease in the effective tax rate was due to a reduction in the blended state tax rate and less amortization of non-deductible goodwill as a percentage of taxable income.

Minority interests. Minority interests represent the pretax income earned by minority partners who directly or indirectly own minority interests in our partnership affiliates and the net income in certain of our corporate subsidiaries. Minority interests increased \$925,000 to \$2,318,000 from \$1,393,000 in the first quarter of 1998. As a percentage of net operating revenues, minority interest increased slightly to 0.7% in the first quarter of 1999 from 0.5% in the first quarter of 1998.



Extraordinary loss. In February 1998, in conjunction with our merger with RTC, we terminated RTC's revolving credit agreement, and recorded all of the remaining related unamortized deferred financing costs as an extraordinary loss of \$2,812,000, net of income tax effect.

Cumulative effect of change in accounting principle. Effective January 1, 1998, we adopted Statement of Position No. 98-5, Reporting on the Costs of Start-up Activities, or SOP 98-5. SOP 98-5 requires that pre-opening and organizational costs, incurred in conjunction with our pre-opening activities on our de novo facilities, which previously had been treated as deferred costs and amortized over five years, should be expensed as incurred. In connection with the adoption of SOP 98-5, we recorded a charge of \$6,896,000, net of income tax effect as a cumulative effect of a change in accounting principle, in the first quarter of 1998.

## Liquidity and capital resources

### Sources and uses of cash

Our primary capital requirements have been the funding of our growth through acquisitions and de novo developments, and equipment purchases. Net cash provided by operating activities was \$38.3 million for the first quarter of 1999 and net cash used in operating activities was \$35.6 million for the first quarter of 1998. Net cash provided by operating activities consists of our net income (loss), increased by non-cash expenses such as depreciation, amortization, non-cash interest and the provision for doubtful accounts, and adjusted by changes in components of working capital, primarily accounts receivable.

Accounts receivable, net of allowance for doubtful accounts, increased during the first quarter of 1999 by \$25.3 million, of which approximately \$13.0 million was due to the increase in our revenues and approximately \$6.9 million was due to a payment suspension imposed on our Florida-based laboratory by its Medicare carrier. The remaining \$5.4 million was primarily due to an increase in receivables in our international business, mostly due to a slow down in payment by certain large health care unions in Argentina.

Net cash used in investing activities was \$133.7 million for the first quarter of 1999 and \$96.0 million for the first quarter of 1998. Our principal uses of cash in investing activities have been related to acquisitions, purchases of new equipment and leasehold improvements for our facilities, as well as the development of new facilities. Net cash provided by financing activities was \$93.8 million for the first quarter of 1999 and \$190.9 million for the first quarter of 1998 primarily consisting of borrowings from our two credit facilities. As of March 31, 1999, we had working capital of \$397.2 million, including cash of \$39.9 million.

We believe that we will have sufficient liquidity to fund our debt service obligations and our growth strategy over at least the next twelve months.

### Expansion

In the quarter ended March 31, 1999, we developed seven new facilities, two of which we manage, and we expect to develop approximately 33 additional de novo facilities in the remainder of 1999. We anticipate that our capital requirements for purchases of equipment and leasehold improvements for facilities, including de novo facilities, will be approximately \$85 to \$95 million in aggregate for 1999.

During the quarter ended March 31, 1999, we paid cash of approximately \$77.4 million to acquire 23 facilities and additional interests from minority partners in certain of our partnerships. Subsequent to March 31, 1999, we completed acquisitions of 11 dialysis facilities for consideration of approximately \$50.5 million, which has been funded by additional borrowings under our credit facilities.

### Credit facilities

As of March 31, 1999 the principal amount outstanding under our revolving facility was \$438 million and under our term facility was \$396 million. The term facility requires annual principal payments of \$4.0 million,

with the \$360.0 million balance due on maturity. As of March 31, 1999, we had \$512 million available for borrowing under the revolving facility.

The credit facilities contain financial and operating covenants including, among other things, requirements that we maintain certain financial ratios and satisfy certain financial tests, and impose limitations on our ability to make capital expenditures, to incur other indebtedness and to pay dividends. As of the filing date of this Form 10-Q/A, including violations waived by the lenders as described in our Form 10-Q for the quarter ended June 30, 1999, we are in compliance with all such covenants.

#### Interest rate swaps

During the quarter ended June 30, 1998, we entered into forward interest rate cancelable swap agreements with a combined notional amount of \$800.0 million. The lengths of the agreements are between three and ten years with cancellation clauses at the swap holder's option from one to seven years. The underlying blended interest rate is fixed at approximately 5.65% plus an applicable margin based upon our current leverage ratio. Currently, the effective interest rate for these swaps is 7.2%.

#### Subordinated notes

The \$125.0 million outstanding 5 5/8% convertible subordinated notes due 2006 issued by RTC bear interest at the rate of 5 5/8%, payable semi-annually and require no principal payments until 2006. The 5 5/8% notes are convertible into shares of our common stock at an effective conversion price of \$25.62 per share and are redeemable by us beginning in July 1999.

In November 1998 we issued 7% convertible subordinated notes due 2009 in the aggregate principal amount of \$345.0 million. The 7% notes are convertible at any time, in whole or in part, into shares of our common stock at a conversion price of \$32.81 and will be redeemable after November 16, 2001. We used the net proceeds from the sale of the 7% notes to pay down debt under the revolving facility, which may be reborrowed.

#### Year 2000 considerations

Since the summer of 1998, all of our departments have been meeting with our information systems department to determine the extent of our Year 2000, or Y2K, exposure. Project teams have been assembled to work on correcting Y2K problems and to perform contingency planning to reduce our total exposure. Our goal is to have all corrective action and contingency plans in place by the third quarter of 1999.

Software applications and hardware. Each component of our software application portfolio, or SAP, must be examined with respect to its ability to properly handle dates in the next millennium. As part of our software assessment plan, key users will test each and every component of our SAP. These tests will be constructed to make sure each component operates properly with the system date advanced to the next millennium.

The major phases of our software assessment plan are as follows:

- . Complete SAP inventory;
- . Implement Y2K compliant software as necessary;
- . Analyze which computers have Y2K problems and the cost to repair;
- . Test all vendors' representations; and
- . Fix any computer-specific problems.

Our billing and accounts receivable software is known to have a significant Y2K problem. We have already addressed this issue by obtaining a new, Y2K compliant version of this software. We expect to complete conversion to this Y2K compliant version by the end of the third quarter of 1999.

Operating systems. We are also reviewing our operating systems to assess possible Y2K exposure. We use several different network operating systems, or NOS, for multi-user access to the software that resides on the respective servers. Each NOS must be examined with respect to its ability to properly handle dates in the next millennium. Key users will test each component of our SAP with a compliant version of the NOS. One level beneath the NOS is a special piece of software that comes into play when the computer is "booted" that potentially has a Y2K problem and that is the basic input output system software, or BIOS. The BIOS takes the date from the system clock and uses it in passing the date to the NOS which in turn passes the date to the desktop operating system. The system clock poses another problem in that some system clocks were only capable of storing a two-digit year while other computer clocks stored a four-digit year. This issue affects each and every computer we have purchased. To remedy these problems, we plan to inventory all computer hardware using a Y2K utility program to determine whether we have a BIOS or a system clock problem. We then intend to perform a BIOS upgrade or perform a processor upgrade to a Y2K compliant processor.

Dialysis centers, equipment and suppliers. The operations of our dialysis centers can be affected by the Y2K problem so a contingency plan must be in place to prevent the shutdown of these centers. Each center will be responsible for completing a survey of the possible consequences of a failure of the information systems of our vendors and formulating a contingency plan by the third quarter of 1999. Divisional vice presidents will then review these plans to assure compliance.

All of our biomedical devices, including dialysis machines that have a computer chip in them will be checked thoroughly for Y2K compliance. We have contacted or will contact each of the vendors of the equipment we use and ask them to provide us with documentation regarding Y2K compliance. Where it is technically and financially feasible without jeopardizing any warranties, we will test our equipment by advancing the clock to a date in the next millennium.

In general, we expect to have all of our biomedical devices Y2K compliant by the third quarter of 1999. We have not yet been able to estimate the costs of upgrading or replacing certain of our biomedical devices as we do not yet know which of these machines, if any, are not currently Y2K compliant.

In addition to factors noted above which are directly within our control, factors beyond our direct control may disrupt our operations. If our suppliers are not Y2K compliant, we may experience inventory shortages and run short of critical supplies. If the utilities companies, transportation carriers and telecommunications companies which service us experience Y2K difficulties, our operations will also be adversely affected and some of our facilities may need to be closed. We are in the process of taking steps to reduce the impact on our operations in such instances and implementing contingency plans to address any possible unavoidable effect which these difficulties would have on our operations.

To address the possibility of a physical plant failure, we are contacting the landlords of each of our facilities to insure that they will provide access to our staff and any other key service providers. We are also providing written notification to our utilities companies of the locations, schedules and emergency services required of each of our dialysis facilities. In case a physical plant failure should result in an emergency closure of any of our facilities, we are currently:

- .Confirming that backup hospital affiliation agreements are up-to-date and complete;

- .Reviewing appropriate elements of our disaster preparedness plan with our staff and patients;

- . Adopting/modifying emergency treatment orders and rationing plans with our medical directors to provide patient safety; and

- .Conducting patient meetings with social workers and dieticians.

To minimize the affect of any Y2K non-compliance on the part of suppliers, we are currently taking steps to:

- . Identify our critical suppliers and survey each of them to assess their Y2K compliance status;

- . Identify alternative supply sources where necessary;
- . Identify Y2K compliant transportation/shipping companies and establish agreements with them to cover situations where our current supplier's delivery systems go down;
- . Include language in contracts with new suppliers addressing Y2K performance obligations, requirements and failures;
- . Stock our dialysis facilities with one week of additional inventory; the orders will be placed two weeks before January 2000, to ensure receipt;
- . Require critical distributors to carry additional inventory earmarked for us; and
- . Prepare a critical supplier contact/pager list for Y2K emergency supply problems and ensure that contact persons will be on call 24 hours a day.

Our financial exposure from all sources of SAP and operating system Y2K issues as well as from dialysis center, equipment and supplier Y2K issues known to date ranges from approximately \$500,000 to \$1,200,000, none of which has been expended.

General. The extent and magnitude of the Y2K problem as it will affect us, both before, and for some period after, January 1, 2000, are difficult to predict or quantify for a number of reasons. Among the most important are our lack of control over systems that are used by the third parties who are critical to our operations, such as telecommunications and utilities companies, the complexity of testing interconnected networks and applications that depend on third-party networks and the uncertainty surrounding how others will deal with liability issues raised by Y2K-related failures. Moreover, the estimated costs of implementing our plans for fixing Y2K problems do not take into account the costs, if any, that might be incurred as a result of Y2K-related failures that occur despite our implementation of these plans.

With respect to third-party non-governmental payors, we are in the process of determining where our exposure is and developing contingency plans to prevent the interruption of cash flow. With respect to Medicare payments, neither the Health Care Financing Administration, or HCFA, nor its financial intermediaries have any contingency plan in place. However, HCFA has mandated that its financial intermediaries submit a draft of their contingency plans to it by March 1999 and that they be prepared to ensure that no interruption of Medicare payments results from Y2K-related failures of their systems. With respect to MediCal, the largest of our third-party state payors, we are already submitting our claims with a four-digit numerical year in accordance with the current system. We are currently working with our other state payors individually to determine the extent of their Y2K compliance.

Although we currently are not aware of any material operational issues associated with preparing our internal computer systems, facilities and equipment for Y2K, we cannot assure you, due to the overall complexity of the Y2K issues and the uncertainty surrounding third party responses to Y2K issues, that we will not experience material unanticipated negative consequences and/or material costs caused by undetected errors or defects in our or third party systems or by our failure to adequately prepare for the results of such errors or defects, including costs of related litigation, if any. The impact of such consequences could have a material adverse effect on our business, financial condition or results of operations.

### Item 3. Quantitative and Qualitative Disclosures About Market Risk.

There have been no material changes in our market risk exposure from that reported in our Form 10-K for the fiscal year ended December 31, 1998.



## RISK FACTORS

In addition to the other information set forth in this Form 10-Q, you should note the following risks related to our business.

If we fail to build adequate internal systems and controls then our revenue and net income may be adversely affected.

We have experienced rapid growth in the last five years, and especially in 1998, as a result of our business strategy to acquire, develop and manage a large number of dialysis centers. We also intend to continue to acquire, develop and manage additional dialysis centers, both in the U.S. and internationally. This historical growth and business strategy subjects us to the following risks:

- . Our billing and collection structures, systems and personnel may prove inadequate to collect all amounts owed to us for services we have rendered, resulting in a lack of sufficient cash flow;
- . We may require additional management, administrative and clinical personnel to manage and support our expanded operations, and we may not be able to attract and retain sufficient personnel;
- . Our assessment of the requirements of our growth on our information systems may prove inaccurate, and we may have to spend substantial amounts to enhance or replace our information systems;
- . Our expanded operations may require cash expenditures in excess of the cash available to us after paying our debt service obligations;
- . We may inaccurately assess the historical and projected results of operations of acquisition candidates, which may cause us to overpay for acquisitions;
- . We may inaccurately assess the historical and projected results of operations of existing and recently acquired facilities, which may cause us not to achieve the results of operations expected for these facilities; and
- . We may not be able to integrate acquired facilities as quickly or smoothly as we expect, which may cause us not to achieve the results of operations expected for these acquired facilities.

These risks are enhanced when we acquire entire regional networks or other national dialysis providers, such as RTC, or enter into multi-facility management agreements.

Future declines, or the lack of an increase, in Medicare reimbursement rates could substantially decrease our net income.

We are reimbursed for dialysis services primarily at fixed rates established in advance under the Medicare end stage renal disease, or ESRD, program. Unlike many other Medicare programs, which receive periodic cost of living increases, these rates have not increased since 1991. Increases in operating costs that are subject to inflation, such as labor and supply costs, have occurred and continue to occur without a compensating increase in reimbursement rates. In addition, if Medicare should begin to include in its composite reimbursement rate any ancillary services that it currently reimburses separately, our revenue would decrease to the extent there was not a corresponding increase in that composite rate. We cannot predict whether future rate changes will be made. Approximately 49% of our net operating revenues in the first quarter of 1999 was generated from patients who had Medicare as the primary payor.

The Department of Health and Human Services, or HHS, has recommended, and the Clinton administration has included in its fiscal year 2000 budget proposal to the Congress, a 10% reduction in Medicare reimbursement for erythropoietin, or EPO. We cannot predict whether this proposal or other future rate or reimbursement method changes will be made. Approximately 13% of our net operating revenues in the first quarter of 1999 was generated from EPO reimbursement through Medicare and Medicaid programs.

Consequently, any reduction in the rate of EPO reimbursement through Medicare and Medicaid programs could materially reduce our revenues and net income.

Medicare separately reimburses us for other outpatient prescription drugs that we administer to dialysis patients at the rate of 95% of the average wholesale price of each drug. The Clinton administration has also included in its fiscal year 2000 budget proposal to the Congress a reduction in the reimbursement rate for outpatient prescription drugs to 83% of average wholesale price. We cannot predict whether Congress will approve this rate change, or whether other reductions in reimbursement rates for outpatient prescription drugs will be made. If such changes are implemented, they could have a material adverse effect on our revenues and net income.

Many Medicaid programs base their reimbursement rates for the services we provide on the Medicare reimbursement rates. Any reductions in the Medicare rates could also result in reductions in the Medicaid reimbursement rates. Approximately 5% of our net operating revenues in the first quarter of 1999 was generated from patients who had Medicaid or comparable state programs as the primary payor.

If Medicare changes its ESRD program to a capitated reimbursement system, our revenues and profits could be materially reduced.

HCFA has initiated a pilot demonstration project, expected to end in 2001, to test the feasibility of allowing managed care plans to participate in the Medicare ESRD program on a capitated basis. Under a capitated plan we or managed care plans would receive a fixed periodic payment for servicing all of our Medicare-eligible ESRD patients regardless of certain fluctuations in the number of services provided in that period or the number of patients treated. Under the current demonstration project, Medicare is paying managed care plans a capitated rate equal to 95% of Medicare's current average cost of treating dialysis patients. If HCFA considers this pilot program successful, HCFA or Congress could lower the average Medicare reimbursement for dialysis.

If we charge private payors at rates less than our current rates, then our revenues and net income could be substantially reduced.

Approximately 41% of our net operating revenues in the first quarter of 1999 was generated from patients who had domestic private payors as the primary payor. Domestic private payors, particularly managed care payors, have become more aggressive in demanding contract rates approaching or at Medicare reimbursement rates. We believe that the financial pressures on private payors to decrease the rates at which they reimburse us will continue to increase and could have a material impact on our revenues and net income.

If our assumptions regarding the beneficial life of our goodwill prove to be inaccurate, or subsequently change, our current earnings may be overstated and future earnings also may be affected.

Our balance sheet has an amount designated as "goodwill" that represents 45% of our assets and 184% of our stockholders' equity at March 31, 1999. Goodwill arises when an acquiror pays more for a business than the fair value of the tangible and separately measurable intangible net assets. Generally accepted accounting principles require the amortization of goodwill and all other intangible assets over the period benefited. The current average useful life is 34 years for our goodwill and 21 years for all of our intangible assets that relate to business combinations. We have determined that most acquisitions after December 31, 1996 will continue to provide a benefit to us for no less than 40 years after the acquisition. In making this determination, we have reviewed with our independent accountants the significant factors that we considered in arriving at the consideration we paid for, and the expected period of benefit from, acquired businesses.

We and our independent accountants continuously review the appropriateness of the amortization periods we are using and change them as necessary to reflect current expectations. If the factors we considered, and which give rise to a material portion of our goodwill, result in an actual beneficial period shorter than our

determined useful life, earnings reported in periods immediately following some acquisitions would be overstated. In addition, in later years, we would be burdened by a continuing charge against earnings without the associated benefit to income. Earnings in later years could also be affected significantly if we subsequently determine that the remaining balance of goodwill has been impaired.

Interruption in the supply of, or cost increases in, EPO could materially reduce our net income and affect our ability to care for our patients.

A single manufacturer, Amgen Corporation, produces EPO. In the future, Amgen may be unwilling or unable to supply us with EPO. Additionally, shortages in the raw materials or other resources necessary to manufacture EPO, or simply an arbitrary decision on the part of this sole supplier, may increase the wholesale price of EPO. Interruptions of the supply of EPO or increases in the price we pay for EPO could have a material adverse effect on our financial condition as well as our ability to provide appropriate care to our patients.

If we fail to identify, assess and respond successfully to the unique attributes of each of our foreign operations, our net income could be adversely affected.

We only recently commenced operations outside the U.S., and expect to enter additional foreign markets in the next few years. Our failure to identify, understand and respond to the unique attributes of any of the foreign markets that we enter could cause us to:

- . Overpay for acquisitions of foreign dialysis centers;
- . Fail to integrate foreign acquisitions into our operations successfully; and
- . Assess the performance of our foreign operations incorrectly.

The unique attributes of our foreign operations include:

- . Differences in payment and reimbursement rules and procedures, including unanticipated slowdowns in payments from large payors in Argentina;
- . Differences in accepted clinical standards and practices;
- . Differences in management styles and practices;
- . The unfamiliarity of foreign companies with U.S. financial reporting standards; and
- . Local laws that restrict or limit employee discharges and disciplinary actions.

If we fail to adhere to all of the complex government regulations that apply to our business, we could incur substantial fines or be excluded from participating in government reimbursement programs.

Our dialysis operations are subject to extensive federal, state and local government regulations in the U.S. and to extensive government regulation in every foreign country in which we operate. Any of the following could adversely impact our revenues:

- . Loss of required government certifications;
- . Loss of authorizations to participate in or exclusion from government reimbursement programs, such as the Medicare ESRD Program and Medicaid programs;
- . Suspension of payments from government programs;
- . Loss of licenses required to operate health care facilities in some of the states in which we operate; and
- . Any challenge to the relationships we have structured in some foreign countries to comply with barriers to direct foreign ownership of healthcare businesses.



The regulatory scrutiny of healthcare providers has increased significantly in recent years. For example, the Office of Inspector General of HHS reported that it recovered \$1.2 billion in fiscal 1997 from health care fraud investigations, an amount five times greater than that recovered in the previous fiscal year.

- . We may never collect the revenues from the payments suspended as a result of an investigation of our laboratory subsidiary

Our Florida-based laboratory subsidiary is the subject of a third-party carrier review relating to claims this laboratory submitted for Medicare reimbursement. In May 1998, the carrier suspended all further Medicare payments to this laboratory. Medicare revenues from this laboratory represent approximately 2% of our net revenues. For the review period the carrier initially identified, January 1995 to April 1996, the carrier has alleged that the prescribing physician's medical justification did not properly support 99.3% of the tests this laboratory performed. The carrier also determined that it overpaid the laboratory \$5.6 million for this period. The carrier subsequently requested billing records with respect to the additional period from May 1996 to March 1998. The suspension of payments relates to all payments due after the suspension started, regardless of when the laboratory performed the tests. The carrier had withheld approximately \$18 million as of March 31, 1999, which has adversely affected our cash flow. We may never recover the amounts withheld.

- . Our failure to comply with federal and state fraud and abuse statutes could result in sanctions

Neither our arrangements with the medical directors of our facilities nor the minority ownership interests of referring physicians in some of our dialysis facilities meet all of the requirements of published safe harbors to the anti-kickback provisions of the Social Security Act and similar state laws. These laws impose civil and criminal sanctions on anyone who receives or makes payments for referring a patient for any service reimbursed by Medicare, Medicaid or similar federal and state programs. Arrangements within published safe harbors are deemed not to violate these provisions. Enforcement agencies may subject arrangements that do not fall within a safe harbor to greater scrutiny. If we are challenged under these statutes, we may have to change our relationships with our medical directors and with referring physicians holding minority ownership interests.

The laws of several states in which we do business prohibit a physician from making referrals for laboratory services to entities with which the physician, or an immediate family member, has a financial interest. We currently operate a large number of facilities in these states, which account for a significant percentage of our business. These state statutes could apply to laboratory services incidental to dialysis services. If so, we may have to change our relationships with referring physicians who serve as medical directors of our facilities or hold minority interests in any of our facilities.

We may not have sufficient cash flow from our business to service our debt.

The amount of our outstanding debt is large compared to the net book value of our assets, and we have substantial repayment obligations under our outstanding debt. As of March 31, 1999 we had:

- . Total consolidated debt of approximately \$1.3 billion;
- . Stockholders' equity of approximately \$504 million; and
- . A ratio of earnings to fixed charges of 2.24.

The following chart shows our aggregate interest and principal payments due on all of our currently outstanding debt for each of the next five fiscal years. Under interest swap agreements covering \$800 million of debt, the interest rate under our credit facilities varies based on the amount of debt we incur relative to our assets and equity. Accordingly, the amount of these interest payments could fluctuate in the future.

Interest Payments    Principal Payments

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For the year ending December 31:

1999	\$96,200,000	\$ 21,847,000
2000	95,100,000	10,893,000
2001	88,400,000	94,579,000
2002	77,700,000	153,567,000
2003	68,800,000	241,559,000

Due to the large amount of these principal and interest payments, we may not have enough cash to pay the interest on our debt as it becomes due.

The large amount and terms of our outstanding debt may prevent us from taking actions we would otherwise consider in our best interest.

Our credit facilities contain numerous financial and operating covenants that limit our ability, and the ability of most of our subsidiaries, to engage in activities such as incurring additional senior debt and disposing of our assets. These covenants require that we meet interest coverage, net worth and leverage tests.

Our level of debt and the limitations our credit facilities impose on us could have other important consequences to you, including:

- . We will have to use a portion of our cash flow from operations, approximately \$96.2 million in 1999 and \$95.1 million in 2000, for debt service rather than for our operations;
- . We may not be able to obtain additional debt financing for future working capital, capital expenditures, acquisitions or other corporate purposes;
- . We could be less able to take advantage of significant business opportunities, including acquisitions, and react to changes in market or industry conditions.

If a change of control occurs, we may not have sufficient funds to repurchase our outstanding notes.

Upon a change of control, generally the sale or transfer of a majority of our voting stock or almost all of our assets, our noteholders may require us to repurchase all or a portion of their notes. If a change of control occurs, we may not be able to pay the repurchase price for all of the notes submitted for repurchase. In addition, the terms of our credit facilities generally prohibit us from purchasing any notes until we have repaid all debt outstanding under these credit facilities. Future credit agreements or other agreements relating to debt may contain similar provisions. We may not be able to secure the consent of our lenders to repurchase our outstanding notes or refinance the borrowings that prohibit us from repurchasing our outstanding notes. If we do not obtain a consent or repay the borrowings, we could not repurchase these notes.

We may experience material unanticipated negative consequences beginning in the year 2000 due to undetected computer defects.

The Y2K issue concerns the potential exposures related to the automated generation of incorrect information from the use of computer programs which have been written using two digits, rather than four, to define the applicable year of business transactions. Due to the overall complexity of the Y2K issues and the uncertainty surrounding third party responses to Y2K issues, we cannot assure you that undetected errors or defects in our or third party systems or

our failure to prepare adequately for the results of those errors or defects will not cause us material unanticipated problems or costs.

The extent and magnitude of the Y2K problem as it will affect us, both before, and for some period after, January 1, 2000, are difficult to predict or quantify for a number of reasons. Among the most important are:

- . Our lack of control over third party systems that are critical to our operations, including those of telecommunications and utilities companies and governmental and non-governmental payors;
- . The complexity of testing interconnected internal and external computer networks, software applications and dialysis equipment; and
- . The uncertainty surrounding how others will deal with liability issues raised by Y2K-related failures.

Moreover, the estimated costs of implementing our plans for fixing Y2K problems do not take into account the costs, if any, that we might incur as a result of Y2K-related failures that occur despite our implementation of these plans.

While we are developing contingency plans to address possible computer failure scenarios, we recognize that there are "worst case" scenarios which may occur. We may experience the extended failure of external and internal computer networks and equipment that control

- . Medicare, Medicaid and other third party payors' ability to reimburse us;
- . Regional infrastructures, such as power, water and telecommunications systems;
- . Equipment and machines that are essential for the delivery of patient care; and
- . Computer software necessary to support our billing process.

If any one of these events occurs, our cash flow could be materially reduced. Even in the absence of a failure of these networks and equipment, we will likely continue to incur costs related to remediation efforts, the replacement or upgrade of equipment, continued efforts regarding contingency planning, increased staffing for the periods immediately preceding and after January 1, 2000 and the possible implementation of alternative payment schemes with our payors.

Provisions in our charter documents may deter a change of control which our stockholders may otherwise determine to be in their best interests.

Our certificate of incorporation and bylaws and the Delaware General Corporation Law include provisions which may deter hostile takeovers, delay or prevent changes in 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 provisions include:

- . A provision requiring that our stockholders may take action only at a duly called annual or special meeting of our stockholders and not by written consent;
- . A provision requiring a stockholder to give at least 60 days' advance notice of a proposal or director nomination that the stockholder desires to present at any annual or special meeting of stockholders; and
- . A provision granting our 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 existence of this "blank-check" preferred stock could discourage an attempt to obtain control of us by means of a tender offer, merger, proxy contest or otherwise. Furthermore, this "blank-check" preferred stock may have other rights, including economic rights, senior to our common stock. Therefore, issuance of the preferred stock could have an adverse effect on the market price of our common stock.

We may, in the future, adopt other measures that may have the effect of delaying, deferring or preventing an unsolicited takeover, even if such a change in control were at a premium price or favored by a majority of unaffiliated stockholders. We may adopt certain of these measures without any further vote or action by our stockholders.



## Forward-looking statements

We believe that this Form 10-Q contains statements that are forward-looking statements within the meaning of the federal securities laws. These include statements about our expectations, beliefs, intentions or strategies for the future, which we indicate by words or phrases such as "anticipate," "expect," "intend," "plan," "will," "believe" and similar language. These statements involve known and unknown risks, including risks resulting from economic and market conditions, the regulatory environment in which we operate, competitive activities and other business conditions, and are subject to uncertainties and assumptions set forth elsewhere in this Form 10-Q. Our actual results may differ materially from results anticipated in these forward-looking statements. We base our forward-looking statements on information currently available to us, and we assume no obligation to update these statements.

PART II

OTHER INFORMATION

Items 1, 2, 3, 4 and 5 are not applicable.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

27.1 Financial Data Schedule--three months ended March 31, 1999 and three months ended March 31, 1998.X

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X Filed herewith.

(b) Reports on Form 8-K

None.

SIGNATURES

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

TOTAL RENAL CARE HOLDINGS, INC.

/s/ John J. McDonough

By: \_\_\_\_\_

John J. McDonough

Vice President, Finance and

Chief Accounting Officer

Date: August 30, 1999

John J. McDonough is signing in the dual capacities as (i) Chief Accounting Officer and (ii) a duly authorized officer of the Company.

INDEX TO EXHIBITS

Exhibit  
Number  
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Description  
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27.1 Financial Data Schedule--three months ended March 31, 1999 and three  
months ended March 31, 1998.X

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X Filed herewith.



3-MOS	3-MOS		
DEC-31-1999	DEC-31-1998		
JAN-01-1999	JAN-01-1998		
MAR-31-1999	MAR-31-1998		
39,905,000			0
0	0		
510,638,000	0		
68,828,000	0		
27,260,000	0		
574,157,000	0		
261,189,000			0
0	0		
2,047,404,000	0		
176,909,000	0		0
0	0		
0		0	
81,000			0
503,814,000		0	
2,047,404,000	0		
352,244,000	258,749,000		
352,244,000	258,749,000		0
295,473,000	289,697,000		
0	0		
10,478,000	6,763,000		
22,767,000	14,517,000		
33,016,000	(45,216,000)		
13,075,000	872,000		
19,941,000	(46,088,000)		
0	0		
0	2,812,000		
0	6,896,000		
19,941,000	(55,796,000)		
0.25	(0.71)		
0.24	(0.71)		