

PROSPECTUS  
OCTOBER 31, 1996

2,500,000 SHARES

[LOGO OF TOTAL RENAL CARE HOLDINGS, INC.]

TOTAL RENAL CARE HOLDINGS, INC.

COMMON STOCK

Of the 2,500,000 shares of Common Stock being offered hereby (the "Offering"), 500,000 are being issued and sold by Total Renal Care Holdings, Inc. (the "Company") and 2,000,000 are being sold by the Selling Stockholders. See "Principal and Selling Stockholders." The Company will not receive any proceeds from the sale of Common Stock by the Selling Stockholders.

The Common Stock is listed on the New York Stock Exchange under the symbol "TRL." On October 30, 1996 the closing price for the Common Stock as reported on the New York Stock Exchange was \$39.625 per share. See "Price Range of Common Stock."

SEE "RISK FACTORS" BEGINNING ON PAGE 7 FOR A DISCUSSION OF CERTAIN FACTORS THAT SHOULD BE CONSIDERED IN CONNECTION WITH AN INVESTMENT IN THE COMMON STOCK.

THESE SECURITIES HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE SECURITIES AND EXCHANGE COMMISSION OR ANY STATE SECURITIES COMMISSION NOR HAS THE SECURITIES AND EXCHANGE COMMISSION OR ANY STATE SECURITIES COMMISSION PASSED UPON THE ACCURACY OR ADEQUACY OF THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

	PRICE TO THE PUBLIC	UNDERWRITING DISCOUNTS AND COMMISSIONS (1)	PROCEEDS TO THE COMPANY (2)	PROCEEDS TO THE SELLING STOCKHOLDERS
Per Share.....	\$39.00	\$1.56	\$37.44	\$37.44
Total (3).....	\$97,500,000	\$3,900,000	\$18,720,000	\$74,880,000

- (1) The Company has agreed to indemnify the Underwriters against certain liabilities, including liabilities under the Securities Act of 1933, as amended. See "Underwriting."
- (2) Before deducting expenses estimated at \$500,000, all of which are payable by the Company.
- (3) Certain of the Selling Stockholders have granted the Underwriters a 30-day option to purchase up to an additional 375,000 shares of Common Stock, at the Price to the Public less Underwriting Discounts and Commissions, solely to cover over-allotments, if any. If such option is exercised in full, the total Price to the Public, Underwriting Discounts and Commissions and Proceeds to the Selling Stockholders will be \$112,125,000, \$4,485,000 and \$88,920,000, respectively. See "Underwriting."

The shares of Common Stock are being offered by the several Underwriters, subject to prior sale when, as and if delivered to and accepted by the Underwriters and subject to various prior conditions, including their right to reject orders in whole or in part. It is expected that delivery of share certificates will be made in New York, New York on or about November 5, 1996.

DONALDSON, LUFKIN & JENRETTE  
SECURITIES CORPORATION

[LOGO OF TOTAL RENAL CARE HOLDINGS, INC.]  
Total Renal Care Holdings, Inc.  
Network of 128 Dialysis Facilities

[MAP APPEARS HERE]

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IN CONNECTION WITH THIS OFFERING, THE UNDERWRITERS MAY OVER-ALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICE OF THE SECURITIES OFFERED HEREBY AT A LEVEL ABOVE THAT WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH TRANSACTIONS MAY BE EFFECTED ON THE NEW YORK STOCK EXCHANGE OR OTHERWISE. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

2

#### PROSPECTUS SUMMARY

The following summary is qualified in its entirety by reference to, and should be read in conjunction with, the more detailed information and financial statements and notes thereto appearing elsewhere in this Prospectus. Unless the context otherwise requires, the term "Company" refers to Total Renal Care Holdings, Inc. and its subsidiaries. Unless otherwise indicated, all information in this Prospectus assumes that the Underwriters' over-allotment option will not be exercised. This Prospectus contains forward-looking statements which involve risks and uncertainties. The Company's actual results may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such a difference include, but are not limited to, those discussed in "Risk Factors."

#### THE COMPANY

Total Renal Care Holdings, Inc. is the third largest provider of integrated dialysis services in the United States for patients suffering from chronic kidney failure, also known as end stage renal disease ("ESRD"). The Company provides dialysis and ancillary services to more than 9,800 patients through a network of 128 outpatient dialysis facilities in 16 states, the District of Columbia and Guam. In addition, the Company provides inpatient dialysis services at 84 hospitals. The Company has implemented an aggressive growth strategy since the August 1994 Transaction, described below, adding 91 outpatient dialysis facilities to its network as well as 56 hospital inpatient contracts. The Company has also expanded its in-house ancillary services to include ESRD laboratory and pharmacy facilities, as well as vascular access management and transplant services programs. The increase in the number of facilities and hospital contracts, combined with the enhancement of the Company's ancillary businesses, has resulted in an increase in net operating revenues of 96% to \$73.3 million in the quarter ended September 30, 1996 as compared to the same period in the previous year. Since the Company's most recent equity offering the Company has acquired 16 facilities and, in addition, entered into a management contract with Georgetown University, which together service over 1,800 patients. As ten of such facilities were acquired on or after August 1, 1996, the full impact of such operations are not reflected in the Company's financial results for the quarter ended September 30, 1996. In addition, the Company has recently signed letters of intent to acquire six facilities servicing approximately 300 patients.

ESRD is the state of advanced renal impairment that is irreversible and requires routine dialysis treatments or kidney transplantation to sustain life. According to figures published by the Health Care Financing Administration ("HCFA"), the number of patients requiring chronic dialysis services in the U.S. has increased at a 9% compounded annual growth rate ("CAGR") to 200,000 patients in 1995 from 66,000 patients in 1982. It is estimated that the ESRD population will continue to grow at a CAGR of approximately 9% over the next five years. The Company estimates that the U.S. market for outpatient and inpatient services to ESRD patients in 1995 exceeded \$11.1 billion. The Company

believes that this market will continue to grow due to the aging of the general population, improved dialysis technology and improved treatment and longer survival of patients with hypertension, diabetes and other chronic illnesses that lead to ESRD.

There were over 2,700 dialysis facilities in the United States at the end of 1995, of which approximately 33% were owned by independent physicians, 27% were hospital-based facilities, and 40% were owned by seven major multi-facility dialysis providers, including the Company. The dialysis services industry has been undergoing rapid consolidation. The Company believes that this trend will continue due to the changing health care environment which is motivating independent physicians and hospitals to sell to, or form alliances with, major multi-facility providers.

The Company's growth strategy is focused on establishing strong regional networks of clustered facilities that provide comprehensive care for ESRD patients. The Company believes that this approach enhances its operating efficiency and positions the Company to be a leader in a health care environment increasingly influenced by managed care. The Company strives to continue its growth and margin improvement by

3

(i) expanding its existing networks and by creating new regional facility networks through acquisitions, the development of new facilities ("de novo" developments) and the formation of hospital alliances, (ii) forming strategic alliances with physicians and managed care organizations, (iii) expanding the range of ancillary services it provides to patients, (iv) continuously improving the quality of care provided through the Company's Quality Management Program and (v) maximizing operating efficiencies and utilization. As part of the Company's growth strategy, it has begun evaluating the development of operations in various overseas markets.

The 91 outpatient dialysis facilities added since the August 1994 Transaction are comprised of 79 acquisitions, ten de novo developments and management contracts with Georgetown University and the University of Southern California. The acquisition of a facility has an immediate impact on the Company's results of operations by increasing revenues with minimal incremental general and administrative cost. In reviewing a potential acquisition, the Company's evaluation includes analyzing financial pro formas, reviewing the local competitive market and assessing the target facility's reputation for providing quality care. As a part of its growth strategy, the Company continually reviews and evaluates potential acquisition candidates and seeks to identify locations for de novo developments. The Company is currently developing eight new facilities scheduled for completion by the end of first quarter 1997.

The Company's wholly-owned subsidiary, Total Renal Care, Inc. ("TRC"), formerly known as Medical Ambulatory Care, Inc., was organized in 1979 by Tenet Healthcare Corporation ("Tenet"), formerly known as National Medical Enterprises, Inc., to own and operate Tenet's hospital-based dialysis services business as freestanding dialysis facilities and to acquire and develop additional dialysis facilities in Tenet's markets. The Company was organized to facilitate the sale by Tenet of approximately 75% of its ownership interest (the "August 1994 Transaction") to DLJ Merchant Banking Partners, L.P. and certain of its affiliates ("DLJMB"), management of the Company and certain holders of debt securities of the Company. In connection with the August 1994 Transaction, the Company, NME Properties Corporation, Tenet and DLJMB entered into a number of agreements relating to, among other things, corporate governance, the provision of certain services to the Company by Tenet, and restrictions on stock transfers.

4

#### THE OFFERING

Common Stock offered by the Company.....	500,000 shares
Common Stock offered by the Selling	
Stockholders (1).....	2,000,000 shares
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(1) Does not include up to 375,000 shares of Common Stock which may be sold by certain of the Selling Stockholders pursuant to the over-allotment option.

(2) As of September 30, 1996. Does not include 1,782,953 shares issuable upon the exercise of options outstanding as of September 30, 1996.

Prospective purchasers of Common Stock should carefully consider the matters set forth herein under "Risk Factors" as well as the other information set forth in this Prospectus.

						SEVEN MONTHS ENDED DECEMBER 31, (1)		NINE MONTHS ENDED SEPTEMBER 30,	
	YEARS ENDED MAY 31,								
	1991	1992	1993	1994	1995	1994	1995	1995	1996
	(DOLLARS IN THOUSANDS, EXCEPT PER SHARE DATA)								
INCOME STATEMENT AND OPERATING DATA: (2)									
Net operating revenues.	\$ 53,019	\$ 63,888	\$ 71,576	\$ 80,470	\$ 98,968	\$ 53,593	\$ 89,711	\$ 93,508	\$188,153
Facility operating expenses.....	37,016	45,599	49,440	56,828	65,583	36,012	57,406	60,304	126,121
General and administrative expenses (3).....	4,209	4,819	5,292	7,457	9,115	4,916	7,645	8,307	13,644
Operating income .....	7,327	8,185	11,360	10,883	17,159	8,716	18,466	18,310	34,233
Interest expense, net..	208	110	9	13	7,203	3,300	5,584	7,287	3,862
Income before extraordinary item ...	4,121	4,665	6,447	5,718	4,852	2,650	6,467 (4)	5,384	16,538 (5)
Income per share before extraordinary item ...	--	--	--	--	\$ 0.22 (6)	\$ 0.08 (6)	\$ 0.36 (4)	\$ 0.35	\$ 0.65 (5)
Outpatient facilities (at period end).....	32	35	36	37	57	42	68	62	126
Treatments (7).....	308,029	349,736	379,397	423,353	481,537	268,820	390,806	423,677	807,289
Hospitals receiving inpatient services (at period end).....	34	33	32	28	48	28	55	54	82

[illegible]

.....	3,633	4,026	4,286	6,248	7,776	8,356	9,551	11,556	13,126
Income before extraordinary item .....	1,053	705	1,001	1,898	2,485	3,285 (4)	4,276	5,726	6,536 (5)
Income per share before extraordinary item .....	0.01 (6)	0.05	0.07	0.12	0.16	0.16 (4)	0.19	0.22	0.25

SEPTEMBER 30, 1996

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 ACTUAL AS ADJUSTED (8)  
 (IN THOUSANDS)

BALANCE SHEET DATA:

Working capital.....	\$ 85,254	\$104,139
Total assets.....	320,421	370,468
Long-term debt (including current portion).....	78,787	110,077
Stockholders' equity.....	204,359	222,579

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- (1) In 1995, the Company changed its fiscal year end to December 31 from May 31.
  - (2) The August 1994 Transaction and subsequent acquisitions have had a significant impact on the Company's results of operations. Consequently, the Income Statement Data for the fiscal year ended May 31, 1995 and for the seven months ended December 31, 1995 are not directly comparable to corresponding information for prior periods.
  - (3) General and administrative expenses for the fiscal years ended May 31, 1991, 1992, 1993 and 1994 include overhead allocations by the Company's former parent of \$523,000, \$662,000, \$235,000 and \$1,458,000, respectively. The overhead allocations for the fiscal years ended May 31, 1991, 1992 and 1993 were made using a different methodology than that used for the fiscal year ended May 31, 1994, and the substantial increase in that year reflects this change in methodology rather than a change in the level of services provided. No overhead allocation was made for the period from March 1, 1994 through the completion of the August 1994 Transaction, at which time the Company began to record general and administrative expenses as incurred on a stand-alone basis. General and administrative expenses for the fiscal year ended May 31, 1994 reflects \$458,000 in expenses relating to a terminated equity offering.
  - (4) In December 1995, the Company recorded an extraordinary loss of \$2,555,000, or \$0.14 per share, net of income tax effect, on the early extinguishment of debt. See Note 6 of Notes to Consolidated Financial Statements.
  - (5) During July and September 1996, the Company recorded an extraordinary loss of \$7.7 million, or \$0.30 per share, net of income tax effect, on the early extinguishment of debt. See "Management's Discussion and Analysis of Financial Condition and Results of Operations."
  - (6) Income per share before extraordinary item for the year ended May 31, 1995, for the seven months ended December 31, 1994 and for the calendar quarter ended September 30, 1994 is presented on a pro forma basis to give effect to the August 1994 Transaction as if it had occurred on June 1, 1994. See Note 1 of Notes to Consolidated Financial Statements.
  - (7) Represents dialysis treatments provided in outpatient facilities, at home and in acute care hospitals. Home dialysis treatments are stated in hemodialysis equivalents. Only treatments rendered by the Company after the acquisition of a facility are included.
  - (8) As Adjusted Balance Sheet Data reflects (i) acquisitions consummated since September 30, 1996 and probable acquisitions as of October 30, 1996 and (ii) the sale of 500,000 shares of Common Stock by the Company at the public offering price of \$39.00 per share. See "Use of Proceeds" and "Capitalization."

RISK FACTORS

In evaluating the Company and its business, prospective investors should carefully consider the following risk factors in addition to the other information contained herein.

DEPENDENCE ON MEDICARE, MEDICAID AND OTHER SOURCES OF REIMBURSEMENT

The Company is reimbursed for dialysis services primarily at fixed rates established in advance under the Medicare End Stage Renal Disease program. Under this program, once a patient becomes eligible for Medicare reimbursement, Medicare is responsible for payment of 80% of the composite rates determined by the Health Care Financing Administration ("HCFA") for dialysis treatments. Since 1972, qualified patients suffering from chronic kidney failure, also known as end stage renal disease ("ESRD") have been entitled to Medicare benefits regardless of age or financial circumstances. The Company estimates that approximately 62% of its net patient revenues during its fiscal year ended May 31, 1995, approximately 60% during the seven months ended December 31, 1995 and 60% during the nine months ended September 30, 1996 were funded by Medicare. Since 1983, numerous Congressional actions have resulted in changes in the Medicare composite reimbursement rate from a national average of \$138 per treatment in 1983 to a low of \$125 per treatment on average in 1986 and to approximately \$126 per treatment on average at present. The Company is not able to predict whether future rate changes will be made. Reductions in composite rates could have a material adverse effect on the Company's revenues and net earnings. Furthermore, increases in operating costs that are subject to inflation, such as labor and supply costs, without a compensating increase in prescribed rates, may adversely affect the Company's earnings in the future. The Company is also unable to predict whether certain services, as to which the Company is currently separately reimbursed, may in the future be included in the Medicare composite rate. See "Business--Operations--Sources of Revenue Reimbursement" and "Business--Operations--Medicare Reimbursement."

Since June 1, 1989, the Medicare ESRD program has provided reimbursement for the administration to dialysis patients of erythropoietin ("EPO"). EPO is beneficial in the treatment of anemia, a medical complication frequently experienced by dialysis patients. Many of the Company's dialysis patients receive EPO. Revenues from EPO (the substantial majority of which are reimbursed through Medicare and Medicaid programs) were approximately \$18.2 million, or 18% of net operating revenues, in its fiscal year ended May 31, 1995 and were \$18.0 million, or 20% of net operating revenues, during the seven months ended December 31, 1995 and \$37.3 million, or 20% of net operating revenues during the nine months ended September 30, 1996. EPO reimbursement significantly affects the Company's net income. Medicare reimbursement for EPO was reduced from \$11 to \$10 per 1,000 units for services rendered after December 31, 1993. EPO is produced by a single manufacturer, and any interruption of supply or product cost increases could adversely affect the Company's operations. See "Business--Operations--Medicare Reimbursement."

The Company provides certain of its patients with intradialytic parenteral nutrition ("IDPN"), a nutritional supplement administered during dialysis to patients suffering from nutritional deficiencies. The Company has historically been reimbursed by the Medicare program for the administration of IDPN therapy. Beginning in 1993, HCFA designated four durable medical equipment regional carriers ("DMERCs") to process reimbursement claims for IDPN therapy. The DMERCs established new, more stringent medical policies for reimbursement of IDPN therapy which were adopted by HCFA in April 1996, and many dialysis providers' claims have been denied or delayed. Where appropriate, the Company has appealed and continues to appeal such denials. The final outcome of some appeals and the anticipated review is uncertain. The Company's allowance for doubtful accounts reflects a reserve that the Company believes is adequate against the possibility of an adverse outcome. The Company has continued to provide IDPN therapy only to a select number of its patients whom the Company believes meet the most stringent guidelines. Although the Company fully expects to be paid on outstanding claims, there can be no certainty to that effect.

All of the states in which the Company currently operates dialysis facilities provide Medicaid (or comparable) benefits to qualified recipients to supplement their Medicare entitlement. The Company estimates that approximately 8% of its net patient revenues during the fiscal year ended May 31, 1995, 7% of its net operating revenues during the seven months ended December 31, 1995 and 6% of its net operating revenues during the nine month period ended September 30, 1996 were funded by Medicaid or comparable state programs. The Medicaid programs are subject to statutory and regulatory changes, administrative rulings, interpretations of policy and governmental funding restrictions, all of which may have the effect of decreasing program payments, increasing costs or modifying the way the Company operates its

dialysis business. See "Business--Operations--Medicaid Reimbursement."

Approximately 30% of the Company's net patient revenues during the fiscal year ended May 31, 1995, 33% during the seven month period ended December 31, 1995 and 34% during the nine month period ended September 30, 1996 were from sources other than Medicare and Medicaid. These sources include payments from third-party, non-government payors, at rates that generally exceed the Medicare and Medicaid rates, and payments from hospitals with which the Company has contracts for the provision of acute dialysis treatments. Any restriction or reduction of the Company's ability to charge for such services at rates in excess of those paid by Medicare would adversely affect the Company's net operating revenues and net income. The Company is unable to quantify or predict the degree, if any, of the risk of reductions in payments under these various payment plans. The Company is a party to non-exclusive agreements with certain third-party payors and termination of such third-party agreements could have an adverse effect on the Company. See "Business--Operations--Sources of Revenue Reimbursement."

#### OPERATIONS SUBJECT TO GOVERNMENT REGULATION

The Company is subject to extensive regulation by both the federal government and the states in which the Company conducts its business. The Company is subject to the illegal remuneration provisions of the Social Security Act and similar state laws, which impose civil and criminal sanctions on persons who solicit, offer, receive or pay any remuneration, directly or indirectly, for referring a patient for treatment that is paid for in whole or in part by Medicare, Medicaid or similar state programs. In July 1991 and November 1992, the federal government published regulations that provide exceptions or "safe harbors" for certain business transactions. Transactions that are structured within the safe harbors are deemed not to violate the illegal remuneration provisions. Transactions that do not satisfy all elements of a relevant safe harbor do not necessarily violate the illegal remuneration statute, but may be subject to greater scrutiny by enforcement agencies. Neither the arrangements between the Company and the physician directors of its facilities ("Medical Directors") nor the minority ownership interests of referring physicians in certain of the Company's dialysis facilities fall within the protection afforded by these safe harbors. Although the Company has never been challenged under these statutes and believes it complies in all material respects with these and all other applicable laws and regulations, there can be no assurance that the Company will not be required to change its practices or relationships with its Medical Directors or with referring physicians holding minority ownership interests or that the Company will not experience material adverse effects as a result of any such challenge.

The Omnibus Budget Reconciliation Act of 1989 includes certain provisions ("Stark I") that restrict physician referrals for clinical laboratory services to entities with which a physician or an immediate family member has a "financial relationship." In August 1995, HCFA published regulations interpreting Stark I. The regulations specifically provide that services furnished in an ESRD facility that are included in the composite billing rate are excluded from the coverage of Stark I. The Company believes that the language and legislative history of Stark I indicate that Congress did not intend to include laboratory services provided incidental to dialysis services within the Stark I prohibition; however, laboratory services not included in the Medicare composite rate could be included within the coverage of Stark I. Violations of Stark I are punishable by civil penalties which may include exclusion or suspension of a provider from future participation in Medicare and Medicaid programs and substantial fines. Due to the breadth of the statutory provisions, it is possible that the Company's practices might be challenged under this law. A broad interpretation of Stark I would apply to the Company's competitors as well.

The Omnibus Budget Reconciliation Act of 1993 includes certain provisions ("Stark II") that restrict physician referrals for certain "designated health services" to entities with which a physician or an immediate family member has a "financial relationship." The Company believes that the language and legislative history of Stark II indicate that Congress did not intend to include dialysis services and the services and items provided incident to dialysis services within the Stark II prohibitions; however, certain services, including the provision of, or arrangement and assumption of financial responsibility for, outpatient prescription drugs, including EPO, and clinical laboratory services, could be construed as designated health services within

the meaning of Stark II. Violations of Stark II are punishable by civil penalties, which may include exclusion or suspension of the provider from future participation in Medicare and Medicaid programs and substantial fines. Due to the breadth of the statutory provisions and the absence of regulations or court decisions addressing the specific arrangements by which the Company conducts its business, it is possible that the Company's practices might be challenged under these laws. A broad interpretation of Stark II to include dialysis services and items provided incident to dialysis services would apply to the Company's competitors as well.

A California statute that became effective January 1, 1995 makes it unlawful for a physician who has, or a member of whose immediate family has, a financial interest with or in an entity to refer a person to that entity for, among other services, laboratory services. The Company currently operates centers in California, which accounted for a significant percentage of net operating revenues for the fiscal year ended May 31, 1995 and the seven months ended December 31, 1995. Although the Company does not believe that the statute is intended to apply to laboratory services that are provided incident to dialysis services, it is possible that the statute could be interpreted to apply to such laboratory services. If the California statute were so interpreted, the Company would be required to restructure some or all of its relationships with referring physicians who serve as Medical Directors of the Company's facilities and with the physicians who hold minority interests in certain of the Company's facilities.

At present, ESRD patients eligible for California's Medicaid program, MediCal, are reimbursed for their transportation costs relating to ESRD treatments. From time to time, the Company pays Medicare supplemental insurance premiums for patients with a financial need. If this practice is deemed to violate applicable federal or state law, the Company may be forced to halt this practice and the Company cannot predict the effect the foregoing would have on the desire of such patients to use the Company's services.

A number of proposals for health care reform have been made in recent years, some of which have included radical changes in the health care system. Health care reform could result in material changes in the financing and regulation of the health care business, and the Company is unable to predict the effect of such changes on its future operations. It is uncertain what legislation on health care reform, if any, will ultimately be implemented or whether other changes in the administration or interpretation of governmental health care programs will occur. There can be no assurance that future health care legislation or other changes in the administration or interpretation of governmental health care programs will not have a material adverse effect on the results of operations of the Company. See "Business--Operations--Medicare Reimbursement" and "Business-- Governmental Regulation."

#### RISKS INHERENT IN GROWTH STRATEGY

Following the August 1994 Transaction, the Company began an aggressive growth strategy. This growth strategy is dependent on the continued availability of suitable acquisition candidates and subjects the Company to the risks inherent in assessing the value, strengths and weaknesses of acquisition candidates, the operations of acquired companies and identifying suitable locations for additional facilities. The Company's growth is expected to place significant demands on the Company's financial and management resources. In recent years, acquisition prices and competition for facilities has increased. To the extent the Company is unable to acquire or develop facilities in a cost-effective manner, its ability to expand its business and enhance results of operations would be adversely affected. In addition, although the Company believes it has a demonstrable track record of integrating the operations of acquired companies with its historic operations, the process for integrating acquired

operations, particularly for newly acquired regional clusters, presents a significant challenge to the Company's management and may lead to unanticipated costs or a diversion of management's attention from day-to-day operations. There can be no assurance that the Company will be able to continue its growth strategy or that this strategy will ultimately prove successful. A failure to successfully continue its growth strategy could have an adverse effect on the Company's results of operations. See "Business-- Business Strategy."



## COMPETITION

The dialysis industry is fragmented and highly competitive, particularly in terms of acquisitions of existing dialysis facilities and developing relationships with referring physicians. Certain of the Company's competitors have substantially greater financial resources than the Company and may compete with the Company for acquisitions of facilities in markets targeted by the Company. Competition for acquisitions has increased the cost of acquiring existing dialysis facilities. The Company has from time to time experienced competition from referring physicians who have opened their own dialysis facilities. A portion of the Company's business consists of monitoring and providing supplies for ESRD treatments in patients' homes. Certain physicians also provide similar services and, if the number of such physicians were to increase, the Company could be adversely affected. See "Business--Competition."

## DEPENDENCE ON KEY PERSONNEL

The Company is dependent upon the services and management experience of the Company's executive officers, and accordingly has entered into employment agreements with, and provided a variety of equity incentives to, each of these executives. The Company's continued growth depends upon its ability to attract and retain skilled employees, in particular highly skilled nurses, for whom competition is intense. The Company believes that its future success will also be significantly dependent on its ability to attract and retain qualified physicians to serve as Medical Directors of its dialysis facilities. The Company does not carry key-man life insurance on any of its officers.

## DEPENDENCE ON PHYSICIAN REFERRALS

The Company's facilities are dependent upon referrals of ESRD patients for treatment by physicians specializing in nephrology and practicing in the communities served by the Company's dialysis facilities. As is generally true in the dialysis industry, at each facility one or a few physicians account for all or a significant portion of the patient referral base. The loss of one or more key referring physicians at a particular facility could have a material adverse effect on the operations of that facility and could adversely affect the Company's overall operations. Referring physicians own minority interests in 21 of the Company's dialysis facilities. If such interests are deemed to violate applicable federal or state law, such physicians may be forced to dispose of their ownership interests. The Company cannot predict the effect such dispositions would have on its business. See "Risk Factors--Operations Subject to Government Regulation," "Business--Operations--Physician Relationships" and "Business--Governmental Regulation."

## SIGNIFICANT INFLUENCE BY DLJMB

DLJ Merchant Banking Partners, L.P. and certain of its affiliates ("DLJMB") own approximately 10% of the outstanding Common Stock of the Company and after the Offering will own approximately 7.6% of the outstanding Common Stock of the Company. Upon consummation of the Offering, DLJMB's right to nominate four of the five members of the Company's Board of Directors pursuant to a Shareholders Agreement (as defined herein) among certain of the Company's stockholders will terminate. The four individuals previously nominated by DLJMB (three of whom are DLJMB employees) and elected as Company directors will remain directors until the next election or any earlier resignation and, to that extent and until such time, will continue to be able to influence significantly the affairs of the Company, including corporate transactions such as any "going private" transaction, merger, consolidation or sale of all or substantially all of the Company's assets. The Company has been informed that two of such DLJMB employees intend to resign as directors as soon as practicable following consummation of the Offering. See "Principal and Selling Stockholders" and "Certain Relationships and Related Transactions."

## POSSIBLE VOLATILITY OF STOCK PRICE

The trading price and volume of the Common Stock historically has been and could in the future be subject to significant fluctuations in response to many factors, including quarter-to-quarter variations in operating results, changes in earnings estimates by analysts, changes in federal or state regulation of services provided by the Company or reimbursement rates for such services, competition, general market conditions and other events or factors. See "Price

Range of Common Stock."

#### ANTITAKEOVER PROVISIONS

The Company's Certificate of Incorporation and Bylaws include several provisions which may have the effect of deterring hostile takeovers, delaying or preventing changes in control or changes in management of the Company, or limiting the ability of stockholders to approve transactions that they may deem to be in their best interests, including (i) a provision requiring that any action required or permitted to be taken by stockholders of the Company must be effected at a duly called annual or special meeting of stockholders and may not be effected by written consent, and (ii) a provision requiring at least 60 days' advance notice by a stockholder of a proposal or director nomination which such stockholder desires to present at any annual or special meeting of stockholders. In addition, pursuant to the Company's Certificate of Incorporation the Board of Directors has the authority to issue up to 5,000,000 shares of Preferred Stock and to determine the rights and preferences of such Preferred Stock without the need for further stockholder approval. The Company has no present plans to issue any shares of Preferred Stock. See "Principal and Selling Stockholders."

#### SHARES ELIGIBLE FOR FUTURE SALE; REGISTRATION RIGHTS

Substantially all of the shares of Common Stock that will be outstanding after the Offering will be available for immediate sale in the public market (subject to certain resale limitations under Rule 144 of the Securities Act). Sales of substantial amounts of Common Stock into the public market or the perception that such sales could occur, could adversely affect the prevailing market price for the Common Stock and the ability of the Company to raise equity capital. The Company can make no prediction as to the effect, if any, that sales of shares of its Common Stock, or the availability of shares for future sale, will have on the market price of the Common Stock prevailing from time to time. Such sales may also make it more difficult for the Company to sell equity securities or equity-related securities at a time and price that it deems appropriate. Certain stockholders of the Company are also entitled to registration rights. See "Principal and Selling Stockholders."

11

#### RECENT FACILITY NETWORK EXPANSION

The Company has implemented an aggressive growth strategy since the August 1994 Transaction through acquisitions, de novo developments and hospital alliances. The Company's acquisition model has served as the foundation for the Company's disciplined and rapid growth through acquisitions. The Company's acquisition strategy is to leverage its operating infrastructure in existing regions by acquiring centers where it already has a strong market presence and to establish a strong presence in new markets by acquiring clusters of facilities that can support new regional operating infrastructures. The Company's comprehensive range of ESRD services, including laboratory, oral pharmaceutical, vascular access management and transplant management services programs, allows the Company to rapidly expand the range of ESRD services offered to patients in the operations it acquires.

Since the implementation of the growth strategy in August 1994, the Company has become the third largest provider of dialysis services in the United States by adding 91 centers (comprised of 79 acquisitions, ten de novo developments and management contracts with Georgetown University and the University of Southern California) representing, at the time of acquisition or commencement of operations, 1,293 dialysis stations and more than 6,800 patients.

Since the Company's most recent equity offering the Company has acquired 16 facilities and, in addition, entered into a management contract with Georgetown University, which together service over 1,800 patients. As ten of such facilities were acquired on or after August 1, 1996, the full impact of such operations are not reflected in the Company's financial results for the quarter ended September 30, 1996. In addition, the Company has also recently signed letters of intent to acquire six facilities, servicing approximately 300 patients.

On March 15, 1996, the Company completed the \$49.0 million acquisition of the nephrology services business of Caremark International Inc. (the "Caremark Acquisition"), which represents the Company's largest acquisition to date. The

acquired operations included over 1,400 ESRD patients and 32 outpatient dialysis facilities (the "Caremark Facilities"), which are concentrated in the Minneapolis/St. Paul area as well as in Northern California. The Caremark Facilities generated \$46.8 million of net revenue in 1995. Additional benefits to the Company of the Caremark Acquisition include (i) establishing it as the leading dialysis provider in the Minneapolis/St. Paul region, (ii) significantly strengthening its presence in Northern California, (iii) expanding its ESRD related ancillary services, (iv) broadening its affiliations with nationally recognized nephrologists and academic medical centers, (v) strengthening its managed care capabilities and experience, and (vi) realizing significant cost savings.

During the second quarter of 1996 the Company successfully integrated the operations of the Caremark Facilities into its overall network. At the time of acquisition, the Caremark Facilities in aggregate were unprofitable and during the second quarter the Company was able to improve operating results through (i) a consolidation of corporate functions, including reimbursement administration, human resources management and accounting, (ii) making available to the Caremark Facilities the benefits of the Company's purchasing contracts, (iii) personnel reductions and (iv) the implementation of the Company's ancillary programs at or in association with the Caremark Facilities.

12

#### NETWORK EXPANSION SINCE THE INITIAL PUBLIC OFFERING

The following chart lists the 55 centers acquired, the seven de novo facilities developed and the management contract established by the Company since its initial public offering in October 1995 (the "Initial Public Offering"):

##### CAREMARK ACQUISITION (MARCH 1996)

Chabot Dialysis Clinic, Dublin	CA	Minneapolis Dialysis Unit	MN
Chabot Dialysis Clinic, Hayward	CA	Minnetonka Dialysis Unit	MN
Chabot Dialysis Clinic, San Leandro	CA	Montevideo Dialysis Unit	MN
Chabot Dialysis Clinic, Union City	CA	Morris Dialysis Unit	MN
East Bay Peritoneal Dialysis	CA	Pine City Dialysis Unit	MN
Alexandria Dialysis Unit	MN	Red Lake Dialysis Unit	MN
Anoka-Good Samaritan Dialysis Unit	MN	Red Wing Dialysis Unit	MN
Arden Hills Dialysis Unit	MN	Redwood Falls Dialysis Unit	MN
Burnsville Dialysis Unit	MN	Special Needs Dialysis Unit	MN
Cass Lake Dialysis Unit	MN	St. Paul Dialysis Unit	MN
Coon Rapids Dialysis Unit	MN	West St. Paul Dialysis Unit	MN
Edina Dialysis Unit	MN	Mitchell Dialysis Unit	SD
Fairmont Dialysis Unit	MN	Pine Ridge Dialysis Unit	SD
Faribault Dialysis Unit	MN	Rosebud Dialysis Unit	SD
Maplewood Dialysis Unit	MN	Sioux Falls Dialysis Unit	SD
Marshall Dialysis Unit	MN	St. Croix Falls Dialysis Unit	WI

##### OTHER ACQUISITIONS AND MANAGEMENT CONTRACTS

Total Renal Care East	TX	November 1995
Total Renal Care West	TX	November 1995
Burbank Regional Dialysis Center	CA	January 1996
Downtown Dialysis Center	MD	January 1996
Pacific Peritoneal Dialysis Center	Guam	January 1996

Upstate Dialysis Center	SC	March 1996
Greer Kidney Center (1)	SC	March 1996
Eaton Canyon Dialysis Center	CA	June 1996
Georgetown Dialysis Center (2)	DC	June 1996
St. Mary Medical Center	PA	June 1996
Piedmont Dialysis	CA	July 1996
Peralta Dialysis	CA	July 1996
Bertha Sirk Dialysis	MD	July 1996
Greenspring Dialysis	MD	July 1996
Houston Kidney Center	TX	August 1996
Houston Kidney Center Southeast	TX	August 1996
North Houston Kidney Center	TX	August 1996
Northwest Kidney Center	TX	August 1996
Port Charlotte Artificial Kidney	FL	August 1996
Gulf Coast Peritoneal	FL	August 1996
Paramount Dialysis	CA	September 1996
Doctors Dialysis East L.A. (3)	CA	October 1996
Doctors Dialysis Montebello (3)	CA	October 1996
Complete Dialysis Care	FL	October 1996

#### DE NOVO FACILITIES

Shiprock Dialysis Facility	NM	December 1995
Kenner Dialysis Center	LA	February 1996
Potrero Hill Dialysis Center	CA	February 1996
Mission Dialysis Center	CA	March 1996
Guam Renal Center	Guam	May 1996
Loma Vista	TX	August 1996
Pine Island	FL	October 1996

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- (1) On March 13, 1996, the Company entered into a definitive agreement to manage the affiliated Greer Kidney Center, Inc. ("Greer") and to acquire Greer upon receipt of a certificate of need from the State of South Carolina. The Company has placed the funds for the acquisition of Greer into escrow pending regulatory approval.
  - (2) Management contract.
  - (3) In October 1996 the Company entered into a definitive agreement to manage the Doctors Dialysis Center of East Los Angeles and Doctors Dialysis Center of Montebello and expects to complete the acquisition during the first four months of 1997.

#### USE OF PROCEEDS

The net proceeds to the Company from the sale of 500,000 shares of Common Stock offered by the Company hereby are estimated to be approximately \$18,220,000, at the public offering price of \$39.00 per share and after deducting the underwriting discount and estimated offering expenses. The Company intends to use such net proceeds for acquisitions, de novo developments and other capital expenditures, and general corporate purposes. Pending such uses, the Company intends to reduce amounts outstanding (and permitted to be reborrowed) under the revolving portion of the Company's credit facility (the "Senior Credit Facility"). The Company will not receive any proceeds from the sale of Common Stock by the Selling Stockholders.

The Company continually reviews and evaluates acquisition candidates as part of its growth strategy, and is at various stages of evaluation, discussion or negotiation with a number of such candidates. As of the date of this Prospectus, except for letters of intent to acquire six facilities servicing approximately 300 patients, the Company has not reached a final binding agreement with respect to any such potential acquisition.

Borrowings under the Senior Credit Facility (which are permitted to be made up to \$400 million) bear interest at one of two floating rates selected from time to time by the Company. These borrowings currently bear interest at 6.125% per annum. At October 30, 1996, approximately \$300 million was available for borrowing under the Senior Credit Facility. See "Management's

Discussion and Analysis of Financial Condition and Results of Operations--  
Liquidity and Capital Resources."

PRICE RANGE OF COMMON STOCK

The Company's Common Stock is traded on the New York Stock Exchange. The following table sets forth, for the periods indicated, the high and low sale prices for the Common Stock as reported by the New York Stock Exchange since the Initial Public Offering.

	HIGH	LOW
Transitional Fiscal Year Ended December 31, 1995		
4th Quarter (beginning October 31, 1995).....	\$30	\$18
Fiscal Year Ending December 31, 1996		
1st Quarter .....	32 1/4	27
2nd Quarter .....	45 1/2	31
3rd Quarter .....	42 5/8	32
4th Quarter (through October 30, 1996) .....	46 3/8	38 7/8

The closing price of the Common Stock on October 30, 1996 was \$39 5/8 per share. As of September 30, 1996 there were approximately 115 holders of record of the Company's Common Stock.

DIVIDEND POLICY

Since the August 1994 Transaction, the Company has not declared or paid cash dividends to its holders of Common Stock. The Company currently anticipates that all earnings will be retained for the development and expansion of its business and, therefore, does not anticipate paying dividends on its Common Stock in the foreseeable future. The Senior Credit Facility contains provisions which prohibit the Company from paying dividends on its Common Stock.

CAPITALIZATION

The following table sets forth the cash and capitalization of the Company (i) as of September 30, 1996, (ii) as adjusted to reflect acquisitions consummated after September 30, 1996 and probable acquisitions as of October 30, 1996, and (iii) as further adjusted to reflect the sale of 500,000 shares of Common Stock offered hereby by the Company at the public offering price of \$39.00 per share. See "Use of Proceeds" and the Company's Consolidated Financial Statements and the notes thereto. See also "Management's Discussion and Analysis of Financial Condition and Results of Operations."

	SEPTEMBER 30, 1996		
	-----		
	AS		
	AS	FURTHER ADJUSTED	
	ACTUAL	ADJUSTED	FOR THE OFFERING
	-----	-----	-----
	(DOLLARS IN THOUSANDS)		
Cash.....	\$ 5,440	\$ 4,395	\$ 22,615
	=====	=====	=====
Long-term debt (including current			
portion).....	\$ 78,787	\$110,077	\$110,077
Minority interests.....	5,326	3,791	3,791
Stockholders' equity:			
Common Stock, \$0.001 par value,			
55,000,000 shares authorized; 25,967,029			
shares outstanding, actual; 25,967,029			
shares outstanding, as adjusted; and			
26,467,029 shares outstanding as further			

adjusted (1).....	26	26	26
Additional paid-in capital.....	236,433	236,433	254,653
Notes receivable from stockholders.....	(2,783)	(2,783)	(2,783)
Retained earnings (deficit).....	(29,317)	(29,317)	(29,317)
	-----	-----	-----
Total stockholders' equity.....	204,359	204,359	222,579
	-----	-----	-----
Total capitalization.....	\$288,472	\$318,227	\$336,447
	=====	=====	=====

(1) Does not include 1,782,953 shares issuable upon the exercise of options outstanding as of September 30, 1996.

15

#### SELECTED FINANCIAL AND OPERATING DATA

The following table presents selected consolidated financial and operating data of the Company for the periods indicated. The consolidated financial data as of May 31, 1991, 1992, 1993, 1994 and 1995 and as of December 31, 1995 and for each of the years in the five year period ended May 31, 1995 and the seven month period ended December 31, 1995 have been derived from the Company's audited consolidated financial statements. The consolidated financial data for the seven months ended December 31, 1994 and for the nine month periods ended September 30, 1995 and 1996 are unaudited and include all adjustments consisting solely of normal recurring adjustments necessary to present fairly the Company's results of operations for the period indicated. The results of operations for the seven month periods ended December 31, 1994 and 1995 and for the nine month periods ended September 30, 1995 and 1996 are not necessarily indicative of the results which may occur for the full fiscal year. The following financial and operating data should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations," the Company's Consolidated Financial Statements and the notes thereto and the other information contained elsewhere in this Prospectus or incorporated herein by reference.

	YEARS ENDED MAY 31,					SEVEN MONTHS ENDED DECEMBER 31, (1)		NINE MONTHS ENDED SEPTEMBER 30,	
	1991	1992	1993	1994	1995	1994	1995	1995	1996
	(DOLLARS IN THOUSANDS, EXCEPT PER SHARE DATA)								
INCOME STATEMENT DATA:									
(2)									
Net operating revenues.	\$53,019	\$63,888	\$71,576	\$80,470	\$98,968	\$ 53,593	\$ 89,711	\$93,508	\$188,153
Facility operating expenses.....	37,016	45,599	49,440	56,828	65,583	36,012	57,406	60,304	126,121
General and administrative expenses (3).....	4,209	4,819	5,292	7,457	9,115	4,916	7,645	8,307	13,644
Provision for doubtful accounts.....	1,846	2,118	2,050	1,550	2,371	1,363	1,811	2,023	3,892
Depreciation and amortization.....	2,621	3,167	3,434	3,752	4,740	2,586	4,383	4,564	10,263
Total operating expenses.....	45,692	55,703	60,216	69,587	81,809	44,877	71,245	75,198	153,920
Operating income.....	7,327	8,185	11,360	10,883	17,159	8,716	18,466	18,310	34,233
Interest expense, net..	208	110	9	13	7,203	3,300	5,584	7,287	3,862
Income before income taxes, minority interests and extraordinary item....	7,119	8,075	11,351	10,870	9,956	5,416	12,882	11,023	30,371
Income taxes.....	2,519	2,875	4,129	4,106	3,511	1,933	4,631	3,852	11,537
Income before minority interests and extraordinary item....	4,600	5,200	7,222	6,764	6,445	3,483	8,251	7,171	18,834
Minority interests in income of consolidated subsidiaries.....	479	535	775	1,046	1,593	833	1,784	1,787	2,296
Income before extraordinary item....	\$ 4,121	\$ 4,665	\$ 6,447	\$ 5,718	\$ 4,852	\$ 2,650	\$ 6,467 (4)	\$ 5,384	\$ 16,538 (5)
Income per share before extraordinary item....					\$ 0.22 (6)	\$ 0.08 (6)	\$ 0.36 (4)	\$ 0.35	\$ 0.65 (5)

	YEARS ENDED MAY 31,					SEVEN MONTHS ENDED DECEMBER 31, (1)		NINE MONTHS ENDED SEPTEMBER 30,	
	1991	1992	1993	1994	1995	1994	1995	1995	1996
OPERATING DATA:									
Outpatient facilities (at period end).....	32	35	36	37	57	42	68	62	126
Treatments (7).....	308,029	349,736	379,397	423,353	481,537	268,820	390,806	423,677	807,289
Hospitals receiving inpatient services (at period end).....	34	33	32	28	48	28	55	54	82

	MAY 31,					DECEMBER 31, SEPTEMBER 30,	
	1991	1992	1993	1994	1995	1995	1996

(DOLLARS IN THOUSANDS)

BALANCE SHEET DATA:							
Working capital.....	\$ 5,471	\$ 8,508	\$14,609	\$20,064	\$ 14,971	\$ 54,691	\$ 85,254
Total assets.....	26,876	32,509	36,003	43,621	77,558	163,998	320,421
Long-term debt (including current portion).....	465	437	267	198	88,142	55,894	78,787
Mandatorily redeemable Common Stock (8).....	--	--	--	--	3,990	--	--
Stockholders' equity (deficit).....	17,903	22,568	29,015	34,733	(30,879) (9)	82,804	204,359

(See Notes on following page)

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- (1) In 1995, the Company changed its fiscal year to December 31 from May 31.
  - (2) The August 1994 Transaction and subsequent acquisitions had a significant impact on the Company's financial position and on the Company's results of operations. Consequently, the Balance Sheet Data as of May 31, 1995, December 31, 1995 and September 30, 1996 and the Income Statement Data for the fiscal year ended May 31, 1995, the seven months ended December 31, 1995 and the nine months ended September 30, 1995 and 1996 are not directly comparable to corresponding information as of prior dates and for prior periods, respectively.
  - (3) General and administrative expenses for the fiscal years ended May 31, 1991, 1992, 1993 and 1994 include overhead allocations by the Company's former parent of \$523,000, \$662,000, \$235,000 and \$1,458,000, respectively. The overhead allocations for the fiscal years ended May 31, 1991, 1992 and 1993 were made using a different methodology than that used in the fiscal year ended May 31, 1994 and the substantial increase in that year reflects this change in methodology rather than a change in the level of services provided. No overhead allocation was made for the period from March 1, 1994 through the closing of the August 1994 Transaction, at which time the Company began to record general and administrative expenses as incurred on a stand-alone basis. General and administrative expenses for the fiscal year ended May 31, 1994 reflect \$458,000 in expenses relating to a terminated equity offering.
  - (4) In December 1995, the Company recorded an extraordinary loss of \$2,555,000, or \$0.14 per share, net of tax, on the early extinguishment of debt. See Note 6 of Notes to Consolidated Financial Statements.
  - (5) During July and September 1996, the Company recorded an extraordinary loss of \$7.7 million, or \$0.30 per share, net of income tax effect, on the early extinguishment of debt. See "Management's Discussion and Analysis of Financial Condition and Results of Operations."
  - (6) Income per share before extraordinary item for the year ended May 31, 1995 and for the seven months ended December 31, 1994 is presented on a pro forma basis to give effect to the August 1994 Transaction as if it had occurred on June 1, 1994. See Note 1 of Notes to Consolidated Financial Statements.
  - (7) Represents dialysis treatments provided in outpatient facilities, at home and in acute care hospitals. Home dialysis treatments are stated in

hemodialysis equivalents. Only treatments rendered by the Company after the acquisition of a facility are included.

- (8) Mandatorily redeemable Common Stock represents shares of Common Stock issued in certain acquisitions subject to put options that terminated upon the completion of the Initial Public Offering. See Note 8 to Notes to Consolidated Financial Statements.
- (9) In connection with the August 1994 Transaction, the Company paid a dividend to Tenet of \$75.5 million.

17

#### MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following should be read in conjunction with the Company's Consolidated Financial Statements and the notes thereto contained elsewhere in this Prospectus. This Prospectus contains forward-looking statements which involve risks and uncertainties. The Company's actual results may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such a difference include, but are not limited to, those discussed in "Risk Factors."

#### BACKGROUND

The Company was formed in contemplation of the August 1994 Transaction as the parent corporation of Total Renal Care, Inc. (formerly Medical Ambulatory Care, Inc.). In the August 1994 Transaction, the Company paid a dividend of \$75.5 million to NME Properties out of the net proceeds from (i) the issuance of units consisting of an aggregate of \$100 million in principal amount at maturity of 12% Senior Subordinated Discount Notes due 2004 (the "Discount Notes"), which were issued at approximately 70% of par, and 600,000 shares of Common Stock and (ii) borrowing under the Company's revolving credit facility with the Bank of New York (the "Senior Credit Facility"). The Company raised additional capital to fund the continuation of its growth strategy through the Initial Public Offering on October 30, 1995 in which the Company issued and sold 6,900,000 shares of its Common Stock and raised gross proceeds of \$107 million. Concurrent with the Initial Public Offering, the Company listed its Common Stock on the New York Stock Exchange under the symbol "TRL." Subsequent to the Initial Public Offering the Company changed its fiscal year end from May 31 to December 31. The Company raised additional capital through a subsequent public offering on April 3, 1996 in which the Company issued and sold 3,500,000 shares of its Common Stock and raised net proceeds of \$109.7 million. In July and September 1996 the Company retired all outstanding Discount Notes for an aggregate payment of \$68.4 million (including consent payments of \$1.1 million and \$474,000 in related transaction costs). In October 1996 the Company secured a seven year \$400 million bank credit facility to provide further financing for the Company's growth strategy.

Following the August 1994 Transaction, the Company implemented a growth strategy designed to enhance revenues and improve operating income. A major part of the Company's growth strategy is to expand the Company's existing facility network and to create new regional facility networks through acquisitions, de novo developments and hospital alliances. The acquisition of a facility has an immediate impact on the Company's results of operations by increasing revenues with minimal incremental general and administrative cost resulting in enhanced operating income. Since the August 1994 Transaction the Company has added 91 centers to its network (comprised of 79 acquisitions and ten de novo developments and management contracts with Georgetown University and the University of Southern California) representing, at the time of acquisition or commencement of operations, 1,293 dialysis stations and more than 6,800 patients. Of these increases, additions since the Initial Public Offering total 63 new centers (comprised of 55 acquisitions, seven de novo developments and one management contract with Georgetown University) representing, at the time of acquisition or commencement of operations, 906 dialysis stations and more than 4,700 patients.

Following the August 1994 Transaction, the Company implemented a focused strategy to increase net operating revenues per treatment and improve operating income margins. The Company has significantly increased per-treatment revenues through the addition of in-house clinical laboratory services, improved pricing, increased utilization of ancillary services and the addition of in-house pharmacy services. To improve operating income, the Company also began a systematic review of the Company's vendor relations leading to the renegotiation of a number of supply contracts and insurance



arrangements that reduced operating expenses. In addition the Company has focused on improving facility operating efficiencies and leveraging corporate and regional management. These improvements have been offset in part by increased amortization of goodwill and other intangible assets relating to the Company's acquisitions (all of which have been accounted for as purchase transactions) and start-up expenses related to de novo developments.

The Company incurred approximately \$70.4 million of indebtedness as a result of the August 1994 Transaction. The related interest expense has had a significant impact on the Company's results of operations for

18

the fiscal year ended May 31, 1995, the seven months ended December 31, 1995 and the nine months ended September 30, 1995 and 1996. The Company's results of operations for the year ended May 31, 1995, the seven months ended December 31, 1995 and the nine months ended September 30, 1995 and 1996 have also been materially affected by the implementation of the Company's growth strategy. Consequently, the results of operations for the year ended May 31, 1995, the seven months ended December 31, 1995 and the nine months ended September 30, 1995 and 1996 are not directly comparable to the results of operations for comparable prior periods.

#### NET OPERATING REVENUES

Net operating revenues are derived primarily from four sources: (i) outpatient facility hemodialysis services, (ii) ancillary services, including EPO administration, clinical laboratory services and intravenous and oral pharmaceutical products and services, (iii) home dialysis services and related products and (iv) inpatient dialysis services provided to hospitalized patients pursuant to arrangements with hospitals. Additional revenues are derived from the provision of dialysis facility management services to certain subsidiaries and affiliated and unaffiliated dialysis centers. The Company's 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 21 months of treatment as mandated by law. Rates paid for services provided to hospitalized patients are negotiated with individual hospitals. For the year ended May 31, 1995, approximately 62% and 8% of the Company's net patient revenues were derived from reimbursement under Medicare and Medicaid, respectively. For the seven months ended December 31, 1995, approximately 60% and 7% of the Company's net patient revenues were derived from reimbursement under Medicare and Medicaid. For the nine months ended September 30, 1996, approximately 60% and 6% of the Company's net patient revenues were derived from reimbursement under Medicare and Medicaid, respectively. See "Business--Operations--Sources of Revenue Reimbursement."

#### QUARTERLY RESULTS OF OPERATIONS

The following table sets forth selected unaudited financial and operating information for each of the nine calendar quarters ended after the August 1994 Transaction:

	QUARTERS ENDED								
	SEPTEMBER 30, 1994	DECEMBER 31, 1994	MARCH 31, 1995	JUNE 30, 1995	SEPTEMBER 30, 1995	DECEMBER 31, 1995	MARCH 31, 1996	JUNE 30, 1996	SEPTEMBER 30, 1996
	(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AND PER TREATMENT DATA)								
Net operating revenues.....	\$22,434	\$24,244	\$25,469	\$30,624	\$37,415	\$41,335	\$50,237	\$64,583	\$73,333
Facility operating expenses.....	15,265	16,017	16,922	19,498	23,884	26,673	33,329	43,318	49,474
General and administrative expenses.....	1,930	2,346	2,423	2,777	3,107	3,537	3,901	4,800	4,943
Operating income.....	3,633	4,026	4,286	6,248	7,776	8,356	9,551	11,556	13,126
Income before extraordinary item.....	1,053	705	1,001	1,898	2,485	3,285	4,276	5,726	6,536
Income per share before extraordinary item.....	\$ 0.01	\$ 0.05	\$ 0.07	\$ 0.12	\$ 0.16	\$ 0.16	\$ 0.19	\$ 0.22	\$ 0.25
Outpatient facilities.....	42	42	45	60	62	68	108	116	126

Treatments.....	112,407	120,443	123,107	136,937	163,633	179,807	217,451	274,256	315,580
Net operating revenues per treatment.....	\$199.58	\$201.29	\$206.89	\$223.64	\$228.65	\$229.89	\$231.03	\$235.48	\$232.38

Utilization of the Company's services is generally not subject to material seasonal fluctuations. The quarterly variations shown above reflect the significant impact of the Company's growth strategy and margin improvement programs.

19

## RESULTS OF OPERATIONS

The following table sets forth for the periods indicated selected information expressed as a percentage of net operating revenues for such periods.

	YEARS ENDED MAY 31,			SEVEN MONTHS ENDED DECEMBER 31,		NINE MONTHS ENDED SEPTEMBER 30,	
	1993	1994	1995	1994	1995	1995	1996
Net operating revenues....	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Facility operating expenses.....	69.1	70.6	66.3	67.2	64.0	64.5	67.0
General and administrative expenses.....	7.4	9.3	9.2	9.2	8.5	8.9	7.3
Provision for doubtful accounts.....	2.8	1.9	2.4	2.5	2.0	2.1	2.0
Depreciation and amortization.....	4.8	4.7	4.8	4.8	4.9	4.9	5.5
Operating income.....	15.9	13.5	17.3	16.3	20.6	19.6	18.2
Interest expense, net of interest income.....	--	--	7.3	6.2	6.2	7.8	2.1
Income taxes.....	5.8	5.1	3.5	3.6	5.2	4.1	6.1
Minority interests.....	1.1	1.3	1.6	1.6	2.0	1.9	1.2
Income before extraordinary item.....	9.0	7.1	4.9	4.9	7.2	5.8	8.8

NINE MONTHS ENDED SEPTEMBER 30, 1996 COMPARED TO THE NINE MONTHS ENDED SEPTEMBER 30, 1995

**Net Operating Revenues.** Net operating revenues for the nine months ended September 30, 1996 increased \$94,645,000 to \$188,153,000 from \$93,508,000 for the nine months ended September 30, 1995 representing a 101.2% increase. Of this increase, \$84,665,000 was due to increased treatments from acquisitions, existing facility growth and from de novo developments. The remainder was due to an increase in net operating revenues per treatment, \$233.07 in the first nine months of 1996 compared to \$220.71 in the first nine months of 1995, and an increase in affiliated and unaffiliated facility management fees. The increase in operating revenues per treatment was due to the addition of the Company's ESRD laboratory, increased ancillary utilization primarily in the administration of EPO, an overall increase in average reimbursement rates, and the opening of an IV and oral pharmaceutical program and an access management program.

**Facility Operating Expenses.** Facility operating expenses increased \$65,817,000 to \$126,121,000 in the first nine months of 1996 from \$60,304,000 in the first nine months of 1995. As a percentage of net operating revenues, facility operating expenses increased to 67.0% in the first nine months of 1996 from 64.5% in the first nine months of 1995 due to the significant amount of recent acquisitions and de novo development activity with an operating expense structure that is initially higher due to integration costs incurred in the first few months of operations coupled with a lower base of revenue generated until the Company's ancillary programs are added, leading to an overall lower operating margin.

**General and Administrative Expenses.** General and administrative expenses increased \$5,337,000 to \$13,644,000 in the first nine months of 1996 from

\$8,307,000 in the first nine months of 1995. As a percentage of net operating revenues, general and administrative expenses declined to 7.3% in the first nine months of 1996 from 8.9% in the first nine months of 1995. This decline as a percentage of net revenue is a result of revenue growth and economies of scale achieved through the leveraging of corporate staff across a higher revenue base.

**Provision for Doubtful Accounts.** The provision for doubtful accounts increased \$1,869,000 to \$3,892,000 in the first nine months of 1996 from \$2,023,000 in the first nine months of 1995. As a percentage of net operating revenues, the provision for doubtful accounts decreased to 2.0% in the first nine months of 1996 from 2.1% in the first nine months of 1995. Due to the significant acquisition activity since the first nine months of 1995, the percentage of accounts receivable, for which the Company provision methodology will be applied, in the more recent aging categories has increased, causing a corresponding decrease in the provision as a percentage of revenues.

20

**Depreciation and Amortization.** Depreciation and amortization increased \$5,699,000 to \$10,263,000 in the first nine months of 1996 from \$4,564,000 in the first nine months of 1995. As a percentage of net operating revenues, depreciation and amortization increased to 5.5% in the first nine months of 1996 from 4.9% in the first nine months of 1995. The increase was attributable to goodwill, other intangibles and fixed assets recorded through acquisition activity relative to the existing base of facilities and increased depreciation from new center leaseholds and routine capital expenditures.

**Operating Income.** Operating income increased \$15,923,000 to \$34,233,000 in the first nine months of 1996 from \$18,310,000 in the first nine months of 1995. As a percentage of net operating revenues, operating income decreased to 18.2% in the first nine months of 1996 from 19.6% in the first nine months of 1995. This decrease in operating income is primarily due to an increase in depreciation and amortization as a percentage of net operating revenue.

**Interest Expense.** Interest expense, net of interest income, decreased \$3,425,000 to \$3,862,000 in the first nine months of 1996 from \$7,287,000 in the first nine months of 1995. As a percentage of net operating revenues, interest expense, net of interest income, decreased to 2.1% in the first nine months of 1996 from 7.8% in the first nine months of 1995. Cash interest expense during the first nine months of 1996 was \$1,473,000 and non-cash interest during the same period was \$4,396,000 versus \$805,000 and \$6,729,000 in the first nine months of 1995, respectively. The decrease in the first nine months of 1996 non-cash interest expense was due primarily to the redemption of 35% of the accreted value of the Company's Discount Notes in December 1995 and the repurchase of additional Discount Notes during the third quarter of 1996. The increase in cash interest expense was due primarily to borrowings made under the Company's Senior Credit Facility to fund the Company's acquisitions and to repurchase the remaining outstanding Discount Notes during the first nine months of 1996. The increase in interest income was due to investments of excess cash generated from the Company's initial public offering and secondary equity offering placed in short-term high-grade instruments.

**Provisions for Income Taxes.** Provision for income taxes increased \$7,685,000 to \$11,537,000 in the first nine months of 1996 from \$3,852,000 in the first nine months of 1995. As a percentage of net operating revenues, provision for income taxes increased to 6.1% in the first nine months of 1996 from 4.1% in the first nine months of 1995 and the effective tax rate decreased to 41.1% from 41.7% over the same period. The increase as a percentage of net operating revenues was primarily due to the increased profitability of the Company in the first nine months of 1996 versus the same period in the prior year.

**Minority Interest.** Minority interests increased \$509,000 to \$2,296,000 in the first nine months of 1996 from \$1,787,000 in the first nine months of 1995. As a percentage of net operating revenues, minority interest decreased to 1.2% in the first nine months of 1996 from 1.9% in the first nine months of 1995. This decrease in minority interest as a percentage of net operating revenues is a result of a relative proportionate decrease in the formation of partnership affiliates and subsidiaries as a percentage of total new acquisitions.

**Extraordinary Loss.** In July and September 1996 the Company retired all outstanding Discount Notes for an aggregate payment of \$68.4 million

(including consent payments of \$1.1 million). The debt retirement resulted in an extraordinary loss, net of tax, of \$7.7 million during the third quarter of 1996.

SEVEN MONTHS ENDED DECEMBER 31, 1995 COMPARED TO SEVEN MONTHS ENDED DECEMBER 31, 1994

Net Operating Revenues. Net operating revenues increased \$36,118,000 to \$89,711,000 for the seven months ended December 31, 1995 ("1995 Seven Month Period") from \$53,593,000 for the seven months ended December 31, 1994 ("1994 Seven Month Period") representing a 67.4% increase. Of this increase \$24,411,000 was due to increased treatments from acquisitions, existing facility growth and from de novo developments. The remainder was due to an increase in net operating revenues per treatment which was \$229.55 in the 1995 Seven Month Period compared to \$199.36 in the 1994 Seven Month Period, and an increase in affiliated and unaffiliated facility management fees. The increase in operating revenues per treatment was due to the addition of TRC's ESRD laboratory, an overall increase in reimbursement rates, increased ancillary services utilization primarily in the administration of EPO and the opening of its oral pharmaceutical and IV therapy program.

Facility Operating Expenses. Facility operating expenses increased \$21,394,000 to \$57,406,000 in the 1995 Seven Month Period from \$36,012,000 in the 1994 Seven Month Period and as a percentage of net operating revenue, facility operating expenses declined to 64.0% in the 1995 Seven Month Period from 67.2% in the 1994

21

Seven Month Period. In the 1995 Seven Month Period the decrease in facility operating expenses as a percentage of revenue was due to substantial reductions achieved in the costs of providing services, including medical and pharmaceutical supplies, and overall labor resource efficiencies.

General and Administrative Expenses. General and administrative expenses increased \$2,729,000 to \$7,645,000 in the 1995 Seven Month Period from \$4,916,000 in the 1994 Seven Month Period, and as a percentage of net operating revenue, general and administrative expenses declined to 8.5% in the 1995 Seven Month Period from 9.2% in the 1994 Seven Month Period. This decline as a percentage of net revenue is a result of revenue growth and economies of scale achieved through the leveraging of corporate staff across a higher revenue base.

Provision for Doubtful Accounts. The provision for doubtful accounts increased \$448,000 to \$1,811,000 in the 1995 Seven Month Period from \$1,363,000 in the 1994 Seven Month Period, and as a percentage of net operating revenue, provision for doubtful accounts decreased to 2.0% in the 1995 Seven Month Period from 2.5% in the 1994 Seven Month Period. The provision for doubtful accounts is influenced by the amount of net operating revenues generated from non-governmental payor sources. The decrease for the 1995 Seven Month Period reflects better management of accounts receivable, including increased collection efforts, billing accuracy and improved preauthorization procedures with payors.

Depreciation and Amortization. Depreciation and amortization increased \$1,797,000 to \$4,383,000 in the 1995 Seven Month Period from \$2,586,000 in the 1994 Seven Month Period, and as a percentage of net operating revenue, depreciation and amortization increased to 4.9% in the 1995 Seven Month Period from 4.8% in the 1994 Seven Month Period. This increase was attributable to increased amortization due to acquisition activity and increased depreciation from new center leaseholds and routine capital expenditures.

Operating Income. Operating income increased \$9,750,000 to \$18,466,000 in the 1995 Seven Month Period from \$8,716,000 in the 1994 Seven Month Period, and as a percentage of net operating revenue, operating income increased to 20.6% in the 1995 Seven Month Period from 16.3% in the 1994 Seven Month Period. This increase in operating income is primarily due to a decrease in facility operating expenses as a percentage of net operating revenue.

Interest Expense. Interest expense, net of interest income, increased \$2,284,000 to \$5,584,000 in the 1995 Seven Month Period from \$3,300,000 in the 1994 Seven Month Period, and as a percentage of net operating revenues, interest expense, net of interest income, was 6.2% in the 1995 Seven Month Period and 6.2% in the 1994 Seven Month Period. Cash interest expense during

the 1995 Seven Month Period was \$1,063,000 and non-cash interest during the same period was \$5,228,000 versus \$26,000 and \$3,274,000 in the 1994 Seven Month Period, respectively. The increase in the 1995 Seven Month Period cash interest expense was due primarily to increased borrowing under the Senior Credit Facility and the increase in non cash interest expense was due to the August 11, 1994 issuance of the Discount Notes ("Discount Notes"), which resulted in four and a half months of interest expense recognized in the 1994 Seven Month Period as compared to a full seven months of interest expense recognized in the 1995 Seven Month Period. In addition, interest accrued in the 1995 Seven Month Period on a higher accreted principal amount through December 7, 1995, on which date the Company redeemed 35% of the principal amount of the Discount Notes at maturity. Cash interest will initially be incurred on the Discount Notes on August 15, 1997.

Provision for Income Taxes. Provision for income taxes increased \$2,698,000 to \$4,631,000 in the 1995 Seven Month Period from \$1,933,000 in the 1994 Seven Month Period, and as a percentage of net operating revenue, provision for income taxes increased to 5.2% in the 1995 Seven Month Period from 3.6% in the 1994 Seven Month Period. The increase was primarily due to the increased profitability of the Company in the 1995 Seven Month Period versus the same period in the prior year.

Minority Interests. Minority interests increased \$951,000 to \$1,784,000 in the 1995 Seven Month Period from \$833,000 in the 1994 Seven Month Period, and as a percentage of net operating revenue, minority interest

22

increased to 2.0% in the 1995 Seven Month Period from 1.6% in the 1994 Seven Month Period. This increase in minority interest as a percentage of revenue is a result of increased profitability at these partnership affiliates and subsidiaries and an increase in the number of company facilities owned by such partnership affiliates.

Extraordinary Loss. On December 7, 1995 the Company redeemed 35% of the accreted value of the Discount Notes at a redemption premium of 111% for a total redemption price of \$31,912,000. In connection with this redemption, the Company recorded an extraordinary loss of \$2,555,000 (net of income tax effect) in December 1995.

#### FISCAL 1995, 1994 AND 1993

Net Operating Revenues. Net operating revenues increased \$18,498,000 to \$98,968,000 for the fiscal year ended May 31, 1995 from \$80,470,000 for fiscal year ended May 31, 1994 representing a 23.0% increase. In the fiscal year ended May 31, 1994 net operating revenues increased \$8,894,000 from \$71,576,000 for the fiscal year ended May 31, 1993 representing a 12.4% increase. Of these increases, \$11,412,000 and \$8,293,000 were due to increased treatments (including acquisitions) for the fiscal year ended May 31, 1995 and the fiscal year ended May 31, 1994, respectively. In the fiscal year ended May 31, 1995, the fiscal year ended May 31, 1994, and the fiscal year ended May 31, 1993, net operating revenues on a per-treatment basis were \$205.53, \$190.08, and \$188.66, respectively. The increase in net operating revenues per treatment in the fiscal year ended May 31, 1995 was primarily due to the addition of a Company-owned laboratory, an overall increase in reimbursement rates, and increases in administration of EPO per treatment. The increase in net operating revenues per treatment for the fiscal year ended May 31, 1994 was due primarily to increases in administration of EPO. In the fiscal year ended May 31, 1995 and the fiscal year ended May 31, 1994, the increases were partially offset by the effect of decreases in Medicare and Medicaid reimbursement rates for EPO beginning January 1, 1994.

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. In the fiscal year ended May 31, 1995, facility operating expenses increased \$8,755,000 to \$65,583,000 from \$56,828,000 in the fiscal year ended May 31, 1994 and as a percentage of net operating revenues, facility operating expenses declined to 66.3% in the fiscal year ended May 31, 1995 from 70.6% in the fiscal year ended May 31, 1994. In the fiscal year ended May 31, 1995, the decrease in facility operating expenses as a percentage of net operating revenues was due to substantial reductions achieved in the costs of providing services, including medical supplies, general and corporate insurance products

and overall labor resource efficiencies. In the fiscal year ended May 31, 1994, facility operating expenses increased \$7,388,000 from \$49,440,000 in the fiscal year ended May 31, 1993, and, as a percentage of net operating revenues, facility operating expenses increased to 70.6% in the fiscal year ended May 31, 1994 from 69.1% in the fiscal year ended May 31, 1993. In the fiscal year ended May 31, 1994, the increase in facility operating expenses as a percentage of net operating revenues was a result of increases in the cost of labor, supplies and services which were not completely offset by an increase in net operating revenues.

**General and Administrative Expenses.** General and administrative expenses include headquarters expense and administrative, legal, quality assurance, information systems and centralized accounting support functions. In the fiscal year ended May 31, 1995, general and administrative expenses increased \$1,658,000 to \$9,115,000 from \$7,457,000 in the fiscal year ended May 31, 1994, and as a percentage of net operating revenues, general and administrative expenses declined to 9.2% in the fiscal year ended May 31, 1995 from 9.3% in the fiscal year ended May 31, 1994. This decline as a percentage of net operating revenues is a result of revenue growth and includes the full impact of stand-alone costs incurred since August 11, 1994 in place of overhead allocations for services provided by Tenet. In the fiscal year ended May 31, 1994, general and administrative expenses increased \$2,165,000 from \$5,292,000 in the fiscal year ended May 31, 1993, and, as a percentage of net operating revenues, general and administrative expenses increased to 9.3% from 7.4% in 1993. This increase as a percentage of net operating revenues is primarily a result of a change in the overhead allocation methodology used by Tenet. During the fiscal year ended May 31, 1994 and the fiscal year ended May 31, 1993, the Company

23

was charged an overhead allocation by Tenet of \$1,458,000 and \$235,000, respectively, which was included in general and administrative expenses. Additionally, the Company absorbed \$458,000 of expenses associated with a terminated equity offering in the fiscal year ended May 31, 1994.

**Provision for Doubtful Accounts.** In the fiscal year ended May 31, 1995, the provision for doubtful accounts increased \$821,000 to \$2,371,000 from \$1,550,000 in the fiscal year ended May 31, 1994, and as a percentage of net operating revenues, the provision for doubtful accounts increased to 2.4% in the fiscal year ended May 31, 1995 from 1.9% in the fiscal year ended May 31, 1994. This increase was attributable to an increase in reserves for IDPN services rendered and increased amounts owed from private third party payors and patients. In the fiscal year ended May 31, 1994, the provision for doubtful accounts declined \$500,000 from \$2,050,000 in the fiscal year ended May 31, 1993, and as a percentage of net operating revenues, the provision for doubtful accounts declined to 1.9% in the fiscal year ended May 31, 1994 from 2.8% in the fiscal year ended May 31, 1993. The decline in the fiscal year ended May 31, 1994 was attributable to better management of accounts receivable, including increased collection efforts, billing accuracy and improved preauthorization procedures with payors. Additionally, during the fiscal year ended May 31, 1994 the Company experienced a decline in amounts billed directly to patients (co-payments and deductibles) due to the growth of its business with managed care organizations.

**Depreciation and Amortization.** In the fiscal year ended May 31, 1995, depreciation and amortization increased \$988,000 to \$4,740,000 from \$3,752,000 in the fiscal year ended May 31, 1994, and as a percentage of net operating revenues, depreciation and amortization increased to 4.8% in the fiscal year ended May 31, 1995 from 4.7% in the fiscal year ended May 31, 1994. This increase was attributable to increased amortization due to acquisition activity and increased depreciation from new center leaseholds and routine capital expenditures. In the fiscal year ended May 31, 1994, depreciation and amortization increased \$318,000 from \$3,434,000 in the fiscal year ended May 31, 1993, although as a percentage of net operating revenues, depreciation and amortization decreased to 4.7% in the fiscal year ended May 31, 1994 from 4.8% in the fiscal year ended May 31, 1993 due to a general increase in net operating revenues at existing facilities.

**Operating Income.** In the fiscal year ended May 31, 1995, operating income increased \$6,276,000 to \$17,159,000 from \$10,883,000 in the fiscal year ended May 31, 1994, and as a percentage of net operating revenues, operating income increased to 17.3% in the fiscal year ended May 31, 1995 from 13.5% in the fiscal year ended May 31, 1994. This increase in operating income is primarily

due to a decrease in facility operating expenses as a percentage of net operating revenues. In the fiscal year ended May 31, 1994, operating income decreased \$477,000 from \$11,360,000 in the fiscal year ended May 31, 1993 and as a percentage of net operating revenues, operating income decreased to 13.5% in the fiscal year ended May 31, 1994 from 15.9% in the fiscal year ended May 31, 1993. The decrease in the fiscal year ended May 31, 1994 resulted primarily from the increase in general and administrative expenses, specifically a \$1,223,000 increase in the Tenet overhead allocation and incurrence of \$458,000 in expenses relating to a proposed equity offering of the Company which was subsequently terminated.

Interest Expense. Prior to the fiscal year ended May 31, 1995, the Company did not have any significant interest bearing debt. In connection with the August 1994 Transaction and the implementation of the Company's growth strategy, the Company incurred substantial debt, some of which requires interest to be paid in cash and most of which is recognized as non-cash interest expense. For the fiscal year ended May 31, 1995, total interest expense, net of interest income, was \$7,203,000, with non-cash interest expense of \$6,947,000 and cash interest expense, net of cash interest income, of \$256,000.

Provision for Income Taxes. In the fiscal year ended May 31, 1995, the provision for income taxes decreased \$595,000 to \$3,511,000 from \$4,106,000 in the fiscal year ended May 31, 1994, and as a percentage of net operating revenues, the provision for income taxes decreased to 3.5% in the fiscal year ended May 31, 1995 from 5.1% in the fiscal year ended May 31, 1994. This decrease was primarily due to the effects of the August 1994 Transaction, and the associated resulting increase in deductible non-cash interest expense causing a decline in income subject to income taxes of \$914,000. In the fiscal year ended May 31, 1994, the provision for

24

income taxes decreased \$23,000 from \$4,129,000 in the fiscal year ended May 31, 1993, and, as a percentage of net operating revenues, provision for income taxes decreased to 5.1% in the fiscal year ended May 31, 1994 from 5.8% in the fiscal year ended May 31, 1993.

Minority Interests. Minority interests represent the pretax income earned by individuals who directly or indirectly own minority interests in the Company's partnership affiliates and the net income in two of the Company's corporate subsidiaries. In the fiscal year ended May 31, 1995, minority interests increased \$547,000 to \$1,593,000 from \$1,046,000 in the fiscal year ended May 31, 1994, and as a percentage of net operating revenues, minority interests increased to 1.6% in the fiscal year ended May 31, 1995 from 1.3% in the fiscal year ended May 31, 1994. In the fiscal year ended May 31, 1994, minority interests increased \$271,000 from \$775,000 in the fiscal year ended May 31, 1993, and, as a percentage of net operating revenues, minority interests increased to 1.3% in the fiscal year ended May 31, 1994 from 1.1% in the fiscal year ended May 31, 1993. The increases for both periods resulted from increased profitability at these partnership affiliates and subsidiaries, relating primarily to increased treatments.

#### LIQUIDITY AND CAPITAL RESOURCES

Net cash provided by operating activities was \$1,973,000 for the first nine months of 1996. Net cash provided by operating activities consists of the Company's net income, 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, in the first nine months of 1996. Net cash used in investing activities was \$141,219,000 for the first nine months of 1996. The Company's principal uses of cash in investing activities have been related to acquisitions, purchases of new equipment and leasehold improvements for the Company's outpatient facilities, as well as the development of new outpatient facilities. Net cash provided by financing activities was \$114,505,000, of which the primary source of financing were \$110,079,000 net proceeds from sale of common stock and \$33,335,000 net borrowings on bank credit facility. The remaining cash required for other acquisitions, de novo developments and working capital needs were funded by the Company's available cash. As a result, cash decreased by \$24,741,000 in the first nine months of 1996.

In July 1996, the Company repurchased \$27.4 million of the outstanding Discount Notes for \$28.4 million. In September 1996, the Company completed a

tender offer for its Discount Notes pursuant to which it purchased all outstanding Discount Notes, with a principal amount of \$37.6 million at maturity, for \$38.9 million and made aggregate consent payments of \$1.1 million. The repurchase and tender offer resulted in an extraordinary loss, net of tax, of \$7.7 million during the third quarter of 1996.

Effective October 17, 1996, the Company refinanced its prior bank credit facility with the Senior Credit Facility, which permits borrowings thereunder of up to \$400,000,000. Under the Senior Credit Facility, up to \$50,000,000 may be used in connection with letters of credit, and up to \$15,000,000 in short-term funds may be borrowed the same day notice is given to the banks under a "Swing Line" facility. In general, borrowings under the Senior Credit Facility bear interest at one of two floating rates selected by the Company: (i) the Alternate Base Rate (defined as the higher of The Bank of New York's prime rate or the federal funds rate plus 0.5%); and (ii) Adjusted LIBOR (defined as the 30-, 60-, 90- or 180-day London Interbank Offered Rate, adjusted for statutory reserves) plus a margin that ranges from 0.45% to 1.25% depending on the Company's leverage ratio. Swing Line borrowings bear interest at either a rate negotiated by the Company and the banks at the time of borrowing or, if no rate is negotiated and agreed, the Alternate Base Rate. Maximum borrowings under the Senior Credit Facility will be reduced by \$50,000,000 on September 30, 2000, \$75,000,000 on September 30, 2001, and another \$75,000,000 on September 30, 2002, and the Senior Credit Facility terminates on September 30, 2003. The Senior Credit Facility contains financial and operating covenants including, among other things, requirements that the Company maintain certain financial ratios and satisfy certain financial tests, and imposes limitations on the Company's ability to make capital expenditures, to incur other indebtedness and to pay dividends. As of the date hereof, the Company is in compliance with all such covenants.

As of September 30, 1996, the Company had working capital of \$85,254,000, including cash of \$5,440,000.

25

The Company anticipates that its aggregate capital requirements for purchases of equipment and leasehold improvements for outpatient facilities after September 30, 1996 through December 31, 1996 will be approximately \$6.8 million.

The Company's strategy is to continue to expand its operations both through development of de novo centers and through acquisitions. The development of a typical outpatient facility generally requires \$700,000 for initial construction and equipment and \$200,000 for working capital. Based on the Company's experience, a de novo facility typically achieves operating profitability, before depreciation and amortization, by the 12th to 15th month of operation. However, the period of time for a development facility to break even is dependent on many factors which can vary significantly from facility to facility, and, therefore, the Company's past experience may not be indicative of the performance of future developed facilities. The Company is currently developing eight new facilities.

During the period January 1, 1996 through September 30, 1996, the Company paid approximately \$128.4 million in consideration for acquisitions, including approximately \$49.0 million for the Caremark Acquisition. From October 1, 1996 to October 30, 1996, the Company completed acquisitions of three facilities for consideration of \$17.5 million of which \$4.7 million was paid in cash, the remainder in the issuance of a letter of credit under its Senior Credit Facility to secure a subsequent cash payment to be made in the first half of 1997. See "Recent Facility Network Expansion." The Company has signed letters of intent in which it has agreed to purchase six centers servicing approximately 300 patients and has agreed to purchase the minority interest at one of its existing centers.

The Company believes that the net proceeds from this Offering, borrowings under the Senior Credit Facility, cash generated from operations and other current sources of financing will be sufficient to meet the Company's need for capital for the foreseeable future, including working capital, purchases of additional property and equipment for the operation of its existing facilities, and interest on the Senior Credit Facility. To continue its growth strategy, however, the Company may need to issue additional debt or equity securities. There can be no assurance that additional financing and capital, if and when required, will be available on terms acceptable to the Company or at all.



## BUSINESS

The Company is a leading, high-quality provider of integrated dialysis services for patients suffering from ESRD and is the third largest dialysis provider (based on number of patients served) in the United States. The Company currently provides dialysis and ancillary services to more than 9,800 patients through a network of 128 outpatient dialysis facilities in 16 states, the District of Columbia and Guam. In addition, the Company provides inpatient dialysis services at 84 hospitals. The Company has implemented an aggressive growth strategy since the August 1994 Transaction, adding 91 outpatient dialysis facilities to its network as well as 56 hospital inpatient contracts. The Company has also expanded its in-house ancillary services to include ESRD laboratory and pharmacy facilities, as well as vascular access management and transplant services programs.

## THE DIALYSIS INDUSTRY

## END-STAGE RENAL DISEASE

ESRD is the state of advanced renal impairment that is irreversible and requires routine dialysis treatments or kidney transplantation to sustain life. Qualified patients in the United States with ESRD have been entitled since 1972 to Medicare benefits regardless of age or financial circumstances. According to figures published by HCFA, the number of patients requiring chronic dialysis services in the U.S. has increased at a 9% CAGR to 200,000 patients in 1995 from 66,000 in 1982. It is estimated that the ESRD population will continue to grow at a CAGR of approximately 9% over the next five years. The Company estimates that the U.S. market for outpatient and inpatient services to ESRD patients in 1995 exceeded \$11.1 billion.

The Company attributes the continuing growth in the number of domestic ESRD patients principally to the aging of the general population and better treatment and longer survival of patients with hypertension, diabetes and other illnesses that lead to ESRD. Management also believes improved dialysis technology has enabled older patients and those who previously could not tolerate dialysis due to other illnesses to benefit from this life-prolonging treatment.

There were over 2,700 dialysis facilities in the United States at the end of 1995, of which approximately 33% were owned by independent physicians (down from 37% in 1992), 27% were hospital-based facilities (down from 33% in 1992), and 40% were owned by seven major multi-facility dialysis providers (up from 30% in 1992), including the Company. The dialysis services industry has been undergoing rapid consolidation. The Company believes that many physician owners are selling their facilities to obtain relief from changing government regulation and administrative constraints, to enable them to focus on patient care and to realize a return on their investment. Hospitals are also motivated to sell or outsource management of their facilities as they refocus their resources on their core business due to increasing competitive pressures within the hospital industry. The Company believes that these changes in the U.S. health care environment will continue to drive consolidation within the dialysis services industry.

## TREATMENT OPTIONS FOR END-STAGE RENAL DISEASE

Treatment options for ESRD include hemodialysis, peritoneal dialysis and kidney transplantation. ESRD patients are treated predominantly in outpatient treatment facilities. HCFA estimates that as of December 31, 1995, 83% of the ESRD patients in the United States were receiving hemodialysis treatment in outpatient facilities, with the remaining patients being treated in the home either through peritoneal dialysis (16%) or home hemodialysis (1%).

Hemodialysis. Hemodialysis, the most common form of ESRD treatment, is generally performed either in a freestanding facility or in a hospital-based facility. Hemodialysis uses an artificial kidney, called a dialyzer, to remove certain toxins, fluids and salt from the patient's blood combined with a machine to control external blood flow and to monitor certain vital signs of the patient. The dialysis process occurs across a semi-permeable

membrane that divides the dialyzer into two distinct chambers. While blood is circulated through one chamber, a pre-mixed dialyzer fluid is circulated through the other chamber. The toxins and excess fluid from the blood selectively cross the membrane into the dialysis fluid. A hemodialysis treatment usually lasts approximately three hours and is performed three times per week per patient.

**Peritoneal Dialysis.** Peritoneal dialysis is generally performed by the patient at home. There are several variations of peritoneal dialysis. The most common are continuous ambulatory peritoneal dialysis ("CAPD") and continuous cycling peritoneal dialysis ("CCPD") or automated peritoneal dialysis ("APD"). All forms of peritoneal dialysis use the patient's peritoneal (abdominal) cavity to eliminate fluid and toxins from the patient. CAPD utilizes a sterile, pharmaceutical-grade dialysis solution which is introduced into the patient's peritoneal cavity through a surgically placed catheter. Toxins in the blood continuously cross the peritoneal membrane into the dialysis solution. After several hours, the patient drains the used dialysis solution and replaces it with fresh solution. CCPD and APD are performed in a manner similar to CAPD, but use a mechanical device to cycle dialysis solution while the patient is sleeping or at rest.

**Other Treatment Options.** An alternative treatment not provided by the Company is kidney transplantation. While transplantation, when successful, is generally the most desirable form of therapeutic intervention, the shortage of suitable donors limits the availability of this treatment option.

#### BUSINESS STRATEGY

The Company has implemented an aggressive growth strategy since the August 1994 Transaction adding 91 outpatient dialysis facilities to its network as well as 56 hospital inpatient contracts. The Company has also expanded its in-house ancillary services to include ESRD laboratory and pharmacy facilities, as well as vascular access management and transplant services programs. The strong growth in the number of facilities and hospital contracts, combined with the enhancement of the Company's ancillary businesses, has resulted in an increase in net operating revenues of 96% to \$73.3 million in the quarter ended September 30, 1996 as compared to the same period in the previous year. Since the Company's most recent equity offering the Company has acquired 16 facilities and a management contract with Georgetown University, which together service over 1,800 patients. As ten of such facilities were acquired on or after August 1, 1996, the full impact of such operations are not reflected in the Company's financial results for the quarter ended September 30, 1996. As part of its growth strategy, the Company continually reviews and evaluates potential acquisition candidates and seeks to identify locations for de novo developments. The Company is currently developing eight new facilities scheduled for completion by the end of first quarter 1997.

The Company's growth strategy is focused on establishing strong regional networks of clustered facilities that provide comprehensive care for ESRD patients. The Company believes that this approach enhances its operating efficiency and positions the Company to be a leader in a health care environment increasingly influenced by managed care. The Company strives to continue its growth and margin improvement by (i) expanding its existing networks and by creating new regional facility networks through acquisitions, de novo developments and the formation of hospital alliances, (ii) forming strategic alliances with physicians and managed care organizations, (iii) expanding the range of ancillary services it provides to patients, (iv) continuously improving the quality of care provided through the Company's Quality Management Program and (v) maximizing operating efficiencies and utilization. As part of the Company's growth strategy, it has begun evaluating the development of operations in various overseas markets.

#### CREATION AND EXPANSION OF THE FACILITY NETWORKS

**Acquisitions.** The Company's acquisition strategy is to leverage its operating infrastructure in existing regions by acquiring centers where it already has a strong market presence and to establish a strong presence in new markets by acquiring clusters of facilities that can support new regional operating infrastructures. In reviewing a potential acquisition, the Company's evaluation includes analyzing financial pro formas, reviewing

the local competitive market and assessing the target facility's reputation for providing quality care. Since the August 1994 Transaction, the Company has acquired 90 new facilities. The 90 new facilities have expanded the Company's existing facility networks and provided significant entries into new markets including the Minneapolis/St. Paul region, the Chicago metropolitan area, South Florida and the Houston metropolitan area.

**De Novo Developments.** The Company develops new facilities to further enhance its regional clusters and better serve the managed care market, to accommodate the growing number of ESRD patients and to satisfy demand by local nephrologists. The Company has established an expertise in the design and construction of dialysis facilities, having developed ten of its dialysis facilities, since the August 1994 Transaction. In addition, the Company is currently developing eight new facilities.

**Hospital Alliances.** Management believes alliances with hospital-based facilities represent a growth opportunity for the Company as hospitals refocus on their core business due to the changing competitive environment in the hospital industry. These alliances allow the Company to be a value-added partner for hospitals through application of the Company's industry-specific expertise to hospital-based dialysis facilities. Accordingly, the Company is actively pursuing alliances with academic medical centers, as well as community and county hospitals. In January 1995, the Company entered into an agreement with the University of Southern California ("USC") and USC Internal Medicine, Inc. ("IMI") pursuant to which the parties have established a long-term cooperative relationship for the operation of dialysis facilities in the area of the Los Angeles County/USC Medical Center. Under this cooperative relationship, the Company manages USC's existing outpatient dialysis facility and home dialysis program. The Company is currently developing, and will operate, a new dialysis facility located near USC's existing facility (expected to open in November 1996). IMI currently provides medical director services at the existing facility and will also provide these services at the new facility. In March 1995, the Company reached an agreement with Louisiana State University ("LSU") to hire certain LSU faculty nephrologists to serve as medical directors at certain dialysis facilities in the New Orleans metropolitan area. The Company has opened two new dialysis facilities in New Orleans since May 1995 in which LSU-affiliated nephrologists are currently serving as Medical Directors. In June 1996 the Company signed definitive agreements with Georgetown University to manage its existing facility and to purchase 80% of such facility in 1997. The Company also expects to open new dialysis facilities with Georgetown.

The Company has signed a letter of intent with a major university-affiliated west coast medical center to develop a dialysis center for which medical directors services will be provided by the medical center's nationally recognized nephrologists.

#### ALLIANCES WITH PHYSICIANS AND MANAGED CARE

**Alliances With Physicians.** The Company seeks to organize and manage networks of nephrologists which further enhance the ability of these nephrologists and the Company to provide integrated ESRD services. A key to the Company's long-term managed care strategy is to form alliances with managed care organizations ("MCOs") in conjunction with its nephrologists to align economic incentives, reduce total ESRD service costs and to improve quality. The Company is committed to pursuing its quality management and improvement programs to improve the effectiveness of its service processes. The Company is actively promoting the development of standardized quality outcome reporting. As such, the Company has developed a clinical information system containing key quality outcome criteria for each of its patients. These cohesive programs have been successfully marketed to MCOs as the foundation for long-term relationships.

The Company entered into a long-term management contract with Total Nephrology Care Network Medical Associates, a Professional Corporation (the "Physician Network"), a network of nephrologists in Southern California that works in conjunction with the Company to provide high-quality, integrated ESRD services while reducing total costs. The Physician Network markets the services of participating nephrologists to preferred provider organizations, insurance companies, health maintenance organizations and other third-party payors for ESRD services both on a discounted fee-for-service basis and on a prepaid or capitated basis. The Company is responsible for providing billing, information systems and other services to the Physician Network. The Company is paid a management fee for all the services provided by the Company to the Physician Network. The Company is in the process of developing Physician

Networks in its other major markets.

29

Alliances with Managed Care. The Company is committed to forming innovative alliances directly with managed care organizations by providing comprehensive, integrated ESRD services that deliver high-quality care and reduce overall healthcare costs. In July 1995, the Company was awarded the first long-term ESRD contract to develop and manage a dialysis center for Kaiser Permanente ("Kaiser") in San Diego, California and in March 1996 the 25-station facility was opened and currently serves over 80 dialysis patients. This contract is also the first "partnership" of its type for Kaiser. Kaiser contracts services for one of the largest dialysis and kidney transplant populations (approximately 3,000 in California) in the country.

In August 1996, the Company entered into a contract with Aetna Health Plans of Louisiana, Inc. in which virtually all of Aetna's ESRD patients in the Greater New Orleans area will be transferred to the Company's facilities from competitive facilities. In September, the Company entered into a contract with Maxicare of Louisiana, Inc. in which virtually all of Maxicare's ESRD patients in the Greater New Orleans area will be transferred to the Company's facilities from competitive facilities. Both Aetna and Maxicare decided to transition their patients to the Company's facilities for a variety of reasons including the Company's (i) extensive geographic coverage of the area, (ii) Quality Management Program, and (iii) Clinical Information System.

The Company believes that its managed care efforts have been strengthened as a result of the Caremark Acquisition, given the new affiliations established with highly respected research nephrologists and leaders in the development of nephrology networks and integrated delivery systems. Furthermore, the clustering of the Company's acquired facilities, including the Caremark Facilities, has allowed the Company to offer managed care payors broad facility networks that can support a large segment of each managed care payor's ESRD patient population within each of the Company's markets. As a result of its managed care programs, the Company has signed over 111 contracts with managed care payors.

#### COMPREHENSIVE RENAL SERVICES

The Company is committed to broadening the range of services it provides to its ESRD patients while adding additional sources of revenue and profits. The Company acquired an ESRD laboratory in January 1995 that provides both routine (those in the Medicare composite rate) and non-routine (those for which an additional fee is charged) laboratory tests for its own and other ESRD patients throughout the United States. As part of the Caremark Acquisition, the Company also acquired an additional ESRD laboratory that provides the Company with additional capacity to accommodate its rapidly expanding patient base and also allows the Company to perform an extended range of specialty tests, including research and transplant related tests.

The Company opened a pharmacy in February 1995 that provides intravenous therapy for patients requiring nutritional support such as IDPN. The pharmacy also provides a comprehensive prescription oral drug program to patients receiving treatments at the Company's facilities. The Company's dialysis facilities administer EPO to patients upon a physician's prescription.

In November 1995, the Company expanded its range of ESRD services by entering into two separate joint ventures to provide vascular access management services to ESRD patients. Clotting of the hemodialysis vascular access, the physical entry point to the circulatory system for the dialysis procedure, is one of the most common causes of hospitalization for ESRD patients. The Company's vascular access management program uses diagnostic and preventive procedures to help keep the access point functioning. The Caremark Acquisition includes vascular access services that have added to the Company's existing programs. The Caremark Acquisition also provided the Company with an entry into pre- and post-kidney transplant services programs.

During the nine months ended September 30, 1996, the percentage of the Company's patients receiving home peritoneal dialysis remained at approximately 12% when compared to the nine month period ended September 30, 1995. Management believes that it can increase the proportion of its patients receiving peritoneal dialysis services, as an estimated 17% of all patients in

the federal ESRD program at September 30, 1996 received such services.

#### QUALITY MANAGEMENT PROGRAM

The Company believes its reputation for quality care is a significant competitive advantage in attracting patients and physicians and in pursuing growth in the managed care environment. The Company engages in organized and systematic efforts to measure, maintain and improve the quality of services it delivers through its

30

Quality Management Program. In response to current payor demands for cost-effective health care treatments with measurable outcomes, the Company has developed a proprietary PC-based, networked clinical information system that provides managed care organizations with detailed patient outcome reports and critical on-line clinical information. See "Operations--Quality Assurance."

#### MAXIMIZING OPERATING EFFICIENCIES

The Company believes it has adequate capacity within its existing facilities network to accommodate greater patient volume and expects such operating leverage to contribute to increasing margins. In addition, at certain of its facilities, the Company is able to add dialysis stations to meet growing demand. Since the Initial Public Offering, the Company has added over 20 dialysis stations to four existing facilities and is currently expanding station capacity at several other facilities. The Company will continue to focus on enhancing operating efficiencies, including staffing, purchasing and financial reporting systems and controls.

#### OPERATIONS

##### LOCATION, CAPACITY AND USE OF FACILITIES

The Company currently operates 128 outpatient dialysis centers with 1,876 dialysis stations. The Company owns or operates, directly or through wholly-owned subsidiary corporations, 104 of these facilities. The remaining 24 centers are partially-owned by physicians. The Company's facilities range in size from eight to 52 dialysis stations. The facilities are located in the following states in the following numbers: California (33); Minnesota (22); Florida (17); Texas (8); Arizona (7); Illinois (7); Louisiana (6); Virginia (6); Georgia (5); South Dakota (4); Maryland (3); Guam (2); New Mexico (2); South Carolina (2); District of Columbia (1); Pennsylvania (1); Washington (1) and Wisconsin (1). The Company also provides acute inpatient dialysis services to 84 hospitals. System-wide, the Company provides training, supplies and on-call support services to all of its CAPD and CCPD patients.

##### OPERATION OF FACILITIES

The Company's dialysis facilities are designed specifically for outpatient hemodialysis and generally contain, in addition to space for dialysis treatments, a nurses' station, a patient weigh-in area, a supply room, a water treatment space used to purify the water used in hemodialysis treatments, a dialyzer reprocessing room (where, with both the patient's and physician's consent, the patient's dialyzer is sterilized for reuse), staff work areas, offices and a staff lounge and kitchen. Many of the Company's facilities also have a designated area for training patients in home dialysis. Each facility also offers amenities for the patients, such as a color television with headsets at each dialysis station.

In accordance with conditions for participation in the Medicare ESRD program, each facility has a qualified Medical Director. See "Physician Relationships" below. Each facility also has an Administrator, typically a registered nurse, who supervises the day-to-day operations of each facility and the staff. The staff of each facility typically consists of registered nurses, licensed practical or vocational nurses, patient care technicians, a social worker, a registered dietitian, a unit clerk and bio-medical technicians.

All of the Company's facilities offer high-flux and high-efficiency hemodialysis, which most physicians practicing at the Company's facilities deem suitable for most of their patients. High-flux and high-efficiency hemodialysis utilize machinery that allow patients to dialyze in a shorter period of time per treatment because such methods cleanse the blood at a

faster rate than conventional hemodialysis. Many of the Company's facilities also offer conventional hemodialysis. The Company considers the equipment installed in its facilities to be among the most technologically advanced equipment presently available to the dialysis industry.

Many of the Company's facilities also offer various forms of home dialysis, primarily CAPD. Home dialysis services consist of providing equipment and supplies, training, patient monitoring and follow-up assistance to patients who prefer and are able to receive dialysis treatments in their homes. Patients and their families or other patient helpers are trained by a registered nurse to perform either CAPD or CCPD at home. Company training programs for CAPD or CCPD generally encompass two to three weeks.

31

#### INPATIENT DIALYSIS SERVICES

The Company provides inpatient dialysis services (excluding physician professional services) to 84 hospitals. These services are required in connection with the hospital's inpatient services for a per treatment fee individually negotiated with the hospital. In most instances, the Company transports the dialysis equipment and supplies to the hospital when requested and administers the dialysis treatment. Examples of cases in which such inpatient services are required include patients with acute kidney failure resulting from trauma or similar causes, patients in the early stages of ESRD and ESRD patients who require hospitalization for other reasons.

#### ANCILLARY SERVICES

Dialysis facilities provide a comprehensive range of ancillary services to ESRD patients, the most significant of which is the administration of EPO upon a physician's prescription. EPO is a bio-engineered protein which stimulates the production of red blood cells and is used in connection with all forms of dialysis to treat anemia, a medical complication frequently experienced by ESRD patients. The Company also has a licensed pharmacy which provides ESRD patients with oral medications and IDPN services upon a physician's prescription. Other ancillary services include studies to test the degree of bone deterioration; electrocardiograms ("EKGs"); nerve conduction studies to test the degree of deterioration of nerves; doppler flow testing to test the effectiveness of the patient's vascular access for dialysis; and blood transfusions.

In February 1995, the Company acquired a licensed clinical laboratory specializing in ESRD patient testing. Concurrently the Company entered into a management agreement with an independent third-party to manage the laboratory. With the Caremark Acquisition, the Company acquired an additional ESRD laboratory that provides the Company with additional laboratory capacity and further expands the range of specialty tests provided by the Company. These ESRD laboratories provide various forms of laboratory tests, a large majority of which are performed for the Company's outpatient dialysis facilities. The types of laboratory tests performed at the ESRD laboratories consist of (i) blood tests which are reimbursed as part of the dialysis composite rate, (ii) blood tests ordered for co-morbidity ESRD conditions (i.e., diseases that are the result of or cause of ESRD) and (iii) general symptom testing. In addition, the laboratory acquired in the Caremark Acquisition provides specialty tests, including therapeutic drug monitoring, bone deterioration and renal stone disease monitoring and certain pre and post-kidney transplant testing.

In November 1995, the Company expanded its range of ESRD services by entering into two separate joint ventures to provide vascular access management services to ESRD patients. Clotting of the hemodialysis vascular access, the physical entry point to the circulatory system for the dialysis procedure, is one of the most common causes of hospitalization for ESRD patients. The vascular access management program uses diagnostic and preventive procedures to help keep the access point functioning. The Caremark Acquisition includes additional vascular access services that will add to the Company's existing programs. The Caremark Acquisition also provided the Company with an entry into pre- and post-kidney transplant services.

#### PHYSICIAN RELATIONSHIPS

A key factor in the success of a facility is its relationship with local nephrologists. An ESRD patient generally seeks treatment at a facility near

such patient's home and where such patient's nephrologist has practice privileges. Consequently, the Company relies on its ability to meet the needs of referring physicians in order to continue to receive physician referrals of ESRD patients.

The conditions of participation in the Medicare ESRD program mandate that treatment at a dialysis facility be "under the general supervision of a Director who is a physician." The Company has engaged qualified physicians or groups of qualified physicians to serve as Medical Directors for each of its facilities. Generally, the Medical Director must be board eligible or board certified in internal medicine or pediatrics and have had at least 12 months of experience or training in the care of patients at ESRD facilities. At some facilities, the Company also contracts with one or more physicians to serve as Assistant or Associate Medical Directors or to direct specific programs, such as CAPD training.

32

Medical Directors, Associate Medical Directors and Assistant Medical Directors enter into written contracts with the Company which specify their duties and establish their compensation (which is fixed for periods of one year or more). Such agreements are terminable under certain circumstances by either party on advance written notice. The Company believes that this allows the Company to evaluate frequently the quality of the Medical Director's performance. The compensation of the Medical Directors and other physicians under contract is separately negotiated for each facility and generally depends upon competitive factors in the local market, the physician's professional qualifications and responsibilities and the size and utilization of the facility or relevant program.

As is often true in the dialysis industry, one or a few physicians may account for all or a significant portion of a dialysis facility's patient referral base. Therefore the Company's selection of a location for a dialysis facility is determined in part by the location of the practice of physicians or nephrologists whose practices include significant numbers of patients needing dialysis. The loss of an important referring physician at a particular facility could have a material adverse effect on the operations of that facility.

Generally, the Company has non-competition agreements with its Medical Directors or referring physicians. In all cases in which the Company acquired a facility from one or more physicians, or where one or more physicians own interests in facilities as partners or co-shareholders with the Company, such physicians have agreed to refrain from owning interests in and serving as Medical Directors of competing facilities for various periods. In other cases, physicians who provide Medical Director services have executed non-competition agreements. While not frequent, the Company has from time to time experienced competition from a dialysis facility established by a former Medical Director following the termination of his or her relationship with the Company.

#### QUALITY ASSURANCE

Quality Management Program. The Company engages in organized and systematic efforts to measure, maintain and improve the quality of services it delivers and believes that it has earned a favorable reputation for quality in the dialysis community. The Company has implemented a Quality Management Program designed to measure outcomes and improve the quality of its services. The Company has also developed and has rolled-out a proprietary PC-based clinical information system to support its Quality Management and Managed Care Programs. The Company's Quality Management Program and clinical information systems have been developed under the direction of the Company's Vice President-Quality Management and Integrated Programs, who is a Clinical Professor of Medicine at the University of California Medical Center in San Francisco. The implementation of the Quality Management Program is being coordinated by the Company's Corporate Director of Quality Management and twelve regional Quality Management Coordinators. This corporate quality management team works with each facility's multi-disciplinary quality management team (including the Medical Director) at each facility to implement the Program. The Quality Management Program involves all areas of the Company's services, monitoring and evaluating all of the Company's activities with a focus on continuous improvement. These objectives are accomplished through measurable trend analysis based on specific statistical tools for analysis and communication, and through continuing employee and patient education.

Clinical Information Systems. To support the Quality Management Program and in response to current payor demands for cost-effective health care treatments with measurable outcomes, the Company has developed a proprietary PC-based, networked clinical information system that will provide the facilities and managed care organizations with detailed patient outcome reports and critical clinical information. The clinical information system is being rolled-out to all the Company's facilities. Furthermore, the Company has implemented connectivity between Kaiser's mainframe and the Company's clinical information system at the new Mission Dialysis Center in San Diego.

Physicians Advisory Board. The Company has a Physicians Advisory Board consisting of certain Medical Directors of facilities from different regions of the country who advise management on the Company's Quality Management Program. Members of the Physicians Advisory Board respond to specific questions on quality

33

issues and the Physicians Advisory Board meets semi-annually to discuss Company quality and related operational issues. In addition, the Company has formed an Academic Physicians Advisory Board in which leading researchers that work with the Company meet to discuss and review recent research development and clinic data with the Company's senior management. The Company believes its reputation for quality care is a competitive advantage in formulating alliances with managed care organizations and referring physicians and in attracting new patients.

Patient Satisfaction. Since 1991, the Company has retained an independent consulting firm to conduct patient satisfaction surveys. These surveys track and identify trends in resulting patient satisfaction indicators that are in turn shared with management, Medical Directors and patients for discussion. In conjunction with the patient satisfaction surveys, the Company is currently developing a pilot program in cooperation with its laboratory to analyze specific laboratory test data and related patient treatment outcome data to evaluate patient treatment quality. The Company also compiles patient hospitalization and related patient treatment outcomes data and is developing standards to evaluate such data as part of the Company's national Quality Management Program.

#### SOURCES OF REVENUE REIMBURSEMENT

The following table provides information for the periods indicated regarding the percentage of Company net patient revenues provided by (i) the Medicare ESRD program, (ii) Medicaid, (iii) private/alternative payors, such as private insurance and private funds, and (iv) hospital inpatient dialysis services.

	YEARS ENDED MAY 31,			SEVEN MONTHS ENDED DECEMBER 31,		NINE MONTHS ENDED SEPTEMBER 30,
	-----	-----	-----	-----	-----	-----
	1993	1994	1995	1994	1995	1996
Medicare.....	66.5%	65.6%	62.0%	59.4%	60.2%	60.5%
Medicaid.....	8.4	9.0	8.1	9.3	6.7	5.9
Private/alternative payors..	19.0	19.7	24.3	26.3	27.9	28.0
Hospital inpatient dialysis services.....	6.1	5.7	5.6	5.0	5.2	5.6
	-----	-----	-----	-----	-----	-----
Total.....	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
	=====	=====	=====	=====	=====	=====

Under the Medicare ESRD program, Medicare reimburses dialysis providers for the treatment of individuals who are diagnosed to have ESRD and are eligible for participation in the Medicare program, regardless of age or financial circumstances. For each treatment, Medicare pays 80% of the amount set by the Medicare prospective reimbursement system, and a secondary payor (usually Medicare supplemental insurance or the state Medicaid program) pays approximately 20% of the amount set by the Medicare prospective reimbursement system. From time to time the Company pays Medicare supplemental insurance premiums for patients with financial need. All of the states in which the



Company operates dialysis facilities provide Medicaid benefits to qualified recipients to supplement their Medicare entitlement. The Medicare and Medicaid programs are subject to statutory and regulatory changes, administrative rulings, interpretations of policy and governmental funding restrictions, some of which may have the effect of decreasing program payments, increasing costs or modifying the way the Company operates its dialysis business. See "-- Medicare Reimbursement."

Assuming a patient is eligible for participation in the Medicare program, the commencement date of Medicare benefits for ESRD patients electing hemodialysis is dependent on several factors. For ESRD patients 65 years of age or older who are not covered by an employer group health plan, Medicare coverage commences immediately. For ESRD patients 65 years of age or older who are covered by an employer group health plan, Medicare coverage commences after an 18-month coordination period. ESRD patients under 65 years of age who are not covered by an employer group health plan (for example, the uninsured, those covered by Medicaid and those covered by an individual health insurance policy) must wait 90 days after commencing dialysis treatments to be eligible for Medicare benefits. During the first 90 days of treatment, the patient, Medicaid or the private insurer is responsible for payment (and, in the case of the individual covered by private insurance, such responsibility is limited to the terms of the policy, with the patient being responsible for the balance). ESRD

34

patients under 65 years of age who are covered by an employer group health plan must wait 21 months after commencing dialysis treatments before Medicare becomes the primary payor. During the first 21 months of treatments, the employer group health plan is responsible for payment at its negotiated rate or, in the absence of such a rate, at the Company's usual and customary rates, and the patient is responsible for deductibles and co-payments, if applicable, under the terms of the employer group health plan.

If an ESRD patient with an employer group health plan elects home dialysis training during the first 90 days of dialysis, Medicare becomes the primary payor after 18 months. If an ESRD patient without an employer group health plan begins home dialysis training during the first three months of dialysis, Medicare immediately becomes the primary payor.

On August 10, 1993, the provisions of the Omnibus Budget Reconciliation Act of 1993 ("OBRA 93") became effective. The OBRA 93 provisions were originally interpreted by HCFA to require employer group health sponsored insurance plans ("EGHP") to be the primary payor for ESRD patients for the first 18 months of service regardless of whether such patients were otherwise Medicare eligible. In April 1995, HCFA issued instructions of clarification to the fiscal intermediaries that Medicare would continue as the primary payor during such period if such patients were originally Medicare eligible but not yet suffering from ESRD. In June 1995, a preliminary injunction was issued by a federal court preventing HCFA from retroactively applying its reinterpretation of the OBRA 93 regulations as unlawful retroactive rulemaking. Accordingly, the Company has recognized as revenue payments from private payors in excess of the revenue previously recognized at lower rates which are attributable to such patients. The Company intends to continue to recognize revenues as cash is received in the future. The Company cannot estimate, at the present time, the potential impact that any final ruling or interpretation or the timing of the same may have upon earnings.

#### CERTAIN PAYOR ARRANGEMENTS

The Company has entered into contracts with third-party payors, including many leading health maintenance organizations in the Company's service areas, to provide dialysis services to their beneficiaries. The Company is a party to non-exclusive agreements with certain of such third-party payors and termination of such third-party agreements could have an adverse effect on the Company. The Company has a contract with the Department of Health and Human Services Navajo Area Indian Health Service to provide (i) chronic dialysis services to Native Americans at the Company's facilities in Farmington and Shiprock, New Mexico as well as at the Company's facilities in Chinle, Kayenta, Tuba City and Ganado, Arizona and (ii) acute dialysis in Indian Health Service Hospitals in Chinle and Tuba City (the "Indian Health Service Contract"). The Company is providing dialysis services to a substantial number of chronic dialysis patients pursuant to the Indian Health Service Contract.

## MEDICARE REIMBURSEMENT

The Company is reimbursed by Medicare under a prospective reimbursement system for chronic dialysis services provided to ESRD patients. Under this system, the reimbursement rates are fixed in advance and have been adjusted from time to time by Congress. Although this form of reimbursement limits the allowable charge per treatment, it provides the Company with predictable and recurring per-treatment revenues and allows the Company to retain any profit earned. Medicare has established a composite rate set by HCFA that governs the Medicare reimbursement available for a designated group of dialysis services, including the dialysis treatment, supplies used for such treatment, certain laboratory tests and certain medications. The Medicare composite rate is subject to regional differences based upon certain factors, including regional differences in wage earnings. Certain other services and items are eligible for separate reimbursement under Medicare and are not part of the composite rate, including certain drugs (including EPO), blood (for amounts in excess of three units per patient per year), and certain physician-ordered tests provided to dialysis patients. Claims for Medicare reimbursement must generally be presented within 15 to 27 months of treatment depending on the month in which the service was rendered and for Medicaid secondary reimbursement, if applicable, within 60 to 90 days after payment of the Medicare claim. The Company generally submits claims monthly and is usually paid by Medicare within 30 days of the submission. If in the future Medicare were to include in its composite reimbursement rate any of the

35

ancillary services presently reimbursed separately, the Company would not be able to seek separate reimbursement for these services and this would adversely affect the Company's results of operations to the extent a corresponding increase were not provided in the Medicare composite rate.

The Company receives reimbursement for outpatient dialysis services provided to Medicare-eligible patients at rates that are currently between \$118 and \$139 per treatment, depending upon regional wage variations. The Medicare reimbursement rate is subject to change by legislation and recommendations by the Prospective Payment Assessment Commission ("PROPAC"). The Medicare ESRD reimbursement rate was unchanged from commencement of the program in 1972 until 1983. From 1983 through December 1990 numerous Congressional actions resulted in net reduction of the average reimbursement rate from a fixed fee of \$138 per treatment in 1983 to approximately \$125 per treatment in 1990. Congress increased the ESRD reimbursement rate, effective January 1, 1991, resulting in an average ESRD reimbursement rate of \$126 per treatment. In 1990, Congress required that the Department of Health and Human Services ("HHS") and PROPAC study dialysis costs and reimbursement and make findings as to the appropriateness of ESRD reimbursement rates. In March 1996, PROPAC recommended a 2% increase be made in the reimbursement rate. However, Congress is not required to implement this recommendation and could either raise or lower the reimbursement rate. The Company is unable to predict what, if any, future changes may occur in the rate of reimbursement, or, if made, whether any such changes will have a material effect on the Company's revenues and net earnings.

On June 1, 1989, the FDA approved the production and sale of EPO, and HCFA approved Medicare reimbursement for EPO's use by dialysis patients. EPO stimulates the production of red blood cells and is beneficial in the treatment of anemia, with the effect of reducing or eliminating the need for blood transfusions for dialysis patients. Physicians began prescribing EPO for their patients in the Company's dialysis facilities in August 1989.

From June 1, 1989 through December 31, 1990, the Medicare ESRD program reimbursed for EPO at the fixed rate of \$40 per administration of EPO in addition to the dialysis facility's allowable composite rate for dosages of up to 9,999 units per administration. For higher dosages, an additional \$30 per EPO administration was allowed. Effective January 1, 1991, the Medicare allowable prescribed rate for EPO was changed to \$11 per 1,000 units, rounded to the nearest 100 units. Subsequently, legislation was enacted to reduce the Medicare prescribed rate for EPO by \$1 per 1,000 units after December 31, 1993. There can be no assurance that the Company can maintain current operating margins in the future for EPO administrations due to potential reimbursement decreases, or to potential increases in product costs from its sole manufacturer.

The Company provides certain of its patients with IDPN, a nutritional

supplement administered during dialysis to patients suffering from nutritional deficiencies. The Company has historically been reimbursed by the Medicare program for the administration of IDPN therapy. Beginning in 1993, HCFA designated four DMERCs to process reimbursement claims for IDPN therapy. The DMERCs established new, more stringent medical policies for reimbursement of IDPN therapy which were adopted by HCFA in April 1996, and many dialysis providers' claims have been denied or delayed. Where appropriate, the Company has appealed and continues to appeal such denials. The final outcome of some appeals and the anticipated review is uncertain. The Company's allowance for doubtful accounts reflects a reserve that the Company believes is adequate against the possibility of an adverse outcome. The Company has continued to provide IDPN therapy only to a select number of its patients whom the Company believes meet the most stringent guidelines. Although the Company fully expects to be paid on outstanding claims, there can be no certainty to that effect.

#### MEDICAID REIMBURSEMENT

Medicaid programs are state administered programs partially funded by the federal government. These programs are intended to provide coverage for patients whose income and assets fall below state defined levels and who are otherwise uninsured. The programs also serve as supplemental insurance programs for the Medicare co-insurance portion and provide certain coverages (e.g., oral medications) that are not covered by Medicare.

36

State regulations generally follow Medicare reimbursement levels and coverages without any co-insurance amounts. Certain states, however, require beneficiaries to pay a monthly share of the cost based upon levels of income or assets. Further, the State of Florida does not provide Medicaid benefits on a primary insurance basis, but does provide benefits as a secondary insurer to Medicare. Within the State of Florida, various governmental subdivision agencies provide insurance coverage for the indigent who are otherwise uninsured. The Company is a licensed ESRD Medicaid provider in all states in which it does business.

#### GOVERNMENT REGULATION

##### GENERAL

The Company's dialysis operations are subject to extensive governmental regulations at the federal, state and local levels. These regulations require the Company to meet various standards relating to, among other things, the management of facilities, personnel, maintenance of proper records, equipment and quality assurance programs. The dialysis facilities are subject to periodic inspection by state agencies and other governmental authorities to determine if the premises, equipment, personnel and patient care meet applicable standards. To receive Medicare reimbursement, the Company's dialysis facilities must be certified by HCFA. All of the Company's dialysis facilities are so certified.

Any loss by the Company of its various federal certifications, its authorization to participate in the Medicare or Medicaid programs or its licenses under the laws of any state or other governmental authority from which a substantial portion of its revenues is derived or a change resulting from healthcare reform reducing dialysis reimbursement or reducing or eliminating coverage for dialysis services would have a material adverse effect on the Company's business. To date, the Company has not had any difficulty in maintaining its licenses or its Medicare and Medicaid authorizations. The healthcare services industry will continue to be subject to intense regulation at the federal and state levels, the scope and effect of which cannot be predicted. No assurance can be given that the activities of the Company will not be reviewed and challenged or that healthcare reform will not result in a material adverse change to the Company.

##### FRAUD AND ABUSE

The Company's dialysis operations are subject to the illegal remuneration provisions of the Social Security Act (sometimes referred to as the "anti-kickback" statute) and similar state laws that impose criminal and civil sanctions on persons who solicit, offer, receive or pay any remuneration, whether directly or indirectly, in return for inducing the referral of a patient for treatment or the ordering or purchasing of items or services that

are paid for in whole or in part by Medicare, Medicaid or similar state programs. Violations of the federal anti-kickback statute are punishable by criminal penalties, including imprisonment, fines or exclusion of the provider from future participation in the Medicare and Medicaid programs, and civil penalties, including assessments of \$2,000 per improper claim for payment plus twice the amount of such claim and suspension from future participation in Medicare and Medicaid. Some state statutes also include criminal penalties. While the federal statute expressly prohibits transactions that have traditionally had criminal implications, such as kickbacks, rebates or bribes for patient referrals, its language has not been limited to such obviously wrongful transactions. Court decisions state that, under certain circumstances, the statute is also violated when one purpose (as opposed to the "primary" or a "material" purpose) of a payment is to induce referrals. Proposed federal legislation would expand the federal illegal remuneration laws to include referrals of any patients regardless of payor source.

In July 1991 and in November 1992, the Secretary of HHS published regulations that create exceptions or "safe harbors" for certain business transactions. Transactions that are structured within the safe harbors will be deemed not to violate the federal illegal remuneration statute. For a business arrangement to receive the protection of a relevant safe harbor, each and every element of the safe harbor must be satisfied. Transactions that do not satisfy all elements of a relevant safe harbor do not necessarily violate the illegal remuneration statute, but may be subject to greater scrutiny by enforcement agencies. The Company believes its arrangements with referring physicians are in material compliance with applicable laws. The Company seeks wherever practicable to structure its various business arrangements to satisfy as many safe harbor elements as possible under the

37

circumstances. Except with respect to the Company's lease arrangements with referring physicians, which the Company believes materially satisfy all the relevant safe harbor requirements, none of the Company's arrangements satisfy all elements of a relevant safe harbor. Although the Company has never been challenged under these statutes and believes it complies in all material respects with these and all other applicable laws and regulations, there can be no assurance that the Company will not be required to change its practices or experience a material adverse effect as a result of any such challenge.

The conditions of participation in the Medicare ESRD program mandate that treatment at a dialysis facility be "under the general supervision of a Director who is a physician." Generally, the Medical Director must be board eligible or board certified in internal medicine or pediatrics and have had at least 12 months of experience or training in the care of patients at ESRD facilities. The Company has by written agreement engaged qualified physicians or groups of qualified physicians to serve as Medical Directors for its facilities. At some facilities the Company also contracts with one or more physicians to serve as Assistant or Associate Medical Directors, or to direct specific programs, such as CAPD training, or to provide Medical Director services for acute dialysis services provided to hospitals. The compensation of the Medical Directors and other physicians under contract is separately negotiated for each facility and generally depends upon competitive factors in the local market, the physician's professional qualifications and responsibilities and the size and utilization of the facility or relevant program. The aggregate compensation of the Medical Directors and other physicians under contract is fixed for periods of one year or more by written agreement. Because in all cases the Company's Medical Directors and the other physicians under contract refer patients to the Company's facilities, the federal anti-kickback statute may apply. The Company believes it is in material compliance with the anti-kickback statute with respect to its arrangements with these physicians under contract. Among the safe harbors promulgated by the Secretary of HHS is one relevant to the Company's arrangements with its Medical Directors and the other physicians under contract. That safe harbor, generally applicable to personal services and management contracts, sets forth six requirements. None of the Company's agreements with its Medical Directors or other physicians under contract satisfy all of these elements. However, the Company believes that, except in cases where a facility is in transition from one Medical Director to another, or where the term of an agreement with a physician has expired and a new agreement is in negotiation, the Company's agreements with its Medical Directors and other physicians under contract satisfy five of the six safe harbor requirements.

Eleven of the Company's dialysis facilities are owned by general partnerships in which physicians who refer patients to the facilities hold interests (four facilities are owned by general partnerships in which non-referring physicians hold interests). In addition, four of the Company's facilities are owned by Limited Liability Partnerships (LLP) in which physicians who refer patients to the facility hold interests. Five of the Company's dialysis facilities are owned by two majority-owned subsidiary corporations in which physicians who refer patients to the facilities hold shares of stock. Because these physicians refer patients to these facilities, the anti-kickback statute may apply. The Company believes these business arrangements are in material compliance with the anti-kickback statute. With regard to the anti-kickback statute, there is a relevant safe harbor (the "small entity investment interests" safe harbor) which, although none of these arrangements satisfies all elements of that safe harbor, the Company believes that each of the above-mentioned partnerships satisfies a majority of the safe harbor's elements. While the Company believes there are good arguments to the contrary, a majority of these elements may not be satisfied with respect to the above-mentioned subsidiary corporations.

Sixteen of the Company's dialysis facilities are leased from entities in which physicians who refer patients to the centers hold interests, and one additional facility is leased from certain non-referring physicians with whom the Company is in partnership at two facilities. In addition, a medical facility at which the Company provides ESRD ancillary services is leased from physicians who refer patients for the provision of such ancillary services. Because of the referral of patients to the facilities by these physicians, the anti-kickback statute may apply. The Secretary of HHS has promulgated a safe harbor relevant to such arrangements, generally applicable to space rentals. The Company believes that these leases are in material compliance with the anti-kickback statute and that the leases satisfy in all material respects each of the elements of the space rental safe harbor.

On July 21, 1994, the Secretary of HHS proposed a rule that the Secretary said "would modify the original set of safe harbor provisions to give greater clarity to the rulemaking's original intent." The proposed rule would,

38

among other things, make changes to the safe harbors on personal services and management contracts, small entity investment interests and space rentals. The Company does not believe that its conclusions with respect to the application of these safe harbors to its current arrangements as set forth above would change if the proposed rule were adopted in the form proposed. However, the Company cannot predict the outcome of the rulemaking process or whether changes in the safe harbors rule will affect the Company's position with respect to the anti-kickback statute.

Several states in which the Company operates dialysis facilities, including California, Virginia, Georgia, Florida, Illinois, Minnesota and Maryland, have enacted statutes prohibiting physicians from holding financial interests in various types of medical facilities to which they refer patients.

A California statute makes it unlawful for a physician who has, or a member of whose immediate family has, a financial interest with or in an entity to refer a person to that entity for laboratory, diagnostic nuclear medicine, radiation oncology, physical therapy, physical rehabilitation, psychometric testing, home infusion therapy, or diagnostic imaging goods or services. Under the statute, "financial interest" includes, among other things, any type of ownership interest, debt, loan, lease, compensation, remuneration, discount, rebate, refund, dividend, distribution, subsidy or other form of direct or indirect payment, whether in money or otherwise, between a physician and the entity to which the physician makes a referral for the items described above. The statute also prohibits the entity to which the referral was made from presenting a claim for payment to any payor for a service furnished pursuant to a prohibited referral and prohibits a payor from paying for such a service. Violation of the statute by a physician is a misdemeanor and subjects the physician to civil fines. Violation of the prohibition on submitting a claim in violation of the statute is a public offense, subjecting the offender to a fine of up to \$15,000 for each violation and possible action against licensure. Some of the Company's facilities perform laboratory services incidental to dialysis services pursuant to the orders of referring physicians; certain laboratory services, which are performed by laboratories independent of the Company for all outpatient dialysis patients, are identified as included among the services for which the Company is financially

responsible under the composite rate under Medicare and under other payment arrangements. Therefore, although the Company does not believe that the statute is intended to apply to laboratory services that are provided incident to dialysis services, it is possible that the statute could be interpreted to apply to such laboratory services. The statute includes certain exemptions from its prohibitions. However, the California statute includes no explicit exemption for Medical Director services or other services for which the Company contracts with and compensates referring physicians in California or for partnership interests of the type held by the referring physicians in eight of the Company's facilities in California. Thus, if the California statute is interpreted to apply to referring physicians with whom the Company contracts, by law, for Medical Director and similar services and with the referring physicians with whom it is in partnership, the Company would be required to restructure some or all of its relationships with such referring physicians. The consequences of such restructuring, if any, cannot be predicted.

A Virginia statute (the "Virginia Statute") generally prohibits a physician from referring a patient for health services to an entity outside the physician's office if the physician or any of the physician's immediate family members is an investor in such entity unless the physician directly provides health services within the entity and will be personally involved with the provision of care to the referred patient or has been granted an exception by the Virginia Board of Health Professions (the "Virginia Board"). Violation of the Virginia Statute by the physician constitutes grounds for disciplinary action as unprofessional conduct and subjects the entity to which a prohibited referral is made to a monetary penalty of not more than \$20,000 per referral, bill or claim if the entity knows or has reason to know that the referral is prohibited by the Virginia Statute. With respect to investment interests acquired prior to February 1, 1993, compliance with the Virginia Statute is required by July 1, 1996. Investment interests of the physicians holding minority interests in the Company's Virginia facilities were acquired prior to February 1, 1993. The Company believes it is reasonable to argue that physicians who refer patients to dialysis facilities directly provide health care within such facilities and are personally involved with the provision of care to such referred patients within the meaning of the Virginia Statute. However, the Company is unaware of any official interpretation of the Virginia Statute by any agency charged with its enforcement that either supports or rejects this interpretation of the Virginia Statute. The Company also believes that, as a public

39

policy matter, it would be reasonable to argue that the Virginia Board should grant an exception to a physician who is an investor in a dialysis facility to which such physician refers his or her patients for care. However the Company is not aware of the grant of any exception by the Board with respect to ownership interests in dialysis facilities by physicians who refer patients to such facilities. The Company believes that, if necessary, the ownership of its Virginia facilities could be restructured to conform to the requirements of the Virginia Statute.

A Georgia statute (the "Georgia Statute"), prohibits a health care provider (defined to include physicians) from referring a patient for the provision of designated health services to an entity in which the healthcare provider has an investment interest, unless the provider satisfies certain disclosure requirements. An "investment interest" is defined as an equity or debt security issued by an entity, including shares of stock in a corporation, units or other interests in a partnership, bonds, debentures, notes or other equity interest or debt instruments, but excludes investments in a publicly held corporation with total assets over \$50 million whose shares are traded on a national exchange or over-the-counter market if the investment interest constitutes ownership of less than one percent of the corporation, there are no special stock classes for health care provider investors, and no income from the investment interest is tied to the volume of referrals. The term "entity" is defined as any individual, partnership, firm, corporation or other business entity. A "designated health service" is defined as clinical laboratory services, physical therapy services, rehabilitation services, diagnostic imaging services, pharmaceutical services and outpatient surgical services. While dialysis is not itself a designated health service, a dialysis supplier could be subject to the Georgia Statute to the extent that the dialysis service involves the provision of clinical laboratory services, pharmaceutical services or outpatient surgical services. To comply with the Georgia Statute, the health care provider must furnish the patient with a

written disclosure form approved by the health care provider's respective board of licensure, informing the patient of (i) the existence of the investment interest, (ii) the name and address of each applicable entity in which the referring health care provider is an investor, and (iii) the patient's right to obtain the items or services at the location or from the health care provider or supplier of the patient's choice. In addition, the provider must post a copy of the disclosure form in a conspicuous public place in the provider's office. The Georgia Statute applies to any consideration paid as compensation or in any manner which is a product of, or incident to, or in any way related to any membership, proprietary interest or co-ownership with an individual, group or organization to whom patients, clients or customers are referred or to any employer-employee or independent contractor relationship including those that may occur in a limited partnership, profit-sharing arrangement, or other similar arrangement with any licensed person to whom these patients are referred. The health care provider or an entity may not present a claim for payment to any individual, third-party payor, or other entity for services provided pursuant to a prohibited referral. If the health care provider or entity improperly collects any amount, the provider or entity must refund such amount to the payor or individual. Any health care provider or other entity that enters into an arrangement or scheme which the health care provider or entity knows or should know has a principal purpose of assuring referrals by the health care provider to a particular entity is subject to a civil penalty of not more than \$50,000 for each such circumvention, arrangement or scheme. Furthermore, any person who presents or causes to be presented a bill for a claim for services that such person knows or should know is for a service for which payment may not be made under the Georgia Statute is subject to a civil penalty of up to \$15,000 for each such service. The Company believes that all physicians who have an investment interest in the Company and who also refer patients to the Company's dialysis facilities are in compliance with the disclosure requirements of the Georgia statute and will be exempt from such statute.

A Florida statute (the "Florida Statute") prohibits health care providers (defined to include physicians) from referring a patient for the provision of designated health services to an entity in which the health care provider is an investor or has an investment interest. The term "designated health services" means clinical laboratory services, physical therapy services, comprehensive rehabilitative services, diagnostic imaging services and radiation therapy services. "Comprehensive rehabilitative services" includes speech, occupational or physical therapy services on an outpatient or ambulatory basis. The term "referral" includes any referral of a patient by a physician for infusion therapy services to a patient of that physician or a member of that physician's group practice. Further, a health care provider may not refer a patient for the provision of any other health care item or service (i.e., an item or service that is not a "designated health service") to an entity in which the health care provider is an investor unless the entity is a publicly traded corporation whose shares are traded on a national

exchange or on the over-the-counter market with total assets over \$50 million, or certain disclosure requirements are met and (i) no more than 50 percent of the value of the investment interests are held by investors who are in a position to make referrals to the entity, (ii) the terms under which an investment interest is offered to an investor who is in a position to make referrals to the entity are no different from the terms offered to investors who are not in a position to make such referrals, (iii) the terms offered to an investor in a position to make referrals are not related to the previous or expected volume of referrals from that investor to the entity, and (iv) there is no requirement that an investor make referrals or be in a position to make referrals to the entity as a condition for becoming or remaining an investor. The Florida Statute carries with it penalties of up to \$15,000 for each service for any person who presents or causes to be presented a bill or claim for services that such person knows or should know is prohibited. Furthermore, any health care provider or other entity that enters into an arrangement or scheme which the physician or entity knows or should know has a principal purpose of assuring referrals by the physician to a particular entity may be subject to a civil penalty of up to \$100,000 for each such arrangement. With respect to disclosure requirements for permissible referrals, a health care provider who makes a permitted referral must provide the patient with a written disclosure form informing the patient of extensive information, including the existence of the investment interest, the names and addresses of at least two alternative sources of such services and the name and address of each applicable entity in which the referring provider is an investor. A

violation of the disclosure requirements constitutes a misdemeanor and may be grounds for disciplinary action. The Company believes that all physicians with an investment interest in the Company who also refer patients to the Company's dialysis facilities are in compliance with the disclosure requirements of the Florida statute and continue to be exempt from such statute.

An Illinois Statute (the "Illinois Statute") provides that a health care provider (defined to include physicians) may not refer a patient for health services to an entity outside the health care provider's office or group practice in which the health care provider's office or group practice in which the health care provider is an investor unless the health care provider directly provides health services within the entity and will be personally involved with the provision of care to the referred patient. The term "health services" means health care procedures and services provided by or through a health care provider. The term "investment interest" means an equity or debt security issued by an entity including shares of stock in a corporation. The Illinois Statute applies to referrals for health services made on or after January 1, 1993; however, if a health care provider acquired an investment interest before July 1, 1992, the Illinois Statute does not apply to referrals made for health services before January 1, 1996. The Illinois Statute includes two potential exceptions. First, it is not a violation for a health care provider to refer a patient for health services to a publicly-traded entity in which he or she has an investment interest provided that certain conditions are met. Under the second exception, assuming that the Illinois Health Facilities Planning Board determines that this exception is applicable, a health care provider may invest in and refer to an entity if there is demonstrated need in the community for the entity and alternative financing is not available. The Illinois Statute may prohibit physicians who own stock in the Company from referring patients to the Company, and may prohibit the Company from billing for services rendered pursuant to such impermissible referrals. The Company believes that it is reasonable to argue that physicians who refer patients to dialysis facilities are directly providing health care within such facilities and are personally involved with the provision of care to such referred patients within the meaning of the Illinois Statute. The Company is unaware, however, of any official interpretation of the Illinois Statute by any agency charged with its enforcement that either supports or rejects this interpretation of the Illinois Statute. The Company believes that all physicians who have an investment interest in the Company and who also refer patients to the Company's dialysis facilities are in compliance with the disclosure requirements of the Illinois statute and may be exempt from such statute.

A Minnesota statute (the "Minnesota Statute") prohibits physicians from referring a patient to any health care provider in which the referring physician has a significant financial interest unless the physician has disclosed the physician's own financial interest. Violation of the Minnesota Statute by the physician constitutes grounds for disciplinary action against the physician. The term "health care provider" is defined to include certain licensed individuals such as physicians, dentists and the like, physician assistants and mental health practitioners and nursing homes. The term "significant financial interest" is not defined by the Statute. It could

be construed to include compensation received by physicians as medical directors or consultants. However, the Statute does not on its face appear to apply to the Company's facilities. The Company believes that it will be exempt from such Statute.

A Maryland statute (the "Maryland Statute") prohibits health care practitioners from referring patients to a health care entity in which the health care practitioner or the health care practitioner's immediate family owns a beneficial interest or has a compensation arrangement. The term "compensation arrangement" does not include an arrangement between a health care entity and a health care practitioner or the immediate family member of a health care practitioner for the provision of any services, as an independent contractor, if the arrangement is for identifiable services, the amount of the remuneration under the arrangement is consistent with the fair market value of the service and is not determined in a manner that takes into account, directly or indirectly, the volume or value of any referrals by the referring health care practitioner; and the compensation is provided in accordance with an agreement that would be commercially reasonable even if no referrals were made to the health care provider. The Company believes that it will be exempt from such statute.



The Company believes it is in material compliance with current applicable laws and regulations. No assurance can be made that in the future the Company's business arrangements, past or present, will not be the subject of an investigation or prosecution by a federal or state governmental authority. Such an investigation or prosecution could result in any, or any combination, of the penalties discussed above depending upon the agency involved in such investigation and prosecution. None of the Company's business arrangements with physicians, vendors, patients or others have been the subject of investigation by any governmental authority. No assurance can be given that the Company's activities will not be reviewed or challenged by regulatory authorities. The Company monitors legislative developments and would seek to restructure a business arrangement if the Company determined that one or more of its business relationships placed it in material noncompliance with such a statute.

#### STARK I

Stark I restricts physician referrals for clinical laboratory services to entities with which a physician or an immediate family member has a "financial relationship." The entity is precluded from claiming payment for such services under the Medicare or Medicaid programs, is liable for the refund of amounts received pursuant to prohibited claims, can receive civil penalties of up to \$15,000 per service and can be excluded from participation in the Medicare and Medicaid programs. Because of its broad language, Stark I may be interpreted by HCFA to apply to the Company's operations. However, regulations interpreting Stark I have created an exception to its applicability for services furnished in a dialysis facility if payment for those services is included in the ESRD composite rate. The Company believes that its compensation arrangements with medical directors and other physicians under contract are in material compliance with the provisions of Stark I.

#### STARK II

Stark II restricts physician referrals for certain "designated health services" to entities with which a physician or an immediate family member has a "financial relationship." The entity is prohibited from claiming payment for such services under the Medicare or Medicaid programs, is liable for the refund of amounts received pursuant to prohibited claims, can receive civil penalties of up to \$15,000 per service and can be excluded from participation in the Medicare and Medicaid programs. Comparable provisions applicable to clinical laboratory services became effective in 1992. Stark II provisions which may be relevant to the Company became effective on January 1, 1995.

Because of its broad language, Stark II may be interpreted by HCFA to apply to the Company's operations. Consequently, Stark II may require the Company to restructure certain existing compensation agreements with its Medical Directors and to repurchase or to request the sale of ownership interests in subsidiaries and partnerships held by referring physicians or, in the alternative, to refuse to accept referrals for designated health services from such physicians. The Company believes, but cannot assure, that if Stark II is interpreted to apply to the Company's operations, the Company will be able to bring its financial relationships with referring physicians into material compliance with the provisions of Stark II, including relevant exceptions. If the

Company cannot achieve such material compliance, and Stark II is broadly interpreted by HCFA to apply to the Company, such application of Stark II could have a material adverse effect on the Company. A broad interpretation of Stark II to include dialysis services and items provided incident to dialysis services would apply to the Company's competitors as well.

A "financial relationship" under Stark II is defined as an ownership or investment interest in, or a compensation arrangement between, the physician and the entity. The Company has entered into compensation agreements with its Medical Directors and other referring physicians; some Medical Directors either own stock in a Company subsidiary which operates a particular dialysis facility or a partnership interest in a Company dialysis facility; and 16 of the Company's dialysis facilities are leased from entities in which physicians who refer patients to the facilities hold interests. In the case of five of the Company's facilities, the spouse of the Medical Director is an employee of the Company. Certain of the Medical Directors, as part of their compensation,

and certain of the physicians from whom the Company has acquired dialysis facilities, as part of the consideration for such acquisitions, have acquired stock or stock options in the Company. The Company believes that the granting of the stock and stock options is in material compliance with the anti-kickback statute, Stark II and the various state statutes.

Stark II includes certain exceptions. A personal services compensation arrangement is excepted from Stark II prohibitions if (i) the arrangement is set out in writing, signed by the parties, and specifies the services covered by the arrangement, (ii) the arrangement covers all of the services to be provided by the physician (or an immediate family member of such physician) to the entity, (iii) the aggregate services contracted for do not exceed those that are reasonable and necessary for the legitimate business purposes of the arrangement, (iv) the term of the arrangement is for at least one year, (v) the compensation to be paid over the term of the arrangement is set in advance, does not exceed fair market value, and is not determined in a manner that takes into account the volume or value of any referrals or other business generated between the parties, (vi) the services to be performed do not involve the counseling or promotion or a business arrangement or other activity that violates any state or federal law and (vii) the arrangement meets such other requirements that may be imposed pursuant to regulations promulgated by HCFA. The Company believes that its compensation arrangements with Medical Directors and other physicians under contract materially satisfy the personal services exception to the Stark II prohibitions.

Payments made by a lessor to a lessee for the use of premises are excepted from Stark II prohibitions if (i) the lease is set out in writing, signed by the parties, and specifies the premises covered by the lease, (ii) the space rented or leased does not exceed that which is reasonable and necessary for the legitimate business purposes of the lease or rental and is used exclusively by the lessee when being used by the lessee, subject to certain permitted payments for common areas, (iii) the lease provides for a term of rental or lease for at least one year, (iv) the rental charges over the term of the lease are set in advance, are consistent with fair market value, and are not determined in a manner that takes into account the volume or value of any referrals or other business generated between the parties, (v) the lease would be commercially reasonable even if no referrals were made between the parties, and (vi) the lease meets such other requirements that may be imposed pursuant to regulations promulgated by HCFA. The Company believes that its leases with referring physicians materially satisfy the lease of premises exception to the Stark II prohibitions. The Stark II exception provisions that are applicable to physician ownership interests in entities to which they make referrals do not encompass the kinds of ownership arrangements that referring physicians own in Company subsidiaries that operate particular dialysis facilities.

For purposes of Stark II, "designated health services" includes: clinical laboratory services, radiology and other diagnostic services, durable medical equipment, parenteral and enteral nutrients, equipment and supplies, prosthetics and prosthetic devices, home health services, outpatient prescription drugs, and inpatient and outpatient hospital services. The Company believes that the language and legislative history of Stark II indicate that Congress did not intend to include dialysis services and the services and items provided incident to dialysis services within the Stark II prohibitions. However, the Company's provision of, or arrangement and assumption of financial responsibility for, outpatient prescription drugs, including EPO and IDPN, clinical laboratory services, facility dialysis services and supplies, home dialysis supplies and equipment, and services to hospital

inpatients and outpatients under its dialysis services agreements with hospitals, include services and items which could be construed as designated health services within the meaning of Stark II. Although the Company does not bill Medicare or Medicaid for hospital inpatient and outpatient services, the Company's Medical Directors may request or establish a plan of care that includes dialysis services for hospital inpatients and outpatients that may be considered a referral to the Company within the meaning of Stark II.

#### MEDICARE

Because the Medicare program represents a substantial portion of the federal budget, Congress takes action in almost every legislative session to modify

the Medicare program for the purpose of reducing the amounts otherwise payable from the program to health care providers. Legislation or regulations may be enacted in the future that may significantly modify the ESRD program or substantially reduce the amount paid for Company services. Further, statutes or regulations may be adopted which impose additional requirements in order for the Company to be eligible to participate in the federal and state payment programs. Such new legislation or regulations may adversely affect the Company's business operations.

#### OTHER REGULATIONS

The Company's operations are subject to various state hazardous waste disposal laws. Those laws as currently in effect do not classify most of the waste produced during the provision of dialysis services to be hazardous, although disposal of non-hazardous medical waste is also subject to regulation. Occupational Safety and Health Administration regulations require employers of workers who are occupationally subject to blood or other potentially infectious materials to provide those workers with certain prescribed protections against bloodborne pathogens. The regulatory requirements apply to all health care facilities, including dialysis facilities, and require employers to make a determination as to which employees may be exposed to blood or other potentially infectious materials and to have in effect a written exposure control plan. In addition, employers are required to provide or employ hepatitis B vaccinations, personal protective equipment, infection control training, post-exposure evaluation and follow-up, waste disposal techniques and procedures, and engineering and work practice controls. Employers are also required to comply with certain record-keeping requirements. The Company believes it is in material compliance with the foregoing laws and regulations.

Some states have established certificate of need ("CON") programs regulating the establishment or expansion of health care facilities, including dialysis facilities. The Company believes it is in material compliance with all state CON laws, as applicable, in which it does business.

Although the Company believes it complies in all material respects with current applicable laws and regulations, the health care service industry will continue to be subject to substantial regulation at the federal and state levels, the scope and effect of which cannot be predicted by the Company. No assurance can be given that the Company's activities will not be reviewed or challenged by regulatory authorities.

#### COMPETITION

The dialysis industry is fragmented and highly competitive, particularly in terms of acquisition of existing dialysis facilities and developing relationships with referring physicians. Competition for qualified physicians to act as Medical Directors is also high. There were over 2,700 dialysis facilities in the United States at the end of 1995, of which approximately 33% were owned by independent physicians (down from 37% in 1992), 27% were hospital-based facilities (down from 33% in 1992), and 40% were owned by seven major multi-facility dialysis providers (up from 30% in 1992), the largest of which is National Medical Care, Inc. ("NMC"). NMC is a subsidiary of W. R. Grace & Co., which, in February 1996, announced its intention to spin-off NMC pursuant to an agreement whereby NMC will subsequently be merged with Fresenius A.G. In September 1996, the stockholders of W.R. Grace & Co. approved the spin-off. The new entity is now called Fresenius Medical Care. There are also a number of health care providers that have entered or may decide to enter the dialysis business. Certain of the Company's competitors have substantially greater financial resources than the Company and may compete with the Company for acquisitions and development of facilities in markets targeted by the Company.

Competition for acquisitions has increased the cost of acquiring existing dialysis facilities. While it occurs infrequently, the Company has experienced competition from the establishment of a facility by a former Medical Director or referring physician.

#### INSURANCE

The Company carries property and general liability insurance, professional liability insurance and other insurance coverage in amounts deemed adequate by

management. However, there can be no assurance that any future claims will not exceed applicable insurance coverage. Furthermore, no assurance can be given that malpractice and other liability insurance will be available at a reasonable cost or that the Company will be able to maintain adequate levels of malpractice insurance and other liability insurance in the future. Physicians practicing at the Company's facilities are required to maintain their own malpractice insurance. However, the Company maintains coverage for the activities of its Medical Directors (but not for their individual private medical practices).

#### EMPLOYEES

As of October 11, 1996, the Company had over 2,900 employees, including a professional staff of over 1,900 registered nurses and technicians, a corporate and regional staff of approximately 285 employees and a facilities support and maintenance staff of approximately 725 employees. Of the Company's employees, approximately 2,150 are full time employees. With the exception of Stan Lindenfeld, M.D., an officer of the Company, Medical Directors of the Company's dialysis facilities are not employees of the Company.

#### PROPERTIES

The Company operates 128 outpatient dialysis facilities, of which six are located in premises owned by the Company or its respective general partnerships or subsidiary corporations, and the remainder of which are leased. The Company leases 16 facilities from entities in which referring physicians hold an interest. The Company's leases generally cover periods from five to ten years and typically contain renewal options of five to ten years at the fair rental value at the time of renewal or at rates subject to consumer price index increases since the inception of the lease. The Company's facilities range in size from approximately 2,000 to 10,000 square feet, with an approximate average size of 4,800 square feet. The Company's headquarters are located in a 17,000 square foot facility in Torrance, California. The Company's headquarters lease expires in 2000. The Company's general accounting office in Tacoma, Washington, is also leased for a term expiring in 2000. The Company owns one property that it is presently leasing to a third party. The Company considers its physical properties to be in good operating condition and suitable for the purposes for which they are being used.

Certain of the Company's facilities are operating at or near capacity. However, the Company believes it has adequate capacity within most of its existing facilities to accommodate significantly greater patient volume through increased hours and/or days of operation, or through the addition of dialysis stations at a given facility upon obtaining appropriate governmental approvals. With respect to other facilities, the Company believes that it can lease space at economically reasonable rates in the area of each of these facilities. Expansion or relocation of Company facilities would be subject to review for compliance with conditions relating to participation in the Medicare ESRD program. In states that require a CON, approval of a Company application would be necessary for expansion.

#### LEGAL PROCEEDINGS

The Company is subject to claims and suits in the ordinary course of business, including those arising from patient treatment, for which the Company believes its liability, if any, will be immaterial and it will be covered by malpractice insurance. The Company does not believe that the ultimate resolution of pending proceedings will have an adverse effect on the Company's financial condition, results of operations or cash flows.

#### MANAGEMENT

##### DIRECTORS AND EXECUTIVE OFFICERS

The directors and executive officers of the Company are as follows:

NAME	AGE	POSITION
Victor M.G. Chaltiel	55	Chairman of the Board, Chief Executive

	Officer, President and Director
Leonard W. Frie	50 Executive Vice President and Chief Operating Officer
Mary Ellen Chambers, R.N.	34 Vice President, Managed Care
Barry C. Cosgrove	39 Vice President, General Counsel and Secretary
Sidney J. Kernion	55 Vice President, Operations--Eastern Division
John E. King	35 Vice President, Finance and Chief Financial Officer
Stan M. Lindenfeld, M.D.	49 Vice President, Quality Management and Integrated Programs
Lois A. Mills, R.N.	57 Vice President, Operations--Western Division
Maris Andersons	59 Director
Peter T. Grauer	51 Director
Marsha M. Plotnitsky	41 Director
David B. Wilson	37 Director

Victor M.G. Chaltiel has been the Chairman, CEO and President of the Company and a Director of the Company since August 1994. Mr. Chaltiel served as President and CEO of Abbey Healthcare Group, Inc. ("Abbey") from November 1993 to February 1994 and prior thereto as Chairman, CEO and President of Total Pharmaceutical Care, Inc. ("TPC") from March 1989 to November 1993, when Abbey completed its acquisition of TPC. From May 1985 to October 1988, Mr. Chaltiel served as President, Chief Operating Officer and a Director of Salick Health Care, Inc., a publicly-held company focusing on the development of outpatient cancer and dialysis treatment centers. Mr. Chaltiel served in a consulting capacity with Salick Health Care, Inc. from October 1988 until he joined TPC. Prior to May 1985, Mr. Chaltiel was associated with Baxter International, Inc. ("Baxter") for 18 years in numerous corporate and divisional management positions, including Corporate Group Vice President with responsibility for the International Group and five domestic divisions with combined revenue in excess of \$1 billion, President of Baxter's Artificial Organs Division, Vice President of its International Division, Area Managing Director for Europe, and President of its French operations. While at Baxter, Mr. Chaltiel was instrumental in the development and successful worldwide commercialization of CAPD, currently the most common mode of home dialysis.

Leonard W. Frie has been Executive Vice President and Chief Operating Officer of the Company since August 1994. Mr. Frie was President of the Company from April 1994 through August 1994. Prior thereto, Mr. Frie served as President of Medical Ambulatory Care, Inc. and its subsidiaries since 1984.

Mary Ellen Chambers, R.N., has been Vice President, Managed Care for the Company since August 1994. Ms. Chambers was Vice President of Managed Care for TPC, with which she was associated from 1987 through July 1994. From 1984 to 1987, Ms. Chambers practiced oncology nursing at Goleta Valley Community Hospital as a Registered Nurse.

Barry C. Cosgrove has been Vice President, General Counsel and Secretary of the Company since August 1994. Prior to joining the Company, from May 1991 to April 1994, he served as Vice President, General Counsel and Secretary of TPC. From February 1988 to 1991, Mr. Cosgrove served as Vice President and General Counsel of McGaw Laboratories, Inc. (a subsidiary of the Kendall Company). Prior to February of 1988, Mr. Cosgrove was with the Kendall Company for seven years in numerous corporate legal and management positions, including Assistant to the General Counsel.

Sidney J. Kernion has served as Vice President, Operations--Eastern Division of the Company since August 1994. Mr. Kernion served in the same capacity with Medical Ambulatory Care, Inc., from April 1, 1992.

Mr. Kernion was employed by Tenet for 20 years and performed various operational functions for Medical Ambulatory Care, Inc. since July 1983.

John E. King has been the Vice President, Finance and Chief Financial Officer for the Company since its inception in April 1994. Mr. King served in the same capacity with Medical Ambulatory Care, Inc. from May 1, 1993. From December 1990 to April 1993, he was the Chief Financial Officer for one of Tenet's general acute hospitals.

Stan M. Lindenfeld, M.D., a nephrologist, has served as the Vice President, Quality Management and Integrated Programs of the Company since January 1995

and has served as a Medical Director for the Company since 1981. Since 1988 he has held the position of Clinical Professor of Medicine at the University of California Medical Center in San Francisco. Dr. Lindenfeld developed the Office of Clinical Resources Management at the University of California Medical Center in San Francisco and has served as its Director since July, 1993.

Lois A. Mills, R.N., has been a Vice President, Operations--Western Division of the Company since August 1994, and has been in charge of Operations for the Western Region for the Company and Medical Ambulatory Care, Inc. since April 1992. Ms. Mills has a long and varied experience in nursing (patient care) and as an administrator. Ms. Mills has been with the Company for 19 years serving as Staff Nurse (1976), Head Nurse (1978), Hemodialysis Supervisor (1980), Assistant Administrator (1983) and Regional Administrator for dialysis centers.

Maris Andersons has been a Director of the Company since August 1994. Mr. Andersons is a Senior Vice President and Senior Advisor, Corporate Finance, of Tenet and has held various senior executive offices with Tenet since 1976. Prior to joining Tenet, Mr. Andersons served as a Vice President of Bank of America.

Peter T. Grauer has been a Director of the Company since August 1994. Mr. Grauer has been a Managing Director of DLJMB since September 1992. From April 1989 to September 1992, he was a Co-Chairman of Grauer & Wheat, Inc., an investment firm specializing in leveraged buyouts. Prior thereto Mr. Grauer was a Senior Vice President of DLJ. Mr. Grauer is a Director of S.D. Warren Holdings Corporation, Doane Products Co. and Jitney Jungle Stores Co.

Marsha M. Plotnitsky has been a Director of the Company since July 1995. Ms. Plotnitsky is a Managing Director in Mergers and Acquisitions at DLJ. She joined DLJ in 1984 and has been in her present position since 1991.

David B. Wilson has been a Director of the Company since August 1994. Mr. Wilson has been a Senior Vice President of DLJMB since January 1993, and from January 1992 to January 1993 he was a Vice President of DLJ. From April 1989 to December 1991 he was a Vice President at Grauer & Wheat, Inc. Mr. Wilson is a director of several privately-held companies.

47

#### PRINCIPAL AND SELLING STOCKHOLDERS

The following table provides information as of September 30, 1996 as to the beneficial ownership, as defined by the regulations of the Securities and Exchange Commission, of Common Stock by (i) each person known to the Company to be the beneficial owner of 5% or more of the Common Stock and (ii) the Selling Stockholders.

NAME OF BENEFICIAL OWNER	SHARES OF COMMON STOCK BENEFICIALLY OWNED PRIOR TO THE OFFERING		SHARES TO BE SOLD IN THE OFFERING(1)	SHARES OF COMMON STOCK BENEFICIALLY OWNED AFTER THE OFFERING	
	NUMBER	PERCENTAGE		NUMBER	PERCENTAGE
Victor M.G. Chaltiel....	1,215,800	4.7%	305,286	910,514	3.4%
DLJ Merchant Banking Partners, L.P. and related stockholders (2)					
DLJ Merchant Banking Partners, L.P. ....	1,270,646	4.9%	319,058	951,588	3.6%
DLJ International Partners, C.V. ....	570,348	2.2%	143,214	427,134	1.6%
DLJ Offshore Partners, C.V. ....	33,068	*	8,303	24,765	*
DLJ First ESC, LLC....	317,413	1.2%	79,702	237,711	*
DLJ Merchant Banking Funding, Inc. ....	511,464	2.0%	128,428	383,036	1.4%
NME Properties Corp. ...	3,000,000	11.6%	--	3,000,000	11.3%
Putnam Fiduciary Trust					

Company and Putnam Investment Management, Inc. (3).....	491,135	1.9%	491,135	0	0%
Crescent/MACH I Partners, L.P. (4) ....	81,856	*	81,856	0	0%
TCW Shared Opportunity Fund II, L.P. (5) .....	81,855	*	81,855	0	0%
Other Selling Stockholders (6).....	1,051,656	4.0%	361,163	690,493	2.6%

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\*Less than 1%

(1) Does not include shares subject to the Underwriters' over-allotment option granted by Victor M.G. Chaltiel and the Related Investors (as defined below). Mr. Chaltiel will sell 31.03% of any shares sold pursuant to the over-allotment option and the Related Investors will sell the remainder (on a pro rata basis).

(2) Each of these stockholders is a related investor (collectively, the "Related Investors") and is affiliated with Donaldson, Lufkin & Jenrette Securities Corporation ("DLJ"). The address of DLJ Merchant Banking Partners, L.P. ("DLJMBP"), DLJ First ESC, LLC ("DLJESC") and DLJ Merchant Banking Funding, Inc. ("DLJMBF") is 277 Park Avenue, New York, New York 10172. The address of each of DLJ International Partners, C.V. ("DLJIP") and DLJ Offshore Partners, C.V. ("DLJOP") is John B. Gorsiraweg 6, Willemstad, Curacao, Netherlands Antilles. As a general partner of each of DLJMBP, DLJIP and DLJOP, DLJ Merchant Banking, Inc. may be deemed to beneficially own indirectly all of the shares held directly by DLJMBP, DLJIP and DLJOP, and as the parent of each of DLJ Merchant Banking, Inc. and DLJMBF, DLJ, Inc. may be deemed to beneficially own indirectly all of the shares held by DLJMBP, DLJIP, DLJOP, DLJ LBO Planned Management Corporation ("DLJLBO"), the manager of DLJESC and DLJMBF. DLJ, Inc. is an 80.2% owned subsidiary of The Equitable Companies Incorporated ("Equitable"). Equitable is an approximately 61% owned subsidiary of The Mutuelles AXA ("AXA"). The address of DLJ Merchant Banking, Inc., DLJLBO and DLJ, Inc. is 277 Park Avenue, New York, New York 10172. Equitable and AXA may be deemed to be beneficial owners of the Common Stock owned by the Related Entities.

(3) Shares of Common Stock beneficially owned prior to the Offering and shares to be sold in the Offering by the following investment funds that are clients of Putnam Fiduciary Trust Company or Putnam Investment Management, Inc., as investment advisors, consist of: Putnam Capital Manager Trust-PCM High Yield Fund (29,141 shares owned; 29,141 shares to be sold); Putnam High Yield Managed Trust (5,566 shares owned; 5,566 shares to be sold); Putnam High Yield Trust (251,460 shares owned; 251,460 shares to be sold); Putnam High Yield Advantage Fund (62,866 shares owned; 62,866 shares to be sold); Putnam Managed High Yield Trust (6,549 shares owned; 6,549 shares to be sold); Putnam Master Income Trust (11,787 shares owned; 11,787 shares to be sold); Putnam Premier Income Trust (28,813 shares owned; 28,813 shares

48

to be sold); Putnam Master Intermediate Income Trust (8,186 shares owned; 8,186 shares to be sold); Putnam Diversified Income Trust (80,873 shares owned; 80,873 shares to be sold); and Putnam Capital Manager Trust-PCM Diversified Income Fund (5,894 shares owned; 5,894 shares to be sold).

(4) The shares of Common Stock are held beneficially by Crescent/MACH I Partners, L.P. (the "Partnership") and TCW Asset Management Company ("TAMCO"), as Portfolio Manager, pursuant to a Management Agreement dated as of December 17, 1993, as amended. The TCW Group, Inc. owns 100% of the stock of TAMCO. The Portfolio Manager of the Partnership controls the investment decisions and voting of the shares of Common Stock beneficially owned by The TCW Group, Inc.

(5) The shares of Common Stock are held beneficially by TCW Shared Opportunity Fund II, L.P. (the "Fund") and TCW Investment Management Company ("TIMCO"), as Investment Manager, pursuant to an Amended Investment Management Agreement dated as of October 31, 1995. The TCW Group, Inc. owns 100% of the stock of TIMCO. The Investment Manager of the Fund controls the investment decisions and voting of the shares of Common Stock beneficially owned by The TCW Group, Inc.

(6) Shares of Common Stock beneficially owned prior to the Offering and shares to be sold in the Offering by the following individuals, none of whom own more than 1% of the outstanding Common Stock either before or after the Offering, consist of: Louis J. Borucki (26,000 shares owned; 6,000 shares to be sold); Michael F.S. Douglas (59,616 shares owned; 35,650 shares to be sold); Frederico Dumenigo (37,533 shares owned; 2,500 shares to be sold); Seymour and Barbara Frankfurt (40,927 shares owned; 10,927 shares to be sold); Edward D. Frederickson (33,000 shares owned; 8,889 shares to be sold); Oscar G. Galvez (37,533 shares owned; 13,500 shares to be sold); Donald Hollandsworth (183,333 shares owned; 50,000 shares to be sold); David Kanzler (15,000 shares owned; 12,000 shares to be sold); Jorge and Marta Olga Mordujovich (46,841 shares owned; 36,842 shares to be sold); Hareesh M. Muni (14,000 shares owned; 2,000 shares to be sold); Robert E. Mutterperl (169,233 shares owned; 10,000 shares to be sold); Baiju Patel Trust (23,500 shares owned; 23,500 shares to be sold); Viraj Patel Trust (23,500 shares owned; 23,500 shares to be sold); Jorge and Elena Presser (40,927 shares owned; 40,927 shares to be sold); Melvin K. Roseman (169,233 shares owned; 30,000 shares to be sold); Gerald J. Rutecki (40,928 shares owned; 40,928 shares to be sold); Carole J. Shepherd (79,952 shares owned; 10,000 shares to be sold); Ing Liong Wong (10,000 shares owned; 3,500 shares to be sold); and Mark A. Zawiski (600 shares owned; 500 shares to be sold). Each of these stockholders received such shares in connection with the sale of a business to the Company. Carole J. Shepherd is an employee of the Company.

#### SHARES ELIGIBLE FOR FUTURE SALE

Upon completion of this Offering, the Company will have 26,467,029 shares of Common Stock outstanding, assuming no exercise of outstanding options under the Company's employee stock plans. Of these shares, approximately 24,200,000 shares (including the shares registered in this Offering and the shares outstanding that are registered pursuant to registration statements on Form S-8) will be freely tradeable without restriction under the Securities Act (except certain of such shares will be subject to certain resale limitations under Rule 144 of the Securities Act). The remaining shares of Common Stock which will be outstanding after this Offering have not been registered pursuant to the Securities Act and are "restricted securities" within the meaning of Rule 144 under the Securities Act. Such shares will become freely tradeable without restriction (subject to certain resale limitations under Rule 144) between November 1996 and October 1998. Such shares, as well as any Common Stock held by any person deemed to be an affiliate of the Company, may be sold only if registered under the Securities Act or sold in accordance with an available exemption from registration thereunder. For purposes of Rule 144 under the Securities Act, an "affiliate" of an issuer is a person who directly, or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with, such issuer.

Persons holding shares of Common Stock that constitute restricted securities, and any affiliates of the Company, may be able to sell shares of Common Stock without registration in accordance with Rule 144 under the Securities Act. In general, under Rule 144 as currently in effect, a person (or persons whose shares are

aggregated in accordance with the Rule) who has beneficially owned his or her shares for a least two years, including any such persons who are affiliates of the Company, would be entitled to sell, within any three month period, a number of shares of Common Stock that does not exceed the greater of (i) one percent of the then outstanding number of shares or (ii) one percent of the average weekly trading volume of the shares during the four calendar weeks preceding each such sale. In addition, sales under Rule 144 are also subject to certain manner of sale provisions and notice requirements and to the availability of current public information about the Company. After shares are held for three years, a person who is not an affiliate of the Company is entitled to sell such shares under Rule 144 without regard to such volume limitations, manner of sale, notice or public information requirements under Rule 144. Sales of shares by affiliates will continue to be subject to such volume limitations, manner of sale, notice and public information requirements. The Commission has published a notice of proposed rulemaking that, if adopted as proposed, would shorten the applicable holding periods under Rule 144(d) and Rule 144(k) to one and two years, respectively (from the current two and three-year periods). The Company cannot predict whether such



amendments will be adopted or the effect thereof on the trading market for its Common Stock.

The Company has filed with the Commission registration statements on Form S-8 covering 5,200,000 shares of Common Stock issued or reserved for issuance pursuant to grants of stock awards and options to purchase Common Stock under the Company's employee stock plans. Shares of Common Stock issued pursuant to such plans may be resold by affiliates and non-affiliates into the public market (subject, in the case of affiliates, to certain resale limitations of Rule 144).

The Company and its directors and executive officers, the Selling Stockholders, stockholders with registration rights and certain other stockholders have agreed pursuant to the Underwriting Agreement and other agreements that they will not offer, sell, contract to sell or otherwise dispose of, directly or indirectly, or file with the Commission a registration statement under the Securities Act relating to any shares of their Common Stock without the prior written consent of the Underwriters for a period of 90 days from the date of this Prospectus, except that the Company may, without such consent, issue stock and options to purchase stock (i) pursuant to certain employee stock plans of the Company and (ii) as consideration in connection with acquisitions. See "Underwriting."

Sales of substantial amounts of unregistered Common Stock into the public market could adversely affect the prevailing market price for the Common Stock and the ability of the Company to raise equity capital. The Company can make no prediction as to the effect, if any, that sales of shares of its unregistered Common Stock, or the availability of such shares for future sale, will have on the market price of the Common Stock prevailing from time to time. Such sales may also make it more difficult for the Company to sell equity securities or equity-related securities at a time and price that it deems appropriate.

#### REGISTRATION RIGHTS

The Shareholders Agreement (as defined below) provides that, giving effect to consummation of this Offering, the holders of approximately 9,500,000 shares of Common Stock and options to purchase shares of Common Stock will be entitled to certain rights with respect to the registration of such shares under the Securities Act. Subject to certain limitations, if the Company registers any of its securities under the Securities Act, either for its own account or the account of other security holders, such holders are entitled to written notice of the registration and are entitled to include (at the Company's expense) such shares therein; provided, among other conditions, that the underwriters of any such offering have the right to limit the number of such shares included in the registration. In addition, certain of such holders can require the Company to file registration statements under the Securities Act and the Company is required to use its best efforts to effect such registrations, subject to certain conditions and limitations. All fees, costs and expenses of such registrations (other than underwriting discounts, commissions and transfer taxes and certain legal fees of selling stockholders) will be borne by the Company.

#### CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The Company historically engaged in various intercompany transactions with and was provided certain services by Tenet and its affiliates, for which Tenet allocated overhead costs, as set forth in the Company's financial statements. At the closing of the August 1994 Transaction, (a) the Company, NME Properties, DLJMB, and certain members of management entered into the Shareholders Agreement (the "Shareholders Agreement") and (b) the Company and Tenet entered into a Non-Competition Agreement ("Non-Competition Agreement") and a Services Agreement (the "Services Agreement"). These agreements (together with the Company's existing agreements to provide dialysis services to 11 Tenet hospitals on a set fee-per-treatment basis and existing leases for three facilities owned by Tenet affiliates) govern their relationships. In addition, in connection with the August 1994 Transaction, DLJMB was reimbursed by the Company for DLJMB's reasonable expenses (including legal fees) and DLJ was paid usual and customary fees for acting as financial advisor. DLJ was also paid usual and customary fees for acting as underwriter in connection with the sale of the Discount Notes and in connection with the Company's

public offerings on October 30, 1995 and April 3, 1996 and for acting as dealer-manager in connection with the Company's tender offer for its Discount Notes, which was consummated in September 1996. DLJ Capital Funding, Inc., an affiliate of DLJ, served as the documentation agent and a lender under the Senior Credit Facility entered into by the Company in October 1996. At the closing of the August 1994 Transaction, all items included in the intercompany receivable due to TRC from Tenet were extinguished other than amounts payable relating to dialysis services rendered by TRC to Tenet or its affiliates and laboratory services rendered to TRC by Tenet or its affiliates.

Pursuant to the Shareholders Agreement, the Company's Board consists of five members: four nominated by DLJMB and one nominated by NME Properties. Upon consummation of the Offering, DLJMB's right to nominate directors will terminate. The four individuals previously nominated by DLJMB (three of whom are DLJMB employees) and elected as Company directors will remain directors, however, until the next election or any earlier resignation and to that extent and until such time, will continue to be able to influence significantly the affairs of the Company, including corporate transactions such as any "going private" transaction, merger, consolidation or sale of all or substantially all of the Company's assets. The Company has been informed that two of such DLJMB employees intend to resign as directors as soon as practicable following consummation of the Offering. The Shareholders Agreement also provides for restrictions on transfers of Common Stock, certain rights of first refusal in favor of DLJMB in the event NME Properties proposes to transfer shares of Common Stock and certain rights and obligations on the part of NME Properties to participate in transfers of shares by DLJMB.

The Shareholders Agreement restricts DLJMB from owning more than 50% of (or controlling) other dialysis entities except as part of the process of combining such entities with the Company. The Shareholders Agreement further provides that DLJMB and NME Properties each have the right, subject to certain conditions, to request that the Company register shares of the Common Stock they own under the Securities Act of 1933, as amended (but not more than four times each), and to participate in other registrations of the Company's securities, in each case at the Company's expense.

Pursuant to the Non-Competition Agreement, Tenet may not own, operate or manage a mobile or free-standing dialysis unit within the United States and may not (subject to certain exceptions) seek to cause physicians who are parties to arrangements with the Company to refer patients requiring services provided by the Company to other providers of those services. The Company is not permitted (subject to certain exceptions) to own, operate or manage any mobile or free-standing healthcare unit or service, other than dialysis units, within 30 miles (or ten miles in the case of a metropolitan area with a population of at least two million) of a Tenet acute-care hospital or outpatient facility offering the same healthcare services. If the Company subsequently acquires, as part of a larger acquisition, an operation that otherwise would violate the Non-Competition Agreement, the Company will have one year to dispose of the operation (subject to rights of first refusal held by Tenet). The Non-Competition Agreement automatically terminates in August 1999, or upon a sale or change of control of Tenet, whichever is the earlier. In addition, upon such a sale or change of control, DLJMB and/or the Company will be entitled to repurchase NME Properties' interest in the Company at the fair market value thereof. The Non-Competition Agreement will also terminate if DLJMB requires NME Properties to sell its Common Stock as part of a transfer of shares by DLJMB.

51

Pursuant to the Services Agreement, Tenet provided certain limited administrative services to the Company through December 31, 1994, for which Tenet was reimbursed its costs. In addition, to the extent permitted by Tenet's and the Company's respective purchasing arrangements, until August 11, 1999 unless there is a sale or change in control of Tenet, both Tenet and the Company will be entitled to participate in the other party's joint purchasing arrangements.

In connection with the August 1994 Transaction, the Company and Tenet agreed that the Company's contracts to provide acute dialysis services to 11 Tenet hospitals would continue on their then current terms. The Company also has certain rights of first refusal until August 11, 1999 to continue to provide services to such Tenet hospitals.

DLJMB has arranged a procurement program designed to realize the benefits of

the combined purchasing power of the various companies within the DLJMB portfolio as well as the other affiliates of DLJMB, including Donaldson, Lufkin & Jenrette, Inc. ("DLJ Inc.") and The Equitable Companies Incorporated. The program is focused on securing efficiencies in the procurement of property and casualty insurance, telecommunication services and employee medical benefits and insurance. DLJMB offers its purchasing program to all DLJMB portfolio companies, regardless of the size of DLJMB's ownership interest. As a DLJMB portfolio company, the Company has taken advantage of this purchasing program, resulting in a reduction of property and casualty insurance premiums of over 35%. The Company plans to explore opportunities for further savings through the purchase of telecommunications services, employee medical benefits and other insurance under the DLJMB purchasing program.

Certain of the Company's officers and employees have received loans from the Company in connection with the purchase of shares of Common Stock. All of the loans have similar terms. The loans bear interest at the lower of 8% or the prime rate, and are secured by all of the borrower's interests in capital stock of the Company, including all vested stock options. When made, the loans had a four-year term and one quarter of the original principal amount thereof plus all accrued interest thereon had to be paid annually, subject to the limitation that the borrower was not required to make any payment that exceeded 50% of the proceeds of such borrower's after-tax bonus from the Company (based on maximum tax rates then in effect). In July 1995, the Board approved a one-year deferral of all scheduled principal and accrued interest payments under all such loans. No other terms of the loans have been changed. As of September 30, 1996, Leonard W. Frie and Barry C. Cosgrove had loans outstanding from the Company with principal amounts of \$100,000 and \$70,000, respectively (with respect to Mr. Cosgrove, \$50,000 was borrowed to purchase shares of Common Stock and \$20,000 was borrowed for relocation costs). Victor M.G. Chaltiel had an outstanding loan of \$835,000 prior to the addition on September 18, 1995 of \$2,678,447 pursuant to similar loans in connection with Mr. Chaltiel's exercise of options for 886,667 shares of Common Stock. These loans are secured by a pledge of 866,667 shares of Common Stock. The Company has agreed to release all shares (including over-allotment shares) being sold by Mr. Chaltiel pursuant to this Prospectus from the pledge and the proceeds of the sale of such shares will not be used to repay the loans. Mr. Chaltiel received a similar loan from the Company on April 15, 1996, in the amount of \$173,073, in connection with additional taxes associated with the exercise of such options.

Maris Andersons, a Director of the Company, serves as a consultant to the Company. He has been granted options, vesting over four years, to purchase an aggregate of 46,183 shares of Common Stock, of which 8,000 of such options have been exercised, in consideration for these services.

52

#### DESCRIPTION OF CAPITAL STOCK

The following summary is a description of certain provisions of the Company's Certificate of Incorporation, as amended and restated (the "Certificate of Incorporation"). Such summary does not purport to be complete and is subject to, and is qualified in its entirety by, all of the provisions of the Certificate of Incorporation.

The Company's authorized capital stock consists of 55,000,000 shares of Common Stock, \$0.001 par value, and 5,000,000 shares of Preferred Stock, \$0.001 par value ("Preferred Stock").

#### COMMON STOCK

As of September 30, 1996, there were 25,967,029 shares of Common Stock issued and outstanding. The Company does not anticipate paying any cash dividends on the Common Stock in the foreseeable future. The Company is subject to certain restrictions on its ability to pay dividends on the Common Stock under the Senior Credit Facility.

Holders of Common Stock are entitled to one vote for each share held of record on all matters submitted to a vote of stockholders. There are no cumulative voting rights applicable to the Common Stock.

Subject to the preferences applicable to shares of Preferred Stock outstanding at any time, holders of shares of Common Stock are entitled to

dividends, if, when and as declared by the Board of Directors from funds legally available therefor and are entitled, in the event of liquidation, to share ratably in all assets remaining after payment of liabilities and preferred stock preferences, if any.

The authorized but unissued shares of Common Stock are available for issuance without further action by the Company's stockholders, unless such action is required by applicable law or the rules of any stock exchange on which the Common Stock may be listed. Shares of Common Stock are not redeemable and there are no sinking fund provisions.

#### PREFERRED STOCK

The Certificate of Incorporation authorizes the Company's Board of Directors to establish series of Preferred Stock and to determine, with respect to any series of Preferred Stock, the voting powers, or no voting powers, and such designations, preferences and relative, participating, optional or other special rights and such qualifications, limitations or restrictions thereof, as are stated in the resolutions of the Board of Directors providing for such series.

The authorized but unissued shares of Preferred Stock are available for issuance without further action by the Company's stockholders. This will allow the Company to issue shares of Preferred Stock without the expense and delay of a special stockholders' meeting, unless such action is required by applicable law or the rules of any stock exchange on which the Company's securities may be listed. The Company believes that the Preferred Stock will provide flexibility in structuring possible future financing and acquisitions, and in meeting other corporate needs. Although the Company's Board of Directors has no intention at the present time of doing so, it could issue a series of Preferred Stock, the terms of which, subject to certain limitations imposed by the securities laws, impede the completion of a merger, tender offer or other takeover attempt. The Company's Board of Directors will make any determination to issue such shares based on its judgment as to the best interests of the Company and its stockholders at the time of issuance. The Company's Board of Directors, in so acting, could issue Preferred Stock having terms that could discourage an acquisition attempt or other transaction that some, or a majority, of the stockholders might believe to be in their best interests or in which stockholders might receive a premium for their stock over the then market price of such stock.

#### TRANSFER AGENT

The Company's registrar and transfer agent for the Common Stock is The Bank of New York.

53

#### UNDERWRITING

Subject to the terms and conditions contained in the Underwriting Agreement (the "Underwriting Agreement"), Donaldson, Lufkin & Jenrette Securities Corporation, Merrill Lynch, Pierce, Fenner & Smith Incorporated and UBS Securities LLC (the "Underwriters") have agreed to purchase from the Company and the Selling Stockholders an aggregate of 2,500,000 shares of Common Stock. The number of shares that each Underwriter has agreed to purchase is set forth opposite its name below:

UNDERWRITERS	NUMBER OF SHARES
Donaldson, Lufkin & Jenrette Securities Corporation.....	833,334
Merrill Lynch, Pierce, Fenner & Smith Incorporated.....	833,333
UBS Securities LLC.....	833,333
	-----
Total.....	2,500,000
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The Underwriting Agreement provides that the obligations of the several Underwriters to accept delivery of the shares of Common Stock offered hereby

are subject to approval of certain legal matters by counsel and to certain other conditions. If any shares of Common Stock are purchased by the Underwriters pursuant to the Underwriting Agreement, all such shares (other than shares covered by the over-allotment option described below) must be purchased.

The Underwriters have advised the Company and the Selling Stockholders that they propose to offer the shares of Common Stock in part directly to the public initially at the Price to the Public set forth on the cover page of this Prospectus and in part to certain dealers at such price less a concession not in excess of \$0.93 per share; that the Underwriters may allow, and such dealers may realow, a concession not in excess of \$0.10 per share on sales to other dealers; and that after the Offering, the Price to the Public, concession and discount to dealers may be changed by the Underwriters.

Certain of the Selling Stockholders have granted to the Underwriters an option, exercisable for 30 days from the date of this Prospectus, to purchase up to an additional 375,000 shares of Common Stock at the initial Price to the Public less underwriting discounts and commissions. The Underwriters may exercise such option only for the purpose of covering over-allotments, if any, incurred in connection with the sale of shares of Common Stock offered hereby. To the extent that the Underwriters exercise such option, each Underwriter will become obligated, subject to certain conditions, to purchase the same proportion of such additional shares as the number of other shares to be purchased by that Underwriter bears to the total number of shares set forth on the cover page of this Prospectus.

The Company and the Selling Stockholders have agreed to indemnify the Underwriters against certain liabilities, including liabilities under the Securities Act, or to contribute to payments that the Underwriters may be required to make in respect thereof.

Subject to certain exceptions (including certain issuances by the Company of Common Stock in connection with acquisitions), the Company, all of its executive officers and directors and certain stockholders of the Company, including all of the Selling Stockholders, each have agreed not to, directly or indirectly, offer, sell, contract to sell, grant any option to purchase or otherwise dispose of any Common Stock or any securities convertible into or exercisable or exchangeable for such Common Stock or cause to be filed with the Securities and Exchange Commission a registration statement under the Securities Act to register any shares of the Common Stock or, in any manner, transfer all or a portion of the economic consequences associated with the ownership of the Common Stock without the prior written consent of Donaldson, Lufkin & Jenrette Securities Corporation for a period of 90 days after the date of this Prospectus.

The provisions of Schedule E ("Schedule E") to the By-laws of the National Association of Securities Dealers, Inc. (the "NASD") apply to the Offering. Under the By-laws of the NASD, when a NASD member such as DLJ distributes an affiliated company's equity securities, one of the following two criteria must be met:

54

(1) the price of such equity security can be no higher than that recommended by a "qualified independent underwriter" or (2) the offering is of a class of equity securities for which a "bona fide independent market" exists. See "Certain Relationships and Transactions." Because the shares of Common Stock are traded on the New York Stock Exchange, the aggregate trading volume for the twelve months immediately preceding the filing of the registration statement of which this Prospectus forms a part was at least 100,000 shares and the Company had outstanding for the twelve month period immediately preceding the filing of such registration statement a minimum of 250,000 publicly held shares, a "bona fide independent market" exists. Accordingly, the price of the Common Stock will not be passed upon by a "qualified independent underwriter."

Pursuant to the provisions of Schedule E, NASD members may not execute transactions in the Shares in discretionary accounts without the prior written approval of the customer.

#### LEGAL MATTERS

Certain legal matters with respect to the legality of the Shares offered

hereby will be passed upon for the Company by Riordan & McKinzie, a Professional Corporation, Orange County, California. Certain legal matters will be passed upon for the Underwriters by Skadden, Arps, Slate, Meagher & Flom LLP, Los Angeles, California.

#### EXPERTS

The consolidated financial statements of Total Renal Care Holdings, Inc. as of December 31, 1995 and the seven months then ended and May 31, 1995 and the year then ended included in this Prospectus have been so included in reliance on the reports of Price Waterhouse LLP, independent accountants, given on the authority of said firm as experts in auditing and accounting. The combined financial statements of Center for Kidney Disease, Inc., Venture Dialysis Center, Inc. and Miami Beach Kidney Center, Inc. for the year ended December 31, 1994 incorporated in this Prospectus by reference to the Company's Form 8-K/A dated September 29, 1995; the combined financial statements of Southwest Renal Care, Ltd. and Dialysis Medical Supplies, Inc. for the year ended October 31, 1995 incorporated in this Prospectus by reference to the Company's Form 8-K/A dated February 13, 1996; the financial statements of Downtown Dialysis Center, Inc. for the year ended December 31, 1995 incorporated in this Prospectus by reference to the Company's Form 8-K dated March 18, 1996; the financial statements of the Nephrology Services Business of Caremark International Inc. as of December 31, 1995 and 1994 and for the years ended December 31, 1995 and 1994 and for the one month ended December 31, 1993 incorporated in this Prospectus by reference to the Company's Form 8-K dated March 18, 1996; and the financial statements of Pasadena Dialysis Center, Inc. for the year ended December 31, 1995, the financial statements of Burbank Dialysis Group, Inc. for the year ended December 31, 1995, the combined financial statements of Piedmont Dialysis, Inc. and Peralta Renal Center for the year ended December 31, 1995, the combined financial statements of Bertha Sirk Dialysis Center, Inc. and Greenspring Dialysis Center, Inc. for the year ended December 31, 1995, and the combined financial statements of Houston Kidney Center, Northwest Kidney Center, LLP, North Houston Kidney Center, LLP, and Houston Kidney Center--Southeast, LLP for the year ended December 31, 1995 incorporated by reference in this Prospectus by reference to the Company's Form 8-K dated October 18, 1996 have been so incorporated in reliance on the reports of Price Waterhouse LLP, independent accountants, given on the authority of said firm as experts in auditing and accounting.

The consolidated balance sheet of Total Renal Care Holdings, Inc. and subsidiaries as of May 31, 1994 and the related consolidated statements of income, stockholders' equity (deficit) and cash flows for each of the years in the two-year period ended May 31, 1994 and the related financial statement schedule have been included herein and in the Registration Statement in reliance on the reports of KPMG Peat Marwick LLP, independent certified public accountants, appearing elsewhere herein, and upon the authority of said firm as experts in accounting and auditing. KPMG Peat Marwick LLP's report on the consolidated financial statements of Total Renal Care Holdings, Inc. refers to a change in the method of accounting for income taxes by adopting Statement of Financial Accounting Standards No. 109, Accounting For Income Taxes, effective June 1, 1993.

#### 55

The financial statements of Greer Kidney Center, Inc. and Upstate Dialysis Center, Inc. as of December 31, 1994 and 1995 and for the years then ended incorporated in this Prospectus by reference to the Company's Form 8-K dated March 18, 1996 have been so incorporated in reliance on the reports of Meeks, Roberts, Ashley, Sumner & Sirmans, independent certified public accountants, given upon the authority of said firm as experts in auditing and accounting.

#### AVAILABLE INFORMATION

The Company is subject to the informational requirements of the Securities Exchange Act of 1934, and in accordance therewith files reports and other information with the Commission. A copy of the reports and other information filed by the Company with the Commission may be inspected without charge at the offices of the Commission at Room 1024, Judiciary Plaza, 450 Fifth Street, N.W., Washington, D.C. 20549 and at the following Regional Offices of the Commission: the Midwest Regional Office at Citicorp Center, 500 West Madison Street, Suite 1400, Chicago, Illinois 60661-2511; and the Northeast Regional Office at 13th Floor, 7 World Trade Center, New York, New York 10048. Copies of such material can be obtained from the Public Reference Section of the Commission at Judiciary Plaza, 450 Fifth Street, N.W., Washington, D.C. 20549

at prescribed rates. Such reports and other information concerning the Company are also available for inspection at the offices of the New York Stock Exchange, 20 Broad Street, New York, New York 10005. In addition the Commission maintains an Internet site at <http://www.sec.gov> that contains reports, proxy and information statements and other information regarding registrants, including the Company, that file electronically with the Commission.

The Company has filed with the Commission a registration statement on Form S-3 (together with all amendments and exhibits thereto, the "Registration Statement") under the Securities Act. This Prospectus does not contain all of the information set forth in the Registration Statement, certain parts of which are omitted in accordance with the rules and regulations of the Commission. For further information, reference is made to the Registration Statement.

56

#### DOCUMENTS INCORPORATED BY REFERENCE

The following documents filed by the Company with the Commission are incorporated herein by reference:

(1) The Company's Annual Report on Form 10-K for its fiscal year ended May 31, 1995;

(2) The Company's Annual Report on Form 10-K for the transitional fiscal year ended December 31, 1995;

(3) The Company's Quarterly Reports on Form 10-Q for the periods ended August 31, 1995; November 30, 1995; March 30, 1996; and June 30, 1996;

(4) The Company's Current Reports on Form 8-K dated May 15, 1995; May 22, 1995; August 1, 1995; December 14, 1995; December 20, 1995; March 18, 1996; August 29, 1996; October 18, 1996; October 25, 1996; and October 30, 1996; and the Company's Current Reports on Form 8-K/A-1 dated July 15, 1995; September 29, 1995; and February 13, 1996;

(5) The description of the Common Stock contained in the Company's Form 8-A dated October 23, 1995; and

(6) All documents subsequently filed by the Company with the Commission pursuant to Section 13(a), (c), 14 or 15(d) of the Exchange Act and prior to the termination of this offering shall be deemed to be incorporated by reference in this Prospectus. Any statement contained in a document incorporated or deemed to be incorporated by reference herein shall be deemed to be modified or superseded for purposes of this Prospectus to the extent that a statement contained herein, modified or supersedes such statement. Any such statement so modified or superseded shall not be deemed, except as so modified or superseded, to constitute a part of this Prospectus.

Copies of all documents which are incorporated herein by reference (not including the exhibits to such information, unless such exhibits are specifically incorporated by reference in such information) will be provided without charge to each person, including any beneficial owner, to whom this Prospectus is delivered, upon written or oral request. Copies of this Prospectus, as amended or supplemented from time to time, and any other documents (or parts of documents) that constitute part of the Prospectus under Section 10(a) of the Securities Act will also be provided without charge to each such person, upon written or oral request. Requests should be directed to Total Renal Care Holdings, Inc., Attention: John E. King, 21250 Hawthorne Boulevard, Suite 800, Torrance, California 90503, telephone number (310) 792-2600.

57

#### INDEX TO FINANCIAL STATEMENTS

TOTAL RENAL CARE HOLDINGS, INC.

Report of Independent Accountants of Price Waterhouse LLP.....	F-2
Independent Auditors' Report of KPMG Peat Marwick LLP.....	F-3
Consolidated Balance Sheets.....	F-4
Consolidated Statements of Income.....	F-5
Consolidated Statements of Stockholders' Equity (Deficit).....	F-6
Consolidated Statements of Cash Flows.....	F-7
Notes to Consolidated Financial Statements.....	F-8

## F-1

## REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Stockholders of  
Total Renal Care Holdings, Inc.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, of stockholders' equity (deficit), and of cash flows present fairly, in all material respects, the financial position of Total Renal Care Holdings, Inc. and its subsidiaries at December 31, 1995 and May 31, 1995, and the results of their operations and their cash flows for the periods then ended in conformity with generally accepted accounting principles. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards which 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

PRICE WATERHOUSE LLP  
Seattle, Washington  
March 15, 1996

## F-2

## INDEPENDENT AUDITORS' REPORT

The Board of Directors and Stockholders  
Total Renal Care Holdings, Inc.:

We have audited the accompanying consolidated balance sheet of Total Renal Care Holdings, Inc. (formerly Total Renal Care, Inc.) and subsidiaries as of May 31, 1994, and the related consolidated statements of income, stockholders' equity (deficit), and cash flows for each of the years in the two-year period ended May 31, 1994. 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 generally accepted auditing standards. 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 Total Renal Care Holdings, Inc. and subsidiaries as of May 31, 1994, and the results of their operations and their cash flows for each of the years in the two-year period ended May 31, 1994 in conformity with generally accepted accounting principles.

As discussed in note 1 to the consolidated financial statements, effective June 1, 1993 the Company changed its method of providing for income taxes by



adopting Statement of Financial Accounting Standards No. 109, Accounting for  
Income Taxes.

KPMG Peat Marwick LLP

Seattle, Washington

July 8, 1994

F-3

TOTAL RENAL CARE HOLDINGS, INC.

CONSOLIDATED BALANCE SHEETS

	MAY 31, -----		DECEMBER 31, 1995	SEPTEMBER 30, 1996 (UNAUDITED)
	1994	1995		
ASSETS				
Cash and cash equivalents.....	\$ 1,449,000	\$ 2,046,000	\$ 30,181,000	\$ 5,440,000
Accounts receivable, less allowance for doubtful accounts of \$1,927,000, \$4,434,000, \$5,668,000 and \$10,734,000 (unaudited), respectively.....	13,538,000	23,652,000	40,014,000	95,314,000
Receivable from Tenet....	9,427,000	401,000	432,000	322,000
Inventories.....	1,223,000	1,731,000	2,482,000	4,579,000
Deferred income taxes....	1,133,000	1,283,000	1,542,000	3,234,000
Prepaid expenses and other current assets....	330,000	693,000	843,000	7,042,000
Total current assets.	27,100,000	29,806,000	75,494,000	115,931,000
Property and equipment, net.....	14,128,000	18,051,000	25,505,000	49,443,000
Notes receivable from stockholder.....			1,379,000	1,851,000
Investment in affiliate, at equity.....			972,000	1,018,000
Other long-term assets...	14,000	552,000	885,000	899,000
Intangible assets, net...	2,379,000	29,149,000	59,763,000	151,279,000
	\$43,621,000	\$ 77,558,000	\$163,998,000	\$320,421,000
	=====	=====	=====	=====
LIABILITIES, MANDATORILY REDEEMABLE COMMON STOCK AND STOCKHOLDERS' EQUITY (DEFICIT)				
Accounts payable.....	\$ 3,250,000	\$ 4,849,000	\$ 7,901,000	\$ 8,570,000
Employee compensation and benefits.....	2,430,000	4,914,000	5,012,000	9,432,000
Other accrued liabilities.....	1,345,000	4,750,000	7,006,000	12,113,000
Income taxes payable....			314,000	--
Current portion of long-term obligations.....	11,000	322,000	570,000	562,000
Total current liabilities.....	7,036,000	14,835,000	20,803,000	30,677,000
Long-term debt.....	187,000	87,820,000	55,324,000	78,225,000
Deferred income taxes....	611,000	518,000	510,000	1,052,000
Other long-term liabilities.....	--	--	1,214,000	782,000
Minority interests.....	1,054,000	1,274,000	3,343,000	5,326,000

Mandatorily redeemable common stock.....	--	3,990,000	--	--
Commitments and contingencies (Notes 7 and 12)				
Stockholders' equity (deficit)				
Common stock, voting (\$ .001 par value, 1,000,000, 50,000,000, 55,000,000 and 55,000,000 (unaudited) shares authorized; 66,667, 12,309,384, 22,308,207 and 25,967,029 (unaudited) shares issued and outstanding).....		12,000	22,000	26,000
Common stock, Class B nonvoting (\$ .001 par value; 0, 5,000,000, 5,000,000 and 5,000,000 (unaudited) shares authorized; 0, 600,000, 0 and 0 (unaudited) shares issued and outstanding).....		1,000		
Additional paid-in capital.....		12,683,000	123,710,000	236,433,000
Notes receivable from stockholders.....		(1,508,000)	(2,773,000)	(2,783,000)
Retained earnings (deficit).....	34,733,000	(42,067,000)	(38,155,000)	(29,317,000)
Total stockholders' equity (deficit)....	34,733,000	(30,879,000)	82,804,000	204,359,000
	\$43,621,000	\$ 77,558,000	\$163,998,000	\$320,421,000
	=====	=====	=====	=====

See accompanying notes to consolidated financial statements.

F-4

TOTAL RENAL CARE HOLDINGS, INC.

CONSOLIDATED STATEMENTS OF INCOME

	YEAR ENDED MAY 31,			SEVEN MONTHS ENDED DECEMBER 31,		NINE MONTHS ENDED SEPTEMBER 30,	
	1993	1994	1995	1994 (UNAUDITED)	1995	1995 (UNAUDITED)	1996
Net operating revenues..	\$71,576,000	\$80,470,000	\$98,968,000	\$53,593,000	\$89,711,000	\$93,508,000	\$188,153,000
Operating expenses							
Facilities.....	49,440,000	56,828,000	65,583,000	36,012,000	57,406,000	60,304,000	126,121,000
General and administrative.....	5,292,000	7,457,000	9,115,000	4,916,000	7,645,000	8,307,000	13,644,000
Provision for doubtful accounts.....	2,050,000	1,550,000	2,371,000	1,363,000	1,811,000	2,023,000	3,892,000
Depreciation and amortization.....	3,434,000	3,752,000	4,740,000	2,586,000	4,383,000	4,564,000	10,263,000
Total operating expenses.....	60,216,000	69,587,000	81,809,000	44,877,000	71,245,000	75,198,000	153,920,000
Operating income.....	11,360,000	10,883,000	17,159,000	8,716,000	18,466,000	18,310,000	34,233,000
Interest expense.....	(49,000)	(56,000)	(7,447,000)	(3,378,000)	(6,291,000)	(7,534,000)	(5,869,000)
Interest income.....	40,000	43,000	244,000	78,000	707,000	247,000	2,007,000
Income before income taxes, minority interests and extraordinary item....	11,351,000	10,870,000	9,956,000	5,416,000	12,882,000	11,023,000	30,371,000
Income taxes.....	4,129,000	4,106,000	3,511,000	1,933,000	4,631,000	3,852,000	11,537,000

Income before minority interests and extraordinary item.....	7,222,000	6,764,000	6,445,000	3,483,000	8,251,000	7,171,000	18,834,000
Minority interests in income of consolidated subsidiaries.....	775,000	1,046,000	1,593,000	833,000	1,784,000	1,787,000	2,296,000
Income before extraordinary item.....	6,447,000	5,718,000	4,852,000	2,650,000	6,467,000	5,384,000	16,538,000
Extraordinary loss related to early extinguishment of debt, net of tax.....					2,555,000		7,700,000
Net income.....	\$ 6,447,000	\$ 5,718,000	\$ 4,852,000	\$ 2,650,000	\$ 3,912,000	\$ 5,384,000	\$ 8,838,000
Earnings (loss) per common share:							
Income before extraordinary item.....					\$ 0.36	\$ 0.35	\$ 0.65
Extraordinary items.....					(0.14)		(0.30)
Net income.....					\$ 0.22	\$ 0.35	\$ 0.35
Weighted average number of common shares and equivalents outstanding.....					17,824,000	15,427,000	25,409,000
Pro forma data (unaudited)							
Net income per common share.....		\$ 0.22	\$ 0.08				
Weighted average number of common shares and equivalents outstanding.....		15,316,000	14,381,000				

See accompanying notes to consolidated financial statements.

F-5

# TOTAL RENAL CARE HOLDINGS, INC.

## CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)

	COMMON STOCK		ADDITIONAL PAID-IN CAPITAL	NOTES RECEIVABLE FROM STOCKHOLDERS	RETAINED EARNINGS (DEFICIT)	TOTAL
	SHARES	AMOUNT				
Balance at June 1, 1992.	66,667				\$ 22,568,000	\$ 22,568,000
Net income.....					6,447,000	6,447,000
Balance at May 31, 1993.	66,667				29,015,000	29,015,000
Net income.....					5,718,000	5,718,000
Balance at May 31, 1994.	66,667				34,733,000	34,733,000
Shares issued to Tenet..	2,933,334	\$ 3,000	\$ 1,000			4,000
Shares issued in change of control:						
DLJMB.....	7,000,000	7,000	10,493,000			10,500,000
Employees.....	1,246,667	1,000	1,869,000	\$ (995,000)		875,000
Shares issued in offering.....	600,000	1,000	899,000			900,000
Stock issuance costs....			(2,172,000)			(2,172,000)
Dividend paid to Tenet:						
Cash.....					(75,500,000)	(75,500,000)
Intercompany receivable.....					(6,152,000)	(6,152,000)
Shares issued to employees and others.....	765,252	1,000	1,147,000	(513,000)		635,000
Shares issued in acquisitions.....	297,464		446,000			446,000
Net income.....					4,852,000	4,852,000
Balance at May 31, 1995.	12,909,384	13,000	12,683,000	(1,508,000)	(42,067,000)	(30,879,000)
Net proceeds from initial public offering...	6,900,000	6,000	98,288,000			98,294,000
Shares and options issued in acquisitions...	742,820	1,000	5,334,000			5,335,000

Shares issued to employees and others.....	27,670		59,000	(13,000)		46,000
Options exercised.....	1,046,666	1,000	1,565,000	(1,330,000)		236,000
Conversion of mandatorily redeemable common stock.....	681,667	1,000	3,989,000			3,990,000
Payments on notes receivable, net of interest accrued.....				78,000		78,000
Income tax benefit related to stock options exercised.....			1,792,000			1,792,000
Net income.....					3,912,000	3,912,000
Balance at December 31, 1995.....	22,308,207	22,000	123,710,000	(2,773,000)	(38,155,000)	82,804,000
Net proceeds from public offering (unaudited)...	3,500,000	4,000	109,960,000			109,964,000
Shares issued to employees and others (unaudited).....	998		10,000			10,000
Options exercised (unaudited).....	96,106		105,000			105,000
Shares issued in acquisitions (unaudited)....	61,718		1,829,000			1,829,000
Interest accrued on notes receivable, net of payments (unaudited).....				(10,000)		(10,000)
Income tax benefit related to stock options exercised (unaudited)...			819,000			819,000
Net income (unaudited)...					8,838,000	8,838,000
Balance at September 30, 1996 (unaudited).....	25,967,029	\$26,000	\$236,433,000	\$ (2,783,000)	\$ (29,317,000)	\$204,359,000

See accompanying notes to consolidated financial statements.

F-6

TOTAL RENAL CARE HOLDINGS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	YEAR ENDED MAY 31,			SEVEN MONTHS ENDED DECEMBER 31,		NINE MONTHS ENDED SEPTEMBER 30,	
	1993	1994	1995	1994 (UNAUDITED)	1995	1995 (UNAUDITED)	1996
Cash flows from operating activities							
Net income.....	\$ 6,447,000	\$ 5,718,000	\$ 4,852,000	\$ 2,650,000	\$ 3,912,000	\$ 5,384,000	\$ 8,838,000
Adjustments to reconcile net income to net cash provided by operating activities:							
Depreciation and amortization.....	3,434,000	3,752,000	4,740,000	2,586,000	4,383,000	4,564,000	10,263,000
Extraordinary item....					4,258,000		12,623,000
Noncash interest.....			6,947,000	3,274,000	5,228,000	6,729,000	4,396,000
Deferred income taxes.	(316,000)	213,000	(716,000)	16,000	(469,000)	(286,000)	(1,150,000)
Provision for doubtful accounts.....	2,050,000	1,550,000	2,371,000	1,363,000	1,811,000	2,023,000	3,892,000
Loss (gain) on disposition of property and equipment.....	(137,000)	98,000	(34,000)		(144,000)	(149,000)	24,000
Minority interests in income of consolidated subsidiaries.....	775,000	1,046,000	1,593,000	833,000	1,784,000	1,787,000	2,296,000
Changes in operating assets and liabilities, net of effect of							

acquisitions:							
Accounts receivable..	(2,037,000)	(1,957,000)	(9,547,000)	(4,023,000)	(15,256,000)	(14,286,000)	(35,355,000)
Inventories.....	(83,000)	(108,000)	(122,000)	(303,000)	(331,000)	72,000	(636,000)
Prepaid expenses and other current assets.....	(1,000)	109,000	(856,000)	(261,000)	(134,000)	(1,375,000)	(6,040,000)
Other long-term assets.....					(300,000)	(119,000)	(167,000)
Accounts payable....	(2,076,000)	272,000	(536,000)	728,000	205,000	616,000	(2,706,000)
Employee compensation and benefits.....	(447,000)	445,000	1,994,000	2,000	(622,000)	1,508,000	2,094,000
Other accrued liabilities.....	(6,000)	924,000	4,383,000	544,000	461,000	4,678,000	4,348,000
Income taxes payable.				465,000	277,000	(1,208,000)	(314,000)
Other long-term liabilities.....				107,000	1,214,000	(46,000)	(433,000)
Net cash provided by operating activities.....	7,603,000	12,062,000	15,069,000	7,981,000	6,277,000	9,892,000	1,973,000
Cash flows from investing activities							
Purchases of property and equipment.....	(4,140,000)	(4,380,000)	(3,835,000)	(860,000)	(3,748,000)	(4,699,000)	(18,118,000)
Additions to intangible assets....	(7,000)	(161,000)	(358,000)	(159,000)	(972,000)	(1,347,000)	(2,880,000)
Cash paid for acquisitions, net of cash acquired.....			(22,476,000)	(5,722,000)	(28,303,000)	(31,440,000)	(120,495,000)
Investment in affiliate.....					(972,000)		(46,000)
Issuance of long-term note receivable.....					(1,379,000)	(2,726,000)	(472,000)
Proceeds from disposition of property and equipment.....	493,000	82,000	62,000	28,000		273,000	144,000
Proceeds from collection of notes receivables.....	60,000	95,000					
Contributions from minority interests...					244,000	244,000	648,000
Net cash used in investing activities.....	(3,594,000)	(4,364,000)	(26,607,000)	(6,713,000)	(35,130,000)	(39,695,000)	(141,219,000)
Cash flows from financing activities							
Advances (to) from Tenet.....	(4,330,000)	(5,604,000)	2,874,000	3,499,000			
Proceeds from issuance of note payable.....					258,000	814,000	869,000
Principal payments on long-term obligations.....	(39,000)	(39,000)	(367,000)	(11,000)	(880,000)	(675,000)	(767,000)
Cash dividends paid to Tenet.....			(75,500,000)	(75,500,000)			
Net proceeds from debt offering.....			66,841,000	66,140,000			
Cash paid to retire bonds.....					(31,912,000)		(28,499,000)
Proceeds from bank credit facility.....			13,253,000		21,341,000	28,050,000	84,335,000
Payment of bank credit facility.....			(4,000,000)		(31,625,000)	(4,000,000)	(51,000,000)
Net proceeds from issuance of common stock.....			10,742,000	10,810,000	98,941,000	2,900,000	110,079,000
Income tax benefit related to stock options exercised....					1,792,000		819,000
Cash received on notes receivable from stockholders.....					175,000	34,000	157,000
Distributions to minority interests...	(610,000)	(819,000)	(1,708,000)	(723,000)	(1,102,000)	(1,453,000)	(1,488,000)
Net cash provided by (used in) financing activities.....	(4,979,000)	(6,462,000)	12,135,000	4,215,000	56,988,000	25,670,000	114,505,000
Net increase (decrease) in cash.....	(970,000)	1,236,000	597,000	5,483,000	28,135,000	(4,133,000)	(24,741,000)
Cash and cash equivalents at beginning of period...	1,183,000	213,000	1,449,000	1,449,000	2,046,000	6,932,000	30,181,000
Cash and cash equivalents at end of period.....	\$ 213,000	\$ 1,449,000	\$ 2,046,000	\$ 6,932,000	\$ 30,181,000	\$ 2,799,000	\$ 5,440,000

See accompanying notes to consolidated financial statements.

TOTAL RENAL CARE HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

Total Renal Care Holdings, Inc. (the "Company") operates kidney dialysis facilities and provides related medical services in Medicare certified dialysis facilities in various geographic sectors in the United States and in Guam.

The Company was a wholly owned subsidiary of Tenet Healthcare Corporation ("Tenet," formerly National Medical Enterprises, Inc.) until August 1994. In August 1994, the Company completed a public offering of senior subordinated notes and Class B common stock, the proceeds of which were used to partially fund a dividend to Tenet. Immediately after payment of the dividend, Donaldson, Lufkin, Jenrette Merchant Banking Funding, Inc. and certain of its affiliates ("DLJMB") and certain members of management acquired newly issued Class A common stock of the Company to effect a change in control of the Company. Following these transactions DLJMB owned 59% of the Company's outstanding common stock. Although there was a change in control, the Company's accounts were not adjusted from their historical bases due to the significant continuing ownership interest of Tenet.

Basis of presentation

The consolidated financial statements include the accounts of Total Renal Care Holdings, Inc. and its wholly-owned and majority-owned corporate subsidiaries and partnership investments. All significant intercompany transactions and balances have been eliminated in consolidation.

Net operating revenues

Revenues are recognized when services and related products are provided to patients in need of ongoing life sustaining kidney dialysis treatments. Operating revenues consist primarily of dialysis and ancillary fees from patient treatments. These amounts are reported at the amounts expected to be realized from governmental and third-party payors, patients and others for services provided. Receivables which are deemed uncollectible are reflected in the provision for doubtful accounts as a component of operating expenses in the consolidated statements of income.

During the years ended May 31, 1993, 1994 and 1995 and the seven months ended December 31, 1995, the Company received approximately 75%, 75%, 70% and 67%, respectively, of its dialysis revenues from Medicare and Medicaid programs. Accounts receivable from Medicare and Medicaid amounted to \$8,783,000, \$15,855,000 and \$21,862,000 as of May 31, 1994 and 1995 and December 31, 1995, respectively. Medicare historically pays approximately 80% of government established rates for services provided by the Company. The remaining 20% is typically paid by state Medicaid programs, private insurance companies or directly by the patients receiving the services.

Medicare and Medicaid programs funded by the U.S. government generally reimburse the Company under prospective payment systems at amounts different from the Company's established private rates. Revenues under these programs are generally recognized at prospective rates which are subject to periodic adjustment by federal and state agencies. The Company bills non-governmental third-party payors at established private rates. The Company has contracts for the provision of dialysis services to members of certain managed care organizations which generally include rate provisions at less than the established private rates.

In August 1993, the provisions of the Omnibus Budget Reconciliation Act of 1993 ("OBRA 93") became effective. The OBRA 93 provisions were originally interpreted by the Health Care Financing Administration ("HCFA") to modify the requirements that employer group health sponsored insurance plans (private

payors) be the primary payor for end-stage renal disease ("ESRD") patients who subsequently become dually entitled to Medicare benefits because of ESRD following initial eligibility under age or disability provisions. In July 1994, HCFA instructed the Medicare fiscal intermediaries to retroactively apply the provisions of OBRA 93 to August 10, 1993. In April 1995, HCFA issued instructions of clarification to the fiscal intermediaries that it had misinterpreted the OBRA regulations and that Medicare would continue as the primary payor after dual eligibility was achieved under the ESRD provision. In June 1995, a preliminary injunction was issued by a federal court preventing HCFA from retroactively applying its reinterpretation of the OBRA 93 regulations as unlawful retroactive rulemaking. The Company has recognized revenue related to payments which have been received from private payors in excess of the revenue previously recognized at lower rates. For the seven months ended December 31, 1995, the Company recognized approximately \$800,000 of such payments. The Company intends to continue to recognize revenues in the future as cash is received. The Company believes that there are additional amounts that may be recoverable under the OBRA 93 provisions.

#### Cash and cash equivalents

Cash equivalents are highly liquid investments with original maturities of three months or less.

#### Inventories

Inventories are stated at the lower of cost (first-in, first-out) or market and consist principally of drugs and dialysis related supplies.

#### Property and equipment

Property and equipment are stated at cost. Maintenance and repairs are charged to expense as incurred. Depreciation and amortization expense are computed using the straight-line method over the useful lives of the assets estimated as follows: buildings, 20 to 40 years; leaseholds and improvements, over the shorter of their estimated useful life or the lease term; and equipment, 3 to 15 years.

#### Intangible assets

Business acquisition costs allocated to patient lists are amortized over five years using the straight-line method. Business acquisition costs allocated to covenants not to compete are amortized over the terms of the agreements, typically seven to ten years, using the straight-line method. Deferred debt issuance costs are amortized over the term of the debt using the effective interest method.

The excess of aggregate purchase price over the fair value of net assets of businesses acquired is recorded as goodwill. Goodwill is amortized over 15 to 25 years using the straight-line method.

The carrying value of intangible assets is assessed for any permanent impairment by evaluating the operating performance and future undiscounted cash flows of the underlying businesses. Adjustments are made if the sum of the expected future net cash flows is less than book value. Statement of Financial Accounting Standards No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of ("SFAS 121"), requires that long-lived assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of assets may not be recoverable. SFAS 121 is required to be implemented by the Company for the fiscal year beginning January 1, 1996 and is not expected to have a significant impact on the Company's financial statements.

F-9

TOTAL RENAL CARE HOLDINGS, INC.

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(CONTINUED)

##### Income taxes

Effective June 1, 1993, the Company adopted Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes ("SFAS 109"). The statement requires recognition of deferred income taxes for all temporary differences between the tax and financial reporting bases of the Company's

assets and liabilities based on enacted tax rates applicable to the periods in which the differences are expected to be recovered or settled. Adoption of SFAS 109 did not have a material impact on the Company's financial statements.

Following the change in control described above, the Company's results of operations were no longer included in Tenet's consolidated federal and applicable unitary state income tax returns. For financial reporting purposes, the provision for income taxes for fiscal year 1994 and through August 11 of the first quarter of fiscal year 1995 was calculated as if the Company filed separate federal and state income tax returns.

#### Minority interest

Minority interest represents the proportionate equity interest of other partners and stockholders in the Company's consolidated entities which are not wholly owned. As of December 31, 1995, this comprised nine limited partnerships and two corporations.

#### Earnings per share and unaudited pro forma net income per share

Earnings per share are calculated by dividing net income before extraordinary item, the extraordinary loss and net income by the weighted average number of shares of common stock outstanding. When dilutive, stock options and warrants are included as share equivalents using the treasury stock method.

Pro forma net income per share for the seven months ended December 31, 1994 and the year ended May 31, 1995 has been computed as if the August 11, 1994 recapitalization transaction described above occurred on June 1, 1994 (see Notes 6 and 8). Specifically, net income has been decreased \$1,551,000 to reflect an increase in general and administrative expenses (\$625,000) for estimated incremental costs of the Company as a stand-alone entity, increases in interest expense (\$1,811,000), amortization expense (\$105,000) and bank fees (\$42,000) for the issuance of the 12% senior subordinated debt, and a corresponding decrease to the provision for income taxes (\$1,032,000) for the tax effect of the pro forma adjustments. Shares issued as part of the recapitalization were also assumed to have been outstanding from June 1, 1994.

During the period from October 1, 1994 to November 2, 1995, the Company issued approximately 2,190,000 shares and options at prices significantly below the assumed offering price of the Company's initial public offering (see Note 8). Such shares and common stock equivalents have been included in the number of shares outstanding from June 1, 1994 using the treasury stock method and an offering price of \$15.50 per share.

Earnings per share amounts are not presented for fiscal years 1993 and 1994 as the historical equity structure is not considered meaningful.

#### Financial instruments

The Company's financial instruments consist primarily of cash, accounts receivable, accounts payable, employee compensation and benefits, and other accrued liabilities. These balances, as presented in the financial statements at December 31, 1995, approximate their fair value.

The Company has long-term debt, which is also a financial instrument. The fair market value of the long-term debt is approximately \$64,180,000, which is greater than its carrying value of \$55,894,000. The fair value has been estimated based upon market quotations of the 12% Senior Subordinate Discount Notes which are publicly traded.

#### Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and



reporting period. Actual results could differ from those estimates.

#### Unaudited interim financial statements

In December 1995, the Company changed its year-end to December 31 from May 31. The information presented as of September 30, 1996 and for the seven months ended December 31, 1994 and the nine month periods ended September 30, 1995 and 1996 has not been audited. In the opinion of management, the unaudited interim consolidated balance sheet, statements of income, of stockholders' equity (deficit) and of cash flows include all adjustments consisting solely of normal recurring adjustments necessary to present fairly the Company's consolidated results of operations and cash flows as of and for the periods indicated.

#### Reclassifications

Certain prior year balances have been reclassified to conform to the current year presentation.

## 2. PROPERTY AND EQUIPMENT

Property and equipment comprise the following:

	MAY 31, -----		DECEMBER 31, -----
	1994	1995	1995
Land.....	\$ 262,000	\$ 267,000	\$ 309,000
Buildings.....	3,018,000	3,054,000	4,072,000
Leaseholds and improvements.....	9,891,000	10,934,000	12,211,000
Equipment.....	16,545,000	22,742,000	26,737,000
Construction in progress.....	411,000	37,000	2,097,000
	-----	-----	-----
	30,127,000	37,034,000	45,426,000
Less accumulated depreciation and amortization.....	(15,999,000)	(18,983,000)	(19,921,000)
	-----	-----	-----
Net property and equipment.....	\$ 14,128,000	\$ 18,051,000	\$ 25,505,000
	=====	=====	=====

Depreciation and amortization expense on property and equipment was \$2,630,000, \$2,961,000, \$3,163,000 and \$2,326,000 for the years ended May 31, 1993, 1994 and 1995 and the seven months ended December 31, 1995, respectively.

## 3. INTANGIBLE ASSETS

A summary of intangible assets is as follows:

	MAY 31, -----		DECEMBER 31, -----
	1994	1995	1995
Goodwill.....	\$2,865,000	\$21,647,000	\$46,791,000
Patient lists.....	2,751,000	4,055,000	6,505,000
Noncompete agreements.....	398,000	3,856,000	10,005,000
Deferred debt issuance costs.....		4,400,000	3,324,000
Other.....	254,000	653,000	491,000
	-----	-----	-----
	6,268,000	34,611,000	67,116,000
Less accumulated amortization.....	(3,889,000)	(5,462,000)	(7,353,000)
	-----	-----	-----
	\$2,379,000	\$29,149,000	\$59,763,000
	=====	=====	=====

## TOTAL RENAL CARE HOLDINGS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(CONTINUED)

Amortization expense applicable to intangible assets was \$804,000, \$791,000, \$1,577,000 and \$2,057,000 for the years ended May 31, 1993, 1994 and 1995 and the seven months ended December 31, 1995, respectively.

## 4. OTHER ACCRUED LIABILITIES

Other accrued liabilities comprise the following:

	MAY 31,		DECEMBER 31,
	1994	1995	1995
Customer refunds.....	\$ 978,000	\$3,908,000	\$4,981,000
Payable to former owners of acquired facility (Note 13).....			1,243,000
Other.....	367,000	842,000	782,000
	-----	-----	-----
	\$1,345,000	\$4,750,000	\$7,006,000
	=====	=====	=====

## 5. INCOME TAXES

The provision for income taxes consists of the following:

	YEAR ENDED MAY 31,			SEVEN MONTHS ENDED DECEMBER 31,
	1993	1994	1995	1995
Current				
Federal.....	\$3,630,000	\$3,084,000	\$3,275,000	\$3,708,000
State.....	815,000	809,000	952,000	954,000
Deferred				
Federal.....	(268,000)	170,000	(555,000)	9,000
State.....	(48,000)	43,000	(161,000)	(40,000)
	-----	-----	-----	-----
	\$4,129,000	\$4,106,000	\$3,511,000	\$4,631,000
	=====	=====	=====	=====

Temporary differences which give rise to deferred tax assets and liabilities are as follows:

	MAY 31,		DECEMBER 31,
	1994	1995	1995
Receivables, primarily allowance for doubtful accounts.....	\$ 844,000	\$ 1,521,000	\$ 1,653,000
Accrued vacation.....	289,000	347,000	459,000
Intangible assets.....			325,000
Deferred compensation.....	78,000	117,000	117,000
	-----	-----	-----
Gross deferred tax assets.....	1,211,000	1,985,000	2,554,000
	-----	-----	-----
Depreciation and amortization.....	(549,000)	(547,000)	(952,000)
Intangible assets.....	(88,000)	(88,000)	
Change in tax accounting method.....		(585,000)	(570,000)
Other.....	(52,000)		
	-----	-----	-----
Gross deferred tax liabilities.....	(689,000)	(1,220,000)	(1,522,000)

Net deferred tax assets.....	\$ 522,000	\$ 765,000	\$ 1,032,000
	=====	=====	=====

F-12

TOTAL RENAL CARE HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(CONTINUED)

A reconciliation between the Company's effective tax rate and the U.S. federal income tax rate on income is as follows:

	YEAR ENDED MAY 31, ----- 1993    1994    1995			SEVEN MONTHS ENDED DECEMBER 31, 1995
Federal income tax rate.....	34.0%	34.0%	34.0%	35.0%
State taxes, net of federal benefit.....	4.5%	5.2%	5.2%	3.6%
Minority interests.....	(2.0%)	(3.0%)	(5.0%)	(4.7%)
Nondeductible amortization of intangible assets.....	0.2%	0.6%	0.9%	2.9%
Other.....	(0.3%)	1.0%	0.2%	(0.8%)
	-----	-----	-----	-----
	36.4%	37.8%	35.3%	36.0%
	=====	=====	=====	=====

6. LONG-TERM DEBT AND OTHER

Long-term debt and other comprises:

	MAY 31, ----- 1994    1995		DECEMBER 31, 1995
12% Senior Subordinated Discount Notes (net of unamortized discount of \$22,659,000 and \$11,180,000 respectively).....		\$77,341,000	\$53,820,000
Senior Credit Facility.....		10,100,000	
Capital lease obligations (Note 7).....		591,000	1,680,000
Other.....	\$198,000	110,000	394,000
	-----	-----	-----
	198,000	88,142,000	55,894,000
Less current portion.....	(11,000)	(322,000)	(570,000)
	-----	-----	-----
	\$187,000	\$87,820,000	\$55,324,000
	=====	=====	=====

12% Senior Subordinated Discount Notes

In August 1994, the Company completed a public offering of 100,000 units, each consisting of \$1,000 of 12% Senior Subordinated Discount Notes (the "Notes") and six shares of nonvoting Class B common stock. Aggregate proceeds from the offering were \$71,294,000, of which \$900,000 was allocated to the Class B common stock, based upon the estimated value of the stock, and the remaining \$70,394,000 to the Notes. The Notes mature on August 15, 2004. Interest does not accrue on the Notes until August 15, 1997. Commencing on February 15, 1998, cash interest on the Notes will be payable semiannually at a rate of 12% per annum. Prior to February 15, 1998, interest will be paid in kind through amortization of the discount. The discount is amortized using the effective interest rate of 12.39%.

The Company has certain rights to redeem the Notes at specified percentages

in various circumstances as specified in the agreement. Upon a change of control, as defined and other than the change of control discussed in Note 1, the Company is required to offer to repurchase all of the Notes at 101% of the accreted value through August 15, 1997 and at 101% of face value thereafter. Additionally, the Company has the right to redeem the Notes beginning August 15, 1999 at the accreted value plus a defined premium.

On December 7, 1995, the Company redeemed 35% of the accreted value of the Notes equaling \$28,749,000 at a redemption premium of 111% for a total redemption price of \$31,912,000. An extraordinary loss on the early extinguishment of debt of \$4,258,000, net of income tax effect of \$1,703,000, was recorded during the seven months ended December 31, 1995.

F-13

TOTAL RENAL CARE HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(CONTINUED)

The Notes are subordinated to all senior debt and are guaranteed on a senior subordinated basis by certain of the Company's wholly owned subsidiaries (the "Guarantor Subsidiaries") subject to certain specified limitations (see Note 16).

The Notes contain certain restrictive and financial covenants including limitations on additional indebtedness, limitations on payment of dividends other than the dividend discussed in Note 8, and redemption of capital stock, limitations on the sales of assets and capital stock of certain subsidiaries and limitations on the Company's ability to consolidate, merge or transfer assets to another entity. The Company is in compliance with all covenants.

Senior Credit Facility

Effective August 11, 1994, the Company's wholly owned subsidiary, Total Renal Care, Inc. ("TRC," formerly Medical Ambulatory Care, Inc.), entered into a credit agreement providing for a senior secured revolving credit facility. This credit agreement, as amended and restated on March 15, 1996, provides a \$100,000,000 senior secured revolving credit facility (the "Senior Credit Facility"). Borrowings under the Senior Credit Facility may be used to purchase certain domestic companies engaged in the treatment of end-stage renal disease with up to \$10,000,000 available for general corporate and working capital purposes. The Senior Credit Facility expires on February 15, 2002 and may be extended for one year upon prior written notice to and consent of the lenders. The amount available under the Senior Credit Facility will be reduced by \$10,000,000, \$15,000,000 and \$15,000,000 at February 15, 1999, 2000 and 2001, respectively. Additionally, mandatory prepayments are required under certain circumstances including certain equity and debt issuances or the sale of certain assets.

Loans under the Senior Credit Facility will bear interest at either (1) the higher of the bank's prime rate or the federal funds rate plus .5% per annum or (2) adjusted LIBOR, as defined, plus an applicable margin, at the Company's option, payable at least quarterly. The applicable margin will vary between .625% and 1.5% based on the Company's leverage ratio, as defined. The Senior Credit Facility includes a commitment fee of between .25% and .5% of the unused portion based on the Company's leverage ratio, as defined.

The Company and TRC's wholly owned subsidiaries have guaranteed TRC's obligations under the Senior Credit Facility on a senior basis and have pledged their assets (including the stock of their subsidiaries) in support of such guarantees. Additionally, the Senior Credit Facility is secured by all of the tangible and intangible assets of TRC and certain subsidiaries.

The Senior Credit Facility contains certain restrictive and financial covenants including a limitation on the sale of assets, limitations on investments and limitations on the incurrence of additional indebtedness. The Company is in compliance with all covenants.

Maturities of long-term debt for the years ending December 31 are as follows:

1996.....	\$ 570,000
1997.....	482,000
1998.....	392,000
1999.....	362,000
2000.....	268,000
Thereafter.....	65,000,000

F-14

TOTAL RENAL CARE HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(CONTINUED)

7. LEASES

The Company leases the majority of its facilities under noncancelable operating leases expiring in various years through 2006. Certain of these facilities leases are with Tenet (see Note 10). Most lease agreements cover periods from five to ten years and contain renewal options of five to ten years at the fair rental value at the time of renewal or at rates subject to consumer price index increases since the inception of the lease. In the normal course of business, operating leases are generally renewed or replaced by other similar leases.

Future minimum lease payments under noncancelable operating leases for the years ending December 31 are as follows:

1996.....	\$ 5,175,000
1997.....	4,805,000
1998.....	4,083,000
1999.....	3,532,000
2000.....	2,222,000
Thereafter.....	4,330,000
	-----
Total minimum lease payments.....	\$24,147,000
	=====

Rental expense under all operating leases for the years ended May 31, 1993, 1994 and 1995 and the seven months ended December 31, 1995 amounted to \$2,713,000, \$3,016,000, \$3,323,000 and \$2,644,000, respectively.

The Company also leases certain equipment under capital lease agreements. Future minimum lease payments under capital leases for the years ending December 31 are as follows:

1996.....	\$ 499,000
1997.....	437,000
1998.....	402,000
1999.....	392,000
2000.....	278,000
	-----
	2,008,000
Less--Portion representing interest.....	(328,000)
	-----
Total capital lease obligation, including current portion of \$489,000.....	\$1,680,000
	=====

The net book value of fixed assets under capital lease was \$1,652,000 at December 31, 1995. Capital lease obligations are included in long-term debt and other.

8. STOCKHOLDERS' EQUITY

Initial public offering of common stock

On November 3, 1995, the Company completed an initial public offering of its common stock at an offering price of \$15.50 per share. The Company received net proceeds of \$98.3 million after the deduction of underwriting discounts and commissions and other expenses. The Company used net proceeds of \$31.9 million to redeem 35% of the Notes and \$31 million to repay all then outstanding borrowings on the Senior Credit Facility (see Note 6). The remainder of the proceeds will be used for general corporate purposes, acquisitions, de novo facility developments and other capital expenditures.

F-15

TOTAL RENAL CARE HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(CONTINUED)

Change in shares and stock split

In July 1994, the Company's Certificate of Incorporation was amended to increase the number of authorized shares of common stock from 1,000 shares to 35,000,000 shares and to reduce the par value of such stock from \$1.00 per share to \$.001 per share. Concurrent with this change, the Board of Directors approved a 1,000-for-1 stock split. Shares held by Tenet were the only shares affected by this action. Following the split, Tenet purchased an additional 2,933,334 shares of common stock for \$4,400.

During October 1995 and in anticipation of the initial public offering, the Company's directors redesignated the Class A common stock as "common stock," authorized an increase in the authorized number of shares of common stock to 55,000,000, authorized 5,000,000 new shares of \$.001 par value preferred stock, and approved a three-into-two reverse stock split of the Company's Class A and Class B common stock. Additionally, during the seven months ended December 31, 1995, all Class B common stock was converted to common stock. All information in these consolidated financial statements pertaining to shares of common stock and per share amounts have been restated to retroactively reflect the stock splits.

Debt offering

In August 1994, the Company completed a public offering of 100,000 units, each consisting of a \$1,000 Senior Subordinated Discount Note (see Note 6), and six shares of Class B common stock. The shares became separately transferrable from the Notes in February 1995 and were valued at \$1.50 per share which represented the stock's estimated fair value at the date of issuance as determined by the Company.

Dividends

Immediately following the public debt offering in August 1994, the Company paid Tenet a dividend totaling \$81,652,000. The dividend comprised \$75,500,000 in cash and \$6,152,000 in the forgiveness of Tenet's intercompany balance due the Company.

1994 Stock Plan

In August 1994, the Company established the Total Renal Care Holdings, Inc. 1994 Equity Compensation Plan (the "1994 Stock Plan") which provides for awards of nonqualified stock options to purchase common stock and other rights to purchase shares of common stock to certain employees, directors and facility medical directors of the Company.

Under terms of the 1994 Stock Plan, options granted generally vest on the ninth anniversary of the date of grant, subject to accelerated vesting in the event the Company meets certain performance criteria.

Purchase rights to acquire 788,670 Class A common shares for \$1.50-\$6.00 per share have been awarded to certain employees under the 1994 Stock Plan, the majority of which were granted in connection with the change in control. All such rights were exercised and the Company received notes for the uncollected portion of the purchase proceeds. The notes bear interest at the lesser of the Bank of New York's prime rate or 8%, are full recourse to the employees, and are secured by the employees' stock. The notes are repayable four years from the date of issuance, subject to certain prepayment requirements. At December

31, 1995, the outstanding notes plus accrued interest totaled \$378,000.

During the year ended May 31, 1995, 886,667 of the options issued to purchase common stock were issued to the Company's President. These options originally vested 50% over four years and 50% in the same manner as other options granted under the 1994 Stock Plan.

In September 1995, the Board of Directors and stockholders agreed to accelerate the Company's President's vesting period and all of the options became 100% vested. Pursuant to this action, the Company's President exercised all of the stock options through issuance of a full recourse note of \$1,330,000 bearing interest at the lesser of prime or 8%. Additionally, the Company's President executed a full recourse note for \$1,379,000

F-16

TOTAL RENAL CARE HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(CONTINUED)

bearing interest at the lesser of prime or 8% per annum to meet his tax liability in connection with the stock option exercise. These notes are secured by other shares of company stock and mature in September 1999 or upon disposition of the common stock by the Company's President.

Activity with respect to the 1994 Stock Plan is as follows:

	SHARES AVAILABLE	OPTIONS OUTSTANDING	EXERCISE PRICE
Authorization of the plan.....	4,000,000		
Purchase rights granted.....	(761,000)		
Options granted.....	(1,718,334)	1,718,334	\$1.50
	-----	-----	
Balance at May 31, 1995.....	1,520,666	1,718,334	\$1.50
Purchase rights granted.....	(27,670)		
Options granted.....	(193,343)	193,343	\$1.50-\$26.88
Options exercised.....		(1,046,666)	\$1.50
	-----	-----	
Balance at December 31, 1995.....	1,299,653	865,011	\$1.50-\$26.88
	=====	=====	

As of December 31, 1995, 211,113 options were vested under the 1994 Stock Plan.

1995 Stock Plan

In November 1995, the Company established the Total Renal Care Holdings, Inc. 1995 Equity Incentive Plan (the "1995 Stock Plan") which provides awards of stock options and the issuance of common shares subject to certain restrictions to certain employees, directors and other individuals providing services to the Company. There are 1,000,000 common shares reserved for issuance under the 1995 Stock Plan. No shares or options have been issued as of December 31, 1995.

Stock Purchase Plan

In November 1995, the Company established the Total Renal Care Holdings, Inc. Employees Stock Purchase Plan (the "Stock Purchase Plan") which entitles each employee to purchase up to \$25,000 of common stock during each calendar year. The amounts used to purchase stock are typically accumulated through payroll withholdings. The Stock Purchase 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. Except for the initial purchase right period which begins on November 3, 1995, the date of completion of the initial public offering, and will end on December 31, 1996, each purchase right period begins on January 1 or July 1, as selected by the employee and ends on December 31. At December 31, 1995, \$411,000 in payroll withholdings related to the Stock Purchase Plan was included in accrued employee compensation and benefits.

## Stock issued outside of plans

In connection with the change in control, the Company awarded its President and Chief Operating Officer purchase rights to acquire 1,113,333 and 133,333 Class A common shares, respectively, at a purchase price of \$1.50 per share. These rights were awarded outside of the 1994 Stock Plan in connection with the respective employment agreements. All such rights were exercised and the Company received notes totaling \$995,000 for the uncollected portion of the purchase proceeds. The notes bear terms similar to those issued in connection with the 1994 Stock Plan.

## New accounting pronouncement

In December 1995, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation ("SFAS 123"). This pronouncement requires the

F-17

## TOTAL RENAL CARE HOLDINGS, INC.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(CONTINUED)

Company to elect to account for stock-based compensation on a fair value based model or an intrinsic value based model. The intrinsic value based model is currently used by the Company and is the accounting principle prescribed by Accounting Principles Board No. 25, Accounting for Stock Issued to Employees ("APB 25"). Under this model, compensation cost is the excess, if any, of the quoted market price of the stock at the date of grant or other measurement date over the amount an employee must pay to acquire the stock. The fair value based model prescribed by SFAS 123 would require the Company to value stock-based compensation using an accepted valuation model. Compensation cost would be measured at the grant date based on the value of the award and would be recognized over the service period which is usually the vesting period.

The Company has elected to continue to apply the provisions of APB 25 to their employee stock-based compensation plans. SFAS 123 requires disclosure in the footnotes of the pro forma impact on net income and earnings per share of the difference between compensation expense using the intrinsic value method and the fair value method. The adoption of SFAS 123 is required for the fiscal year ending December 31, 1996, and will not have an impact on the Company's financial position or results of operations.

## 9. MANDATORILY REDEEMABLE COMMON STOCK

Of the shares of common stock issued in connection with the acquisitions (see Note 13), 1,215,000 included a put option to require the Company to repurchase the shares in May 2000 at stipulated amounts. The put options expired upon completion of the Company's initial public offering of common stock. As of May 31, 1995, 681,667 of these shares were outstanding and presented as mandatorily redeemable common stock on the consolidated balance sheet. All of these shares were converted into common stock during the seven months ended December 31, 1995.

## 10. TRANSACTIONS WITH RELATED PARTIES

### Tenet

Prior to August 1994, the Company maintained an intercompany payable/receivable account with Tenet to fund operating cash requirements or to concentrate excess cash at Tenet for investment purposes. The Company was charged interest on balances payable to Tenet; however, interest was not earned on receivable balances. No interest was incurred during the years ended May 31, 1993, 1994 and 1995 and the seven months ended December 31, 1995.

The Company was charged an overhead allocation for services rendered on its behalf by Tenet. For the year ended May 31, 1993, Tenet charged the Company \$235,000 primarily based on an estimation of services directly provided to the Company and secondarily on a ratio of the Company's gross revenues to total Tenet consolidated gross revenues. For the year ended May 31, 1994, the charge of \$1,458,000 was based on a ratio of the Company's operating costs to total Tenet consolidated operating costs through February 28, 1994. There were no overhead costs charged after February 28, 1994. These amounts have been included in general and administrative expenses.



The Company also provides dialysis services to Tenet hospital patients under agreements with terms of one to three years. The contract terms are comparable to contracts with unrelated third parties. Included in the receivable from Tenet are amounts related to these services of \$385,000, \$401,000 and \$432,000 at May 31, 1994 and 1995 and December 31, 1995, respectively. Net operating revenues received from Tenet for these services were \$2,084,000, \$2,248,000, \$2,130,000 and \$1,332,000 for the years ended May 31, 1993, 1994 and 1995 and the seven months ended December 31, 1995, respectively.

Prior to October 1994, company employees were eligible to participate in the Tenet Retirement Savings Plan, a defined contribution retirement plan, covering substantially all full-time employees, whereby employees' contributions to the plan were matched by the Company up to certain limits. Defined contributions made by the Company for the years ended May 31, 1993, 1994 and 1995 amounted to \$376,000, \$411,000 and \$152,000, respectively.

F-18

#### TOTAL RENAL CARE HOLDINGS, INC.

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(CONTINUED)

Prior to December 1994, the Company was insured for employee health coverage and a substantial portion of workers' compensation through self-insurance programs administered by Tenet. Additionally, all professional and general liability risks were insured by a wholly owned subsidiary of Tenet. The Company has no liability for employee health coverage claims incurred prior to December 31, 1994 or workers' compensation claims prior to August 11, 1994. Insurance expense under these programs amounted to \$2,263,000, \$2,962,000 and \$1,409,000 for years ended May 31, 1993, 1994 and 1995, respectively.

#### DLJMB

An affiliate of DLJMB was the underwriter for the initial public offering of common stock, the public debt offering of units comprising Senior Subordinated Discount Notes and Class B common stock and DLJMB participated in the change in control transaction in which DLJMB and certain employees acquired 74% of the Company. Fees for these transactions were \$7,245,000, \$2,496,000 and \$1,160,000, respectively.

#### 11. EMPLOYEE BENEFIT PLAN

The Company has a savings plan (the "Plan") for substantially all employees, which has been established pursuant to the provisions of Section 401(k) of the Internal Revenue Code ("IRC"). The Plan provides for employees to contribute from 1% to 15% of their base annual salaries on a tax-deferred basis not to exceed IRC limitations. The Company, in its sole discretion, may make a contribution under the Plan each fiscal year as determined by the Board of Directors. This contribution will be allocated for the year ended May 31, 1995 to each participant not eligible for participation in the 1994 Stock Plan (see Note 8) in proportion to the compensation paid during the year and the length of employment for each of the participants. For the year ended May 31, 1995 and the seven months ended December 31, 1995, the Company accrued contributions under the Plan in the amount of \$224,000 and \$268,000, respectively.

#### 12. CONTINGENCIES

The Company is subject to various claims and lawsuits in the ordinary course of business. In the opinion of management, the ultimate resolution of these matters will not have a material adverse effect on the Company's financial condition, results of operations or cash flows.

#### 13. ACQUISITIONS

Beginning in August 1994, the Company implemented an acquisition strategy which resulted in the acquisition of twenty-six facilities providing services to ESRD patients, three programs providing acute hospital in-patient dialysis services and one laboratory. In addition, during this period the Company developed six de novo facilities and entered into a management contract covering an additional facility.

The following is a summary of acquisitions activity:

	YEAR ENDED MAY 31, 1995	SEVEN MONTHS ENDED DECEMBER 31, 1995
Number of facilities.....	18	12
Number of common shares issued.....	297,464	742,820
Numbers of mandatorily redeemable shares issued....	681,667	
Number of common stock options issued.....		40,000
Estimated fair value of common shares issued..... \$	446,000	\$ 5,284,000
Estimated fair value of mandatorily redeemable shares issued.....	3,990,000	
Estimated fair value of common stock options issued.....		51,000
Payable to former owners of acquired facility.....		1,243,000
Cash paid.....	23,007,000	28,303,000
	-----	-----
Aggregate purchase price.....	\$27,443,000	\$34,881,000
	=====	=====

F-19

TOTAL RENAL CARE HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(CONTINUED)

All of the acquisitions were accounted for as purchases and, accordingly, the assets and liabilities of the acquired entities were recorded at their estimated fair market values at the dates of acquisition. These initial allocations resulted in other intangible assets of approximately \$4,807,000 and \$8,063,000 and goodwill of approximately \$18,782,000 and \$24,700,000 during the year ended May 31, 1995 and the seven months ended December 31, 1995, respectively. The results of operations of the facilities and laboratory have been included in the Company's financial statements from their respective acquisition dates.

The Company committed to issue 35,000 shares of common stock and \$263,000 of cash in connection with an acquisition that closed during December 1995. The shares were not issued until February 1996 and, accordingly, are not reported as outstanding at December 31, 1995. A liability of \$1,243,000 for these shares and cash is reflected in other liabilities at December 31, 1995.

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

Pro forma net income per share also gives effect to the August 11, 1994 recapitalization transaction as if it had occurred on June 1, 1994 as further described in Note 1:

	YEAR ENDED MAY 31, 1995	SEVEN MONTHS ENDED DECEMBER 31, 1995
	(UNAUDITED)	
Net revenues.....	\$120,503,000	\$96,552,000
Net income before extraordinary items.....	4,685,000	5,624,000
Pro forma net income per share before extraordinary items.....	0.29	0.31

The unaudited pro forma results are not necessarily indicative of what actually would have occurred if the acquisitions had been completed prior to

the beginning of the periods presented. In addition, they are not intended to be a projection of future results and do not reflect any of the synergies, additional revenue-generating services or direct facility operating expense reduction that might be achieved from combined operations.

During the period from January 1 to March 15, 1996, the Company entered into five agreements to acquire additional facilities which have either been consummated or which are expected to close imminently. The aggregate purchase price is \$71,100,000. The composition of the final purchase price is expected to be cash and proceeds from the Senior Credit Facility, however, a portion of the purchase price may consist of issuance of the Company's common stock.

F-20

TOTAL RENAL CARE HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(CONTINUED)

14. SUPPLEMENTAL CASH FLOW INFORMATION

The table below provides supplemental cash flow information:

	YEAR ENDED MAY 31, -----			SEVEN MONTHS ENDED DECEMBER 31, 1995
	1993	1994	1995	
Cash paid for:				
Income taxes.....	\$4,175,000	\$4,821,000	\$4,112,000	\$ 957,000
Interest.....	143,000	32,000	256,000	1,063,000
Noncash investing and financing activities:				
Notes receivable for issuance of common stock.....			1,508,000	1,330,000
Dividend of Tenet intercompany receivable.....			6,152,000	
Estimated value of stock and options issued in acquisitions.....			4,436,000	5,335,000
Fixed assets acquired under capital lease obligations...				1,483,000
Contribution to partnerships.				1,111,000

The Company has implemented a growth strategy which includes acquisitions. In conjunction with these acquisitions, the purchase price consisted of the following:

	YEAR ENDED MAY 31, 1995	SEVEN MONTHS ENDED DECEMBER 31, 1995
Fair value of assets acquired.....	\$ 30,434,000	\$ 39,561,000
Cash paid.....	(23,007,000)	(28,303,000)
Estimated value of common stock issued.....	(446,000)	(5,284,000)
Estimated value of mandatorily redeemable common stock issued.....	(3,990,000)	
Estimated value of common stock options issued..		(51,000)
Payable to former owners of acquired facilities.		(1,243,000)
	-----	-----
Liabilities assumed.....	\$ 2,991,000	\$ 4,680,000
	=====	=====

15. SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)

Summary unaudited quarterly financial data has been restated from the Company's filings on Form 10-Q to reflect the calendar quarters due to the

change in fiscal year-end and is summarized as follows (in thousands, except per share amounts):

	MARCH 31, 1995	JUNE 30, 1995	SEPTEMBER 30, 1995	DECEMBER 31, 1995
Net operating revenues.....	\$25,469	\$30,624	\$37,415	\$41,335
Operating income.....	4,286	6,248	7,776	8,356
Income before extraordinary item.....	1,001	1,898	2,485	3,285
Net income (see Note 6).....	1,001	1,898	2,485	730
Income before extraordinary item per share.....	0.07	0.12	0.16	0.16
Net income per share.....	0.07	0.12	0.16	0.04

F-21

TOTAL RENAL CARE HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(CONTINUED)

16. SUPPLEMENTAL CONDENSED CONSOLIDATING FINANCIAL INFORMATION

The following is summarized condensed consolidating financial information for the Company, segregating Guarantor Subsidiaries (Note 6) and Non-Guarantor Subsidiaries. In August 1994, five additional subsidiaries were included as Guarantor Subsidiaries under the revolving credit facility. The accompanying financial information in the "Guarantor Subsidiaries" column are those subsidiaries which were guarantors for that period. The guarantor subsidiaries are wholly-owned subsidiaries of the Company and guarantees are full, unconditional, and joint and several. Separate financial statements of the guarantor subsidiaries are not presented because management believes that these financial statements would not be material to investors.

BALANCE SHEETS

	MAY 31, 1994				
	TOTAL RENAL CARE HOLDINGS, INC.	GUARANTOR SUBSIDIARIES	NON-GUARANTOR SUBSIDIARIES	CONSOLIDATING ADJUSTMENTS	CONSOLIDATED TOTAL
Current assets					
Accounts receivable....	\$ 6,558,000	\$ 6,980,000			\$13,538,000
Receivable from NME....	9,427,000				9,427,000
Other current assets...	1,152,000	2,983,000			4,135,000
	-----	-----			-----
Total current assets.	17,137,000	9,963,000			27,100,000
Property and equipment, net.....	8,681,000	5,447,000			14,128,000
Investments in subsidiaries.....	\$34,733,000	26,889,000		\$ (61,622,000) (a)	
Advances to parent.....			18,603,000	(18,603,000) (b)	
Other assets, net.....	1,723,000	670,000			2,393,000
	-----	-----	-----	-----	-----
	\$34,733,000	\$54,430,000	\$34,683,000	\$ (80,225,000)	\$43,621,000
	=====	=====	=====	=====	=====
Current liabilities.....	\$ 483,000	\$ 6,553,000			\$ 7,036,000
Payable to subsidiaries.	18,603,000			\$ (18,603,000) (b)	
Long-term obligations...	611,000	187,000			798,000
Minority interests.....				1,054,000 (a)	1,054,000
Stockholders' equity....	\$34,733,000	34,733,000	27,943,000	(62,676,000) (a)	34,733,000
	-----	-----	-----	-----	-----
	\$34,733,000	\$54,430,000	\$34,683,000	\$ (80,225,000)	\$43,621,000
	=====	=====	=====	=====	=====

MAY 31, 1995

	TOTAL					CONSOLIDATED
	RENAL CARE	GUARANTOR	NON-GUARANTOR	CONSOLIDATING		TOTAL
	HOLDINGS, INC.	SUBSIDIARIES	SUBSIDIARIES	ADJUSTMENTS		
Current assets						
Accounts receivable....	\$ 291,000	\$19,660,000	\$3,701,000			\$ 23,652,000
Receivable from Tenet..		401,000				401,000
Other current assets...	89,000	3,844,000	1,820,000			5,753,000
	-----	-----	-----			-----
Total current assets.	380,000	23,905,000	5,521,000			29,806,000
Property and equipment, net.....	326,000	14,999,000	2,726,000			18,051,000
Investments in subsidiaries.....	35,970,000	1,512,000		\$ (37,482,000) (a)		
Advance to subsidiaries.	10,815,000			(10,815,000) (b)		
Other assets, net.....	3,287,000	26,188,000	226,000			29,701,000
	-----	-----	-----	-----		-----
	\$ 50,778,000	\$66,604,000	\$8,473,000	\$ (48,297,000)		\$ 77,558,000
	=====	=====	=====	=====		=====
Current liabilities.....	\$ 326,000	\$12,321,000	\$2,188,000			\$ 14,835,000
Payable to parent.....		7,316,000	3,499,000	\$ (10,815,000) (b)		
Long-term obligations...	77,341,000	10,997,000				88,338,000
Minority interests.....				1,274,000 (a)		1,274,000
Mandatorily redeemable common stock.....	3,990,000					3,990,000
Stockholders' equity (deficit).....	(30,879,000)	35,970,000	2,786,000	(38,756,000) (a)		(30,879,000)
	-----	-----	-----	-----		-----
	\$ 50,778,000	\$66,604,000	\$8,473,000	\$ (48,297,000)		\$ 77,558,000
	=====	=====	=====	=====		=====

F-22

TOTAL RENAL CARE HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(CONTINUED)

DECEMBER 31, 1995

	TOTAL					CONSOLIDATED
	RENAL CARE	GUARANTOR	NON-GUARANTOR	CONSOLIDATING		TOTAL
	HOLDINGS, INC.	SUBSIDIARIES	SUBSIDIARIES	ADJUSTMENTS		
Current assets						
Accounts receivable....	\$ 212,000	\$ 33,974,000	\$ 5,828,000			\$ 40,014,000
Receivable from Tenet..		432,000				432,000
Other current assets...	30,235,000	2,587,000	2,226,000			35,048,000
	-----	-----	-----			-----
Total current assets.	30,447,000	36,993,000	8,054,000			75,494,000
Property and equipment, net.....	625,000	19,882,000	4,998,000			25,505,000
Deposits and other.....	5,000	868,000	12,000			885,000
Investments in subsidiaries.....	43,151,000	3,429,000		\$ (46,580,000) (a)		
Advances to subsidiaries.....	59,429,000			(59,429,000) (b)		
Other assets, net.....	3,486,000	56,809,000	1,819,000			62,114,000
	-----	-----	-----	-----		-----
	\$137,143,000	\$117,981,000	\$14,883,000	\$ (106,009,000)		\$163,998,000
	=====	=====	=====	=====		=====
Current liabilities.....	\$ 519,000	\$ 16,848,000	\$ 3,436,000			\$ 20,803,000
Payable to parent.....		54,886,000	4,543,000	\$ (59,429,000) (b)		
Long-term obligations...	53,820,000	3,096,000	132,000			57,048,000
Minority interests.....				3,343,000 (a)		3,343,000
Stockholders' equity....	82,804,000	43,151,000	6,772,000	(49,923,000) (a)		82,804,000
	-----	-----	-----	-----		-----
	\$137,143,000	\$117,981,000	\$14,883,000	\$ (106,009,000)		\$163,998,000
	=====	=====	=====	=====		=====

F-23

## TOTAL RENAL CARE HOLDINGS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(CONTINUED)

## STATEMENTS OF INCOME

## YEAR ENDED MAY 31, 1993

	TOTAL RENAL CARE HOLDINGS, INC.	GUARANTOR SUBSIDIARIES	NON-GUARANTOR SUBSIDIARIES	CONSOLIDATING ADJUSTMENTS	CONSOLIDATED TOTAL
Net operating revenues..	\$ --	\$39,604,000	\$31,972,000		\$71,576,000
Operating expenses.....		33,791,000	26,425,000		60,216,000
	-----	-----	-----		-----
Operating income.....	--	5,813,000	5,547,000		11,360,000
Interest expense.....			9,000		9,000
Income taxes.....		2,141,000	1,988,000		4,129,000
Equity in earnings of subsidiaries.....		2,775,000		\$ (2,775,000) (a)	
Minority interests.....				(775,000) (b)	775,000
	-----	-----	-----	-----	-----
Net income.....	\$ --	\$ 6,447,000	\$ 3,550,000	\$ (3,550,000)	\$ 6,447,000
	=====	=====	=====	=====	=====

## YEAR ENDED MAY 31, 1994

	TOTAL RENAL CARE HOLDINGS, INC.	GUARANTOR SUBSIDIARIES	NON-GUARANTOR SUBSIDIARIES	CONSOLIDATING ADJUSTMENTS	CONSOLIDATED TOTAL
Net operating revenues..		\$43,707,000	\$36,763,000		\$80,470,000
Operating expenses.....		39,850,000	29,737,000		69,587,000
		-----	-----		-----
Operating income.....		3,857,000	7,026,000		10,883,000
Interest expense.....			13,000		13,000
Income taxes.....		1,632,000	2,474,000		4,106,000
Equity in earnings of subsidiaries.....	\$5,718,000	3,493,000		\$ (9,211,000) (a)	
Minority interests.....				(1,046,000) (b)	1,046,000
	-----	-----	-----	-----	-----
Net income.....	\$5,718,000	\$ 5,718,000	\$ 4,539,000	\$ (10,257,000)	\$ 5,718,000
	=====	=====	=====	=====	=====

## YEAR ENDED MAY 31, 1995

	TOTAL RENAL CARE HOLDINGS, INC.	GUARANTOR SUBSIDIARIES	NON-GUARANTOR SUBSIDIARIES	CONSOLIDATING ADJUSTMENTS	CONSOLIDATED TOTAL
Net operating revenues..	\$ 453,000	\$76,894,000	\$21,621,000		\$98,968,000
Operating expenses.....	(2,270,000)	67,537,000	16,542,000		81,809,000
	-----	-----	-----		-----
Operating income.....	2,723,000	9,357,000	5,079,000		17,159,000
Interest expense.....	6,947,000	255,000	1,000		7,203,000
Income taxes.....	(1,687,000)	3,740,000	1,458,000		3,511,000
Equity in earnings of subsidiaries.....	7,389,000	2,027,000		\$ (9,416,000) (a)	
Minority interests.....				(1,593,000) (b)	1,593,000
	-----	-----	-----	-----	-----
Net income.....	\$ 4,852,000	\$ 7,389,000	\$ 3,620,000	\$ (11,009,000)	\$ 4,852,000
	=====	=====	=====	=====	=====

SEVEN MONTHS ENDED DECEMBER 31, 1995

	TOTAL RENAL CARE HOLDINGS, INC.	GUARANTOR SUBSIDIARIES	NON-GUARANTOR SUBSIDIARIES	CONSOLIDATING ADJUSTMENTS	CONSOLIDATED TOTAL
Net operating revenues..	\$ 612,000	\$67,815,000	\$21,284,000		\$89,711,000
Operating expenses.....	(2,823,000)	58,313,000	15,755,000		71,245,000
Operating income.....	3,435,000	9,502,000	5,529,000		18,466,000
Interest expense.....	4,623,000	992,000	(31,000)		5,584,000
Income taxes.....	(475,000)	3,532,000	1,574,000		4,631,000
Equity in earnings of subsidiaries.....	7,180,000	2,202,000		\$ (9,382,000) (a)	
Minority interests.....				(1,784,000) (b)	1,784,000
Income before extraordinary item.....	6,467,000	7,180,000	3,986,000	(11,166,000)	6,467,000
Extraordinary item.....	2,555,000				2,555,000
Net income.....	\$ 3,912,000	\$ 7,180,000	\$ 3,986,000	\$ (11,166,000)	\$ 3,912,000

F-24

TOTAL RENAL CARE HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(CONTINUED)

STATEMENTS OF CASH FLOWS

	YEAR ENDED MAY 31, 1993				
	TOTAL RENAL CARE HOLDINGS, INC.	GUARANTOR SUBSIDIARIES	NON-GUARANTOR SUBSIDIARIES	CONSOLIDATING ADJUSTMENTS	CONSOLIDATED TOTAL
CASH FLOWS PROVIDED BY OPERATING ACTIVITIES					
Net income.....	\$ --	\$ 6,447,000	\$ 3,550,000	\$ (3,550,000) (a)	\$ 6,447,000
Adjustments to net income:					
Depreciation and amortization.....		1,813,000	1,621,000		3,434,000
Provision for doubtful accounts...		1,310,000	740,000		2,050,000
Equity in earnings of subsidiaries.....		(2,775,000)		2,775,000 (a)	
Other items.....		(3,770,000)	(866,000)	775,000 (a) (467,000) (b)	(4,328,000)
Net cash provided by operating activities.....	--	3,025,000	5,045,000	(467,000)	7,603,000
CASH FLOWS FROM INVESTING ACTIVITIES					
Purchases of property and equipment.....		(3,213,000)	(927,000)		(4,140,000)
Other items.....		5,000	541,000		546,000
Net cash used in investing activities.....	--	(3,208,000)	(386,000)	--	(3,594,000)
CASH FLOWS FROM FINANCING ACTIVITIES					
Advances to Tenet.....		(4,330,000)			(4,330,000)
Advances to parent....			(4,048,000)	4,048,000 (c)	
Payable to subsidiaries.....		4,048,000		(4,048,000) (c)	
Other items.....			(649,000)		(649,000)
Net cash used in financing activities.....	--	(282,000)	(4,697,000)	--	(4,979,000)

Net decrease in cash...	-----	-----	-----	-----	-----
Cash at beginning of year.....		(465,000)	(38,000)	(467,000)	(970,000)
		465,000	718,000		1,183,000
Cash at end of year....	\$ --	\$ --	\$ 680,000	\$ (467,000) (b)	\$ 213,000
	=====	=====	=====	=====	=====

F-25

TOTAL RENAL CARE HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(CONTINUED)

(Table continued from previous page)

	YEAR ENDED MAY 31, 1994				
	TOTAL RENAL CARE HOLDINGS, INC.	GUARANTOR SUBSIDIARIES	NON-GUARANTOR SUBSIDIARIES	CONSOLIDATING ADJUSTMENTS	CONSOLIDATED TOTAL
CASH FLOWS PROVIDED BY OPERATING ACTIVITIES					
Net income.....	\$ 5,718,000	\$ 5,718,000	\$ 4,539,000	\$ (10,257,000) (a)	\$ 5,718,000
Adjustments to net income:					
Depreciation and amortization.....		2,076,000	1,676,000		3,752,000
Provision for doubtful accounts...		1,302,000	248,000		1,550,000
Equity in earnings of subsidiaries.....	(5,718,000)	(3,493,000)		9,211,000 (a)	
Other items.....		(1,534,000)	1,413,000	1,046,000 (a)	1,042,000
				467,000 (b)	
				(350,000) (b)	
Net cash provided by operating activities.....	--	4,069,000	7,876,000	117,000	12,062,000
CASH FLOWS FROM INVESTING ACTIVITIES					
Purchases of property and equipment.....		(2,877,000)	(1,503,000)		(4,380,000)
Other items.....		(114,000)	130,000		16,000
Net cash used in investing activities.....	--	(2,991,000)	(1,373,000)	--	(4,364,000)
CASH FLOWS FROM FINANCING ACTIVITIES					
Advances to Tenet.....		(5,604,000)			(5,604,000)
Advances to parent....			(4,526,000)	4,526,000 (c)	
Advances from subsidiaries.....		4,526,000		(4,526,000) (c)	
Other items.....			(858,000)		(858,000)
Net cash used in financing activities.....	--	(1,078,000)	(5,384,000)	--	(6,462,000)
Net increase in cash...			1,119,000	117,000	1,236,000
Cash at beginning of year.....			680,000	(467,000) (b)	213,000
Cash at end of year....	\$ --	\$ --	\$ 1,799,000	\$ (350,000) (b)	\$ 1,449,000
	=====	=====	=====	=====	=====

F-26



## TOTAL RENAL CARE HOLDINGS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(CONTINUED)

(Table continued from previous page)

	YEAR ENDED MAY 31, 1995				
	TOTAL RENAL CARE HOLDINGS, INC.	GUARANTOR SUBSIDIARIES	NON-GUARANTOR SUBSIDIARIES	CONSOLIDATING ADJUSTMENTS	CONSOLIDATED TOTAL
CASH FLOWS PROVIDED BY OPERATING ACTIVITIES					
Net income.....	\$ 4,852,000	\$ 7,389,000	\$ 3,620,000	\$(11,009,000)	\$ 4,852,000
Adjustments to net income:					
Depreciation and amortization.....	289,000	3,517,000	934,000		4,740,000
Provision for doubtful accounts...		2,089,000	282,000		2,371,000
Equity in earnings of subsidiaries.....	(7,389,000)	(2,027,000)		9,416,000 (a)	
Noncash interest.....	6,947,000				6,947,000
Other items.....	(57,000)	(3,221,000)	(2,156,000)	1,593,000	(3,841,000)
	-----	-----	-----	-----	-----
Net cash provided by operating activities.....	4,642,000	7,747,000	2,680,000	--	15,069,000
	-----	-----	-----	-----	-----
CASH FLOWS FROM INVESTING ACTIVITIES					
Purchases of property and equipment.....	(337,000)	(3,109,000)	(389,000)		(3,835,000)
Cash paid for acquisitions.....		(22,476,000)			(22,476,000)
Other items.....	(7,000)	(292,000)	3,000		(296,000)
	-----	-----	-----	-----	-----
Net cash used in investing activities.....	(344,000)	(25,877,000)	(386,000)	--	(26,607,000)
	-----	-----	-----	-----	-----
CASH FLOWS FROM FINANCING ACTIVITIES					
Advances from Tenet...		2,874,000			2,874,000
Intercompany advances.	(6,379,000)	2,880,000	3,499,000		
Net proceeds from debt offering.....	66,841,000				66,841,000
Net proceeds from bank credit facility.....		9,253,000			9,253,000
Net proceeds from issuance of common stock.....	10,742,000				10,742,000
Cash dividends to Tenet.....	(75,500,000)				(75,500,000)
Non-guarantor distributions.....		4,359,000	(6,067,000)		(1,708,000)
Principal payments on long-term obligations.....		(351,000)	(16,000)		(367,000)
	-----	-----	-----	-----	-----
Net cash (used in) provided by financing activities.....	(4,296,000)	19,015,000	(2,584,000)	--	12,135,000
	-----	-----	-----	-----	-----
Net increase (decrease) in cash.....	2,000	885,000	(290,000)		597,000
Cash at beginning of year.....		(312,000)	1,761,000		1,449,000
	-----	-----	-----	-----	-----
Cash at end of year....	\$ 2,000	\$ 573,000	\$ 1,471,000	\$ --	\$ 2,046,000
	=====	=====	=====	=====	=====

## TOTAL RENAL CARE HOLDINGS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(CONTINUED)

(Table continued from previous page)

	SEVEN MONTHS ENDED DECEMBER 31, 1995				
	TOTAL RENAL CARE HOLDINGS, INC.	GUARANTOR SUBSIDIARIES	NON-GUARANTOR SUBSIDIARIES	CONSOLIDATING ADJUSTMENTS	CONSOLIDATED TOTAL
CASH FLOWS PROVIDED BY (USED IN) OPERATING ACTIVITIES					
Net income.....	\$ 3,912,000	\$ 7,180,000	\$3,986,000	\$ (11,166,000)	\$ 3,912,000
Adjustments to net income:					
Depreciation and amortization.....	236,000	3,653,000	494,000		4,383,000
Extraordinary item...	4,258,000				4,258,000
Provision for doubtful accounts...		1,301,000	510,000		1,811,000
Equity in earnings of subsidiaries.....	(7,180,000)	(2,202,000)		9,382,000	
Noncash interest.....	5,228,000				5,228,000
Other items.....	(125,000)	(13,568,000)	(1,406,000)	1,784,000	(13,315,000)
Net cash provided by (used in) operating activities.....	6,329,000	(3,636,000)	3,584,000	--	6,277,000
CASH FLOWS FROM INVESTING ACTIVITIES					
Purchase of property and equipment.....	(366,000)	(1,811,000)	(1,571,000)		(3,748,000)
Cash paid for acquisitions.....		(28,303,000)			(28,303,000)
Issuance of long-term note receivable.....	(1,379,000)				(1,379,000)
Investment in affiliate.....		(972,000)			(972,000)
Other items.....	(76,000)	(852,000)	200,000		(728,000)
Net cash used in investing activities.....	(1,821,000)	(31,938,000)	(1,371,000)	--	(35,130,000)
CASH FLOWS FROM FINANCING ACTIVITIES					
Intercompany advances.	(43,390,000)	42,346,000	1,044,000		
Cash paid to retire debt.....	(31,912,000)				(31,912,000)
Payment of bank credit facility, net.....		(10,284,000)			(10,284,000)
Net proceeds from issuance of common stock.....	98,941,000				98,941,000
Income tax benefit related to stock options exercised....	1,792,000				1,792,000
Distributions to minority interest....		2,100,000	(3,202,000)		(1,102,000)
Cash received on notes receivable from shareholders.....	175,000				175,000
Other items.....		(843,000)	221,000		(622,000)
Net cash provided by (used in) financing activities.....	25,606,000	33,319,000	(1,937,000)	--	56,988,000
Net increase (decrease) in cash.....	30,114,000	(2,255,000)	276,000		28,135,000

Cash at beginning of year.....	2,000	573,000	1,471,000		2,046,000
	-----	-----	-----	-----	-----
Cash at end of year....	\$30,116,000	\$ (1,682,000)	\$1,747,000	\$ --	\$30,181,000
	=====	=====	=====	=====	=====

F-28

TOTAL RENAL CARE HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(CONTINUED)

Investments in subsidiaries in the foregoing condensed consolidating financial statements are accounted for under the equity method of accounting.

Consolidating adjustments to the condensed consolidating balance sheet include the following:

- (a) Elimination of investments in subsidiaries and recording of minority interest
- (b) Elimination of intercompany accounts

Consolidating adjustments to the condensed consolidating statements of income include the following:

- (a) Elimination of equity in earnings of subsidiaries
- (b) Recognition of minority interests in income of consolidated subsidiaries

Consolidating adjustments to the condensed consolidating statements of cash flows include the following:

- (a) Elimination of equity in earnings of subsidiaries and recognition of minority interests in income of consolidated subsidiaries
- (b) Reclassification of bank overdrafts
- (c) Elimination of intercompany accounts

F-29

17. SUBSEQUENT EVENTS (UNAUDITED)

- A. Effective March 1, 1996, the Company purchased substantially all of the assets and assumed certain specified liabilities of the Nephrology Services Business of Caremark International, Inc. (the "Caremark Acquisition") and two centers located in South Carolina for each consideration of \$49 million and \$8.2 million, respectively.

The transactions were recorded under the purchase method of accounting and the results of operations from March 1, 1996 have been recognized in the accompanying financial statements. Goodwill of \$21.5 million and \$5.9 million, respectively, was recorded in connection with these transactions and will be amortized over their estimated lives in accordance with the Company's existing accounting policies.

During the quarter ended June 30, 1996, the Company purchased substantially all of the assets and assumed certain specified liabilities of two unrelated centers in Maryland for cash consideration of \$8.0 million and \$2.9 million, respectively. Goodwill of \$5.8 million and \$2.6 million was recorded in connection with these transactions in accordance with the Company's existing accounting policies.

During the period January 1, 1996 through June 30, 1996, the Company also purchased selected net assets of an existing dialysis company for \$6.4 million and two existing dialysis companies for \$2.6 million and contributed those assets during the formation of three unrelated general partnerships. Aggregate goodwill associated with these transactions was \$7.3 million.

The Company entered into two management agreements with two additional unaffiliated centers, one in each of the quarters ended June 30, 1996 and March 31, 1996, respectively.

During the quarter ended September 30, 1996, the Company purchased substantially all of the assets and assumed certain liabilities of eleven centers for total consideration of \$43.9 million consisting of cash of \$42.1 million and common stock valued at \$1.8 million. Goodwill of \$33.7 million was recorded in connection with these transactions in accordance with the Company's existing accounting policies.

The results of operations on a pro forma basis as though the above acquisitions had been combined with the Company at the beginning of each period presented for the nine months ended September 30, are as follows:

	1995	1996
	-----	-----
Pro forma net operating revenues.....	\$180,978	\$232,902
	=====	=====
Pro forma net income.....	\$ 1,965	\$ 6,548
	=====	=====
Pro forma earnings per share.....	\$ 0.13	\$ 0.26
	=====	=====

B. On April 3, 1996, the Company completed an equity offering of 8,050,000 shares of common stock, 3,500,000 of which were sold for the Company's account and 4,550,000 of which were sold by certain of the Company's stockholders. The net proceeds to the Company of \$110.1 million were used to repay borrowings incurred under the Company's senior credit facility in connection with the Caremark Acquisition or were invested in short-term, investment grade instruments to be used for future acquisitions, de novo developments, routine capital expenditures, and other general corporate purposes.

C. Effective October 17, 1996, the Company refinanced its prior bank credit facility with the senior credit facility which permits borrowings of up to \$400,000,000 (the "Senior Credit Facility"). Under the Senior Credit Facility, up to \$50,000,000 may be used in connection with letters of credit, and up to \$15,000,000 in short-term funds may be borrowed the same day notice is given to the banks under a "Swing Line" facility. In general, borrowings under the Senior Credit Facility bear interest at one of two floating rates selected by the Company: (i) the Alternate Base Rate (defined as the higher of The Bank of New York's prime rate or the federal funds rate plus 0.5%); and (ii) Adjusted LIBOR (defined as the 30-, 60-, 90- or 180-day London Interbank Offered Rate, adjusted for statutory reserves) plus a margin that ranges from 0.45% to 1.25% depending on the Company's leverage ratio. Swing Line borrowings bear interest at either a rate negotiated by the Company and the banks at the time of borrowing or, if no rate is negotiated and agreed, the Alternate Base Rate. Maximum borrowings under the Senior Credit Facility will be reduced by

F-30

\$50,000,000 on September 30, 2000, \$75,000,000 on September 30, 2001, and another \$75,000,000 on September 30, 2002, and the Senior Credit Facility terminates on September 30, 2003. The Senior Credit Facility contains financial and operating covenants including, among other things, requirements that the Company maintain certain financial ratios and satisfy certain financial tests, and imposes limitations on the Company's ability to make capital expenditures, to incur other indebtedness and to pay dividends. As of the date hereof, the Company is in compliance with all such covenants.

D. In July and September 1996, the Company irrevocably purchased and subsequently retired its remaining outstanding Discount Notes for \$68.4 million, including consent payments of \$1.1 million. Including the writedown of related bond issuance costs of \$1.9 million, and \$474,000 in related transaction costs, the Company recognized an extraordinary loss, net of taxes, of approximately \$7.7 million in the quarter ending September 30, 1996.

E. Subsequent to September 30, 1996, the Company completed acquisitions of or entered into letters of intent to acquire nine facilities for consideration of approximately \$35.9 million, which will primarily be

funded by borrowings under the Senior Credit Facility. In addition, the Company has agreed to purchase the minority interest in one of its existing centers.

F-31

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TABLE OF CONTENTS

	PAGE
Prospectus Summary.....	3
Risk Factors.....	7
Recent Facility Network Expansion.....	12
Use of Proceeds.....	14
Price Range of Common Stock.....	14
Dividend Policy.....	14
Capitalization.....	15
Selected Financial and Operating Data.....	16
Management's Discussion and Analysis of Financial Condition and Results of Operations.....	18
Business.....	27
Management.....	46
Principal and Selling Stockholders.....	48
Certain Relationships and Related Transactions.....	51
Description of Capital Stock.....	53
Underwriting.....	54
Legal Matters.....	55
Experts.....	55
Available Information.....	56
Documents Incorporated by Reference.....	57
Index to Financial Statements.....	F-1

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2,500,000 SHARES

[LOGO OF TOTAL RENAL CARE HOLDINGS, INC.]

TOTAL RENAL CARE  
HOLDINGS, INC.

COMMON STOCK  
  
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PROSPECTUS

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DONALDSON, LUFKIN & JENRETTE  
SECURITIES CORPORATION

MERRILL LYNCH & CO.

UBS SECURITIES

OCTOBER 31, 1996

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