

DAVITA HEALTHCARE PARTNERS INC.

Form 10-Q

November 06, 2014

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**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-Q**

**For the Quarterly Period Ended September 30, 2014**

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF**

**THE SECURITIES EXCHANGE ACT OF 1934**

**Commission File Number: 1-14106**

**DAVITA HEALTHCARE PARTNERS INC.**

**2000 16<sup>th</sup> Street**

**Denver, CO 80202**

**Telephone number (303) 405-2100**

**Delaware**  
**(State of incorporation)**

**51-0354549**  
**(I.R.S. Employer**

**Identification No.)**

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)

Smaller reporting company

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

As of October 31, 2014, the number of shares of the Registrant's common stock outstanding was approximately 214.9 million shares and the aggregate market value of the common stock outstanding held by non-affiliates based upon the closing price of these shares on the New York Stock Exchange was approximately \$16.8 billion.

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**DAVITA HEALTHCARE PARTNERS INC.**  
**CONSOLIDATED STATEMENTS OF INCOME**

(unaudited)

(dollars in thousands, except per share data)

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2014	2013	2014	2013
Patient service revenues	\$ 2,242,533	\$ 2,126,699	\$ 6,543,880	\$ 6,155,223
Less: Provision for uncollectible accounts	(98,971)	(74,477)	(270,220)	(216,725)
Net patient service revenues	2,143,562	2,052,222	6,273,660	5,938,498
Capitated revenues	848,546	747,264	2,435,480	2,219,953
Other revenues	259,716	200,100	757,949	542,390
Total net revenues	3,251,824	2,999,586	9,467,089	8,700,841
Operating expenses and charges:				
Patient care costs and other costs	2,326,534	2,095,334	6,752,844	6,070,545
General and administrative	322,822	305,138	905,519	857,658
Depreciation and amortization	149,196	132,765	437,682	389,263
Provision for uncollectible accounts	3,961	1,498	9,680	3,636
Equity investment income	(5,225)	(9,223)	(18,692)	(26,239)
Loss contingency reserve	17,000	97,000	17,000	397,000
Contingent earn-out obligation adjustment				(56,977)
Total operating expenses and charges	2,814,288	2,622,512	8,104,033	7,634,886
Operating income	437,536	377,074	1,363,056	1,065,955
Debt expense	(99,878)	(108,421)	(312,345)	(322,334)
Debt refinancing charges			(97,548)	
Other (loss) income, net	(1,246)	2,113	2,145	1,337
Income from continuing operations before income taxes	336,412	270,766	955,308	744,958
Income tax expense	116,628	100,930	342,366	245,266
Income from continuing operations	219,784	169,836	612,942	499,692
Discontinued operations:				
Loss from operations of discontinued operations, net of tax				(139)
				13,375

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<b>Gain on disposal of discontinued operations, net of tax</b>				
Net income	219,784	169,836	612,942	512,928
Less: Net income attributable to noncontrolling interests	(35,662)	(33,208)	(97,848)	(91,760)
Net income attributable to DaVita HealthCare Partners Inc.	\$ 184,122	\$ 136,628	\$ 515,094	\$ 421,168
<b>Earnings per share:</b>				
Basic income from continuing operations per share attributable to DaVita HealthCare Partners Inc.	\$ 0.87	\$ 0.65	\$ 2.43	\$ 1.95
Basic net income per share attributable to DaVita HealthCare Partners Inc.	\$ 0.87	\$ 0.65	\$ 2.43	\$ 2.01
Diluted income from continuing operations per share attributable to DaVita HealthCare Partners Inc.	\$ 0.85	\$ 0.64	\$ 2.38	\$ 1.90
Diluted net income per share attributable to DaVita HealthCare Partners Inc.	\$ 0.85	\$ 0.64	\$ 2.38	\$ 1.96
<b>Weighted average shares for earnings per share:</b>				
Basic	212,617,238	210,394,560	212,086,735	209,725,439
Diluted	217,236,493	214,902,860	216,695,033	214,631,587
<b>Amounts attributable to DaVita HealthCare Partners Inc.:</b>				
Income from continuing operations	\$ 184,122	\$ 136,628	\$ 515,094	\$ 407,919
Discontinued operations				13,249
Net income	\$ 184,122	\$ 136,628	\$ 515,094	\$ 421,168

See notes to condensed consolidated financial statements.

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**DAVITA HEALTHCARE PARTNERS INC.**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

(unaudited)

(dollars in thousands)

	<b>Three months ended September 30,</b>		<b>Nine months ended September 30,</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
Net income	\$ 219,784	\$ 169,836	\$ 612,942	\$ 512,928
Other comprehensive income (loss), net of tax:				
Unrealized gains (losses) on interest rate swap and cap agreements:				
Unrealized gain (loss) on interest rate swap and cap agreements	537	(7,733)	(7,177)	1,583
Reclassifications of net swap and cap agreements realized loss into net income	1,403	3,464	9,759	9,433
Unrealized (loss) gains on investments:				
Unrealized (loss) gain on investments	(392)	648	517	1,367
Reclassification of net investment realized gains into net income			(207)	(94)
Foreign currency translation adjustments	(13,838)	2,741	(11,871)	(1,206)
Other comprehensive (loss) income	(12,290)	(880)	(8,979)	11,083
Total comprehensive income	207,494	168,956	603,963	524,011
Less: Comprehensive income attributable to noncontrolling interests	(35,662)	(33,208)	(97,848)	(91,760)
Comprehensive income attributable to DaVita HealthCare Partners Inc.	\$ 171,832	\$ 135,748	\$ 506,115	\$ 432,251

See notes to condensed consolidated financial statements.

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

	<b>September 30, 2014</b>	<b>December 31, 2013</b>
<b>ASSETS</b>		
Cash and cash equivalents	\$ 1,527,035	\$ 946,249
Short-term investments	142,122	6,801
Accounts receivable, less allowance of \$235,192 and \$237,143	1,468,563	1,485,163
Inventories	114,677	88,805
Other receivables	346,712	349,090
Other current assets	172,255	176,414
Income tax receivable		10,315
Deferred income taxes	407,071	409,441
Total current assets	4,178,435	3,472,278
Property and equipment, net of accumulated depreciation of \$1,997,894 and \$1,778,259	2,359,203	2,189,411
Intangibles, net of accumulated amortization of \$577,124 and \$483,773	1,997,772	2,024,373
Equity investments	66,728	40,686
Long-term investments	87,307	79,557
Other long-term assets	67,330	79,598
Goodwill	9,344,641	9,212,974
	<b>\$ 18,101,416</b>	<b>\$ 17,098,877</b>
<b>LIABILITIES AND EQUITY</b>		
Accounts payable	\$ 442,183	\$ 435,465
Other liabilities	503,198	464,422
Accrued compensation and benefits	761,912	603,013
Medical payables	306,076	287,452
Loss contingency reserve	414,000	397,000
Current portion of long-term debt	121,530	274,697
Income tax payable	48,732	
Total current liabilities	2,597,631	2,462,049
Long-term debt	8,380,903	8,141,231
Other long-term liabilities	368,475	380,337
Deferred income taxes	844,189	812,419
Total liabilities	12,191,198	11,796,036

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Commitments and contingencies		
Noncontrolling interests subject to put provisions	758,743	697,300
Equity:		
Preferred stock (\$0.001 par value, 5,000,000 shares authorized; none issued)		
Common stock (\$0.001 par value, 450,000,000 shares authorized; 214,878,274 and 213,163,248 shares issued and outstanding at September 30, 2014 and at December 31, 2013, respectively)		
	215	213
Additional paid-in capital	1,107,368	1,070,922
Retained earnings	3,879,083	3,363,989
Accumulated other comprehensive loss	(11,624)	(2,645)
Total DaVita HealthCare Partners Inc. shareholders equity	4,975,042	4,432,479
Noncontrolling interests not subject to put provisions	176,433	173,062
Total equity	5,151,475	4,605,541
	\$ 18,101,416	\$ 17,098,877

See notes to condensed consolidated financial statements.



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**DAVITA HEALTHCARE PARTNERS INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(unaudited)

(dollars in thousands)

	Nine months ended	
	2014	September 30, 2013
<b>Cash flows from operating activities:</b>		
Net income	\$ 612,942	\$ 512,928
Adjustments to reconcile net income to cash provided by operating activities:		
Loss contingency reserve	17,000	397,000
Depreciation and amortization	437,335	389,387
Debt refinancing charges	97,548	
Stock-based compensation expense	44,323	47,095
Tax benefits from stock award exercises	45,527	40,870
Excess tax benefits from stock award exercises	(32,665)	(31,722)
Deferred income taxes	(2,167)	(52,085)
Equity investment income, net	6,007	1,074
Other non-cash charges (income) and loss on disposal of assets	30,604	(54,203)
Changes in operating assets and liabilities, other than from acquisitions and divestitures:		
Accounts receivable	16,610	20,856
Inventories	(25,198)	(5,494)
Other receivables and other current assets	7,563	(35,757)
Other long-term assets	2,622	17,861
Accounts payable	2,332	(71,581)
Accrued compensation and benefits	147,570	114,877
Other current liabilities	72,932	91,503
Income taxes	72,283	(15,212)
Other long-term liabilities	(23,770)	51,757
<b>Net cash provided by operating activities</b>	<b>1,529,398</b>	<b>1,419,154</b>
<b>Cash flows from investing activities:</b>		
Additions of property and equipment, net	(443,507)	(399,527)
Acquisitions	(218,117)	(234,802)
Proceeds from asset and business sales	3,620	62,282
Purchase of investments available for sale	(7,138)	(6,630)
Purchase of investments held-to-maturity	(163,046)	(1,034)
Proceeds from sale of investments available for sale	1,321	1,091
Proceeds from sale of investments held-to-maturity	27,781	1,376

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Purchase of intangible assets and equity investment	(50)	(53)
Purchase of an equity investment	(32,483)	
Distributions received on equity investments	434	211
<b>Net cash used in investing activities</b>	<b>(831,185)</b>	<b>(577,086)</b>
<b>Cash flows from financing activities:</b>		
Borrowings	46,619,292	49,941,883
Payments on long-term debt and other financing costs	(46,587,984)	(50,325,455)
Deferred financing costs and debt redemption costs	(122,154)	(719)
Distributions to noncontrolling interests	(105,143)	(99,736)
Stock award exercises and other share issuances, net	14,524	12,432
Excess tax benefits from stock award exercises	32,665	31,722
Contributions from noncontrolling interests	38,083	30,041
Proceeds from sales of additional noncontrolling interests	3,777	6,083
Purchases from noncontrolling interests	(12,069)	(474)
<b>Net cash used in financing activities</b>	<b>(119,009)</b>	<b>(404,223)</b>
Effect of exchange rate changes on cash and cash equivalents	1,582	(899)
<b>Net increase in cash and cash equivalents</b>	<b>580,786</b>	<b>436,946</b>
<b>Cash and cash equivalents at beginning of the year</b>	<b>946,249</b>	<b>533,748</b>
<b>Cash and cash equivalents at end of the year</b>	<b>\$ 1,527,035</b>	<b>\$ 970,694</b>

See notes to condensed consolidated financial statements.

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**DAVITA HEALTHCARE PARTNERS INC.**  
**CONSOLIDATED STATEMENTS OF EQUITY**  
**(unaudited)**  
**(dollars and shares in thousands)**

	Non- controlling interests subject to put provisions	Common stock	DaVita HealthCare Partners Inc. Shareholders				Equity Accumulated other comprehensive income (loss)	Total	Non- controlling interests not subject to put provisions	
			Additional paid-in capital	Retained earnings	Treasury stock					
Balance at December 31, 2012	\$ 580,692	269,725	\$ 270	\$ 1,208,665	\$ 3,731,835	(58,728)	\$ (1,162,336)	\$ (15,297)	\$ 3,763,137	\$ 153,784
Comprehensive income:										
Net income	78,215			633,446					633,446	45,540
Other comprehensive income							12,652		12,652	
Stock purchase shares issued		238		12,817					12,817	
Stock unit shares issued		7		(3,286)		164	3,247		(39)	
Stock-settled RSR shares issued		313		(29,025)		1,444	28,561		(464)	
Stock-based compensation expense				59,998					59,998	
Less tax benefits from stock awards exercised				36,197					36,197	
Contributions to non-controlling interests	(80,353)									(58,974)
Contributions from non-controlling interests	22,053									14,979

es and assumptions of additional controlling interests	23,642			(1,442)				(1,442)	10,77	
urchases from controlling interests	(512)			(3,119)				(3,119)	(14	
piration of option and er	(7,141)								7,14	
classification changes in fair value of controlling interests	80,704			(80,704)				(80,704)		
treasury stock reimbursement		(57,120)	(57)	(129,179)	(1,001,292)	57,120	1,130,528			
Balance at December 31, 2013	\$ 697,300	213,163	\$ 213	\$ 1,070,922	\$ 3,363,989		\$	\$ (2,645)	\$ 4,432,479	\$ 173,00
Comprehensive income:										
Net income	65,262				515,094				515,094	32,58
Other comprehensive income								(8,979)	(8,979)	
Stock unit shares issued		298		(27)					(27)	
Stock-settled RSU shares vested		1,417	2	(2)						
Stock-based compensation expense				44,323					44,323	
Less tax benefits from stock awards exercised				32,665					32,665	
Contributions to controlling interests	(67,150)									(37,99
Contributions from controlling interests	26,926									11,15
Reserves and assumptions of additional controlling interests	852			355					355	4,16

Interests										
Acquisition and										
Interests from										
controlling										
Interests	(4,809)			(716)				(716)		(6,525)
Adjustment in										
ownership										
Interests				210				210		
Changes in fair										
value of										
controlling										
Interests	40,362			(40,362)				(40,362)		
Balance at										
September 30,										
2014	\$ 758,743	214,878	\$ 215	\$ 1,107,368	\$ 3,879,083	\$		\$ (11,624)	\$ 4,975,042	\$ 176,437

See notes to condensed consolidated financial statements

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**DAVITA HEALTHCARE PARTNERS INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(unaudited)**

(dollars and shares in thousands, except per share data)

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

**1. Condensed consolidated interim financial statements**

The condensed consolidated interim financial statements included in this report are prepared by the Company without audit. In the opinion of management, all adjustments necessary for a fair presentation of the results of operations are reflected in these consolidated interim financial statements. All significant intercompany accounts and transactions have been eliminated. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. The most significant estimates and assumptions underlying these financial statements and accompanying notes generally involve the accrual of an estimated loss contingency reserve and its impact on the Company's income taxes, revenue recognition and accounts receivable, impairments of long-lived assets, fair value estimates, accounting for income taxes, variable compensation accruals, consolidation of variable interest entities, purchase accounting valuation estimates, long-term incentive program compensation and medical liability claims. The results of operations for the nine months ended September 30, 2014 are not necessarily indicative of the operating results for the full year. The condensed consolidated interim financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2013. Prior year balances and amounts have been reclassified to conform to the current year presentation. The Company has evaluated subsequent events through the date these condensed consolidated financial statements were issued and has included all necessary adjustments and disclosures.

**2. Earnings per share**

Basic net income per share is calculated by dividing net income attributable to the Company, adjusted for any change in noncontrolling interests redemption rights in excess of fair value, by the weighted average number of common shares and vested stock units outstanding. Diluted net income per share includes the dilutive effect of outstanding stock-settled stock appreciation rights and unvested stock units (under the treasury stock method).

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(dollars and shares in thousands, except per share data)

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

	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
<b>Basic:</b>				
Income from continuing operations attributable to DaVita HealthCare Partners Inc.	\$ 184,122	\$ 136,628	\$ 515,094	\$ 407,919
Increase in noncontrolling interests redemption rights in excess of fair value		259		
Income from continuing operations for basic earnings per share calculation	\$ 184,122	\$ 136,887	\$ 515,094	\$ 407,919
Discontinued operations attributable to DaVita HealthCare Partners Inc.				13,249
Net income attributable to DaVita HealthCare Partners Inc. for basic earnings per share calculation	\$ 184,122	\$ 136,887	\$ 515,094	\$ 421,168
Weighted average shares outstanding during the period	214,810	212,584	214,280	211,914
Vested stock units	1	5	1	5
Contingently returnable shares held in escrow for the DaVita HealthCare Partners merger	(2,194)	(2,194)	(2,194)	(2,194)
Weighted average shares for basic earnings per share calculation	212,617	210,395	212,087	209,725
Basic income from continuing operations per share attributable to DaVita HealthCare Partners Inc.	\$ 0.87	\$ 0.65	\$ 2.43	\$ 1.95
Basic income from discontinued operations per share attributable to DaVita HealthCare Partners Inc.	\$	\$	\$	\$ 0.06
<b>Basic net income per share attributable to DaVita HealthCare Partners Inc.</b>	<b>\$ 0.87</b>	<b>\$ 0.65</b>	<b>\$ 2.43</b>	<b>\$ 2.01</b>

**Diluted:**

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Income from continuing operations attributable to DaVita HealthCare Partners Inc.	\$ 184,122	\$ 136,628	\$ 515,094	\$ 407,919
Increase in noncontrolling interests redemption rights in excess of fair value		259		
Income from continuing operations for diluted earnings per share calculation	\$ 184,122	\$ 136,887	\$ 515,094	\$ 407,919
Discontinued operations attributable to DaVita HealthCare Partners Inc.				13,249
Net income attributable to DaVita HealthCare Partners Inc. for diluted earnings per share calculation	\$ 184,122	\$ 136,887	\$ 515,094	\$ 421,168
Weighted average shares outstanding during the period	214,810	212,584	214,280	211,914
Vested stock units	1	5	1	5
Assumed incremental shares from stock plans	2,425	2,314	2,414	2,713
Weighted average shares for diluted earnings per share calculation	217,236	214,903	216,695	214,632
Diluted income from continuing operations per share attributable to DaVita HealthCare Partners Inc.	\$ 0.85	\$ 0.64	\$ 2.38	\$ 1.90
Diluted income from discontinued operations per share attributable to DaVita HealthCare Partners Inc.	\$	\$	\$	\$ 0.06
<b>Diluted net income per share attributable to DaVita HealthCare Partners Inc.</b>	<b>\$ 0.85</b>	<b>\$ 0.64</b>	<b>\$ 2.38</b>	<b>\$ 1.96</b>
Anti-dilutive stock-settled awards excluded from calculation <sup>(1)</sup>	1,422	4,908	1,804	3,871

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



**Table of Contents****DAVITA HEALTHCARE PARTNERS INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)****(unaudited)**

(dollars and shares in thousands, except per share data)

**3. Accounts receivable**

Accounts receivable are reduced by an allowance for doubtful accounts. In evaluating the ultimate collectability of the Company's accounts receivable, the Company analyzes its historical cash collection experience and trends for each of its government payors and commercial payors to estimate the adequacy of the allowance for doubtful accounts and the amount of the provision for uncollectible accounts. Management regularly updates its analysis based upon the most recent information available to determine its current provision for uncollectible accounts and the adequacy of its allowance for doubtful accounts. For receivables associated with dialysis patient services covered by government payors, like Medicare, the Company receives 80% of the payment directly from Medicare as established under the government's bundled payment system and determines an appropriate allowance for doubtful accounts and provision for uncollectible accounts on the remaining balance due depending upon the Company's estimate of the amounts ultimately collectible from other secondary coverage sources or from the patients. For receivables associated with services to patients covered by commercial payors that are either based upon contractual terms or for non-contracted health plan coverage, the Company provides an allowance for doubtful accounts by recording a provision for uncollectible accounts based upon its historical collection experience, potential inefficiencies in its billing processes and for which collectability is determined to be unlikely. Approximately 1% of the Company's net accounts receivable are associated with patient pay and it is the Company's policy to record an allowance for 100% of these outstanding dialysis accounts receivable balances when those amounts due are outstanding for more than four months.

During the nine months ended September 30, 2014, the Company's allowance for doubtful accounts decreased by approximately \$1,951. This was primarily due to an increase in Medicare and commercial collections, partially offset by an increase in dialysis provision for uncollectible accounts. There were no unusual transactions impacting the allowance for doubtful accounts.

**4. Investments in debt and equity securities and other investments**

Based on the Company's intentions and strategy concerning investments in debt securities, the Company classifies certain debt securities as held-to-maturity and records them at amortized cost. Equity securities that have readily determinable fair values, including those of mutual funds, common stock and other debt securities, are classified as available-for-sale and recorded at fair value.

The Company's investments in securities consist of the following:

<b>September 30, 2014</b>			<b>December 31, 2013</b>		
<b>Held to maturity</b>	<b>Available for sale</b>	<b>Total</b>	<b>Held to</b>	<b>Available for sale</b>	<b>Total</b>

	<b>maturity</b>					
Certificates of deposit and money market funds due within one year	\$ 140,722	\$	\$ 140,722	\$ 5,601	\$	\$ 5,601
Investments in mutual funds and common stock		26,237	26,237		19,421	19,421
	\$ 140,722	\$ 26,237	\$ 166,959	\$ 5,601	\$ 19,421	\$ 25,022
Short-term investments	\$ 140,722	\$ 1,400	\$ 142,122	\$ 5,601	\$ 1,200	\$ 6,801
Long-term investments		24,837	24,837		18,221	18,221
	\$ 140,722	\$ 26,237	\$ 166,959	\$ 5,601	\$ 19,421	\$ 25,022

**Table of Contents****DAVITA HEALTHCARE PARTNERS INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)****(unaudited)**

(dollars and shares in thousands, except per share data)

The cost of the certificates of deposit and money market funds at September 30, 2014 and December 31, 2013 approximates their fair value. As of September 30, 2014 and December 31, 2013, the available-for-sale investments included \$5,594 and \$5,096 of gross pre-tax unrealized gains, respectively. During the nine months ended September 30, 2014, the Company recorded gross pre-tax unrealized gains of \$838, or \$517 after tax, in other comprehensive income associated with changes in the fair value of these investments. During the nine months ended September 30, 2014, the Company sold investments in mutual funds for net proceeds of \$1,321 and recognized a pre-tax gain of \$340, or \$207 after-tax, which was previously recorded in other comprehensive income. During the nine months ended September 30, 2013, the Company sold investments in mutual funds for net proceeds of \$1,091 and recognized a pre-tax gain of \$155, or \$94 after-tax, which was previously recorded in other comprehensive income.

The investments in mutual funds classified as available-for-sale are held within a trust to fund existing obligations associated with several of the Company's non-qualified deferred compensation plans.

As of September 30, 2014, the Company held \$5,000 of preferred stock in a privately held company that is accounted for under the cost method as this investment does not have a readily determinable fair value.

Certain HCP entities are required to maintain minimum cash balances in order to comply with regulatory requirements in conjunction with medical claim reserves. As of September 30, 2014, this minimum cash balance was approximately \$56,000.

**5. Goodwill**

Changes in goodwill by reportable segments were as follows:

	<b>Nine months ended September 30, 2014</b>			<b>Consolidated total</b>
	<b>U.S. dialysis and related lab services</b>	<b>HCP</b>	<b>Other-ancillary services and strategic initiatives</b>	
Balance at December 31, 2013	\$ 5,469,473	\$ 3,516,162	\$ 227,339	\$ 9,212,974
Acquisitions	85,779	48,548	12,072	146,399
Divestitures	(1,851)			(1,851)
Other adjustments		(2,277)	(10,604)	(12,881)
Balance at September 30, 2014	\$ 5,553,401	\$ 3,562,433	\$ 228,807	\$ 9,344,641

## Year ended December 31, 2013

	U.S. dialysis and related lab services	HCP	Other-ancillary services and strategic initiatives	Consolidated total
Balance at December 31, 2012	\$ 5,309,152	\$ 3,506,571	\$ 137,027	\$ 8,952,750
Acquisitions	163,037	17,833	90,397	271,267
Divestitures	(2,728)			(2,728)
Other adjustments	12	(8,242)	(85)	(8,315)
Balance at December 31, 2013	\$ 5,469,473	\$ 3,516,162	\$ 227,339	\$ 9,212,974

Each of the Company's operating segments described in Note 16 to these condensed consolidated financial statements represents an individual reporting unit for goodwill impairment testing purposes, except that each sovereign jurisdiction within our international operations segments is considered a separate reporting unit.

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Within the U.S. dialysis and related lab services operating segment, the Company considers each of its dialysis centers to constitute an individual business for which discrete financial information is available. However, since these dialysis centers have similar operating and economic characteristics, and the allocation of resources and significant investment decisions concerning these businesses are highly centralized and the benefits broadly distributed, the Company has aggregated these centers and deemed them to constitute a single reporting unit.

The Company has applied a similar aggregation to the HCP operations in each region, to the vascular access service centers in its vascular access services reporting unit, to the physician practices in its physician services reporting unit, and to the dialysis centers within each sovereign international jurisdiction. For the Company's additional operating segments, no component below the operating segment level is considered a discrete business and therefore these operating segments directly constitute individual reporting units.

HCP's current and expected future operating results have been eroded, primarily as a result of recent reductions in its Medicare Advantage reimbursement rates. As a result, the Company has determined that three of its HCP reporting units, HCP California, HCP Nevada and HCP New Mexico, are at risk of goodwill impairment. HCP California, HCP Nevada and HCP New Mexico have goodwill of \$2,511,477, \$517,618, and \$72,130, respectively.

The Company's preliminary valuations of these three businesses as of September 30, 2014, resulted in the estimated fair values of HCP California, HCP Nevada and HCP New Mexico exceeding their total carrying values by approximately 5.3%, 11.3% and 8.3%, respectively. Further reductions in HCP's reimbursement rates or other significant adverse changes in its expected future cash flows or valuation assumptions could result in a goodwill impairment charge in the future.

For example, a sustained, long-term reduction of 3% in operating income for HCP California, HCP Nevada and HCP New Mexico could reduce their estimated fair values by up to 2.4%, 2.9% and 2.7%, respectively. Separately, an increase in their respective discount rates of 100 basis points could reduce the estimated fair values of HCP California, HCP Nevada and HCP New Mexico by up to 5.1%, 6.0% and 5.7%, respectively.

During the first nine months of 2014, the Company did not record any goodwill impairment charges. Except as described above, none of the goodwill associated with the Company's various other reporting units was considered at risk of impairment as of September 30, 2014. Since the dates of the Company's last annual goodwill impairment tests, there have been certain developments, events, changes in operating performance and other changes in key circumstances that have affected the Company's businesses. However, these did not cause management to believe it is more likely than not that the fair value of any of its reporting units would be less than its carrying amount.

**6. Health care costs payable**

The health care costs shown in the following table include estimates for the cost of professional medical services provided by non-employed physicians and other providers, as well as inpatient and other ancillary costs for all markets, where state regulation allows for the assumption of global risk. Health care costs payable are included in medical payables.

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The following table shows the components of changes in the health care costs payable for the nine months ended September 30, 2014:

	<b>Nine months ended September 30, 2014</b>
Health care costs payable, beginning of the period	\$ 172,310
Add: Components of incurred health care costs	
Current year	1,180,740
Prior years	6,442
<b>Total incurred health care costs</b>	<b>1,187,182</b>
Less: Claims paid	
Current year	993,731
Prior years	156,525
<b>Total claims paid</b>	<b>1,150,256</b>
Health care costs payable, end of the period	\$ 209,236

Our prior year estimates of health care costs payable increased by \$6,442 resulting from certain medical claims being settled for amounts more than originally estimated. When significant increases (decreases) in prior-year health care cost estimates occur that we believe significantly impact our current year operating results, we disclose that amount as unfavorable (favorable) development of prior-year's health care cost estimates. Actual claim payments for prior year services have not been materially different from our year-end estimates.

**7. Income taxes**

As of September 30, 2014, the Company's total liability for unrecognized tax benefits relating to tax positions that do not meet the more-likely-than-not threshold is \$33,207, all of which would impact the Company's effective tax rate if recognized. This balance represents a decrease of \$27,331 from the December 31, 2013 balance of \$60,538, of which \$27,427 is due to a change of accounting method and did not impact the Company's effective tax rate.

The Company recognizes accrued interest and penalties related to unrecognized tax benefits in its income tax expense. At September 30, 2014 and December 31, 2013, the Company had approximately \$10,802 and \$10,742, respectively,

accrued for interest and penalties related to unrecognized tax benefits, net of federal tax benefits.



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**8. Long-term debt**

Long-term debt was comprised of the following:

	<b>September 30, 2014</b>	<b>December 31, 2013</b>
<b>Senior Secured Credit Facilities:</b>		
New Term Loan A	\$ 987,500	\$
New Term Loan B	3,491,250	
Prior Term Loan A		800,000
Prior Term Loan A-3		1,282,500
Prior Term Loan B		1,697,500
Prior Term Loan B-2		1,633,500
Senior notes	3,775,000	2,800,000
Acquisition obligations and other notes payable	70,847	67,352
Capital lease obligations	194,689	152,751
<b>Total debt principal outstanding</b>	<b>8,519,286</b>	<b>8,433,603</b>
Discount on long-term debt	(16,853)	(17,675)
	8,502,433	8,415,928
Less current portion	(121,530)	(274,697)
	<b>\$ 8,380,903</b>	<b>\$ 8,141,231</b>

Scheduled maturities and pay-outs of long-term debt at September 30, 2014 were as follows:

2014 (remainder of the year)	35,170
2015	113,185
2016	116,633
2017	142,834
2018	154,782
2019	728,303

Thereafter	7,228,379
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During the first nine months of 2014, the Company made mandatory principal payments under its then existing Senior Secured Credit Facilities (before entering into a new senior secured credit agreement and repaying all outstanding amounts under the then existing Senior Secured Credit Facilities) totaling \$37,500 on the Term Loan A, \$16,875 on the Term Loan A-3, \$4,375 on the Term Loan B and \$4,125 on the Term Loan B-2. During the third quarter of 2014 we made mandatory principal payments under our New Senior Secured Credit Facility (the New Credit Agreement), as described below, totaling \$12,500 on the New Term Loan A and \$8,750 on the New Term Loan B.

In June 2014, the Company entered into a \$5,500,000 senior secured credit agreement. The New Credit Agreement consists of a five year Revolving Credit Facility in the aggregate principal amount of \$1,000,000 (the New Revolver), a five year Term Loan A facility in the aggregate principal amount of \$1,000,000 (the New Term Loan A) and a seven year Term Loan B facility in the aggregate principal amount of \$3,500,000 (the New Term Loan B and collectively with the New Revolver and the New Term Loan A, the New Loans). In addition, the

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Company can increase the existing revolving commitments and enter into one or more incremental term loan facilities in an amount not to exceed the sum of \$1,500,000 (less the amount of other permitted indebtedness incurred or issued in reliance on such amount), plus an amount of indebtedness such that the senior secured leverage ratio is not in excess of 3.50 to 1.00 after giving effect to such borrowings. The New Revolver and the New Term Loan A initially bear interest at LIBOR plus an interest rate margin of 1.75% which is subject to adjustment depending upon the Company's leverage ratio and can range from 1.50% to 2.00%. The New Term Loan A requires annual principal payments beginning on September 30, 2014 of \$25,000 in 2014, \$50,000 in 2015, \$62,500 in 2016, \$87,500 in 2017 and \$100,000 in 2018 with the balance of \$675,000 due in 2019. The New Term Loan B bears interest at LIBOR (Floor of 0.75%) plus an interest rate margin of 2.75%. The New Term Loan B requires annual principal payments of \$17,500 in 2014 and \$35,000 for each year from 2015 through 2020, with the balance of \$3,272,500 due in 2021. These New Loans under the New Credit Agreement are guaranteed by certain of the Company's direct and indirect wholly-owned domestic subsidiaries holding most of the Company's domestic assets and are secured by substantially all of the Company's and the guarantors' assets. The New Credit Agreement contains certain customary affirmative and negative covenants such as various restrictions or limitations on the amount of investments, acquisitions, the payment of dividends and redemptions and the incurrence of other indebtedness. Many of these restrictions and limitations will not apply as long as the Company's leverage ratio is below 3.50 to 1.00. In addition, the New Credit Agreement places limitations on the amount of tangible net assets of the non-guarantor subsidiaries and also requires compliance with a maximum leverage ratio covenant.

In addition, in June 2014, the Company issued \$1,750,000 5 1/8% Senior Notes due 2024 (the 5 1/8% Senior Notes). The 5 1/8% Senior Notes pay interest on January 15 and July 15 of each year beginning January 15, 2015. The 5 1/8% Senior Notes are unsecured obligations and will rank equally in right of payment with our existing and future unsecured senior indebtedness. The 5 1/8% Senior Notes are guaranteed by each of the Company's domestic subsidiaries that guarantees the Company's New Credit Agreement. The Company may redeem up to 35% of the 5 1/8% Senior Notes at any time prior to July 15, 2017 at a certain specified price from the proceeds of one or more equity offerings. In addition, the Company may redeem the 5 1/8% Senior Notes at any time prior to July 15, 2019 at make whole redemption prices and after such date at certain specified redemption prices.

The Company received total proceeds from these borrowings of \$6,250,000, \$4,500,000 from the issuance of the New Term Loans and \$1,750,000 from the issuance of the 5 1/8% Senior Notes. The Company used a portion of the proceeds to pay off the total outstanding principal balances under its then existing Senior Secured Credit Facilities plus accrued interest totaling \$5,362,428 and in addition, to purchase pursuant to a cash tender offer \$483,093 of the outstanding principal balances of the Company's \$775,000 6 3/8% Senior Notes due 2018 (6 3/8% Senior Notes) plus accrued interest and cash tender premium totaling \$512,386. The total amount paid for the 6 3/8% Senior Notes from the cash tender offer was \$1,051.25 per 1,000 of principal amount of the 6 3/8% Senior Notes, which resulted in the Company paying a cash tender premium of \$24,759 for the redemption of this portion of the 6 3/8% Senior Notes. The Company also incurred an additional \$81,569 in fees, discounts and other professional expenses associated with these transactions.

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In July 2014, the Company also purchased an additional \$188 principal amount of the 6 <sup>3</sup>/<sub>8</sub>% Senior Notes plus accrued interest totaling \$194 pursuant to the cash tender offer at a price of \$1,021.25 per 1,000 of principal amount of the 6 <sup>3</sup>/<sub>8</sub>% Senior Notes, which resulted in the Company paying an additional cash tender premium of \$4.

In addition, in July 2014, the Company redeemed the remaining outstanding principal balance of the 6 <sup>3</sup>/<sub>8</sub>% Senior Notes of \$291,719 at a redemption price of \$1,047.81 per 1,000 of principal amount of the 6 <sup>3</sup>/<sub>8</sub>% Senior

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Notes plus accrued interest and a redemption premium which totaled \$309,954. This resulted in an additional redemption premium of \$13,947 being recorded as debt refinancing charges.

In addition, the Company terminated \$1,137,500 notional amounts of amortizing swaps and also terminated \$600,000 of forward swaps during June 2014, that resulted in the Company recognizing a loss of \$3,140, of which \$2,972 was previously recorded in other comprehensive income due to the Company's previously outstanding principal debt being paid-off as described above, and as a result of future forecasted transactions that are no longer probable. The loss is included as a component of the Company's debt refinancing charges. During the nine months ended September 30, 2014, the Company recognized debt expense of \$6,137 from these swaps.

As a result of these transactions, the Company recorded debt refinancing charges of \$97,548 that consist of the cash tender premiums, the redemption premium, the write-off of existing deferred financing costs, the write-off of certain new refinancing costs, other professional fees and losses associated with the termination of several of the Company's interest rate swap agreements.

The Company has entered into several interest rate swap agreements as a means of hedging its exposure to and volatility from variable-based interest rate changes as part of its overall interest rate risk management strategy. These agreements are not held for trading or speculative purposes and have the economic effect of converting the LIBOR variable component of the Company's interest rate to a fixed rate. These swap agreements are designated as cash flow hedges, and as a result, hedge-effective gains or losses resulting from changes in the fair values of these swaps are reported in other comprehensive income until such time as the hedged forecasted cash flows occur, at which time the amounts are reclassified into net income. Net amounts paid or received for each specific swap tranche that have settled have been reflected as adjustments to debt expense. In addition, the Company has entered into several interest rate cap agreements that have the economic effect of capping the Company's maximum exposure to LIBOR variable interest rate changes on specific portions of the Company's floating rate debt, as described below. Certain cap agreements are also designated as cash flow hedges and, as a result, changes in the fair values of these cap agreements are reported in other comprehensive income. Certain other cap agreements are ineffective cash flow hedges, and as a result, changes in the fair value of these cap agreements are reported in net income. The amortization of the original cap premium is recognized as a component of debt expense on a straight-line basis over the term of the cap agreements. The swap and cap agreements do not contain credit-risk contingent features.

As of September 30, 2014, the Company maintains several interest rate swap agreements that were entered into in March 2013 with amortizing notional amounts of these swap agreements totaling \$866,875. These agreements have the economic effect of modifying the LIBOR variable component of the Company's interest rate on an equivalent amount of the Company's New Term Loan A to fixed rates ranging from 0.49% to 0.52%, resulting in an overall weighted average effective interest rate of 2.26%, including the New Term Loan A margin of 1.75%. The overall weighted average effective interest rate also includes the effects of \$120,625 of unhedged New Term Loan A debt that bears interest at LIBOR plus an interest rate margin of 1.75%. The swap agreements expire on September 30, 2016

and require monthly interest payments. During the nine months ended September 30, 2014, the Company recognized debt expense of \$2,387 from these swaps. As of September 30, 2014, the total fair value of these swap agreements was a net asset of approximately \$2,702. The Company estimates that approximately \$2,035 of existing unrealized pre-tax losses in other comprehensive income at September 30, 2014 will be reclassified into income over the next twelve months.

As of September 30, 2014, the Company maintains several interest rate cap agreements that were entered into in March 2013 with notional amounts totaling \$2,735,000 on the Company's New Term Loan B debt. These

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agreements have the economic effect of capping the LIBOR variable component of the Company's interest rate at a maximum of 2.50% on an equivalent amount of the Company's New Term Loan B. During the nine months ended September 30, 2014, the Company recognized debt expense of \$1,829 from these caps. The cap agreements expire on September 30, 2016. As of September 30, 2014, the total fair value of these cap agreements was an asset of approximately \$2,514. During the nine months ended September 30, 2014, the Company recorded a loss of \$5,052 in other comprehensive income due to a decrease in the unrealized fair value of these cap agreements.

Previously, the Company maintained five other interest rate cap agreements with notional amounts totaling \$1,250,000. These agreements had the economic effect of capping the LIBOR variable component of our interest rate at a maximum of 4.00% on an equivalent amount of our New Term Loan B debt. However, these interest rate cap agreements expired on September 30, 2014. During the nine months ended September 30, 2014, the Company recognized \$2,691 of debt expense related to these cap agreements.

The following table summarizes the Company's derivative instruments as of September 30, 2014 and December 31, 2013:

<b>Derivatives designated as hedging instruments</b>	<b>September 30, 2014</b>		<b>December 31, 2013</b>	
	<b>Balance sheet location</b>	<b>Fair value</b>	<b>Balance sheet location</b>	<b>Fair value</b>
Interest rate swap agreements	Other short-term liabilities	\$ 2,035	Other short-term liabilities	\$ 12,069
Interest rate swap agreements	Other long-term assets	\$ 4,737	Other long-term assets	\$ 10,004
Interest rate cap agreements	Other long-term assets	\$ 2,514	Other long-term assets	\$ 7,567

The following table summarizes the effects of the Company's interest rate swap and cap agreements for the three and nine months ended September 30, 2014 and 2013:

<b>Derivatives designated as cash flow hedges</b>	<b>Amount of gains (losses) recognized in OCI on interest rate swap and cap agreements</b>		<b>Location of losses reclassified from accumulated OCI into income</b>	<b>Amount of losses reclassified from accumulated OCI into income</b>	
	<b>Three months ended September 30,</b>	<b>Nine months ended September 30,</b>		<b>Three months ended September 30,</b>	<b>Nine months ended September 30,</b>

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	2014	2013	2014	2013		2014	2013	2014	2013
Interest rate swap agreements	\$ 1,058	\$ (10,010)	\$ (6,728)	\$ 2,292	Debt expense (including refinancing charges)	\$ (795)	\$ (4,162)	\$ (11,495)	\$ (11,528)
Interest rate cap agreements	(178)	(2,646)	(5,052)	299	Debt expense (including refinancing charges)	(1,507)	(1,507)	(4,521)	(3,911)
Tax benefit (expense)	(343)	4,923	4,603	(1,008)		899	2,205	6,257	6,006
Total	\$ 537	\$ (7,733)	\$ (7,177)	\$ 1,583		\$ (1,403)	\$ (3,464)	\$ (9,759)	\$ (9,433)

As of September 30, 2014, the interest rate on the Company's New Term Loan B debt is effectively fixed because of an embedded LIBOR floor which is higher than actual LIBOR as of such date and the New Term Loan B is also subject to interest rate caps if LIBOR should rise above 2.50%. See above for further details.



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Interest rates on the Company's senior notes are fixed by their terms. The LIBOR variable component of the Company's interest rate on a majority of the Company's New Term Loan A is economically fixed as a result of interest rate swaps.

As a result of embedded LIBOR floors on the New Term Loan B debt agreement and the swap and cap agreements, the Company's overall weighted average effective interest rate on the Senior Secured Credit Facilities was 3.43%, based upon the current margins in effect of 1.75% for the New Term Loan A and 2.75% for the New Term Loan B, as of September 30, 2014.

The Company's overall weighted average effective interest rate during the third quarter of 2014 was 4.52% and as of September 30, 2014 was 4.46%.

As of September 30, 2014, the Company had undrawn revolving credit facilities totaling \$1,000,000 of which approximately \$96,000 was committed for outstanding letters of credit. In addition, HCP has an outstanding letter of credit of approximately \$1,000 that is secured by a certificate of deposit.

**9. Contingencies**

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

***Inquiries by the Federal Government and Certain Related Civil Proceedings***

**Vainer Private Civil Suit:** In December 2008, the Company received a subpoena for documents from the Office of Inspector General (OIG) for the U.S. Department of Health and Human Services (HHS) relating to the pharmaceutical products Zemplar, Hectorol, Venofer, Ferrlecit and erythropoietin (EPO), as well as other related matters. The subpoena covered the period from January 2003 to December 2008. The Company has been in contact with the U.S. Attorney's Office for the Northern District of Georgia and the U.S. Department of Justice in Washington, DC since November 2008 relating to this matter, and has been advised that this was a civil inquiry. On June 17, 2009, the Company learned that the allegations underlying this inquiry were made as part of a civil complaint filed by individuals and brought pursuant to the *qui tam* provisions of the federal False Claims Act. On April 1, 2011, the U.S. District Court for the Northern District of Georgia ordered the case to be unsealed. At that time, the Department of Justice and U.S. Attorney's Office filed a notice of declination stating that the federal government would not be

intervening and not pursuing the relators' allegation in litigation. On July 25, 2011, the relators, Daniel Barbir and Dr. Alon Vainer, filed their amended complaint in the U.S. District Court for the Northern District of Georgia, purportedly on behalf of the federal government. The allegations in the complaint relate to the Company's drug administration practices for the Company's dialysis operations for Vitamin D and iron agents for a period from 2003 through 2010. The complaint seeks monetary damages and civil penalties as well as costs and expenses. The Company is vigorously defending this matter and intends to continue to do so. The Company can make no assurances as to the time or resources that will be needed to devote to this litigation or its final outcome.

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2010 U.S. Attorney Physician Relationship Investigation: As previously disclosed, the U.S. Attorney's Office for the District of Colorado and the OIG have been investigating, among other things, the Company's financial relationships with physicians and joint ventures, and whether those relationships and joint ventures comply with the federal anti-kickback statute and the False Claims Act. This investigation has been described in the Company's prior Reports on Forms 10-K and 10-Q and referred to as the 2010 U.S. Attorney Physician Relationship Investigation. This investigation overlapped substantially with the investigation described below under the caption 2011 U.S. Attorney Physician Relationship Investigation. The Company disclosed earlier this year it had reached an agreement in principle with the government to resolve these matters.

As described more fully in the Company's current report on Form 8-K filed on October 23, 2014, the Company entered into a final settlement agreement on October 22, 2014 (the Settlement Agreement) with the United States of America, acting through the United States Department of Justice and on behalf of the OIG, the Defense Health Agency on behalf of TRICARE, through its General Counsel (collectively, the United States) and relator David Barbetta, to resolve the pending 2010 and 2011 U.S. Attorney Physician Relationship Investigations. In connection with the resolution of these matters, the Company has agreed to pay to the United States \$350 million plus accrued interest from the date of the Company's agreement in principle with the United States, plus a civil forfeiture of \$39 million. In addition, the Company has agreed in principle to a settlement of certain state Medicaid claims in the amount of \$11.5 million plus interest. Under the Settlement Agreement, among other things, the United States agrees to release the Company from any civil or administrative monetary liability arising from allegations that the Company caused the submission of claims to the federal health care programs that were ineligible for reimbursement due to certain violations of the Anti-Kickback Statute in connection with certain of its dialysis center joint venture arrangements, and the United States and the relator agree to dismissal of the civil action filed by the relator under the *qui tam* provisions of the federal False Claims Act. The Company also has entered into a five-year corporate integrity agreement (the Corporate Integrity Agreement) with the OIG. The Corporate Integrity Agreement, among other things, (i) requires that the Company maintain certain elements of its compliance programs, (ii) imposes certain expanded compliance-related requirements during the term of the Corporate Integrity Agreement, including the appointment of a compliance monitor, and (iii) contains certain business restrictions related to a subset of the Company's joint venture arrangements, including the Company's agreeing to: (1) unwind 11 joint venture transactions that were created through partial divestitures to or partial acquisitions from nephrologists and that cover 26 of the Company's 2,119 clinics; (2) not enter into certain types of partial divestiture joint venture transactions with nephrologists during the term of the Corporate Integrity Agreement; and (3) certain other restrictions. In the event of a breach of the Corporate Integrity Agreement, the Company could become liable for payment of certain stipulated penalties, or could be excluded from participation in federal health care programs. The costs associated with compliance with the Corporate Integrity Agreement could be substantial and may be greater than we currently anticipate. In 2013, the Company accrued an estimated loss contingency reserve of \$397,000 related to this matter. In the third quarter of 2014, the Company accrued an additional \$17,000 related to this matter which resulted in an increase in the reserve from \$397,000 to \$414,000.

2011 U.S. Attorney Physician Relationship Investigation: In August 2011, the Company announced it had learned that the U.S. Attorney's Office for the District of Colorado would be investigating certain activities of its dialysis business in connection with information being provided to a grand jury. This investigation related to the Company's relationships with physicians, including its joint ventures, and whether those relationships and joint ventures comply with the federal anti-kickback statute, and overlapped substantially with the 2010 U.S. Attorney Physician Relationship Investigation described above. As described above, both the 2010 and 2011 U.S. Attorney Physician Relationship Investigations have now been resolved. The United States has informed the Company that it has declined to proceed with any criminal charges in connection with this matter.

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**2011 U.S. Attorney Medicaid Investigation:** In October 2011, the Company announced that it would be receiving a request for documents, which could include an administrative subpoena from the OIG. Subsequent to the Company's announcement of this 2011 U.S. Attorney Medicaid Investigation, the Company received a request for documents in connection with the inquiry by the U.S. Attorney's Office for the Eastern District of New York. The request relates to payments for infusion drugs covered by Medicaid composite payments for dialysis. It is the Company's understanding that this inquiry is civil in nature. The Company understands that certain other providers that operate dialysis clinics in New York may be receiving or have received a similar request for documents. The Company has cooperated with the government and produced the requested documents. In April 2014, we reached an agreement in principle to resolve this matter. The specific terms of a settlement have not been finalized.

**Swoben Private Civil Suit:** In April 2013, the Company's HealthCare Partners (HCP) subsidiary was served with a civil complaint filed by a former employee of SCAN Health Plan (SCAN), a health maintenance organization (HMO). On July 13, 2009, pursuant to the *qui tam* provisions of the federal False Claims Act and the California False Claims Act, James M. Swoben, as relator, filed a *qui tam* action in the United States District Court for the Central District of California purportedly on behalf of the United States of America and the State of California against SCAN, and certain other defendants whose identities were under seal. The allegations in the complaint relate to alleged overpayments received from government healthcare programs. In or about August 2012, SCAN entered into a settlement agreement with the United States of America and the State of California. The United States and the State of California partially intervened in the action for the purpose of settlement with and dismissal of the action against SCAN. In or about November 2011, the relator filed his Third Amended Complaint under seal alleging violations of the federal False Claims Act and the California False Claims Act, which named additional defendants, including HCP and certain health insurance companies (the defendant HMOs). The allegations in the complaint against HCP relate to patient diagnosis coding to determine reimbursement in the Medicare Advantage program, referred to as Hierarchical Condition Coding (HCC) and Risk Adjustment Factor (RAF) scores. The complaint sought monetary damages and civil penalties as well as costs and expenses. The United States Department of Justice reviewed these allegations and in January 2013 declined to intervene in the case. On June 26, 2013, HCP and the defendant HMOs filed their respective motions to dismiss the Third Amended Complaint pursuant to Federal Rules of Civil Procedure 12(b)(6) and 9(b), challenging the legal sufficiency of the claims asserted in the complaint. On July 30, 2013, the court granted HCP's motion and dismissed with prejudice all of the claims in the Third Amended Complaint and judgment was entered in September 2013. The court specifically determined that further amendments to the complaint would be futile because, in part, the allegations were publicly disclosed in reports and other sources relating to audits conducted by the Centers of Medicare & Medicaid Services. In October 2013, the plaintiff appealed to the United States Court of Appeals for the Ninth Circuit and the court's disposition of the appeal is pending.

Except for the private civil complaints filed by the relators as described above, to the Company's knowledge, no proceedings have been initiated against the Company at this time in connection with any of the inquiries by the federal government. Although the Company cannot predict whether or when proceedings might be initiated or when these matters may be resolved, it is not unusual for inquiries such as these to continue for a considerable period of time

through the various phases of document and witness requests and on-going discussions with regulators. Responding to the subpoenas or inquiries and defending the Company in the relator proceedings will continue to require management's attention and significant legal expense. Any negative findings in the inquiries or relator proceedings could result in substantial financial penalties or awards against the Company, exclusion from future participation in the Medicare and Medicaid programs and, to the extent criminal proceedings may be initiated against the Company, possible criminal penalties. At this time, the Company cannot predict the ultimate outcome of these inquiries, or the potential outcome of the relator's claims (except as described above), or the potential range of damages, if any.

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In re DaVita HealthCare Partners Inc. Derivative Litigation: On January 7, 2014, the U.S. District Court for the District of Colorado consolidated the two previously disclosed shareholder derivative lawsuits: the Haverhill Retirement System action filed on May 17, 2013 and the Clark Shareholder action filed on August 7, 2012. The court appointed Haverhill lead plaintiff. The complaints filed against the directors of the Company and against the Company, as nominal defendant allege, among other things, that our directors breached fiduciary duties to the Company relating to the 2010 and 2011 U.S. Attorney Physician Relationship Investigations described above, the Vainer qui tam private civil suit described above and the Woodard qui tam private civil suit for which the Company previously announced a settlement in July 2012. The Company has entered into a settlement with the lead plaintiff, subject to court approval. The terms of the settlement, which will be described in a court-approved notice, include enhancements to the Company's corporate governance practices and provides that the Company will not oppose the derivative plaintiff's application for an award of fees and expenses, the dollar amount of which is not material to the Company.

*Other*

The Company has received several notices of claims from commercial payors and other third parties related to historical billing practices and claims against DVA Renal Healthcare (formerly known as Gambro Healthcare), a subsidiary of the Company, related to historical Gambro Healthcare billing practices and other matters covered by its 2004 settlement agreement with the Department of Justice and certain agencies of the U.S. government. The Company has received no further indication that any of these claims are active, and some of them may be barred by applicable statutes of limitations. To the extent any of these claims might proceed, the Company intends to defend against them vigorously; however, the Company may not be successful and these claims may lead to litigation and any such litigation may be resolved unfavorably. At this time, the Company cannot predict the ultimate outcome of these matters or the potential range of damages, if any.

A wage and hour claim, which has been styled as a class action, is pending against the Company in the Superior Court of California. The Company was served with the complaint in this lawsuit in April 2008, and it has been amended since that time. The complaint, as amended, alleges that the Company failed to provide meal periods, failed to pay compensation in lieu of providing rest or meal periods, failed to pay overtime, and failed to comply with certain other California Labor Code requirements. In September 2011, the court denied the plaintiffs' motion for class certification. Plaintiffs appealed that decision. In January 2013, the Court of Appeals affirmed the trial court's decision on some claims, but remanded the case to the trial court for clarification of its decision on one of the claims. The Company reached an agreement with the plaintiffs to settle the claim that was remanded to the trial court, and that settlement has been finalized. The amount of the settlement is not material to the Company's consolidated financial statements. The Company intends to continue to vigorously defend against the remaining claims. Any potential settlement of the remaining claims is not anticipated to be material to the Company's consolidated financial statements.

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



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**10. Noncontrolling interests subject to put provisions and other commitments**

The Company has potential obligations to purchase the noncontrolling interests held by third parties in several of its majority-owned joint ventures, non-owned and minority-owned entities. These obligations are in the form of put provisions and are exercisable at the third-party owners' discretion within specified periods as outlined in each specific put provision. If these put provisions were exercised, the Company would be required to purchase the third-party owners' noncontrolling interests at either the appraised fair market value or a predetermined multiple of earnings or cash flow attributable to the noncontrolling interests put to the Company, which is intended to approximate fair value. The methodology the Company uses to estimate the fair values of noncontrolling interests subject to put provisions assumes the higher of either a liquidation value of net assets or an average multiple of earnings, based on historical earnings, patient mix and other performance indicators that can affect future results, as well as other factors. The estimated fair values of the noncontrolling interests subject to put provisions is a critical accounting estimate that involves significant judgments and assumptions and may not be indicative of the actual values at which the noncontrolling interests may ultimately be settled, which could vary significantly from the Company's current estimates. The estimated fair values of noncontrolling interests subject to put provisions can fluctuate and the implicit multiple of earnings at which these noncontrolling interests obligations may be settled will vary significantly depending upon market conditions including potential purchasers' access to the capital markets, which can impact the level of competition for dialysis and non-dialysis related businesses, the economic performance of these businesses and the restricted marketability of the third-party owners' noncontrolling interests. The amount of noncontrolling interests subject to put provisions that employ a contractually predetermined multiple of earnings rather than fair value are immaterial.

The Company has certain other potential commitments to provide operating capital to several dialysis centers that are wholly-owned by third parties or centers in which the Company owns a minority equity investment as well as to physician-owned vascular access clinics or medical practices that the Company operates under management and administrative service agreements of approximately \$2,000. In addition, the Company has certain other potential commitments related to service agreements of approximately \$1,000.

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

**11. Long-term incentive compensation**

Long-term incentive program (LTIP) compensation includes both stock-based awards (principally stock-settled stock appreciation rights, restricted stock units and performance stock units) as well as long-term performance-based cash

awards. Long-term incentive compensation expense, which was primarily general and administrative in nature, was attributed to the dialysis and related lab services business, the HCP business, corporate support costs, and the ancillary services and strategic initiatives.

The Company's stock-based compensation awards are measured at their estimated fair values on the date of grant if settled in shares or at their estimated fair values at the end of each reporting period if settled in cash. The value of stock-based awards so measured is recognized as compensation expense on a cumulative straight-line basis over the vesting terms of the awards, adjusted for expected forfeitures.

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During the nine months ended September 30, 2014, the Company granted 1,502 stock-settled stock appreciation rights with an aggregate grant-date fair value of \$24,606 and a weighted-average expected life of approximately 4.2 years, and also granted 329 stock units with an aggregate grant-date fair value of \$23,767 and a weighted-average expected life of approximately 3.4 years, 105 of which are performance-based.

For the nine months ended September 30, 2014 and 2013, the Company recognized \$88,323 and \$58,204, respectively, in total LTIP expense, of which \$44,323 and \$47,095, respectively, was stock-based compensation expense for stock appreciation rights, stock units and discounted employee stock plan purchases, which are primarily included in general and administrative expenses. The estimated tax benefits recorded for stock-based compensation through September 30, 2014 and 2013 was \$16,075 and \$17,466, respectively. As of September 30, 2014, there was \$147,760 of total estimated unrecognized compensation cost for outstanding LTIP awards, including \$87,729 related to stock-based compensation arrangements under the Company's equity compensation and stock purchase plans. The Company expects to recognize the performance-based cash component of these LTIP costs over a weighted average remaining period of 1.1 years and the stock-based component of these LTIP costs over a weighted average remaining period of 1.4 years.

For the nine months ended September 30, 2014 and 2013, the Company received \$45,527 and \$40,870, respectively, in actual tax benefits upon the exercise of stock awards.

**12. Comprehensive income**

	For the three months ended September 30, 2014				For the nine months ended September 30, 2014			
	Interest rate swap and cap agreements	Investment securities	Foreign currency translation adjustments	Accumulated other comprehensive income (loss)	Interest rate swap and cap agreements	Investment securities	Foreign currency translation adjustments	Accumulated other comprehensive income (loss)
Beginning balance	\$ (1,702)	\$ 3,822	\$ (1,454)	\$ 666	\$ (2,344)	\$ 3,120	\$ (3,421)	\$ (2,645)
Unrealized gains (losses)	880	(567)	(13,838)	(13,525)	(11,780)	838	(11,871)	(22,813)
Related income tax (expense) benefit	(343)	175		(168)	4,603	(321)		4,282

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	537	(392)	(13,838)	(13,693)	(7,177)	517	(11,871)	(18,531)
Reclassification from accumulated other comprehensive income into net income	2,302			2,302	16,016	(340)		15,676
Related tax	(899)			(899)	(6,257)	133		(6,124)
	1,403			1,403	9,759	(207)		9,552
Ending balance	\$ 238	\$ 3,430	\$ (15,292)	\$ (11,624)	\$ 238	\$ 3,430	\$ (15,292)	\$ (11,624)

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(dollars and shares in thousands, except per share data)

	For the three months ended September 30, 2013				For the nine months ended September 30, 2013			
	Interest rate swap and cap agreements	Investment securities	Foreign currency translation adjustments	Accumulated other comprehensive income (loss)	Interest rate swap and cap agreements	Investment securities	Foreign currency translation adjustments	Accumulated other comprehensive income (loss)
Beginning balance	\$ (117)	\$ 1,935	\$ (5,152)	\$ (3,334)	\$ (15,402)	\$ 1,310	\$ (1,205)	\$ (15,297)
Unrealized (losses) gains	(12,656)	1,059	2,741	(8,856)	2,591	2,236	(1,206)	3,621
Related income tax benefit (expense)	4,923	(411)		4,512	(1,008)	(869)		(1,877)
	(7,733)	648	2,741	(4,344)	1,583	1,367	(1,206)	1,744
Reclassification from accumulated other comprehensive income into net income	5,669			5,669	15,439	(155)		15,284
Related tax	(2,205)			(2,205)	(6,006)	61		(5,945)
	3,464			3,464	9,433	(94)		9,339
Ending balance	\$ (4,386)	\$ 2,583	\$ (2,411)	\$ (4,214)	\$ (4,386)	\$ 2,583	\$ (2,411)	\$ (4,214)

The reclassification of net swap and cap realized losses into income are recorded as debt expense in the corresponding condensed consolidated statements of income. See Note 8 to the condensed consolidated financial statements for further details.

The reclassification of net investment realized gains into income are recorded in other income in the corresponding condensed consolidated statements of income. See Note 4 to the condensed consolidated financial statements for further details.

**13. Acquisitions**

During the first nine months of 2014, the Company acquired dialysis businesses and other businesses consisting of sixteen dialysis centers located in the U.S., four dialysis centers located outside the U.S. and other medical businesses for a total of \$218,117 in net cash and deferred purchase price obligations totaling \$23,777. The assets and liabilities for all acquisitions were recorded at their estimated fair values at the dates of the acquisitions and are included in the Company's condensed consolidated financial statements and operating results from the designated effective dates of the acquisitions. Certain income tax amounts are pending final evaluation and quantification of any pre-acquisition tax contingencies. In addition, valuation of medical claims reserves and certain other working capital items relating to several of these acquisitions are pending final quantification.

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The following table summarizes the assets acquired and liabilities assumed in these transactions and recognized at their acquisition dates at estimated fair values:

	<b>Nine months ended September 30, 2014</b>
Tangible assets, principally leasehold improvements and equipment, net of cash	\$ 4,424
Amortizable intangible-customer relationships	74,351
Other amortizable intangible and long-term assets	18,316
Goodwill	146,399
Noncontrolling interest	(1,596)
Aggregate purchase price	\$ 241,894

Amortizable intangible assets acquired during the first nine months of 2014 had weighted-average estimated useful lives of 9.7 years. The total amount of goodwill deductible for tax purposes associated with these acquisitions was approximately \$124,105.

**Contingent earn-out obligations**

The Company has several contingent earn-out obligations associated with acquisitions that could result in the Company paying the former shareholders of those acquired companies a total of up to approximately \$140,300 or a portion of that amount if certain EBITDA performance targets and quality margins are met over the next two years, if certain percentages of operating income are met over the next three years or if certain percentages of other annual EBITDA targets are met. As of September 30, 2014, the Company has estimated the fair value of these contingent earn-out obligations to be \$41,163.

Contingent earn-out obligations will be remeasured to fair value at each reporting date until the contingencies are resolved with changes in the liability due to the re-measurement recorded in earnings. See Note 15 to the condensed consolidated financial statements for further details. Of the total contingent earn-out obligations of \$41,163 recognized at September 30, 2014, a total of \$15,747 is included in other liabilities and the remaining \$25,416 is included in other long-term liabilities in the Company's condensed consolidated balance sheet.

The following is a reconciliation of changes in the contingent earn-out obligations for the nine months ended September 30, 2014:

Beginning balance, January 1, 2014	\$ 28,058
Contingent earn-out obligations associated with acquisitions	18,234
Remeasurement of fair value for other contingent earn-outs	(2,414)
Payments of contingent earn-outs	(2,715)
	\$ 41,163



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**14. Variable interest entities**

The Company relies on the operating activities of certain entities that it does not directly own or control, but over which it has indirect influence and of which it is considered the primary beneficiary. These entities are subject to the consolidation guidance applicable to variable interest entities (VIEs).

Under U.S. generally accepted accounting principles (GAAP), VIEs typically include (i) those for which the entity's equity is not sufficient to finance its activities without additional subordinated financial support; (ii) those for which the equity holders as a group lack the power to direct the activities that most significantly influence the entity's economic performance, the obligation to absorb the entity's expected losses, or the right to receive the entity's expected returns; or (iii) those for which the voting rights of some investors are not proportional to their obligations to absorb the entity's losses.

Under U.S. GAAP, the Company has determined that substantially all of the entities it is associated with that qualify as VIEs must be included in its consolidated financial statements. The Company manages these entities and provides operating and capital funding as necessary for the entities to accomplish their operational and strategic objectives. A number of these entities are subject to nominee share ownership or share transfer restriction agreements that effectively transfer the majority of the economic risks and rewards of their ownership to the Company. In other cases the Company's management agreements with these entities include both financial terms and protective and participating rights to the entities' operating, strategic and non-clinical governance decisions which transfer substantial powers over and economic responsibility for the entities to the Company. In some cases such entities are subject to broad exclusivity or noncompetition restrictions that benefit the Company. Further, in some cases the Company has contractual arrangements with its related party nominee owners that effectively indemnify these parties from the economic losses from, or entitle the Company to the economic benefits of, these entities.

The analyses upon which these consolidation determinations rest are complex, involve uncertainties, and require significant judgment on various matters, some of which could be subject to different interpretations. At September 30, 2014, these condensed consolidated financial statements include total assets of VIEs of \$572,026 and total liabilities and noncontrolling interests of VIEs to third parties of \$312,363.

The Company also sponsors certain deferred compensation plans whose trusts qualify as VIEs and the Company consolidates each of these plans as their primary beneficiary. The assets of these plans are recorded in short-term or long-term investments with matching offsetting liabilities recorded in accrued compensation and benefits and other long-term liabilities. See Note 4 for disclosures on the assets of these consolidated non-qualified deferred compensation plans.

**15. Fair value of financial instruments**

The Company measures the fair value of certain assets, liabilities and noncontrolling interests subject to put provisions (temporary equity) based upon certain valuation techniques that include observable or unobservable inputs and assumptions that market participants would use in pricing these assets, liabilities, temporary equity and commitments. The Company also has classified certain assets, liabilities and temporary equity that are measured at fair value into the appropriate fair value hierarchy levels as defined by the FASB.

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The following table summarizes the Company's assets, liabilities and temporary equity measured at fair value on a recurring basis as of September 30, 2014:

	<b>Total</b>	<b>Quoted prices in active markets for identical assets (Level 1)</b>	<b>Significant other observable inputs (Level 2)</b>	<b>Significant unobservable inputs (Level 3)</b>
<b>Assets</b>				
Available-for-sale securities	\$ 26,237	\$ 26,237	\$	\$
Interest rate cap agreements	\$ 2,514	\$	\$ 2,514	\$
Interest rate swap agreements	\$ 4,737	\$	\$ 4,737	\$
Funds on deposit with third parties	\$ 79,247	\$ 79,247	\$	\$
<b>Liabilities</b>				
Contingent earn-out obligations	\$ 41,163	\$	\$	\$ 41,163
Interest rate swap agreements	\$ 2,035	\$	\$ 2,035	\$
<b>Temporary equity</b>				
Noncontrolling interests subject to put provisions	\$ 758,743	\$	\$	\$ 758,743

The available for sale securities represent investments in various open-ended registered investment companies, or mutual funds, and are recorded at fair value based upon quoted prices reported by each mutual fund. See Note 4 to these condensed consolidated financial statements for further discussion.

The interest rate swap and cap agreements are recorded at fair value based upon valuation models utilizing the income approach and commonly accepted valuation techniques that use inputs from closing prices for similar assets and liabilities in active markets as well as other relevant observable market inputs at quoted intervals such as current interest rates, forward yield curves, implied volatility and credit default swap pricing. The Company does not believe the ultimate amount that could be realized upon settlement of these interest rate swap and cap agreements would be

materially different from the fair values currently reported. See Note 8 to the condensed consolidated financial statements for further discussion.

The funds on deposit with third parties represent funds held with various third parties as required by regulation or contract and invested by those parties in various investments, which are measured at estimated fair value based primarily on quoted market prices.

The estimated fair value measurements of contingent earn-out obligations are primarily based on unobservable inputs including projected EBITDA, estimated probability of achieving gross margin and the estimated probability of earn-out payments being made using an option pricing technique and a simulation model for expected EBITDA and operating income. In addition, a probability adjusted model was used to estimate the fair values of the quality results amounts. The estimated fair value of these contingent earn-out obligations will be remeasured as of each reporting date and could fluctuate based upon any significant changes in key assumptions, such as changes in the Company credit risk adjusted rate that is used to discount obligations to present value.

See Note 10 to these condensed consolidated financial statements for a discussion of the Company's methodology for estimating the fair value of noncontrolling interests subject to put obligations.

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Other financial instruments consist primarily of cash, accounts receivable, accounts payable, other accrued liabilities and debt. The balances of the non-debt financial instruments are presented in the consolidated financial statements at September 30, 2014 at their approximate fair values due to the short-term nature of their settlements. The carrying balance of the Company's Senior Secured Credit Facilities totaled \$4,461,897 as of September 30, 2014, and the fair value was approximately \$4,435,100 based upon quoted market prices. The fair value of the Company's senior notes was approximately \$3,834,700 at September 30, 2014 based upon quoted market prices, as compared to the carrying amount of \$3,775,000.

**16. Segment reporting**

The Company operates two major divisions, Kidney Care and HCP. The Kidney Care division is comprised of the Company's U.S. dialysis and related lab services business, various other ancillary services and strategic initiatives, including its international dialysis operations, and the Company's support expenses. The HCP division is comprised of the Company's HealthCare Partners integrated healthcare business.

As of September 30, 2014, the Company's ancillary services and strategic initiatives consisted primarily of pharmacy services, disease management services, vascular access services, ESRD clinical research programs, physician services, direct primary care and the Company's international dialysis operations.

The Company's operating segments have been defined based on the separate financial information that is regularly produced and reviewed by the Company's chief operating decision maker in making decisions about allocating resources to and assessing the financial results of the Company's different business units. The chief operating decision maker for the Company is its Chief Executive Officer.

The Company's separate operating segments include its U.S. dialysis and related lab services business, its HCP operations in each region, each of its ancillary services and strategic initiatives, and its international operations in the European and Middle Eastern, Asia Pacific, and Latin American regions. The U.S. dialysis and related lab services business and the HCP business each qualify as separately reportable segments, and all of the other ancillary services and strategic initiatives operating segments, including the international operating segments, have been combined and disclosed in the other segments category.

The Company's operating segment financial information included in this report is prepared on the internal management reporting basis that the chief operating decision maker uses to allocate resources and assess the financial results of the operating segments. For internal management reporting, segment operations include direct segment operating expenses but exclude corporate support expenses, which consist primarily of indirect labor, benefits and long-term incentive based compensation of certain departments which provide support to all of the Company's different operating lines of business. Corporate support expenses in 2014 have been reduced by internal management fees paid by the Company's ancillary lines of businesses.



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

	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
<b>Segment net revenues:</b>				
<b>U.S. dialysis and related lab services</b>				
Patient service revenues:				
External sources	\$ 2,153,914	\$ 2,043,838	\$ 6,279,263	\$ 5,932,888
Intersegment revenues	10,701	7,867	27,617	23,537
Total dialysis and related lab services revenues	2,164,615	2,051,705	6,306,880	5,956,425
Less: Provision for uncollectible accounts	(91,996)	(71,819)	(257,687)	(208,475)
Net dialysis and related lab services patient service revenues	2,072,619	1,979,886	6,049,193	5,747,950
Other revenues <sup>(1)</sup>	3,427	3,016	10,159	9,335
Total net dialysis and related lab services revenues	2,076,046	1,982,902	6,059,352	5,757,285
<b>HCP</b>				
HCP revenues:				
Capitated revenues	827,933	730,400	2,382,656	2,168,828
Net patient service revenues	49,783	58,049	164,081	161,084
Other revenues <sup>(2)</sup>	14,013	14,156	72,566	37,459
Intersegment capitated and other revenues	251	144	608	144
Total revenues	891,980	802,749	2,619,911	2,367,515
<b>Other Ancillary services and strategic initiatives</b>				
Net patient service revenues U.S.	5,250	4,159	14,112	10,648
Net patient service revenues International	26,610	17,996	73,891	42,353
Capitated revenues	20,613	16,864	52,824	51,125
Other external sources U.S.	240,770	181,499	670,441	491,244
Other external sources International	1,507	1,428	4,783	4,352

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Intersegment revenues	4,995	3,719	14,287	9,895
Total ancillary services and strategic initiatives revenues	299,745	225,665	830,338	609,617
Total net segment revenues	3,267,771	3,011,316	9,509,601	8,734,417
Elimination of intersegment revenues	(15,947)	(11,730)	(42,512)	(33,576)
Consolidated net revenues	\$ 3,251,824	\$ 2,999,586	\$ 9,467,089	\$ 8,700,841
<b>Segment operating margin (loss):</b>				
U.S. dialysis and related lab services	\$ 400,226	\$ 305,987	\$ 1,194,874	\$ 792,215
HCP	46,339	97,862	182,341	287,328
Other Ancillary services and strategic initiatives	(5,502)	(8,118)	(5,744)	(29,510)
Total segment margin	441,063	395,731	1,371,471	1,050,033
<b>Reconciliation of segment operating margin to consolidated income from continuing operations before income taxes:</b>				
Contingent earn-out obligation adjustment				56,977
Corporate support expenses	(3,527)	(18,657)	(8,415)	(41,055)
Consolidated operating income	437,536	377,074	1,363,056	1,065,955
Debt expense	(99,878)	(108,421)	(312,345)	(322,334)
Debt refinancing charges			(97,548)	
Other (loss) income	(1,246)	2,113	2,145	1,337
Consolidated income from continuing operations before income taxes	\$ 336,412	\$ 270,766	\$ 955,308	\$ 744,958



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- (1) Includes management fees for providing management and administrative services to dialysis centers that are wholly-owned by third parties or centers in which the Company owns a minority equity investment.
- (2) Includes payments received for medical consulting services and management fees for providing management and administrative services to an unconsolidated joint venture that provides medical services in which the Company owns a 50% interest, as well as revenue related to the maintenance of existing physician networks.

Depreciation and amortization expense by segment is as follows:

	<b>Three months ended September 30,</b>		<b>Nine months ended September 30,</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
U.S. dialysis and related lab services.	\$ 101,870	\$ 89,465	\$ 297,477	\$ 263,005
HCP	42,558	39,255	126,555	115,862
Ancillary services and strategic initiatives	4,768	4,045	13,650	10,396
	\$ 149,196	\$ 132,765	\$ 437,682	\$ 389,263

Summary of assets by segment is as follows:

	<b>September 30, 2014</b>	<b>December 31, 2013</b>
<b>Segment assets</b>		
U.S. dialysis and related lab services	\$ 11,097,897	\$ 10,248,993
HCP	6,314,202	6,265,767
Other Ancillary services and strategic initiatives	689,317	584,117
<b>Consolidated assets</b>	<b>\$ 18,101,416</b>	<b>\$ 17,098,877</b>

Expenditures for property and equipment by segment is as follows:

	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
U.S. dialysis and related lab services.	\$ 149,247	\$ 128,799	\$ 399,114	\$ 359,574
HCP	6,121	6,281	16,401	20,660
Ancillary services and strategic initiatives	9,546	6,051	27,992	19,293
	\$ 164,914	\$ 141,131	\$ 443,507	\$ 399,527

**Table of Contents****DAVITA HEALTHCARE PARTNERS INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)****(unaudited)**

(dollars and shares in thousands, except per share data)

**17. Changes in DaVita HealthCare Partners Inc.'s ownership interest in consolidated subsidiaries**

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

	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
Net income attributable to DaVita HealthCare Partners Inc.	\$ 184,122	\$ 136,628	\$ 515,094	\$ 421,168
(Decrease) increase in paid-in capital for sales of noncontrolling interests	(316)	21	355	(866)
Decrease in paid-in capital for the purchase of noncontrolling interests and adjustments to ownership interest	(1,962)		(506)	(474)
Net transfers to noncontrolling interests	(2,278)	21	(151)	(1,340)
Net income attributable to DaVita HealthCare Partners Inc., net of transfers to noncontrolling interests	\$ 181,844	\$ 136,649	\$ 514,943	\$ 419,828

**18. New accounting standards**

In May 2014, the FASB issued Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers*, which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. The new standard is effective for the Company on January 1, 2017. Early application is not permitted. The standard permits the use of either the retrospective or cumulative effect transition method. The Company is evaluating the effect that ASU 2014-09 will have on its consolidated financial statements and related disclosures. The Company has not yet selected a transition method nor has it determined the effect of the standard on its ongoing financial reporting.

In April 2014, the FASB issued ASU No. 2014-08, *Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity*. The amendments in the ASU change the criteria for reporting discontinued operations while enhancing disclosures in this area. It also addresses sources of confusion and inconsistent application related to financial reporting of discontinued operations guidance in U.S. GAAP. Under the new guidance, only disposals representing a

strategic shift in operations should be presented as discontinued operations. Those strategic shifts should have a major effect on the organization's operations and financial results. Examples include a disposal of a major geographic area, a major line of business, or a major equity method investment. In addition, the new guidance requires expanded disclosures about discontinued operations that will provide financial statement users with more information about the assets, liabilities, income, and expenses of discontinued operations. The new guidance also requires disclosure of the pre-tax income attributable to a disposal of a significant part of an organization that does not qualify for discontinued operations reporting. This disclosure will provide users with information about the ongoing trends in a reporting organization's results from continuing operations. The amendments in this ASU enhance convergence between U.S. GAAP and International Financial Reporting Standards (IFRS). Part of the new definition of discontinued operation is based on elements of the definition of discontinued operations in IFRS 5, *Non-Current Assets Held for Sale and Discontinued Operations*. The amendments in the ASU are effective in the first quarter of 2015 for public organizations with calendar year ends. Early adoption is permitted. The adoption of this standard will not have a material impact on the Company's condensed consolidated financial statements.

Table of Contents**DAVITA HEALTHCARE PARTNERS INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)****(unaudited)**

(dollars and shares in thousands, except per share data)

**19. Condensed consolidating financial statements**

The following information is presented in accordance with Rule 3-10 of Regulation S-X. The operating and investing activities of the separate legal entities included in the Company's consolidated financial statements are fully interdependent and integrated. Revenues and operating expenses of the separate legal entities include intercompany charges for management and other administrative services. The Company's senior notes are guaranteed by substantially all of its domestic wholly-owned subsidiaries. Each of the guarantor subsidiaries has guaranteed the notes on a joint and several basis. However, the guarantor subsidiaries can be released from their obligations in the event of a sale or other disposition of all or substantially all of the assets of such subsidiary, including by merger or consolidation or the sale of all equity interests in such subsidiary owned by the Company, if such subsidiary guarantor is designated as an unrestricted subsidiary or otherwise ceases to be a restricted subsidiary, and if such subsidiary guarantor no longer guaranties any other indebtedness of the Company. Non-wholly-owned subsidiaries, certain wholly-owned subsidiaries, foreign subsidiaries, joint ventures, partnerships, non-owned entities and third parties are not guarantors of these obligations.

**Condensed Consolidating Statements of Income**

	<b>DaVita</b>				
	<b>Partners Inc.</b>	<b>Guarantor subsidiaries</b>	<b>Non-Guarantor subsidiaries</b>	<b>Consolidating adjustments</b>	<b>Consolidated total</b>
<b>For the three months ended September 30, 2014</b>					
Patient service revenues	\$	\$ 1,592,398	\$ 651,031	\$ (896)	\$ 2,242,533
Less: Provision for uncollectible accounts		(61,973)	(36,998)		(98,971)
Net patient service revenues		1,530,425	614,033	(896)	2,143,562
Capitated revenues		442,472	406,926	(852)	848,546
Other revenues	174,226	422,733	37,961	(375,204)	259,716
Total net revenues	174,226	2,395,630	1,058,920	(376,952)	3,251,824
Operating expenses	123,856	2,126,918	940,466	(376,952)	2,814,288
Operating income	50,370	268,712	118,454		437,536
Debt expense, including debt refinancing charges	(98,496)	(89,048)	(8,730)	96,396	(99,878)
Other income (loss)	94,258	388	504	(96,396)	(1,246)
Income tax expense (benefit)	18,395	99,927	(1,694)		116,628
Equity earnings in subsidiaries	156,385	76,260		(232,645)	

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Net income	184,122	156,385	111,922	(232,645)	219,784
Less: Net income attributable to noncontrolling interests				(35,662)	(35,662)
Net income attributable to DaVita HealthCare Partners Inc.	\$ 184,122	\$ 156,385	\$ 111,922	\$ (268,307)	\$ 184,122

Table of Contents**DAVITA HEALTHCARE PARTNERS INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)****(unaudited)**

(dollars and shares in thousands, except per share data)

	<b>DaVita</b>				
	<b>HealthCare</b>	<b>Guarantor</b>	<b>Non-Guarantor</b>	<b>Consolidating</b>	<b>Consolidated</b>
<b>For the three months ended September 30, 2013</b>	<b>Partners Inc.</b>	<b>subsidiaries</b>	<b>subsidiaries</b>	<b>adjustments</b>	<b>total</b>
Patient service revenues	\$	\$ 1,527,860	\$ 602,708	\$ (3,869)	\$ 2,126,699
Less: Provision for uncollectible accounts		(47,381)	(27,096)		(74,477)
<b>Net patient service revenues</b>		<b>1,480,479</b>	<b>575,612</b>	<b>(3,869)</b>	<b>2,052,222</b>
Capitated revenues		357,058	392,040	(1,834)	747,264
Other revenues	159,546	384,676	26,411	(370,533)	200,100
<b>Total net revenues</b>	<b>159,546</b>	<b>2,222,213</b>	<b>994,063</b>	<b>(376,236)</b>	<b>2,999,586</b>
Operating expenses	117,216	2,014,126	867,406	(376,236)	2,622,512
Operating income	42,330	208,087	126,657		377,074
Debt expense	(107,550)	(83,432)	(8,505)	91,066	(108,421)
Other income (expense)	100,943	(9,615)	1,851	(91,066)	2,113
Income tax expense	16,144	81,180	3,606		100,930
Equity earnings in subsidiaries	117,049	88,791		(205,840)	
<b>Net income</b>	<b>136,628</b>	<b>122,651</b>	<b>116,397</b>	<b>(205,840)</b>	<b>169,836</b>
Less: Net income attributable to noncontrolling interests				(33,208)	(33,208)
<b>Net income attributable to DaVita HealthCare Partners Inc.</b>	<b>\$ 136,628</b>	<b>\$ 122,651</b>	<b>\$ 116,397</b>	<b>\$ (239,048)</b>	<b>\$ 136,628</b>

	<b>DaVita</b>				
	<b>HealthCare</b>	<b>Guarantor</b>	<b>Non-Guarantor</b>	<b>Consolidating</b>	<b>Consolidated</b>
<b>For the nine months ended September 30, 2014</b>	<b>Partners Inc.</b>	<b>subsidiaries</b>	<b>subsidiaries</b>	<b>adjustments</b>	<b>total</b>
Patient service revenues	\$	\$ 4,622,943	\$ 1,918,700	\$ 2,237	\$ 6,543,880
Less: Provision for uncollectible accounts		(169,133)	(101,087)		(270,220)
<b>Net patient service revenues</b>		<b>4,453,810</b>	<b>1,817,613</b>	<b>2,237</b>	<b>6,273,660</b>
Capitated revenues		1,261,385	1,175,354	(1,259)	2,435,480
Other revenues	518,468	1,241,043	105,964	(1,107,526)	757,949

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Total net revenues	518,468	6,956,238	3,098,931	(1,106,548)	9,467,089
Operating expenses	358,968	6,141,200	2,710,413	(1,106,548)	8,104,033
Operating income	159,500	815,038	388,518		1,363,056
Debt expense, including debt refinancing charges	(406,037)	(277,854)	(28,662)	302,660	(409,893)
Other income	293,733	9,323	1,749	(302,660)	2,145
Income tax expense	18,826	315,473	8,067		342,366
Equity earnings in subsidiaries	486,724	255,690		(742,414)	
Net income	515,094	486,724	353,538	(742,414)	612,942
Less: Net income attributable to noncontrolling interests				(97,848)	(97,848)
Net income attributable to DaVita HealthCare Partners Inc.	\$ 515,094	\$ 486,724	\$ 353,538	\$ (840,262)	\$ 515,094



**Table of Contents****DAVITA HEALTHCARE PARTNERS INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)****(unaudited)**

(dollars and shares in thousands, except per share data)

	<b>DaVita</b>				
	<b>HealthCare</b>	<b>Guarantor</b>	<b>Non-Guarantor</b>	<b>Consolidating</b>	<b>Consolidated</b>
<b>For the nine months ended September 30, 2013</b>	<b>Partners Inc.</b>	<b>subsidiaries</b>	<b>subsidiaries</b>	<b>adjustments</b>	<b>total</b>
Patient service revenues	\$	\$ 4,456,215	\$ 1,720,574	\$ (21,566)	\$ 6,155,223
Less: Provision for uncollectible accounts		(148,456)	(68,269)		(216,725)
<b>Net patient service revenues</b>		<b>4,307,759</b>	<b>1,652,305</b>	<b>(21,566)</b>	<b>5,938,498</b>
Capitated revenues		1,054,394	1,170,166	(4,607)	2,219,953
Other revenues	461,571	1,117,710	65,251	(1,102,142)	542,390
<b>Total net revenues</b>	<b>461,571</b>	<b>6,479,863</b>	<b>2,887,722</b>	<b>(1,128,315)</b>	<b>8,700,841</b>
<b>Operating expenses</b>	<b>309,601</b>	<b>5,922,490</b>	<b>2,531,110</b>	<b>(1,128,315)</b>	<b>7,634,886</b>
Operating income	151,970	557,373	356,612		1,065,955
Debt expense	(320,218)	(273,747)	(30,475)	302,106	(322,334)
Other income	302,111	66	1,266	(302,106)	1,337
Income tax expense	50,199	175,697	19,370		245,266
Equity earnings in subsidiaries	337,504	216,273		(553,777)	
<b>Income from continuing operations</b>	<b>421,168</b>	<b>324,268</b>	<b>308,033</b>	<b>(553,777)</b>	<b>499,692</b>
Discontinued operations			13,236		13,236
<b>Net income</b>	<b>421,168</b>	<b>324,268</b>	<b>321,269</b>	<b>(553,777)</b>	<b>512,928</b>
Less: Net income attributable to noncontrolling interests				(91,760)	(91,760)
<b>Net income attributable to DaVita HealthCare Partners Inc.</b>	<b>\$ 421,168</b>	<b>\$ 324,268</b>	<b>\$ 321,269</b>	<b>\$ (645,537)</b>	<b>\$ 421,168</b>

**Condensed Consolidating Statements of Comprehensive Income**

	<b>DaVita</b>				
	<b>HealthCare</b>	<b>Guarantor</b>	<b>Non-Guarantor</b>	<b>Consolidating</b>	<b>Consolidated</b>
<b>For the three months ended September 30, 2014</b>	<b>Partners Inc.</b>	<b>subsidiaries</b>	<b>subsidiaries</b>	<b>adjustments</b>	<b>total</b>
Net income	\$ 184,122	\$ 156,385	\$ 111,922	\$ (232,645)	\$ 219,784
Other comprehensive loss		(12,290)			(12,290)

Total comprehensive income	171,832	156,385	111,922	(232,645)	207,494
Less: comprehensive income attributable to the noncontrolling interests				(35,662)	(35,662)
Comprehensive income attributable to DaVita HealthCare Partners Inc.	\$ 171,832	\$ 156,385	\$ 111,922	\$ (268,307)	\$ 171,832

Table of Contents**DAVITA HEALTHCARE PARTNERS INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)****(unaudited)**

(dollars and shares in thousands, except per share data)

	<b>DaVita</b>					
	<b>HealthCare Partners Inc.</b>		<b>Guarantor Non-Guarantor subsidiaries</b>		<b>Consolidating adjustments</b>	<b>Consolidated total</b>
<b>For the three months ended September 30, 2013</b>						
Net income	\$ 136,628	\$ 122,651	\$ 116,397	\$ (205,840)		\$ 169,836
Other comprehensive loss		(880)				(880)
<b>Total comprehensive income</b>	<b>135,748</b>	<b>122,651</b>	<b>116,397</b>	<b>(205,840)</b>		<b>168,956</b>
Less: comprehensive income attributable to the noncontrolling interests				(33,208)		(33,208)
<b>Comprehensive income attributable to DaVita HealthCare Partners Inc.</b>	<b>\$ 135,748</b>	<b>\$ 122,651</b>	<b>\$ 116,397</b>	<b>\$ (239,048)</b>		<b>\$ 135,748</b>

	<b>DaVita</b>					
	<b>HealthCare Partners Inc.</b>		<b>Guarantor Non-Guarantor subsidiaries</b>		<b>Consolidating adjustments</b>	<b>Consolidated total</b>
<b>For the nine months ended September 30, 2014</b>						
Net income	\$ 515,094	\$ 486,724	\$ 353,538	\$ (742,414)		\$ 612,942
Other comprehensive loss		(8,979)				(8,979)
<b>Total comprehensive income</b>	<b>506,115</b>	<b>486,724</b>	<b>353,538</b>	<b>(742,414)</b>		<b>603,963</b>
Less: comprehensive income attributable to the noncontrolling interests				(97,848)		(97,848)
<b>Comprehensive income attributable to DaVita HealthCare Partners Inc.</b>	<b>\$ 506,115</b>	<b>\$ 486,724</b>	<b>\$ 353,538</b>	<b>\$ (840,262)</b>		<b>\$ 506,115</b>

	<b>DaVita</b>					
	<b>HealthCare Partners Inc.</b>		<b>Guarantor Non-Guarantor subsidiaries</b>		<b>Consolidating adjustments</b>	<b>Consolidated total</b>
<b>For the nine months ended September 30, 2013</b>						
Net income	\$ 421,168	\$ 324,268	\$ 321,269	\$ (553,777)		\$ 512,928
Other comprehensive income		11,083				11,083
<b>Total comprehensive income</b>	<b>432,251</b>	<b>324,268</b>	<b>321,269</b>	<b>(553,777)</b>		<b>524,011</b>
Less: comprehensive income attributable to the noncontrolling interests				(91,760)		(91,760)

Comprehensive income attributable to DaVita HealthCare Partners Inc.	\$ 432,251	\$ 324,268	\$ 321,269	\$ (645,537)	\$ 432,251
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**Table of Contents****DAVITA HEALTHCARE PARTNERS INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)****(unaudited)**

(dollars and shares in thousands, except per share data)

**Condensed Consolidating Balance Sheets**

<b>As of September 30, 2014</b>	<b>DaVita HealthCare Partners Inc.</b>	<b>Guarantor subsidiaries</b>	<b>Non-Guarantor subsidiaries</b>	<b>Consolidating adjustments</b>	<b>Consolidated total</b>
Cash and cash equivalents	\$ 1,187,719	\$ 127,331	\$ 211,985	\$	\$ 1,527,035
Accounts receivable, net		886,574	581,989		1,468,563
Other current assets	157,897	929,139	95,801		1,182,837
Total current assets	1,345,616	1,943,044	889,775		4,178,435
Property and equipment, net	191,897	1,425,392	741,914		2,359,203
Amortizable intangibles, net	88,537	1,850,725	58,510		1,997,772
Investments in subsidiaries	8,714,911	1,544,864		(10,259,775)	
Intercompany receivables	3,452,572		530,994	(3,983,566)	
Other long-term assets and investments	59,555	84,940	76,870		221,365
Goodwill		7,955,215	1,389,426		9,344,641
Total assets	\$ 13,853,088	\$ 14,804,180	\$ 3,687,489	\$ (14,243,341)	\$ 18,101,416
Current liabilities	269,843	1,936,798	390,990		2,597,631
Intercompany payables		2,912,917	1,070,649	(3,983,566)	
Long-term debt and other long-term liabilities	8,116,659	1,239,554	237,354		9,593,567
Noncontrolling interests subject to put provisions	491,544			267,199	758,743
Total DaVita HealthCare Partners Inc. shareholders' equity	4,975,042	8,714,911	1,544,864	(10,259,775)	4,975,042
Noncontrolling interests not subject to put provisions			443,632	(267,199)	176,433
Total equity	4,975,042	8,714,911	1,988,496	(10,526,974)	5,151,475
Total liabilities and equity	\$ 13,853,088	\$ 14,804,180	\$ 3,687,489	\$ (14,243,341)	\$ 18,101,416



**Table of Contents****DAVITA HEALTHCARE PARTNERS INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)****(unaudited)**

(dollars and shares in thousands, except per share data)

<b>As of December 31, 2013</b>	<b>DaVita HealthCare Partners Inc.</b>	<b>Guarantor subsidiaries</b>	<b>Non-Guarantor subsidiaries</b>	<b>Consolidating adjustments</b>	<b>Consolidated total</b>
Cash and cash equivalents	\$ 602,188	\$ 175,004	\$ 169,057	\$	\$ 946,249
Accounts receivable, net		939,543	545,620		1,485,163
Other current assets	27,910	908,010	104,946		1,040,866
Total current assets	630,098	2,022,557	819,623		3,472,278
Property and equipment, net	177,633	1,377,924	633,854		2,189,411
Amortizable intangibles, net	77,531	1,882,685	64,157		2,024,373
Investments in subsidiaries	8,231,059	1,389,558		(9,620,617)	
Intercompany receivables	3,983,214		480,993	(4,464,207)	
Other long-term assets and investments	61,391	67,402	71,048		199,841
Goodwill		7,837,421	1,375,553		9,212,974
Total assets	\$ 13,160,926	\$ 14,577,547	\$ 3,445,228	\$ (14,084,824)	\$ 17,098,877
Current liabilities	\$ 328,875	\$ 1,774,634	\$ 358,540	\$	\$ 2,462,049
Intercompany payables		3,421,198	1,043,009	(4,464,207)	
Long-term debt and other long-term liabilities	7,948,390	1,150,656	234,941		9,333,987
Noncontrolling interests subject to put provisions	451,182			246,118	697,300
Total DaVita HealthCare Partners Inc. shareholders equity	4,432,479	8,231,059	1,389,558	(9,620,617)	4,432,479
Noncontrolling interests not subject to put provisions			419,180	(246,118)	173,062
Total equity	4,432,479	8,231,059	1,808,738	(9,866,735)	4,605,541
Total liabilities and equity	\$ 13,160,926	\$ 14,577,547	\$ 3,445,228	\$ (14,084,824)	\$ 17,098,877

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## DAVITA HEALTHCARE PARTNERS INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(unaudited)

(dollars and shares in thousands, except per share data)

## Condensed Consolidating Statements of Cash Flows

For the nine months ended September 30, 2014	DaVita HealthCare Partners Inc.	Guarantor subsidiaries	Non-Guarantor subsidiaries	Consolidating adjustments	Consolidated total
<b>Cash flows from operating activities:</b>					
Net income	\$ 515,094	\$ 486,724	\$ 353,538	\$ (742,414)	\$ 612,942
Changes in operating assets and liabilities and non-cash items included in net income	(479,441)	578,851	74,632	742,414	916,456
Net cash provided by operating activities	35,653	1,065,575	428,170		1,529,398
<b>Cash flows from investing activities:</b>					
Additions of property and equipment, net	(37,752)	(215,072)	(190,683)		(443,507)
Acquisitions		(204,670)	(13,447)		(218,117)
Proceeds from asset and business sales		3,620			3,620
Purchases/proceeds from investment sales and other items	(137,313)	(33,111)	(2,757)		(173,181)
Net cash used in investing activities	(175,065)	(449,233)	(206,887)		(831,185)
<b>Cash flows from financing activities:</b>					
Long-term debt and related financing costs, net	40,250	(9,247)	295		31,298
Intercompany borrowing	759,648	(646,476)	(113,172)		
Other items	(74,955)	(8,292)	(67,060)		(150,307)
Net cash provided by (used in) financing activities	724,943	(664,015)	(179,937)		(119,009)
Effect of exchange rate changes on cash			1,582		1,582
Net increase (decrease) in cash and cash equivalents	585,531	(47,673)	42,928		580,786
Cash and cash equivalents at beginning of period	602,188	175,004	169,057		946,249
Cash and cash equivalents at end of period	\$ 1,187,719	\$ 127,331	\$ 211,985	\$	\$ 1,527,035





Table of Contents**DAVITA HEALTHCARE PARTNERS INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)****(unaudited)**

(dollars and shares in thousands, except per share data)

<b>For the nine months ended September 30, 2013</b>	<b>DaVita HealthCare Partners Inc.</b>	<b>Guarantor subsidiaries</b>	<b>Non-Guarantor subsidiaries</b>	<b>Consolidating adjustments</b>	<b>Consolidated total</b>
<b>Cash flows from operating activities:</b>					
Net income	\$ 421,168	\$ 324,268	\$ 321,269	\$ (553,777)	\$ 512,928
Changes in operating assets and liabilities and non-cash items included in net income	(370,991)	720,662	2,778	553,777	906,226
Net cash provided by operating activities	50,177	1,044,930	324,047		1,419,154
<b>Cash flows from investing activities:</b>					
Additions of property and equipment, net	(32,305)	(196,918)	(170,304)		(399,527)
Acquisitions		(185,945)	(48,857)		(234,802)
Proceeds from asset sales	60,650	1,632			62,282
Purchases of investments and other items	(2,574)	(2,565)	100		(5,039)
Net cash provided by (used in) investing activities	25,771	(383,796)	(219,061)		(577,086)
<b>Cash flows from financing activities:</b>					
Long-term debt and related financing costs, net	(370,774)	(9,211)	(4,316)		(384,301)
Intercompany borrowing	684,985	(653,287)	(31,698)		
Other items	44,164	5,609	(69,695)		(19,922)
Net cash provided by (used in) financing activities	358,375	(656,889)	(105,709)		(404,223)
Effect of exchange rate changes on cash			(899)		(899)
Net increase (decrease) in cash and cash equivalents	434,323	4,245	(1,622)		436,946
Cash and cash equivalents at beginning of period	195,037	166,107	172,604		533,748
Cash and cash equivalents at end of period	\$ 629,360	\$ 170,352	\$ 170,982	\$	\$ 970,694

**Table of Contents****DAVITA HEALTHCARE PARTNERS INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)****(unaudited)**

(dollars and shares in thousands, except per share data)

**20. Supplemental data**

The following information is presented as supplemental data as required by the indentures governing our senior notes.

**Condensed Consolidating Statements of Income**

	<b>Consolidated</b>	<b>Physician</b>	<b>Unrestricted</b>	<b>Company and Restricted</b>
<b>For the three months ended September 30, 2014</b>	<b>Total</b>	<b>Groups</b>	<b>Subsidiaries</b>	<b>Subsidiaries<sup>(1)</sup></b>
Patient service operating revenues	\$ 2,242,533	\$ 31,231	\$	\$ 2,211,302
Less: Provision for uncollectible accounts	(98,971)	(5,053)		(93,918)
Net patient service operating revenues	2,143,562	26,178		2,117,384
Capitated revenues	848,546	387,405		461,141
Other revenues	259,716	856		258,860
Total net operating revenues	3,251,824	414,439		2,837,385
Operating expenses	2,814,288	409,550	27	2,404,711
Operating income	437,536	4,889	(27)	432,674
Debt expense, including refinancing charges	(99,878)	(2,364)		(97,514)
Other (loss) income	(1,246)	42		(1,288)
Income tax expense	116,628	721	(11)	115,918
Net income	219,784	1,846	(16)	217,954
Minority interests	(35,662)			(35,662)
Net income attributable to DaVita HealthCare Partners Inc.	\$ 184,122	\$ 1,846	\$ (16)	\$ 182,292

	<b>Consolidated</b>	<b>Physician</b>	<b>Unrestricted</b>	<b>Company and Restricted</b>
<b>For the nine months ended September 30, 2014</b>	<b>Total</b>	<b>Groups</b>	<b>Subsidiaries</b>	<b>Subsidiaries<sup>(1)</sup></b>
Patient service operating revenues	\$ 6,543,880	\$ 91,731	\$	\$ 6,452,149
Less: Provision for uncollectible accounts	(270,220)	(7,642)		(262,578)

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Net patient service operating revenues	6,273,660	84,089		6,189,571
Capitated revenues	2,435,480	1,122,085		1,313,395
Other revenues	757,949	3,735		754,214
Total net operating revenues	9,467,089	1,209,909		8,257,180
Operating expenses	8,104,033	1,185,349	263	6,918,421
Operating income	1,363,056	24,560	(263)	1,338,759
Debt expense, including refinancing charges	(409,893)	(8,982)		(400,911)
Other income	2,145	75		2,070
Income tax expense	342,366	4,878	(105)	337,593
Net income	612,942	10,775	(158)	602,325
Minority interests	(97,848)			(97,848)
Net income attributable to DaVita HealthCare Partners Inc.	\$ 515,094	\$ 10,775	\$ (158)	\$ 504,477

(1) After the elimination of the unrestricted subsidiaries and the physician groups

Table of Contents**DAVITA HEALTHCARE PARTNERS INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)****(unaudited)**

(dollars and shares in thousands, except per share data)

**Condensed Consolidating Statements of Comprehensive Income**

<b>For the three months ended September 30, 2014</b>	<b>Consolidated Total</b>	<b>Physician Groups</b>	<b>Unrestricted Subsidiaries</b>	<b>Company and Restricted Subsidiaries<sup>(1)</sup></b>
Net income	\$ 219,784	\$ 1,846	\$ (16)	\$ 217,954
Other comprehensive loss	(12,290)			(12,290)
<b>Total comprehensive income</b>	<b>207,494</b>	<b>1,846</b>	<b>(16)</b>	<b>205,664</b>
Less: comprehensive income attributable to the noncontrolling interests	(35,662)			(35,662)
<b>Comprehensive income attributable to DaVita HealthCare Partners Inc.</b>	<b>\$ 171,832</b>	<b>\$ 1,846</b>	<b>\$ (16)</b>	<b>\$ 170,002</b>

<b>For the nine months ended September 30, 2014</b>	<b>Consolidated Total</b>	<b>Physician Groups</b>	<b>Unrestricted Subsidiaries</b>	<b>Company and Restricted Subsidiaries<sup>(1)</sup></b>
Net income	\$ 612,942	\$ 10,775	\$ (158)	\$ 602,325
Other comprehensive loss	(8,979)			(8,979)
<b>Total comprehensive income</b>	<b>603,963</b>	<b>10,775</b>	<b>(158)</b>	<b>593,346</b>
Less: comprehensive income attributable to the noncontrolling interests	(97,848)			(97,848)
<b>Comprehensive income attributable to DaVita HealthCare Partners Inc.</b>	<b>\$ 506,115</b>	<b>\$ 10,775</b>	<b>\$ (158)</b>	<b>\$ 495,498</b>

(1) After the elimination of the unrestricted subsidiaries and the physician groups

Table of Contents**DAVITA HEALTHCARE PARTNERS INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)****(unaudited)**

(dollars and shares in thousands, except per share data)

**Condensed Consolidating Balance Sheets**

<b>As of September 30, 2014</b>	<b>Consolidated Total</b>	<b>Physician Groups</b>	<b>Unrestricted Subsidiaries</b>	<b>Company and Restricted Subsidiaries<sup>(1)</sup></b>
Cash and cash equivalents	\$ 1,527,035	\$ 112,135	\$	\$ 1,414,900
Accounts receivable, net	1,468,563	235,882		1,232,681
Other current assets	1,182,837	20,349		1,162,488
Total current assets	4,178,435	368,366		3,810,069
Property and equipment, net	2,359,203	4,872		2,354,331
Amortizable intangibles, net	1,997,772	6,490		1,991,282
Other long-term assets	221,365	65,138	3,061	153,166
Goodwill	9,344,641	9,181		9,335,460
<b>Total assets</b>	<b>\$ 18,101,416</b>	<b>\$ 454,047</b>	<b>\$ 3,061</b>	<b>\$ 17,644,308</b>
Current liabilities	\$ 2,597,631	\$ 193,082	\$	\$ 2,404,549
Payables to parent		166,269	3,061	(169,330)
Long-term debt and other long-term liabilities	9,593,567	82,458		9,511,109
Noncontrolling interests subject to put provisions	758,743			758,743
Total DaVita HealthCare Partners Inc. shareholders equity	4,975,042	12,238		4,962,804
Noncontrolling interests not subject to put provisions	176,433			176,433
Shareholders equity	5,151,475	12,238		5,139,237
<b>Total liabilities and shareholder s equity</b>	<b>\$ 18,101,416</b>	<b>\$ 454,047</b>	<b>\$ 3,061</b>	<b>\$ 17,644,308</b>

Table of Contents**DAVITA HEALTHCARE PARTNERS INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)****(unaudited)**

(dollars and shares in thousands, except per share data)

<b>As of December 31, 2013</b>	<b>Consolidated Total</b>	<b>Physician Groups</b>	<b>Unrestricted Subsidiaries</b>	<b>Company and Restricted Subsidiaries<sup>(1)</sup></b>
Cash and cash equivalents	\$ 946,249	\$ 127,309	\$	\$ 818,940
Accounts receivable, net	1,485,163	235,463		1,249,700
Other current assets	1,040,866	35,640		1,005,226
<b>Total current assets</b>	<b>3,472,278</b>	<b>398,412</b>		<b>3,073,866</b>
Property and equipment, net	2,189,411	5,541		2,183,870
Amortizable intangibles, net	2,024,373	7,283		2,017,090
Other long-term assets	199,841	64,013	3,325	132,503
Goodwill	9,212,974	8,981		9,203,993
<b>Total assets</b>	<b>\$ 17,098,877</b>	<b>\$ 484,230</b>	<b>\$ 3,325</b>	<b>\$ 16,611,322</b>
Current liabilities	\$ 2,462,049	\$ 193,079	\$	\$ 2,268,970
Payables to parent		194,958	3,325	(198,283)
Long-term debt and other long-term liabilities	9,333,987	94,727		9,239,260
Noncontrolling interests subject to put provisions	697,300			697,300
Total DaVita HealthCare Partners Inc. shareholders equity	4,432,479	1,466		4,431,013
Noncontrolling interests not subject to put provisions	173,062			173,062
<b>Shareholders equity</b>	<b>4,605,541</b>	<b>1,466</b>		<b>4,604,075</b>
<b>Total liabilities and shareholder s equity</b>	<b>\$ 17,098,877</b>	<b>\$ 484,230</b>	<b>\$ 3,325</b>	<b>\$ 16,611,322</b>

(1) After the elimination of the unrestricted subsidiaries and the physician groups

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## DAVITA HEALTHCARE PARTNERS INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(unaudited)

(dollars and shares in thousands, except per share data)

## Condensed Consolidating Statements of Cash Flows

For the nine months ended September 30, 2014	Consolidated Total	Physician Groups	Unrestricted Subsidiaries	Company and Restricted Subsidiaries <sup>(1)</sup>
<b>Cash flows from operating activities:</b>				
Net income	\$ 612,942	\$ 10,775	\$ (158)	\$ 602,325
Changes in operating and intercompany assets and liabilities and non-cash items included in net income	916,456	5,752	158	910,546
Net cash provided by operating activities	1,529,398	16,527		1,512,871
<b>Cash flows from investing activities:</b>				
Additions of property and equipment	(443,507)	(145)		(443,362)
Acquisitions and divestitures, net	(218,117)			(218,117)
Proceeds from discontinued operations	3,620			3,620
Investments and other items	(173,181)	(2,757)		(170,424)
Net cash used in investing activities	(831,185)	(2,902)		(828,283)
<b>Cash flows from financing activities:</b>				
Long-term debt	31,298			31,298
Intercompany		(28,799)		28,799
Other items	(150,307)			(150,307)
Net cash used in by financing activities	(119,009)	(28,799)		(90,210)
Effect of exchange rate changes on cash	1,582			1,582
Net increase (decrease) in cash	580,786	(15,174)		595,960
Cash at beginning of year	946,249	127,309		818,940
Cash at end of year	\$ 1,527,035	\$ 112,135	\$	\$ 1,414,900

<sup>(1)</sup> After the elimination of the unrestricted subsidiaries and the physician groups





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

*This Management's Discussion and Analysis of Financial Condition and Results of Operations contains statements that are forward-looking statements within the meaning of the federal securities laws. All statements that do not concern historical facts are forward-looking statements and include, among other things, statements about our expectations, beliefs, intentions and/or strategies for the future. These forward-looking statements include statements regarding our future operations, financial condition and prospects, expectations for treatment growth rates, revenue per treatment, expense growth, levels of the provision for uncollectible accounts receivable, operating income, cash flow, operating cash flow, estimated tax rates, capital expenditures, the development of new dialysis centers and dialysis center acquisitions, government and commercial payment rates, revenue estimating risk and the impact of our level of indebtedness on our financial performance, and including earnings per share. These statements involve substantial known and unknown risks and uncertainties that could cause our actual results to differ materially from those described in the forward-looking statements, including but not limited to, risks resulting from the concentration of profits generated by higher-paying commercial payor plans for which there is continued downward pressure on average realized payment rates, and a reduction in the number of patients under such plans, which may result in the loss of revenues or patients, a reduction in government payment rates under the Medicare ESRD program or other government-based programs, the impact of the Center for Medicare and Medicaid Services (CMS) 2014 Medicare Advantage benchmark structure, risks arising from potential federal and/or state legislation that could have an adverse effect on our operations and profitability, changes in pharmaceutical or anemia management practice patterns, payment policies, or pharmaceutical pricing, legal compliance risks, including our continued compliance with complex government regulations and current or potential investigations by various government entities and related government or private-party proceedings, and in compliance with the Corporate Integrity Agreement and the related restrictions on our business and operations required by the Corporate Integrity Agreement and other settlement terms, and the financial impact thereof, continued increased competition from large and medium-sized dialysis providers that compete directly with us, our ability to maintain contracts with physician medical directors, changing affiliation models for physicians, and the emergence of new models of care introduced by the government or private sector that may erode our patient base and reimbursement rates such as accountable care organizations (ACOs), independent practice associations (IPAs) and integrated delivery systems, or to businesses outside of dialysis and HCP's business, our ability to complete acquisitions, mergers or dispositions that we might be considering or announce, or to integrate and successfully operate any business we may acquire or have acquired, including HCP, or to expand our operations and services to markets outside the U.S., variability of our cash flows, the risk that we might invest material amounts of capital and incur significant costs in connection with the growth and development of our international operations, yet we might not be able to operate them profitably anytime soon, if at all, risks arising from the use of accounting estimates, judgments and interpretations in our financial statements, loss of key HCP employees, potential disruption from the HCP transaction making it more difficult to maintain business and operational relationships with customers, partners, associated physicians and physician groups, hospitals and others, the risk that laws regulating the corporate practice of medicine could restrict the manner in which HCP conducts its business, the risk that the cost of providing services under HCP's agreements may exceed our compensation, the risk that reductions in reimbursement rates, including Medicare Advantage rates, and future regulations may negatively impact HCP's business, revenue and profitability, the risk that HCP may not be able to successfully establish a presence in new geographic regions or successfully address competitive threats that could reduce its profitability, the risk that a disruption in HCP's healthcare provider networks could have an adverse effect on HCP's business operations and profitability, the risk that reductions in the quality ratings of health maintenance organization plan customers of HCP could have an adverse effect on HCP's business, or the risk that health plans that acquire health maintenance organizations may not be willing to contract with HCP or may be willing to contract only on less favorable terms, and the other risk factors set forth in Part II, Item 1A. of this Quarterly Report on Form 10-Q. We base our forward-looking statements on information currently available to us, and we undertake no obligation to*

*update or revise any forward-looking statements, whether as a result of changes in underlying factors, new information, future events or otherwise.*

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

**Consolidated results of operations**

We operate two major divisions, Kidney Care and HealthCare Partners (HCP). Our Kidney Care division is comprised of our U.S. dialysis and related lab services business, our ancillary services and strategic initiatives including our international operations, and our corporate support expenses. Our HCP division is comprised of our HCP integrated healthcare business.

Our largest major line of business is our U.S. dialysis and related lab services, which is a leading provider of kidney dialysis services in the U.S. for patients suffering from chronic kidney failure, also known as ESRD. Our other major line of business is HCP, which is a patient- and physician-focused integrated health care delivery and management company.

Following is a summary of our consolidated operating results for the third quarter of 2014 compared with the prior sequential quarter and the same quarter of 2013, as well as the nine months ended September 30, 2014 compared to the same period in 2013, for reference in the discussion that follows.

	Three months ended			Nine months ended		
	September 30, 2014	June 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013	
	(dollar amounts rounded to nearest million)					
Net revenues:						
Patient service revenues	\$ 2,243	\$ 2,187	\$ 2,127	\$ 6,544	\$ 6,155	
Less: Provision for uncollectible accounts	(99)	(88)	(74)	(270)	(217)	
Net patient service revenues	2,144	2,099	2,053	6,274	5,938	
Capitated revenues	848	799	747	2,435	2,220	
Other revenues	260	274	200	758	543	
Total consolidated net revenues	3,252	3,172	3,000	9,467	8,701	100%
Operating expenses and charges:						
Patient care costs	2,326	2,247	2,096	6,753	6,070	70%
General and administrative	323	298	305	905	858	10%
Depreciation and amortization	149	146	133	438	389	4%
Provision for uncollectible	4	3	1	10	4	

accounts

Equity investment income	(5)		(6)		(9)		(19)		(26)	
Loss contingency reserve	17				97	3%	17		397	5%
Contingent earn-out obligation adjustment									(57)	(1%)
Total operating expenses and charges	2,814	87%	2,688	85%	2,623	87%	8,104	86%	7,635	88%
Operating income	\$ 438	13%	\$ 484	15%	\$ 377	13%	\$ 1,363	14%	\$ 1,066	12%

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The following table summarizes consolidated net revenues for our Kidney Care division and our HCP division:

	Three months ended			Nine months ended	
	September 30, 2014	June 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
<b>(dollar amounts rounded to nearest million)</b>					
Net revenues:					
Kidney Care:					
U.S. dialysis and related lab services patient service revenues	\$ 2,165	\$ 2,106	\$ 2,052	\$ 6,307	\$ 5,956
Less: Provision for uncollectible accounts	(92)	(84)	(72)	(258)	(208)
U.S. dialysis and related lab services net patient service revenues	\$ 2,073	\$ 2,022	\$ 1,980	\$ 6,049	\$ 5,748
Other revenues	3	3	3	10	9
Total net U.S. dialysis and related lab services revenues	2,076	2,025	1,983	6,059	5,757
Other Ancillary services and strategic initiatives revenues	247	229	187	690	506
Other Capitated revenues	21	16	17	53	51
Other Ancillary services and strategic initiatives net patient service revenues (less provision for uncollectible accounts)	32	29	22	88	53
Total net other-ancillary services and strategic initiatives revenues	300	274	226	831	610
Elimination of intersegment and division revenues	(16)	(14)	(12)	(43)	(33)
Total Kidney Care net revenues	2,360	2,285	2,197	6,847	6,334
HCP:					
HCP capitated revenues	828	783	731	2,383	2,169
HCP net patient service revenues (less provision for uncollectible accounts)	50	58	58	164	161
Other revenues	14	46	14	73	37
Total net HCP revenues	892	887	803	2,620	2,367
Total consolidated net revenues	\$ 3,252	\$ 3,172	\$ 3,000	\$ 9,467	\$ 8,701



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The following table summarizes consolidated operating income and adjusted consolidated operating income:

	Three months ended			Nine months ended	
	September 30, 2014	June 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
(dollar amounts rounded to nearest million)					
<b>Operating income:</b>					
<b>Kidney Care:</b>					
U.S. dialysis and related lab services	\$ 400	\$ 408	\$ 306	\$ 1,195	\$ 792
Other Ancillary services and strategic initiatives losses	(6)	(2)	(8)	(6)	(29)
Contingent earn-out obligation adjustment					57
Corporate support costs	(3)	(4)	(11)	(8)	(33)
Adjustment to reduce a tax asset associated with the HCP acquisition escrow provisions			(8)		(8)
<b>Total kidney care operating income</b>	<b>391</b>	<b>402</b>	<b>279</b>	<b>1,181</b>	<b>779</b>
<b>HCP</b>	<b>47</b>	<b>82</b>	<b>98</b>	<b>182</b>	<b>287</b>
<b>Total consolidated operating income</b>	<b>438</b>	<b>484</b>	<b>377</b>	<b>1,363</b>	<b>1,066</b>
<b>Reconciliation of non-GAAP measures:</b>					
<b>Add:</b>					
Loss contingency reserve	17		97	17	397
Adjustment to reduce a tax asset associated with HCP acquisition escrow provisions			8		8
Contingent earn-out obligation adjustment					(57)
<b>Adjusted consolidated operating income<sup>(1)</sup></b>	<b>\$ 455</b>	<b>\$ 484</b>	<b>\$ 482</b>	<b>\$ 1,380</b>	<b>\$ 1,414</b>

(1) For the three and nine months ended September 30, 2014 we have excluded \$17 million related to a loss contingency reserve. In addition, for the three and nine months ended September 30, 2013, we have excluded \$97 million and \$397 million, respectively, related to the loss contingency reserve and have excluded \$8 million related to an adjustment to reduce a tax asset associated with HCP acquisition escrow provisions. In addition, for the nine months ended September 30, 2013, we have excluded \$57 million related to an adjustment to decrease HCP's contingent earn-out obligation. These are non-GAAP measures and are not intended as substitutes for the GAAP equivalent measures. We have presented these adjusted amounts because management believes that these presentations enhance a user's understanding of our normal consolidated operating income by excluding unusual amounts of \$17 million, \$97 million and \$397 million, as described above, for a loss contingency reserve related to the 2010 and 2011 U.S. Attorney Physician Relationship Investigations (see Note 9 to the condensed



consolidated financial statements), an adjustment of \$8 million to reduce a tax asset associated with HCP acquisition escrow payments that was established a receivable to offset any potential tax liabilities and a \$57 million adjustment for a decrease in HCP's contingent earn-out obligation. We therefore consider these adjusted consolidated operating income amounts meaningful and comparable to our prior period results.

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**Table of Contents***Consolidated net revenues*

Consolidated net revenues for the third quarter of 2014 increased by approximately \$80 million, or approximately 2.5%, as compared to the second quarter of 2014. The increase in consolidated net revenues was primarily due to an increase of approximately \$51 million associated with the U.S. dialysis and related lab services net revenues, principally due to one additional treatment day in the third quarter of 2014 as compared to the second quarter of 2014, strong acquired and non-acquired growth and an increase of \$1 in the average dialysis revenue per treatment mainly due to an increase in seasonal administration of flu vaccine, partially offset by an increase in our dialysis provision for uncollectable accounts. In addition, HCP's net operating revenues increased by approximately \$5 million as a result of an increase in senior capitated members and improvements in HCP's risk pool performance, partially offset by a decrease in HCP revenue associated with its annual premium reconciliation of capitated members that was recognized in the second quarter of 2014 and from the recognition of additional HCP revenues related to the maintenance of existing physician networks that was also recorded in the second quarter of 2014. The increase in consolidated net revenues was also due to an increase of approximately \$26 million associated with our ancillary services and strategic initiatives revenues primarily from additional pharmacy revenues.

Consolidated net revenues for the third quarter of 2014 increased by approximately \$252 million, or approximately 8.4%, as compared to the third quarter of 2013. The increase in consolidated net revenues was mostly due to an increase of \$93 million in the U.S. dialysis and related lab services net revenues, primarily as a result of strong volume growth from acquired and non-acquired treatment growth in existing and new centers and an increase of \$1 in the average dialysis revenue per treatment, driven by changes in the mix of our government reimbursements and an increase in some of our commercial payment rates, partially offset by an increase in our dialysis provision for uncollectible accounts. The increase in consolidated net revenues was also due to an increase in HCP net revenues of \$89 million due to acquired growth, an increase in senior capitated members in the third quarter of 2014 and improvements in HCP's risk pool performance, partially offset by the timing of revenue from its annual premium reconciliation for senior capitated members which occurred in the second quarter of 2014, when typically the revenue would have been received in the third quarter of 2014, as well as a reduction in HCP's Medicare Advantage payments. In addition, the increase in consolidated net revenues was also due to an increase of approximately \$74 million in our ancillary services and strategic initiatives, mainly from growth in our pharmacy services and in our international operations.

Consolidated net revenues for the nine months ended September 30, 2014 increased by approximately \$766 million, or approximately 8.8%, as compared to the same period in 2013. The increase in consolidated net revenues was primarily due to an increase of \$302 million in the U.S. dialysis and related lab services net revenues, largely as a result of strong volume growth from acquired and non-acquired treatment growth, and an increase in the average dialysis revenue per treatment of \$1, partially offset by an increase in our dialysis provision for uncollectable accounts. In addition, consolidated net revenues was positively impacted by an increase in HCP net revenues of \$253 million, primarily due to an increase in senior capitated members, improvements in HCP's risk pool performance, and from the recognition of additional HCP revenues related to the maintenance of existing physician networks, that occurred in the second quarter of 2014, partially offset by a reduction in HCP's Medicare Advantage payments. In addition, the increase in consolidated net revenues was also due to an increase of approximately \$221 million in our ancillary services and strategic initiatives, largely due to growth in our pharmacy services and in our international operations.

*Consolidated operating income*

Consolidated operating income for the third quarter of 2014 decreased by approximately \$46 million, or approximately 9.5%, as compared to the second quarter of 2014, including an adjustment of \$17 million to the loss

contingency reserve. Excluding this item from the third quarter of 2014, adjusted operating income would have decreased by \$29 million. The decrease in the consolidated operating income was primarily due to an increase in pharmaceutical costs, higher labor and benefit costs, a slight decrease in productivity, higher long-term incentive compensation, an increase in the dialysis provision for uncollectible accounts, an increase in

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HCP's medical claims expense as a result of additional senior and Medicaid members who have higher utilization, as well as a decrease in HCP revenue associated with its annual premium reconciliation of capitated members which occurred in the second quarter of 2014, and from the recognition of additional HCP revenues related to the maintenance of existing physician networks that was also recorded in the second quarter of 2014. Consolidated operating income was positively impacted by an increase in U.S. dialysis and related lab services net revenues due to strong volume growth primarily from one additional treatment day in the third quarter of 2014 as compared to the second quarter of 2014, lower payroll taxes, lower travel costs for management meetings and an increase in HCP senior capitated members.

Consolidated operating income for the third quarter of 2014 increased by approximately \$61 million, or approximately 16.2%, as compared to the third quarter of 2013, including adjustments of \$17 million and \$97 million to the loss contingency reserve in 2014 and 2013, respectively, and an \$8 million adjustment to reduce a tax asset associated with HCP acquisition escrow provisions in the third quarter of 2013. Excluding these items from their respective periods, adjusted consolidated operating income would have decreased by \$27 million. The decrease in adjusted consolidated operating income was primarily impacted by lower HCP Medicare Advantage payments, an increase in HCP's medical claims expenses as a result of additional senior capitated members, higher pharmaceutical unit costs, an increase in the dialysis provision for uncollectible accounts, higher labor and benefit costs and related payroll taxes, and higher long-term incentive compensation. Consolidated operating income was positively impacted by strong volume growth in the number of treatments from non-acquired growth and acquisitions, and from improved productivity. In addition, adjusted consolidated operating income was also positively impacted by an increase in HCP overall revenues as described above, improved operating performance of certain ancillary services and strategic initiatives, mainly our pharmacy services, and an increase as a result of the write-off of certain obsolete software costs that occurred in the third quarter of 2013.

Consolidated operating income for the nine months ended September 30, 2014 increased by approximately \$297 million, or approximately 27.9%, as compared to the same period in 2013, including adjustments of \$17 million and \$397 million to a loss contingency reserve in 2014 and 2013, respectively, the contingent earn-out obligation adjustment of \$57 million, and the \$8 million adjustment to reduce a tax asset associated with HCP acquisition escrow provisions during 2013. Excluding these items from their respective periods, adjusted consolidated operating income would have decreased by \$34 million. The decrease in adjusted consolidated operating income was impacted by lower HCP Medicare Advantage payments, partially offset by an overall increase in HCP's revenues as described above, higher labor costs and related payroll taxes, higher long-term incentive compensation, an increase in benefit costs, higher pharmaceutical costs and an increase in the dialysis provision for uncollectible accounts. The increase in adjusted consolidated operating income was primarily due to strong volume growth in the number of treatments, an increase of \$1 in our average dialysis revenue per treatment, improvements in productivity, lower professional fees and an increase due to the write-off of certain obsolete software costs that occurred in the second quarter of 2013. In addition, adjusted consolidated operating income also increased as a result of improved operating performance of certain ancillary services and strategic initiatives, primarily our pharmacy services, and the recognition of additional revenue related to the maintenance of existing physician networks and an increase in senior capitated members.

**Table of Contents***U.S. dialysis and related lab services business**Results of operations*

	Three months ended			Nine months ended	
	September 30, 2014	June 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
	(dollar amounts rounded to nearest million, except per treatment data)				
<b>Net revenues:</b>					
Dialysis and related lab services patient service revenues	\$ 2,165	\$ 2,106	\$ 2,052	\$ 6,307	\$ 5,956
Less: Provision for uncollectible accounts	(92)	(84)	(72)	(258)	(208)
Dialysis and related lab services net patient service revenues	\$ 2,073	\$ 2,022	\$ 1,980	\$ 6,049	\$ 5,748
Other revenues	3	3	3	10	9
Total net dialysis and related lab services revenues	\$ 2,076	\$ 2,025	\$ 1,983	\$ 6,059	\$ 5,757
<b>Operating expenses and charges:</b>					
Patient care costs	1,390	1,358	1,311	4,070	3,793
General and administrative	170	164	183	490	521
Depreciation and amortization	102	99	89	297	263
Loss contingency reserve	17		97	17	397
Equity investment income	(3)	(4)	(3)	(10)	(9)
Total operating expenses and charges	1,676	1,617	1,677	4,864	4,965
Operating income	\$ 400	\$ 408	\$ 306	\$ 1,195	\$ 792
Dialysis treatments	6,343,706	6,196,394	6,034,647	18,515,727	17,531,419
Average dialysis treatments per treatment day	80,300	79,441	76,388	79,330	75,081
Average dialysis and related lab services revenue per treatment	\$ 341	\$ 340	\$ 340	\$ 341	\$ 340
<i>Net revenues</i>					

Dialysis and related lab services net revenues for the third quarter of 2014 increased by approximately \$51 million, or approximately 2.5%, as compared to the second quarter of 2014. The increase in dialysis and related lab services net revenues was due to an increase in the number of treatments as a result of one additional treatment day in the third quarter of 2014 as compared to the second quarter of 2014 and strong acquired and non-acquired treatment growth and an increase in the average dialysis revenue per treatment of approximately \$1. The increase in the average dialysis revenue per treatment was primarily due to a seasonal increase in our flu vaccine, partially offset by a slight decrease in our commercial mix and an increase in the provision for uncollectible accounts.

Dialysis and related lab services net revenues for the third quarter of 2014 increased by approximately \$93 million, or approximately 4.7%, as compared to the third quarter of 2013. The increase in net revenues in the third quarter of 2014 was principally due to strong volume growth from additional treatments. The increase in the number of treatments was primarily attributable to strong acquired and non-acquired treatment growth. The average dialysis revenue per treatment also increased by approximately \$1 in the third quarter of 2014 as compared to the third quarter of 2013. The increase in our average dialysis revenue per treatment was primarily

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due to an increase as a result of changes in the mix of our government reimbursements and an increase in some of our average commercial payment rates, partially offset by an increase in the provision for uncollectible accounts.

Dialysis and related lab services net revenues for the nine months ended September 30, 2014 increased by approximately \$302 million, or approximately 5.2%, as compared to the same period in 2013. The increase in net revenues in the first nine months of 2014 was principally due to strong volume growth from additional treatments. The increase in the number of treatments was primarily attributable to strong acquired and non-acquired treatment growth. The average dialysis revenue per treatment increased by approximately \$1 in the first nine months of 2014 as compared to the first nine months of 2013. The increase in our average dialysis revenue per treatment was primarily due to an increase in our acute services and an increase in some of our average commercial payment rates, partially offset by a decrease in our Medicare reimbursements as a result of sequestration that went into effect on April 1, 2013, and a slight decrease in our commercial mix. Dialysis and related lab services net revenues were also negatively impacted by an increase in the provision for uncollectible accounts.

*Provision for uncollectible accounts.* The provision for uncollectible accounts receivable for dialysis and related lab services was 4.25% for the third quarter of 2014, 4.0% for the second quarter of 2014, and 3.5% for the third quarter of 2013. We continue to experience higher amounts of non-covered Medicare write-offs. We assess our level of the provision for uncollectible accounts based upon our historical cash collection experience and trends, and have and will continue to adjust the provision as necessary as a result of changes in our cash collections.

*Medicare update*

CMS issued the 2014 final rule for the ESRD Prospective Payment System (PPS), which phases in over three to four years the 12% cut mandated by the American Taxpayer Relief Act of 2012 (ATRA). Although no reimbursement reduction is expected for the remainder of 2014 or in 2015 under the final ESRD PPS rule, it is anticipated that future reductions will occur no later than 2017. However, the recent Protecting Access to Medicare Act that was passed on March 31, 2014 further modified the reduction to only 1.25% in 2016 and 2017, and 1% in 2018. While this modification eases reimbursement pressure, future legislative actions could have the opposite effect. CMS recently issued the 2015 proposed rule for the ESRD PPS, which was published in the Federal Register on July 11, 2014. The proposed rule would increase payments to dialysis facilities modestly by 0.3% to 0.5%, although rural facilities would receive a decrease of 0.5%.

The Protecting Access to Medicare Act was passed by Congress on March 31, 2014 which delayed the implementation of oral-only medications that will be included in the bundled ESRD payment rate to dialysis centers until June 1, 2024.

As previously disclosed, sequestration spending cuts took effect on April 1, 2013, which reduced our Medicare payments by 2%. These spending cuts were extended through 2014 and 2015 by a two-year funding bill signed into law on December 31, 2013, which will continue to negatively impact our condensed consolidated financial results.

*Operating expenses and charges*

*Patient care costs.* Dialysis and related lab services patient care costs of approximately \$219 per treatment for the third quarter of 2014 was flat as compared to the second quarter of 2014. Patient care costs per treatment were impacted primarily by a slight decrease in productivity, an increase in occupancy costs and higher pharmaceutical unit costs, offset by a decrease in travel expenses related to management meetings, lower professional fees, a decrease in insurance expense and a decrease in our other direct operating expenses associate with our dialysis centers.





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Dialysis and related lab services patient care costs on a per treatment basis for the third quarter of 2014 increased by approximately \$2 as compared to the third quarter of 2013. The increase was primarily attributable to higher labor costs, higher pharmaceutical unit costs, higher occupancy costs, an increase in our other direct operating expenses associated with our dialysis centers and an increase in intensities of physician-prescribed pharmaceuticals, partially offset by improved productivity and lower benefit costs.

Dialysis and related lab services patient care costs on a per treatment basis for the nine months ended September 30, 2014 increased by approximately \$4 as compared to the same period in 2013. The increase was primarily attributable to higher labor costs, higher pharmaceutical unit costs, higher occupancy costs, an increase in our other direct operating expenses associated with our dialysis centers and an increase in intensities of physician-prescribed pharmaceuticals, partially offset by improved productivity, and a decrease in benefit costs

*General and administrative expenses.* Dialysis and related lab services general and administrative expenses of approximately \$170 million in the third quarter of 2014 increased by approximately \$6 million as compared to the second quarter of 2014. The increase in general and administrative expenses was primarily due to higher labor and benefit costs, an increase in professional fees and higher long-term incentive compensation, partially offset by a decrease in travel expenses related to management meetings.

Dialysis and related lab services general and administrative expenses for the third quarter of 2014 decreased by approximately \$13 million as compared to the third quarter of 2013. The decrease was primarily due to lower labor costs, a decrease in professional fees for legal matters and the write-off of certain obsolete software costs that occurred in the third quarter of 2013, partially offset by higher long-term incentive compensation.

Dialysis and related lab services general and administrative expenses for the nine months ended September 30, 2014 decreased by approximately \$31 million as compared to the same period in 2013. The decrease was primarily due to lower labor costs, lower travel expenses, a decrease in professional fees for compliance matters and information technology initiatives and the write-off of certain obsolete software costs that occurred in the third quarter of 2013, partially offset by higher long-term incentive compensation.

*Depreciation and amortization.* Depreciation and amortization for dialysis and related lab services was approximately \$102 million for the third quarter of 2014, \$99 million for the second quarter of 2014 and \$89 million for the third quarter of 2013. The increases in depreciation and amortization in the third quarter of 2014, as compared to both the second quarter of 2014 and the third quarter of 2013, were primarily due to growth in newly developed centers and from acquired centers.

Depreciation and amortization for dialysis and related lab services was approximately \$297 million for the nine months ended September 30, 2014 as compared to \$263 million for the same period in 2013. The increase was primarily due to the same factors as described above.

*Loss contingency reserve.* As described more fully in our current report on Form 8-K filed on October 23, 2014, we entered into a final settlement agreement on October 22, 2014 with various federal governmental agencies of the United States of America to resolve the pending 2010 and 2011 U.S. Attorney physician relationship matters. In connection with the resolution of these matters, we have agreed to pay to the United States \$350 million plus accrued interest from the date of our agreement in principle with the United States, plus a civil forfeiture of \$39 million. In addition, we have agreed in principle to a settlement of certain state Medicaid claims in the amount of \$11.5 million plus interest. We had previously announced an agreement in principle in these matters and had accrued an estimated loss contingency reserve of \$397 million. In the third quarter of 2014, we accrued an additional \$17 million related to this matter which resulted in an increase in the reserve from \$397 million to \$414 million.

In connection with the resolution of this matter, we have entered into a five-year corporate integrity agreement (the Corporate Integrity Agreement) with the OIG. The Corporate Integrity Agreement requires that

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we maintain certain elements of our compliance programs and imposes certain expanded compliance-related requirements during the term of the Corporate Integrity Agreement, including the appointment of a compliance monitor and our agreeing to (1) unwind 11 joint venture transactions that were created through partial divestitures to or partial acquisitions from nephrologists and that cover 26 of our 2,119 clinics; (2) not enter into certain types of partial divestiture joint venture transactions with nephrologists; and (3) certain other restrictions.

*Equity investment income.* Equity investment income for dialysis and related lab services was approximately \$3.2 million for the third quarter of 2014, as compared to \$4.1 million for the second quarter of 2014 and \$3.1 million for the third quarter of 2013. The decrease in equity investment income in the third quarter of 2014 as compared to the second quarter of 2014 was primarily due to an increase in Medicare bad debt cost recoveries in the second quarter of 2014.

*Accounts receivable*

Our dialysis and related lab services accounts receivable balances at September 30, 2014 and June 30, 2014 were \$1,117 million and \$1,148 million, respectively, which represented approximately 50 days and 53 days, respectively, which is net of the provision for uncollectible accounts. The decrease in day sales outstanding (DSO) in the third quarter of 2014 was primarily due to additional Medicare and commercial collections. Our DSO calculation is based on the current quarter's average revenues per day. There were no significant changes during the third quarter of 2014 from the second quarter of 2014 in the amount of unreserved accounts receivable over one year old or the amounts pending approval from third-party payors.

*Segment operating income*

Dialysis and related lab services' operating income for the third quarter of 2014 decreased by approximately \$8 million, or approximately 2.0%, as compared to the second quarter of 2014, including a \$17 million adjustment for a loss contingency reserve. Excluding this item from the third quarter of 2014, adjusted operating income would have increased by \$9 million. The increase in adjusted operating income was primarily due to strong volume growth in the number of treatments due to one additional treatment day in the third quarter of 2014 as compared to the second quarter of 2014 and strong acquired and non-acquired growth. Dialysis and related lab services adjusted operating income also increased as a result of an increase in the average dialysis revenue per treatment of \$1, partially offset by higher labor costs, a decline in productivity, higher pharmaceutical unit costs, an increase in professional fees, an increase in long-term incentive compensation and an increase in the provision for uncollectible accounts.

Dialysis and related lab services' operating income for the third quarter of 2014 increased by approximately \$94 million, or approximately 30.7%, as compared to the third quarter of 2013 including \$17 million and \$97 million of adjustments to a loss contingency reserve in the third quarters of 2014 and 2013, respectively. Excluding these items from their respective periods, adjusted operating income would have increased by \$14 million. The increase in adjusted operating income was primarily attributable to strong volume growth in revenues from additional treatments as a result of acquired and non-acquired treatment growth, an increase in the average dialysis revenue per treatment of \$1, a decrease in professional fees, improved productivity and an increase as a result of a write-off of certain obsolete software costs that occurred in the third quarter of 2013. Dialysis and related lab services operating income was negatively impacted by higher labor costs, higher pharmaceutical unit costs, an increase in the provision for uncollectible accounts and an increase in long-term incentive compensation.

Dialysis and related lab services' operating income for the nine months ended September 30, 2014 increased by approximately \$403 million, or approximately 50.9%, as compared to the same period in 2013, which includes \$17 million and \$397 million of a loss contingency reserve during 2014 and 2013, respectively. Excluding these items

from their respective periods, adjusted operating income would have increased by \$23 million, primarily attributable to strong volume growth in revenues from additional treatments as a result of

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acquired and non-acquired treatment growth, an increase in the average dialysis revenue per treatment of \$1, improved productivity, lower professional fees and an increase as a result of the write-off of certain obsolete software costs that occurred in the third quarter of 2013. Adjusted dialysis and related lab services operating income was negatively impacted by higher labor costs and related payroll taxes, higher benefit costs, higher pharmaceutical unit costs, an increase in the intensities of physician-prescribed pharmaceuticals, an increase in the provision for uncollectible accounts and higher long-term incentive compensation.

**HCP business****Results of operations**

	Three months ended						Nine months ended			
	September 30, 2014		June 30, 2014		September 30, 2013		September 30, 2014		September 30, 2013	
(dollar amounts rounded to nearest millions)										
Net revenues:										
HCP capitated revenue	\$ 828	93%	\$ 783	88%	\$ 731	91%	\$ 2,383	91%	\$ 2,169	92%
Patient service revenue	56		62		61		176		169	
Less: Provision for uncollectible accounts	(6)		(4)		(3)		(12)		(8)	
Net patient service revenue	50	6%	58	7%	58	7%	164	6%	161	7%
Other revenues	14	1%	46	5%	14	2%	73	3%	37	1%
Total net revenues	\$ 892	100%	\$ 887	100%	\$ 803	100%	\$ 2,620	100%	\$ 2,367	100%
Operating expense:										
Patient care costs	\$ 719	80%	\$ 688	77%	\$ 605	76%	\$ 2,079	79%	\$ 1,789	76%
General and administrative expense	86	10%	77	9%	67	8%	241	9%	192	8%
Depreciation and amortization	42	5%	42	5%	39	5%	127	5%	116	5%
Equity investment income	(2)		(2)		(6)	(1)%	(9)		(17)	(1)%
Total expenses	845	95%	805	91%	705	88%	2,438	93%	2,080	88%
Operating income	\$ 47	5%	\$ 82	9%	\$ 98	12%	\$ 182	7%	\$ 287	12%

**Capitated membership information**

The following table provides (i) the total number of capitated members to whom HCP provided healthcare services as of September 30, 2014, June 30, 2014 and September 30, 2013, and (ii) the aggregate member months for the nine

months ended September 30, 2014, June 30, 2014 and September 30, 2013. Member months represent the aggregate number of months of healthcare services HCP has provided to capitated members during a period of time:

	Members at			Members months for Three months ended		
	September 30, 2014	June 30, 2014	September 30, 2013	September 30, 2014	June 30, 2014	September 30, 2013
HCP total capitated membership	836,200	828,500	760,000	2,504,600	2,455,700	2,237,000

In addition to the members above, HCP provided healthcare services to members of Magan Medical Group, an unconsolidated joint venture that is accounted for as an equity investment. The Magan Medical Group joint venture provided health care services for approximately 45,400 members as of September 30, 2014 and for approximately 134,500 member months for the quarter ended September 30, 2014.

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The increase in members and member months was primarily attributable to an increase in senior members resulting from new acquisitions and non-acquired growth and an increase in Medicaid memberships due to Medicaid expansion, partially offset by a decline in commercial members.

*Revenues*

The following table provides HCP's revenue by source:

	Three months ended			Nine months ended						
	September 30, 2014	June 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013					
(dollars rounded to nearest millions)										
HCP revenues:										
Commercial revenues	\$ 188	21%	\$ 177	20%	\$ 176	22%	\$ 552	21%	\$ 533	23%
Senior revenues	605	68%	576	65%	539	67%	1,745	67%	1,587	67%
Medicaid revenues	35	4%	30	3%	16	2%	86	3%	49	2%
Total capitated revenues	\$ 828	93%	\$ 783	88%	\$ 731	91%	\$ 2,383	91%	\$ 2,169	92%
Patient service revenue, net of provision for uncollectible accounts	50	6%	58	7%	58	7%	164	6%	161	7%
Other revenues	14	1%	46	5%	14	2%	73	3%	37	1%
Total net revenues	\$ 892	100%	\$ 887	100%	\$ 803	100%	\$ 2,620	100%	\$ 2,367	100%

*Net revenues*

HCP's net revenue for the third quarter of 2014 increased by \$5 million, or approximately 0.6%, as compared to the second quarter of 2014. The increase in revenue was primarily attributable to an increase in senior capitated members, an increase in Medicaid membership and improved commercial risk pool performance due to increased funding and reduced costs, partially offset by the recognition of revenues associated with HCP's annual premium reconciliation of senior capitated members which occurred in the second quarter of 2014, and from the recognition of additional HCP revenues related to the maintenance of existing physician networks during the second quarter of 2014.

HCP's net revenue for the third quarter of 2014 increased by \$89 million, or approximately 11.1%, as compared to the third quarter of 2013. The increase in revenue was primarily attributable to an increase in the number of senior capitated members from acquired and organic growth and an increase in Medicaid memberships, partially offset by a decrease in Medicare Advantage rates and a decline in the number of commercial members to whom HCP provides health care services and the timing of revenue from its annual premium reconciliation for senior capitated members which occurred in the second quarter of 2014, when typically the revenue would have been recorded in the third quarter of 2014.

HCP's net revenue for the nine months ended September 30, 2014 increased by \$253 million, or approximately 10.7%, as compared to the same period in 2013. The increase in revenue was primarily attributable to an increase in the number of senior capitated members from acquired and organic growth, an increase in Medicaid memberships and from the recognition of additional HCP revenues related to the maintenance of existing physician networks, partially

offset by a decrease in Medicare Advantage rates and a decline in the number of commercial members to whom HCP provides health care services.

On April 7, 2014 CMS issued final guidance for 2015 Medicare Advantage rates, which incorporated a re-blending of the risk adjustment models that CMS utilizes to determine the risk acuity scores of Medicare Advantage patients. We estimate that the final cumulative impact of the 2015 rate structure will represent an increase of up to approximately 0.5% of HCP's average Medicare Advantage revenues it manages on behalf of its senior capitated population as compared to 2014, instead of a decrease of 1.9% that was originally proposed by CMS in February 2014.



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### *Operating expenses*

HCP's patient care costs of approximately \$719 million for the third quarter of 2014, increased by approximately \$31 million, or approximately 4.5%, as compared to the second quarter of 2014. The increase was primarily attributable to an increase in medical claims expense due to an increase in senior and Medicaid memberships from acquisitions and Medicaid expansion, an increase in contracted provider payments from additional capitated contracts and the recognition of additional contractual payments to physicians and the recognition of additional benefit expense in the third quarter of 2014.

HCP's patient care costs of approximately \$719 million for the third quarter of 2014, increased by approximately \$114 million, or approximately 18.8%, as compared to the third quarter of 2013. The increase was primarily attributable to the same factors as described for the increase in the third quarter of 2014 as compared to the second quarter of 2014.

HCP's patient care costs of approximately \$2,079 million for the nine months ended September 30, 2014, increased by approximately \$290 million, or approximately 16.2%, as compared to the same period in 2013. The increase was primarily attributable to the same factors as described for the increase in the third quarter of 2014 as compared to the second quarter of 2014.

HCP's general and administrative costs of approximately \$86 million for the third quarter of 2014, increased by approximately \$9 million or approximately 11.7%, as compared to the second quarter of 2014. The increase in general and administrative expenses was primarily attributable to the recognition of additional benefit expense in the third quarter of 2014 and an increase in information technology related expenses.

HCP's general and administrative costs of approximately \$86 million for the third quarter of 2014, increased by approximately \$19 million, or approximately 28.4%, as compared to the third quarter of 2013. The increase in general and administrative expenses was primarily attributable to an increase in corporate support expenses to accommodate additional acquisitions and the recognition of additional benefit costs in the third quarter of 2014.

HCP's general and administrative costs of approximately \$241 million for the nine months ended September 30, 2014, increased by approximately \$49 million, or approximately 25.5%, as compared to the same period in 2013. The increase in general and administrative expenses was primarily attributable to the same factors as described for the increase in third quarter of 2014 as compared to the third quarter in 2013.

HCP's depreciation and amortization of approximately \$42 million for the third quarter of 2014 was relatively flat as compared to the second quarter of 2014.

HCP's depreciation and amortization of approximately \$42 million for the third quarter of 2014 increased by approximately \$3 million, as compared to the third quarter of 2013, primarily attributable to depreciation and amortization of acquired assets associated with acquisitions.

HCP's depreciation and amortization of approximately \$127 million for the nine months ended September 30, 2014 increased by approximately \$11 million, as compared to the same period in 2013, primarily attributable to depreciation and amortization of acquired assets associated with acquisitions.

### *Segment operating income*

HCP's operating income for the third quarter of 2014 decreased by approximately \$35 million, or approximately 42.7%, as compared to the second quarter of 2014. The decrease was primarily attributable to an increase in medical

claims expense due to an increase in senior capitated and Medicaid memberships from acquisitions and organic growth and the recognition of additional benefit expense during third quarter of 2014, the timing of recognition of revenues associated with HCP's annual premium reconciliation of senior capitated members that occurred in the second quarter of 2014 and from the recognition of additional HCP revenues related to the maintenance of existing physician networks during second quarter of 2014.

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For the three months ended September 30, 2014, HCP s operating income included approximately \$5 million of operating income related to the physician owned entities (physician groups).

HCP s operating income for the third quarter of 2014 decreased by approximately \$51 million, or approximately 52%, as compared to the third quarter of 2013. The decrease was primarily attributable to a decrease in Medicare advantage payments, the timing of revenue from its annual premium reconciliation for senior capitated members which occurred in the second quarter of 2014, when typically the revenue would have been received in the third quarter of 2014, a decrease in commercial memberships and higher medical claims expense, partially offset by an increase in Medicare and Medicaid revenues due to acquisitions, organic growth and Medicaid expansion.

HCP s operating income for the nine months ended September 30, 2014 decreased by approximately \$105 million, or approximately 36.6%, as compared to the same period in 2013. The decrease was primarily attributable to a decrease in Medicare Advantage payments, a decrease in commercial memberships and higher medical claims expense, partially offset by an increase in our senior capitated members, an increase in Medicaid membership and from the recognition of additional HCP revenues related to the maintenance of existing physician networks.

For the nine months ended September 30, 2014, HCP s operating income included approximately \$25 million of operating income associated with the physician groups.

### ***Other Ancillary services and strategic initiatives business***

Our other operations include ancillary services and strategic initiatives which are primarily aligned with our core business of providing dialysis services to our network of patients. As of September 30, 2014, these consisted primarily of pharmacy services, disease management services, vascular access services, ESRD clinical research programs, physician services, direct primary care and our international dialysis operations. The ancillary services and strategic initiatives generated approximately \$300 million of net revenues in the third quarter of 2014, representing approximately 9.1% of our consolidated net revenues. We currently expect to continue to invest in our ancillary services and strategic initiatives, including our continued expansion into certain international markets as we work to develop successful new business operations in the U.S. as well as outside the U.S. Any significant change in market conditions, business performance or the regulatory environment may impact the economic viability of any of these strategic initiatives. Any unfavorable changes in these strategic initiatives could result in a write-off or an impairment of some or all of our investments, including goodwill and could also result in significant termination costs if we were to exit a particular line of business.

As of September 30, 2014, we provided dialysis and administrative services to a total of 87 outpatient dialysis centers located in ten countries outside of the U.S. The total net revenues generated from our international operations are provided below.

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The following table reflects the results of operations for the ancillary services and strategic initiatives:

	Three months ended			Nine months ended	
	September 30, 2014	June 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
<b>(dollar amounts rounded to nearest millions)</b>					
<b>U.S. revenues</b>					
Net patient service revenues	\$ 5	\$ 5	\$ 4	\$ 14	\$ 11
Other revenues	246	227	185	685	501
Capitated revenues	21	16	17	53	51
<b>Total</b>	<b>272</b>	<b>248</b>	<b>206</b>	<b>752</b>	<b>563</b>
<b>International revenues</b>					
Net patient service revenues	27	24	18	74	42
Other revenues	1	2	2	5	5
<b>Total</b>	<b>28</b>	<b>26</b>	<b>20</b>	<b>79</b>	<b>47</b>
<b>Total net revenues</b>	<b>\$ 300</b>	<b>\$ 274</b>	<b>\$ 226</b>	<b>\$ 831</b>	<b>\$ 610</b>
<b>Total operating loss</b>	<b>\$ (6)</b>	<b>\$ (2)</b>	<b>\$ (8)</b>	<b>\$ (6)</b>	<b>\$ (29)</b>

*Net revenues*

The ancillary services and strategic initiatives net revenues for the third quarter of 2014 increased by approximately \$26 million or 9.5% as compared to the second quarter of 2014. The increase was primarily from growth in pharmacy services revenue and an increase due to a mid-year risk factor adjustment in our Special Needs Plan in VillageHealth.

The ancillary services and strategic initiatives net revenues for the third quarter of 2014 increased by approximately \$74 million, or 32.7%, as compared to the third quarter of 2013. The increase was primarily from growth in prescriptions dispensed, an increase in pharmacy services revenue and growth in our international operations.

The ancillary services and strategic initiatives net revenues for the nine months ended September 30, 2014 increased by approximately \$221 million, or 36.2%, as compared to the same period in 2013. The increase was primarily from growth in prescriptions dispensed, an increase in pharmacy services revenue and growth in our international operations.

*Operating expenses*

Ancillary services and strategic initiatives operating expenses for the third quarter of 2014 increased by approximately \$30 million as compared to the second quarter of 2014. The increase in operating expenses was primarily due to an increase in drug costs in our pharmacy business, an increase in labor costs, an increase in expenses associated with our international dialysis expansion and an increase in business related licensing and the right to use newly developed intellectual property and corporate level services.

Ancillary services and strategic initiatives operating expenses for the third quarter of 2014 increased by approximately \$72 million as compared to the third quarter of 2013. The increase in operating expenses was primarily due to an increase in prescription dispensing volume and costs in our pharmacy business, an increase in expenses associated with our international dialysis expansion into Europe, Middle East, South America and Asia Pacific, an increase in labor costs and related payroll taxes, an increase in benefit costs and an increase in business related licensing and the right to use newly developed intellectual property and corporate level services.

Ancillary services and strategic initiatives operating expenses for the nine months ended September 30, 2014 increased by approximately \$198 million as compared to the same period in 2013. The increase in operating

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expenses was primarily due to an increase in prescription dispensing volume and costs in our pharmacy business, an increase in expenses associated with our international dialysis expansion into Europe, Middle East, South America and Asia Pacific, higher labor costs and related payroll taxes, an increase in benefit costs and an increase in business related licensing and the right to use newly developed intellectual property and corporate level services.

*Ancillary services and strategic initiatives operating losses*

Ancillary services and strategic initiatives operating losses for the third quarter of 2014 increased by approximately \$4 million from the second quarter of 2014. The decrease in operating income was primarily due to an increase in costs associated with international dialysis expansion, partially offset by improved operating performance in our pharmacy business and from the mid-year risk factor adjustment in our Special Needs Plan in VillageHealth.

Ancillary services and strategic initiatives operating losses for the third quarter of 2014 decreased by approximately \$2 million from the third quarter of 2013. The decrease in operating losses was primarily due to improved operating performance of our pharmacy business related to increased prescriptions dispensed, partially offset by an increase in costs associated with international dialysis expansion, an increase in labor costs and related payroll taxes, and an increase in benefit costs.

Ancillary services and strategic initiatives operating losses for the nine months ended September 30, 2014 decreased by approximately \$23 million from the same period in 2013. The decrease in operating losses was primarily due to improved operating performance of our pharmacy business related to increased prescriptions dispensed, partially offset by an increase in labor costs and related payroll taxes, an increase in benefit costs and an increase in costs associated with international dialysis expansion.

**Corporate-level charges**

*Debt expense.* Debt expense was \$99.9 million in the third quarter of 2014 representing a decrease of approximately \$6.2 million as compared to the second quarter of 2014 and a decrease of approximately \$8.5 million as compared to the third quarter of 2013. The decrease in debt expense in the third quarter of 2014 as compared to both the second quarter of 2014 and the third quarter of 2013 was primarily related to the New Credit Agreement, as defined below, and the issuance of our 5  $\frac{1}{8}$ % Senior Notes that were entered into in June 2014 that contain lower weighted average interest rates.

Debt expense for the nine months ended September 30, 2014 decreased by approximately \$10 million as compared to the same period in 2013, primarily due to lower average outstanding principal balances, as compared to the nine months ended September 30, 2013, as well as the same factors for the decrease in debt expense in the third quarter of 2014.

Our overall weighted average effective interest rate for the third quarter of 2014 was 4.52% compared to 4.85% for the second quarter of 2014 and 4.87% for the third quarter of 2013.

*Corporate support costs.* Corporate support costs consist primarily of labor, benefits and long-term incentive compensation costs for departments which provide support to all of our different operating lines of business. Corporate support costs were approximately \$3.5 million in the third quarter of 2014, \$3.8 million in the second quarter of 2014 and \$10.9 million in third quarter of 2013. These expenses are included in our consolidated general and administrative expenses. Corporate support costs in the third quarter of 2014 as compared to the second quarter of 2014 were relatively flat. The decrease in corporate support costs in the third quarter of 2014 as compared to the third quarter of 2013 was primarily from internal management fees paid by our ancillary lines of businesses related to the

licensing and the right to use newly developed intellectual property and other corporate level services.

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Corporate support costs were approximately \$8.4 million in the nine months ended September 30, 2014, as compared to \$33.3 million for the same period in 2013. These expenses are included in our consolidated general and administrative expenses. The decrease in corporate support costs were primarily due to the same reasons as noted above for the change in the third quarter of 2014 as compared to the third quarter of 2013.

*Other income.* Other income for the third quarter of 2014 was a negative \$1.2 million as compared to \$1.7 million for the second quarter of 2014 and \$2.1 million for the third quarter of 2013. The decrease in other income in the third quarter of 2014 as compared to both the second quarter of 2014 and the third quarter of 2013 was primarily related to changes in our foreign exchange rates affecting our long-term investment amounts.

### *Noncontrolling interests*

Net income attributable to noncontrolling interests was \$35.7 million for the third quarter of 2014 as compared to \$33.7 million for the second quarter of 2014, and \$33.2 million for the third quarter of 2013. The increases in net income attributable to noncontrolling interests in the third quarter of 2014, as compared to both the second quarter of 2014 and the third quarter of 2013, was primarily due to the overall number of joint ventures and an increase in the overall profitability of certain of our dialysis joint ventures.

### *Accounts receivable*

Our consolidated total accounts receivable balances at September 30, 2014 and June 30, 2014 were \$1,469 million and \$1,550 million, respectively, which represented approximately 43 and 46 days of revenue, respectively, which is net of the provision for uncollectible accounts.

### *Outlook*

We are updating our consolidated operating income guidance for 2014 to now be in the range of \$1.785 billion to \$1.835 billion. Our previous consolidated operating income guidance for 2014 was in the range of \$1.755 billion to \$1.840 billion.

We expect our consolidated operating income for 2015 to be in the range of \$1.750 billion to \$1.900 billion.

We are also updating our operating income guidance for our Kidney Care division for 2014 to now be in the range of \$1.580 billion to \$1.610 billion. Our previous operating income guidance for Kidney Care for 2014 was in the range of \$1.550 billion to \$1.600 billion.

We expect our operating income for Kidney Care for 2015 to be in the range of \$1.525 billion to \$1.625 billion.

We are lowering the high end of our operating income guidance for HCP for 2014 to now be in the range of \$205 million to \$225 million. Our previous operating income guidance for HCP for 2014 was in the range of \$205 million to \$240 million.

We expect our operating income for HCP for 2015 to be in the range of \$225 million to \$275 million.

We are updating our consolidated operating cash flow guidance for 2014 to now be in the range of \$1.700 billion to \$1.800 billion. Our previous consolidated operating cash flow guidance for 2014 was in the range of \$1.450 billion to \$1.550 billion.



We expect our consolidated operating cash flow for 2015 to be in the range of \$1.500 billion to \$1.700 billion.

The consolidated operating cash flow amounts for 2014 exclude any potential payment relating to the 2010 and 2011 U.S. Attorney Physician Relationship Investigations.

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These projections and the underlying assumptions involve significant risks and uncertainties, and actual results may vary significantly from these current projections. See page 43 for further details regarding our forward looking statements.

*Liquidity and capital resources*

*Liquidity and capital resources.* Cash flow from operations during the third quarter of 2014 was \$848 million, compared to \$733 million during the third quarter of 2013. Cash flow from operations in the third quarter of 2014 increased as a result of an increase in Medicare cash collections, the timing of certain other working capital items, and the timing of income tax payments. Non-operating cash outflows for the third quarter of 2014 included capital asset expenditures of \$165 million, including \$97 million for new center developments and relocations and \$68 million for maintenance and information technology. In addition, we spent \$120 million for acquisitions and we paid distributions to noncontrolling interests of \$39 million in that period. Non-operating cash outflows for the third quarter of 2013 included capital asset expenditures of \$141 million, including \$86 million for new center developments and relocations and \$55 million for maintenance and information technology. In addition, we spent \$83 million for acquisitions and we paid distributions to noncontrolling interests of \$35 million in that period.

Cash flow from operations for the nine months ended September 30, 2014 was \$1,529 million, compared to \$1,419 million during the same period in 2013. Cash flow from operations in 2014 increased as a result of an increase in cash collections, the timing of certain working capital items and the timing of income tax payments. Non-operating cash outflows during the nine months ended September 30, 2014, included capital asset expenditures of \$444 million, including \$262 million for new center developments and relocations and \$182 million for maintenance and information technology. In addition, we spent \$218 million for acquisitions and we paid distributions to noncontrolling interests of \$105 million in that period. Non-operating cash outflows during the nine months ended September 30, 2013, included capital asset expenditures of \$400 million, including \$241 million for new center developments and relocations and \$159 million for maintenance and information technology. In addition, we spent \$235 million for acquisitions and we paid distributions to noncontrolling interests of \$100 million in that period.

During the third quarter of 2014, our U.S. dialysis and related lab services business acquired a total of 15 dialysis centers and opened 29 dialysis centers, sold one dialysis center, merged nine dialysis centers into other existing centers and closed one dialysis center. In addition, our international dialysis operations acquired one dialysis centers and opened two dialysis centers. During the third quarter of 2013, we acquired a total of 10 dialysis centers, opened 25 dialysis centers, merged two dialysis centers into other existing dialysis centers, and closed one dialysis center. In addition, our international dialysis operations acquired a total of 18 dialysis centers, opened one dialysis center and closed one dialysis center.

During the nine months ended September 30, 2014, our U.S. dialysis and related lab services business acquired a total of 16 dialysis centers, opened 75 dialysis centers, sold one dialysis center, merged 11 dialysis centers into other existing centers and closed one dialysis center. In addition, our international dialysis operations acquired four dialysis centers, opened nine dialysis centers, closed two dialysis centers and provided management and administrative services to three additional centers. During the nine months ended September 30, 2013, our U.S. dialysis and related lab services business acquired a total of 21 dialysis centers, opened 70 dialysis centers, merged three dialysis centers into other existing dialysis centers, sold and closed four dialysis centers and provided management and administrative services to four additional dialysis centers, two of which we own an equity investment interest. In addition, our international dialysis operations acquired a total of 30 dialysis centers, four of which we provide management and administrative services to, which we consolidate under applicable accounting standards, opened two dialysis centers, and closed two dialysis centers.

During the third quarter of 2014, our HCP business acquired one private medical practice. During the nine months ended September 30, 2014, our HCP business acquired one management services organization, seven

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private medical practices, one family practice and two primary care physician practices. During the third quarter of 2013, our HCP business acquired two primary care physician practices. During the nine months ended September 30, 2013, our HCP business acquired five primary care physician practices, one oncology services center and one hospice care services business.

During the first nine months of 2014, we made mandatory principal payments under our then existing Senior Secured Credit Facilities (before entering into a new senior secured credit agreement and repaying all outstanding amounts under the then existing Senior Secured Credit Facilities) totaling \$37.5 million on the Term Loan A, \$16.9 million on the Term Loan A-3, \$4.4 million on the Term Loan B and \$4.1 million on the Term Loan B-2. During the third quarter of 2014, we made mandatory principal payments under our New Senior Secured Credit Facility (the New Credit Agreement), as described below, totaling \$12.5 million on the New Term Loan A and \$8.8 million on the New Term Loan B.

In June 2014, we entered into a \$5,500 million senior secured credit agreement. The New Credit Agreement consists of a five year Revolving Credit Facility in the aggregate principal amount of \$1,000 million (the New Revolver), a five year Term Loan A facility in the aggregate principal amount of \$1,000 million (the New Term Loan A) and a seven year Term Loan B facility in the aggregate principal amount of \$3,500 million (the New Term Loan B and collectively with the New Revolver and the New Term Loan A, the New Loans). In addition, we can increase the existing revolving commitments and enter into one or more incremental term loan facilities in an amount not to exceed the sum of \$1,500 million (less the amount of other permitted indebtedness incurred or issued in reliance on such amount), plus an amount of indebtedness such that the senior secured leverage ratio is not in excess of 3.50 to 1.00 after giving effect to such borrowings. The New Revolver and the New Term Loan A initially bear interest at LIBOR plus an interest rate margin of 1.75% which is subject to adjustment depending upon our leverage ratio and can range from 1.50% to 2.00%. The New Term Loan A requires annual principal payments beginning on September 30, 2014 of \$25 million in 2014, \$50 million in 2015, \$62.5 million in 2016, \$87.5 million in 2017, and \$100 million in 2018 with the balance of \$675 million due in 2019. The New Term Loan B bears interest at LIBOR (Floor of 0.75%) plus an interest rate margin of 2.75%. The New Term Loan B requires annual principal payments of \$17.5 million in 2014, and \$35 million for each year from 2015 through 2020, with the balance of \$3,272.5 million due in 2021. These New Loans under the New Credit Agreement are guaranteed by certain of our direct and indirect wholly-owned domestic subsidiaries holding most of our domestic assets and are secured by substantially all of DaVita HealthCare Partners Inc. s and the guarantors assets. The New Credit Agreement contains certain customary affirmative and negative covenants such as various restrictions or limitations on the amount of investments, acquisitions, the payment of dividends and redemptions and the incurrence of other indebtedness. Many of these restrictions and limitations will not apply as long as our leverage ratio is below 3.50 to 1.00. In addition, the New Credit Agreement places limitations on the amount of tangible net assets of the non-guarantor subsidiaries and also requires compliance with a maximum leverage ratio covenant.

In addition, in June 2014, we issued \$1,750 million 5 1/8% Senior Notes due 2024 (the 5 1/8% Senior Notes). The 5 1/8% Senior Notes pay interest on January 15 and July 15 of each year beginning January 15, 2015. The 5 1/8% Senior Notes are unsecured obligations and will rank equally in right of payment with our existing and future unsecured senior indebtedness. The 5 1/8% Senior Notes are guaranteed by each of our domestic subsidiaries that guarantees our New Credit Agreement. We may redeem up to 35% of the 5 1/8% Senior Notes at any time prior to July 15, 2017 at a certain specified price from the proceeds of one or more equity offerings. In addition, we may redeem the 5 1/8% Senior Notes at any time prior to July 15, 2019 at make whole redemption prices and after such date at certain specified redemption prices.

We received total proceeds from these borrowings of \$6,250 million, \$4,500 million from the issuance of the New Term Loans and \$1,750 million from the issuance of the 5 1/8% Senior Notes. We used a portion of the proceeds to pay

off the total outstanding principal balances under our then existing Senior Secured Credit Facilities plus accrued interest totaling \$5,362.4 million and in addition, to purchase pursuant to a cash tender offer \$483.1 million of the outstanding principal balances of our \$775 million 6<sup>3</sup>/<sub>8</sub>% Senior Notes plus accrued

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interest and cash tender premium totaling \$512.4 million. The total amount paid for the 6 <sup>3</sup>/<sub>8</sub>% Senior Notes from the cash tender offer was \$1,051.25 per 1,000 of principal amount of the 6 <sup>3</sup>/<sub>8</sub>% Senior Notes, which resulted in our paying a cash tender premium of \$24.8 million for the redemption of this portion of the 6 <sup>3</sup>/<sub>8</sub>% Senior Notes. We also incurred an additional \$81.6 million in fees, discounts and other professional expenses associated with these transactions.

In July 2014, we also purchased an additional \$0.188 million principal amount of the 6 <sup>3</sup>/<sub>8</sub>% Senior Notes plus accrued interest totaling \$0.194 million pursuant to the cash tender offer at a price of \$1,021.25 per 1,000 of principal amount of the 6 <sup>3</sup>/<sub>8</sub>% Senior Notes, which resulted in our paying an additional cash tender premium of \$0.004 million.

In addition, in July 2014, we redeemed the remaining outstanding principal balance of the 6 <sup>3</sup>/<sub>8</sub>% Senior Notes of \$291.7 million at a redemption price of \$1,047.81 per 1,000 of principal amount of the 6 <sup>3</sup>/<sub>8</sub>% Senior Notes plus accrued interest and a redemption premium which totaled \$310.0 million. This resulted in an additional redemption premium of \$14.0 million being recorded as debt refinancing charges.

In addition, we terminated \$1,137.5 million notional amounts of amortizing swaps and also terminated \$600.0 million of forward swaps during June 2014, that resulted in our recognizing a loss of \$3.1 million, of which \$3.0 million was previously recorded in other comprehensive income due to our previously outstanding principal debt being paid-off as described above, and as a result of future forecasted transactions that are no longer probable. The loss is included as a component of our debt refinancing charges. During the nine months ended September 30, 2014, we recognized debt expense of \$6.1 million from these swaps.

As a result of these transactions, we recorded debt refinancing charges of \$97.5 million that consist of the cash tender premiums, the redemption premium, the write-off of existing deferred financing costs, the write-off of certain new refinancing costs, other professional fees and losses associated with the termination of several of our interest rate swap agreements.

As of September 30, 2014, we maintain several interest rate swap agreements that were entered into in March 2013 with amortizing notional amounts of these swap agreements totaling \$866.9 million. These agreements have the economic effect of modifying the LIBOR variable component of our interest rate on an equivalent amount of our New Term Loan A to fixed rates ranging from 0.49% to 0.52%, resulting in an overall weighted average effective interest rate of 2.26%, including the New Term Loan A margin of 1.75%. The overall weighted average effective interest rate also includes the effects of \$120.6 million of unhedged New Term Loan A debt that bears interest at LIBOR plus an interest rate margin of 1.75%. The swap agreements expire on September 30, 2016 and require monthly interest payments. During the nine months ended September 30, 2014, we recognized debt expense of \$2.4 million from these swaps. As of September 30, 2014, the total fair value of these swap agreements was a net asset of approximately \$2.7 million. We estimate that approximately \$2.0 million of existing unrealized pre-tax losses in other comprehensive income at September 30, 2014 will be reclassified into income over the next twelve months.

As of September 30, 2014, we maintain several interest rate cap agreements that were entered into in March 2013 with notional amounts totaling \$2,735 million on our New Term Loan B debt. These agreements have the economic effect of capping the LIBOR variable component of our interest rate at a maximum of 2.50% on an equivalent amount of our New Term Loan B. During the nine months ended September 30, 2014, we recognized debt expense of \$1.8 million from these caps. The cap agreements expire on September 30, 2016. As of September 30, 2014, the total fair value of these cap agreements was an asset of approximately \$2.5 million. During the nine months ended September 30, 2014, we recorded a loss of \$5.1 million in other comprehensive income due to a decrease in the unrealized fair value of these cap agreements.

Previously, we maintained five other interest rate cap agreements with notional amounts totaling \$1,250 million. These agreements had the economic effect of capping the LIBOR variable component of our interest rate

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at a maximum of 4.00% on an equivalent amount of our New Term Loan B debt. However, these interest rate cap agreements expired on September 30, 2014. During the nine months ended September 30, 2014 we recognized \$2.7 million of debt expense related to these cap agreements.

As a result of an embedded LIBOR floor on the New Term Loan B debt agreement and the swap and cap agreements, our overall weighted average effective interest rate on the Senior Secured Credit Facilities was 3.43%, based upon the current margins in effect of 1.75% for the New Term Loan A and 2.75% for the New Term Loan B, as of September 30, 2014.

As of September 30, 2014, the interest rate on our New Term Loan B debt is effectively fixed because of an embedded LIBOR floor which is higher than actual LIBOR as of such date and the New Term Loan B is also subject to interest rate caps if LIBOR should rise above 2.50%. Interest rates on our senior notes are fixed by their terms. The LIBOR variable component of our interest rates on the majority of our New Term Loan A is economically fixed as a result of interest rate swaps.

Our overall weighted average effective interest rate during the third quarter of 2014 was 4.52% and as of September 30, 2014 was 4.46%.

As of September 30, 2014, we had undrawn revolving credit facilities totaling \$1,000 million of which approximately \$96 million was committed for outstanding letters of credit. In addition, HCP has an outstanding letter of credit of approximately \$1 million that is secured by a certificate of deposit.

We believe that we will have sufficient liquidity and will generate significant operating cash flows to fund our scheduled debt service and other obligations for the foreseeable future, including the next 12 months, under the terms of our debt agreements. Our primary sources of liquidity are cash from operations and cash from borrowings.

### *Goodwill*

HCP's current and expected future operating results have been eroded, primarily as a result of recent reductions in its Medicare Advantage reimbursement rates. As a result, we have determined that three of HCP's reporting units, HCP California, HCP Nevada and HCP New Mexico, are at risk of goodwill impairment. HCP California, HCP Nevada and HCP New Mexico have goodwill of \$2,511 million, \$518 million and \$72 million, respectively.

Our preliminary valuations of these three businesses as of September 30, 2014, resulted in the estimated fair values of HCP California, HCP Nevada and HCP New Mexico exceeding their total carrying values by approximately 5.3%, 11.3% and 8.3%, respectively. Further reductions in HCP's reimbursement rates or other significant adverse changes in its expected future cash flows or valuation assumptions could result in a goodwill impairment charge in the future.

For example, a sustained, long-term reduction of 3% in operating income for HCP California, HCP Nevada and HCP New Mexico could reduce their estimated fair values by up to 2.4%, 2.9% and 2.7%, respectively. Separately, an increase in their respective discount rates of 100 basis points could reduce the estimated fair values of HCP California, HCP Nevada and HCP New Mexico by up to 5.1%, 6.0% and 5.7%, respectively.

During the first nine months of 2014, we did not record any goodwill impairment charges. Except as described above, none of the goodwill associated with our various other reporting units was considered at risk of impairment as of September 30, 2014. Since the dates of our last annual goodwill impairment tests, there have been certain developments, events, changes in operating performance and other changes in circumstances that have affected our businesses. However, these did not cause management to believe it is more likely than not that the fair value of any of



its reporting units would be less than its carrying amount.

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**Table of Contents***Stock-based compensation awards*

Stock-based compensation awards are measured at their estimated fair values on the date of grant if settled in shares, or at their estimated fair values at the end of each reporting period if settled in cash. The value of stock-based awards so measured is recognized as compensation expense on a cumulative straight-line basis over the vesting terms of the awards, adjusted for expected forfeitures. During the nine months ended September 30, 2014, we granted 1,501,789 stock-settled stock appreciation rights with an aggregate grant-date fair value of \$24.6 million and a weighted-average expected life of approximately 4.2 years and 329,143 stock units with an aggregate grant-date fair value of \$23.8 million and a weighted-average expected life of approximately 3.4 years, 105,360 of which are performance-based.

*Long-term incentive compensation*

Long-term incentive program (LTIP) compensation includes both stock-based awards (principally stock-settled stock appreciation rights, restricted stock units and performance stock units) as well as long-term performance-based cash awards. Long-term incentive compensation expense, which was primarily general and administrative in nature, was attributed to our dialysis and related lab services business, our HCP business, corporate support costs, and the ancillary services and strategic initiatives.

Long-term incentive compensation costs of \$35.4 million in the third quarter of 2014 increased by approximately \$5.5 million as compared to the second quarter of 2014 and increased by approximately \$15.9 million as compared to the third quarter of 2013. The increase in long-term incentive compensation in the third quarter of 2014 as compared to the second quarter of 2014 was primarily due to an increase in the fair value of LTIP awards during the quarter that contributed additional expense as well as a full quarter of expense from LTIP awards granted during the second quarter. The increase in long-term incentive compensation in the third quarter of 2014 as compared to the third quarter of 2013 was primarily due to an increase in the fair value of LTIP awards that contributed expense to this period.

As of September 30, 2014, there was \$147.8 million of total estimated unrecognized compensation cost for outstanding LTIP awards, including \$87.7 million related to stock-based compensation arrangements under our equity compensation and stock purchase plans. We expect to recognize the performance-based cash component of these LTIP costs over a weighted average remaining period of 1.1 years and the stock-based component of these LTIP costs over a weighted average remaining period of 1.4 years.

*Off-balance sheet arrangements and aggregate contractual obligations*

In addition to the debt obligations reflected on our balance sheet, we have commitments associated with operating leases and letters of credit, as well as potential obligations associated with our equity investments in nonconsolidated businesses and to dialysis centers that are wholly-owned by third parties. Substantially all of our U.S. dialysis facilities are leased. We have potential obligations to purchase the noncontrolling interests held by third parties in several of our majority-owned joint ventures, non-owned and minority-owned entities. These obligations are in the form of put provisions and are exercisable at the third-party owners' discretion within specified periods as outlined in each specific put provision. If these put provisions were exercised, we would be required to purchase the third-party owners' noncontrolling interests at either the appraised fair market value or a predetermined multiple of earnings or cash flow attributable to the noncontrolling interests put to us, which is intended to approximate fair value. The methodology we use to estimate the fair values of noncontrolling interests subject to put provisions assumes the higher of either a liquidation value of net assets or an average multiple of earnings, based on historical earnings, patient mix and other performance indicators that can affect future results, as well as other factors. The estimated fair values of the noncontrolling interests subject to put provisions is a critical accounting estimate that involves significant judgments and assumptions and may not be indicative of the actual values at which the noncontrolling interests may ultimately

be settled, which could vary significantly from our current estimates. The estimated fair values of noncontrolling interests subject to put provisions can fluctuate and the implicit multiple of earnings at which these noncontrolling interests obligations

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may be settled will vary significantly depending upon market conditions including potential purchasers' access to the capital markets, which can impact the level of competition for dialysis and non-dialysis related businesses, the economic performance of these businesses and the restricted marketability of the third-party owners' noncontrolling interests. The amount of noncontrolling interests subject to put provisions that employ a contractually predetermined multiple of earnings rather than fair value are immaterial. For additional information see Note 10 to the condensed consolidated financial statements.

We also have certain other potential commitments to provide operating capital to several dialysis centers that are wholly-owned by third parties or centers in which we own a minority equity investment as well as to physician-owned vascular access clinics that we operate under management and administrative services agreements. We have certain other potential commitments related to service agreements of approximately \$1 million.

The following is a summary of these contractual obligations and commitments as of September 30, 2014 (in millions):

	<b>Remainder of 2014</b>	<b>1-3 years</b>	<b>4-5 years</b>	<b>After 5 years</b>	<b>Total</b>
<b>Scheduled payments under contractual obligations:</b>					
Long-term debt	\$ 32	\$ 344	\$ 859	\$ 7,089	\$ 8,324
Interest payments on the senior notes	26	577	426	786	1,815
Interest payments on the New Term Loan B <sup>(1)</sup>	31	336	238	204	809
Interest payments on the New Term Loan A <sup>(2)</sup>	5	48	24		77
Capital lease obligations	3	28	24	140	195
Operating leases	96	1,056	530	799	2,481
	\$ 193	\$ 2,389	\$ 2,101	\$ 9,018	\$ 13,701
<b>Potential cash requirements under existing commitments:</b>					
Letters of credit	\$ 97	\$	\$	\$	\$ 97
Noncontrolling interests subject to put provisions	423	140	101	95	759
Non-owned and minority owned put provisions	31				31
Pay-fixed swaps potential obligations	1	1			2
Operating capital advances	3				3
	\$ 555	\$ 141	\$ 101	\$ 95	\$ 892

(1) Assuming no changes to LIBOR-based interest rates as the New Term Loan B currently bears interest at LIBOR (floor of 0.75%) plus an interest rate margin of 2.75%.

(2) Based upon current LIBOR-based interest rates in effect at September 30, 2014 plus an interest rate margin of 1.75% for the New Term Loan A.

The pay-fixed swap obligations represent the estimated fair market values of our interest rate swap agreements that are based upon valuation models utilizing the income approach and commonly accepted valuation techniques that use inputs from closing prices for similar assets and liabilities in active markets as well as other relevant observable market inputs and other current market conditions that existed as of September 30, 2014. This amount represents the

estimated potential obligation that we would be required to pay based upon the estimated future settlement of each specific tranche over the term of the swap agreements, assuming no future changes in the forward yield curve. The actual amount of our obligation associated with these swaps in the future will depend upon changes in the LIBOR-based interest rates that can fluctuate significantly depending upon market conditions, and other relevant factors that can affect the fair market value of these swap agreements.

In addition to the above commitments, we are obligated to purchase a certain amount of our hemodialysis products and supplies at fixed prices through 2015 from Gambro Renal Products, Inc. (Gambro) in connection with a product supply agreement with Gambro. Our total expenditures for the nine months ended September 30,

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2014 on such products were approximately 2% of our total U.S. dialysis operating costs. In January 2010, we entered into an agreement with Fresenius which originally committed us to purchase a certain amount of dialysis equipment, parts and supplies from them through 2013. However, this agreement has been extended through 2015. Our total expenditures for the nine months ended September 30, 2014 on such dialysis products were approximately 2% of our total U.S. dialysis operating costs. The actual amount of purchases in future years from Gambro Renal Products and Fresenius will depend upon a number of factors, including the operating requirements of our centers, the number of centers we acquire, growth of our existing centers, and in the case of the Product Supply Agreement, Gambro Renal Products' ability to meet our needs.

In November 2011, we entered into a seven year sourcing and supply agreement with Amgen USA Inc. that expires on December 31, 2018. Under the terms of the agreement, we will purchase EPO in amounts necessary to meet no less than 90% of our requirements for erythropoiesis stimulating agents (ESAs). The actual amount of EPO that we will purchase from Amgen will depend upon the amount of EPO administered during dialysis as prescribed by physicians and the overall number of patients that we serve.

Settlements of approximately \$46 million of existing income tax liabilities for unrecognized tax benefits including interest, penalties and other long-term tax liabilities are excluded from the above table as reasonably reliable estimates of their timing cannot be made.

**Supplemental information concerning certain Physician Groups and unrestricted subsidiaries**

The following information is presented as supplemental data as required by the indentures governing our senior notes.

We provide services to certain physician groups that, while consolidated in our financial statements for financial reporting purposes, are not subsidiaries of or owned by us, do not constitute "Subsidiaries", as defined in the indentures governing our outstanding senior notes, and do not guarantee those senior notes. In addition, we have entered into management agreements with these physician groups pursuant to which we receive management fees from the physician groups.

As of September 30, 2014, if these physician groups were not consolidated in our financial statements, our consolidated indebtedness would have been approximately \$8,502 million, our consolidated other liabilities (excluding indebtedness) would have been approximately \$3,413 million and our consolidated assets would have been approximately \$17,647 million. If these physician groups were not consolidated in our financial statements (i) for the three months ended September 30, 2014, our consolidated total net revenues (including approximately \$156 million of management fees payable to us), consolidated operating income and consolidated net income would be reduced by approximately \$258 million, \$5 million, and \$2 million, respectively, and (ii) for the nine months ended September 30, 2014, our consolidated total net revenues (including approximately \$458 million of management fees payable to us), consolidated operating income and consolidated net income would be reduced by approximately \$752 million, \$25 million, and \$11 million, respectively.

In addition, we own a 67% equity interest in California Medical Group Insurance (CMGI). CMGI is an Unrestricted Subsidiary, as defined in the indentures governing our outstanding senior notes, and does not guarantee those senior notes. Our equity interest in CMGI is accounted for under the equity method of accounting, meaning that, although CMGI is not consolidated in our financial statements for financial reporting purposes, our consolidated income statement reflects our pro rata share of CMGI's net loss as equity investment loss.

For the three months ended September 30, 2014, our equity investment income attributable to CMGI was a loss of approximately \$0.027 million, and for the three months ended September 30, 2014, excluding our equity investment

income attributable to CMGI, our consolidated operating income and consolidated net income would be increased by approximately \$0.027 million and \$0.016 million, respectively. For the nine months ended

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September 30, 2014, our equity investment loss attributable to CMGI was a loss of approximately \$0.3 million, and for the nine months ended September 30, 2014, excluding our equity investment loss attributable to CMGI, our consolidated operating income and consolidated net income would be increased by approximately \$0.3 million and \$0.2 million, respectively. See Note 20 to the condensed consolidated financial statements for further details.

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

The tables below provide information about our financial instruments that are sensitive to changes in interest rates. The table below presents principal repayments and current weighted average interest rates on our debt obligations as of September 30, 2014. The variable rates presented reflect the weighted average LIBOR rates in effect for all debt tranches plus interest rate margins in effect as of September 30, 2014. The New Term Loan A margin in effect is 1.75% at September 30, 2014, and along with the revolving line of credit are subject to adjustment depending upon changes in certain of our financial ratios, including a leverage ratio. The New Term Loan B currently bears interest at LIBOR (floor of 0.75%) plus an interest rate margin of 2.75%.

	Expected maturity date							Total	Average interest rate	Fair value
	2014	2015	2016	2017	2018	2019	Thereafter			
	(dollars in millions)									
Long term debt:										
Fixed rate	\$ 22	\$ 61	\$ 53	\$ 53	\$ 53	\$ 52	\$ 7,228	\$ 7,522	4.76%	\$ 7,538
Variable rate	\$ 13	\$ 52	\$ 64	\$ 89	\$ 102	\$ 676	\$ 1	\$ 997	1.91%	\$ 997

	Notional amount	Contract maturity date				Pay fixed	Receive variable	Fair value
		2014	2015	2016	2017 2018			
		(dollars in millions)						
Swaps:								
Pay-fixed rate	\$ 867	\$ 12	\$ 95	\$ 760	\$ \$	0.49% to 0.52%	LIBOR	\$ 2.7
Cap agreements	\$ 2,735	\$	\$	\$ 2,735	\$ \$		LIBOR above 2.50%	\$ 2.5

Our Senior Secured Credit Facilities, which include the New Term Loan A and the New Term Loan B, consist of various individual tranches of debt that can range in maturity from one month to twelve months (currently, all tranches are one month in duration). For the New Term Loan A, each tranche bears interest at a LIBOR rate that is determined by the duration of such tranche plus an interest rate margin. The LIBOR variable component of the interest rate for each tranche is reset as such tranche matures and a new tranche is established. LIBOR can fluctuate significantly depending upon conditions in the credit and capital markets. However, the LIBOR variable component of the interest rate for the majority of the New Term Loan A is economically fixed as a result of our swap agreements, as described below.

The New Term Loan B is subject to a LIBOR floor of 0.75%. Because actual LIBOR, as of September 30, 2014, was lower than this embedded LIBOR floors, the interest rate on the New Term Loan B is treated as effectively fixed for purposes of the table above. We have included the New Term Loan B in the fixed rate totals in the table above until such time as the actual LIBOR-based variable component of our interest rate exceeds 0.75% on the New Term Loan



B. At such time, we will then be subject to LIBOR-based interest rate volatility on the LIBOR variable component of our interest rate for the New Term Loan B, but limited to a maximum LIBOR rate of 2.50% on \$2,735 million of outstanding principal debt on the New Term Loan B as a result of the interest rate cap agreements, as described below. The remaining \$756 million outstanding principal balance of the New Term Loan B is subject to LIBOR-based interest rate volatility above a floor of 0.75%.

As of September 30, 2014, we maintain several interest rate swap agreements that were entered into in March 2013 with amortizing notional amounts of these swap agreements totaling \$866.9 million. These

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agreements have the economic effect of modifying the LIBOR variable component of our interest rate on an equivalent amount of our New Term Loan A to fixed rates ranging from 0.49% to 0.52%, resulting in an overall weighted average effective interest rate of 2.26%, including the New Term Loan A margin of 1.75%. The overall weighted average effective interest rate also includes the effects of \$120.6 million of unhedged New Term Loan A debt that bears interest at LIBOR plus an interest rate margin of 1.75%. The swap agreements expire on September 30, 2016 and require monthly interest payments. During the nine months ended September 30, 2014, we recognized debt expense of \$2.4 million from these swaps. As of September 30, 2014, the total fair value of these swap agreements was a net asset of approximately \$2.7 million. We estimate that approximately \$2.0 million of existing unrealized pre-tax losses in other comprehensive income at September 30, 2014 will be reclassified into income over the next twelve months.

As of September 30, 2014, we maintain several interest rate cap agreements that were entered into in March 2013 with notional amounts totaling \$2,735 million on our New Term Loan B debt. These agreements have the economic effect of capping the LIBOR variable component of our interest rate at a maximum of 2.50% on an equivalent amount of our New Term Loan B. During the nine months ended September 30, 2014, we recognized debt expense of \$1.8 million from these caps. The cap agreements expire on September 30, 2016. As of September 30, 2014, the total fair value of these cap agreements was an asset of approximately \$2.5 million. During the nine months ended September 30, 2014, we recorded a loss of \$5.1 million in other comprehensive income due to a decrease in the unrealized fair value of these cap agreements.

Previously, we maintained five other interest rate cap agreements with notional amounts totaling \$1,250 million. These agreements had the economic effect of capping the LIBOR variable component of our interest rate at a maximum of 4.00% on an equivalent amount of our New Term Loan B debt. However, these interest rate cap agreements expired on September 30, 2014. During the nine months ended September 30, 2014 we recognized \$2.7 million of debt expense related to these cap agreements.

As a result of an embedded LIBOR floor on the New Term Loan B debt agreement and the swap and cap agreements, our overall weighted average effective interest rate on the Senior Secured Credit Facilities was 3.43%, based upon the current margins in effect of 1.75% for the New Term Loan A and 2.75% for the New Term Loan B, as of September 30, 2014.

As of September 30, 2014, the interest rate on our New Term Loan B debt is effectively fixed because of an embedded LIBOR floor which is higher than actual LIBOR as of such date and the New Term Loan B is subject to an interest rate cap if LIBOR should rise above 2.50%. Interest rates on our senior notes are fixed by their terms. The LIBOR variable component of our interest rate on the majority of our New Term Loan A is economically fixed as a result of interest rate swaps.

Our overall weighted average effective interest rate for the third quarter of 2014 was 4.52% and as of September 30, 2014 was 4.46%.

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

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

allow for timely decisions regarding required disclosures.

At the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures in accordance with the Exchange Act

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requirements. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective for timely identification and review of material information required to be included in the Company's Exchange Act reports, including this report on Form 10-Q. Management recognizes that these controls and procedures can provide only reasonable assurance of desired outcomes, and that estimates and judgments are still inherent in the process of maintaining effective controls and procedures.

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

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**PART II**

**OTHER INFORMATION**

**Item 1. Legal Proceedings**

The information in Note 9 of the Notes to Condensed Consolidated Financial Statements in Part I, Item 1 of this report is incorporated by this reference in response to this item.

**Item 1A. Risk Factors**

*A restated description of the risk factors associated with our business is set forth below. This description includes any material changes to and supersedes the description of the risk factors associated with our business previously disclosed in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2013. The risks discussed below are not the only ones facing our business. Please read the cautionary notice regarding forward-looking statements under the heading Management's Discussion and Analysis of Financial Condition and Results of Operations .*

**Risk factors related to our U.S. dialysis and related lab services, ancillary services and strategic initiatives:**

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

Approximately 33% of our dialysis and related lab services revenues for the nine months ended September 30, 2014, were generated from patients who have commercial payors as their primary payor. The majority of these patients have insurance policies that pay us on terms and at rates that are generally significantly higher than Medicare rates. The payments we receive from commercial payors generate nearly all of our profit and all of our nonacute dialysis profits come from commercial payors. We continue to experience downward pressure on some of our commercial payment rates as a result of general conditions in the market, recent and future consolidations among commercial payors, increased focus on dialysis services and other factors. There is no guarantee that commercial payment rates will not be materially lower in the future.

We are continuously in the process of negotiating our existing or potentially new agreements with commercial payors who tend to be aggressive in their negotiations with us. Sometimes many significant agreements are up for renewal or being renegotiated at the same time. In the event that our continual negotiations result in overall commercial rate reductions in excess of overall commercial rate increases, the cumulative effect could have a material adverse effect on our financial results. Consolidations have significantly increased the negotiating leverage of commercial payors. Our negotiations with payors are also influenced by competitive pressures, and we may experience decreased contracted rates with commercial payors or experience decreases in patient volume as our negotiations with commercial payors continue. In addition to downward pressure on contracted commercial payor rates, payors have been attempting to impose restrictions and limitations on non-contracted or out-of-network providers, and in some circumstances designate our centers as out-of-network providers. Rates for out-of-network providers are on average higher than rates for in-network providers. We believe commercial payors have or will begin to restructure their benefits to create disincentives for patients to select or remain with out-of-network providers and to decrease payment rates for out-of-network providers. Decreases in out-of-network rates and restrictions on out-of-network access, our turning away new patients in instances where we are unable to come to agreement on rates, or decreases in contracted

rates could result in a significant decrease in our overall revenues derived from commercial payors. If the average rates that commercial payors pay us decline significantly, or if we see a decline in commercial patients, it would have a material adverse effect on our revenues, earnings and cash flows. For additional details regarding specific risks we face regarding regulatory changes that could result in fewer patients covered under commercial plans or an increase of patients covered under more restrictive commercial plans with lower reimbursement rates, see the discussion of individual and small group health plans in the risk factor below under the heading Health care reform could substantially reduce our revenues, earnings and cash flows.

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

Our revenue levels are sensitive to the percentage of our patients with higher-paying commercial insurance coverage. A patient's insurance coverage may change for a number of reasons, including changes in the patient's or a family member's employment status. Currently, for a patient covered by an employer group health plan, Medicare generally becomes the primary payor after 33 months, or earlier, if the patient's employer group health plan coverage terminates. When Medicare becomes the primary payor, the payment rate we receive for that patient decreases from the employer group health plan rate to the lower Medicare payment rate. We have seen an increase in the number of patients who have government-based programs as their primary payors which we believe is largely a result of improved mortality and recent economic conditions which have a negative impact on the percentage of patients covered under commercial insurance plans. To the extent there are sustained or increased job losses in the U.S., independent of whether general economic conditions might be improving, we could experience a continued decrease in the number of patients covered under commercial plans. We could also experience a further decrease if changes to the healthcare regulatory system result in fewer patients covered under commercial plans or an increase of patients covered under more restrictive commercial plans with lower reimbursement rates. In addition, our continuous process of negotiations with commercial payors under existing or potentially new agreements could result in a decrease in the number of patients under commercial plans to the extent that we cannot reach agreement with commercial payors on rates and other terms, resulting in termination or non-renewals of existing agreements or our inability to enter into new ones. If there is a significant reduction in the number of patients under higher-paying commercial plans relative to government-based programs that pay at lower rates, it would have a material adverse effect on our revenues, earnings and cash flows.

**Changes in the structure of and payment rates under the Medicare ESRD program, including the American Taxpayer Relief Act of 2012, the Budget Control Act of 2011 and other healthcare reform initiatives, could substantially reduce our revenues, earnings and cash flows.**

Approximately 47% of our dialysis and related lab services revenues for the nine months ended September 30, 2014 was generated from patients who have Medicare as their primary payor. For patients with Medicare coverage, all ESRD payments for dialysis treatments are made under a single bundled payment rate which provides a fixed payment rate to encompass all goods and services provided during the dialysis treatment, including pharmaceuticals that were historically separately reimbursed to the dialysis providers, such as Epogen (EPO), vitamin D analogs and iron supplements, irrespective of the level of pharmaceuticals administered or additional services performed. Most lab services that used to be paid directly to laboratories are also included in the bundled payment. The bundled payment rate is also adjusted for certain patient characteristics, a geographic usage index and certain other factors.

The current bundled payment system presents certain operating, clinical and financial risks, which include:

Risk that our rates are reduced by CMS. CMS issued the 2014 final rule for the ESRD PPS, which phases in over three to four years the 12% cut mandated by ATRA. Although no reimbursement reduction is expected in 2014 or 2015 under the final ESRD PPS rule, it is anticipated that future reductions will occur no later than 2017. However, the recent Protecting Access to Medicare Act that was passed on March 31, 2014 further modified the reduction to only 1.25% in 2016 and 2017, and 1% in 2018. While this modification eases reimbursement pressure, future legislative actions could have the opposite effect. CMS recently issued the 2015 proposed rule for the ESRD PPS, which was published in the Federal Register on July 11, 2014. The proposed rule, which may change before it is finalized, would increase payments to dialysis facilities

modestly by 0.3% to 0.5%, although rural facilities would receive a decrease of 0.5%. Uncertainty about future payment rates remain a material risk to our business.

Risk that increases in our operating costs will outpace the Medicare rate increases we receive. We expect to continue experiencing increases in operating costs that are subject to inflation, such as labor



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and supply costs, regardless of whether there is a compensating inflation-based increase in Medicare payment rates or in payments under the bundled payment rate system.

Risk of federal budget sequestration cuts. As a result of the Budget Control Act of 2011 (BCA) and subsequent activity in Congress, a \$1.2 trillion sequester (across-the-board spending cuts) in discretionary programs took effect on March 1, 2013. In particular, a 2% reduction to Medicare payments took effect on April 1, 2013, which was recently extended through 2014 and 2015 by a two-year funding bill signed into law on December 26, 2013. The across-the-board spending cuts pursuant to the sequester have affected and will continue to adversely affect our revenues, earnings and cash flows.

Risk that we may not be able to comply with the CMS ESRD Quality Incentive Program (QIP) requirements. Beginning in payment year 2016, CMS proposed to adopt two new clinical and reporting measures, continue using six existing clinical and reporting measures, revise two existing clinical and reporting measures, and expand one existing reporting measure. The final rule establishes calendar year 2014 as the performance period for all of the quality measures. The July 11, 2014 proposed rule further modifies the QIP by removing hemoglobin as a measurable indicator and adding hospital readmission as a reporting measure. CMS proposes to have a total of eleven clinical measures and five reporting measures in 2018. The QIP continues to evolve and undergo material changes. To the extent we are not able to meet CMS's quality measures, it could have a material adverse effect on our revenues, earnings and cash flows.

Risk that if our clinical systems fail to accurately capture the data we report to CMS in connection with claims for which at least part of the government's payments to us is based on clinical performance or patient outcomes or co-morbidities, we might be over-reimbursed by the government which could subject us to certain liability. For additional details regarding specific risks and potential liability we face regarding increased regulatory scrutiny on possible over-payment retention by providers and potential severe penalties, see the risk factor below under the heading "If we fail to adhere to all of the complex government regulations that apply to our business, we could suffer severe consequences that would substantially reduce our revenues, earnings, cash flows and stock price."

For additional details regarding the risks we face for failing to adhere to our Medicare and Medicaid regulatory compliance obligations, see the risk factor below under the heading "If we fail to adhere to all of the complex government regulations that apply to our business, we could suffer severe consequences that would substantially reduce our revenues, earnings, cash flows and stock price."

**Health care reform could substantially reduce our revenues, earnings and cash flows.**

We cannot predict how employers, private payors or persons buying insurance might react to the changes brought on by broad U.S. health care reform legislation or what form many of these regulations will take before implementation.

The health care reform legislation introduced health care insurance exchanges which provide a marketplace for eligible individuals and small employers to purchase health care insurance. Although we cannot predict the short or long term effects of these measures, we believe the health care insurance exchanges could result in a reduction in patients covered by commercial insurance or an increase of patients covered through the exchanges under more restrictive commercial plans with lower reimbursement rates. To the extent that the implementation of such exchanges results in a reduction in patients covered by commercial insurance or a reduction in reimbursement rates for our services from commercial and/or government payors, our revenues, earnings and cash flows could be adversely

affected.

In addition, the health care reform legislation introduced severe penalties for the knowing and improper retention of overpayments collected from government payors and reduced the timeline to file Medicare claims.

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As a result, we made significant initial investments in new resources to accelerate the time it takes us to identify and process overpayments and we deployed significant resources to reduce our timeline and improve our claims processing methods to ensure that our Medicare claims are filed in a timely fashion. We may be required to make additional investments in the future. Failure to timely identify and return overpayments may result in significant additional penalties, which may have a negative impact on our revenues, earnings and cash flows. Failure to file a claim within the one year window could result in payment denials, adversely affecting our revenues, earnings and cash flows.

The health care reform legislation also added several new tax provisions that, among other things, impose various fees and excise taxes, and limit compensation deductions for health insurance providers and their affiliates. These rules could negatively impact our cash flow and tax liabilities.

The CMS Center for Medicare & Medicaid Innovation (Innovation Center) is currently working with various healthcare providers to develop and implement ACOs and other innovative models of care for Medicare and Medicaid beneficiaries. We are currently uncertain of the extent to which these models of care, including ACOs, Bundled Payments for Care Improvement Initiative, Comprehensive ESRD Care Model (which includes the development of ESCOs), the Comprehensive Primary Care Initiative, the Duals Demonstration, or other models, will impact the health care market. Our U.S. dialysis business may choose to participate in one or several of these models either as a partner with other providers or independently. We are currently seeking to participate in the Comprehensive ESRD Care Model with the Innovation Center. Even if we do not participate in this or other programs, some of our patients may be assigned to a program, in which case the quality and cost of care that we furnish will be included in an ACO's or other programs' calculations. As new models of care emerge, we may be at risk for losing our Medicare patient base, which would have a materially adverse effect on our revenues, earnings and cash flow. Other initiatives in the government or private sector may arise, including the development of models similar to ACOs, IPAs and integrated delivery systems or evolutions of those concepts which could adversely impact our business.

CMS instituted new screening procedures which we expect will delay the Medicare contractor approval process, potentially causing a delay in reimbursement. We anticipate the new screening and enrollment requirements will require additional personnel and financial resources and will potentially delay the enrollment and revalidation of our centers which in turn will delay payment. These delays may negatively impact our revenues, earnings and cash flows.

Other reform measures allow CMS to place a moratorium on new enrollment of providers and to suspend payment to providers upon a credible allegation of fraud from any source. These types of reform measures, as well as other measures, could adversely impact our revenues, earnings and cash flows depending upon the scope and breadth of the implementing regulations.

There is also a considerable amount of uncertainty as to the prospective implementation of the federal healthcare reform legislation and what similar measures might be enacted at the state level. The enacted reforms as well as future legislative changes could have a material adverse effect on our results of operations, including lowering our reimbursement rates and increasing our expenses.

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

Approximately 20% of our dialysis and related lab services revenues for the nine months ended September 30, 2014 was generated from patients who have state Medicaid or other non-Medicare government-based programs, such as coverage through the Department of Veterans Affairs (VA), as their primary coverage. As state governments and other governmental organizations face increasing budgetary pressure, we may in turn face reductions in payment rates,

delays in the receipt of payments, limitations on enrollee eligibility or other changes to the applicable programs. For example, certain state Medicaid programs and the VA have recently considered, proposed or implemented payment rate reductions.

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The VA recently adopted Medicare's bundled PPS pricing methodology for any veterans receiving treatment from non-VA providers under a new national contracting initiative. Since we are a non-VA provider, these reimbursements are now tied to a percentage of Medicare reimbursement, and we have additional exposure to any dialysis reimbursement changes made by CMS. Approximately 2% of our dialysis and related lab services revenues for the nine months ended September 30, 2014 was generated by the VA. In 2013, we entered into a five-year Nationwide Dialysis Services contract with the VA which is subject to one-year renewal periods, consistent with all provider agreements with the VA under this contract. These agreements provide for the right of the VA to terminate the agreements without cause on short notice. Should the VA not renew or cancel these agreements for any reason, we may cease accepting patients under this program and may be forced to close centers, which could adversely affect our revenues, earnings and cash flows.

State Medicaid programs are increasingly adopting Medicare-like bundled payment systems, but sometimes these payment systems are poorly defined and are implemented without any claims processing infrastructure, or patient or facility adjusters. If these payment systems are implemented without any adjusters and claims processing changes, Medicaid payments will be substantially reduced and the costs to submit such claims may increase, which will have a negative impact on our revenues, earnings and cash flows. In addition, some state Medicaid program eligibility requirements mandate that citizen enrollees in such programs provide documented proof of citizenship. If our patients cannot meet these proof of citizenship documentation requirements, they may be denied coverage under these programs, resulting in decreased patient volumes and revenue. These Medicaid payment and enrollment changes, along with similar changes to other non-Medicare government programs could reduce the rates paid by these programs for dialysis and related services, delay the receipt of payment for services provided, and further limit eligibility for coverage which could adversely affect our revenues, earnings and cash flows.

**Changes in clinical practices, payment rates or regulations impacting EPO and other pharmaceuticals could adversely affect our operating results, reduce our revenues, earnings and cash flows and negatively impact our ability to care for patients.**

Medicare bundles EPO into the prospective payment system such that dosing variations do not change the amount paid to a dialysis facility. Although some Medicaid programs and other payors suggest movement towards a bundled payment system inclusive of EPO, some non-Medicare payors continue to pay for EPO separately from the treatment rate. The administration of EPO and other pharmaceuticals that are separately billable accounted for approximately 3% of our dialysis and related lab services revenues for the nine months ended September 30, 2014, with EPO alone accounting for approximately 2% of our dialysis and related lab services revenues during that period. Changes in physician clinical practices that result in further decreased utilization of prescribed pharmaceuticals or changes in payment rates for those pharmaceuticals could reduce our revenues, earnings and cash flows.

Evaluations on the utilization and reimbursement for ESAs, which have occurred in the past and may occur in the future, and related actions by the U.S. Congress and federal agencies, could result in further restrictions on the utilization and reimbursement for ESAs. Additionally, commercial payors have increasingly examined their administration policies for EPO and, in some cases, have modified those policies. Changes in labeling of EPO and other pharmaceuticals in a manner that alters physician practice patterns or accepted clinical practices, changes in private and governmental payment criteria, including the introduction of EPO administration policies or the conversion to alternate types of administration of EPO or other pharmaceuticals that result in further decreases in utilization of EPO for patients covered by commercial payors could have a material adverse effect on our revenues, earnings and cash flows. Further increased utilization of EPO for patients for whom the cost of EPO is included in a bundled reimbursement rate, or further decreases in reimbursement for EPO and other pharmaceuticals that are not included in a bundled reimbursement rate, could also have a material adverse effect on our revenues, earnings and cash flows.

Additionally, as a result of the current high level of scrutiny and controversy, we may be subject to increased inquiries or audits from a variety of governmental bodies or claims by third parties. Although we

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believe our anemia management practices and other pharmaceutical administration practices have been compliant with existing laws and regulations, increased inquiries or audits from governmental bodies or claims by third parties would require management's attention, and could result in significant legal expense. Any negative findings could result in substantial financial penalties or repayment obligations, the imposition of certain obligations on and changes to our practices and procedures as well as the attendant financial burden on us to comply with the obligations, or exclusion from future participation in the Medicare and Medicaid programs, and could have a material adverse effect on our revenues, earnings and cash flows.

**Changes in EPO pricing could materially reduce our earnings and cash flows and affect our ability to care for our patients.**

Future increases in the cost of EPO without corresponding increases in payment rates for EPO from commercial payors and without corresponding increases in the Medicare bundled rate could have a material adverse effect on our earnings and cash flows and ultimately reduce our income. In November 2011, we entered into a seven year Sourcing and Supply Agreement with Amgen USA Inc., pursuant to which we committed to purchase EPO in amounts necessary to meet no less than 90% of our requirements for ESAs. As long as we meet certain conditions, the agreement limits Amgen's ability to unilaterally increase the price for EPO during the term of the agreement. Our agreement with Amgen for EPO provides for discounted pricing and rebates for EPO. However, some of the rebates are subject to various conditions including, but not limited to, future pricing levels of EPO by Amgen and data submission by us. In addition, the rebates are subject to certain limitations. We cannot predict whether, over the seven year term of the agreement, we will continue to receive the rebates for EPO that we have received in the past, or whether we will continue to achieve the same levels of rebates within that structure as we have historically achieved. In the initial years of the agreement, the total rebate opportunity is less than what was provided in the agreement that expired at the end of 2011; however, the opportunity for us to earn discounts and rebates increases over the term of the agreement. Factors that could impact our ability to qualify for rebates provided for in our agreement with Amgen in the future include, but are not limited to, our ability to track certain data elements. We cannot predict whether we will be able to meet the applicable qualification requirements for receiving rebates. Failure to meet certain targets and earn the specified rebates could have a material adverse effect on our earnings and cash flows.

**We are the subject of a number of investigations by the federal government and two private civil suits, any of which could result in substantial penalties or awards against us, the imposition of certain obligations on our practices and procedures, exclusion from future participation in the Medicare and Medicaid programs and possible criminal penalties.**

We are the subject of a number of investigations by the federal government. We have received subpoenas or other requests for documents from the federal government in connection with the Vainer private civil suit, the 2010 U.S. Attorney physician relationship investigation, the 2011 U.S. Attorney physician relationship investigation and the 2011 U.S. Attorney Medicaid investigation. Certain current and former members of our Board, as well as executives and other teammates have been subpoenaed to testify before a grand jury in Colorado related to the 2011 U.S. Attorney physician relationship investigation. (See Note 9 to the condensed consolidated financial statements of this report for additional details regarding these matters.)

With respect to the Vainer private civil suit, after investigation, the federal government did not intervene and is not actively pursuing this private civil suit. With respect to the Swoben civil suit, the United States Department of Justice declined to intervene after its review of the allegations contained in the Third Amended Complaint and is not actively pursuing this private civil suit other than its partial intervention for the purpose of settlement with and dismissal of the initial defendant in this proceeding. In each of these private civil suits, a relator filed a complaint against us in federal court under the *qui tam* provisions of the False Claims Act (FCA) (and in the Swoben matter, provisions of the

California False Claims Act, as well) and pursued the claims independently after the government declined to intervene. The parties are engaged in active litigation in the Vainer private civil suit. With regard to the Swoben private civil suit, in July 2013, the court granted HCP s



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motion and dismissed with prejudice all of the claims in the Third Amended Complaint, and in October 2013 the plaintiff filed an appeal of the dismissal, which is currently pending. (See Note 9 to the condensed consolidated financial statements of this report for additional details regarding these matters).

In October 2014, we entered into the Settlement Agreement with the United States and relator David Barbetta to resolve the pending 2010 and 2011 U.S. Attorney Physician Relationship Investigations. In connection with the resolution of this matter, we have entered into the five-year Corporate Integrity Agreement with the OIG. The Corporate Integrity Agreement (i) requires that we maintain certain elements of our compliance programs, (ii) imposes certain expanded compliance-related requirements during the term of the Corporate Integrity Agreement, (iii) requires ongoing monitoring, reporting, certification, records retention and training obligations, the formal allocation of certain oversight responsibility to the Board's Compliance Committee, the creation of a Management Compliance Committee and the retention of an independent compliance advisor to the Board, and (iv) contains certain business restrictions related to a subset of our joint venture arrangements, including our agreeing to: (1) unwind 11 joint venture transactions that were created through partial divestitures to or partial acquisitions from nephrologists and that cover 26 of our 2,119 clinics; (2) not enter into certain types of partial divestiture joint venture transactions with nephrologists during the term of the Corporate Integrity Agreement; and (3) certain other restrictions. The costs associated with compliance with the Corporate Integrity Agreement could be substantial and may be greater than we currently anticipate. In addition, in the event of a breach of the Corporate Integrity Agreement, we could become liable for payment of certain stipulated penalties, or could be excluded from participation in federal health care programs. The costs associated with compliance with the Corporate Integrity Agreement, or any liability or consequences associated with its breach, could have an adverse effect on our revenues, earnings and cash flows.

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

Our dialysis operations are subject to extensive federal, state and local government regulations, including Medicare and Medicaid payment rules and regulations, federal and state anti-kickback laws, the physician self-referral law (Stark Law) and analogous state self-referral prohibition statutes, Federal Acquisition Regulations, the FCA and federal and state laws regarding the collection, use and disclosure of patient health information and the storage, handling and administration of pharmaceuticals. The Medicare and Medicaid reimbursement rules related to claims submission, enrollment and licensing requirements, cost reporting, and payment processes impose complex and extensive requirements upon dialysis providers as well. A violation or departure from any of these legal requirements may result in government audits, lower reimbursements, significant fines and penalties, the potential loss of certification, recoupment efforts or voluntary repayments.

We endeavor to comply with all legal requirements, however, there is no guarantee that we will be able to adhere to all of the complex government regulations that apply to our business. For example, we have experienced past security breaches with regard to patient health information and there can be no assurance that we will not suffer security breaches in the future. We further endeavor to structure all of our relationships with physicians to comply with state and federal anti-kickback and physician self-referral laws. We utilize considerable resources to monitor the laws and implement necessary changes. However, the laws and regulations in these areas are complex and often subject to varying interpretations. For example, if an enforcement agency were to challenge the level of compensation that we pay our medical directors or the number of medical directors whom we engage, we could be required to change our practices, face criminal or civil penalties, pay substantial fines or otherwise experience a material adverse effect as a result of a challenge to these arrangements. In addition, amendments to the FCA impose severe penalties for the knowing and improper retention of overpayments collected from government payors. These amendments could subject our procedures for identifying and processing overpayments to greater scrutiny. We have made significant investments in new resources to decrease the time it takes to identify and process overpayments and we may be

required to make additional investments in the future. An acceleration in our ability to identify and process overpayments could

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result in us refunding overpayments to government and other payors more rapidly than we have in the past which could have a material adverse effect on our operating cash flows. Additionally, amendments to the federal anti-kickback statute in the health reform law make anti-kickback violations subject to FCA prosecution, including *qui tam* or whistleblower suits.

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

Suspension or termination of our participation in government payment programs;

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

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

Loss of licenses required to operate health care facilities or administer pharmaceuticals in some of the states in which we operate;

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

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

Enforcement actions by governmental agencies and/or state claims for monetary damages by patients who believe their protected health information has been used, disclosed or not properly safeguarded in violation of federal or state patient privacy laws, including Health Insurance Portability and Accountability Act (HIPAA) of 1996;

Mandated changes to our practices or procedures that significantly increase operating expenses;

Imposition of and compliance with corporate integrity agreements that could subject us to ongoing audits and reporting requirements as well as increased scrutiny of our billing and business practices which could lead to potential fines;

Termination of relationships with medical directors; and

Harm to our reputation which could impact our business relationships, affect our ability to obtain financing and decrease access to new business opportunities.

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

Before we can begin billing for patients treated in our outpatient dialysis centers who are enrolled in government-based programs, we are required to obtain state and federal certification for participation in the Medicare and Medicaid programs. As state agencies responsible for surveying dialysis centers on behalf of the state and Medicare program face increasing budgetary pressure, certain states are having difficulty keeping up with certifying dialysis centers in the normal course resulting in significant delays in certification. If state governments continue to have difficulty keeping up with certifying new centers in the normal course and we continue to experience significant delays in our ability to treat and bill for services provided to patients covered under government programs, it could cause us to incur write-offs of investments or accelerate the recognition of lease obligations in the event we have to close centers or our centers' operating performance deteriorates, and it could have an adverse effect on our revenues, earnings and cash flows.

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As of September 30, 2014, we owned a controlling interest in numerous dialysis-related joint ventures, which represented approximately 22% of our U.S. dialysis and related lab services revenues for the nine months ended September 30, 2014. In addition, we also owned minority equity investments in several other dialysis related joint ventures. We may continue to increase the number of our joint ventures. Many of our joint ventures with physicians or physician groups also have certain physician owners providing medical director services to centers we own and operate. Because our relationships with physicians are governed by the federal and state anti-kickback statutes, we have sought to structure our joint venture arrangements to satisfy as many federal safe harbor requirements as we believe are commercially reasonable. However, if our joint venture arrangements do not satisfy all of the elements of any safe harbor under the federal anti-kickback statute, they are not automatically prohibited under the federal anti-kickback statute but are susceptible to government scrutiny. In October 2014, we entered into the Settlement Agreement with the United States and relator David Barbetta to resolve the pending 2010 and 2011 U.S. Attorney Physician Relationship Investigations. In connection with the resolution of this matter, we have entered into the five-year Corporate Integrity Agreement with the OIG. The Corporate Integrity Agreement, among other things, contains certain business restrictions related to a subset of our joint venture arrangements, including our agreeing to: (i) unwind 11 joint venture transactions that were created through partial divestitures to or partial acquisitions from nephrologists and that cover 26 of our 2,119 clinics; (ii) not enter into certain types of partial divestiture joint venture transactions with nephrologists during the term of the Corporate Integrity Agreement; and (iii) certain other restrictions. The costs associated with compliance with the Corporate Integrity Agreement could be substantial and may be greater than we currently anticipate. In addition, in the event of a breach of the Corporate Integrity Agreement, we could become liable for payment of certain stipulated penalties, or could be excluded from participation in federal health care programs. The costs associated with compliance with the Corporate Integrity Agreement, or any liability or consequences associated with its breach, could have an adverse effect on our revenues, earnings and cash flows.

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

There are significant estimating risks associated with the amount of dialysis and related lab services revenues and related refund liabilities that we recognize in a reporting period. The billing and collection process is complex due to ongoing insurance coverage changes, geographic coverage differences, differing interpretations of contract coverage, and other payor issues. Determining applicable primary and secondary coverage for approximately 170,000 U.S. patients at any point in time, together with the changes in patient coverage that occur each month, requires complex, resource-intensive processes. Errors in determining the correct coordination of benefits may result in refunds to payors. Revenues associated with Medicare and Medicaid programs are also subject to estimating risk related to the amounts not paid by the primary government payor that will ultimately be collectible from other government programs paying secondary coverage, the patient's commercial health plan secondary coverage or the patient. Collections, refunds and payor retractions typically continue to occur for up to three years and longer after services are provided. We generally expect our range of U.S. dialysis and related lab services revenues estimating risk to be within 1% of net revenues for the segment, which represents approximately 5% of dialysis and related lab services adjusted operating income. If our estimates of dialysis and related lab services revenues and related refund liabilities are materially inaccurate, it could impact the timing and the amount of our revenues recognition and have a significant impact on our operating results.



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

Our ancillary services and strategic initiatives currently include pharmacy services, disease management services, vascular access services, ESRD clinical research programs, physician services, direct primary care and our international dialysis operations. We expect to add additional service offerings and pursue additional strategic initiatives in the future as circumstances warrant, which could include healthcare services not related to dialysis. Many of these initiatives require or would require investments of both management and financial resources and can generate significant losses for a substantial period of time and may not become profitable. There can be no assurance that any such strategic initiative will ultimately be successful. Any significant change in market conditions, or business performance, or in the political, legislative or regulatory environment, may impact the economic viability of any of these strategic initiatives. If any of our ancillary services or strategic initiatives, including our international dialysis operations, do not perform as planned, we may incur a material write-off or an impairment of our investment, including goodwill, in one or more of these activities or we could incur significant termination costs if we were to exit a certain line of business.

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

We believe that physicians prefer to have their patients treated at dialysis centers where they or other members of their practice supervise the overall care provided as medical director of the center. As a result, the primary referral source for most of our centers is often the physician or physician group providing medical director services to the center.

Our medical director contracts are for fixed periods, generally ten years, and at any given time a large number of them could be up for renewal at the same time. Medical directors have no obligation to extend their agreements with us and if we are unable to enforce noncompetition provisions contained in terminated medical director agreements, our former medical directors may choose to provide medical director services for competing providers or establish their own dialysis centers in competition with ours. Neither our current nor former medical directors have an obligation to refer their patients to our centers.

Opportunities presented by our competitors or different affiliation models in the changing healthcare environment, such as an increase in the number of physicians becoming employed by hospitals or a perceived decrease in the quality of service levels at our centers may negatively impact a medical director's decision to enter into or extend his or her agreement with us, refer patients to our centers or otherwise negatively impact treatment volumes.

In addition, we may take actions to restructure existing relationships or take positions in negotiating extensions of relationships to assure compliance with the anti-kickback statute, Stark Law and other similar laws. If the terms of any existing agreement are found to violate applicable laws, we may not be successful in restructuring the relationship which could lead to the early termination of the agreement, or cause the physician to stop referring patients to our dialysis centers. These actions in an effort to comply with applicable laws and regulations could negatively impact the decision of physicians to extend their medical director agreements with us or to refer their patients to us. If a significant number of physicians were to cease referring patients to our dialysis centers, our revenues, earnings and cash flows would be substantially reduced.

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### **Deterioration in economic conditions as well as further disruptions in the financial markets could have a material adverse effect on our revenues, earnings and cash flows and otherwise adversely affect our financial condition.**

Deterioration in economic conditions could adversely affect our business and our profitability. Among other things, the potential decline in federal and state revenues that may result from such conditions may create additional pressures to contain or reduce reimbursements for our services from Medicare, Medicaid and other government sponsored programs. Increasing job losses or slow improvement in the unemployment rate in the U.S. as a result of adverse economic conditions has and may continue to result in a smaller percentage of our patients being covered by an employer group health plan and a larger percentage being covered by lower paying Medicare and Medicaid programs. Employers may also select more restrictive commercial plans with lower reimbursement rates. To the extent that payors are negatively impacted by a decline in the economy, we may experience further pressure on commercial rates, a further slowdown in collections and a reduction in the amounts we expect to collect. In addition, uncertainty in the financial markets could adversely affect the variable interest rates payable under our credit facilities or could make it more difficult to obtain or renew such facilities or to obtain other forms of financing in the future, if at all. Any or all of these factors, as well as other consequences of a deterioration in economic conditions which cannot currently be anticipated, could have a material adverse effect on our revenues, earnings and cash flows and otherwise adversely affect our financial condition.

### **If there are shortages of skilled clinical personnel or if we experience a higher than normal turnover rate, we may experience disruptions in our business operations and increases in operating expenses.**

We are experiencing increased labor costs and difficulties in hiring nurses due to a nationwide shortage of skilled clinical personnel. We compete for nurses with hospitals and other health care providers. This nursing shortage may limit our ability to expand our operations. In addition, changes in certification requirements or increases in the required staffing levels for skilled clinical personnel can impact our ability to maintain sufficient staff levels to the extent our teammates are not able to meet new requirements or we experience a higher than normal turnover rate due to increased competition for qualified clinical personnel. If we are unable to hire skilled clinical personnel when needed, or if we experience a higher than normal turnover rate for our skilled clinical personnel, our operations and treatment growth will be negatively impacted, which would result in reduced revenues, earnings and cash flows.

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

Our business is labor intensive, and our results are subject to variations in labor-related costs, productivity and the number of pending or potential claims against us related to labor and employment practices. If political efforts at the national and local level result in actions or proposals that increase the likelihood of union organizing activities at our facilities or if union organizing activities increase for other reasons, or if labor and employment claims, including the filing of class action suits, trend upwards, our operating costs could increase and our employee relations, productivity, earnings and cash flows could be adversely affected.

### **Complications associated with our migration to a new billing and collections system could have a material adverse effect on our revenues, cash flows and operating results.**

We are preparing to launch a new billing system that is critical to our billing operations. If the launch is unsuccessful or is delayed, or if there are defects in the new billing system, we may experience difficulties in our ability to successfully bill and collect for services rendered, including a delay in collections, a reduction in the amounts



collected, increased risk of retractions from and refunds to commercial and government payors, an increase in our provision for uncollectible accounts receivable and noncompliance with reimbursement

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regulations. To mitigate this risk, we plan to launch the new system in phases; however, the failure to successfully implement the new billing and collection system could have a material adverse effect on our revenues, cash flows and operating results.

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

We have significant suppliers that are either the sole or primary source of products critical to the services we provide, including Amgen, Baxter Healthcare Corporation, NxStage Medical, Inc. and others or to which we have committed obligations to make purchases including Gambro and FMC. If any of these suppliers are unable to meet our needs for the products they supply, including in the event of a product recall or shortage, and we are not able to find adequate alternative sources, or if some of the drugs that we purchase are not reimbursed or not adequately reimbursed by commercial payors or through the bundled payment rate by Medicare, our revenues, earnings and cash flows could be substantially reduced. In addition, the technology related to the products critical to the services we provide is subject to new developments and may result in superior products. If we are not able to access superior products on a cost-effective basis or if suppliers are not able to fulfill our requirements for such products, we could face patient attrition which could substantially reduce our revenues, earnings and cash flows.

### **Risk factors related to HCP:**

**HCP is subject to many of the same risks to which our dialysis business is subject.**

As a participant in the healthcare industry, HCP is subject to many of the same risks to which our dialysis business is subject to as described in the risk factors set forth above in this Part II, Item 1A, any of which could materially and adversely affect HCP's revenues, earnings or cash flows. Among these risks are the following:

The healthcare business is heavily regulated and changes in laws, regulations, or government programs could have a material impact on HCP;

Failure to comply with complex governmental regulations could have severe consequences to HCP, including, without limitation, exclusion from governmental payor programs like Medicare and Medicaid;

HCP could become the subject of governmental investigations, claims, and litigation;

HCP may be unable to continue to explore potential acquisition candidates, make acquisitions or successfully integrate such acquisitions into its business, and such acquisitions may include liabilities of which HCP was not aware; and

As a result of the broad scope of HCP's medical practice, HCP is exposed to medical malpractice claims, as well as claims for damages and other expenses, that may not be covered by insurance or for which adequate limits of insurance coverage may not be available.

**Under most of HCP's agreements with health plans, HCP assumes some or all of the risk that the cost of providing services will exceed its compensation.**

Substantially all of HCP's revenue is derived from fixed Per Member Per Month (PMPM) fees paid by health plans under capitation agreements with HCP or its associated physician groups. While there are variations specific to each arrangement, DaVita HealthCare Partners Plan, Inc., a subsidiary of HealthCare Partners Holdings, LLC and a restricted Knox-Keene licensed entity (DaVita HealthCare Partners Plan), HCP's associated physician groups generally contract with health plans to receive a PMPM fee for professional services and assume the financial responsibility for professional services only. In some cases, the health plans separately enter into capitation contracts with third parties (typically hospitals) who receive directly a PMPM fee and assume contractual financial responsibility for hospital services. In other cases, the health plan does not pay any portion

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of the PMPM fee to the hospital, but rather administers claims for hospital expenses itself. In both scenarios, HCP enters into managed care-related administrative services agreements or similar arrangements with those third parties (typically hospitals) under which HCP agrees to be responsible for utilization review, quality assurance, and other managed care-related administrative functions and claim payments. As compensation for such administrative services, HCP is entitled to receive a percentage of the amount by which the institutional capitation revenue received from health plans exceeds institutional expenses; any such risk-share amount to which HCP is entitled is recorded as medical revenues and HCP is also responsible for a percentage of any short-fall in the event that institutional expenses exceed institutional revenues. To the extent that members require more care than is anticipated, aggregate fixed PMPM amounts, or capitation payments, may be insufficient to cover the costs associated with treatment. If medical expenses exceed estimates, except in very limited circumstances, HCP will not be able to increase the PMPM fee received under these risk agreements during their then-current terms and could, directly or indirectly through its contracts with its associated physician groups, suffer losses with respect to such agreements.

Changes in HCP's or its associated physician groups' anticipated ratio of medical expense to revenue can significantly impact HCP's financial results. Accordingly, the failure to adequately predict and control medical expenses and to make reasonable estimates and maintain adequate accruals for incurred but not reported claims, may have a material adverse effect on HCP's financial condition, results of operations or cash flows.

Historically, HCP's and its associated physician groups' medical expenses as a percentage of revenue have fluctuated. Factors that may cause medical expenses to exceed estimates include:

the health status of members;

higher than expected utilization of new or existing healthcare services or technologies;

an increase in the cost of healthcare services and supplies, including pharmaceuticals, whether as a result of inflation or otherwise;

changes to mandated benefits or other changes in healthcare laws, regulations, and practices;

periodic renegotiation of provider contracts with specialist physicians, hospitals, and ancillary providers;

periodic renegotiation of contracts with HCP's affiliated primary care physicians and specialists;

changes in the demographics of the participating members and medical trends;

contractual or claims disputes with providers, hospitals, or other service providers within a health plan's network;

the occurrence of catastrophes, major epidemics, or acts of terrorism; and

the reduction of health plan premiums.

**Risk-sharing arrangements that HCP and its associated physician groups have with health plans and hospitals could result in their costs exceeding the corresponding revenues, which could reduce or eliminate any shared risk profitability.**

Most of the agreements between health plans and HCP and its associated physician groups contain risk-sharing arrangements under which the physician groups can earn additional compensation from the health plans by coordinating the provision of quality, cost-effective healthcare to members. However, such arrangements may require the physician group to assume a portion of any loss sustained from these arrangements, thereby reducing HCP's net income. Under these risk-sharing arrangements, HCP and its associated physician groups are responsible for a portion of the cost of hospital services or other services that are not capitated. The terms of the particular risk-sharing arrangement allocate responsibility to the respective parties when the cost of services exceeds the related revenue, which results in a deficit, or permit the parties to share in any surplus amounts when actual costs are less than the related revenue. The amount of non-capitated medical and hospital costs in any

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period could be affected by factors beyond the control of HCP, such as changes in treatment protocols, new technologies, longer lengths of stay by the patient, and inflation. To the extent that such non-capitated medical and hospital costs are higher than anticipated, revenue may not be sufficient to cover the risk-sharing deficits the health plans and HCP are responsible for, which could reduce HCP's revenues and profitability. Certain of HCP's agreements with health plans stipulate that risk-sharing pool deficit amounts are carried forward to offset any future years' surplus amounts HCP would otherwise be entitled to receive. HCP accrues for any such risk-sharing deficits.

Although HCP seeks to contractually reduce or eliminate its liability for risk-sharing deficits, risk-sharing deficits could significantly impact HCP's profitability.

### **Renegotiation, renewal, or termination of capitation agreements with health plans could have a significant impact on HCP's future profitability.**

Under most of HCP's and its associated physician groups' capitation agreements with health plans, the health plan is generally permitted to modify the benefit and risk obligations and compensation rights from time to time during the terms of the agreements. If a health plan exercises its right to amend its benefit and risk obligations and compensation rights, HCP and its associated physician groups are generally allowed a period of time to object to such amendment. If HCP or its associated physician group so objects, under some of the risk agreements, the relevant health plan may terminate the applicable agreement upon 90 to 180 days written notice. If HCP or its associated physician groups enter into capitation contracts or other risk sharing arrangements with unfavorable economic terms, or a capitation contract is amended to include unfavorable terms, HCP could, directly or indirectly through its contracts with its associated physician groups, suffer losses with respect to such contract. Since HCP does not negotiate with CMS or any health plan regarding the benefits to be provided under their Medicare Advantage plans, HCP often has just a few months to familiarize itself with each new annual package of benefits it is expected to offer. Depending on the health plan at issue and the amount of revenue associated with the health plan's risk agreement, the renegotiated terms or termination may have a material adverse effect on HCP's and DaVita's future revenues and profitability.

### **Laws regulating the corporate practice of medicine could restrict the manner in which HCP is permitted to conduct its business and the failure to comply with such laws could subject HCP to penalties or require a restructuring of HCP.**

Some states have laws that prohibit business entities, such as HCP, from practicing medicine, employing physicians to practice medicine, exercising control over medical decisions by physicians (also known collectively as the corporate practice of medicine) or engaging in certain arrangements, such as fee-splitting, with physicians. In some states these prohibitions are expressly stated in a statute or regulation, while in other states the prohibition is a matter of judicial or regulatory interpretation. Of the states in which HCP currently operates, California and Nevada prohibit the corporate practice of medicine.

In California and Nevada, HCP operates by maintaining long-term contracts with its associated physician groups which are each owned and operated by physicians and which employ or contract with additional physicians to provide physician services. Under these arrangements, HCP provides management services and, receives a management fee for providing non-medical management services; however, HCP does not represent that it offers medical services, and does not exercise influence or control over the practice of medicine by the physicians or the associated physician groups.

In addition to the above management arrangements, HCP has certain contractual rights relating to the orderly transfer of equity interests in certain of its associated California and Nevada physician groups through succession agreements and other arrangements with their physician equity holders. However, such equity interests cannot be transferred to or

held by HCP or by any non-professional organization. Accordingly, neither HCP nor HCP's subsidiaries directly own any equity interests in any physician groups in California and Nevada. In the event that any of these associated physician groups fails to comply with the management arrangement or

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any management arrangement is terminated and/or HCP is unable to enforce its contractual rights over the orderly transfer of equity interests in its associated physician groups, such events could have a material adverse effect on HCP's business, financial condition or results of operations.

It is possible that a state regulatory agency or a court could determine that HCP's agreements with physician equity holders of certain managed California and Nevada associated physician groups as described above, either independently or coupled with the management services agreements with such associated physician groups are in violation of the corporate practice of medicine doctrine. As a result, these arrangements could be deemed invalid, potentially resulting in a loss of revenues and an adverse effect on results of operations derived from such associated physician groups. Such a determination could force a restructuring of HCP's management arrangements with associated physician groups in California and/or Nevada, which might include revisions of the management services agreements, including a modification of the management fee and/or establishing an alternative structure, which would permit HCP to contract with a physician network without violating the corporate practice of medicine prohibition. There can be no assurance that such a restructuring would be feasible, or that it could be accomplished within a reasonable time frame without a material adverse effect on HCP's operations and financial results. In December 2013, DaVita HealthCare Partners Plan obtained a restricted Knox-Keene license in California pursuant to the California Knox-Keene Health Care Service Plan Act of 1975 (the Knox-Keene Act), which permits DaVita HealthCare Partners Plan to contract with health plans in California to accept global risk without violating the corporate practice of medicine prohibition. However, HCP's Nevada associated physician groups and HCP, as well as those physician equity holders of associated physician groups who are subject to succession agreements with HCP, could be subject to criminal or civil penalties or an injunction for practicing medicine without a license or aiding and abetting the unlicensed practice of medicine.

**If HCP's agreements or arrangements with any physician equity holder(s) of associated physicians, physician groups, or IPAs are deemed invalid under state law, including laws against the corporate practice of medicine, or federal law, or are terminated as a result of changes in state law, or if there is a change in accounting standards by the Financial Accounting Standards Board (FASB) or the interpretation thereof affecting consolidation of entities, it could impact HCP's consolidation of total revenues derived from such associated physician groups.**

HCP's financial statements are consolidated and include the accounts of its majority-owned subsidiaries and certain non-owned HCP-associated and managed physician groups, which consolidation is effectuated in accordance with applicable accounting standards. Such consolidation for accounting and/or tax purposes does not, is not intended to, and should not be deemed to, imply or provide to HCP any control over the medical or clinical affairs of such physician groups. In the event of a change in accounting standards promulgated by FASB or in interpretation of its standards, or if there were an adverse determination by a regulatory agency or a court, or a change in state or federal law relating to the ability to maintain present agreements or arrangements with such physician groups, HCP may not be permitted to continue to consolidate the total revenues of such organizations. A change in accounting for consolidation with respect to HCP's present agreement or arrangements would diminish HCP's reported revenues but would not be expected to materially adversely affect its reported results of operations, while regulatory or legal rulings or changes in law interfering with HCP's ability to maintain its present agreements or arrangements could materially diminish both revenues and results of operations.



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**If DaVita HealthCare Partners Plan, Inc. is not able to satisfy financial solvency or other regulatory requirements, DaVita HealthCare Partners Plan, Inc. could become subject to sanctions and its license to do business in California could be limited, suspended or terminated.**

The Knox-Keene Act requires health care service plans operating in California to comply with financial solvency and other requirements overseen by the California Department of Managed Health Care (DMHC). Under the Knox-Keene Act, and as a California health care services plan, DaVita HealthCare Partners Plan, Inc. is required to, among other things:

Maintain, at all times, a minimum tangible net equity;

Submit periodic financial solvency reports to the DMHC containing various data regarding performance and financial solvency;

Comply with extensive regulatory requirements; and

Submit to periodic regulatory audits and reviews concerning DaVita HealthCare Partner Plan, Inc.'s operations and compliance with the Knox-Keene Act.

In the event that DaVita HealthCare Partners Plan, Inc. is not in compliance with the provisions of the Knox-Keene Act, it could be subject to sanctions, or limitations on, or suspension of its license to do business in California.

**If HCP's associated physician group is not able to satisfy the California Department of Managed Health Care's financial solvency requirements, HCP's associated physician group could become subject to sanctions and HCP's ability to do business in California could be limited or terminated.**

The DMHC has instituted financial solvency regulations to monitor the financial solvency of capitated physician groups. Under these regulations, HCP's associated physician group is required to, among other things:

Maintain, at all times, a minimum cash-to-claims ratio (where cash-to-claims ratio means the organization's cash, marketable securities, and certain qualified receivables, divided by the organization's total unpaid claims liability). The regulation currently requires a cash-to-claims ratio of 0.75.

Submit periodic reports to the DMHC containing various data and attestations regarding performance and financial solvency, including incurred but not reported calculations and documentation, and attestations as to whether or not the organization was in compliance with the Knox-Keene Act requirements related to claims payment timeliness had maintained positive tangible net equity (i.e., at least \$1.00), and had maintained positive working capital (i.e., at least \$1.00).

In the event that HCP's associated physician group is not in compliance with any of the above criteria, HCP's associated physician group could be subject to sanctions, or limitations on, or removal of, its ability to do business in California.

**Reductions in Medicare Advantage health plan reimbursement rates stemming from recent healthcare reforms and any future related regulations may negatively impact HCP's business, revenue and profitability.**

A significant portion of HCP's revenue is directly or indirectly derived from the monthly premium payments paid by CMS to health plans for medical services provided to Medicare Advantage enrollees. As a result, HCP's results of operations are, in part, dependent on government funding levels for Medicare Advantage programs. Any changes that limit or reduce Medicare Advantage reimbursement levels, including those recently approved and effective in 2014, such as reductions in or limitations of reimbursement amounts or rates under programs, reductions in funding of programs, expansion of benefits without adequate funding, elimination of coverage for certain benefits, or elimination of coverage for certain individuals or treatments under programs,

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could have a material adverse effect on HCP's revenues, earnings and cash flows. On April 7, 2014 CMS issued final guidance for 2015 Medicare Advantage rates, which incorporated a re-blending of the risk adjustment models that CMS utilizes to determine risk acuity scores of Medicare Advantage patients. In 2014, CMS blended the risk scores calculated using the 2013 CMS-HCC model and the 2014 CMS-HCC model by weighting the scores from the 2013 model by 25% and the scores from the 2014 model by 75%. In 2015, CMS will blend the scores by 67% and 33%, respectively. Although we estimate that the final cumulative impact of the 2015 rate structure represents an increase of up to approximately 0.5% of HCP's average Medicare Advantage revenues as compared to 2014, there is no guarantee that CMS's risk acuity adjustment models and the resulting Medicare Advantage rates will, in the future, increase HCP's Medicare Advantage revenues. HCP's Medicare Advantage revenues may continue to be volatile in the future, which could have a material impact on HCP's ongoing financial performance.

The Health Reform Acts contain a number of provisions that negatively impact Medicare Advantage plans, which may each have an adverse effect on HCP's revenues, earnings, and cash flows. These provisions include the following:

Medicare Advantage benchmarks for 2011 were frozen at 2010 levels. Beginning in 2012, Medicare Advantage benchmark rates are being phased down from prior levels to levels that are between 95% and 115% of the Medicare FFS costs, depending on a plan's geographic area. Failure to meet these revised benchmarks may have a significant negative impact on HCP's revenues, earnings and cash flows.

Rebates received by Medicare Advantage plans that underbid based on payment benchmarks will be reduced, with larger reductions for plans failing to receive certain quality ratings.

The Secretary of the HHS has been granted the explicit authority to deny Medicare Advantage plan bids that propose significant increases in cost sharing or decreases in benefits. If the bids submitted by plans contracted with HCP are denied, this would have a significant negative impact on HCP's revenues, earnings and cash flows.

Beginning in 2014, Medicare Advantage plans with medical loss ratios below 85% are required to pay a rebate to the Secretary of HHS. The rebate amount will be the total revenue under the contract year multiplied by the difference between 85% and the plan's actual medical loss ratio. The Secretary of HHS will halt enrollment in any plan failing to meet this ratio for three consecutive years, and terminate any plan failing to meet the ratio for five consecutive years. If an HCP-contracting Medicare Advantage plan experiences a limitation on enrollment or is otherwise terminated from the Medicare Advantage program, HCP may suffer materially adverse consequences to its business or financial condition.

Since January 1, 2011, cost-sharing for certain services (such as chemotherapy and skilled nursing care) has been limited to the cost-sharing permitted under the original FFS Medicare program, which could reduce HCP's revenues, earnings and cash flows by reducing the amount that enrollees are permitted to pay for such services.

Prescription drug plans are now required to cover all drugs on a list developed by the Secretary of HHS, which could increase the cost of providing care to Medicare Advantage enrollees, and thereby reduce HCP's revenues. The Medicare part D premium subsidy for high-income beneficiaries has been reduced by 25%, which could lower the number of Medicare Advantage enrollees, which would have a negative impact on HCP's revenues, earnings and cash flows.

Beginning in 2014, CMS is required to increase coding intensity adjustments for Medicare Advantage plans, which is expected to reduce CMS payments to Medicare Advantage plans, which in turn will likely reduce the amounts payable to HCP and its associated physicians, physician groups, and IPAs under its capitation agreements. The government's budget for Fiscal Year 2014 further increases the coding intensity adjustments starting in 2015, which may further reduce HCP's revenues, earnings and cash flows.

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The President's proposed 2015 budget proposes nearly \$400 million in cuts to Medicare over the next decade. Although the majority of the cuts are not targeted at Medicare Advantage plans, the broad cuts could signal further downward pressure on reimbursement to Medicare providers and Medicare Advantage plans, which would have a negative impact on HCP's revenues, earnings and cash flows.

On April 1, 2013, CMS published its final 2014 Call Letter - CMS's annual notice to health plans regarding the Medicare Advantage payment methodology and estimated rates for 2014. In a reversal of its previous estimates, which called for a 2.2% reduction in the 2014 Medicare Advantage rates, CMS included in its final 2014 Call Letter an estimated 3.3% increase in the 2014 Medicare Advantage rates. This reversal was the result of CMS's new assumption that congressional action would prospectively fix the Medicare physician fee schedule's SGR formula. By assuming an imminent solution to the SGR formula's automatic rate reductions, CMS was able to base its 2014 Medicare Advantage estimates on an assumed 0% change in the Medicare physician fee schedule rates for 2014. As noted above, this change in CMS's assumption has a dramatic positive impact on the estimated Medicare Advantage rates for 2014; however, a resolution of the SGR formula has yet to be passed by Congress. On March 31, 2014 Congress passed its 17<sup>th</sup> delay to the implementation of the SGR formula, which would have led to a 24% reduction in Medicare payments to physicians. This delay extends implementation for a further 12 months, during which time we believe that Congress intends to be able to pass a more permanent solution to the SGR formula. Although a congressionally mandated change to the SGR formula, as described above, would potentially have a significant positive impact on HCP's Medicare Advantage revenues and net income, the likelihood of increasing medical costs and the uncertainty of congressional action mitigate against the positive impact of CMS's recent Medicare Advantage estimates.

In addition to the uncertainty surrounding whether Congress will be able to resolve the SGR formula's automatic rate reductions, there is uncertainty regarding both Medicare Advantage payment rates and beneficiary enrollment, which, if reduced as a result of the implementation of the Health Reform Acts, would reduce HCP's overall revenues and net income. For example, although the Congressional Budget Office (CBO) predicted in 2012 that Medicare Advantage participation would drop precipitously by 2020, in 2013 the CBO reversed its prediction and instead predicted that enrollment in Medicare Advantage could increase by up to 50% in the next decade. Further fluctuation in Medicare Advantage payment rates were evidenced by CMS's announcement in its final 2015 Call Letter that Medicare Advantage rates would rise an average of 0.4% in 2015, instead of falling 1.9% as it had proposed in February 2014. Uncertainty over Medicare Advantage enrollment and payment rates present a continuing risk to HCP's business.

Finally, although the Health Reform Acts provide for reductions in payments to Medicare Advantage plans, the Health Reform Acts also provide for bonus payments to Medicare Advantage plans with four or five star quality ratings. In November 2011, CMS announced a three-year demonstration project with an alternative bonus structure that awards bonuses to plans with three or more stars. In the 2015 guidance issued by CMS on April 7, 2014, CMS indicated that the demonstration project to provide incremental reimbursement to health plans with less than four stars would not be continued. This may negatively impact the level of reimbursement HCP receives from those health plans, which may have an adverse effect on HCP's revenues, earnings and cash flows.

**HCP's operations are dependent on competing health plans and, at times, a health plan's and HCP's economic interests may diverge.**

For the nine months ended September 30, 2014, 65% of HCP's consolidated capitated medical revenues were earned through contracts with three health plans.

HCP expects that, going forward, substantially all of its revenue will continue to be derived from its contracts with health plans. Each health plan may immediately terminate any of HCP's contracts and/or any individual credentialed physician upon the occurrence of certain events. They may also amend the material terms of the contracts under

certain circumstances. Failure to maintain the contracts on favorable terms, for any reason, would materially and adversely affect HCP's results of operations and financial condition. A material decline in the number of members could also have a material adverse effect on HCP's results of operations.

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Notwithstanding each health plan's and HCP's current shared interest in providing service to HCP's members who are enrolled in the subject health plans, the health plans may have different and, at times, opposing economic interests from those of HCP. The health plans provide a wide range of health insurance services across a wide range of geographic regions, utilizing a vast network of providers. As a result, they and HCP may have different views regarding the proper pricing of services and/or the proper pricing of the various service providers in their provider networks, the cost of which HCP bears to the extent that the services of such service providers are utilized. These health plans may also have different views than HCP regarding the efforts and expenditures that they, HCP, and/or other service providers should make to achieve and/or maintain various quality ratings. In addition, several health plans have acquired or announced their intent to acquire provider organizations. If health plans with which HCP contracts acquire a significant number of provider organizations, they may not continue to contract with HCP or contract on less favorable terms or seek to prevent HCP from acquiring or entering into arrangements with certain providers. Similarly, as a result of changes in laws, regulations, consumer preferences, or other factors, the health plans may find it in their best interest to provide health insurance services pursuant to another payment or reimbursement structure. In the event HCP's interests diverge from the interests of the health plans, HCP may have limited recourse or alternative options in light of its dependence on these health plans. There can be no assurances that HCP will continue to find it mutually beneficial to work with the health plans. As a result of various restrictive provisions that appear in some of the managed care agreements with health plans, HCP may at times have limitations on its ability to cancel an agreement with a particular health plan and immediately thereafter contract with a competing health plan with respect to the same service area.

**HCP and its associated physicians, physician groups and IPAs and other physicians may be required to continue providing services following termination or renegotiation of certain agreements with health plans.**

There are circumstances under federal and state law pursuant to which HCP and its associated physician groups, IPAs, and other physicians could be obligated to continue to provide medical services to HCP members in their care following a termination of their applicable risk agreement with health plans and termination of the receipt of payments thereunder. In certain cases, this obligation could require the physician group or IPA to provide care to such member following the bankruptcy or insolvency of a health plan. Accordingly, the obligations to provide medical services to HCP members (and the associated costs) may not terminate at the time the applicable agreement with the health plan terminates, and HCP may not be able to recover its cost of providing those services from the health plan, which could have a material adverse effect on HCP's financial condition, results of operations, and/or cash flows.

**HCP operates primarily in Arizona, California, Florida, Nevada and New Mexico, and may not be able to successfully establish a presence in new geographic regions.**

HCP derives substantially all of its revenue from operations in Arizona, California, Florida, Nevada and New Mexico, (hereinafter referred to as the Existing Geographic Regions). As a result, HCP's exposure to many of the risks described herein is not mitigated by a greater diversification of geographic focus. Furthermore, due to the concentration of HCP's operations in the Existing Geographic Regions, it may be adversely affected by economic conditions, natural disasters (such as earthquakes or hurricanes), or acts of war or terrorism that disproportionately affect the Existing Geographic Regions as compared to other states and geographic markets.

To expand the operations of its network outside of the Existing Geographic Regions, including entry into the Pennsylvania market with operations expected to commence the first quarter of 2015, HCP must devote resources to identifying and exploring such perceived opportunities. Thereafter, HCP must, among other things, recruit and retain qualified personnel, develop new offices, establish potentially new relationships with one or more health plans, and establish new relationships with physicians and other healthcare providers. The ability to establish such new relationships may be significantly inhibited by competition for such relationships and personnel in the health care

marketplace in the targeted new geographic regions. Additionally, HCP may face the risk that a substantial portion of the patients served in a new geographic area may be enrolled in a Medicare FFS



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program and will not desire to transition to a Medicare Advantage program, such as those offered through the health plans that HCP serves, or they may enroll with other health plans with whom HCP does not contract to receive services, which could reduce substantially HCP's perceived opportunity in such geographic area. In addition, if HCP were to seek to expand outside of the Existing Geographic Regions, HCP would be required to comply with laws and regulations of states that may differ from the ones in which it currently operates, and could face competitors with greater knowledge of such local markets. HCP anticipates that any geographic expansion may require it to make a substantial investment of management time, capital, and/or other resources. There can be no assurance that HCP will be able to establish profitable operations or relationships in any new geographic markets.

**Reductions in the quality ratings of the health plans HCP serves could have an adverse effect on its results of operations, financial condition, and/or cash flow.**

As a result of the Health Reform Acts, HCP anticipates that the level of reimbursement each health plan receives from CMS will be dependent, in part, upon the quality rating of the Medicare plan that such health plan serves. Such ratings are expected to impact the percentage of any cost savings rebate and any bonuses earned by such health plan. Since a significant portion of HCP's revenue is expected to be calculated as a percentage of CMS reimbursements received by these health plans with respect to HCP members, reductions in the quality ratings of a health plan that HCP serves could have an adverse effect on its results of operations, financial condition, and/or cash flows. In addition, CMS has announced its intention to terminate any plan that has a rating of less than three stars for three consecutive years. Medicare Advantage plans with five stars are permitted to conduct enrollment throughout the year and enrollees in plans with 4.5 or fewer stars are permitted to change plans during the year. Given each health plan's control of its plans and the many other providers that serve such plans, HCP believes that it will have limited ability to influence the overall quality rating of any such plan. Accordingly, since low quality ratings can potentially lead to the termination of a plan that HCP serves, HCP may not be able to prevent the potential termination of a contracting plan or a shift of patients to other plans based upon quality issues which could, in turn, have an adverse effect on HCP's results of operations, financial condition, and/or cash flows.

**HCP's records and submissions to a health plan may contain inaccurate or unsupported information regarding risk adjustment scores of members, which could cause HCP to overstate or understate its revenue and subject it to various penalties.**

HCP, on behalf of itself and its associated physicians, physician groups and IPAs, submits to health plans claims and encounter data that support the risk adjustment factor, or RAF, scores attributable to members. These RAF scores determine, in part, the revenue to which the health plans and, in turn, HCP is entitled for the provision of medical care to such members. The data submitted to CMS by each health plan is based on medical charts and diagnosis codes prepared and submitted by HCP. Each health plan generally relies on HCP to appropriately document and support such RAF data in HCP's medical records. Each health plan also relies on HCP to appropriately code claims for medical services provided to members. HCP may periodically review medical records and may find inaccurate or unsupported coding or otherwise inaccurate records. Erroneous claims and erroneous encounter records and submissions could result in inaccurate PMPM fee revenue and risk adjustment payments, which may be subject to correction or retroactive adjustment in later periods. This corrected or adjusted information may be reflected in financial statements for periods subsequent to the period in which the revenue was recorded. HCP might also need to refund a portion of the revenue that it received, which refund, depending on its magnitude, could damage its relationship with the applicable health plan and could have a material adverse effect on HCP's results of operations, financial condition or cash flows.

CMS audits Medicare Advantage plans for documentation to support RAF-related payments for members chosen at random. The Medicare Advantage plans ask providers to submit the underlying documentation for members that they

serve. It is possible that claims associated with members with higher RAF scores could be subject to more scrutiny in a CMS audit. HCP has experienced increases in RAF scores attributable to its

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members, and thus there is a possibility that a Medicare Advantage plan may seek repayment from HCP as a result of CMS payment adjustments to the Medicare Advantage plan. The plans also may hold HCP liable for any penalties owed to CMS for inaccurate or unsupported RAF scores provided by HCP.

CMS has indicated that, starting with payment year 2011, payment adjustments will not be limited to RAF scores for the specific Medicare Advantage enrollees for which errors are found but may also be extrapolated to the entire Medicare Advantage plan subject to a particular CMS contract. CMS has described its audit process as plan-year specific and stated that it will not extrapolate audit results for plan years prior to 2011.

CMS has not specifically stated that payment adjustments as a result of one plan year's audit will not be extrapolated to prior plan years. There can be no assurance that a health plan will not be randomly selected or targeted for review by CMS or that the outcome of such a review will not result in a material adjustment in HCP's revenue and profitability, even if the information HCP submitted to the plan is accurate and supportable. Since the CMS rules, regulations, and statements regarding this audit program are still not well defined and, in some cases, have not been published in final form, there is also a risk that CMS may adopt new rules and regulations that are inconsistent with their existing rules, regulations, and statements.

### **A failure to accurately estimate incurred but not reported medical expense could adversely affect HCP's profitability.**

Patient care costs include estimates of future medical claims that have been incurred by the patient but for which the provider has not yet billed HCP. These claim estimates are made utilizing actuarial methods and are continually evaluated and adjusted by management, based upon HCP's historical claims experience and other factors, including an independent assessment by a nationally recognized actuarial firm. Adjustments, if necessary, are made to medical claims expense and capitated revenues when the assumptions used to determine HCP's claims liability changes and when actual claim costs are ultimately determined.

Due to the inherent uncertainties associated with the factors used in these estimates and changes in the patterns and rates of medical utilization, materially different amounts could be reported in HCP's financial statements for a particular period under different conditions or using different, but still reasonable, assumptions. It is possible that HCP's estimates of this type of claim may be inadequate in the future. In such event, HCP's results of operations could be adversely impacted. Further, the inability to estimate these claims accurately may also affect HCP's ability to take timely corrective actions, further exacerbating the extent of any adverse effect on HCP's results.

### **HCP faces certain competitive threats which could reduce HCP's profitability and increase competition for patients.**

HCP faces certain competitive threats based on certain features of the Medicare programs, including the following:

As a result of the direct and indirect impacts of the Health Reform Acts, many Medicare beneficiaries may decide that an original FFS Medicare program is more attractive than a Medicare Advantage plan. As a result, enrollment in the health plans HCP serves may decrease.

Managed care companies offer alternative products such as regional preferred provider organizations (PPOs) and private FFS plans. Medicare PPOs and private FFS plans allow their patients more flexibility in

selecting physicians than Medicare Advantage health plans, which typically require patients to coordinate care with a primary care physician. The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 has encouraged the creation of regional PPOs through various incentives, including certain risk corridors, or cost reimbursement provisions, a stabilization fund for incentive payments, and special payments to hospitals not otherwise contracted with a Medicare Advantage plan that treat regional plan enrollees. The formation of regional Medicare PPOs and private FFS plans may affect HCP's relative attractiveness to existing and potential Medicare patients in their service areas.

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The payments for the local and regional Medicare Advantage plans are based on a competitive bidding process that may indirectly cause a decrease in the amount of the PMPM fee or result in an increase in benefits offered.

The annual enrollment process and subsequent lock-in provisions of the Health Reform Acts may adversely affect HCP's level of revenue growth as it will limit the ability of a health plan to market to and enroll new Medicare beneficiaries in its established service areas outside of the annual enrollment period.

CMS allows Medicare beneficiaries who are enrolled in a Medicare Advantage plan with a quality rating of 4.5 stars or less to enroll in a 5-star rated Medicare Advantage plan at any time during the benefit year.

Therefore, HCP may face a competitive disadvantage in recruiting and retaining Medicare beneficiaries.

In addition to the competitive threats intrinsic to the Medicare programs, competition among health plans and among healthcare providers may also have a negative impact on HCP's profitability. For example, HCP's Existing Geographic Regions have become increasingly attractive to health plans that may compete with HCP, including the health plans with which HCP and its associated physicians, physician groups, and IPAs currently compete. HCP may not be able to continue to compete profitably in the healthcare industry if additional competitors enter the same market. If HCP cannot compete profitably, the ability of HCP to compete with other service providers that contract with competing health plans may be substantially impaired. Similarly, HCP's Existing Geographic Regions have also become increasingly attractive to HCP's competitors due to the large populations of Medicare beneficiaries. HCP may not be able to continue to compete effectively if additional competitors enter the same regions.

HCP competes directly with various regional and local companies that provide similar services in HCP's Existing Geographic Regions. HCP's competitors vary in size and scope and in terms of products and services offered. HCP believes that some of its competitors and potential competitors may be significantly larger than HCP and have greater financial, sales, marketing, and other resources. Furthermore, it is HCP's belief that some of its competitors may make strategic acquisitions or establish cooperative relationships among themselves.

### **A disruption in HCP's healthcare provider networks could have an adverse effect on HCP's operations and profitability.**

In any particular service area, healthcare providers or provider networks could refuse to contract with HCP, demand higher payments, or take other actions that could result in higher healthcare costs, disruption of benefits to HCP's members, or difficulty in meeting applicable regulatory or accreditation requirements. In some service areas, healthcare providers or provider networks may have significant market positions. If healthcare providers or provider networks refuse to contract with HCP, use their market position to negotiate favorable contracts, or place HCP at a competitive disadvantage, then HCP's ability to market or to be profitable in those service areas could be adversely affected. HCP's provider networks could also be disrupted by the financial insolvency of a large provider group. Any disruption in HCP's provider networks could result in a loss of members or higher healthcare costs.

### **HCP's revenues and profits could be diminished if HCP fails to retain and attract the services of key primary care physicians.**

Key primary care physicians with large patient enrollment could retire, become disabled, terminate their provider contracts, get lured away by a competing independent physician association or medical group, or otherwise become unable or unwilling to continue practicing medicine or contracting with HCP or its associated physicians, physician groups, or IPAs. In addition, HCP's associated physicians, physician groups and IPAs could view the business model

as unfavorable or unattractive to such providers, which could cause such associated physicians, physician groups or IPAs to terminate their relationships with HCP. Moreover, given limitations relating to the enforcement of post-termination noncompetition covenants in California, it would be

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difficult to restrict a primary care physician from competing with HCP's associated physicians, physician groups, or IPAs. As a result, members who have been served by such physicians could choose to enroll with competitors physician organizations or could seek medical care elsewhere, which could reduce HCP's revenues and profits. Moreover, HCP may not be able to attract new physicians to replace the services of terminating physicians or to service its growing membership.

**Participation in Accountable Care Organization programs is new and subject to federal regulation, supervision, and evolving regulatory developments and may result in financial liability.**

The Health Reform Acts establish Medicare Shared Savings Program (MSSP) for ACOs, which took effect in January 2012. Under the MSSP, eligible organizations are accountable for the quality, cost and overall care of Medicare beneficiaries assigned to an ACO and may be eligible to share in any savings below a specified benchmark amount. The Secretary of HHS is also authorized, but not required, to use capitation payment models with ACOs. HCP has formed an MSSP ACO through its subsidiary and is evaluating whether to participate in more ACOs in the future. The continued development and expansion of ACOs will have an uncertain impact on HCP's revenue and profitability.

The ACO programs are new and therefore operational and regulatory guidance is limited. It is possible that the operations of HCP's subsidiary ACO may not fully comply with current or future regulations and guidelines applicable to ACOs, may not achieve quality targets or cost savings, or may not attract or retain sufficient physicians or patients to allow HCP to meet its objectives. Additionally, poor performance could put the HCP ACO at financial risk with a potential obligation to CMS. Traditionally, other than Fee-for-Service (FFS) billing by the medical clinics and healthcare facilities operated by HCP, HCP has not directly contracted with CMS and has not operated any health plans or provider sponsored networks. Therefore, HCP may not have the necessary experience, systems, or compliance to successfully achieve a positive return on its investment in the ACO or to avoid financial or regulatory liability. To date, demonstration projects using healthcare delivery models substantially similar to an ACO have not resulted in savings. HCP believes that its historical experience with fully delegated managed care will be applicable to operation of its subsidiary ACO, but there can be no such assurance.

**California hospitals may terminate their agreements with HealthCare Partners Affiliates Medical group (HCPAMG) or reduce the fees they pay to HCP.**

In California, HCPAMG maintains significant hospital arrangements designed to facilitate the provision of coordinated hospital care with those services provided to members by HCPAMG and its associated physicians, physician groups, and IPAs. Through contractual arrangements with certain key hospitals, HCPAMG provides utilization review, quality assurance, and other management services related to the provision of patient care services to members by the contracted hospitals and downstream hospital contractors. In the event that any one of these key hospital agreements is amended in a financially unfavorable manner or is otherwise terminated, such events could have a material adverse effect on HCP's financial condition, and results of operations.

**HCP's professional liability and other insurance coverage may not be adequate to cover HCP's potential liabilities.**

HCP maintains primary professional liability insurance and other insurance coverage through California Medical Group Insurance Company, Risk Retention Group, an Arizona corporation in which HCP is the majority owner, and through excess coverage contracted through third-party insurers. HCP believes such insurance is adequate based on its review of what it believes to be all applicable factors, including industry standards. Nonetheless, potential liabilities may not be covered by insurance, insurers may dispute coverage or may be unable to meet their obligations, the amount of insurance coverage and/or related reserves may be inadequate, or the amount of any HCP self-insured

retention may be substantial. There can be no assurances that HCP will be able to obtain insurance coverage in the future, or that insurance will continue to be available on a cost-effective basis, if at all. Moreover, even if claims brought against HCP are unsuccessful or without merit, HCP would have



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to defend itself against such claims. The defense of any such actions may be time-consuming and costly and may distract HCP management's attention. As a result, HCP may incur significant expenses and may be unable to effectively operate its business.

### **Changes in the rates or methods of third-party reimbursements may adversely affect HCP operations.**

Any negative changes in governmental capitation or FFS rates or methods of reimbursement for the services HCP provides could have a significant adverse impact on HCP's revenue and financial results. Since governmental healthcare programs generally reimburse on a fee schedule basis rather than on a charge-related basis, HCP generally cannot increase its revenues from these programs by increasing the amount it charges for its services. Moreover, if HCP's costs increase, HCP may not be able to recover its increased costs from these programs. Government and private payors have taken and may continue to take steps to control the cost, eligibility for, use, and delivery of healthcare services due to budgetary constraints, and cost containment pressures as well as other financial issues. HCP believes that these trends in cost containment will continue. These cost containment measures, and other market changes in non-governmental insurance plans have generally restricted HCP's ability to recover, or shift to non-governmental payors, any increased costs that HCP experiences. HCP's business and financial operations may be materially affected by these cost containment measures, and other market changes.

### **HCP's business model depends on numerous complex management information systems and any failure to successfully maintain these systems or implement new systems could materially harm HCP's operations and result in potential violations of healthcare laws and regulations.**

HCP depends on a complex, specialized, and integrated management information system and standardized procedures for operational and financial information, as well as for HCP's billing operations. HCP may experience unanticipated delays, complications, or expenses in implementing, integrating, and operating these integrated systems. Moreover, HCP may be unable to enhance its existing management information system or implement new management information systems where necessary. HCP's management information system may require modifications, improvements, or replacements that may require both substantial expenditures as well as interruptions in operations. HCP's ability to implement and operate its integrated systems is subject to the availability of information technology and skilled personnel to assist HCP in creating and maintaining these systems.

HCP's failure to successfully implement and maintain all of its systems could have a material adverse effect on its business, financial condition, and results of operations. For example, HCP's failure to successfully operate its billing systems could lead to potential violations of healthcare laws and regulations. If HCP is unable to handle its claims volume, or if HCP is unable to pay claims timely, HCP may become subject to a health plan's corrective action plan or de-delegation until the problem is corrected, and/or termination of the health plan's agreement with HCP. This could have a material adverse effect on HCP's operations and profitability. In addition, if HCP's claims processing system is unable to process claims accurately, the data HCP uses for its incurred but not reported (IBNR) estimates could be incomplete and HCP's ability to accurately estimate claims liabilities and establish adequate reserves could be adversely affected. Finally, if HCP's management information systems are unable to function in compliance with applicable state or federal rules and regulations, including, without limitation, medical information confidentiality laws such as HIPAA, possible penalties and fines due to this lack of compliance could have a material adverse effect on HCP's financial condition, and results of operations.

### **Federal and state privacy and information security laws are complex and HCP may be subject to government or private actions due to privacy and security breaches.**

HCP must comply with numerous federal and state laws and regulations governing the collection, dissemination, access, use, security and privacy of protected health information (PHI), including HIPAA and its

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implementing privacy and security regulations, as amended by the federal HITECH Act and collectively referred to as HIPAA. In the event that HCP's non-compliance with existing or new laws and regulations related to PHI results in privacy or security breaches, HCP could be subject to monetary fines, civil suits, civil penalties or criminal sanctions and requirements to disclose the breach publicly.

### **HCP may be impacted by eligibility changes to government and private insurance programs.**

Due to potential decreased availability of healthcare through private employers, the number of patients who are uninsured or participate in governmental programs may increase. The Health Reform Acts will increase the participation of individuals in the Medicaid program in states that elect to participate in the expanded Medicaid coverage. A shift in payor mix from managed care and other private payors to government payors as well as an increase in the number of uninsured patients may result in a reduction in the rates of reimbursement to HCP or an increase in uncollectible receivables or uncompensated care, with a corresponding decrease in net revenue. Changes in the eligibility requirements for governmental programs such as the Medicaid program under the Health Reform Acts and state decisions on whether to participate in the expansion of such programs also could increase the number of patients who participate in such programs and the number of uninsured patients. Even for those patients who remain in private insurance plans, changes to those plans could increase patient financial responsibility, resulting in a greater risk of uncollectible receivables. These factors and events could have a material adverse effect on HCP's business, financial condition, and results of operations.

### **Negative publicity regarding the managed healthcare industry generally or HCP in particular could adversely affect HCP's results of operations or business.**

Negative publicity regarding the managed healthcare industry generally, the Medicare Advantage program or HCP in particular, may result in increased regulation and legislative review of industry practices that further increase HCP's costs of doing business and adversely affect HCP's results of operations or business by:

requiring HCP to change its products and services;

increasing the regulatory, including compliance, burdens under which HCP operates, which, in turn, may negatively impact the manner in which HCP provides services and increase HCP's costs of providing services;

adversely affecting HCP's ability to market its products or services through the imposition of further regulatory restrictions regarding the manner in which plans and providers market to Medicare Advantage enrollees; or

adversely affecting HCP's ability to attract and retain members.

### **Risk factors related to our overall business and ownership of our common stock:**

**Disruptions in federal government operations and funding create uncertainty in our industry and could have a material adverse effect on our revenues, earnings and cash flows and otherwise adversely affect our financial condition.**

A substantial portion of our revenues is dependent on federal healthcare program reimbursement, and any disruptions in federal government operations could have a material adverse effect on our revenues, earnings and cash flows. Although the government passed a budget for fiscal year 2014, there is no guarantee that the U.S. government will be able to pass the federal budget for subsequent fiscal years. In addition, if the U.S. government defaults on its debt, there could be broad macroeconomic effects that could raise our cost of borrowing funds, and delay or prevent our future growth and expansion. Any future federal government shutdown, U.S. government default on its debt and/or failure of the U.S. government to enact annual appropriations for fiscal year 2014 could have a material adverse effect on our revenues, earnings and cash flows. Additionally, disruptions in federal government operations may negatively impact regulatory approvals and guidance that are important to our operations, and create uncertainty about the pace of upcoming health care regulatory developments.

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**Changes in CMS diagnosis and inpatient procedure coding require us to make modifications to processes and information systems, which could result in significant development costs and which if unsuccessful could adversely affect our revenues, earnings and cash flows.**

CMS has mandated the use of new patient codes for reporting medical diagnosis and inpatient procedures, referred to as ICD-10. CMS is requiring all providers, payors, clearinghouses, and billing services to utilize ICD-10 when submitting claims for payment. ICD-10 will affect diagnosis and inpatient procedure coding for everyone covered by HIPAA, not just those who submit Medicare or Medicaid claims. Claims for services provided on or after the date that CMS sets must use ICD-10 for medical diagnosis and inpatient procedures or they will not be paid. In a bill passed on March 31, 2014, Congress voted to delay the ICD-10 implementation deadline until no earlier than October 1, 2015. Although CMS is expected to delay the deadline only until October 1, 2015, it has the authority to delay implementation even further. Uncertainty about when ICD-10 will be mandated could lead to additional costs of running ICD-9 and ICD-10 systems, which could negatively impact our revenues, earnings and cash flows.

We anticipate that if our services, processes or information systems or those of our payors do not comply with ICD-10 requirements at any future date, it could potentially delay or even reduce reimbursement payments to us. These delays or reductions could negatively impact our revenues, earnings and cash flows.

**We may engage in acquisitions, mergers or dispositions, which may affect our results of operations, debt-to-capital ratio, capital expenditures or other aspects of our business, and if businesses we acquire have liabilities we are not aware of, we could suffer severe consequences that would materially and adversely affect our business.**

Our business strategy includes growth through acquisitions of dialysis centers and other businesses. We may engage in acquisitions, mergers or dispositions, which may affect our results of operations, debt-to-capital ratio, capital expenditures, or other aspects of our business. There can be no assurance that we will be able to identify suitable acquisition targets or merger partners or that, if identified, we will be able to acquire these targets on acceptable terms or agree to terms with merger partners. There can also be no assurance that we will be successful in completing any acquisitions, mergers or dispositions that we announce, or integrating any acquired business into our overall operations. There is no guarantee that we will be able to operate acquired businesses successfully as stand-alone businesses, or that any such acquired business will operate profitably or will not otherwise adversely impact our results of operations. Further, we cannot be certain that key talented individuals at the business being acquired will continue to work for us after the acquisition or that they will be able to continue to successfully manage or have adequate resources to successfully operate any acquired business.

Businesses we acquire may have unknown or contingent liabilities or liabilities that are in excess of the amounts that we originally estimated, and may have other issues, including those related to internal controls over financial reporting or issues that could affect our ability to comply with healthcare laws and regulations and other laws applicable to our expanded business. As a result, we cannot make any assurances that the acquisitions we consummate will be successful. Although we generally seek indemnification from the sellers of businesses we acquire for matters that are not properly disclosed to us, we are not always successful. In addition, even in cases where we are able to obtain indemnification, we may discover liabilities greater than the contractual limits, the amounts held in escrow for our benefit (if any), or the financial resources of the indemnifying party. In the event that we are responsible for liabilities substantially in excess of any amounts recovered through rights to indemnification or alternative remedies that might be available to us, or any applicable insurance, we could suffer severe consequences that would substantially reduce our earnings and cash flows or otherwise materially and adversely affect our business.



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**If we are not able to continue to make acquisitions, or maintain an acceptable level of non-acquired growth, or if we face significant patient attrition to our competitors or a reduction in the number of our medical directors or associated physicians, it could adversely affect our business.**

Acquisitions, patient retention and medical director and physician retention are an important part of our growth strategy. We face intense competition from other companies for acquisition targets. In our U.S. dialysis business, we continue to face increased competition from large and medium-sized providers which compete directly with us for acquisition targets as well as for individual patients and medical directors. In addition, as we continue our international dialysis expansion into various international markets, we will face competition from large and medium-sized providers for these acquisition targets as well. Because of the ease of entry into the dialysis business and the ability of physicians to be medical directors for their own centers, competition for growth in existing and expanding markets is not limited to large competitors with substantial financial resources. Occasionally, we have experienced competition from former medical directors or referring physicians who have opened their own dialysis centers. In addition, Fresenius, our largest competitor, manufactures a full line of dialysis supplies and equipment in addition to owning and operating dialysis centers. This may give it cost advantages over us because of its ability to manufacture its own products. If we are not able to continue to make acquisitions, continue to maintain acceptable levels of non-acquired growth, or if we face significant patient attrition to our competitors or a reduction in the number of our medical directors or associated physicians, it could adversely affect our business.

**HCP operates in a different line of business from our historical business. We may face challenges managing HCP as a new business and may not realize anticipated benefits.**

As a result of the HCP transaction, we are now significantly engaged in a new line of business. We may not have the expertise, experience, and resources to pursue all of our businesses at once, and we may be unable to successfully operate all businesses in the combined Company. The administration of HCP will require implementation of appropriate operations, management, and financial reporting systems and controls. We may experience difficulties in effectively implementing these and other systems. The management of HCP will require the focused attention of our management team, including a significant commitment of its time and resources. The need for management to focus on these matters could have a material and adverse impact on our revenues and operating results. If the HCP operations are less profitable than we currently anticipate or we do not have the experience, the appropriate expertise, or the resources to pursue all businesses in the combined company, the results of operations and financial condition may be materially and adversely affected.

**If we fail to successfully maintain an effective internal control over financial reporting or if the internal control of HCP over financial reporting were found to be ineffective, the integrity of our, and/or HCP's, financial reporting could be compromised which could result in a material adverse effect on our reported financial results.**

The integration of HCP into our internal control over financial reporting has required and will continue to require significant time and resources from our management and other personnel and will increase our compliance costs. Failure to maintain an effective internal control environment could have a material adverse effect on our ability to accurately report our financial results and the market's perception of our business and our stock price.

**The market price of our common stock may be affected by factors different from those affecting the shares of our common stock prior to consummation of the HCP transaction.**

Our historical business differs substantially from that of HCP. Accordingly, the results of operations of the combined company and the market price of our common stock may be affected by factors different from those that previously

affected the independent results of operations of each of the Company and HCP.



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**Expansion of our operations to and offering our services in markets outside of the U.S. subjects us to political, economical, legal, operational and other risks that could adversely affect our business, results of operations and cash flows.**

We are continuing an expansion of our operations by offering our services outside of the U.S., which increases our exposure to the inherent risks of doing business in international markets. Depending on the market, these risks include, without limitation, those relating to:

changes in the local economic environment;

political instability, armed conflicts or terrorism;

social changes;

intellectual property legal protections and remedies;

trade regulations;

procedures and actions affecting approval, production, pricing, reimbursement and marketing of products and services;

foreign currency;

repatriating or moving to other countries cash generated or held abroad, including considerations relating to tax-efficiencies and changes in tax laws;

export controls;

lack of reliable legal systems which may affect our ability to enforce contractual rights;

changes in local laws or regulations;

potentially longer ramp-up times for starting up new operations and for payment and collection cycles;

financial and operational, and information technology systems integration; and

failure to comply with U.S. or local laws that prohibit us or our intermediaries from making improper payments to foreign officials for the purpose of obtaining or retaining business.

Additionally, some factors that will be critical to the success of our international business and operations will be different than those affecting our domestic business and operations. For example, conducting international operations requires us to devote significant management resources to implement our controls and systems in new markets, to comply with local laws and regulations and to overcome the numerous new challenges inherent in managing international operations, including those based on differing languages, cultures and regulatory environments, and those related to the timely hiring, integration and retention of a sufficient number of skilled personnel to carry out operations in an environment with which we are not familiar.

We anticipate expanding our international operations through acquisitions of varying sizes or through organic growth, which could increase these risks. Additionally, though we might invest material amounts of capital and incur significant costs in connection with the growth and development of our international operations, there is no assurance that we will be able to operate them profitably anytime soon, if at all. As a result, we would expect these costs to be dilutive to our earnings over the next several years as we start-up or acquire new operations.

These risks could have a material adverse effect on our financial condition, results of operations and cash flows.

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

We have substantial debt outstanding, we incurred a substantial amount of additional debt in connection with the HCP transaction and we may incur additional indebtedness in the future. The high level of our indebtedness, among other things, could:

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

increase our vulnerability to general adverse economic and industry conditions;

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

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

expose us to interest rate volatility that could adversely affect our earnings and cash flow and our ability to service our indebtedness;

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

limit our ability to borrow additional funds.

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

We cannot provide assurance that our business will generate sufficient cash flow from operations in the future or that future borrowings will be available to us in an amount sufficient to enable us to service our indebtedness or to fund other liquidity needs. If we are unable to generate sufficient funds to service our outstanding indebtedness, we may be required to refinance, restructure, or otherwise amend some or all of such obligations, sell assets, or raise additional cash through the sale of our equity. We cannot make any assurances that we would be able to obtain such refinancing on terms as favorable as our existing financing terms or that such restructuring activities, sales of assets, or issuances of equity can be accomplished or, if accomplished, would raise sufficient funds to meet these obligations.

The borrowings under our Senior Secured Credit Facilities are guaranteed by a substantial portion of our direct and indirect wholly-owned domestic subsidiaries and are secured by a substantial portion of DaVita HealthCare Partners Inc. s and its subsidiaries assets.

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

Our operations and how we manage the Company may subject the Company, as well as its officers and directors to whom the Company owes certain defense and indemnity obligations, to litigation and liability for damages. Our business, profitability and growth prospects could suffer if we face negative publicity or we pay damages or defense costs in connection with a claim that is outside the scope or limits of coverage of any applicable insurance coverage, including claims related to adverse patient events, contractual disputes, professional and general liability, and directors and officers' duties. In addition, we have received several notices of claims from commercial payors and other third parties related to our historical billing practices and the historical billing practices of the centers acquired from Gambro Healthcare and other matters related to their settlement agreement with the Department of Justice. Although the ultimate outcome of these claims cannot be predicted, an adverse result with respect to one or more of these claims could have a material adverse effect on our financial condition, results of operations, and cash flows. We currently maintain insurance coverage for those

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risks we deem are appropriate to insure against and make determinations about whether to self-insure as to other risks or layers of coverage. However, a successful claim, including a professional liability, malpractice or negligence claim which is in excess of any applicable insurance coverage, or that is subject to our self-insurance retentions, could have a material adverse effect on our earnings and cash flows.

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

the collapse or insolvency of our insurance carriers;

further increases in premiums and deductibles;

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

an inability to obtain one or more types of insurance on acceptable terms, if at all.

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

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

Most of our outstanding employee stock-based compensation awards include a provision accelerating the vesting of the awards in the event of a change of control. We also maintain a change of control protection program for our employees who do not have a significant number of stock awards, which has been in place since 2001, and which provides for cash bonuses to the employees in the event of a change of control. Based on the market price of our common stock and shares outstanding on September 30, 2014, these cash bonuses would total approximately \$621 million if a change of control transaction occurred at that price and our Board of Directors did not modify this program. These change of control provisions may affect the price an acquirer would be willing to pay for our Company.

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

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



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

The following table summarizes the Company's repurchases of its common stock during the third quarter of 2014:

Period	Total number of shares purchased	Average price paid per share	Approximate dollar value	
			Total number of shares purchased as part of publicly announced plans or programs	of shares that may yet be purchased under the plans or programs (in millions)
July 1-31, 2014		\$		\$ 358.2
August 1-31, 2014				358.2
September 1-30, 2014				358.2
Total		\$		

In November 2010, our Board of Directors authorized repurchases of our common stock in an aggregate amount of up to \$800 million. This stock repurchase program has no expiration date. We are authorized to make purchases from time to time in the open market or in privately negotiated transactions, depending upon market conditions and other considerations. However, we are subject to share repurchase limitations under the terms of the Senior Secured Credit Facilities and the indentures governing our senior notes.

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

**Table of Contents****Item 6. Exhibits****(a) Exhibits****Exhibit****Number**

10.1	DaVita HealthCare Partners Inc. 2014 Long Term Incentive Program Cash Performance Award Agreement under the DaVita HealthCare Partners Inc. 2011 Incentive Award Plan and Long-Term Incentive Program (for 162(m) designated teammates). ü* **
10.2	DaVita HealthCare Partners Inc. 2014 Long Term Incentive Program Cash Performance Award Agreement under the DaVita HealthCare Partners Inc. 2011 Incentive Award Plan and Long-Term Incentive Program. ü* **
10.3	DaVita HealthCare Partners Inc. 2014 Long Term Incentive Program Performance Stock Units Agreement under the DaVita HealthCare Partners Inc. 2011 Incentive Award Plan and Long-Term Incentive Program (for 162(m) designated teammates). ü* **
10.4	DaVita HealthCare Partners Inc. 2014 Long Term Incentive Program Restricted Stock Units Agreement under the DaVita HealthCare Partners Inc. 2011 Incentive Award Plan and Long-Term Incentive Program. ü*
10.5	DaVita HealthCare Partners Inc. 2014 Long Term Incentive Program Stock Appreciation Rights Agreement under the DaVita HealthCare Partners Inc. 2011 Incentive Award Plan and Long-Term Incentive Program. ü*
10.6	Corporate Integrity Agreement, dated as of October 22, 2014, by and among the Office of Inspector General of The Department of Health and Human Services and DaVita HealthCare Partners, Inc. <sup>(1)</sup>
12.1	Ratio of earnings to fixed charges. ü
31.1	Certification of the Chief Executive Officer, dated November 6, 2014, pursuant to Rule 13a-14(a) or 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. ü
31.2	Certification of the Chief Financial Officer, dated November 6, 2014, pursuant to Rule 13a-14(a) or 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. ü
32.1	Certification of the Chief Executive Officer, dated November 6, 2014, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. ü
32.2	Certification of the Chief Financial Officer, dated November 6, 2014, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. ü
101.INS	XBRL Instance Document. ü
101.SCH	XBRL Taxonomy Extension Schema Document. ü
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document. ü
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document. ü
101.LAB	XBRL Taxonomy Extension Label Linkbase Document. ü
101.PRE	XBRL Taxonomy Extension Presentation, Linkbase Document. ü



- ü Filed herewith.
- \* Management contract or executive compensation plan or arrangement.
- \*\* Portions of this exhibit are subject to a request for confidential treatment and have been redacted and filed separately with the SEC.
- (1) Filed on October 23, 2014 as an exhibit to the Company's Current Report on Form 8-K.

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**SIGNATURE**

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

DAVITA HEALTHCARE PARTNERS INC.

BY: /s/ JAMES K. HILGER  
**James K. Hilger**

**Chief Accounting Officer\***

Date: November 6, 2014

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

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**INDEX TO EXHIBITS**

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