DAVITA INC Files SEC form 10-Q, Quarterly Report

Quarterly Report

Results of operations

	Quarter ended					
	June 30, 2003		March 31, 2003		June 30, 2002	
	(dollars in millions, except per treatment data)					
Net operating revenues	$ 490	100 %	$ 460	100 %	$ 443	100 %
Operating expenses and charges:						
Dialysis centers and labs	336	69 %	317	69 %	300	68 %
General and administrative	42	9 %	37	8 %	40	9 %
Depreciation and amortization	18	4 %	18	4 %	16	4 %
Provision for uncollectible accounts, net of recoveries	9	2 %	8	2 %	6	1 %
Minority interest and equity income, net	2		1		2	
Total operating expenses and charges	407	83 %	381	83 %	364	82 %
Operating income	$ 83	17 %	$ 79	17 %	$ 79	18 %
Dialysis treatments	1,580,000		1,503,000		1,487,000	
Average dialysis treatments per treatment day	20,251		19,673		19,062	
Average dialysis revenue per dialysis treatment	$ 301.52		$ 296.31		$ 290.52	

Net operating revenue

The net operating revenues of $490 million for the second quarter of 2003 represented an increase of $47 million or approximately 11% compared with the second quarter of 2002. The increase in the number of dialysis treatments accounted for approximately 6% and approximately 4% was attributable to increases in the average reimbursement rate per dialysis treatment. The increase in 2003 also included approximately $5 million of Medicare laboratory revenue. No Medicare lab revenue had been recognized during the second quarter of 2002 due to the payment withholds by the third-party carrier, as discussed below. The increase in the number of treatments consisted of non-acquired annual growth of approximately 3.4% plus growth through acquisitions. We continue to expect the non-acquired growth rate to remain in the range of 3.0% to 5.0% throughout 2003. The average dialysis revenue per treatment (excluding lab and clinical research revenues and management fee income) was $301.52 for the second quarter of 2003 as compared to $290.52 for the second quarter of 2002. The increase in average revenue per treatment was primarily due to improved pricing and payor contracting, payor mix, changes in intensity of physician-prescribed pharmaceuticals, and billing and collection improvements.

Compared to the first quarter of 2003, second quarter 2003 net operating revenues represented an increase of $30 million or 6.5%. The increase in the number of dialysis treatments accounted for 4.7% of the increase and an increase in the average reimbursement rate per dialysis treatment accounted for a 1.8% increase in the revenue. The increase in the number of treatments was attributable on average to 1.6 additional treatment days in the second quarter compared with the first quarter, as well as acquired and non-acquired treatment growth. The increase in the revenue per treatment was primarily attributable to the same factors as noted above.

Lab and other services

As discussed in Note 5 to the condensed consolidated interim financial statements (Contingencies), our Florida-based laboratory subsidiary has been under an ongoing third-party carrier review for Medicare reimbursement claims since 1998. Prior to the third quarter 2002, no Medicare payments had been received since May 1998. Following a favorable ruling by an administrative law judge in June 2002 the carrier began releasing funds for lab services provided subsequent to May 2001. The carrier also paid us amounts it is not disputing for prior periods. During 2002, the carrier paid us a total of approximately $69 million, representing approximately 70% of the total outstanding Medicare lab billings for the period from January 1995 through June 2002. These cash collections were recognized as revenue in the quarter received. We do not expect to recognize any significant additional Medicare lab revenue relating to prior periods unless and until the dispute over the remaining disallowed claims are resolved in our favor.

Dialysis centers and lab expenses

Center operating expenses were approximately 69% of net operating revenues in the second quarter of 2003 and the first quarter of 2003 compared to 68% for the second quarter of 2002. On a per-treatment basis, center operating expenses increased approximately $2 from the first quarter of 2003 and approximately $12 from the second quarter of 2002. The increases in both periods were primarily attributable to higher labor, benefits, insurance, and pharmaceutical costs, and changes in the intensity of physician-prescribed pharmaceuticals.

General and administrative expenses

General and administrative expenses were approximately 9% of net operating revenues for the second quarter of 2003 and 2002, compared to 8% in the first quarter of 2003. In absolute dollars, general and administrative expenses for the second quarter of 2003 increased by approximately $6 million or 16% from the first quarter of 2003 and were approximately the same as compared to the second quarter of 2002. The increase in dollar amounts from the first quarter of 2003 was primarily due to higher labor and insurance costs, increases in professional fees for compliance initiatives and acquisition due diligence, as well as the timing of expenditures.

Provision for uncollectible accounts receivable

The provisions for uncollectible accounts receivable before considering cash recoveries were approximately 1.8% of current period net operating revenues for all periods presented. During the second quarter of 2002 we realized recoveries of approximately $2 million, which were netted against the normal provision for uncollectible accounts.

Debt expense

Debt expense of $19.5 million for the second quarter of 2003 was $2.4 million higher than the second quarter of 2002 as a result of higher debt balances, primarily associated with our recapitalization during the second quarter of 2002, offset by lower interest rates. The average effective interest rate for the second quarter of 2003 was 5.1% compared to 6.4% for the second quarter of 2002.

Projections for 2003

Operating income for the full year 2003 is currently projected to be in the range of $315 million to $330 million, and operating income for 2004 is currently projected to be relatively flat compared with 2003. These projections and the underlying assumptions involve significant risks and uncertainties, and actual results may vary significantly from these current projections. These risks, among others, include those relating to private and government reimbursement rates, the concentration of profits generated from non-governmental payors and physician-prescribed pharmaceuticals, changes in pharmaceutical practice patterns or reimbursement policies, our ability to maintain contracts with our physician medical directors, and the ongoing review by the United States Attorney's Office and the OIG. We undertake no duty to update these projections, whether due to changes in current or expected trends, underlying market conditions, decisions of the United States Attorney's Office, the DOJ or the OIG in any pending or future review of our business, or otherwise.

Reclassification of previously reported extraordinary losses

In accordance with SFAS No. 145 Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 14, and Technical Corrections, which became effective as of January 1, 2003, losses from the extinguishment of debt previously classified as an extraordinary item of $29.4 million, net of tax, have been reclassified to refinancing charges of $49 million before taxes for the three and six months ending June 30, 2002. The classification change had no impact on net earnings. As a result of this classification change, previously reported diluted net earnings per share for the three and six months ended June 30, 2002 of $0.13 and $0.54 have been restated to $0.10 and $0.52, respectively, for the convertible subordinated notes that are no longer considered dilutive to income after this classification change.

Liquidity and capital resources

Cash flow from operations during the second quarter of 2003 amounted to $79 million. Investing cash outflows consisted principally of capital asset additions of $20 million, which included approximately $10 million for center development and approximately $10 million for equipment and information technology projects, and approximately $46 million in acquisitions.

Cash flow from operations during the first six months of 2003 amounted to $159 million. Investing cash outflows consisted principally of capital asset additions of $42 million, which included approximately $22 million for center development and approximately $20 million for equipment and information technology projects, and approximately $47 million in acquisitions.

On July 15, 2003, the Company completed a call for redemption of all of its outstanding $125 million 5 5/8% Convertible Subordinated Notes due 2006. Holders of the 5 5/8% Notes had the option to convert their notes into shares of DaVita common stock at a price of $25.62 per share or receive cash at 1.0169 times the principal amount of the 5 5/8% Notes, plus accrued interest. On July 15, 2003, the Company issued 4,868,352 shares of common stock from treasury stock for the conversion of $124.7 million of the 5 5/8% Notes, and redeemed the balance of $300,000 for cash and accrued interest, in the amount of $308,000.

On July 15, 2003, the Company entered into an amended and restated credit agreement in order to, among other things, lower the overall interest rate. The Company secured a replacement Term Loan B for $1,041.5 million. The new Term Loan B bears interest at LIBOR plus 2.5%, for an overall effective rate of 3.6%, as of July 15, 2003, with a provision under certain circumstances to further reduce the interest rate to LIBOR plus 2.25%. The aggregate annual principal payments for the new Term Loan B are approximately $11 million in the first four years of the agreement, approximately $255 million in the fifth year and approximately $741 million in the sixth year, due no later than March 2009.

On July 16, 2003, the Company announced that it is calling for redemption $200 million of its outstanding $345 million 7% Convertible Subordinated Notes due 2009 on August 15, 2003. Holders of the 7% Notes have the option to convert their notes into shares of DaVita common stock at a price of $32.81 per share or receive cash at 1.042 times the principal amount of the 7% Notes, plus accrued interest.

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Accounts receivable at June 30, 2003 amounted to $346 million, unchanged from the first quarter of 2003. The second quarter accounts receivable balance represented 66 days of revenue, compared to 69 days as of March 31, 2003.

Our current plans continue to call for capital expenditures to be at a level consistent with 2002, including investment expenditures for information technology projects and for new dialysis centers, relocations and expansions other than acquisitions. During the second quarter of 2003, we acquired a total of 11 centers and opened 8 new centers.

We believe that we will have sufficient liquidity and operating cash flows to fund our scheduled debt service and other obligations over the next twelve months.

Table of Contents Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Interest rate sensitivity

The table below provides information, as of June 30, 2003, about our financial instruments that are sensitive to changes in interest rates.

Expected maturity date									Average
								Fair	Interest
2003	2004	2005	2006	2007	2008	Thereafter	Total	Value	Rate

				(dollars in millions)						
Long-term debt:										
Fixed rate			$ 125				$ 345	$ 470	$ 504	6.63 %
Variable rate	$ 26	$ 43	$ 43	$ 49	$ 318	$ 404	$ 104	$ 987	$ 987	

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