

DAVITA HEALTHCARE PARTNERS INC.

Form 10-Q

August 01, 2014

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

For the Quarterly Period Ended June 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 16th 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 July 29, 2014, the number of shares of the Registrant's common stock outstanding was approximately 214.8 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 \$15.3 billion.

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

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DAVITA HEALTHCARE PARTNERS INC.
CONSOLIDATED STATEMENTS OF INCOME

(unaudited)

(dollars in thousands, except per share data)

	Three months ended		Six months ended	
	June 30,		June 30,	
	2014	2013	2014	2013
Patient service revenues	\$ 2,187,249	\$ 2,048,651	\$ 4,301,347	\$ 4,028,524
Less: Provision for uncollectible accounts	(88,052)	(72,191)	(171,249)	(142,248)
Net patient service revenues	2,099,197	1,976,460	4,130,098	3,886,276
Capitated revenues	799,369	710,074	1,586,934	1,472,689
Other revenues	273,923	185,139	498,233	342,290
Total net revenues	3,172,489	2,871,673	6,215,265	5,701,255
Operating expenses and charges:				
Patient care costs and other costs	2,246,538	2,014,320	4,426,310	3,975,211
General and administrative	298,636	268,110	582,697	552,520
Depreciation and amortization	145,907	130,589	288,486	256,498
Provision for uncollectible accounts	3,208	1,260	5,719	2,138
Equity investment income	(6,095)	(7,649)	(13,467)	(17,016)
Loss contingency reserve				300,000
Contingent earn-out obligation adjustment		(56,977)		(56,977)
Total operating expenses and charges	2,688,194	2,349,653	5,289,745	5,012,374
Operating income	484,295	522,020	925,520	688,881
Debt expense	(106,132)	(108,096)	(212,467)	(213,913)
Debt refinancing charges	(97,548)		(97,548)	
Other income (loss), net	1,693	(1,374)	3,391	(776)
Income from continuing operations before income taxes	282,308	412,550	618,896	474,192
Income tax expense	100,887	129,192	225,738	144,336
Income from continuing operations	181,421	283,358	393,158	329,856
Discontinued operations:				
Loss from operations of discontinued operations, net of tax				(139)
Gain on disposal of discontinued operations, net of tax				13,375

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Net income	181,421	283,358	393,158	343,092
Less: Net income attributable to noncontrolling interests	(33,738)	(28,982)	(62,186)	(58,552)

Net income attributable to DaVita HealthCare Partners Inc.	\$ 147,683	\$ 254,376	\$ 330,972	\$ 284,540
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Earnings per share:

Basic income from continuing operations per share attributable to DaVita HealthCare Partners Inc.	\$ 0.70	\$ 1.21	\$ 1.56	\$ 1.29
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Basic net income per share attributable to DaVita HealthCare Partners Inc.	\$ 0.70	\$ 1.21	\$ 1.56	\$ 1.36
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Diluted income from continuing operations per share attributable to DaVita HealthCare Partners Inc.	\$ 0.68	\$ 1.18	\$ 1.53	\$ 1.26
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Diluted net income per share attributable to DaVita HealthCare Partners Inc.	\$ 0.68	\$ 1.18	\$ 1.53	\$ 1.33
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Weighted average shares for earnings per share:

Basic	212,258,994	209,797,334	211,817,893	209,385,380
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Diluted	216,720,944	214,849,164	216,420,713	214,490,452
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Amounts attributable to DaVita HealthCare Partners Inc.:

Income from continuing operations	\$ 147,683	\$ 254,376	\$ 330,972	\$ 271,291
Discontinued operations				13,249

Net income	\$ 147,683	\$ 254,376	\$ 330,972	\$ 284,540
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See notes to condensed consolidated financial statements.

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DAVITA HEALTHCARE PARTNERS INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(unaudited)

(dollars in thousands)

	Three months ended		Six months ended	
	June 30,		June 30,	
	2014	2013	2014	2013
Net income	\$ 181,421	\$ 283,358	\$ 393,158	\$ 343,092
Other comprehensive income (loss), net of tax:				
Unrealized losses on interest rate swap and cap agreements:				
Unrealized (loss) gain on interest rate swap and cap agreements	(5,209)	11,685	(7,714)	9,316
Reclassifications of net swap and cap agreements realized loss into net income	4,997	3,462	8,356	5,969
Unrealized gains on investments:				
Unrealized gain on investments	578	101	909	719
Reclassification of net investment realized gains into net income			(207)	(94)
Foreign currency translation adjustments	1,939	(1,841)	1,967	(3,947)
Other comprehensive income	2,305	13,407	3,311	11,963
Total comprehensive income	183,726	296,765	396,469	355,055
Less: Comprehensive income attributable to noncontrolling interests	(33,738)	(28,982)	(62,186)	(58,552)
Comprehensive income attributable to DaVita HealthCare Partners Inc.	\$ 149,988	\$ 267,783	\$ 334,283	\$ 296,503

See notes to condensed consolidated financial statements.

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	June 30, 2014	December 31, 2013
ASSETS		
Cash and cash equivalents	\$ 1,420,973	\$ 946,249
Short-term investments	63,835	6,801
Accounts receivable, less allowance of \$244,878 and \$237,143	1,550,252	1,485,163
Inventories	99,650	88,805
Other receivables	455,620	349,090
Other current assets	164,591	176,414
Income tax receivable	6,965	10,315
Deferred income taxes	399,361	409,441
Total current assets	4,161,247	3,472,278
Property and equipment, net of accumulated depreciation of \$1,936,494 and \$1,778,259	2,290,844	2,189,411
Intangibles, net of accumulated amortization of \$565,839 and \$483,773	2,022,875	2,024,373
Equity investments	42,842	40,686
Long-term investments	87,614	79,557
Other long-term assets	66,106	79,598
Goodwill	9,254,043	9,212,974
	\$ 17,925,571	\$ 17,098,877
LIABILITIES AND EQUITY		
Accounts payable	\$ 405,751	\$ 435,465
Other liabilities	465,242	464,422
Accrued compensation and benefits	626,617	603,013
Medical payables	304,551	287,452
Loss contingency reserve	397,000	397,000
Senior notes (6 ³ / ₈ % Senior Notes)	291,907	
Current portion of long-term debt	117,080	274,697
Total current liabilities	2,608,148	2,462,049
Long-term debt	8,390,578	8,141,231
Other long-term liabilities	386,033	380,337
Deferred income taxes	823,745	812,419
Total liabilities	12,208,504	11,796,036

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Commitments and contingencies		
Noncontrolling interests subject to put provisions	760,242	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; 214,759,091 and 213,163,248 shares issued and outstanding at June 30, 2014 and at December 31, 2013, respectively)		
	215	213
Additional paid-in capital	1,089,929	1,070,922
Retained earnings	3,694,961	3,363,989
Accumulated other comprehensive income (loss)	666	(2,645)
Total DaVita HealthCare Partners Inc. shareholders equity	4,785,771	4,432,479
Noncontrolling interests not subject to put provisions	171,054	173,062
Total equity	4,956,825	4,605,541
	\$ 17,925,571	\$ 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)

	Six months ended	
	June 30,	
	2014	2013
Cash flows from operating activities:		
Net income	\$ 393,158	\$ 343,092
Adjustments to reconcile net income to cash provided by operating activities:		
Loss contingency reserve		300,000
Depreciation and amortization	288,470	256,382
Debt refinancing charges	97,548	
Stock-based compensation expense	29,699	32,266
Tax benefits from stock award exercises	42,110	36,524
Excess tax benefits from stock award exercises	(30,238)	(28,442)
Deferred income taxes	13,826	(102,039)
Equity investment income, net	2,257	(496)
Other non-cash (income) charges and loss on disposal of assets	22,861	(69,050)
Changes in operating assets and liabilities, other than from acquisitions and divestitures:		
Accounts receivable	(65,079)	(17,829)
Inventories	(10,731)	924
Other receivables and other current assets	(95,580)	(65,349)
Other long-term assets	2,158	(1,220)
Accounts payable	(46,022)	(94,894)
Accrued compensation and benefits	19,912	(14,279)
Other current liabilities	31,970	82,905
Income taxes	2,886	(9,182)
Other long-term liabilities	(17,707)	36,713
Net cash provided by operating activities	681,498	686,026
Cash flows from investing activities:		
Additions of property and equipment, net	(278,593)	(258,396)
Acquisitions	(98,442)	(152,112)
Proceeds from asset and business sales	215	64,363
Purchase of investments available for sale	(6,117)	(3,286)
Purchase of investments held-to-maturity	(121,333)	(1,032)
Proceeds from sale of investments available for sale	1,277	1,091
Proceeds from sale of investments held to maturity	64,561	1,376
Purchase of intangible assets and equity investment	(4,760)	(7)

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Distributions received on equity investments	337	116
Net cash used in investing activities	(442,855)	(347,887)
Cash flows from financing activities:		
Borrowings	33,136,743	33,445,567
Payments on long-term debt and other financing costs	(32,788,307)	(33,696,216)
Deferred financing costs and debt redemption costs	(106,937)	(716)
Distributions to noncontrolling interests	(65,818)	(65,206)
Stock award exercises and other share issuances, net	7,274	8,819
Excess tax benefits from stock award exercises	30,238	28,442
Contributions from noncontrolling interests	28,265	20,132
Proceeds from sales of additional noncontrolling interests	933	5,903
Purchases from noncontrolling interests	(5,743)	(474)
Net cash provided by (used in) financing activities	236,648	(253,749)
Effect of exchange rate changes on cash and cash equivalents	(567)	(234)
Net increase in cash and cash equivalents	474,724	84,156
Cash and cash equivalents at beginning of the year	946,249	533,748
Cash and cash equivalents at end of the year	\$ 1,420,973	\$ 617,904

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	45,544
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									14,944

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	43,590				330,972				330,972	18,59
Other comprehensive income								3,311	3,311	
Stock unit shares issued		290		(27)					(27)	
Stock-settled RSR shares issued		1,306	2	(2)						
Stock-based compensation expense				29,699					29,699	
Less tax benefits from stock awards exercised				30,238					30,238	
Contributions to controlling interests	(41,733)									(24,08
Contributions from controlling interests	18,240									10,02
es and assumptions of additional controlling	918			15					15	

Interests										
Acquisition and										
Interests from										
controlling										
Interests	(446)			1,247				1,247		(6,541)
Adjustment in										
ownership										
Interests				210				210		
Changes in fair										
value of										
controlling										
Interests	42,373			(42,373)				(42,373)		
Balance at										
March 31, 2014	\$ 760,242	214,759	\$ 215	\$ 1,089,929	\$ 3,694,961	\$	\$	666	\$ 4,785,771	\$ 171,051

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 six months ended June 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 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).

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

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
Basic:				
Income from continuing operations attributable to DaVita HealthCare Partners Inc.	\$ 147,683	\$ 254,376	\$ 330,972	\$ 271,291
Increase in noncontrolling interests redemption rights in excess of fair value		(259)		(259)
Income from continuing operations for basic earnings per share calculation	\$ 147,683	\$ 254,117	\$ 330,972	\$ 271,032
Discontinued operations attributable to DaVita HealthCare Partners Inc.				13,249
Net income attributable to DaVita HealthCare Partners Inc. for basic earnings per share calculation	\$ 147,683	\$ 254,117	\$ 330,972	\$ 284,281
Weighted average shares outstanding during the period	214,451	211,986	214,010	211,574
Vested stock units	2	5	2	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	212,259	209,797	211,818	209,385
Basic income from continuing operations per share attributable to DaVita HealthCare Partners Inc.	\$ 0.70	\$ 1.21	\$ 1.56	\$ 1.29
Basic income from discontinued operations per share attributable to DaVita HealthCare Partners Inc.	\$	\$	\$	\$ 0.07
Basic net income per share attributable to DaVita HealthCare Partners Inc.	\$ 0.70	\$ 1.21	\$ 1.56	\$ 1.36

Diluted:

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Income from continuing operations attributable to DaVita HealthCare Partners Inc.	\$ 147,683	\$ 254,376	\$ 330,972	\$ 271,291
Increase in noncontrolling interests redemption rights in excess of fair value		(259)		(259)
Income from continuing operations for diluted earnings per share calculation	\$ 147,683	\$ 254,117	\$ 330,972	\$ 271,032
Discontinued operations attributable to DaVita HealthCare Partners Inc.				13,249
Net income attributable to DaVita HealthCare Partners Inc. for diluted earnings per share calculation	\$ 147,683	\$ 254,117	\$ 330,972	\$ 284,281
Weighted average shares outstanding during the period	214,451	211,986	214,010	211,574
Vested stock units	2	5	2	5
Assumed incremental shares from stock plans	2,268	2,858	2,409	2,911
Weighted average shares for diluted earnings per share calculation	216,721	214,849	216,421	214,490
Diluted income from continuing operations per share attributable to DaVita HealthCare Partners Inc.	\$ 0.68	\$ 1.18	\$ 1.53	\$ 1.26
Diluted income from discontinued operations per share attributable to DaVita HealthCare Partners Inc.	\$	\$	\$	\$ 0.07
Diluted net income per share attributable to DaVita HealthCare Partners Inc.	\$ 0.68	\$ 1.18	\$ 1.53	\$ 1.33
Anti-dilutive stock-settled awards excluded from calculation ⁽¹⁾	990	4,520	1,995	3,353

(1) 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.

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(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, in the case of dialysis services receivables, 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 six months ended June 30, 2014, the Company's allowance for doubtful accounts increased by approximately \$7,735. This was mainly due to an increase relating to the U.S. dialysis and related lab services, primarily as a result of additional non-covered Medicare write-offs. 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:

June 30, 2014	December 31, 2013
Total	Total

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	Held to maturity	Available for sale		Held to maturity	Available for sale	
Certificates of deposit and money market funds due within one year	\$ 62,374	\$	\$ 62,374	\$ 5,601	\$	\$ 5,601
Investments in mutual funds and common stock		25,685	25,685		19,421	19,421
	\$ 62,374	\$ 25,685	\$ 88,059	\$ 5,601	\$ 19,421	\$ 25,022
Short-term investments	\$ 62,374	\$ 1,461	\$ 63,835	\$ 5,601	\$ 1,200	\$ 6,801
Long-term investments		24,224	24,224		18,221	18,221
	\$ 62,374	\$ 25,685	\$ 88,059	\$ 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 June 30, 2014 and December 31, 2013 approximates their fair value. As of June 30, 2014 and December 31, 2013, the available-for-sale investments included \$6,161 and \$5,096 of gross pre-tax unrealized gains, respectively. During the six months ended June 30, 2014, the Company recorded gross pre-tax unrealized gains of \$1,405, or \$909 after tax, in other comprehensive income associated with changes in the fair value of these investments. During the six months ended June 30, 2014, the Company sold investments in mutual funds for net proceeds of \$1,277 and recognized a pre-tax gain of \$340, or \$207 after-tax, which was previously recorded in other comprehensive income. During the six months ended June 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 June 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 June 30, 2014, this minimum cash balance was approximately \$58,000.

5. Goodwill

Changes in goodwill by reportable segments were as follows:

	Six months ended June 30, 2014			
	U.S. dialysis and related lab services	HCP	Other-ancillary services and strategic initiatives	Consolidated total
Balance at December 31, 2013	\$ 5,469,473	\$ 3,516,162	\$ 227,339	\$ 9,212,974
Acquisitions	2,915	38,639	820	42,374
Other adjustments		(2,277)	972	(1,305)
Balance at June 30, 2014	\$ 5,472,388	\$ 3,552,524	\$ 229,131	\$ 9,254,043

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

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 eroded recently, primarily as a result of reductions in its Medicare Advantage reimbursement rates. As a result, the Company has determined that two of its HCP reporting units, HCP California and HCP Nevada, are at risk of goodwill impairment. HCP California and HCP Nevada have goodwill of \$2,511,477 and \$517,618, respectively.

The Company obtained preliminary third-party valuations of these two businesses as of June 30, 2014, noting that the estimated fair values of HCP California and HCP Nevada exceed their total carrying values by approximately 6.0% and 10.9%, 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 and HCP Nevada could reduce their estimated fair values by up to 3.1% and 2.9%, respectively. Separately, an increase in their respective discount rates of 100 basis points could reduce the estimated fair values of HCP California and HCP Nevada by up to 7.7% and 6.1%, respectively.

During the first six 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 June 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 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 six months ended June 30, 2014:

	Six months ended June 30, 2014
Health care costs payable, beginning of the period	\$ 172,310
Add: Components of incurred health care costs	
Current year	775,604
Prior years	5,602
Total incurred health care costs	781,206
Less: Claims paid	
Current year	589,968
Prior years	153,223
Total claims paid	743,191
Health care costs payable, end of the period	\$ 210,325

Our prior year estimates of health care costs payable increased by \$5,602 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 June 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 \$60,372, of which \$32,945 would impact the Company's effective tax rate if recognized. This balance represents a decrease of \$166 from the December 31, 2013 balance of \$60,538.

The Company recognizes accrued interest and penalties related to unrecognized tax benefits in its income tax expense. At June 30, 2014 and December 31, 2013, the Company had approximately \$11,969 and \$10,742, respectively, accrued for interest and penalties related to unrecognized tax benefits, net of federal tax benefits.

As of June 30, 2014, it is reasonably possible that \$27,427 of unrecognized tax benefits may be recognized within the next 12 months, primarily related to the filing of tax accounting method changes which will not impact the Company's effective tax rate.

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8. Long-term debt

Long-term debt was comprised of the following:

	June 30, 2014	December 31, 2013
Senior Secured Credit Facilities:		
New Term Loan A	\$ 1,000,000	\$
New Term Loan B	3,500,000	
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	4,066,907	2,800,000
Acquisition obligations and other notes payable	66,511	67,352
Capital lease obligations	183,647	152,751
Total debt principal outstanding	8,817,065	8,433,603
Discount on long-term debt	(17,500)	(17,675)
	8,799,565	8,415,928
Less current portion	(408,987)	(274,697)
	\$ 8,390,578	\$ 8,141,231

Classification of long-term debt at June 30, 2014 was as follows:

Senior notes	\$ 291,907
Current portion	117,080
Total current portion	408,987
Long-term debt	8,390,578
	\$ 8,799,565

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

2014 (remainder of the year, including the 6 ³ / ₈ % Senior Notes)	347,712
2015	112,182
2016	115,645
2017	141,972
2018	153,282
2019	727,238
Thereafter	7,219,034

During the first six 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.

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In June 2014, the Company entered into a \$5,500,000 senior secured credit agreement (the New 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 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 bears 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 ³/₈% 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 ³/₈% 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 ³/₈% Senior Notes of \$291,719 at a redemption price of \$1,047.81 per 1,000 of principal amount of the 6 ³/₈% Senior 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.

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.

In addition, as a result of these transactions, 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 six months ended June 30, 2014, the Company recognized debt expense of \$6,137 from these swaps.

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 June 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 \$878,750. 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 \$121,250 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

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September 30, 2016 and require monthly interest payments. During the six months ended June 30, 2014, the Company recognized debt expense of \$1,592 from these swaps. As of June 30, 2014, the total fair value of these swap agreements was a net asset of approximately \$849. The Company estimates that approximately \$2,696 of existing unrealized pre-tax losses in other comprehensive income at June 30, 2014 will be reclassified into income over the next twelve months.

As of June 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 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 six months ended June 30, 2014, the Company recognized debt expense of \$1,220 from these caps. The cap agreements expire on September 30, 2016. As of June 30, 2014, the total fair value of these cap agreements was an asset of approximately \$2,692. During the six months ended June 30, 2014, the Company recorded a loss of \$4,874 in other comprehensive income due to a decrease in the unrealized fair value of these cap agreements.

As of June 30, 2014, the Company also maintains five other interest rate cap agreements with notional amounts totaling \$1,250,000. These agreements have 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, as a result of the interest rate cap agreements that were entered into in March 2013, as described above, these interest rate cap agreements became ineffective cash flow hedges and as a result any changes in the fair value associated with these interest rate cap agreements will be charged to income. During the six months ended June 30, 2014, the Company recognized debt expense of \$1,794 from these caps. The cap agreements expire on September 30, 2014.

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

Derivatives designated as hedging instruments	June 30, 2014		December 31, 2013	
	Balance sheet location	Fair value	Balance sheet location	Fair value
Interest rate swap agreements	Other short-term liabilities	\$ 2,696	Other short-term liabilities	\$ 12,069
Interest rate swap agreements	Other long-term assets	\$ 3,545	Other long-term assets	\$ 10,004
Interest rate cap agreements	Other long-term assets	\$ 2,692	Other long-term assets	\$ 7,567

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

	Amount of gains (losses) recognized in OCI on interest rate swap and cap agreements				Location of losses reclassified from accumulated OCI into income	Amount of losses reclassified from accumulated OCI into income			
	Three months ended June 30,		Six months ended June 30,			Three months ended June 30,		Six months ended June 30,	
Derivatives designated as cash flow hedges	2014	2013	2014	2013		2014	2013	2014	2013
Interest rate swap agreements	\$ (5,022)	\$ 13,266	\$ (7,786)	\$ 12,302	Debt expense (including refinancing charges)	\$ (6,694)	\$ (4,159)	\$ (10,700)	\$ (7,366)
Interest rate cap agreements	(3,527)	5,858	(4,874)	2,945	Debt expense (including refinancing charges)	(1,507)	(1,507)	(3,014)	(2,404)
Tax benefit (expense)	3,340	(7,439)	4,946	(5,931)		3,204	2,204	5,358	3,801
Total	\$ (5,209)	\$ 11,685	\$ (7,714)	\$ 9,316		\$ (4,997)	\$ (3,462)	\$ (8,356)	\$ (5,969)

As of June 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. 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 3.51%, 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 June 30, 2014.

The Company's overall weighted average effective interest rate during the second quarter of 2014 was 4.85% and as of June 30, 2014 was 4.56%.

As of June 30, 2014, the Company had undrawn revolving credit facilities totaling \$1,000,000 of which approximately \$83,000 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.

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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.

2010 U.S. Attorney Physician Relationship Investigation: In May 2010, the Company received a subpoena from the OIG's office in Dallas, Texas. The civil subpoena covers the period from January 2005 to May 2010, and seeks production of a wide range of documents relating to the Company's dialysis operations, including documents related to, among other things, 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. The Company has been advised by the attorneys conducting this civil investigation that they believe that some or all of the Company's joint ventures do not comply with the anti-kickback statute and the False Claims Act. The Company disagrees that its joint venture structure generally, which the Company believes is widely used in the dialysis industry and other segments of the healthcare industry substantially in the form that the Company uses it, violates the federal anti-kickback statute or the False Claims Act. As to individual transactions, the Company made significant effort to ensure that its joint venture structures and process complied with the rules, but the Company is talking with the government about addressing its concerns. The focus of this investigation overlaps substantially with the 2011 U.S. Attorney Physician Relationship Investigation described below. The Company has agreed to a framework for a global resolution with the United States Attorney's Office for the District of Colorado, the Civil Division of the United States Department of Justice and the Office of the Inspector General for both the 2010 and the 2011 U.S. Attorney Physician Relationship Investigations. The final settlement remains subject to negotiation of specific terms. The settlement will include the payment of approximately \$389,000, entry into a corporate integrity agreement, the appointment of an independent compliance monitor, and the imposition of certain other business restrictions related to a subset of the Company's joint

venture arrangements. Under the terms of the framework for resolution, the Company has agreed to unwind a limited subset of joint ventures that were created through partial divestiture to nephrologists, and agreed not to enter into this type of partial divestiture joint venture with nephrologists in the future. In 2013, the Company accrued an estimated loss contingency reserve of \$397,000 related to this matter. The final settlement remains subject to negotiation of specific terms and will continue to require management's attention and significant legal expense. The Company can make no assurances as to the final outcome.

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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 relates 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 overlaps substantially with the 2010 U.S. Attorney Physician Relationship Investigation described above. As noted above, the Company has agreed to a framework for a global resolution with the United States Attorney's Office for the District of Colorado, the Civil Division of the United States Department of Justice and the Office of the Inspector General for both the 2010 and the 2011 U.S. Attorney Physician Relationship Investigations. The final settlement remains subject to negotiation of specific terms and will continue to require management's attention and significant legal expense. The Company can make no assurances as to the final outcome.

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 remain subject to ongoing negotiation.

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.

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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 relators' claims (except as described above), or the potential range of damages, if any.

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. At this time, the Company cannot predict the ultimate outcome of these matters or the potential range of damages, if any.

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.

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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.

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 interest may ultimately be settled, which could vary significantly from the Company's current estimates. The estimated fair values of noncontrolling interest 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.

Additionally, the Company has certain other potential commitments to provide operating capital to several dialysis centers that are wholly-owned by third parties or centers in which the Company owns 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.

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.

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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.

During the six months ended June 30, 2014, the Company granted 1,248 stock-settled stock appreciation rights with an aggregate grant-date fair value of \$19,997 and a weighted-average expected life of approximately 4.2 years, and also granted 316 stock units with an aggregate grant-date fair value of \$22,809 and a weighted-average expected life of approximately 3.4 years.

For the six months ended June 30, 2014 and 2013, the Company recognized \$52,960 and \$38,773, respectively, in total LTIP expense, of which \$29,699 and \$32,266, 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 June 30, 2014 and 2013 was \$10,997 and \$12,171, respectively. As of June 30, 2014, there was \$162,351 of total estimated unrecognized compensation cost for outstanding LTIP awards, including \$99,331 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 six months ended June 30, 2014 and 2013, the Company received \$42,110 and \$36,524, respectively, in actual tax benefits upon the exercise of stock awards.

12. Comprehensive income

	For the three months ended June 30, 2014				For the six months ended June 30, 2014			
Interest rate swap and cap agreements	Investment securities	Foreign translation adjustments	Accumulated other comprehensive income (loss)	Interest rate swap and cap agreements	Investment securities	Foreign translation adjustments	Accumulated other comprehensive income (loss)	
Beginning balance	\$ (1,490)	\$ 3,244	\$ (3,393)	\$ (1,639)	\$ (2,344)	\$ 3,120	\$ (3,421)	\$ (2,645)
	(8,549)	875	1,939	(5,736)	(12,660)	1,405	1,967	(9,289)

Unrealized (losses) gains								
Related income tax benefit (expense)	3,340	(297)		3,044	4,946	(496)		4,451
	(5,209)	578	1,939	(2,692)	(7,714)	909	1,967	(4,838)
Reclassification from accumulated other comprehensive income into net income	8,201			8,201	13,714	(340)		13,374
Related tax	(3,204)			(3,204)	(5,358)	133		(5,225)
	4,997			4,997	8,356	(207)		8,149
Ending balance	\$ (1,702)	\$ 3,822	\$ (1,454)	\$ 666	\$ (1,702)	\$ 3,822	\$ (1,454)	\$ 666

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	For the three months ended June 30, 2013				For the six months ended June 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	\$ (15,264)	\$ 1,834	\$ (3,311)	\$ (16,741)	\$ (15,402)	\$ 1,310	\$ (1,205)	\$ (15,297)
Unrealized gains (losses)	19,124	166	(1,841)	17,449	15,247	1,178	(3,947)	12,478
Related income tax (expense) benefit	(7,439)	(65)		(7,504)	(5,931)	(459)		(6,390)
	11,685	101	(1,841)	9,945	9,316	719	(3,947)	6,088
Reclassification from accumulated other comprehensive income into net income	5,666			5,666	9,770	(155)		9,615
Related tax	(2,204)			(2,204)	(3,801)	61		(3,740)
	3,462			3,462	5,969	(94)		5,875
Ending balance	\$ (117)	\$ 1,935	\$ (5,152)	\$ (3,334)	\$ (117)	\$ 1,935	\$ (5,152)	\$ (3,334)

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 six months of 2014, the Company acquired dialysis businesses and other businesses consisting of one dialysis center located in the U.S., three dialysis centers located outside the U.S. and other medical businesses for a total of \$98,442 in net cash and deferred purchase price obligations totaling \$14,156. 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.

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

	Six months ended June 30, 2014
Tangible assets, principally leasehold improvements and equipment, net of cash	\$ 858
Amortizable intangible and other long-term assets	69,366
Goodwill	42,374
Aggregate purchase price	\$ 112,598

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Amortizable intangible assets acquired during the first six months of 2014 had weighted-average estimated useful lives of 9.9 years. The total amount of goodwill deductible for tax purposes associated with these acquisitions was approximately \$27,789.

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 \$136,300 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 June 30, 2014, the Company has estimated the fair value of these contingent earn-out obligations to be \$38,335.

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 \$38,335 recognized at June 30, 2014, a total of \$13,682 is included in other liabilities and the remaining \$24,653 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 six months ended June 30, 2014:

Beginning balance, January 1, 2014	\$ 28,058
Contingent earn-out obligations associated with acquisitions	13,772
Remeasurement of fair value for other contingent earn-outs	(1,969)
Payments of contingent earn-outs	(1,526)
	\$ 38,335

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

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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 June 30, 2014, these condensed consolidated financial statements include total assets of VIEs of \$515,618 and total liabilities and noncontrolling interests of VIEs to third parties of \$307,133.

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.

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

Total	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
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Assets				
Available-for-sale securities	\$ 25,685	\$ 25,685	\$	\$
Interest rate cap agreements	\$ 2,692	\$	\$ 2,692	\$
Interest rate swap agreements	\$ 3,545	\$	\$ 3,545	\$
Funds on deposit with third parties	\$ 72,575	\$ 72,575	\$	\$
Liabilities				
Contingent earn-out obligations	\$ 38,335	\$	\$	\$ 38,335
Interest rate swap agreements	\$ 2,696	\$	\$ 2,696	\$
Temporary equity				
Noncontrolling interests subject to put provisions	\$ 760,242	\$	\$	\$ 760,242

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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 probabilities of achieving gross margin of certain medical procedures 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.

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 June 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 \$4,482,500 as of June 30, 2014, and the fair value was approximately \$4,526,300 based upon quoted market prices. The fair value of the Company's senior notes was approximately \$4,229,200 at June 30, 2014 based upon quoted market prices, as compared to the carrying amount of \$4,066,907.

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 and various other ancillary services and strategic initiatives, including its international dialysis operations. The HCP division is comprised of the Company's HealthCare Partners integrated healthcare business.

As of June 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.

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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 the second quarter of 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:

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
Segment net revenues:				
U.S. dialysis and related lab services				
Patient service revenues:				
External sources	\$ 2,096,605	\$ 1,980,267	\$ 4,125,349	\$ 3,889,050
Intersegment revenues	9,084	8,158	16,916	15,669
Total dialysis and related lab services revenues	2,105,689	1,988,425	4,142,265	3,904,719
Less: Provision for uncollectible accounts	(84,227)	(69,585)	(165,690)	(136,656)
Net dialysis and related lab services patient service revenues	2,021,462	1,918,840	3,976,575	3,768,063
Other revenues ⁽¹⁾	3,579	3,424	6,732	6,319
Total net dialysis and related lab services revenues	2,025,041	1,922,264	3,983,307	3,774,382
HCP				
HCP revenues:				
Capitated revenues	783,182	692,357	1,554,724	1,438,428
Net patient service revenues	58,076			