DaVita®

2003 ANNUAL REPORT

Table of Contents

	Page
Management's Discussion and Analysis of Financial Condition and Results of Operations	3
Quantitative and Qualitative Disclosures About Market Risk	15
Consolidated Statements of Income and Comprehensive Income	16
Consolidated Balance Sheets	17
Consolidated Statements of Cash Flows	18
Consolidated Statements of Shareholders' Equity	19
Notes to Consolidated Financial Statements	20
Report of Management	40
Independent Auditors' Report	41
Risk Factors	42
Market for the Registrant's Common Equity and Related Stockholder Matters	47
Selected Financial Data—Five Year Summary	48

In the interest of our Stakeholders, we have kept the cost of this Annual Report to a minimum. For additional information about the Company, please visit our website at www.davita.com or contact LeAnne Zumwalt at DaVita's corporate address.

Dear Stakeholders:

Clinical Outcomes: DaVita had another strong clinical year! DaVita achieved especially strong performance in the areas of nutrition, kinetics and anemia management. 85% of our patients achieved an albumin level of 3.5, (and 42% > 4.0), 93% of our patients achieved a Kt/V of 1.2, and 85% of our patients achieved an HCT of 33 or greater. These values significantly exceed the national averages, and are even more noteworthy given the large number of inner-city patients we take care of. If you added a review of our vascular access, osteodystrophy, and other clinical measures you would happily conclude that the overall care we provided in 2003 was our best ever!

Physician Relationships: In 2003 we strengthened the relationships with our affiliated physicians by continuing to improve our traditional services as well as offering several new ones. One of the new services is vascular access centers. Our Lifeline subsidiary, the leader in this exciting field, is delivering dramatic benefits to patients, physicians, and payers. Yet another promising service is RMS, our leading disease management business, which has a proven track record of helping payers reduce total costs while improving patient outcomes and service. All-in-all, our portfolio of services to help affiliated physician practices grow and prosper is unique in the industry.

DaVita Clinical Research: DaVita Clinical Research (DCR) is a clinical trial site and site management organization (SMO) with over 17 years of experience conducting renal research. DaVita is the only dialysis company with its own 50 bed in patient unit for Phase I-III clinical trials, and an SMO for Phase III-IV trials conducted in the dialysis units. In addition to commercial research, DaVita itself awards research grants to DaVita affiliated physicians and teammates for small focused trials to explore new ideas for advancing the care of dialysis patients. Through these research programs we are supporting healthcare professionals in improving outcomes for all dialysis patients.

Cash Flow: At the beginning of the year, we said operating cash flow, excluding prior period recoveries, would be between $185 to $235 million. We generated $294 million in 2003, substantially exceeding expectations. Our DSO fluctuated between 65-69 days. It moved higher toward the end of the year, as we predicted it would, due to the implementation of a new billing system.

Earnings: Net earnings were $177 million (excluding prior period recoveries and refinancing charges). On a comparable basis, operating income was up 11%, net earnings were up 17%, and earnings per share increased 33%. Margins pulled back slightly compared to 2002, consistent with our previous guidance.

Growth: We said we would be in the 3-5% non-acquired center growth rate for 2003. We achieved 4.3%. In addition, we opened 30 de novo centers during 2003 vs. 19 in 2002. On the acquisition front, we purchased 27 centers serving approximately 2,000 patients, which will add approximately 4% to year over year treatment growth. We continue to target treatment growth from acquisitions of 2-4% per year on average for the next few years. The market is competitive, so achieving this target at acceptable prices will take a lot of work.

Capital Structure: Through a sequence of debt restructurings and stock buy-backs, we were able to lower our aggregate cost of capital, with a significant positive impact to earnings per share. At the end of the year, our debt leverage ratio of 2.3 was below our targeted long-term range.

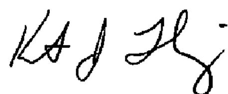
Employer of Choice: We continue to live our mission of becoming the Provider, Partner, and Employer of Choice. This can only be achieved by investing in our teammates' professional and personal growth. Our turnover in 2003 was the lowest in at least the last five years.

Public Policy: As an industry, we failed once again to achieve an automatic inflation update to our reimbursement rate. This is disappointing as our segment clearly needs it and we are one of the few without it. On a positive note, we were successful in obtaining a 1.6% permanent increase effective in 2005 and we were the only segment to be granted a 100% add-back for the impact of 2005 AWP cuts. We continue to make steady progress in building credibility with the various public policy decision-makers.

Conclusion: 2003 was our best year yet in terms of clinical, financial and operating results! Going forward we can look forward to steady demand growth, continued consolidation, and healthy cash flow. At the same time the concentration of our profits in, and the dynamics surrounding, private reimbursement and pharmaceutical administration remain among our chief risk factors.

I would like to take this opportunity to thank our 13,000 teammates. Their tenacity in trying to meet the expectations of all our constituents is remarkable.

Sincerely,



Kent J. Thiry
Chairman and CEO

For financial reconciliations, see our press release for the 4th Quarter and Year Ended 2003, which is on our website.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Forward looking statements

This Annual Report contains statements that are forward-looking statements within the meaning of the federal securities laws, including statements about our expectations, beliefs, intentions or strategies for the future. These statements involve known and unknown risks and uncertainties, including risks resulting from the regulatory environment in which we operate, economic and market conditions, competitive activities, other business conditions, accounting estimates, and the risk factors set forth in this Annual Report. These risks, among others, include those relating to the concentration of profits generated from PPO and private indemnity patients and from the administration of pharmaceuticals, possible reductions in private and government reimbursement rates, changes in pharmaceutical practice patterns or reimbursement policies, the Company's ability to maintain contracts with physician medical directors, and legal compliance risks such as the ongoing review by the US Attorney's Office and the HHS Office of Inspector General in Philadelphia. Our actual results may differ materially from results anticipated in our forward-looking statements. We base our forward-looking statements on information currently available to us, and we have no current intention to update these statements, whether as a result of changes in underlying factors, new information, future events or other developments.

The following should be read in conjunction with our consolidated financial statements and related notes thereto elsewhere in this Annual Report.

Overview

Our stated mission is to be the provider, employer and partner of choice. We believe our attention to these three areas—our patients, our teammates, and our business partners—represent the major drivers of our long-term success, aside from external factors such as government policy and physician practice patterns. Accordingly, two principal non-financial metrics we track are quality clinical outcomes and teammate turnover. We have developed our own composite index for measuring improvements in our clinical outcomes, which we refer to as the DaVita Quality Index (DQI). Our clinical outcomes have improved over each of the past three years, and we ended 2003 with the best clinical outcomes that we have ever achieved. Although it is difficult to reliably measure clinical performance across our industry, we believe our clinical outcomes compare favorably with other dialysis providers in the United States. Over the past three years we have achieved significant reductions in teammate turnover, which has been a major contributor to our performance improvements. We will continue to focus on these fundamental long-term value drivers.

We are pleased with the overall clinical, operating and financial performance levels achieved over the past three years, and we expect to be able to generally maintain our current levels of performance over the foreseeable future, absent significant adverse shifts in government policy, physician practice patterns, or mix of commercial-plan patients. Although our business has areas of significant potential exposure, as delineated in the risk factors following this discussion and analysis, our operating results over the past three years have not been significantly adversely affected by these risk factors.

Our operations represent a single reporting segment, with more than 96% of our revenues currently derived directly from providing dialysis services, of which 88% represents on-site dialysis services in approximately 540 centers that are wholly-owned or majority-owned. Our other direct dialysis services, which operationally are integrated with our center operations, relate to patient-performed peritoneal dialysis and acute treatments in hospitals.

The principal drivers to our revenue are a) the number of treatments, which is primarily a function of the number of chronic patients requiring three treatments per week, and b) average treatment revenue. The total patient base is a relatively stable factor, influenced by a demographically growing need for dialysis, our relationships with referring physicians together with the quality of our clinical care, and our pace of opening and acquiring new centers.

Our year-over-year treatment volume growth for 2003 was 6.7%, compared with 5.0% and 6.3% for 2002 and 2001. Approximately 40% of our 2003 growth was associated with new centers, and approximately 60% was attributable to increased treatments.

Average revenue per treatment is principally driven by our mix of commercial and government (principally Medicare and Medicaid) treatments, the mix and intensity of physician-prescribed pharmaceuticals, commercial and government reimbursement rates, and our charge capture, billing and collecting operations performance.

On average, reimbursement rates from commercial payors are more than double Medicare and Medicaid reimbursement rates, and therefore the percentage of commercial patients to total patients represents a major driver of our total average revenue per treatment. The percent of patients under government reimbursement programs to total dialysis center patients increased approximately 1% during 2003, and is currently approximately 79%.

In terms of revenue dollars, approximately 58% of our total dialysis revenue is from government programs. Government reimbursement rates are principally determined by federal (Medicare) and state (Medicaid) policy, have limited potential for rate increases and are sometimes at risk of reductions. Medicare reimbursements represent approximately 50% of our dialysis revenue, and cumulative increases since 1990 have only totaled 4.6%. There were no Medicare rate increases for 2002 and 2003, and the next increase is scheduled for 2005 at 1.6%. Medicaid rates in some states have been under severe budget pressures, and some reductions are anticipated in certain states. Commercial rates can vary significantly and a major portion of our commercial rates are contracted amounts with major payors and are subject to intense negotiation pressure. Over the past three years we have been successful in maintaining a relatively stable average reimbursement rate in the aggregate for patients with commercial plans, in addition to obtaining periodic fee schedule increases.

Approximately 40% of our dialysis revenue is associated with physician-prescribed pharmaceuticals, and therefore changes in physician practice patterns, pharmaceutical protocols, and pharmaceutical intensities significantly influence our revenue levels. Such changes, driven by physician practice patterns and protocols focused on improving clinical outcomes, have accounted for a significant portion of the increase in average revenue per treatment over the past three years.

Our operating performance with respect to services charge capture billing and collecting can also be a significant factor in how much average revenue per treatment is actually realized. Over the past two years we have invested heavily in new systems and processes to ensure reliable performance, as well as compliance with federal and state regulations.

Because of the inherent uncertainties associated with predicting third-party reimbursements in the healthcare industry, our revenue recognition involves significant estimation risks. Our estimates are developed based on the best information available to us and our best judgement as to the reasonably assured collectibility of our billings as of the reporting date. Changes in estimates are reflected in the financial statements based upon on-going actual experience trends, or subsequent settlements and realizations depending on the nature and predictability of the estimates and contingencies. In 2001 we separately reported cash recoveries of $22 million associated with prior years' dialysis services as a result of improvements in our billing and collecting operations.

Our annual average revenue per treatment increased from $278 in 2001 to $291 in 2002 and to $303 in 2003. These increases were principally due to increases in our standard fee schedules (impacting non-contracted commercial revenue), changes in mix and intensity of physician-prescribed pharmaceuticals, commercial contract negotiations, and continued improvements in revenue capture, billing and collecting operations, while maintaining a relatively stable mix of commercial patients and commercial rates.

The principal drivers for our patient care costs are clinical hours per treatment, labor rates, vendor pricing of pharmaceuticals, and business infrastructure and compliance costs. However, other cost categories can also

represent significant cost changes such as increased insurance costs experienced in 2003. Our average clinical hours per treatment has improved over the past two years primarily because of reduced teammate turnover and improved training and processes. There is limited opportunity for productivity improvements beyond the levels achieved in 2003, and federal and state policies can adversely impact our ability to achieve optimal productivity levels. Labor rates have increased consistent with general industry trends. For the past three years we have been able to negotiate relatively stable pharmaceutical pricing with our vendors, and expect relatively stable pricing through 2004.

General and administrative expenses have remained relatively constant as a percent of total revenue over the past three years, however this reflects substantial increases in spending related to strengthening our business and regulatory compliance processes, legal and other professional fees, and expanding support functions. We expect that these higher levels of general and administrative expenses will be generally maintained to support our long-term initiatives and to ensure the highest levels of regulatory compliance.

Although other revenues represented only approximately 3% of total revenues for 2003 and 2002, changes in the status of disputed Medicare billings at our Florida lab resulted in increased current period revenue and operating income of $21 million in 2002 compared to 2001. The carrier began making payments on Medicare lab billings in the third quarter of 2002 after four years of withholding all payments, and therefore we were able to begin recognizing this revenue which was entirely incremental income because the associated lab revenue costs had always been ongoing. Medicare lab revenues for 2003 current year services amounted to $26 million. In addition to the incremental current period revenue and income, we had Medicare lab recoveries totaling $83 million in 2002 and 2003 associated with lab services provided from 1995 through 2001, representing nearly 90% of the previously disputed Medicare claims.

Outlook for 2004 and beyond. We are targeting operating income to be between $360 and $385 million for 2004, compared with $355 for 2003. This is consistent with our current longer-term three-year outlook of an average annual increase in operating income of three to eight percent for the next three years on a cumulative average basis. However, we believe the potential downside risks for this three-year outlook are greater than the upside potentials outside this range. 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 the concentration of profits generated from PPO and private indemnity patients and from the administration of pharmaceuticals, possible reductions in private and government reimbursement rates, changes in pharmaceutical practice patterns or reimbursement policies, our ability to maintain contracts with our physician medical directors, and legal compliance risks such as the ongoing review by the United States Attorney's Office and HHS Office of Inspector General in Philadelphia. 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.

Results of operations

The following is a summary of operating revenues and operating expenses. The divestiture of our dialysis operations outside the continental United States was substantially completed during 2000, and the sale of our remaining non-continental centers was completed during the second quarter of 2002. The non-continental U.S. operating results are excluded from the revenue and cost trends discussed below.

	Year ended December 31,					
	2003		2002		2001	
	(dollar amounts rounded to nearest million)					
Net operating revenues:						
Continental:						
Current period services	**$1,992**	100%	**$1,790**	100%	**$1,614**	100%
Prior years' services—laboratory	*24*		*59*			
Prior years' services—dialysis					*22*	
Non-continental			*6*		*15*	
	2,016		1,855		1,651	
Operating expenses and charges:						
Continental:						
Patient care costs	**1,361**	68%	**1,212**	68%	**1,087**	67%
General and administrative	**160**	8%	**155**	9%	**128**	8%
Depreciation and amortization	**75**	4%	**64**	4%	**62**	4%
Goodwill amortization					*42*	
Provision for uncollectible accounts	**36**	2%	**32**	2%	**32**	2%
Recoveries			*(5)*		*(35)*	
Minority interest and equity income, net	**7**		**8**		**7**	
Non-continental			*5*		*17*	
Total operating expenses and charges	1,638		1,471		1,340	
Operating income	$ 379		$ 384		$ 311	
Operating income—excluding non-continental operations, prior years' recoveries, and goodwill amortization in 2001 (i.e., excluding amounts in italics)	***$ 355***	*18%*	***$ 319***	*18%*	***$ 298***	*18%*
Dialysis treatments	6,373,894		5,975,280		5,690,199	
Average dialysis treatments per treatment day	20,377		19,090		18,185	
Average dialysis revenue per treatment (excluding prior years' services revenue in 2001)	$303		$291		$278	

Net operating revenues

Net operating revenues. Net operating revenues for current period services for continental U.S. operations increased 11% in both 2003 and 2002. Approximately 4% and 5% of the increases in revenue for 2003 and 2002 were attributable to increases in the average reimbursement rate per treatment and approximately 7% and 5% were due to increases in the number of dialysis treatments. The balance of the increase in 2002 was due to approximately $21 million of additional current year Medicare laboratory revenue. As discussed below, we had not recognized any Medicare laboratory revenue during 2001 due to the ongoing dispute with the third-party carrier.

Dialysis services revenue. Dialysis services revenue, excluding prior period services revenue, represented approximately 97%, 97% and 98% of current operating revenues in 2003, 2002 and 2001, respectively. Lab, other and management fee income account for the balance of revenues.

Dialysis services include outpatient center hemodialysis, which accounts for approximately 88% of total dialysis treatments, home dialysis, and inpatient hemodialysis with contracted hospitals. Major components of dialysis revenue include the administration of EPO and other drugs as part of the dialysis treatment, which represents approximately one third of operating revenues.

Dialysis services are paid for primarily by Medicare and state Medicaid programs in accordance with rates established by CMS, and by other third-party payors such as HMOs and health insurance carriers. Services provided to patients covered by third-party insurance companies are on average more than double the Medicare or Medicaid rates. Patients covered by employer group health plans convert to Medicare after a maximum of 33 months. As of year-end 2003, the Medicare ESRD dialysis treatment rates were between $121 and $144 per treatment, or an overall average of $131 per treatment, excluding the administration of drugs.

The majority of our net earnings from dialysis services are derived from commercial payors, some of which pay at negotiated reimbursement rates and others which pay based on our usual and customary fee schedule. The commercial reimbursement rates are under continual pressure as we negotiate contract rates with large HMOs and insurance carriers. Additionally, as a patient transitions from commercial coverage to Medicare or Medicaid coverage, the reimbursement rates generally decline substantially.

Dialysis services revenues by payor type were as follows:

	Year ended December 31,		
	2003	**2002**	**2001**
Percent of total dialysis revenue:			
Medicare	50%	51%	52%
Medicaid and other government-based programs	8	8	8
	58	59	60
Commercial payors (HMOs, and health insurance carriers)	42	41	40
	100%	100%	100%

The average dialysis revenue recognized per treatment was $303, $291 and $278 for 2003, 2002 and 2001, respectively. The increase in average dialysis revenue per treatment in 2003 was principally due to commercial rate increases and changes in intensity of physician-prescribed pharmaceuticals. The increase in 2002 was principally due to commercial rate increases, changes in mix and intensity of physician-prescribed pharmaceuticals, continued improvements in revenue capture, billing and collecting operations, and payor contracting. The average dialysis revenue per treatment for the fourth quarter of 2003 was $306. Our mix of commercial patients and commercial rates, which is a major profitability factor, remained relatively stable during 2003.

The number of dialysis treatments increased 6.7% in 2003 and 5.0% in 2002, principally attributable to non-acquired annual growth rates of approximately 4.0% plus growth through acquisitions. We expect the non-acquired growth rate to remain in the range of 3.0% to 5.0% through 2004.

The prior years' services revenue of $22 million in 2001 related to cash recoveries associated with prior years' services and resulted from improvements in the Company's billing and collecting operations.

Lab and other services. As discussed in Note 16 to the consolidated 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 relating to review periods from January 1995 to March 1998, the carrier began releasing funds for lab services provided subsequent to May 2001. During the fourth quarter of 2002, the carrier also released funds for certain claims in review periods from

April 1998 through May 2001. During the second half of 2002, the carrier paid us a total of $69 million, representing approximately 70% of the total outstanding prior Medicare lab billings for the period from January 1995 through June 2002. Approximately $10 million of these collections related to 2002 lab services provided through June 2002, and the balance of $59 million related to prior years' services. In addition to the prior-period claims, the carrier also began processing billings for current period services in the third quarter of 2002, at which time we began recognizing current period Medicare lab revenue.

The carrier's hearing officer recently rendered partially favorable decisions relating to review periods from April 1998 to May 2000, which resulted in our recognition of additional recoveries of $24 million, of which approximately $19 million remains to be paid in the first quarter of 2004. We have filed requests for appeal to an administrative law judge for the remaining unpaid claims of approximately $11 million for review periods from April 1998 through May 2001, but cannot be assured of any further recoveries.

Management fee income. Management fee income represented less than 1% of total revenues for 2003 and 2002. Our fees are typically based on a percentage of revenue of the center that we administrate and are established in the management contract. We operated or provided administrative services to 29 and 30 third-party or minority-owned dialysis centers as of December 31, 2003 and 2002. During the third quarter of 2003 we acquired an outpatient vascular access management business that currently manages the vascular access component at fourteen independent third-party physician practices.

Operating expenses and charges

Patient care costs. Patient care costs are those costs directly associated with operating and supporting our dialysis centers and ancillary operations and consist principally of labor, pharmaceuticals, medical supplies and facility costs. As a percentage of net operating revenue, patient care costs were 68% for 2003 and 2002, and 67% for 2001. On a per-treatment basis, patient care costs increased approximately $11 and $12 in 2003 and 2002. The increase in both years was principally due to higher labor and insurance costs, and increases in new center openings, as well as increases in the levels of physician-prescribed pharmaceuticals. Increases in revenue per treatment more than offset these cost increases.

General and administrative expenses. General and administrative expenses consist of those costs not specifically attributable to the dialysis centers and ancillary operations, and include expenses for corporate and regional administration, including centralized accounting, billing and cash collection functions, and regulatory compliance oversight. General and administrative expenses as a percentage of net operating revenues (excluding prior period services revenue) were approximately 8.0%, 8.7% and 8.0% in 2003, 2002 and 2001, respectively. In absolute dollars, general and administrative expenses increased by approximately $25 million in 2002 and an additional $6 million in 2003. The increase in 2003 principally consisted of higher labor costs. The increase in 2002 was principally due to higher labor and legal costs. The substantial increases in labor costs for 2002 and 2003 principally related to strengthening our business and regulatory compliance processes, as well as expanding support functions.

Depreciation and amortization. The increase in depreciation and amortization from $64 million in 2002 to $75 million in 2003 was principally due to new center developments, acquisitions and our new operating and billing systems.

Provision for uncollectible accounts receivable. The provisions for uncollectible accounts receivable (excluding prior period services revenue) were approximately 1.8% of current operating revenues in 2003 and 2002, and 2.0% in 2001. During 2002 and 2001, we realized recoveries of $5 million and $35 million associated with aged accounts receivables that had been reserved in 1999. The recoveries and lower provisions in 2003 and 2002 resulted from continued improvements that we have made in our billing and collecting processes.

Impairments and valuation adjustments. We perform impairment or valuation reviews for our property and equipment, amortizable intangibles, and investments in and advances to third-party dialysis businesses

whenever a change in condition indicates that a review is warranted. Such changes include shifts in our business strategy or plans, the quality or structure of our relationships with our partners, or when an owned or third-party dialysis business experiences deteriorating operating performance or liquidity problems. Goodwill is routinely assessed for possible valuation impairment using fair value methodologies. There were no significant impairments or valuation adjustments during the periods presented.

Other income

The net of other income items were income of approximately $3 million for 2003, $4 million for 2002, and $3 million for 2001. These amounts included interest income of approximately $3 million for each year.

Debt expense and refinancing charges

Debt expense for 2003, 2002 and 2001 consisted of interest expense of approximately $64 million, $69 million and $70 million respectively, and amortization of deferred financing costs of approximately $3 million for each year. The reduction in interest expense in 2003 was primarily due to lower average interest rates and lower average debt balances.

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, an after-tax loss of $29.4 million in 2002 and an after-tax gain of $1 million in 2001 resulting from the extinguishment of debt previously classified as extraordinary items have been reclassified to a pre-tax refinancing charge of $49 million for 2002 and a pre-tax gain of $2 million for 2001. In 2003, the refinancing charges of $27 million related to the consideration paid in excess of book value to redeem our Convertible Subordinated Notes and the write-off of deferred financing costs and financing fees associated with amending our bank credit agreement. In 2002, the refinancing charges of $49 million, related to debt restructuring, which included retiring $225 million 9¼% Senior Subordinated Notes due 2011 and extinguishing our then existing senior credit facilities. In 2001, the net refinancing gain of $2 million related to the write-off of deferred financing costs being more than offset by the accelerated recognition of deferred interest rate swap liquidation gains as a result of debt refinancing.

Provision for income taxes

The provision for income taxes for 2003 represented an effective tax rate of 39.0%, compared with 41.0% in 2002 and 43.4% in 2001. The reduction in the effective tax rate in 2003 compared to 2002 was primarily due to a lower provision for state income taxes and utilization of previously unrecognized tax losses. The reduction in 2002 was primarily due to a lower provision for state income tax rates, the elimination of book amortization not deductible for tax purposes and changes in tax valuation estimates.

Liquidity and capital resources

Cash flow from operations during 2003 amounted to $294 million, compared with $278 million for 2002 not including $64 million in Medicare lab and uncollectible account recoveries related to prior years' services. Non-operating cash outflows in 2003 included $100 million for capital asset expenditures including $58 million for new center developments, $97 million for acquisitions (net of divestitures), and $107 million in stock repurchases. Non-operating cash outflows for 2002 included $103 million for capital asset expenditures, $19 million for acquisitions, and $642 million in stock repurchases. During 2003 we acquired 27 dialysis centers, including controlling ownership interests in two centers in which we previously had minority ownership, for $84 million and opened 30 new dialysis centers. Other 2003 acquisitions related to ancillary operations. During 2002 we acquired 11 dialysis centers for $20 million and opened 19 new dialysis centers.

The accounts receivable balance at December 31, 2003 and 2002 represented approximately 69 and 70 days of net revenue, net of bad debt provision.

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.

Our stated long-term general target range for our debt leverage ratio is 3.0 to 3.5, although we expect that it may be outside this range for periods of time. As of year-end 2003, our ratio was 2.3. For this purpose, debt leverage ratio is defined as total debt net of cash to annualized operating income excluding depreciation, amortization, and minority interests and equity income, net.

2003 capital structure changes. In the first quarter of 2003, we borrowed $150 million that was available under the Term Loan A of our credit facility. The Term Loan A bears interest at LIBOR plus 2.00% for an overall effective rate of 3.19% at December 31, 2003, with provision to potentially further reduce the interest rate to LIBOR plus 1.50% under certain circumstances. The Term Loan A matures in March 2007 and requires annual principal payments of $33.9 million in years 2004 and 2005, $40.1 million in 2006 and $10.6 million in 2007.

In July 2003, we completed a call for redemption of all of our outstanding $125 million 5⅝% Convertible Subordinated Notes due 2006. Holders of the 5⅝% 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 5⅝% Notes, plus accrued interest. In July 2003, we issued 4,868,352 shares of common stock from treasury stock for the conversion of nearly all the 5⅝% Notes, and redeemed the balance for cash and accrued interest.

In July 2003, we also entered into an amended credit agreement in order to, among other things, lower the overall interest rate. We also acquired an additional $200 million of borrowings under the replacement Term Loan B, which amounted to $1.042 billion. In November 2003, we entered into a second amended and restated credit agreement in order to again lower the interest rate on the Term Loan B and to modify certain covenants. The Term Loan B currently bears interest at LIBOR plus 2.25% for an overall effective rate of 3.42%, with a provision to potentially further reduce the interest rate to LIBOR plus 2.00% under certain circumstances. The aggregate annual principal payments for the Term Loan B are approximately $11 million in the first four years of the agreement, $255 million in the fifth year and $741 million in the sixth year, due no later than March 2009.

In August 2003, we completed a call for redemption of $200 million of our outstanding $345 million 7% Convertible Subordinated Notes due 2009. Holders of the 7% Notes had 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. All $200 million of the Notes were redeemed for $208 million in cash plus accrued interest.

In October 2003, we completed a call for redemption of the remaining $145 million of our 7% Convertible Subordinated Notes due 2009. These 7% Notes were redeemed for $155 million in cash, including accrued interest, and 16,030 shares of treasury stock.

In November 2003, we entered into an interest rate swap agreement to effectively fix the LIBOR benchmark interest rate at 3.39% on an amortizing notional amount of $135 million of our Term Loan B outstanding debt that had the economic effect of fixing the interest rate at 5.64% based upon the margin in effect on December 31, 2003. The agreement expires in November 2008 and requires quarterly interest payments. As of December 31, 2003, the notional amount of the swap was approximately $135 million and its fair value was a $2 million liability, resulting in a charge to other comprehensive income of approximately $1 million, net of tax. As a result of the swap agreement, the effective interest rate on the entire credit facility was 3.69% based upon the margin in effect on December 31, 2003.

In January 2004, we entered into another interest rate swap agreement to effectively fix the LIBOR benchmark interest rate at 3.08% on an additional amortizing notional amount of $135 million of our Term Loan B outstanding debt that had the economic effect of fixing the interest rate at 5.33% based upon the margin in effect on January 15, 2004. The agreement expires in January 2009 and requires quarterly interest payments. As a

result of these two interest rate swap agreements, as of January 15, 2004, approximately 25% of our outstanding variable rate debt is effectively fixed at a weighted average interest rate of 5.49% and our overall credit facility effective weighted average interest rate was 3.89%, based upon current margins.

During 2003, we repurchased a total of 3,441,900 shares of our common stock for approximately $107 million, or an average of $31.13 per share, pursuant to Board of Directors' authorizations. As of December 31, 2003, we had $146 million remaining to repurchase shares of our common stock in the open market pursuant to a $200 million Board of Directors' authorization.

2002 capital structure changes. In the first quarter of 2002, we initiated a recapitalization plan to restructure our debt and repurchase common stock. In the initial phase of the recapitalization plan we retired all of our $225 million outstanding 9¼% Senior Subordinated Notes due 2011 for $266 million. Concurrent with the retirement of this debt, we secured a new senior credit facility agreement in the amount of $1.115 billion. The excess of the consideration paid over the book value of the Senior Subordinated Notes and write-off of deferred financing costs associated with extinguishing the existing senior credit facilities and the notes resulted in refinancing charges of $49 million. We completed the next phase of the recapitalization plan with the repurchase of 16,682,337 shares of our common stock for approximately $402 million, or $24.10 per share, through a modified dutch auction tender offer. From May through December 2002 we also purchased 7,699,440 shares in the open market for approximately $172 million pursuant to a $225 million Board of Directors' authorization. For the year ended December 31, 2002, stock repurchases, including 2,945,700 shares acquired prior to initiating the recapitalization plan, amounted to $642 million for 27,327,477 shares, for a composite average of $23.50 per share.

Off-balance sheet arrangements and aggregate contractual obligations

In addition to the debt obligations reflected on our balance sheet, we have commitments associated with operating leases, letters of credit and our investments in third-party dialysis businesses. Nearly all of our facilities are leased. We have potential acquisition obligations for several jointly-owned centers, in the form of put options exercisable at the third-party owners' discretion. These put obligations require us to purchase the third-party owners' interests at either the appraised fair market value or a predetermined multiple of earnings or cash flow. The following is a summary of these contractual obligations and commitments as of December 31, 2003:

	Within One Year	2-3 Years	4-5 Years	After 5 Years	Total
	(dollars in millions)				
Scheduled payments under contractual obligations:					
Long-term debt	$ 50	$ 97	$766	$247	$1,160
Capital lease obligations	1	1	3	3	8
Operating leases	62	115	93	153	423
	$113	$ 213	$862	$403	$1,591
Potential cash requirements under existing commitments:					
Letters of credit	$ 15				$ 15
Acquisition of dialysis centers	38		$ 9	$ 13	60
Working capital advances to third-parties under administrative services agreements	15				15
	$ 68	$ —	$ 9	$ 13	$ 90

Contingencies

Health care provider revenues may be subject to adjustment as a result of (1) examination by government agencies or contractors, for which the resolution of any matters raised may take extended periods of time to finalize; (2) differing interpretations of government regulations by different fiscal intermediaries or regulatory

authorities; (3) differing opinions regarding a patient's medical diagnosis or the medical necessity of services provided; (4) retroactive applications or interpretations of governmental requirements; and (5) claims for refunds from private payors.

As discussed in Note 16 to the consolidated 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 relating to review periods from January 1995 to March 1998, the carrier began releasing funds for lab services provided subsequent to May 2001. During the fourth quarter of 2002, the carrier also released funds related to review periods from April 1998 through May 2001. During the second half of 2002, the carrier paid us a total of $69 million, of which $59 million related to prior years' services. The carrier's hearing officer recently rendered partially favorable decisions relating to review periods from April 1998 to May 2000, which resulted in our recognition of additional recoveries of $24 million, of which approximately $19 million remains to be paid in the first quarter of 2004. We have filed requests for appeal to an administrative law judge for the remaining unpaid claims of approximately $11 million for review periods from April 1998 through May 2001, but cannot be assured of any further recoveries.

In February 2001 the Civil Division of the United States Attorney's Office for the Eastern District of Pennsylvania in Philadelphia contacted us and requested our cooperation in a review of some of our historical practices, including billing and other operating procedures and our financial relationships with physicians. We cooperated in this review and provided the requested records to the United States Attorney's Office. In May 2002, we received a subpoena from the Philadelphia office of the Office of Inspector General of the Department of Health and Human Services, or OIG. The subpoena requires an update to the information we provided in our response to the February 2001 request, and also seeks a wide range of documents relating to pharmaceutical and other ancillary services provided to patients, including laboratory and other diagnostic testing services, as well as documents relating to our financial relationships with physicians and pharmaceutical companies. The subpoena covers the period from May 1996 to May 2002. We have provided the documents requested. This inquiry remains at an early stage. As it proceeds, the government could expand its areas of concern. If a court determines that there has been wrongdoing, the penalties under applicable statutes could be substantial.

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

Critical accounting estimates and judgements

Our consolidated financial statements and accompanying notes are prepared in accordance with accounting principles generally accepted in the United States. These accounting principles require us to make estimates, judgements and assumptions that affect the reported amounts of revenues, expenses, assets, liabilities, and contingencies. All significant estimates, judgements and assumptions are developed based on the best information available to us at the time made and are regularly reviewed and updated when necessary. Actual results will generally differ from these estimates. Changes in estimates are reflected in our financial statements in the period of change based upon on-going actual experience trends, or subsequent settlements and realizations depending on the nature and predictability of the estimates and contingencies. Interim changes in estimates are applied prospectively within annual periods. Certain accounting estimates, including those concerning revenue recognition and provision for uncollectible accounts, impairments and valuation adjustments, and accounting for income taxes, are considered to be critical in evaluating and understanding our financial results because they involve inherently uncertain matters and their application requires the most difficult and complex judgements and estimates.

Revenue recognition and provision for uncollectible accounts. Revenue recognition uncertainties inherent in the Company's operations are addressed in AICPA Statement of Position (SOP) No. 00-1 *Auditing Health Care Third-Party Revenues and Related Receivables*. As addressed in SOP No. 00-1, net revenue recognition and allowances for uncollectible billings require the use of estimates of the amounts that will actually be realized considering, among other items, retroactive adjustments that may be associated with regulatory reviews, audits, billing reviews and other matters.

Revenues are recognized as services are provided to patients. Operating revenues consist primarily of reimbursement for dialysis and ancillary services to patients. A usual and customary fee schedule is maintained for our dialysis treatment and other patient services; however, actual collectible revenue is normally at a discount to the fee schedule. Medicare and Medicaid programs are billed at pre-determined net realizable rates per treatment that are established by statute or regulation. Most nongovernmental payors, including contracted managed care payors, are billed at our usual and customary rates, but a contractual allowance is recorded to adjust to the expected net realizable revenue for services provided. Contractual allowances along with provisions for uncollectible accounts are estimated based upon credit risks of third-party payors, contractual terms, inefficiencies in our billing and collection processes, regulatory compliance issues and historical collection experience. Our range of dialysis revenue estimating risk is generally expected to be within 1% of total revenue, which can represent as much as 5% of operating income. Changes in estimates are reflected in the financial statements based on on-going actual experience trends, or subsequent settlements and realizations depending on the nature and predictability of the estimates and contingencies. Changes in revenue estimates for prior periods are separately disclosed and reported if material to the current reporting period and longer term trend analyses. For example, we recognized $22 million of prior period dialysis revenue in 2001 related to cash recoveries in excess of previous estimates made possible by improvements in our billing and collecting operations.

Lab service revenues for current period dates of services are recognized at the estimated net realizable amounts to be received after considering possible retroactive adjustments that may be made as a result of the ongoing third-party carrier review.

Impairments of long-lived assets. We account for impairment of long-lived assets, which include property and equipment, investments, amortizable intangible assets and goodwill, in accordance with the provisions of SFAS No. 144 *Accounting for the Impairment or Disposal of Long-Lived Assets* or SFAS No. 142 *Goodwill and Other Intangible Assets,* as applicable. An impairment review is performed annually or whenever a change in condition occurs which indicates that the carrying amounts of assets may not be recoverable. Such changes include changes in our business strategies and plans, changes in the quality or structure of our relationships with our partners and deteriorating operating performance of individual dialysis centers. We use a variety of factors to assess the realizable value of assets depending on their nature and use. Such assessments are primarily based upon the sum of expected future undiscounted net cash flows over the expected period the asset will be utilized, as well as market values and conditions. The computation of expected future undiscounted net cash flows can be complex and involves a number of subjective assumptions. Any changes in these factors or assumptions could impact the assessed value of an asset and result in an impairment charge equal to the amount by which its carrying value exceeds its actual or estimated fair value.

Accounting for income taxes. We estimate our income tax provision to recognize our tax expense for the current year and our deferred tax liabilities and assets for future tax consequences of events that have been recognized in our financial statements, measured using enacted tax rates and laws expected to apply in the periods when the deferred tax liabilities or assets are expected to be realized. Deferred tax assets are assessed based upon the likelihood of recoverability from future taxable income and to the extent that recovery is not likely, a valuation allowance is established. The allowance is regularly reviewed and updated for changes in circumstances that would cause a change in judgement about the realizability of the related deferred tax assets. These calculations and assessments involve complex estimates and judgements because the ultimate tax outcome can be uncertain or future events unpredictable.

Variable compensation accruals. We estimate variable compensation accruals monthly based upon the annual amounts expected to be earned and paid out resulting from the achievement of certain teammate-specific and/or corporate financial and operating goals. Our estimates, which include compensation incentives for bonuses, awards and benefit plan contributions, are updated periodically due to changes in our economic condition or cash flows that could ultimately impact the actual final award. Actual results may vary due to the subjective nature of fulfilling employee specific and/or corporate goals, as well as the final determination and approval of amounts by the Company's Board of Directors.

Quantitative and Qualitative Disclosures About Market Risk

Interest rate sensitivity

The table below provides information about our financial instruments that are sensitive to changes in interest rates. For our debt obligations, the table presents principal repayments and current weighted average interest rates on these obligations as of December 31, 2003. For our debt obligations with variable interest rates, the rates presented reflect the current rates in effect at the end of 2003. These rates are based on LIBOR plus margins based upon performance and leverage criteria. The margins currently in effect are between 2.00% to 2.25%.

	Expected maturity date								
	2004	**2005**	**2006**	**2007**	**2008**	**Thereafter**	**Total**	**Fair Value**	**Average interest rate**
	(dollars in millions)								
Long-term debt:									
Fixed rate	$ 6	$ 1	$ 1	$ 2		$ 3	$13	$13	5.08%
Variable rate	45	45	52	22	$744	247	1,155	1,155	3.69%

Our senior credit facility is based on a floating LIBOR interest rate plus a margin, which is reset periodically and can be locked in for a maximum of six months. As a result, our interest expense is subject to fluctuations as LIBOR interest rates change.

In November 2003, we entered into an interest rate swap agreement to effectively fix the LIBOR benchmark interest rate at 3.39% on an amortizing notional amount of $135 million of our Term Loan B outstanding debt that had the economic effect of fixing the interest rate at 5.64% based upon the margin in effect on December 31, 2003. The agreement expires in November 2008 and requires quarterly interest payments. As of December 31, 2003, the notional amount of the swap was approximately $135 million and its fair value was a $2 million liability. As a result of the swap agreement our overall effective interest rate on the entire credit facility was 3.69% based upon the margin in effect on December 31, 2003.

In January 2004, we entered into another interest rate swap agreement to effectively fix the LIBOR benchmark interest rate at 3.08% on an additional amortizing notional amount of $135 million of our Term Loan B outstanding debt that had the economic effect of fixing the interest rate at 5.33% based upon the margin in effect on January 15, 2004. The agreement expires in January 2009 and requires quarterly interest payments. As a result of these two interest rate swap agreements, as of January 15, 2004, approximately 25% of our outstanding variable rate debt is effectively fixed at a weighted average interest rate of 5.49% and our overall credit facility effective weighted average interest rate was 3.89%, based upon the current margins.

One means of assessing exposure to interest rate changes is duration-based analysis that measures the potential loss in net income resulting from a hypothetical increase in interest rates of 100 basis points across all variable rate maturities (referred to as a "parallel shift in the yield curve"). Under this model, with all else constant, it is estimated that such an increase would have reduced net income by approximately $6.5 million, $3.5 million and $1.6 million, net of tax, for the years ended December 31, 2003, 2002 and 2001, respectively.

Exchange rate sensitivity

We are currently not exposed to any foreign currency exchange rate risk.

Consolidated Statements of Income and Comprehensive Income

(dollars in thousands, except per share data)

	Year ended December 31,		
	2003	2002	2001
Net operating revenues	$ 2,016,418	$ 1,854,632	$ 1,650,753
Operating expenses and charges:			
Patient care costs	1,360,556	1,217,685	1,100,652
General and administrative	159,628	154,073	129,194
Depreciation and amortization	74,687	64,665	105,209
Provision for uncollectible accounts	35,700	26,877	(2,294)
Minority interests and equity income, net	7,312	7,506	7,134
Total operating expenses and charges	1,637,883	1,470,806	1,339,895
Operating income	378,535	383,826	310,858
Debt expense	66,828	71,636	72,438
Refinancing charges (gains)	26,501	48,930	(1,629)
Other income, net	3,060	3,997	2,518
Income before income taxes	288,266	267,257	242,567
Income tax expense	112,475	109,928	105,252
Net income	$ 175,791	$ 157,329	$ 137,315
Earnings per share:			
Basic	$ 2.79	$ 2.19	$ 1.64
Diluted	$ 2.49	$ 1.96	$ 1.52
Weighted average shares for earnings per share:			
Basic	62,897,000	71,831,000	83,768,000
Diluted	75,840,000	90,480,000	103,454,000

STATEMENTS OF COMPREHENSIVE INCOME			
Net income	$ 175,791	$ 157,329	$ 137,315
Unrealized loss on securities, net of tax of $590	(924)		
Comprehensive income	$ 174,867	$ 157,329	$ 137,315

See notes to consolidated financial statements.

Consolidated Balance Sheets
(dollars in thousands, except per share data)

	December 31, 2003	December 31, 2002
ASSETS		
Cash and cash equivalents	$ 61,657	$ 96,475
Accounts receivable, less allowance of $52,554 and $48,927	387,933	344,292
Medicare lab recoveries	19,000	
Inventories	32,853	34,929
Other current assets	43,875	28,667
Deferred income taxes	59,740	40,163
Total current assets	605,058	544,526
Property and equipment, net	342,447	298,475
Amortizable intangibles, net	49,971	63,159
Investments in third-party dialysis businesses	3,095	3,227
Other long-term assets	10,771	1,520
Goodwill	934,188	864,786
	$1,945,530	$1,775,693
LIABILITIES AND SHAREHOLDERS' EQUITY		
Accounts payable	$ 71,868	$ 77,890
Other liabilities	112,654	101,389
Accrued compensation and benefits	100,909	95,435
Current portion of long-term debt	50,557	7,978
Income taxes payable	26,832	9,909
Total current liabilities	362,820	292,601
Long-term debt	1,117,002	1,311,252
Other long-term liabilities	19,310	9,417
Deferred income taxes	106,240	65,930
Minority interests	33,287	26,229
Commitments and contingencies		
Shareholders' equity:		
Preferred stock ($0.001 par value, 5,000,000 shares authorized; none issued)		
Common stock ($0.001 par value, 195,000,000 shares authorized; 89,870,803 and 88,874,896 shares issued)	90	89
Additional paid-in capital	539,575	519,369
Retained earnings	389,128	213,337
Treasury stock, at cost (25,368,019 and 28,216,177 shares)	(620,998)	(662,531)
Accumulated comprehensive income valuations	(924)	
Total shareholders' equity	306,871	70,264
	$1,945,530	$1,775,693

See notes to consolidated financial statements.

Consolidated Statements of Cash Flows

(dollars in thousands)

	Year ended December 31,		
	2003	**2002**	**2001**
Cash flows from operating activities:			
Net income	$ 175,791	$ 157,329	$ 137,315
Adjustments to reconcile net income to cash provided by operating activities:			
Depreciation and amortization	74,687	64,665	105,209
Refinancing charges	26,501	48,930	(1,629)
Loss (gain) on divestitures	2,130	(1,151)	(71)
Deferred income taxes	20,914	62,172	10,093
Non-cash debt expense	3,124	3,217	2,396
Stock option expense and tax benefits	20,180	22,212	17,754
Equity investment income	(1,596)	(1,791)	(2,126)
Minority interests in income of consolidated subsidiaries	8,908	9,299	9,260
Distributions to minority interests	(7,663)	(6,165)	(7,942)
Changes in operating assets and liabilities, net of effect of acquisitions and divestitures:			
Accounts receivable	(41,369)	(17,699)	(37,167)
Medicare lab recoveries	(19,000)		
Inventories	3,159	(342)	(13,575)
Other current assets	(13,297)	(19,089)	3,321
Other long-term assets	4,692	527	227
Accounts payable	(6,875)	10,822	(3,906)
Accrued compensation and benefits	5,821	6,837	17,990
Other current liabilities	9,958	2,585	9,728
Income taxes	17,810	(4,821)	17,757
Other long-term liabilities	9,773	4,458	157
Net cash provided by operating activities	293,648	341,995	264,791
Cash flows from investing activities:			
Additions of property and equipment, net	(100,272)	(102,712)	(51,233)
Acquisitions and divestitures, net	(97,370)	(18,511)	(66,939)
Investments in and advances to affiliates, net	4,456	5,064	25,217
Intangible assets	(790)	(342)	(11)
Net cash used in investing activities	(193,976)	(116,501)	(92,966)
Cash flows from financing activities:			
Borrowings	4,766,276	2,354,105	1,709,996
Payments on long-term debt	(4,797,994)	(1,855,199)	(1,866,232)
Debt redemption premium	(14,473)	(40,910)	
Deferred financing costs	(4,193)	(10,812)	(9,285)
Net proceeds from issuance of common stock	23,056	29,257	19,560
Purchase of treasury shares	(107,162)	(642,171)	(20,360)
Net cash used in financing activities	(134,490)	(165,730)	(166,321)
Net (decrease) increase in cash and cash equivalents	(34,818)	59,764	5,504
Cash and cash equivalents at beginning of year	96,475	36,711	31,207
Cash and cash equivalents at end of year	$ 61,657	$ 96,475	$ 36,711

See notes to consolidated financial statements.

Consolidated Statements of Shareholders' Equity

(in thousands)

	Common Stock		Additional paid-in Capital	Notes receivable from shareholders	Retained earnings (deficit)	Treasury Stock		Accumulated comprehensive income valuations	Total
	Shares	Amount				Shares	Amount		
Balance at December 31, 2000	82,136	$82	$430,676	$ (83)	$ (81,307)				$349,368
Shares issued to employees and others	132		602						602
Options exercised	3,141	3	18,872						18,875
Repayment of notes receivable, net of interest accrued				83					83
Income tax benefit on stock options exercised			17,087						17,087
Stock option expense			667						667
Net income					137,315				137,315
Treasury stock purchases						(889)	$ (20,360)		(20,360)
Balance at December 31, 2001	85,409	85	467,904	—	56,008	(889)	(20,360)		503,637
Shares issued to employees and others	45		798						798
Options exercised	3,421	4	28,455						28,459
Income tax benefit on stock options exercised			22,150						22,150
Stock option expense			62						62
Net income					157,329				157,329
Treasury stock purchases						(27,327)	(642,171)		(642,171)
Balance at December 31, 2002	88,875	89	519,369	—	213,337	(28,216)	(662,531)		70,264
Shares issued upon conversion of debt			14,076			4,884	114,700		128,776
Shares issued to employees and others	42		873						873
Deferred stock unit shares issued			(220)			33	770		550
Options exercised	954	1	(14,703)			1,373	33,225		18,523
Income tax benefit on stock options exercised			20,204						20,204
Stock option expense			(24)						(24)
Net income					175,791				175,791
Treasury stock purchases						(3,442)	(107,162)		(107,162)
Unrealized loss on securities								$(924)	(924)
Balance at December 31, 2003	89,871	$90	$539,575	$ —	$389,128	(25,368)	$(620,998)	$(924)	$306,871

See notes to consolidated financial statements.

Notes to Consolidated Financial Statements

(dollars in thousands, except per share data)

1. Organization and summary of significant accounting policies

Organization

DaVita Inc. operates kidney dialysis centers and provides related medical services primarily in dialysis centers and in contracted hospitals across the United States. These operations represent a single business segment.

Basis of presentation

These consolidated financial statements and accompanying notes are prepared in accordance with accounting principles generally accepted in the United States. The financial statements include the Company's subsidiaries and partnerships that are wholly-owned, majority-owned, or in which the Company maintains a controlling financial interest. All significant intercompany transactions and balances have been eliminated. Non-consolidated equity investments are recorded under the equity or cost method of accounting as appropriate. Prior year balances and amounts have been classified to conform to the current year presentation.

Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires the use of estimates and assumptions that affect the reported amounts of revenues, expenses, assets, liabilities and contingencies. Although actual results in subsequent periods will differ from these estimates, such estimates are developed based on the best information available to management and management's best judgements at the time made. All significant assumptions and estimates underlying the reported amounts in the financial statements and accompanying notes are regularly reviewed and updated. Changes in estimates are reflected in the financial statements based upon on-going actual experience trends, or subsequent settlements and realizations depending on the nature and predictability of the estimates and contingencies. Interim changes in estimates related to annual operating costs are applied prospectively within annual periods.

The most significant assumptions and estimates underlying these financial statements and accompanying notes involve revenue recognition and provisions for uncollectible accounts, impairments and valuation adjustments, accounting for income taxes and variable compensation accruals. Specific estimating risks and contingencies are further addressed in these notes to the consolidated financial statements.

Net operating revenues

Revenue recognition uncertainties inherent in the Company's operations are addressed in AICPA Statement of Position (SOP) No. 00-1 *Auditing Health Care Third-Party Revenues and Related Receivables*. As addressed in SOP No. 00-1, net revenue recognition and allowances for uncollectible billings require the use of estimates of the amounts that will actually be realized considering, among other items, retroactive adjustments that may be associated with regulatory reviews, audits, billing reviews and other matters.

Revenues are recognized as services are provided to patients. Operating revenues consist primarily of reimbursement for dialysis and ancillary services to patients. A usual and customary fee schedule is maintained for dialysis treatments and other patient services; however, actual collectible revenue is at a discount to the fee schedule. Medicare and Medicaid program reimbursement rates are established by statute or regulation. Most nongovernmental payors, including contracted managed care payors, are billed at our usual and customary rates, but a contractual allowance is recorded to adjust to the expected net realizable revenue for services provided. Contractual allowances along with provisions for uncollectible accounts are estimated based upon credit risks of

third-party payors, contractual terms, inefficiencies in our billing and collection processes, regulatory compliance issues and historical collection experience.

Management and administrative support services are provided to dialysis centers and physician practices not owned by the Company. The management fees are principally determined as a percentage of the managed operations' revenues or cash collections, and are included in net operating revenues as earned.

Other income

Other income includes interest income on cash investments and other non-operating gains and losses.

Cash and cash equivalents

Cash equivalents are highly liquid investments with maturities of three months or less at date of purchase.

Inventories

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

Property and equipment

Property and equipment are stated at cost reduced by any impairments. Maintenance and repairs are charged to expense as incurred. Depreciation and amortization expenses are computed using the straight-line method over the useful lives of the assets estimated as follows: buildings, 20 to 40 years; leasehold improvements, the shorter of their estimated useful life or the lease term; and equipment and software, principally 3 to 8 years. Disposition gains and losses are included in current earnings.

Amortizable intangibles

Amortizable intangible assets include noncompetition agreements and deferred debt issuance costs, each of which have determinate useful lives. Noncompetition agreements are amortized over the terms of the agreements, typically three to twelve years, using the straight-line method. Deferred debt issuance costs are amortized to debt expense over the term of the related debt using the effective interest method.

Goodwill

Goodwill represents the difference between the purchase cost of acquired businesses and the fair value of the identifiable tangible and intangible net assets acquired. Under Statement of Financial Accounting Standards (SFAS) No. 142 *Goodwill and Other Intangible Assets* goodwill is not amortized after December 31, 2001 but is assessed for valuation impairment as circumstances warrant and at least annually. An impairment charge would be recorded to the extent the book value of goodwill exceeds its fair value. The Company operates as one reporting unit for goodwill impairment assessments. If this standard had been effective as of January 1, 2001, net income and diluted net income per share would have been $162,350 or $1.76 per share for 2001.

Impairment of long-lived assets

Long-lived assets, including property and equipment, investments, and amortizable intangible assets, are reviewed for possible impairment whenever significant events or changes in circumstances indicate that an impairment may have occurred, including changes in our business strategy and plans. An impairment is indicated when the sum of the expected future undiscounted net cash flows identifiable to that asset or asset group is less than its carrying value. Impairment losses are determined from actual or estimated fair values, which are based

on market values, net realizable values or projections of discounted net cash flows, as appropriate. Interest is not accrued on impaired loans unless the estimated recovery amounts justify such accruals.

Income taxes

Federal and state income taxes are computed at current enacted tax rates, less tax credits. Taxes are adjusted both for items that do not have tax consequences and for the cumulative effect of any changes in tax rates from those previously used to determine deferred tax assets or liabilities. Tax provisions include amounts that are currently payable, as well as changes in deferred tax assets and liabilities that arise because of temporary differences between the timing of when items of income and expense are recognized for financial reporting and income tax purposes, which are measured using enacted tax rates and laws expected to apply in the periods when the deferred tax liability or asset is expected to be realized, and any changes in the valuation allowance caused by a change in judgement about the realizability of the related deferred tax assets.

Minority interests

Consolidated income is reduced by the proportionate amount of income accruing to minority interests. Minority interests represent the equity interests of third-party owners in consolidated entities which are not wholly-owned. As of December 31, 2003, there were 30 consolidated entities with third-party minority ownership interests.

Stock-based compensation

Stock-based compensation for employees is determined in accordance with Accounting Principles Board Opinion No. 25 *Accounting for Stock Issued to Employees*, as allowed under SFAS No. 123 *Accounting for Stock-Based Compensation*. Stock option grants to employees do not result in an expense if the exercise price is at least equal to the market price at the date of grant. Stock option expense is also measured and recorded for certain modifications to stock options as required under FASB Interpretation No. 44 *Accounting for Certain Transactions Involving Stock Compensation*. Stock options issued to non-employees and restricted stock units are valued using the Black-Scholes model and amortized over the respective vesting periods.

Pro forma net income and earnings per share. If the Company had adopted the fair value-based compensation expense provisions of SFAS No. 123 upon the issuance of that standard, net income and net income per share would have been adjusted to the pro forma amounts indicated below:

Pro forma—As if all stock options were expensed	Year ended December 31,		
	2003	2002	2001
Net income:			
As reported	$175,791	$157,329	$137,315
Add: Stock-based employee compensation expense included in reported net income, net of tax	1,036	753	1,119
Deduct: Total stock-based employee compensation expense under the fair value-based method, net of tax	(9,554)	(10,182)	(18,350)
Pro forma net income	$167,273	$147,900	$120,084
Pro forma basic earnings per share:			
Pro forma net income for basic earnings per share calculation	$167,273	$147,900	$120,084
Weighted average shares outstanding	62,835	71,787	83,768
Vested restricted stock units	62	44	
Weighted average shares for basic earnings per share calculation	62,897	71,831	83,768
Basic net income per share—Pro forma	$ 2.66	$ 2.06	$ 1.43
Basic net income per share—As reported	$ 2.79	$ 2.19	$ 1.64
Pro forma diluted earnings per share:			
Pro forma net income	$167,273	$147,900	$120,084
Debt expense savings, net of tax, from assumed conversion of convertible debt	13,011	19,661	4,222
Pro forma net income for diluted earnings per share calculations	$180,284	$167,561	$124,306
Weighted average shares outstanding	62,835	71,787	83,768
Vested restricted stock units	62	44	
Assumed incremental shares from stock plans	2,838	4,184	2,708
Assumed incremental shares from convertible debt	9,951	15,394	4,879
Weighted average shares for diluted earnings per share calculations	75,686	91,409	91,355
Diluted net income per share—Pro forma	$ 2.38	$ 1.83	$ 1.36
Diluted net income per share—As reported	$ 2.49	$ 1.96	$ 1.52

The fair values of stock option grants were estimated as of the date of grant using the Black-Scholes option-pricing model with the following assumptions for grants in 2003, 2002 and 2001, respectively: dividend yield of 0% and weighted average expected volatility of 40% for all periods; risk-free interest rates of 2.07%, 3.99% and 4.44% and weighted average expected lives of 3.5, 3.5 and 3.8 years.

Interest rate swap agreements

The Company has from time to time entered into interest rate swap agreements as a means of managing interest rate exposure. These agreements were not for trading or speculative purposes, and had the effect of converting a portion of our variable rate debt to a fixed rate. Net amounts paid or received have been reflected as adjustments to interest expense.

New accounting standards

In January 2003 the FASB issued Interpretation (FIN) No. 46 *Consolidation of Variable Interest Entities,* which addresses the consolidation of certain entities ("variable interest entities") in which an enterprise has a controlling financial interest through other than voting interests. FIN No. 46 requires that a variable interest entity be consolidated by the holder of the majority of the expected risks and rewards associated with the activities of the variable interest entity. Adoption of this standard did not have a material effect on our consolidated financial statements.

SFAS No. 150 *Accounting for certain financial instruments with characteristics of both liabilities and equity* was issued in May 2003. This statement establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It also requires certain mandatorily redeemable instruments such as the liability for other owners' interests in limited-life entities to be measured based upon the fair values of the limited-life entities assets, with changes in the liability reported as interest costs. At the October 29, 2003 FASB Board meeting, the Board decided to defer indefinitely the effective date of Statement 150 related to classification and measurement requirements, but not the disclosure requirements, for mandatorily redeemable financial instruments that become subject to Statement 150 solely as a result of consolidation. Our consolidated partnerships include interests in limited-life companies for which third-party interests are reflected in "minority interests" in the financial statements. See note 18.

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, an after-tax loss of $29,358 in 2002 and an after-tax gain of $977 in 2001, resulting from the extinguishment of debt previously classified as extraordinary items, have been reclassified to a pre-tax refinancing charge of $48,930 for 2002 and a pre-tax gain of $1,629 for 2001. The classification change had no impact on net earnings. In 2002, the refinancing charges of $48,930 related to debt restructuring, which included retiring $225,000 9¼% Senior Subordinated Notes due 2011 and extinguishing our then existing senior credit facilities. In 2001, the refinancing gain of $1,629 related to the write-off of deferred financing costs offset by the accelerated recognition of deferred interest rate swap liquidation gains as a result of debt refinancing.

FASB Interpretation (FIN) No. 45 *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* was issued in November 2002. Under FIN No. 45 the recognition and initial measurement provisions became effective to prospective guarantees issued or modified after December 31, 2002. The Interpretation clarifies the requirements for a guarantor's disclosures in its interim and annual financial statements about its obligations under certain guarantees that it has issued and which remain outstanding and also clarifies that guarantees are required to be recognized in the financial statements and measured initially at fair value including the guarantors' ongoing obligation to stand ready to perform over the term of the guarantee in the event that the specified triggering events or conditions occur.

2. Earnings per share

Basic net income per share is calculated by dividing net income by the weighted average number of common shares outstanding. Diluted net income per share includes the dilutive effect of convertible debt (under the if-converted method), and stock options and unvested restricted stock units (under the treasury stock method).

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

	Year ended December 31,		
	2003	2002	2001
	(in thousands, except per share)		
Basic:			
Net income	$175,791	$157,329	$137,315
Weighted average shares outstanding during the year	62,835	71,787	83,768
Vested restricted stock units	62	44	
Weighted average shares for basic earnings per share calculations	62,897	71,831	83,768
Basic net income per share	$ 2.79	$ 2.19	$ 1.64
Diluted:			
Net income	$175,791	$157,329	$137,315
Debt expense savings, net of tax, from assumed conversion of convertible debt	13,011	19,661	19,449
Net income for diluted earnings per share calculations	$188,802	$176,990	$156,764
Weighted average shares outstanding during the year	62,835	71,787	83,768
Vested restricted stock units	62	44	
Assumed incremental shares from stock plans	2,992	3,255	4,292
Assumed incremental shares from convertible debt	9,951	15,394	15,394
Weighted average shares for diluted earnings per share calculations	75,840	90,480	103,454
Diluted net income per share	$ 2.49	$ 1.96	$ 1.52

Options to purchase 174,535 shares at $28.10 to $39.35 per share, 881,350 shares at $23.63 to $33.00 per share and 630,668 shares at $19.04 to $33.00 per share were excluded from the diluted earnings per share calculations for 2003, 2002 and 2001, respectively, because they were anti-dilutive. The calculation of diluted earnings per share assumes conversion of both the 5⅝% and 7% convertible subordinated notes for 2001, 2002 and the pro-rata periods such notes were outstanding in 2003.

3. Accounts receivable

The provisions for uncollectible accounts receivable, prior to offsetting recoveries in 2003, 2002 and 2001 were $35,700, $32,069 and $32,926, respectively. The provisions before cash recoveries in 2003, 2002 and 2001 were approximately 1.8%, 1.8% and 2.0% of current operating revenues, respectively. During 2002 and 2001, substantial improvements were made in the Company's billing and collection processes, and cash recoveries of $5,192 and $35,220 were realized during 2002 and 2001 on accounts receivable reserved in 1999.

4. Other current assets

Other current assets were comprised of the following:

	December 31,	
	2003	2002
Supplier rebates and other non-trade receivables	$29,745	$16,567
Operating advances under administrative services agreements	10,416	3,284
Prepaid expenses and deposits	3,714	8,816
	$43,875	$28,667

Operating advances under administrative services agreements are unsecured.

5. Property and equipment

Property and equipment were comprised of the following:

	December 31, 2003	December 31, 2002
Land	$ 820	$ 932
Buildings	5,494	5,084
Leasehold improvements	261,437	204,778
Equipment	361,365	301,285
Additions in progress	19,349	49,466
	648,465	561,545
Less accumulated depreciation and amortization	(306,018)	(263,070)
	$ 342,447	$ 298,475

Depreciation and amortization expense on property and equipment was $64,398, $54,701 and $53,182 for 2003, 2002 and 2001, respectively.

Applicable interest charges incurred during significant facility expansion and construction are capitalized as one of the elements of cost and are amortized over the assets' estimated useful lives. Interest capitalized was $1,523, $1,888 and $751 for 2003, 2002 and 2001, respectively.

6. Amortizable intangibles

Amortizable intangible assets were comprised of the following:

	December 31, 2003	December 31, 2002
Noncompetition agreements	$112,407	$104,479
Deferred debt issuance costs	9,851	24,666
	122,258	129,145
Less accumulated amortization	(72,287)	(65,986)
	$ 49,971	$ 63,159

Amortization expense from noncompetition agreements was $10,289, $9,964 and $10,162 for 2003, 2002 and 2001, respectively. Deferred debt issuance costs are amortized to debt expense as described in Note 11.

Scheduled amortization charges from amortizable intangible assets as of December 31, 2003 were as follows:

	Noncompetition agreements	Deferred debt issuance costs
2004	10,302	1,836
2005	9,550	1,576
2006	8,239	1,303
2007	6,350	1,042
2008	3,668	895
Thereafter	5,077	133

7. Investments in third-party dialysis businesses

Investments in third-party dialysis businesses and related advances were $3,095 and $3,227 at December 31, 2003 and 2002. During 2003, 2002 and 2001, the Company recognized income of $1,596, $1,791 and $2,126, respectively, relating to investments in non-consolidated businesses under the equity method. These amounts are included as a reduction to minority interests in the consolidated statement of income.

8. Goodwill

Changes in the book value of goodwill were as follows:

	Year ended December 31,	
	2003	2002
Balance at January 1	$864,786	$855,760
Acquisitions	70,700	15,260
Divestitures	(1,298)	(6,234)
Balance at December 31	$934,188	$864,786

Amortization expense applicable to goodwill was $0 for 2003 and 2002, and $41,865 for 2001. The book value of goodwill was reduced from its original cost by $169,383 in amortization accumulated through December 31, 2000.

A reconciliation of the Company's results previously reported to results excluding goodwill amortization is as follows:

	Year ended December 31,		
	2003	2002	2001
Reported net income	$175,791	$157,329	$137,315
Add back: Goodwill amortization, net of tax			25,035
Adjusted net income	$175,791	$157,329	$162,350
Basic earnings per common share:			
Reported net income	$ 2.79	$ 2.19	$ 1.64
Add back: Goodwill amortization, net of tax			$ 0.30
Adjusted net income	$ 2.79	$ 2.19	$ 1.94
Diluted earnings per common share:			
Reported net income	$ 2.49	$ 1.96	$ 1.52
Add back: Goodwill amortization, net of tax			$ 0.24
Adjusted net income	$ 2.49	$ 1.96	$ 1.76

9. Other liabilities

Other accrued liabilities were comprised of the following:

	December 31, 2003	December 31, 2002
Payor deferrals and refunds	$ 76,235	$ 70,406
Deferred revenue	8,727	
Accrued interest	878	12,476
Accrued tax liabilities	6,229	6,389
Disposition accruals	2,539	3,829
Other	18,046	8,289
	$112,654	$101,389

10. Income taxes

Income tax expense consisted of the following:

	Year ended December 31, 2003	2002	2001
Current:			
Federal	$ 75,817	$ 40,094	$ 76,084
State	15,151	7,366	19,076
Deferred:			
Federal	17,966	50,012	6,931
State	3,541	12,456	3,161
	$112,475	$109,928	$105,252

Temporary differences which gave rise to deferred tax assets and liabilities were as follows:

	December 31, 2003	December 31, 2002
Asset impairment losses	$ 35,817	$ 38,844
Receivables, primarily allowance for doubtful accounts	16,882	18,583
Accrued liabilities	44,861	23,510
Other	11,683	10,124
Deferred tax assets	109,243	91,061
Valuation allowance	(37,200)	(38,669)
Net deferred tax assets	72,043	52,392
Property and equipment	(42,614)	(25,739)
Intangible assets	(73,268)	(49,838)
Other	(2,661)	(2,582)
Deferred tax liabilities	(118,543)	(78,159)
Net deferred tax liabilities	$ (46,500)	$(25,767)

At December 31, 2003, the Company had state net operating loss carryforwards of approximately $26,000 that expire through 2023. The Company has also incurred losses on certain operations that are not included in its consolidated tax return. The utilization of these losses may be limited in future years based on the profitability of certain corporations. In prior years, the Company recognized capital losses for impairments and sales of certain of its assets of which realization of a tax benefit is not certain. The Company has recorded a valuation allowance of $37,200 against these deferred tax assets. The valuation allowance decreased by $1,469 in 2003, primarily reflecting the tax benefit of losses that are expected to be utilized based on the profitability of certain consolidated entities.

The reconciliation between our effective tax rate and the U.S. federal income tax rate is as follows:

	Year ended December 31,		
	2003	**2002**	**2001**
Federal income tax rate	35.0%	35.0%	35.0%
State taxes, net of federal benefit	4.3	4.9	5.8
Nondeductible amortization of intangible assets			0.4
Changes in deferred tax valuation allowances	(0.4)	0.1	0.3
Other	0.1	1.0	1.9
Effective tax rate	39.0%	41.0%	43.4%

11. Long-term debt

Long-term debt was comprised of the following:

	December 31,	
	2003	**2002**
Senior secured credit facility, Term Loan A	$ 118,310	
Senior secured credit facility, Term Loan B	1,035,889	$ 841,825
Convertible subordinated notes, 7%, due 2009		345,000
Convertible subordinated notes, 5⅝%, due 2006		125,000
Acquisition obligations and other notes payable	5,416	585
Capital lease obligations	7,944	6,820
	1,167,559	1,319,230
Less current portion	(50,557)	(7,978)
	$1,117,002	$1,311,252

Scheduled maturities of long-term debt at December 31, 2003 were as follows:

2004	50,557
2005	46,094
2006	52,482
2007	24,316
2008	744,303
Thereafter	249,807

Included in debt expense was interest, net of capitalized interest, of $63,705, $68,420 and $69,978 for 2003, 2002 and 2001, respectively. Also included in debt expense were amortization and write-off of deferred financing costs of $3,123, $3,216 and $2,460 for 2003, 2002 and 2001, respectively.

In the first quarter of 2003, the Company borrowed $150,000 that was available under the Term Loan A of its credit facility. The Term Loan A bears interest at LIBOR plus 2.00%, for an overall effective rate of 3.19% at December 31, 2003, with provision to potentially further reduce the interest rate to LIBOR plus 1.50% under certain circumstances. The Term Loan A matures in March 2007 and requires annual principal payments of $33,800 in years 2004 and 2005, $40,100 in 2006 and $10,600 in 2007.

In the third quarter of 2003, the Company completed a call for redemption of all of its outstanding $125,000 5⅝% Convertible Subordinated Notes due 2006. Holders of the 5⅝% 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 5⅝% Notes, plus accrued interest. In July 2003, the Company issued 4,868,352 shares of common stock from treasury stock for the conversion of $124,700 of the 5⅝% Notes, and redeemed the balance for cash and accrued interest.

In the third quarter of 2003, the Company also entered into an amended credit agreement in order to, among other things, lower the overall interest rate. The Company also acquired an additional $200,000 of borrowings under the replacement Term Loan B, which amounted to $1,042,000. In November 2003, the Company entered into a second amended and restated credit agreement in order to again lower the interest rate on the Term Loan B and to modify certain covenants. The Term Loan B currently bears interest at LIBOR plus 2.25% for an overall effective rate of 3.42% at December 31, 2003, with a provision to potentially further reduce the interest rate to LIBOR plus 2.00% under certain circumstances. The aggregate annual principal payments for the Term Loan B are approximately $11,000 in the first four years of the agreement, $255,000 in the fifth year and $741,000 in the sixth year, due no later than March 2009. As of December 31, 2003 the Company had a $115,000 undrawn revolving credit facility of which $15,138 was committed for outstanding letters of credit.

In the second half of 2003, the Company completed two calls for redemption of all of its outstanding $345,000 7% Convertible Subordinated Notes due 2009. Holders of the 7% Notes had 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. $344,500 of the Notes were redeemed for $359,000 in cash plus accrued interest, and the balance was converted into 16,030 shares of common stock.

In 2003, the excess consideration paid over the book value to redeem the Convertible Subordinated Notes and the write-off of deferred financing costs and financing fees associated with amending our bank credit agreement resulted in refinancing charges of $26,501.

In the first quarter of 2002, the Company initiated a recapitalization plan to restructure the Company's debt and repurchase common stock. In the initial phase of the recapitalization plan the Company retired all of its $225,000 outstanding 9¼% Senior Subordinated Notes due 2011 for $266,000. Concurrent with the retirement of this debt, the Company secured a new senior credit facility agreement in the amount of $1,115,000. The excess of the consideration paid over the book value of the Senior Subordinated Notes and related write-off of the deferred financing costs associated with extinguishing the existing senior credit facility and the notes resulted in refinancing charges of $48,930. The senior credit facility consisted of a Term Loan A for $150,000, a Term Loan B for $850,000 and a $115,000 undrawn revolving credit facility, which includes up to $50,000 available for letters of credit. During the second quarter of 2002, the Company borrowed all $850,000 of the Term Loan B, and $841,825 of the Term Loan B remained outstanding as of December 31, 2002.

Interest rate swap agreements

In November 2003, the Company entered into an interest rate swap agreement to effectively fix the LIBOR benchmark interest rate at 3.39% on an amortizing notional amount of $135,000 of the Term Loan B outstanding

debt that had the economic effect of fixing the interest rate at 5.64% based upon the margin in effect on December 31, 2003. The agreement expires in November 2008 and requires quarterly interest payments. As of December 31, 2003, the notional amount of the swap was approximately $135,000 and its fair value was a $2,000 liability, resulting in a charge to other comprehensive income of approximately $1,000, net of tax. As a result of the swap agreement, the Company's effective interest rate on its entire credit facility was 3.69% based upon the margin in effect on December 31, 2003.

In January 2004, the Company entered into another interest rate swap agreement to effectively fix the LIBOR benchmark interest rate at 3.08% on an additional amortizing notional amount of $135,000 of the Term Loan B outstanding debt that had the economic effect of fixing the interest rate at 5.33% based upon the current margin. The agreement expires in January 2009 and requires quarterly interest payments. As a result of these two swap agreements, the Company's effective interest rate on its entire credit facility was 3.89% based upon the margin in effect on January 15, 2004.

12. Leases

The majority of the Company's facilities are leased under noncancelable operating leases. Most lease agreements cover periods from five to ten years and contain renewal options of five to ten years at the fair rental value at the time of renewal or at rates subject to periodic consumer price index increases. Capital leases are for equipment.

Future minimum lease payments under noncancelable operating leases and under capital leases are as follows:

	Operating leases	Capital leases
2004	$ 62,064	$ 1,460
2005	59,448	1,358
2006	55,796	1,335
2007	50,114	2,896
2008	43,180	685
Thereafter	152,300	3,764
	$422,902	11,498
Less portion representing interest		(3,554)
Total capital lease obligation, including current portion		$ 7,944

Rental expense under all operating leases for 2003, 2002 and 2001 was $71,432, $61,008 and $54,347, respectively. The net book value of property and equipment under capital lease was $7,811 and $7,017 at December 31, 2003 and 2002, respectively. Capital lease obligations are included in long-term debt (see Note 11).

13. Shareholders' equity

During 2003, the Company repurchased a total of 3,441,900 shares of common stock for $107,162 or an average of $31.13 per share, pursuant to Board of Directors' authorizations. As of December 31, 2003, the Company had approximately $146,000 remaining to repurchase shares of its common stock in the open market pursuant to a $200,000 Board of Directors' authorization.

In March 2002, the Company initiated a recapitalization plan consisting of restructuring debt as discussed in Note 11 and repurchasing common stock. Under this plan, the Company repurchased 16,682,337 shares of its common stock for approximately $402,100, or $24.10 per share through a modified dutch auction tender offer in

June 2002. From May through December 2002, the Company also purchased 7,699,440 shares in the open market for $172,200 under a $225,000 Board of Directors' authorization. For the year ended December 31, 2002, stock repurchases, including 2,945,700 shares acquired prior to initiating the recapitalization plan, amounted to 27,327,477 shares for $642,200, at a composite average cost of $23.50 per share.

Stock-based compensation plans

The Company's stock-based compensation plans are described below.

2002 Plan. On April 11, 2002, the Company's shareholders approved the DaVita Inc. 2002 Equity Compensation Plan. This plan provides for grants of stock awards to employees, directors and other individuals providing services to the Company, except that incentive stock options may only be awarded to employees. The plan requires that stock option grants are issued with exercise prices not less than the market price of the stock on the date of grant and requires a maximum award term of five years. Stock options granted under this plan are generally non-qualified awards that vest over four years from the date of grant. Shares available under the 2002 Plan may also be replenished by shares repurchased by the Company from the cash proceeds and actual tax savings from award exercises under the 2002 or predecessor plans.

On May 21, 2003 the shareholders approved an amendment to reduce shares authorized to the 2002 Plan by 1,661,000 and to authorize plan awards in the form of restricted stock, restricted stock units, stock issuances ("full share awards"), stock appreciation rights and other equity-based awards. Full share awards will reduce total shares available under the plan at a rate of 2.75:1. At December 31, 2003, there were 989,231 awards outstanding and 9,463,642 shares available for future grants under the 2002 Plan, including 985,627 shares reserved to the 2002 Plan under its replenishment provision.

Predecessor plans. Upon shareholder approval of the 2002 Plan, the following predecessor plans were terminated, except with respect to options then outstanding: the 1994 Equity Compensation Plan, the 1995 Equity Compensation Plan, the 1997 Equity Compensation Plan, and the 1999 Equity Compensation Plan. Shares available for future grants under these predecessor plans were transferred to the 2002 Plan upon its approval, and all predecessor plan options cancelled become available for new awards under the 2002 Plan. Options granted under these plans were generally issued with exercise prices equal to the market price of the stock on the date of grant, vested over four years from the date of grant, and bore maximum terms of five to 10 years. The RTC plan, a special purpose option plan related to the RTC merger, was also terminated in 1999. At December 31, 2003 there were 5,087,230 stock options outstanding under these terminated plans.

1999 Plan. The 1999 Non-Executive Officer and Non-Director Equity Compensation Plan provides for grants of stock options to employees and other individuals providing services other than executive officers and members of the board of directors. There are 6,000,000 common shares reserved for issuance under this plan. Options granted under this plan generally vest over four years from the date of grant. Grants are generally issued with exercise prices equal to the market price of the stock on the date of grant and maximum terms of five years. At December 31, 2003 there were 3,108,875 options outstanding and 92,451 shares available for future grants under this plan.

A combined summary of the status of these stock-based compensation plans is as follows:

	Year ended December 31,					
	2003		2002		2001	
	Awards	Weighted average exercise price	Awards	Weighted average exercise price	Awards	Weighted average exercise price
Outstanding at beginning of year	9,891,975	$13.61	11,280,730	$ 9.36	14,668,579	$ 8.96
Granted	2,009,251	20.29	2,769,500	23.33	1,609,000	17.44
Exercised	(2,327,208)	7.96	(3,420,950)	8.32	(3,141,326)	6.01
Cancelled	(388,682)	14.90	(737,305)	9.59	(1,855,523)	18.88
Outstanding at end of year	9,185,336	$16.45	9,891,975	$13.61	11,280,730	$ 9.36
Awards exercisable at year end	3,439,354		3,651,702		4,331,910	
Weighted-average fair value of awards granted during the year		$ 7.51		$ 7.99		$ 6.31

Awards granted in 2003 include 86,751 full share awards. During 2001, 1,170,000 options with exercise prices over $15.00 were voluntarily relinquished and no replacement options were issued.

The following table summarizes information about stock plan awards outstanding at December 31, 2003:

Range of exercise prices	Awards Outstanding	Weighted average remaining contractual life	Weighted average exercise price	Awards exercisable	Weighted average exercise price
$ 0.00–$ 5.00	474,535	1.8	$ 2.20	391,345	$ 2.67
$ 5.01–$10.00	2,412,754	3.0	6.89	1,869,337	6.86
$10.01–$15.00	234,853	2.0	11.02	159,978	11.05
$15.01–$20.00	1,313,598	2.5	17.30	651,349	17.48
$20.01–$25.00	4,394,928	3.6	22.26	153,803	22.03
$25.01–$30.00	194,056	3.9	26.51	70,930	26.55
$30.01–$35.00	155,612	3.8	31.98	142,612	32.12
$35.01–$40.00	5,000	4.9	39.35	0	0
	9,185,336	3.2	$16.45	3,439,354	$10.72

Deferred stock unit arrangements. The Company also made awards of restricted stock units to members of the Board of Directors and certain key executive officers in 2003, 2002 and 2001. These awards vest over one to four years and will be settled in cash or stock, as they vest or at a later date at the election of the recipient. Awards of 55,923, 91,474 and 128,913 shares, at grant-date fair values of $1,152, $2,159 and $2,000, were made in 2003, 2002 and 2001, respectively.

Compensation expense associated with the above stock-based compensation plans and arrangements of $1,695, $1,246 and $1,865 was recognized in 2003, 2002 and 2001, respectively.

Employee stock purchase plan. The Employee Stock Purchase Plan entitles qualifying employees to purchase up to $25 of the Company's common stock during each calendar year. The amounts used to purchase stock are accumulated through payroll withholdings or through an optional lump sum payment made in advance of the first day of the purchase right period. The plan allows employees to purchase stock for the lesser of 100% of the fair market value on the first day of the purchase right period or 85% of the fair market value on the last day of the purchase right period. Each purchase right period begins on January 1 or July 1, as elected by the

employee, and ends on December 31. Payroll withholdings related to the plan, included in accrued employee compensation and benefits, were $968, $882 and $820 at December 31, 2003, 2002 and 2001. Subsequent to December 31, 2003, 2002 and 2001, 37,386, 41,638 and 44,909 shares, respectively, were issued to satisfy obligations under the plan.

The fair value of the employees' purchase rights was estimated on the beginning dates of the purchase right periods using the Black-Scholes model with the following assumptions for grants on July 1, 2003, January 1, 2003, July 1, 2002, January 1, 2002, July 1, 2001, and January 1, 2001, respectively: dividend yield of 0% and expected volatility of 40% for all periods; risk-free interest rates of 1.1%, 1.1%, 3.6%, 4.0%, 3.3% and 4.9%; and expected lives of 0.5 and 1.0 years. Using these assumptions, the weighted-average fair value of purchase rights granted were $7.18, $7.69, $2.53, $3.68, $2.44 and $3.08, respectively.

Shareholder rights plan. The Company's Board of Directors approved a shareholder rights plan on November 14, 2002. This plan is designed to assure that DaVita's shareholders receive fair treatment in the event of any proposed takeover of DaVita.

Pursuant to this plan, the Board approved the declaration of a dividend distribution of one common stock purchase right on each outstanding share of its common stock payable on December 10, 2002 to holders of record of DaVita common stock on November 29, 2002. This rights distribution was not taxable to DaVita shareholders. One purchase right is also attached to each of the Company's new shares issued or shares reissued from treasury. These rights will become exercisable if a person or group acquires, or announces a tender offer for, 15% or more of DaVita's outstanding common stock. The triggering person's stock purchase rights will become void at that time and will not become exercisable.

Each right initially entitles its holder to purchase one share of common stock from the Company at a price of $125.00. If the rights become exercisable, each purchase right will then entitle its holder to purchase $125.00 of common stock at a price per share equal to 50% of the average daily closing price of the Company's common stock for the immediately preceding 30 consecutive trading days. If DaVita is acquired in a merger or other business combination transaction after the rights become exercisable, provisions will be made to allow the holder of each right to purchase $125.00 of common stock from the acquiring company at a price equal to 50% of the average daily closing price of that company's common stock for the immediately preceding 30 consecutive trading days.

The Board of Directors may elect to redeem the rights at $0.01 per purchase right at any time prior to, or exchange common stock for the rights at an exchange ratio of one share per right at any time after, a person or group acquires, or announces a tender offer for, 15% or more of DaVita's outstanding common stock. The exercise price, number of shares, redemption price or exchange ratio associated with each right may be adjusted as appropriate upon the occurrence of certain events, including any stock split, stock dividend or similar transaction. These purchase rights will expire no later than November 14, 2012.

14. Transactions with related parties

Richard K. Whitney, the Company's former Chief Financial Officer, received a loan from the Company in the principal amount of $65 bearing interest at a rate of 7% per year in July 1997. Mr. Whitney used the proceeds of this loan in the purchase of his principal residence. In February 2001 Mr. Whitney prepaid this loan in full plus accrued interest.

Joseph C. Mello, the Company's Chief Operating Officer, received a loan from the Company in the principal amount of $275 bearing interest at a rate of 7% per year in December 2000. Mr. Mello used the

proceeds of this loan in the purchase of his principal residence. In December 2002 Mr. Mello prepaid this loan in full plus accrued interest.

Until March 2002, Peter Grauer, a member of the Company's Board of Directors since 1994, was a managing director of Credit Suisse First Boston, or CSFB. In 2002 and 2001, CSFB assisted the Company in connection with the issuance of public debt and securing other financing. Fees for these transactions were approximately $6,000 and $3,000. Mr. Grauer is no longer affiliated with CSFB.

15. Employee benefit plans

The Company has a savings plan for substantially all employees, which has been established pursuant to the provisions of Section 401(k) of the Internal Revenue Code, or IRC. The plan provides for employees to contribute up to 20% of their base annual salaries on a tax-deferred basis not to exceed IRC limitations. Effective January 1, 2002 the Company no longer provides any matching or profit sharing contributions. In 2001, the Company made a matching contribution totaling $62.

During 2000, the Company established the DaVita Inc. Profit Sharing Plan. Contributions to this defined contribution benefit plan are made at the discretion of the Company as determined and approved by the Board of Directors. All contributions are deposited into an irrevocable trust. The profit sharing award for each eligible participant is based upon the achievement of employee-specific and/or corporate financial and operating goals. During 2003, 2002 and 2001, the Company recognized expense of $11,900, $17,440 and $14,935, respectively.

16. Contingencies

Health care provider revenues may be subject to adjustment as a result of (1) examination by government agencies or contractors, for which the resolution of any matters raised may take extended periods of time to finalize; (2) differing interpretations of government regulations by different fiscal intermediaries or regulatory authorities; (3) differing opinions regarding a patient's medical diagnosis or the medical necessity of services provided; (4) retroactive applications or interpretations of governmental requirements; and (5) claims for refunds from private payors.

Florida laboratory

The Company's Florida-based laboratory subsidiary has been the subject of a third-party carrier review of its Medicare reimbursement claims. The carrier has reviewed claims for six separate review periods. In 1998 the carrier issued a formal overpayment determination in the amount of $5,600 for the first review period (January 1995 to April 1996). The carrier also suspended all payments of Medicare claims from the laboratory beginning in May 1998. In 1999, the carrier issued a formal overpayment determination in the amount of $15,000 for the second review period (May 1996 to March 1998). Subsequently, the carrier informed the Company that $16,100 of the suspended claims for the third review period (April 1998 to August 1999), $11,600 of the suspended claims for the fourth review period (August 1999 to May 2000), $2,900 of the suspended claims for the fifth review period (June 2000 through December 2000) and $900 of the suspended claims for the sixth review period (December 2000 through May 2001) were not properly supported by the prescribing physicians' medical justification.

The Company has disputed each of the carrier's determinations and has provided supporting documentation of its claims. In addition to the formal appeal processes with the carrier and a federal administrative law judge, the Company also has pursued resolution of this matter through meetings with representatives of the Centers for Medicare and Medicaid Services, or CMS, and the Department of Justice, or DOJ. The Company initially met with the DOJ in February 2001, at which time the DOJ requested additional information, which the Company provided in September 2001.

In June 2002, an administrative law judge ruled that the sampling procedures and extrapolations that the carrier used as the basis of its overpayment determinations for the first two review periods were invalid. This decision invalidated the carrier's overpayment determinations for the first two review periods. Recently, the carrier's hearing officer rendered partially favorable decisions on appeal for the third and fourth review periods. The Company also filed requests for appeal to an administrative law judge on the unfavorable portions of the decisions on the third and fourth review periods, which involves approximately $7,000 in disputed claims. The Company also filed a notice of appeal to the carrier for the fifth and sixth review periods, which involves approximately $4,000 in disputed claims.

During 2000 the Company stopped accruing Medicare revenue from this laboratory because of the uncertainties regarding both the timing of resolution and the ultimate revenue valuations. Following the favorable ruling by the administrative law judge in 2002 related to the first two review periods covering January 1995 to March 1998, the carrier lifted the payment suspension and began making payments in July 2002 for lab services provided subsequent to May 2001. After making its determination with respect to the fifth and sixth review periods in December 2002, the carrier paid the additional amounts that it is not disputing for the second through sixth review periods. As of December 31, 2002, the Company had received $69,000, which represented approximately 70% of the total outstanding Medicare lab billings for the period from January 1995 through June 2002. Approximately $10,000 of these collections related to 2002 lab services provided through June 2002. In addition to processing prior period claims, the carrier also began processing and paying billings for current period services on a timely basis in the third quarter of 2002. Based on these developments, the Company began recognizing estimated current period Medicare lab revenue in the third quarter of 2002. In the fourth quarter of 2003, the Company recognized additional recoveries of $24,000, principally for review periods three and four, based on the hearing officer's most recent findings.

The carrier is also currently conducting a study of the utilization of dialysis-related laboratory services. During the study, the carrier has suspended all of its previously existing dialysis laboratory prepayment screens. The purpose of the study is to determine what ongoing program safeguards are appropriate. In its initial findings from the study, the carrier had determined that some of its prior prepayment screens were invalidating appropriate claims. The Company cannot determine what prepayment screens, post-payment review procedures, documentation requirements or other program safeguards the carrier may yet implement as a result of its study. The carrier has also informed the Company that any claims that it reimburses during the study period may also be subject to post-payment review and retraction if determined inappropriate.

Minnesota laboratory

The Medicare carrier for our Minnesota laboratory is conducting a post-payment review of Medicare reimbursement claims for the period January 1996 through December 1999. The scope of the review is similar to the review being conducted at our Florida laboratory. At this time, the Company is unable to determine how long it will take the carrier to complete this review. There is currently no overpayment determination with respect to the Minnesota laboratory. The DOJ has also requested information with respect to this laboratory, which the Company has provided. Medicare revenues at the Minnesota laboratory, which was much smaller than the Florida laboratory, were approximately $15,000 for the period under review. In November 2001, the Company closed the Minnesota laboratory and combined the operations of this laboratory with its Florida laboratory.

United States Attorney's inquiry

In February 2001 the Civil Division of the United States Attorney's Office for the Eastern District of Pennsylvania in Philadelphia contacted the Company and requested its cooperation in a review of some of the Company's historical practices, including billing and other operating procedures and its financial relationships

with physicians. The Company cooperated in this review and provided the requested records to the United States Attorney's Office. In May 2002, the Company received a subpoena from the Philadelphia office of the Office of Inspector General of the Department of Health and Human Services, or OIG. The subpoena required an update to the information the Company provided in its response to the February 2001 request, and also sought a wide range of documents relating to pharmaceutical and other ancillary services provided to patients, including laboratory and other diagnostic testing services, as well as documents relating to the Company's financial relationships with physicians and pharmaceutical companies. The subpoena covers the period from May 1996 to May 2002. The Company has provided the documents requested. This inquiry remains at an early stage. As it proceeds, the government could expand its areas of concern. If a court determines that there has been wrongdoing, the penalties under applicable statutes could be substantial.

Other

In addition to the foregoing, DaVita is subject to claims and suits in the ordinary course of business. Management believes that the ultimate resolution of these additional pending proceedings, whether the underlying claims are covered by insurance or not, will not have a material adverse effect on the Company's financial condition, results of operations or cash flows.

17. Concentrations

Revenues associated with patients whose primary coverage is under Medicare, Medicaid and other government-based programs accounted for approximately 58%, 59% and 60% of total dialysis revenues in the continental U.S. for 2003, 2002 and 2001, respectively. Accounts receivable from Medicare and Medicaid were approximately $115,000 as of December 31, 2003. No other single payor accounted for more than 5% of total accounts receivable.

A significant physician-prescribed pharmaceutical administered during dialysis, erythropoietin (EPO), is provided by a sole supplier and accounts for approximately one fourth of net operating revenues. Although the Company currently receives discounted prices for EPO, the supplier has unilateral pricing discretion and in the future the Company may not be able to achieve the same price levels historically obtained.

18. Other commitments

The Company has obligations to purchase the third-party interests in several of its joint ventures. These obligations are in the form of put options, exercisable at the third-party owners' discretion, and require the Company to purchase the minority owners' interests at either the appraised fair market value or a predetermined multiple of cash flow or earnings, which approximates fair value. As of December 31, 2003, the Company's potential obligations under these put options totaled approximately $60,000 of which approximately $38,000 was exercisable within one year. Additionally, the Company has certain other potential working capital commitments relating to administrative services agreements and minority-owned centers of approximately $15,000.

The Company has mandatorily redeemable instruments in connection with certain consolidated partnerships, consisting of future distributions for the minority partner's interests in these limited-life entities which dissolve after terms of ten to fifty years. As of December 31, 2003, such distributions would be valued below the related minority interests balances in the consolidated financial statements.

Other than operating leases disclosed in Note 12, and the letters of credit and the interest rate swap agreements, as disclosed in Note 11, the Company has no off balance sheet financing arrangements as of December 31, 2003.

19. Acquisitions and divestitures

Acquisitions

Acquisition amounts were as follows:

	Year ended December 31,		
	2003	2002	2001
Cash paid, net of cash acquired	$ 99,645	$19,977	$36,330
Application of investments in and advances to previously managed businesses			25,320
Deferred purchase payments and acquisition obligations	5,146	100	6,300
Aggregate purchase cost	$104,791	$20,077	$67,950
Number of chronic dialysis centers acquired	27	11	21
Aggregate purchase costs of acquired dialysis centers	$ 84,102	$20,077	$67,950

The assets and liabilities of the acquired operations were recorded at their estimated fair market values at the dates of acquisition. The results of operations of these centers have been included in the financial statements from their designated effective acquisition dates. The nearest month-end has been designated as the effective date for recording acquisitions that close during the month because there were no partial month accounting cutoffs and partial month results associated with these acquisitions would not have a material impact on consolidated operating results. Settlements with tax authorities relating to pre-acquisition income tax liabilities may result in an adjustment to goodwill attributable to that acquisition.

The initial allocations of purchase cost at fair value are based upon available information for the acquired businesses and are finalized when any contingent purchase price amounts are resolved. The final allocations did not differ materially from the initial allocations. Aggregate purchase cost allocations were as follows:

	Year ended December 31,		
	2003	2002	2001
Tangible assets	$ 26,678	$ 3,360	$19,886
Amortizable intangible assets	7,273	1,975	1,648
Goodwill	70,700	15,260	51,820
Liabilities assumed	(1,777)	(518)	(5,404)
Minority interests extinguished	1,917		
Aggregate purchase cost	$104,791	$20,077	$67,950

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

	Year ended December 31,	
	2003	2002
	(unaudited)	
Net revenues	$2,066,371	$1,962,295
Net income	180,961	165,527
Pro forma basic net income per share	2.88	2.30
Pro forma diluted net income per share	2.56	2.05

These unaudited pro forma results are not necessarily indicative of what actually would have occurred if the acquisitions had been completed as of the beginning of both of the periods presented. In addition, they are not intended to be a projection of future results and do not reflect all of the synergies, additional revenue-generating services or reductions in direct center operating expenses that might be achieved from combined operations.

Divestitures

During 2003, the Company divested of certain center operating assets, which amounted to $2,275. The Company divested of substantially all of its dialysis operations outside the continental United States during 2000 and completed the sale of its remaining non-continental centers during the second quarter of 2002. Revenues of the non-continental operations were $6,159 and $15,313 for 2002 and 2001, and the related pre tax earnings (losses) were $1,383 and $(2,509) respectively.

20. Fair values of financial instruments

Financial instruments consist primarily of cash, accounts receivable, notes receivable, accounts payable, accrued compensation and benefits, and other accrued liabilities and debt. The balances of the non-debt financial instruments as presented in the financial statements at December 31, 2003 approximate their fair values. Borrowings under credit facilities, of which $1,154,199 was outstanding as of December 31, 2003, reflect fair value as they are subject to fees and adjustable rates, competitively determined in the marketplace. The interest rate swap had a fair value of approximately $2,000 liability as of December 31, 2003.

21. Supplemental cash flow information

The table below provides supplemental cash flow information:

	Year ended December 31,		
	2003	2002	2001
Cash paid:			
Income taxes	$ 53,074	$30,217	$68,264
Interest	73,278	69,114	70,149
Non-cash investing and financing activities:			
Fixed assets acquired under capital lease obligations	2,283	2,356	
Contributions to consolidated partnerships	2,645	2,154	25
Deferred financing cost write-offs		73	721
Conversion of debt to equity	125,254		
Liabilities assumed in conjunction with common stock acquisition	357		

22. Selected quarterly financial data (unaudited)

	2003				2002			
	December 31	September 30	June 30	March 31	December 31	September 30	June 30	March 31
Net operating revenues	$553,446	$513,282	$489,883	$459,807	$503,096	$481,194	$442,677	$427,665
Operating income	121,190	95,211	82,800	79,334	118,377	109,919	78,747	76,783
Income before income taxes	100,498	62,910	64,195	60,663	99,411	90,570	15,298	61,978
Net income	62,798	38,060	38,520	36,413	58,811	54,170	8,370	35,978
Basic net income per common share	$ 0.98	$ 0.58	$ 0.63	$ 0.60	$ 0.97	$ 0.84	$ 0.10	$ 0.43
Diluted net income per common share	$ 0.92	$ 0.54	$ 0.55	$ 0.52	$ 0.81	$ 0.72	$ 0.13	$ 0.40

Report of Management

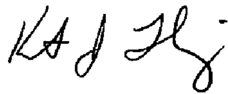
Management is responsible for the preparation, integrity and fair presentation of the accompanying consolidated financial statements of DaVita Inc. and its subsidiaries. The financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and include amounts that are based on management's best estimates and judgements. Financial information included elsewhere in this Annual Report for the year ended December 31, 2003 is consistent with that in the financial statements.

Management has established and maintains a system of internal controls over financial reporting designed to provide reasonable assurance as to the integrity, reliability and accuracy of the financial statements. Management also maintains disclosure controls and procedures designed to accumulate, process and report materially accurate information within the time periods specified in the Securities and Exchange Commission's rules and regulations.

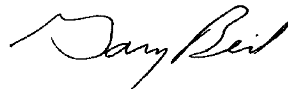
Internal controls over financial reporting and disclosure controls are periodically reviewed and revised if necessary, and are augmented by appropriate oversight and audit functions, as well as an active Code of Conduct requiring adherence to the highest levels of personal and professional integrity. Management however, recognizes that these controls and procedures can provide only reasonable assurance of desired outcomes.

The consolidated financial statements have been audited and reported on by our independent auditors, KPMG LLP, who report directly to the Audit Committee of the Board of Directors. The Audit Committee, which is comprised solely of independent directors, monitors the integrity of the Company's financial reporting process and systems of internal controls over financial reporting and disclosure controls, monitors the independence and performance of the Company's independent auditors, ensures the effectiveness of an anonymous compliance hotline available to all employees, and holds regular meetings without the presence of management.

The Company has carried out an evaluation of the effectiveness of the design and operations of the Company's internal controls over financial reporting and disclosure controls and procedures in accordance with the Exchange Act requirements. Based upon that evaluation, management has concluded that the Company's internal controls over financial reporting are adequate to provide reasonable assurance that transactions are fairly presented in the consolidated financial statements, and that disclosure controls and procedures are effective for timely identification and review of material information required to be included in the Company's Exchange Act reports, including this Annual Report.



Kent J. Thiry
Chief Executive Officer



Gary W. Beil
Acting Chief Financial Officer,
Vice President and Controller

Independent Auditors' Report

The Board of Directors and Shareholders
DaVita Inc.

We have audited the accompanying consolidated balance sheets of DaVita Inc. and subsidiaries as of December 31, 2003 and 2002, and the related consolidated statements of income and comprehensive income, shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2003. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of DaVita Inc. and subsidiaries as of December 31, 2003 and 2002, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2003, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the consolidated financial statements, effective July 1, 2001, the Company adopted the provisions of Statement of Financial Accounting Standards ("SFAS") No. 141, "Business Combinations," and certain provisions of SFAS No. 142, "Goodwill and Other Intangible Assets," as required for goodwill and intangible assets resulting from business combinations consummated after June 30, 2001. In 2002, the Company changed its method of accounting for goodwill and other intangible assets for all other business combinations.

KPMG LLP

Seattle, Washington
February 20, 2004

Risk Factors

This Annual Report contains statements that are forward-looking statements within the meaning of the federal securities laws, including statements about our expectations, beliefs, intentions or strategies for the future. These forward-looking statements include statements regarding our expectations for treatment growth rates, revenue per treatment, expense growth, levels of the provision for uncollectible accounts receivable, operating income, cash flow, and capital expenditures. We base our forward-looking statements on information currently available to us, and we do not intend to update these statements, whether as a result of changes in underlying factors, new information, future events or other developments.

These statements involve known and unknown risks and uncertainties, including risks resulting from economic and market conditions, the regulatory and reimbursement environment in which we operate, competitive activities and other business conditions. Our actual results may differ materially from results anticipated in these forward-looking statements. Important factors that could cause actual results to differ materially from the forward-looking statements include those set forth below. The risks discussed below are not the only ones facing our business.

If the average rates that private payors pay us decline, then our revenues, cash flows and earnings would be substantially reduced.

Approximately 42% of our dialysis revenues are generated from patients who have private payors as the primary payor. The majority of these patients have insurance policies that reimburse us at rates materially higher than Medicare rates. Based on our recent experience in negotiating with private payors, we believe that pressure from private payors to decrease the rates they pay us may increase. If the average rates that private payors pay us decline significantly, it would have a material adverse effect on our revenues, cash flows and earnings.

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

Our revenue levels are sensitive to the percentage of our reimbursements from higher-paying commercial plans. A patient's insurance coverage may change for a number of reasons, including as a result of changes in the patient's or a family member's employment status. If there is a significant change in the number of patients under higher-paying commercial plans relative to plans that pay at lower rates, for example a reduction in the average number of patients under indemnity and PPO plans compared with the average number of patients under HMO plans and government programs, it would negatively impact our revenues, cash flows and earnings.

Changes in clinical practices and reimbursement rates or rules for EPO and other drugs could substantially reduce our revenue and earnings.

The administration of EPO and other drugs accounts for approximately one third of our net operating revenues. Changes in physician practice patterns and accepted clinical practices, changes in private and governmental reimbursement criteria, the introduction of new drugs and the conversion to alternate types of administration, (for example from intravenous administration to subcutaneous or oral administration, that may in turn result in lower or less frequent dosages) could materially reduce our revenues and earnings from the administration of EPO and other drugs. For example, some Medicare fiscal intermediaries are seeking to implement local medical review policies for EPO and vitamin D analogs that would effectively limit utilization of and reimbursement for these drugs. CMS had indicated that it may issue a new national coverage decision that will direct all fiscal intermediaries with respect to reimbursement coverage for EPO. We do not know if or when CMS will issue such decision, or what it will provide.

In addition, reductions in current private and government reimbursement rates for EPO or other pharmaceutical drugs would also reduce our net earnings and cash flows. For example, both CMS and members

of Congress have proposed changes in the Medicare reimbursement rates for many of the outpatient prescription drugs that we administer to dialysis patients.

Adverse developments with respect to EPO could materially reduce our net earnings and cash flows and affect our ability to care for our patients.

Amgen is the sole supplier of EPO and often unilaterally increases its price for EPO. For example, Amgen unilaterally increased its base price for EPO by 3.9% in each of 2002, 2001 and 2000. Although we have contracted coverage for EPO pricing for a fixed time period that includes discount variables depending on certain clinical criteria, we cannot predict whether we will continue to receive the same discount structure for EPO that we currently receive, or whether we will continue to achieve the same levels of discounts within that structure as we have historically achieved. In addition, Amgen has developed a new product, Aranesp®, that may replace EPO or reduce its use with dialysis patients. We cannot predict if or when Aranesp® will be introduced to the U.S. dialysis market, what its cost and reimbursement structure will be, or how it may impact our revenues from EPO. Increases in the cost of EPO and the introduction of Aranesp® could have a material adverse effect on our net earnings and cash flows.

Future declines, or the lack of further increases, in Medicare reimbursement rates would reduce our net earnings and cash flows.

Approximately 50% of our dialysis revenues are generated from patients who have Medicare as their primary payor. The Medicare ESRD program reimburses us for dialysis and ancillary services at fixed rates. Unlike most other Medicare programs, the Medicare ESRD program does not provide for periodic inflation increases in reimbursement rates. Increases of 1.2% in 2000 and 2.4% in 2001 were the first increases in the composite rate since 1991, and were significantly less than the cumulative rate of inflation since 1991. For 2002 through 2004 there has been no increase in the composite rate. In 2005 an increase of only 1.6% has been scheduled. Increases in operating costs that are subject to inflation, such as labor and supply costs, have occurred and are expected to continue to occur with or without a compensating increase in reimbursement rates. We cannot predict with certainty the nature or extent of future rate changes, if any. To the extent these rates are not adjusted to keep pace with inflation, our net earnings and cash flows would be adversely affected.

Future changes in the structure of, and reimbursement rates under, the Medicare ESRD program could substantially reduce our operating earnings and cash flows.

CMS is studying changes to the ESRD program, including whether the Medicare composite rate for dialysis should be modified to include additional services that are now separately billable, such as laboratory and other diagnostic tests and the administration of EPO and other pharmaceuticals, in the composite rate. If Medicare began to include in its composite reimbursement rate any ancillary services that it currently reimburses separately, our revenue would decrease to the extent there was not a corresponding increase in that composite rate. In particular, Medicare revenue from EPO is approximately 28% of our total Medicare revenue. If EPO were included in the composite rate, and if the rate were not increased sufficiently, our operating earnings and cash flow could decrease substantially.

Future declines in Medicaid reimbursement rates would reduce our net earnings and cash flows.

Approximately 5% of our dialysis revenues are generated from patients who have Medicaid as their primary coverage. In addition approximately 3% of our dialysis revenues are from Medicaid secondary coverage. Approximately 45% of our Medicaid revenue is derived from patients in California. If state governments change Medicaid programs or the rates paid by those programs for our services, then our revenue and earnings may decline. Some of the states' Medicaid programs have reduced rates for dialysis services, and others have proposed such reductions or other changes to eligibility for Medicaid coverage. Any actions to limit Medicaid coverage or further reduce reimbursement rates for dialysis and related services would adversely affect our revenue and earnings.

The pending federal reviews of some of our historical practices could result in substantial penalties against us.

We are voluntarily cooperating with the Civil Division of the United States Attorney's Office and OIG in Philadelphia in a review of some of our practices, including billing and other operating procedures, financial relationships with physicians and pharmaceutical companies, and the provision of pharmaceutical and other ancillary services. The DOJ has also requested and received information regarding our laboratories. We are unable to determine when these matters will be resolved, whether any additional areas of inquiry will be opened or any outcome of these matters, financial or otherwise. Any negative findings could result in substantial financial penalties against us and exclusion from future participation in the Medicare and Medicaid programs.

If we fail to adhere to all of the complex government regulations that apply to our business, we could suffer severe consequences that would substantially reduce our revenue and earnings.

Our dialysis operations are subject to extensive federal, state and local government regulations, including Medicare and Medicaid reimbursement rules and regulations, federal and state anti-kickback laws, and federal and state laws regarding the collection, use and disclosure of patient health information. The regulatory scrutiny of healthcare providers, including dialysis providers, has increased significantly in recent years. In addition, the frequency and intensity of Medicare certification surveys and inspections of dialysis centers have increased markedly since 2000.

We endeavor to comply with all of the requirements for receiving Medicare and Medicaid reimbursement and to structure all of our relationships with referring physicians to comply with the anti-kickback laws; however, the laws and regulations in this area are complex and subject to varying interpretations. In addition, our historical dependence on manual processes that vary widely across our network of dialysis centers exposes us to greater risk of errors in billing and other business processes.

Due to regulatory considerations unique to each of these states, all of our dialysis operations in New York and some of our dialysis operations in New Jersey are conducted by privately-owned companies to which we provide a broad range of administrative services. These operations account for approximately 7% of our dialysis revenues. We believe that we have structured these operations to comply with the laws and regulations of these states, but we can give no assurances that they will not be challenged.

If any of our operations are found to violate these or other government regulations, we could suffer severe consequences, including:

- Mandated practice changes that significantly increase operating expenses;
- Suspension of payments from government reimbursement programs;
- Refunds of amounts received in violation of law or applicable reimbursement program requirements;
- Loss of required government certifications or exclusion from government reimbursement programs;
- Loss of licenses required to operate healthcare facilities in some of the states in which we operate, including the loss of revenues from operations in New York and New Jersey conducted by privately-owned companies as described above;
- Fines or monetary penalties for anti-kickback law violations, submission of false claims or other failures to meet reimbursement program requirements and patient privacy law violations; and
- Claims for monetary damages from patients who believe their protected health information has been used or disclosed in violation of federal or state patient privacy laws.

If businesses we acquire failed to adhere to regulations that apply to our business, we could suffer severe consequences that would substantially reduce our revenues and earnings.

Businesses we acquire may have unknown or contingent liabilities, including for failure to adhere to laws and regulations governing dialysis operations. We generally seek indemnification from the sellers of businesses we acquire, but such liabilities may not be covered or may be greater than contractual limits or the financial resources of the indemnifying party.

If a significant number of physicians were to cease referring patients to our dialysis centers, whether due to regulatory or other reasons, our revenue and earnings would decline.

If a significant number of physicians stop referring patients to our centers, it could have a material adverse effect on our revenue and earnings. Many physicians prefer to have their patients treated at dialysis centers where they or other members of their practice supervise the overall care provided as medical directors of the centers. As a result, the primary referral source for most of our centers is often the physician or physician group providing medical director services to the center. If a medical director agreement terminates, whether before or at the end of its term, and a new medical director is appointed, it may negatively impact the former medical director's decision to treat his or her patients at our center. Additionally, both current and former medical directors have no obligation to refer their patients to our centers. Also, if quality or service levels at our centers deteriorate if may negatively impact patient referrals and treatment volumes.

Our medical director contracts are for fixed periods, generally five to ten years. Medical directors have no obligation to extend their agreements with us. As of December 31, 2003, there were 25 centers, accounting for nearly 5% of our treatment volume, at which the medical director agreements required renewal on or before December 31, 2004.

We also may take actions to restructure existing relationships or take positions in negotiating extensions of relationships in order to assure compliance with the safe harbor provisions of the anti-kickback statute and other similar laws. These actions could negatively impact physicians' decisions to extend their medical director agreements with us or to refer their patients to us. In addition, if the terms of an existing agreement were found to violate applicable laws, we may not be successful in restructuring the relationship, which could lead to the early termination of the agreement, or force the physician to stop referring patients to the centers.

If the current shortage of skilled clinical personnel continues, we may experience disruptions in our business operations and increases in operating expenses.

We are experiencing increased labor costs and difficulties in hiring nurses due to a nationwide shortage of skilled clinical personnel. We compete for nurses with hospitals and other health care providers. This nursing shortage may limit our ability to expand our operations. If we are unable to hire skilled clinical personnel when needed, our operations and treatment growth will be negatively impacted.

Provisions in our charter documents and compensation programs we have adopted may deter a change of control that our stockholders would otherwise determine to be in their best interests.

Our charter documents include provisions that may deter hostile takeovers, delay or prevent changes of control or changes in our management, or limit the ability of our stockholders to approve transactions that they may otherwise determine to be in their best interests. These include provisions prohibiting our stockholders from acting by written consent, requiring 60 days advance notice of stockholder proposals or nominations to our Board of Directors and granting our Board of Directors the authority to issue up to five million shares of preferred stock and to determine the rights and preferences of the preferred stock without the need for further stockholder approval, and a poison pill that would substantially dilute the interest sought by an acquirer that our board of directors does not approve.

In addition, most of our outstanding employee stock options include a provision accelerating the vesting of the options in the event of a change of control. We have also adopted a change of control protection program for our employees who do not have a significant number of stock options, which provides for cash bonuses to the employees in the event of a change of control. Based on the shares of our common stock outstanding and the market price of our stock on December 31, 2003, these cash bonuses would total approximately $94 million if a control transaction occurred at that price and our Board of Directors did not modify the program. These compensation programs may affect the price an acquirer would be willing to pay.

These provisions could also discourage bids for our common stock at a premium and cause the market price of our common stock to decline.

Market for the Registrant's Common Equity and Related Stockholder Matters

Our common stock is traded on the New York Stock Exchange under the symbol "DVA". The following table sets forth, for the periods indicated, the high and low closing prices for our common stock as reported by the New York Stock Exchange.

	High	Low
Year ended December 31, 2003:		
1st quarter	$25.59	$19.55
2nd quarter	26.94	19.52
3rd quarter	32.50	26.83
4th quarter	40.00	32.95
Year ended December 31, 2002:		
1st quarter	$26.00	$21.50
2nd quarter	26.13	20.40
3rd quarter	23.91	19.46
4th quarter	25.87	22.80

The closing price of our common stock on February 13, 2004 was $44.89 per share. According to The Bank of New York, our registrar and transfer agent, as of February 13, 2004, there were 2,710 holders of record of our common stock. Since our recapitalization in 1994, we have not declared or paid cash dividends to holders of our common stock. We have no current plans to pay cash dividends. Also, see the heading "Liquidity and capital resources" under "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the notes to our consolidated financial statements.

Selected Financial Data

The following table presents selected consolidated financial and operating data for the periods indicated. The following financial and operating data should be read in conjunction with “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and our consolidated financial statements filed as part of this Annual Report.

	Year ended December 31,				
	2003	2002	2001	2000	1999
	(in thousands, except share data)				
Income statement data:					
Net operating revenues(1)	$2,016,418	$1,854,632	$1,650,753	$1,486,302	$ 1,445,351
Operating expenses(2)	1,637,883	1,470,806	1,339,895	1,318,460	1,513,121
Operating income (loss)	378,535	383,826	310,858	167,842	(67,770)
Debt expense	66,828	71,636	72,438	115,445	109,196
Refinancing charges (gains)(3)	26,501	48,930	(1,629)	7,009	1,601
Other income (loss), net	3,060	3,997	2,518	(6,270)	(3,259)
Income (loss) before income taxes	288,266	267,257	242,567	39,118	(181,826)
Income tax expense (benefit)	112,475	109,928	105,252	25,633	(34,570)
Net income (loss)	$ 175,791	$ 157,329	$ 137,315	$ 13,485	$ (147,256)
Basic earnings (loss) per common share	$ 2.79	$ 2.19	$ 1.64	$ 0.17	$ (1.81)
Diluted earnings (loss) per common share	$ 2.49	$ 1.96	$ 1.52	$ 0.16	$ (1.81)
Ratio of earnings to fixed charges(4)(5)	4.43:1	4.35:1	3.63:1	1.32:1	See (5)
Balance sheet data:					
Working capital(6)	$ 242,238	$ 251,925	$ 175,983	$ 148,348	$(1,043,796)
Total assets	1,945,530	1,775,693	1,662,683	1,596,632	2,056,718
Long-term debt(7)	1,117,002	1,311,252	811,190	974,006	5,696
Shareholders’ equity(8)	306,871	70,264	503,637	349,368	326,404

(1) Net operating revenues include $24,000 in 2003 and $58,778 in 2002 of prior years’ services revenue relating to Medicare lab recoveries, and $22,000 in 2001 of prior years’ dialysis services revenue relating to cash settlements and collections in excess of prior estimates.

(2) Total operating expenses include recoveries of $5,192 in 2002 and $35,220 in 2001 of accounts receivable reserved in 1999, net impairment losses of $4,556 in 2000 and impairment and valuation losses of $139,805 in 1999 principally associated with the disposition of the Company’s non-continental U.S. operations.

(3) Refinancing charges (gains) were $26,501 in 2003, representing the consideration paid to redeem the $125,000 5 ⅝% Convertible Subordinated Notes due 2006 and the $345,000 7% Convertible Subordinated Notes due 2009 in excess of book value, the write off of related deferred financing costs and other financing fees associated with amending the bank credit agreement, $48,930 in 2002 representing the write-off of deferred financing costs associated with the retirement of the $225,000 outstanding 9 ¼% Senior Subordinated Notes due 2011, a net gain of $1,629 in 2001 relating to the write-off of deferred financing costs and the accelerated swap liquidation gains resulting from debt refinancing.

(4) The ratio of earnings to fixed charges is computed by dividing earnings by fixed charges. Earnings for this purpose is defined as pretax income from operations adjusted by adding back fixed charges expensed during the period and debt refinancing charges. Fixed charges include debt expense (interest expense and amortization of financing costs), the estimated interest component of rental expense on operating leases, and capitalized interest.

(5) Due to our loss in 1999, the ratio coverage in 1999 was less than 1:1. We would have had to generate additional earnings of $182,535 to achieve a coverage of 1:1.

(6) The working capital calculation as of December 31, 1999 includes long-term debt of $1,425,610 that was potentially callable under covenant provisions.

(7) Long-term debt as of December 31, 1999 excludes $1,425,610 that was potentially callable under covenant provisions.

(8) We repurchased 3,441,900 shares of common stock for $107,162 in 2003, 27,327,477 shares of common stock for $642,171 in 2002 and 888,700 shares of common stock for $20,360 in 2001. Debt of $124,700 and $526 was also converted into 4,868,352 and 16,030 shares of common stock in 2003.

CORPORATE INFORMATION

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www.davita.com

Independent Auditors
KPMG LLP
Seattle, Washington

Stock Registrar and Transfer Agent
The Bank of New York
New York, New York

Annual Meeting of Stockholders
Monday, May 24, 2004
Hyatt Regency San Francisco Airport
1333 Bayshore Highway
Burlingame, CA 94010

Common Stock Listing
New York Stock Exchange
Symbol: DVA

Section 302 Certifications
Certifications of the Chief Executive Officer and Acting Chief Financial Officer have been included as Exhibit 31 in DaVita's annual report on Form 10-K for the year ended December 31, 2003.

Form 10-K Request
For a free copy of DaVita's annual report on Form 10-K for the year ended December 31, 2003 please send a written request to LeAnne Zumwalt, Vice President of Investor Relations at DaVita's corporate address.

Corporate Governance Guidelines
DaVita's Corporate Governance policies and procedures and Code of Ethics are located on DaVita's website and can be obtained free of charge, upon request from LeAnne Zumwalt at DaVita's corporate address.

DIRECTORS

Nancy-Ann DeParle
Senior Advisor
JP Morgan Partners, LLC

Former Administrator
Healthcare Financing Administration
1997 to 2000

Richard B. Fontaine
Independent Health Care Consultant

Former Senior Vice President
CR&R Incorporated

Former Chief Executive Officer
Vivocell Therapy, Inc.

Peter T. Grauer
Chairman of the Board, President and Treasurer
Bloomberg, Inc.

Michelle J. Hooper
Board Member
AstraZeneca PLC
Target Corporation
PPG Industries, Inc.

Former Chief Executive Officer and President
Voyager Expanded Learning

C. Raymond Larkin, Jr.
Chairman of the Board and Chief Executive Officer
Eunoe, Inc.

Former Chief Executive Officer
Nellcor Incorporated

John M. Nehra
General Partner
New Enterprise Associates

Managing General Partner
Catalyst Ventures

William L. Roper
Chief Executive Officer
University of North Carolina Healthcare System

Dean, School of Medicine
Vice Chancellor for Medical Affairs
University of North Carolina at Chapel Hill

Former Director
Centers for Disease Control and Prevention
1990 to 1993

Former Administrator
Healthcare Financing Administration
1986 to 1989

Kent J. Thiry
Chairman of the Board and Chief Executive Officer
DaVita Inc.

SECTION 16 OFFICERS

Kent J. Thiry
Chairman of the Board and Chief Executive Officer

Joseph C. Mello
Chief Operating Officer

Gary W. Beil
Acting Chief Financial Officer and Controller

Charles A. McAllister, M.D.
Chief Medical Officer

Patrick A. Broderick
Secretary and General Counsel

Lori S. Richardson-Pellicioni
Chief Compliance Officer and Legal Counsel

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