DAVITA HEALTHCARE PARTNERS INC.
Form 10-Q
May 04, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

For the Quarterly Period Ended March 31, 2016

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

THE SECURITIES EXCHANGE ACT OF 1934

Commission File Number: 1-14106

DAVITA HEALTHCARE PARTNERS INC.

2000 16th Street

Denver, CO 80202

Telephone number (303) 405-2100

Delaware	51-0354549
(State of incorporation)	(I.R.S. Employer Identification No.)

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

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

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

Large accelerated filer	x	Accelerated filer	£
Non-accelerated filer	£ (Do not check if a smaller reporting company)	Smaller reporting company	£

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

As of April 29, 2016, the number of shares of the Registrant's common stock outstanding was approximately 206.5 million shares.

DAVITA HEALTHCARE PARTNERS INC.

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

DAVITA HEALTHCARE PARTNERS INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited)

(dollars in thousands, except per share data)

	Three months ended March 31, 2016	2015
Patient service revenues	$2,477,738	$2,271,815
Less: Provision for uncollectible accounts	(109,205)	(99,164)
Net patient service revenues	2,368,533	2,172,651
Capitated revenues	887,047	850,515
Other revenues	325,556	264,799
Total net revenues	3,581,136	3,287,965
Operating expenses and charges:		
Patient care costs and other costs	2,582,333	2,362,612
General and administrative	386,429	341,801
Depreciation and amortization	169,355	153,789
Provision for uncollectible accounts	2,517	1,827
Equity investment income	(1,387)	(2,908)
Goodwill impairment charge	77,000	—
Settlement charge	—	495,000
Total operating expenses and charges	3,216,247	3,352,121
Operating income (loss)	364,889	(64,156)
Debt expense	(102,884)	(97,392)
Other income (loss), net	2,976	(533)
Income (loss) before income taxes	264,981	(162,081)
Income tax expense (benefit)	126,822	(85,933)
Net income (loss)	138,159	(76,148)
Less: Net income attributable to noncontrolling interests	(40,725)	(34,469)
Net income (loss) attributable to DaVita HealthCare Partners Inc.	$97,434	$(110,617)
Earnings per share:		
Basic net income (loss) per share attributable to DaVita HealthCare Partners Inc.	$0.48	$(0.52)
Diluted net income (loss) per share attributable to DaVita HealthCare Partners Inc.	$0.47	$(0.52)
Weighted average shares for earnings per share:		
Basic	204,366,869	213,387,253
Diluted	207,928,096	213,387,253

See notes to condensed consolidated financial statements.

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DAVITA HEALTHCARE PARTNERS INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(unaudited)

(dollars in thousands)

	Three months ended March 31,	
	2016	2015
Net income (loss)	$138,159	$(76,148)
Other comprehensive (loss) income, net of tax:		
Unrealized losses on interest rate swap and cap agreements:		
Unrealized losses on interest rate swap and cap agreements	(5,469)	(5,760)
Reclassifications of net swap and cap agreements realized losses into net income	465	812
Unrealized gains (losses) on investments:		
Unrealized gains on investments	229	382
Reclassification of net investment realized gains into net income	(93)	(157)
Foreign currency translation adjustments	11,181	(17,885)
Other comprehensive income (loss)	6,313	(22,608)
Total comprehensive income (loss)	144,472	(98,756)
Less: Comprehensive income attributable to noncontrolling interests	(40,725)	(34,469)
Comprehensive income (loss) attributable to DaVita HealthCare Partners Inc.	$103,747	$(133,225)

See notes to condensed consolidated financial statements.

DAVITA HEALTHCARE PARTNERS INC.

CONSOLIDATED BALANCE SHEETS

(unaudited)

(dollars in thousands, except per share data)

	March 31, 2016	December 31, 2015
ASSETS		
Cash and cash equivalents	$1,041,427	$1,499,116
Short-term investments	396,468	408,084
Accounts receivable, less allowance of $280,988 and $264,144	1,855,285	1,724,228
Inventories	192,689	185,575
Other receivables	525,548	435,885
Other current assets	187,287	190,322
Income taxes receivable	856	60,070
Total current assets	4,199,560	4,503,280
Property and equipment, net	2,911,205	2,788,740
Intangible assets, net	1,678,707	1,687,326
Equity investments	75,059	73,368
Long-term investments	97,770	94,122
Other long-term assets	66,269	73,560
Goodwill	9,485,628	9,294,479
	$18,514,198	$18,514,875
LIABILITIES AND EQUITY		
Accounts payable	$480,288	$513,950
Other liabilities	779,141	682,123
Accrued compensation and benefits	728,476	741,926
Medical payables	317,747	332,102
Current portion of long-term debt	137,966	129,037
Total current liabilities	2,443,618	2,399,138
Long-term debt	8,979,855	9,001,308
Other long-term liabilities	464,250	439,229
Deferred income taxes	792,038	726,962
Total liabilities	12,679,761	12,566,637
Commitments and contingencies:		
Noncontrolling interests subject to put provisions	912,705	864,066
Equity:		
Preferred stock ($0.001 par value, 5,000,000 shares authorized; none issued)		
Common stock ($0.001 par value, 450,000,000 shares authorized; 217,338,629 and 217,120,346 shares issued and 206,392,776 and 209,754,247 shares outstanding, respectively)	217	217
Additional paid-in capital	1,089,305	1,118,326

Retained earnings	4,454,269	4,356,835
Treasury stock (10,945,853 and 7,366,099 shares, respectively)	(786,352)	(544,772)
Accumulated other comprehensive loss	(53,513)	(59,826)
Total DaVita HealthCare Partners Inc. shareholders’ equity	4,703,926	4,870,780
Noncontrolling interests not subject to put provisions	217,806	213,392
Total equity	4,921,732	5,084,172
	$18,514,198	$18,514,875

See notes to condensed consolidated financial statements.

DAVITA HEALTHCARE PARTNERS INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

(dollars in thousands)

	Three months ended March 31, 2016	2015
Cash flows from operating activities:		
Net income (loss)	$138,159	$(76,148)
Adjustments to reconcile net income to net cash provided by operating activities:		
Settlement charge	—	495,000
Depreciation and amortization	169,355	153,789
Goodwill impairment charge	77,000	—
Stock-based compensation expense	13,097	12,762
Tax benefits from stock award exercises	8,668	9,366
Excess tax benefits from stock award exercises	(4,383)	(7,584)
Deferred income taxes	47,519	(203,940)
Equity investment income, net	5,238	2,539
Other non-cash charges	11,507	7,865
Changes in operating assets and liabilities, other than from acquisitions and divestitures:		
Accounts receivable	(78,097)	(151,743)
Inventories	(4,924)	(9,193)
Other receivables and other current assets	(75,326)	(18,619)
Other long-term assets	(965)	153
Accounts payable	7,782	(10,933)
Accrued compensation and benefits	(32,909)	30,638
Other current liabilities	55,673	60,772
Income taxes	72,400	106,970
Other long-term liabilities	19,208	8,395
Net cash provided by operating activities	429,002	410,089
Cash flows from investing activities:		
Additions of property and equipment	(173,187)	(121,421)
Acquisitions	(405,154)	(40,650)
Proceeds from asset and business sales	4,657	2,565
Purchase of investments available for sale	(4,435)	(1,448)
Purchase of investments held-to-maturity	(228,198)	(290,774)
Proceeds from sale of investments available for sale	5,155	1,217
Proceeds from investments held-to-maturity	252,701	205,650
Purchase of equity investments	(5,850)	(7,426)
Net cash used in investing activities	(554,311)	(252,287)
Cash flows from financing activities:		
Borrowings	13,098,553	13,353,767

Payments on long-term debt and other financing costs	(13,123,124)	(13,382,203)
Purchase of treasury stock	(274,926)	(70,063)
Distributions to noncontrolling interests	(50,409)	(41,499)
Stock award exercises and other share issuances, net	3,167	5,648
Excess tax benefits from stock award exercises	4,383	7,584
Contributions from noncontrolling interests	10,190	15,898
Proceeds from sales of additional noncontrolling interests	3,557	—
Purchase of noncontrolling interests	(4,300)	—
Deferred financing costs	(188)	—
Net cash used in financing activities	(333,097)	(110,868)
Effect of exchange rate changes on cash and cash equivalents	717	(904)
Net (decrease) increase in cash and cash equivalents	(457,689)	46,030
Cash and cash equivalents at beginning of the year	1,499,116	965,241
Cash and cash equivalents at end of the period	$1,041,427	$1,011,271

See notes to condensed consolidated financial statements.

DAVITA HEALTHCARE PARTNERS INC.

CONSOLIDATED STATEMENTS OF EQUITY

(unaudited)

(dollars and shares in thousands)

	Non-controlling interests subject to put provisions	DaVita HealthCare Partners Inc. Shareholders' Equity								Non-controlling interests not subject to put provisions
		Common stock		Additional paid-in capital	Retained earnings	Treasury stock		Accumulated other comprehensive loss	Total	
Balance at December 31, 2014	$829,965	215,641	$216	$1,108,211	$4,087,103	—	$—	$(25,017)	$5,170,513	$189,798
Comprehensive income:										
Net income	96,510				269,732				269,732	61,168
Other comprehensive loss								(34,809)	(34,809)	
Stock purchase shares issued		—	—	(6,079)		414	30,608		24,529	
Stock unit shares issued		348	—	—					—	
Stock-settled SAR shares issued		1,131	1	(1)					—	
Stock-settled stock-based compensation expense				56,899					56,899	
Excess tax benefits from stock awards exercised				28,157					28,157	
Distributions to noncontrolling	(103,355)									(71,280)

interests										
Contributions from noncontrolling interests	25,795									28,849
Sales and assumptions of additional noncontrolling interests	10,654									6,875
Purchase of noncontrolling interests	(8,538)			(55,826)					(55,826)	(2,018)
Changes in fair value of noncontrolling interests	13,035			(13,035)					(13,035)	
Purchase of treasury stock						(7,780)	(575,380)		(575,380)	
Balance at December 31, 2015	$864,066	217,120	$217	$1,118,326	$4,356,835	(7,366)	$(544,772)	$(59,826)	$4,870,780	$213,392
Comprehensive income:										
Net income	26,776				97,434				97,434	13,949
Other comprehensive income								6,313	6,313	
Stock unit shares issued		—	—	(1,206)		17	1,206		—	
Stock-settled SAR shares issued		219	—	(6,695)		93	6,695		—	
Stock-settled stock-based compensation expense				12,855					12,855	
Excess tax benefits from stock				4,383					4,383	

awards exercised										
Distributions to noncontrolling interests	(29,151)									(21,258)
Contributions from noncontrolling interests	7,389									2,801
Sales and assumptions of additional noncontrolling interests	7,719			885					885	9,885
Purchase of noncontrolling interests	—			(3,337)					(3,337)	(963)
Changes in fair value of noncontrolling interests	35,906			(35,906)					(35,906)	
Purchase of treasury stock						(3,690)	(249,481)		(249,481)	
Balance at March 31, 2016	$912,705	217,339	$217	$1,089,305	$4,454,269	(10,946)	$(786,352)	$(53,513)	$4,703,926	$217,806

See notes to condensed consolidated financial statements

DAVITA HEALTHCARE PARTNERS INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

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

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

1. Condensed consolidated interim financial statements

The condensed consolidated interim financial statements included in this report are prepared by the Company without audit. In the opinion of management, all adjustments necessary for a fair presentation of the results of operations are reflected in these consolidated interim financial statements. All significant intercompany accounts and transactions have been eliminated. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. The most significant estimates and assumptions underlying these financial statements and accompanying notes generally involve revenue recognition and accounts receivable, contingencies, impairments of goodwill and other long-lived assets, fair value estimates, accounting for income taxes, variable compensation accruals, consolidation of variable interest entities, purchase accounting valuation estimates, long-term incentive program compensation and medical liability claims. The results of operations for the three months ended March 31, 2016 are not necessarily indicative of the operating results for the full year. The condensed consolidated interim financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2015. Prior year balances and amounts have been reclassified to conform to the current year presentation. The Company has evaluated subsequent events through the date these condensed consolidated financial statements were issued and has included all necessary adjustments and disclosures.

2. Earnings per share

Basic net income (loss) per share is calculated by dividing net income (loss) attributable to the Company, adjusted for any change in noncontrolling interests redemption rights in excess of fair value, by the weighted average number of common shares and vested stock units outstanding, net of shares held in escrow that under certain circumstances may be returned to the Company.

Diluted net income (loss) per share includes the dilutive effect of outstanding stock-settled stock appreciation rights and unvested stock units (under the treasury stock method) as well as contingently returnable shares held in escrow.

DAVITA HEALTHCARE PARTNERS INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(continued)

(unaudited)

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

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

	Three months ended March 31,	
	2016	2015
Basic:		
Net income (loss) attributable to DaVita HealthCare Partners Inc.	$97,434	$(110,617)
Weighted average shares outstanding during the period	206,561	215,581
Contingently returnable shares held in escrow for the DaVita HealthCare Partners merger	(2,194)	(2,194)
Weighted average shares for basic earnings per share calculation	204,367	213,387
Basic net income (loss) per share attributable to DaVita HealthCare Partners Inc.	$0.48	$(0.52)
Diluted:		
Net income (loss) attributable to DaVita HealthCare Partners Inc.	$97,434	$(110,617)
Weighted average shares outstanding during the period	206,561	215,581
Contingently returnable shares held in escrow for the DaVita HealthCare Partners merger	—	(2,194)
Assumed incremental shares from stock plans	1,367	—
Weighted average shares for diluted earnings per share calculation	207,928	213,387
Diluted net income (loss) per share attributable to DaVita HealthCare Partners Inc.	$0.47	$(0.52)
Anti-dilutive potential common shares excluded from calculation [1]	2,273	5,992

[1] Shares associated with stock-settled stock appreciation rights and contingently returnable shares that are excluded from the diluted denominator calculation because they are anti-dilutive on their terms or, in the case of the quarter ended March 31, 2015, due to the Company's net loss attributable to DaVita HealthCare Partners Inc.

3. Accounts receivable

Accounts receivable are reduced by an allowance for doubtful accounts. In evaluating the ultimate collectability of accounts receivable, the Company analyzes its historical cash collection experience and trends for each of its government payors and commercial payors to estimate the adequacy of the allowance for doubtful accounts and the amount of the provision for uncollectible accounts. Management regularly updates its analysis based upon the most recent information available to determine its current provision for uncollectible accounts and the adequacy of its allowance for doubtful accounts.

For receivables associated with dialysis patient services covered by government payors, like Medicare, the Company receives 80% of the payment directly from Medicare as established under the government’s bundled payment system and determines an appropriate allowance for doubtful accounts and provision for uncollectible accounts on the remaining balance due depending upon the Company’s estimate of the amounts ultimately collectible from other secondary coverage sources or from the patients. For receivables associated with services to patients covered by commercial payors that are either based upon contractual terms or for non-contracted health plan coverage, the Company provides an allowance for doubtful accounts by recording a provision for uncollectible accounts based upon its historical collection experience, potential inefficiencies in its billing processes and for which collectability is determined to be unlikely. Approximately 1% of the Company’s dialysis and related lab services net accounts receivable are associated with patient pay and it is the Company’s policy to reserve 100% of the outstanding accounts receivable balances for dialysis services when those amounts due are outstanding for more than three months.

During the three months ended March 31, 2016, the Company’s allowance for doubtful accounts increased by $16,844. This was primarily due to an increase in outstanding balances related to the U.S. dialysis and lab business. There were no unusual transactions impacting the allowance for doubtful accounts.

DAVITA HEALTHCARE PARTNERS INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(continued)

(unaudited)

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

4. Investments in debt and equity securities and other investments

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

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

	March 31, 2016			December 31, 2015		
	Held to maturity	Available for sale	Total	Held to maturity	Available for sale	Total
Certificates of deposit, commercial paper and money market funds due within one year	$382,399	$—	$382,399	$406,884	$—	$406,884
Investments in mutual funds, debt securities and common stock	—	48,667	48,667	—	33,482	33,482
	$382,399	$48,667	$431,066	$406,884	$33,482	$440,366
Short-term investments	$382,399	$14,069	$396,468	$406,884	$1,200	$408,084
Long-term investments	—	34,598	34,598	—	32,282	32,282
	$382,399	$48,667	$431,066	$406,884	$33,482	$440,366

The cost of the certificates of deposit, commercial paper and money market funds at March 31, 2016 and December 31, 2015 approximates their fair value. As of March 31, 2016 and December 31, 2015, the available-for-sale investments included $2,779 and $2,589 of gross pre-tax unrealized gains, respectively. During the three months ended March 31, 2016, the Company recorded gross pre-tax unrealized gains of $342, or $229 after tax, in other comprehensive income associated with changes in the fair value of these investments. During the three months ended March 31, 2016, the Company sold investments in mutual funds for net proceeds of $1,062 and recognized a pre-tax gain of $152, or $93 after-tax, which was previously recorded in other comprehensive income. During the three months ended March 31, 2015, the Company sold investments in mutual funds for net proceeds of $1,217 and recognized a pre-tax gain of $257, or $157 after-tax, which was previously recorded in other comprehensive income.

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

As of March 31, 2016, the Company held $6,250 of preferred stock in two privately held companies that are accounted for under the cost method as these investments do not have readily determinable fair values.

Certain HCP entities are required to maintain minimum cash balances in order to comply with regulatory requirements in conjunction with medical claim reserves. As of March 31, 2016, this minimum cash balance was approximately $58,567.

5. Goodwill

Changes in goodwill by reportable segments were as follows:

	U.S. dialysis and related lab services	HCP	Other-ancillary services and strategic initiatives	Consolidated total
Balance at January 1, 2015	$ 5,610,643	$3,562,534	$ 242,118	$ 9,415,295
Acquisitions	21,910	29,910	45,273	97,093
Divestitures	(3,370)	(5,411)	—	(8,781)
Goodwill impairment charges	—	(188,769)	(4,065)	(192,834)
Foreign currency and other adjustments	—	—	(16,294)	(16,294)
Balance at December 31, 2015	$ 5,629,183	$3,398,264	$ 267,032	$ 9,294,479
Acquisitions	—	251,216	9,233	260,449
Divestitures	—	—	—	—
Goodwill impairment charge	—	(77,000)	—	(77,000)
Foreign currency and other adjustments	—	—	7,700	7,700
Balance at March 31, 2016	$ 5,629,183	$3,572,480	$ 283,965	$ 9,485,628

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DAVITA HEALTHCARE PARTNERS INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(continued)

(unaudited)

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

Each of the Company's operating segments described in Note 17 to these condensed consolidated financial statements represents an individual reporting unit for goodwill impairment testing purposes, except that each sovereign jurisdiction within the Company's international operating segments is considered a separate reporting unit.

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

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

During the quarter ended March 31, 2016 the Company completed its annual goodwill impairment assessments for its at-risk HCP reporting units for the quarter ended December 31, 2015. The results of those completed assessments did not differ materially from the preliminary results reported in the Company's annual financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2015.

Based on continuing developments at the Company's HCP reporting units, including changes in expectations concerning government reimbursement and the Company's expected ability to mitigate them, medical cost trends and other market conditions, the Company performed additional impairment assessments on certain at-risk HCP reporting units during the quarter ended March 31, 2016. Based on these first quarter assessments, the Company recognized an additional $77,000 goodwill impairment charge for its HCP Nevada reporting unit during the quarter ended March 31, 2016.

The Company's HCP Nevada, HCP Florida, HCP Colorado Springs, Kidney Care Germany and Kidney Care Malaysia reporting units are at risk of goodwill impairment. As of March 31, 2016, these reporting units have goodwill amounts of $341,668, $537,813, $16,897, $129,242 and $13,998, respectively. As of March 31, 2016, the latest estimated fair values of the HCP Nevada, HCP Florida, HCP Colorado Springs, Kidney Care Germany and Kidney Care Malaysia reporting units (fell short of) exceeded their total carrying amounts by approximately (9.9)%, 4.0%, 15.4%, 13.0% and 6.1%, respectively.

For the Company's at-risk HCP reporting units, further reductions in reimbursement rates, increases in medical costs, or other significant adverse changes in expected future cash flows or valuation assumptions could result in further goodwill impairment charges in the future. For example, a sustained, long-term reduction of 3% in operating income for HCP Nevada or HCP Florida could reduce their estimated fair values by up to 2.4% and 1.8%, respectively. Separately, an increase in their respective discount rates of 100 basis points could reduce the estimated fair values of HCP Nevada and HCP Florida by up to 3.6% and 3.7%, respectively.

Except as described above, none of the Company's various other reporting units was considered at risk of goodwill impairment as of March 31, 2016. Since the dates of the Company's last annual goodwill impairment tests, there have been certain developments, events, changes in operating performance and other changes in key circumstances that have affected the Company's businesses. However, except as further described above, these did not cause management to believe it is more likely than not that the fair value of any of its reporting units would be less than its carrying amount.

6. Health care costs payable

The following table includes estimates for the cost of professional medical services provided by non-employed physicians and other providers, as well as inpatient and other ancillary costs for all markets other than California. The Company does not include inpatient and other ancillary costs for contracts held by its California licensed health plan and for contracts held by its California medical group entities; only professional medical services are included as state regulation does not allow those medical group entities to assume risk for inpatient services. Health care costs payable are included in medical payables in the condensed consolidated balance sheet.

DAVITA HEALTHCARE PARTNERS INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(continued)

(unaudited)

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

The following table shows the components of changes in health care costs payable for the three months ended March 31, 2016:

	Three months ended March 31, 2016
Health care costs payable, beginning of the period	$212,641
Add: Components of incurred health care costs	
Current year	409,170
Prior years	5,354
Total incurred health care costs	414,524
Less: Claims paid	
Current year	232,310
Prior years	180,185
Total claims paid	412,495
Health care costs payable, end of the period	$214,670

The Company's prior year estimates of health care costs payable increased by $5,354 resulting from certain medical claims being settled for amounts more than originally estimated. When significant increases (decreases) in prior-year health care cost estimates occur that the Company believes significantly impacts its current year operating results, the Company discloses that amount as unfavorable (favorable) development of prior-year's health care cost estimates. Actual claim payments for prior year services have not been materially different from the Company's year-end estimates.

7. Income taxes

As of March 31, 2016, the Company's total liability for unrecognized tax benefits relating to tax positions that do not meet the more-likely-than-not threshold is $39,273, all of which would impact the Company's effective tax rate if recognized. This balance represents an increase of $262 from the December 31, 2015 balance of $39,011.

The Company recognizes accrued interest and penalties related to unrecognized tax benefits in its income tax expense. At March 31, 2016 and December 31, 2015, the Company had approximately $10,173 and $9,918, respectively, accrued for interest and penalties related to unrecognized tax benefits, net of federal tax benefits.

8. Long-term debt

Long-term debt was comprised of the following:

	March 31, 2016	December 31, 2015
Senior Secured Credit Facilities:		
Term Loan A	$912,500	$ 925,000
Term Loan B	3,438,750	3,447,500
Senior notes	4,500,000	4,500,000
Acquisition obligations and other notes payable	70,738	70,645
Capital lease obligations	287,783	283,185
Total debt principal outstanding	9,209,771	9,226,330
Discount and deferred financing costs	(91,950)	(95,985)
	9,117,821	9,130,345
Less current portion	(137,966)	(129,037)
	$8,979,855	$ 9,001,308

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DAVITA HEALTHCARE PARTNERS INC.

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Scheduled maturities of long-term debt at March 31, 2016 were as follows:

2016 (remainder of the year)	103,615
2017	154,525
2018	167,052
2019	741,960
2020	66,216
2021	3,297,308
Thereafter	4,679,095

During the first three months of 2016, the Company made mandatory principal payments under its Senior Secured Credit Facilities totaling $12,500 on the Term Loan A and $8,750 on the Term Loan B.

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

As of March 31, 2016, the Company maintains several interest rate swap agreements that were entered into in March 2013 with amortizing notional amounts totaling $724,375. These agreements have the economic effect of modifying the LIBOR variable component of the Company’s interest rate on an equivalent amount of the Company’s Term Loan A to fixed rates ranging from 0.49% to 0.52%, resulting in an overall weighted average effective interest rate of 2.26%, including the Term Loan A margin of 1.75%. The overall weighted average effective interest rate also includes the effects of $188,125 of unhedged Term Loan A debt that bears interest at LIBOR plus an interest rate margin of 1.75%. The swap agreements expire on September 30, 2016 and require monthly interest payments. During the three months ended March 31, 2016, the Company recognized debt expense of $151 from these swaps. As of March 31, 2016, the total fair value of these swap agreements was a net liability of approximately $25. During the three months ended March 31, 2016, the Company recorded a loss of $692 in other comprehensive income due to a decrease in the unrealized fair value of these swap agreements. The Company estimates that approximately $25 of existing unrealized pre-tax losses in other comprehensive income at March 31, 2016 will be reclassified into income over the next six months.

As of March 31, 2016, the Company maintains several forward interest rate cap agreements that were entered into in October 2015 with notional amounts totaling $3,500,000. These forward cap agreements will be effective June 29, 2018 and will have the economic effect of capping the LIBOR variable component of the Company's interest rate at a maximum of 3.50% on an equivalent amount of its debt. These cap agreements expire on June 30, 2020. As of March 31, 2016, the total fair value of these cap agreements was an asset of approximately $6,545. During the three months ended March 31, 2016, the Company recorded a loss of $7,270 in other comprehensive income due to a decrease in the unrealized fair value of these cap agreements.

As of March 31, 2016, the Company maintains several forward interest rate cap agreements that were entered into in November 2014 with notional amounts totaling $3,500,000. These forward cap agreements will be effective September 30, 2016 and will have the economic effect of capping the LIBOR variable component of the Company's interest rate at a maximum of 3.50% on an equivalent amount of the Company's debt. The cap agreements expire on June 30, 2018. As of March 31, 2016, the total fair value of these cap agreements was an asset of approximately $323. During the three months ended March 31, 2016, the Company recorded a loss of $989 in other comprehensive income due to a decrease in the unrealized fair value of these cap agreements.

As of March 31, 2016, the Company maintains several interest rate cap agreements that were entered into in March 2013 with notional amounts totaling $2,735,000 on the Company's Term Loan B debt. These agreements have the economic effect of capping the LIBOR variable component of the Company's interest rate at a maximum of 2.50% on an equivalent amount of the Company's

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Term Loan B. During the three months ended March 31, 2016, the Company recognized debt expense of $610 from these caps. The cap agreements expire on September 30, 2016. As of March 31, 2016, the total fair value of these cap agreements is immaterial.

The following table summarizes the Company's derivative instruments as of March 31, 2016 and December 31, 2015:

	March 31, 2016		December 31, 2015	
Derivatives designated as hedging instruments	Balance sheet location	Fair value	Balance sheet location	Fair value
Interest rate swap agreements	Other short-term liabilities	$ 25	Other short-term assets	$ 516
Interest rate cap agreements	Other long-term assets	$ 6,868	Other long-term assets	$ 15,127

The following table summarizes the effects of the Company's interest rate swap and cap agreements for the three months ended March 31, 2016 and 2015:

Derivatives designated as cash flow hedges	Amount of (losses) gains recognized in OCI on interest rate swap and cap agreements Three months ended March 31, 2016	2015	Location of losses reclassified from accumulated OCI into income	Amount of (losses) gains reclassified from accumulated OCI into income Three months ended March 31, 2016	2015
Interest rate swap agreements	$ (692)	$ (2,694)	Debt expense	$ (151)	$ (722)
Interest rate cap agreements	(8,259)	(6,757)	Debt expense	(610)	(610)
Tax benefit (expense)	3,482	3,691		296	520
Total	$ (5,469)	$ (5,760)		$ (465)	$ (812)

As of March 31, 2016, the interest rate on the Company's Term Loan B debt is effectively fixed subject to an embedded LIBOR floor which is higher than actual LIBOR as of such date. The Term Loan B is also subject to interest rate caps if LIBOR should rise above 2.50%. See above for further details. Interest rates on the Company's senior notes are fixed by their terms. The LIBOR variable component of the Company's interest rate on the majority of the Company's Term Loan A is economically fixed as a result of interest rate swaps.

As a result of embedded LIBOR floors on the Term Loan B debt agreement and the swap and cap agreements, the Company's overall weighted average effective interest rate on the Senior Secured Credit Facilities was 3.46%, based on the current margins in effect of 1.75% for the Term Loan A and 2.75% for the Term Loan B, as of March 31, 2016.

The Company's overall weighted average effective interest rate during the first quarter of 2016 was 4.40% and as of March 31, 2016 was also 4.40%.

As of March 31, 2016, the Company had undrawn revolving credit facilities totaling $1,000,000 of which approximately $91,178 was committed for outstanding letters of credit. In addition, the Company has approximately $1,286 of committed outstanding letters of credit related to HCP, which is backed by a certificate of deposit.

9. Contingencies

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

Inquiries by the Federal Government and Certain Related Civil Proceedings

Vainer Private Civil Suit: As previously disclosed, the Company received a subpoena for documents from the Office of Inspector General (OIG) for the U.S. Department of Health and Human Services (HHS) relating to the pharmaceutical products Zemplar, Hectorol, Venofer, Ferrlecit and erythropoietin (EPO), as well as other related matters, covering the period from January 2003 to December 2008. The Company subsequently learned that the allegations underlying this inquiry were made as part of a civil complaint filed by relators, Daniel Barbir and Dr. Alon Vainer, pursuant to the qui tam provisions of the federal False Claims Act. The

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relators also alleged that the Company's drug administration practices for the Company's dialysis operations for Vitamin D and iron agents from 2003 through 2010 fraudulently created unnecessary waste, which was billed to and paid for by the government. In

June 2015, the Company finalized the terms of the settlement with plaintiffs, including a settlement amount of $450,000 and attorney fees and other costs of $45,000 which was paid in 2015.

2011 U.S. Attorney Medicaid Investigation: In October 2011, the Company announced that it would be receiving a request for documents, which could include an administrative subpoena from the OIG. Subsequent to the Company's announcement of this 2011 U.S. Attorney Medicaid Investigation, the Company received a request for documents in connection with the inquiry by the U.S. Attorney's Office for the Eastern District of New York. The request related to payments for infusion drugs covered by Medicaid composite payments for dialysis. It is the Company's understanding that this inquiry is civil in nature. The Company understands further that certain other providers that operate dialysis clinics in New York may have received a similar request for documents. The Company cooperated with the government and produced the requested documents. In April 2014, the Company reached an agreement in principle with the government. In March 2016, the Company finalized and executed settlement agreements with the State of New York and the U.S. Department of Justice (DOJ), including a settlement payment of an immaterial amount.

Swoben Private Civil Suit: In April 2013, the Company's HCP subsidiary was served with a civil complaint filed by a former employee of SCAN Health Plan (SCAN), a health maintenance organization (HMO). On July 13, 2009, pursuant to the qui tam provisions of the federal False Claims Act (FCA) and the California False Claims Act, James M. Swoben, as relator, filed a qui tam action in the United States District Court for the Central District of California purportedly on behalf of the United States of America and the State of California against SCAN, and certain other defendants whose identities were under seal. The allegations in the complaint relate to alleged overpayments received from government healthcare programs. In or about August 2012, SCAN entered into a Settlement Agreement with the United States of America and the State of California. The United States and the State of California partially intervened in the action for the purpose of settlement with and dismissal of the action against SCAN. In or about November 2011, the relator filed his Third Amended Complaint under seal alleging violations of the federal FCA and the California False Claims Act, which named additional defendants, including HCP and certain health insurance companies (the defendant HMOs). The allegations in the complaint against HCP relate to patient diagnosis c