

TILLY'S, INC.  
Form SC 13D/A  
July 27, 2018

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**

**SCHEDULE 13D**  
**Under the Securities Exchange Act of 1934**  
**(Amendment No. 7)\***

**TILLY S, INC.**

**(Name of Issuer)**

**Class A Common Stock**

**(Title of Class of Securities)**

**886885102**

**(CUSIP Number)**

**Michael L. Henry**

**Tilly s, Inc.**

**10 Whatney**

**Irvine, California 92618**

**(Name, Address and Telephone Number of Person Authorized to Receive Notices and Communications)**

**July 27, 2018**

**(Date of Event which Requires Filing of this Statement)**

If the filing person has previously filed a statement on Schedule 13G to report the acquisition which is subject of this Schedule 13D, and is filing this statement because of Rule 13d-1(e), 13d-1(f) or 13d-1(g), check the following box.

**Note:** Schedules filed in paper format shall include a signed original and five copies of the schedule, including all exhibits. See Rule 13d-7(b) for other parties to whom copies are to be sent.

- \* The remainder of this cover page shall be filled out for a reporting person's initial filing on this form with respect to the subject class of securities, and for any subsequent amendment containing information which would alter disclosures provided in a prior cover page.
- The information required on the remainder of this cover page shall not be deemed to be filed for the purpose of Section 18 of the Securities Exchange Act of 1934 (the Act) or otherwise subject to the liabilities of that section of the Act but shall be subject to all other provisions of the Act (however, see the Notes).

CUSIP No. 886885102

13D

Page 1 of 9 Pages

1. Name of Reporting Person:

**Hezy Shaked**

2. Check the Appropriate Box if a Member of a Group (See Instructions):

(a)        (b)

3. SEC Use Only:

4. Source of Funds:

OO

5. Check if Disclosure of Legal Proceedings is Required Pursuant to Items 2(d) or 2(e)

6. Citizenship or Place of Organization:

United States, Israel

Number of    7. Sole Voting Power:

Shares

Beneficially    12,510,952

8. Shared Voting Power:

Owned By

Each

Reporting    530,611

9. Sole Dispositive Power:

Person

With:        9,177,805

10. Shared Dispositive Power:

530,611

11. Aggregate Amount Beneficially Owned by Each Reporting Person:

13,041,563

12. Check if the Aggregate Amount in Row (11) Excludes Certain Shares:

13. Percent of Class Represented By Amount in Row (11):

44.4%

14. Type of Reporting Person:

IN

CUSIP No. 886885102

13D

Page 2 of 9 Pages

1. Name of Reporting Person:

**Tilly Levine**

2. Check the Appropriate Box if a Member of a Group (See Instructions):

(a)        (b)

3. SEC Use Only:

4. Source of Funds:

OO

5. Check if Disclosure of Legal Proceedings is Required Pursuant to Items 2(d) or 2(e)

6. Citizenship or Place of Organization:

United States, Israel

Number of    7. Sole Voting Power:

Shares

Beneficially    0

8. Shared Voting Power:

Owned By

Each

648,772

Reporting    9. Sole Dispositive Power:

Person

With:        3,333,147

10. Shared Dispositive Power:

648,772

11. Aggregate Amount Beneficially Owned by Each Reporting Person:

3,981,919

12. Check if the Aggregate Amount in Row (11) Excludes Certain Shares:

13. Percent of Class Represented By Amount in Row (11):

13.6%

14. Type of Reporting Person:

IN

CUSIP No. 886885102

13D

Page 3 of 9 Pages

1. Name of Reporting Person:

**Tilly Levine, Trustee HS Annuity Trust dated August 6, 2010 Trust for Netta Shaked-Schroer**

2. Check the Appropriate Box if a Member of a Group (See Instructions):

(a)        (b)

3. SEC Use Only:

4. Source of Funds:

OO

5. Check if Disclosure of Legal Proceedings is Required Pursuant to Items 2(d) or 2(e)

6. Citizenship or Place of Organization:

California

Number of    7. Sole Voting Power:

Shares

Beneficially    0

8. Shared Voting Power:

Owned By

Each

324,386

Reporting    9. Sole Dispositive Power:

Person

With:        0

10. Shared Dispositive Power:

324,386

11. Aggregate Amount Beneficially Owned by Each Reporting Person:

324,386

12. Check if the Aggregate Amount in Row (11) Excludes Certain Shares:

13. Percent of Class Represented By Amount in Row (11):

1.1%

14. Type of Reporting Person:

OO (Trust)



CUSIP No. 886885102

13D

Page 4 of 9 Pages

1. Name of Reporting Person:

**Tilly Levine, Trustee HS Annuity Trust dated August 6, 2010 Trust for Amy Shaked-Diaz**

2. Check the Appropriate Box if a Member of a Group (See Instructions):

(a)        (b)

3. SEC Use Only:

4. Source of Funds:

OO

5. Check if Disclosure of Legal Proceedings is Required Pursuant to Items 2(d) or 2(e)

6. Citizenship or Place of Organization:

California

Number of    7. Sole Voting Power:

Shares

Beneficially    0

8. Shared Voting Power:

Owned By

Each

324,386

Reporting    9. Sole Dispositive Power:

Person

With:        0

10. Shared Dispositive Power:

324,386

11. Aggregate Amount Beneficially Owned by Each Reporting Person:

324,386

12. Check if the Aggregate Amount in Row (11) Excludes Certain Shares:

13. Percent of Class Represented By Amount in Row (11):

1.1%

14. Type of Reporting Person:

OO (Trust)

CUSIP No. 886885102

13D

Page 5 of 9 Pages

1. Name of Reporting Person:

**Reid Investments, LLC**

2. Check the Appropriate Box if a Member of a Group (See Instructions):

(a)        (b)

3. SEC Use Only:

4. Source of Funds:

OO

5. Check if Disclosure of Legal Proceedings is Required Pursuant to Items 2(d) or 2(e)

6. Citizenship or Place of Organization:

Delaware

Number of 7. Sole Voting Power:

Shares

Beneficially 0

8. Shared Voting Power:

Owned By

Each

Reporting 530,611

9. Sole Dispositive Power:

Person

With: 0

10. Shared Dispositive Power:

530,611

11. Aggregate Amount Beneficially Owned by Each Reporting Person:

530,611

12. Check if the Aggregate Amount in Row (11) Excludes Certain Shares:

13. Percent of Class Represented By Amount in Row (11):

1.8%

14. Type of Reporting Person:

OO (Limited Liability Company)

### Explanatory Note

This Amendment No. 7 to Schedule 13D (this Amendment No. 7 ) amends and supplements the Schedule 13D originally filed with the United States Securities and Exchange Commission (the SEC ) on February 24, 2016 (the Original Statement and, together with all amendments thereto, this Statement ), relating to the Class A common stock, par value \$0.001 per share (the Class A Common Stock ), of Tilly's Inc., a Delaware corporation (the Issuer ). Capitalized terms used herein without definition shall have the meaning set forth in the Original Statement.

#### Item 4. Purpose of Transaction

Item 4 of the Statement is hereby amended by replacing the information contained under the subheading 10b5-1 Plans in its entirety with the following:

##### *10b5-1 Plans*

The Hezy Shaked Living Trust UAD 5/18/1999, of which Mr. Shaked is the trustee and beneficiary (the Hezy Shaked Living Trust ), entered into a stock trading plan on December 14, 2017, each of The Tilly Levine Separate Property Trust Established March 31, 2004, of which Ms. Levine is the trustee and beneficiary (the Tilly Levine Separate Property Trust ), Trust I and Trust II entered into a separate stock trading plan on June 13, 2018, and the LLC entered into a stock trading plan on June 12, 2018, each in accordance with Rule 10b5-1 of the Securities Exchange Act of 1934 (each, a 10b5-1 Plan ), pursuant to which each of the Hezy Shaked Living Trust, the Tilly Levine Separate Property Trust, Trust I, Trust II or the LLC, respectively, may sell a certain number of shares of the Issuer's Class A Common Stock (which would be converted at the time of sale, on a one-to-one basis, from Class B Common Stock held by such Reporting Person) in specified amounts at market prices subject to specified limitations. Each of the 10b5-1 Plans for the Hezy Shaked Living Trust, the Tilly Levine Separate Property Trust, Trust I, Trust II or the LLC expires on the earliest of (1) December 20, 2018, September 6, 2019, July 16, 2019, July 16, 2019 and July 17, 2019, respectively, (2) the sale of all of the shares specified under the respective 10b5-1 Plan, (3) the date that the stock trading plan is terminated, or (4) the date the respective seller undergoes a dissolution.

The description contained in this Statement of each of the 10b5-1 Plans is a summary only and is qualified in its entirety by the form of 10b5-1 plan that is filed as an exhibit to this Statement and is incorporated herein by this reference. See Item 7 Material to be Filed as Exhibits.

#### Item 5. Interest in Securities of the Issuer

Item 5 of the Statement is amended and restated in its entirety by inserting the following information:

(a) and (b)

The following sets forth, as of the date of this Amendment No. 7, the aggregate number and percentage of shares of Class A Common Stock beneficially owned by each of the Reporting Persons, as well as the number of shares of Class A Common Stock as to which each Reporting Person has the sole power to vote or to direct the vote, sole power to dispose or to direct the disposition, or shared power to dispose or to direct the disposition of as of the date hereof, based upon 15,392,584 shares of Class A Common Stock and 13,848,497 shares of Class B Common Stock outstanding as of June 8, 2018, as reported in the Issuer's most recent Quarterly Report on Form 10-Q filed on June 13, 2018. The information set forth below assumes the conversion of all shares of Class B Common Stock into Class A Common Stock on a one-for-one basis. Holders of Class B Common Stock are entitled to ten votes per share on all

matters to be voted on by the Issuer's common stockholders.

Reporting Person	Amount beneficially owned	Percent of class	Sole power to vote or to direct the vote	Shared power to vote or to direct the vote	Sole power to dispose or to direct the disposition of	Shared power to dispose or to direct the disposition of
Hezy Shaked	13,041,563(1)	44.4%	12,510,952	530,611	9,177,805	530,611
Tilly Levine	3,981,919(2)	13.6%	0	648,772	3,333,147	648,772
Tilly Levine, Trustee HS Annuity Trust dated August 6, 2010 Trust for Netta Shaked-Schroer	324,386	1.1%	0	324,386	0	324,386
Tilly Levine, Trustee HS Annuity Trust dated August 6, 2010 Trust for Amy Shaked-Diaz	324,386	1.1%	0	324,386	0	324,386
Reid Investments, LLC	530,611	1.8%	0	530,611	0	530,611

- (1) Includes (a) 9,077,805 shares of Class B Common Stock held by The Hezy Shaked Living Trust, of which Mr. Shaked is the trustee and beneficiary with sole voting and dispositive power, (b) 3,333,147 shares of Class B Common Stock held by The Tilly Levine Separate Property Trust, of which Ms. Levine is the trustee and beneficiary, over which Mr. Shaked has sole voting power pursuant to a voting trust agreement with Ms. Levine, (c) 530,611 shares of Class A Common Stock held by the LLC, for which Mr. Shaked serves as sole manager with sole voting and investment control over the securities held thereby, and (d) 100,000 shares of Class A Common Stock underlying an option granted to Mr. Shaked, of which 25,000 shares vested and became exercisable on March 24 of each of 2015, 2016, 2017 and 2018. See Item 6 of the Original Statement.
- (2) Includes (a) 3,333,147 shares of Class B Common Stock held by The Tilly Levine Separate Property Trust of which Ms. Levine is the sole trustee and beneficiary (the Levine Shares ), and (b) 324,386 shares of Class B Common Stock held by each of Trust I and Trust II, of which Ms. Levine is trustee (648,772 shares in total). Pursuant to a voting trust agreement with Mr. Shaked, Ms. Levine has granted Mr. Shaked, as trustee under the agreement, the right to vote the Levine Shares. Ms. Levine retains dispositive power over and full economic interest in the Levine Shares. See Item 6 of the Original Statement.
- (c) From April 9, 2018, the date that the Amendment No. 6 to this Statement ( Amendment No. 6 ) was filed with the Commission, through July 27, 2018, the Reporting Persons disposed of an aggregate of 300,000 shares of Class A Common Stock of the Issuer in a series of transactions at prices ranging from \$10.80 to \$16.20 per share in open market transactions on the New York Stock Exchange pursuant to the 10b5-1 Plans related to each respective Reporting Person. The number of shares of Class A Common Stock disposed of and the weighted average price per share are provided below. The Reporting Persons undertake to provide, upon request by the staff of the SEC, the Issuer, or a security holder of the Issuer, full information regarding the number of shares sold at each separate price for each transaction.

Reporting Person	Date	Shares Disposed	Weighted Average
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		<b>of</b>	<b>Price per Share</b>
Tilly Levine	April 10, 2018	10,000	\$ 12.0417
Tilly Levine	April 11, 2018	10,000	\$ 11.9883
Trust I	April 17, 2018	5,000	\$ 11.9434
Trust II	April 17, 2018	5,000	\$ 11.9390
The LLC	April 18, 2018	10,000	\$ 11.8537
Tilly Levine	April 26, 2018	10,000	\$ 11.4266
Tilly Levine	April 27, 2018	10,000	\$ 11.3401
The LLC	May 8, 2018	10,000	\$ 11.1168
Trust I	May 9, 2018	5,000	\$ 11.0738
Trust II	May 9, 2018	5,000	\$ 11.0689
Hezy Shaked	May 10, 2018	10,000	\$ 10.9102
Hezy Shaked	May 11, 2018	10,000	\$ 11.0871
Tilly Levine	May 14, 2018	10,000	\$ 11.1090
Tilly Levine	May 15, 2018	10,000	\$ 11.2384
Tilly Levine	May 30, 2018	10,000	\$ 12.1018
Tilly Levine	May 31, 2018	10,000	\$ 13.7231
Hezy Shaked	June 7, 2018	10,000	\$ 15.7155
Hezy Shaked	June 8, 2018	10,000	\$ 15.5724
Tilly Levine	June 12, 2018	10,000	\$ 14.9018
Tilly Levine	June 13, 2018	10,000	\$ 14.8329



<b>Reporting Person</b>	<b>Date</b>	<b>Shares Disposed of</b>	<b>Weighted Average Price per Share</b>
The LLC	June 18, 2018	10,000	\$ 15.0724
Trust I	June 22, 2018	5,000	\$ 14.6747
Trust II	June 22, 2018	5,000	\$ 14.6784
Tilly Levine	June 27, 2018	10,000	\$ 15.0953
Tilly Levine	June 28, 2018	10,000	\$ 15.1239
Tilly Levine	July 11, 2018	10,000	\$ 14.5874
Tilly Levine	July 12, 2018	10,000	\$ 14.6469
Trust I	July 16, 2018	5,000	\$ 15.0617
Trust II	July 16, 2018	5,000	\$ 15.0646
The LLC	July 18, 2018	10,000	\$ 15.1759
Tilly Levine	July 24, 2018	10,000	\$ 15.1110
Tilly Levine	July 25, 2018	10,000	\$ 15.4001
Hezy Shaked	July 26, 2018	10,000	\$ 15.6293
Hezy Shaked	July 27, 2018	10,000	\$ 15.2440

Except for the transactions disclosed in this Item 5(c), none of the Reporting Persons has effected any transactions in the securities of the Issuer in the 60 days preceding the filing date of this Amendment No. 7.

(d) None.

(e) Not applicable.

**Item 7. Material to be Filed as Exhibits.****Exhibit**

<b>Number</b>	<b>Description</b>
1	Tilly Levine Voting Trust Agreement, dated June 30, 2011, by and between Hezy Shaked and Tilly Levine (incorporated by reference to Exhibit 1 of the Schedule 13D filed by the Reporting Persons with the Commission on February 24, 2016).
2	First Amendment to the Tilly Levine Voting Trust Agreement, dated December 4, 2012, by and between Hezy Shaked and Tilly Levine (incorporated by reference to Exhibit 2 of the Schedule 13D filed by the Reporting Persons with the Commission on February 24, 2016).
3	Second Amendment to the Tilly Levine Voting Trust Agreement, dated May 25, 2017, by and between Hezy Shaked and Tilly Levine (incorporated by reference to Exhibit 3 of the Schedule 13D filed by the Reporting Persons with the Commission on May 25, 2017).
4	Form of 10b5-1 Plan (incorporated by reference to Exhibit 3 of the Schedule 13D filed by the Reporting Persons with the Commission on November 22, 2016).
5	Joint Filing Agreement (incorporated by reference to Exhibit 4 of Amendment No. 1 to the Schedule 13D filed by the Reporting Persons with the Commission on November 22, 2016).

**SIGNATURE**

After reasonable inquiry and to the best of my knowledge and belief, I certify that the information set forth in this statement is true, complete and correct.

Dated: July 27, 2018

/s/ Hezy Shaked  
Hezy Shaked

/s/ Tilly Levine  
Tilly Levine

**Tilly Levine, Trustee HS Annuity Trust  
dated August 6, 2010 Trust for Netta  
Shaked-Schroer**

/s/ Tilly Levine  
Tilly Levine

Trustee

**Tilly Levine, Trustee HS Annuity Trust  
dated August 6, 2010 Trust for Amy  
Shaked-Diaz**

/s/ Tilly Levine  
Tilly Levine

Trustee

**Reid Investments, LLC**

a Delaware limited liability company

/s/ Hezy Shaked  
Hezy Shaked

Manager

criminal or civil penalties, including significant fines; claims by people who believe their health information has been improperly used or disclosed; and administrative penalties by payors.

Government investigations of health care providers, including dialysis providers, have continued to increase. We have been the subject of investigations in the past, and the government may investigate our business in the future. One of our competitors, DaVita, Inc., has announced that it is the subject of an investigation by the U.S. Attorney for the Eastern District of Pennsylvania, and another competitor, Gambro Healthcare, Inc., has announced that it is the subject of an investigation by the U.S. Attorney's Office in St. Louis, Missouri. If any of our operations are found to violate applicable laws, then we may be subject to severe sanctions, or we could be required to alter or discontinue the challenged conduct or both. If we are required to alter our practices, we may not be able to do so successfully. If any of these events occurs, our revenue and earnings could decline.

**If Our Joint Ventures are Found to Violate the Law, Our Business Could Be Damaged**

A number of the dialysis centers we operate are owned by joint ventures in which we own a controlling interest and one or more physicians or physician practice groups maintain a minority interest. The physician owners also may provide medical director services to those centers and/or other centers we own and operate. Because our relationships with physicians are governed by the Anti-Kickback Statute, we have sought to satisfy as many safe harbor requirements as possible in structuring these joint venture arrangements. However, our joint venture arrangements do not satisfy all elements of a safe harbor. Also, we believe we have structured the physician relationships in these joint ventures in a way that meets applicable exceptions under the Stark Law or that otherwise complies with the Stark Law. If the joint ventures were found to be in violation of the Anti-Kickback Statute or the Stark Law, we could be required to restructure them or refuse to accept referrals for designated health services from the physicians with whom the joint venture centers have a relationship. We also could be required to repay to Medicare amounts received by the joint ventures pursuant to prohibited referrals, and we could be subject to monetary penalties. If the joint venture centers are subject to any of these penalties, our business could be damaged.

**Changes in the Health Care Delivery, Financing or Reimbursement Systems Could Adversely Affect Our Business**

The health care industry in the United States may be entering a period of change and uncertainty. Health care organizations, public or private, may dramatically change the way they operate and pay for services. Our business is designed to function within the current health care financing and reimbursement system. During the past several years, the health care industry has been subject to increasing levels of government regulation of, among other things, reimbursement rates and relationships with referring physicians. In addition, proposals to reform the health care system have been considered by Congress. In light of the continued increases in the cost of health care and the current economic weakness, there may be new proposals to change the health care system and control costs. These proposals, if enacted, could further increase the government's oversight role and involvement in health care, lower reimbursement rates and otherwise change the operating environment for health care companies. We cannot predict the likelihood of those events or what impact they may have on our business.

## **Table of Contents**

### **The Dialysis Business Is Highly Competitive. If We Do Not Compete Effectively in Our Markets, Then We Could Lose Market Share and Our Rate of Growth Could Slow**

The dialysis industry is largely consolidated, and the consolidation trend continues as large providers acquire smaller providers. There is a small number of large dialysis companies that compete for the acquisition of outpatient dialysis centers and the development of relationships with referring physicians. Two of our major competitors are part of larger companies that also manufacture dialysis equipment, which allows them to benefit from lower equipment costs. Several of our competitors, including these equipment manufacturers, are larger than we are and have greater financial resources and more established operations. We may also face competition from new entrants into the market, including centers established by former medical directors or other referring physicians. We cannot assure you that we will be able to compete effectively with any of our competitors.

### **If We Lose Any of Our Executive Officers, Then Our Ability To Run Our Business Could be Adversely Affected, and Our Revenue and Earnings Could Decline**

We depend on the services of our executive officers William P. Johnston, our chairman of the board, Gary A. Brukardt, our president and chief executive officer, Raymond M. Hakim, M.D., Ph.D., David M. Dill and Timothy P. Martin, each an executive vice president, and Douglas B. Chappell, our general counsel. Mr. Brukardt and Dr. Hakim have each been with Renal Care Group since 1996. The services of our executive officers would be difficult to replace. We selected Mr. Johnston as our chairman, Mr. Brukardt as our president and chief executive officer, Mr. Dill as our chief financial officer and Mr. Martin as executive vice president, operations in 2003.

### **If We are Unable to Make Acquisitions in the Future, Then Our Rate of Growth Will Slow**

Much of our historical growth has come from acquisitions. Although we intend to continue to pursue growth through the acquisition of dialysis centers, we may be unable to identify and complete suitable acquisitions at prices we are willing to pay, or we may be unable to obtain the necessary financing. Further, due to the increased size of our business, the amount that acquired businesses contribute to our revenue and profits will continue to be smaller on a percentage basis. Also, as a result of consolidation in the dialysis industry, as of December 31, 2003, the four largest providers of outpatient dialysis services owned approximately 66% of the outpatient dialysis facilities in the United States. We compete with these other companies to identify and complete suitable acquisitions. We expect this competition to intensify in light of the smaller pool of available acquisition candidates and other market forces. As a result, we believe it will be more difficult for us to acquire suitable companies on favorable terms. Further, the businesses we acquire may not perform well enough to justify our investment. If we are unable to make additional acquisitions on suitable terms, then we may not meet our growth expectations.

### **If We Complete Future Acquisitions, We May Dilute Existing Stockholders by Issuing More of Our Common Stock or We May Incur Expenses Related to Debt and Goodwill, Which Could Reduce Our Earnings**

We may issue equity securities in future acquisitions that could be dilutive to our shareholders. We also may incur additional debt in future acquisitions. Interest expense on debt incurred to fund our acquisitions may significantly reduce our profitability. While goodwill and other intangible assets with indefinite lives are not amortized to expense under generally accepted accounting principles, we are required to review all of these assets at regular intervals for impairment and to charge an appropriate amount to expense when we identify impairment. If we identify impairment and are required to write off a significant portion of our intangible assets at one time, then there could be a material adverse impact on our stock price.

### **If We Complete our Acquisition of National Nephrology Associates and Planned Share Repurchases, Then We Will Have Substantial Leverage**

We have announced a definitive agreement to acquire National Nephrology Associates and our intention to repurchase \$250.0 million of our common stock between November 1, 2003 and March 31, 2004. If we complete both of these initiatives as planned, then we will have indebtedness of more than \$475.0 million and will incur substantial interest expense in 2004 and beyond. For the last several years, we have had very little indebtedness coupled with strong cash flow, which have given us substantial financial flexibility. Our new level of indebtedness could restrict our ability to make

## **Table of Contents**

investments in our business or to expand it through the development of new facilities, to make other acquisitions or to acquire additional common stock. In addition, we are or will be subject to a number of covenants in the agreements governing this indebtedness that could restrict the way we do business, acquire new businesses and repurchase common stock.

### **If We Fail to Integrate Acquired Companies, Then We Will be Less Profitable**

We have grown significantly by acquisitions of other dialysis providers since our formation. We recently acquired Midwest Kidney Centers and announced a definitive agreement to acquire National Nephrology Associates, Inc. and we intend to pursue acquisitions of more dialysis businesses in the future. We are unable to predict the number and size of any future acquisitions. We face significant challenges in integrating an acquired company's management and other personnel, clinical operations, and financial and operating systems with ours, often without the benefit of continued services from key personnel of the acquired company. We face these challenges particularly in larger acquisitions like the acquisition of National Nephrology Associates. We may be unable to integrate the businesses we acquire successfully or to achieve anticipated benefits from an acquisition in a timely manner, which could lead to substantial costs and delays or other operational, technical or financial problems, including diverting management's attention from our existing business. Any of these results could damage our profitability and our prospects for future growth.

### **If Acquired Businesses Have Unknown Liabilities, Then We Could be Exposed to Liabilities That Could Harm Our Business and Profitability**

Businesses we acquire may have unknown or contingent liabilities, including liabilities for failure to comply with health care laws. Although we generally attempt to identify practices that may give rise to unknown or contingent liabilities and conform them to our standards after the acquisition, private plaintiffs or governmental agencies may still assert claims. Even though we generally seek to obtain indemnification from the sellers of businesses we buy, unknown and contingent liabilities may not be covered by indemnification or may exceed contractual limits or the financial capacity of the indemnifying party.

### **If Our Costs of Insurance and Claims Increase, Then Our Earnings Could Decrease**

We currently maintain programs of general and professional liability insurance and directors' and officers' insurance with significant deductible or self-insured retention amounts on each claim. In addition, we generally self-insure our employee health plan and workers compensation program, while maintaining excess insurance for some very large claims. We have accepted higher deductibles and self-insurance exposure in each of the last several years to offset part of the increases in premiums for the programs. These deductibles and premiums increased substantially in 2002 and 2003. Our earnings could be materially and adversely affected by any of the following:

further increases in premiums, deductibles and self-insurance retentions;

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

an inability to obtain one or more types of insurance on acceptable terms.

### **If Our Board of Directors Does Not Approve an Acquisition or Change in Control, Then Our Shareholders May Not Realize the Full Value of Their Stock**

Our certificate of incorporation and bylaws contain a number of provisions that may delay, deter or inhibit a future acquisition or change in control that is not first approved by our board of directors. This could occur even if our shareholders receive an attractive offer for their shares or if a substantial number or even a majority of our shareholders believe the takeover is in their best interest. These provisions are intended to encourage any person interested in acquiring Renal Care Group to negotiate with and obtain approval from our board of directors before pursuing a transaction. Provisions that could delay, deter or inhibit a future acquisition or change in control include the following:

**Table of Contents**

a staggered board of directors that would require two annual meetings to replace a majority of the board of directors;

restrictions on calling special meetings at which an acquisition or change in control might be brought to a vote of the shareholders;

blank check preferred stock that may be issued by our board of directors without shareholder approval and that may be substantially dilutive or contain preferences or rights objectionable to an acquiror; and

a poison pill that would substantially dilute the interest sought by an acquiror.

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

**Our Stock Price Is Volatile and as a Result, the Value of Your Investment May Go Down for Reasons Unrelated To the Performance of Our Business**

Our common stock is traded on the New York Stock Exchange. The market price of our common stock has been volatile, ranging from a low closing price of \$28.05 per share to a high closing price of \$41.62 per share during the year ended December 31, 2003. The market price for our common stock could fluctuate substantially based on a variety of factors, including the following:

future announcements concerning us, our competitors or the health care market;

the threat of litigation or government investigation;

changes in government regulations; and

changes in earnings estimates by analysts.

Furthermore, stock prices for many companies fluctuate widely for reasons that may be unrelated to their operating results. These fluctuations, coupled with changes in demand or reimbursement levels for our services and general economic, political and market conditions, could cause the market price of our common stock to decline.

**Table of Contents****Item 2. Properties****PROPERTIES**

As of December 31, 2003, we operated 284 dialysis centers in 27 states, of which 251 are located in leased facilities and 33 are owned. The following is a summary of our outpatient dialysis centers by state.

**OUTPATIENT FACILITIES BY STATE**

Alabama	4
Alaska	2
Arizona	31
Arkansas	10
Colorado	2
Florida	7
Idaho	1
Illinois	18
Indiana	27
Kansas	12
Kentucky	3
Louisiana	1
Michigan	6
Mississippi	33
Missouri	10
Nebraska	2
New Jersey	3
New Mexico	3
Ohio	22
Oklahoma	4
Oregon	10
Pennsylvania	11
South Carolina	3
Tennessee	6
Texas	41
Washington	10
Wisconsin	2
	<hr/>
TOTAL	284
	<hr/>

Some of our centers are leased from physicians who practice at the center and who are stockholders. Our leases generally have terms ranging from one to 15 years and typically contain renewal options. The size of our centers ranges from approximately 1,000 to 25,000 square feet. We lease office space in Nashville, Tennessee for our corporate headquarters under a lease that expires in 2009. We lease other office space in and around Nashville, Tennessee for certain billing and computer operations. We consider our physical properties to be in good operating condition and suitable for the purposes for which they are being used.

Expansion or relocation of our dialysis centers is subject to compliance with conditions relating to participation in the Medicare ESRD program. In states that require a certificate of need, approval of a certificate of need application is usually necessary for expansion of an existing dialysis center or development of a new center.

We generally own the equipment used in our outpatient centers. We consider our equipment generally to be in good operating condition and suitable for the purposes for which it is being used.





**Table of Contents**

**Item 3. *Legal Proceedings***

On August 30, 2000, 19 patients were hospitalized and one patient died shortly after becoming ill while receiving treatment at one of our dialysis centers in Youngstown, Ohio. One of the 19 hospitalized patients also died some time later.

In March 2001, we were sued in Mahoning County, Ohio by one of the affected patients for injuries related to the August 30, 2000 illnesses. Ten additional suits were filed, and as of December 31, 2003, a total of five of these suits were pending. The suits allege negligence, medical malpractice and product liability. Additional defendants are named in each of the suits. Additional defendants in some of the suits include the water system vendors who installed and maintained the water system in the dialysis center. We have denied the allegations and have filed cross-claims against the water system vendors. We intend to pursue these cross-claims vigorously.

Management believes that our insurance should be adequate to cover these illnesses and does not anticipate a material adverse effect on our consolidated financial position or results of operation.

In addition, we are subject to claims and suits in the ordinary course of business, including those arising from patient treatment, and we believe these claims and suits will be covered by our liability insurance and reserves we have established to satisfy these claims.

**Item 4. *Submission of Matters to a Vote of Security Holders***

We did not submit any matter to a vote of our shareholders during the fourth quarter of 2003.

**Table of Contents****PART II****Item 5. Market for Company's Common Equity and Related Stockholder Matters.****PRICE RANGE OF COMMON STOCK**

The Company's common stock is traded on the New York Stock Exchange under the symbol "RCI". The following table sets forth the quarterly high and low closing sales prices as reported on the New York Stock Exchange for the last two fiscal years.

2002	High	Low
First quarter	\$33.65	\$28.30
Second quarter	\$35.80	\$31.15
Third quarter	\$33.65	\$27.72
Fourth quarter	\$34.01	\$30.35
2003	High	Low
First quarter	\$31.60	\$28.05
Second quarter	\$35.21	\$30.00
Third quarter	\$37.60	\$34.05
Fourth quarter	\$41.62	\$33.04

**HOLDERS**

As of February 26, 2004, the approximate number of registered stockholders was 166, and the Company had approximately 11,000 beneficial owners.

**DIVIDEND POLICY**

Renal Care Group has never paid any cash dividend on its capital stock. Renal Care Group currently anticipates that all of its earnings will be retained to finance the growth and development of its business or to repurchase common stock. Renal Care Group does currently not anticipate that any cash dividend will be declared or paid on the common stock in the foreseeable future. Any future declaration of dividends will be subject to the discretion of Renal Care Group's Board of Directors and its review of Renal Care Group's earnings, financial condition, capital requirements and surplus, contractual restrictions to pay such dividends and other factors the Board of Directors deems relevant.

**SALES OF UNREGISTERED SECURITIES**

There were no sales of unregistered securities during the year ended December 31, 2003.

**Table of Contents****Securities Authorized for Issuance Under Equity Compensation Plans** (number of shares in thousands)

The following table summarizes our equity compensation plans as of December 31, 2003:

Plan Category (1)	Number of Shares to Be Issued Upon Exercise of Outstanding Options, Warrants And Rights (a)	Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights (b)	Number of Shares Remaining Available For Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected In Column (a) (c)
Equity compensation plans approved by Stockholders	5,646	\$ 26.50	1,242
Equity compensation plans not approved by Stockholders (2)	353	\$ 12.86	—
<b>Total</b>	<b>5,999</b>	<b>\$ 25.70</b>	<b>1,242</b>

(1) Renal Care Group currently has three option plans that were assumed in connection with a merger, acquisition or other transaction. The first such plan was adopted by Renal Disease Management by Physicians, Inc. (RDM) in 1997 under which there are nine options issued and outstanding to purchase shares at a weighted average exercise price of \$19.65. The second plan was adopted by Dialysis Centers of America, Inc. (DCA) in 1995 under which there are 16 options issued and outstanding to purchase shares at a weighted average exercise price of \$25.58. The third plan was adopted in 1994 and there are eight options issued and outstanding under such plan to purchase shares at a weighted average exercise price of \$3.33.

(2) These options were issued outside of our existing stock options plans to certain employees, officers, directors, and other key persons. These options vest over various periods up to five years and have a term of ten years from the date of issuance.

Further information concerning these plans is incorporated by reference to Footnote 8 in the Consolidated Financial Statements included in this annual report.

**Table of Contents****Item 6. Selected Financial Data**

The selected financial data for the years ended December 31, 1999, 2000, 2001, 2002 and 2003 are derived from the audited consolidated financial statements of the Company and its subsidiaries. The consolidated financial statements and related notes for the years ended December 31, 2001, 2002 and 2003, together with the related Report of Independent Auditors are included elsewhere in this annual report on Form 10-K. Please read the following data in conjunction with the financial statements and related notes and Management's Discussion and Analysis of Financial Condition and Results of Operations that appear elsewhere in this annual report on Form 10-K.

Selected Financial Data  
(in thousands, except per share data)

	Year Ended December 31,				
	1999	2000	2001	2002	2003
<b>INCOME STATEMENT DATA:</b>					
Net revenue	\$ 541,895	\$ 622,575	\$ 755,082	\$ 903,387	\$ 1,005,319
Patient care costs	351,367	402,009	489,271	589,696	653,307
General and administrative expenses	51,315	57,104	64,530	78,079	90,249
Provision for doubtful accounts	14,632	16,949	20,290	23,501	26,200
Depreciation and amortization	27,835	32,321	38,945	40,432	44,905
Restructuring charge		9,235			
Merger expenses	4,300	3,766			
Total operating costs and expenses	449,449	521,384	613,036	731,708	814,661
Income from operations	92,446	101,191	142,046	171,679	190,658
Interest expense, net	6,224	5,015	2,636	1,140	629
Income before minority interest and income taxes	86,222	96,176	139,410	170,539	190,029
Minority interest	7,768	10,011	15,478	21,410	25,431
Income before income taxes	78,454	86,165	123,932	149,129	164,598
Provision for income taxes	31,367	34,706	47,331	56,669	62,542
Net income	\$ 47,087	\$ 51,459	\$ 76,601	\$ 92,460	\$ 102,056
Basic net income per share	\$ 1.05	\$ 1.12	\$ 1.59	\$ 1.89	\$ 2.11
Basic weighted average shares outstanding	45,015	46,048	48,113	48,978	48,479
Diluted net income per share	\$ 1.00	\$ 1.07	\$ 1.52	\$ 1.82	\$ 2.05
Diluted weighted average shares outstanding	47,052	47,948	50,433	50,767	49,835

December 31,				
1999	2000	2001	2002	2003

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BALANCE SHEET DATA:					
Working capital	\$ 73,651	\$ 108,915	\$ 104,047	\$ 110,481	\$ 122,667
Total assets	500,906	582,672	651,049	740,123	819,873
Long-term debt	79,690	58,316	3,776	10,161	2,652
Stockholders equity	311,839	394,122	510,251	543,888	570,845

**Table of Contents**

**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following discussion and analysis contains forward-looking statements about our plans and expectations of what may happen in the future. Forward-looking statements are based on a number of assumptions and estimates that are inherently subject to significant risks and uncertainties, and our results could differ materially from the results anticipated by our forward-looking statements as a result of many known or unknown factors, including, but not limited to, those factors discussed on pages 20 to 26 under the heading Risk Factors. Also, please read the cautionary notice regarding forward-looking statements set forth at the beginning of this annual report.

Please read the following discussion in conjunction with our consolidated financial statements and the related notes contained elsewhere in this annual report on Form 10-K.

**Overview**

Renal Care Group provides dialysis services to patients with chronic kidney failure. As of December 31, 2003, we provided dialysis and ancillary services to over 21,400 patients through 284 outpatient dialysis centers in 27 states, in addition to providing acute dialysis services to more than 130 hospitals.

Our net revenue has been derived primarily from the following sources:

outpatient hemodialysis services;

ancillary services associated with outpatient dialysis, primarily the administration of EPO and other drugs;

home dialysis services;

inpatient hemodialysis services provided to acute care hospitals and skilled nursing facilities;

laboratory services; and

management contracts with hospital-based medical university dialysis programs.

Most patients with end-stage renal disease receive three dialysis treatments each week in an outpatient setting. Reimbursement for these services is provided primarily by the Medicare ESRD program based on rates established by the Centers for Medicare and Medicaid Services. For the year ended December 31, 2003, approximately 55% of our net revenue was derived from reimbursement under the Medicare and Medicaid programs. Medicare reimbursement is subject to rate and other legislative changes by Congress and periodic changes in regulations, including changes that may reduce payments under the ESRD program. Neither Congress nor CMS approved an increase in the composite rate for 2002, 2003 or 2004.

The Medicaid programs in some of the states in which we operate have formerly reimbursed us, or currently reimburse us, at rates higher than those paid by Medicare. Some of these programs, like Washington's and Wisconsin's, have approved and implemented reductions in reimbursement. Other programs have proposed reductions or have announced that they are considering reductions. If all the states in which we operate that have Medicaid rates that are higher than Medicare rates were to reduce their rates to Medicare rates, and giving effect to the reductions already implemented in Washington and Wisconsin, our earnings per share will likely be adversely affected by between \$0.10 and \$0.15 per share in 2004. We assumed that these reductions would occur when we set and communicated our corporate goals for 2004.

The Medicare composite rate applies to a designated group of outpatient dialysis services, including the dialysis treatment, supplies used for the treatment, certain laboratory tests and medications, and most of the home dialysis services we provide. We receive separate reimbursement outside the composite rate for some other services, drugs (including specific drugs such as EPO) and some physician-ordered tests, including laboratory tests, provided to dialysis patients.

## **Table of Contents**

If a patient has private health insurance, then that patient's treatment is typically reimbursed at rates significantly higher than those paid by Medicare during the first 30 months of care. After that period Medicare becomes the primary payor. Reimbursement for dialysis services provided pursuant to a hospital contract is negotiated with the individual hospital and is usually higher than Medicare rates. Because dialysis is a life-sustaining therapy to treat a chronic disease, utilization is predictable and is not subject to seasonal fluctuations.

We derive a significant portion of our net revenue and net income from the administration of EPO. EPO is manufactured by a single company, Amgen Inc. In April 2002, Amgen implemented its third EPO price increase of 3.9% in as many years. Because we were already under contract with Amgen through 2002, this price increase did not affect our results of operations during 2002. Key components of the 2002 pricing formula were maintained in our 2003 contract with Amgen. Therefore, while the 2002 price increase had an adverse effect on our 2003 results of operations, we were able to mitigate approximately 80% of the increase. Amgen did not implement a price increase in 2003, but changes in our contract with Amgen for 2004 may result in an increase in our cost of EPO. We estimated the impact of these changes and assumed they would take place when we set and communicated our corporate goals for 2004.

### **Critical Accounting Policies**

The Securities and Exchange Commission issued a financial reporting release, FR-60, *Cautionary Advice Regarding Disclosure About Critical Accounting Policies*. In accordance with that release, we have identified accounting policies that we consider critical to our business. Management identified these policies based on their importance to the Consolidated Financial Statements and on the degrees of subjectivity and complexity involved in these policies. In addition to these critical policies, a summary of significant accounting policies is included in our consolidated financial statements and related notes, contained elsewhere in this annual report on Form 10-K.

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities. We continuously evaluate our critical accounting policies and estimates, including those related to net revenue and contractual provisions and provision for doubtful accounts. We base our estimates on historical experience and on various assumptions that we believe to be reasonable under the circumstances. The results of these estimates form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting policies require significant judgments and estimates in the preparation of our consolidated financial statements.

#### *Net Revenue and Contractual Provisions*

We recognize revenue net of contractual provisions as services are provided. Contractual provisions represent the difference between our gross billed charges and the amount we expect to receive. Under the Medicare ESRD program, Medicare reimbursement rates for outpatient dialysis treatments are fixed under a composite rate structure. The composite rate applies to a designated group of outpatient dialysis services, including the dialysis treatment, supplies for the treatment, some laboratory tests and some medications. There are other drugs, laboratory tests and services that are eligible for separate reimbursement outside the composite rate. Most state Medicaid plans follow reimbursement methodologies that are similar to the Medicare program, but other payors, particularly private insurance plans and managed care payors, reimburse us under contractual arrangements or based on our charges. Each of these payor sources provides unique challenges to the process of recording contractual provisions.

We have made significant investments in human resources and information systems to enable us to estimate the appropriate amount of contractual provisions as services are provided. Actual levels of reimbursement, however, are sometimes difficult to determine due to the complexity of the applicable regulations or contracts. As a result, we may in fact collect more or less than the amount expected when the services are provided. In addition, regulations and contracts may be changed, making system updates and maintenance necessary for estimating net revenue accurately. As a result, management



**Table of Contents**

may make adjustments to the contractual provisions estimated by the system based on actual collection experience and other factors.

*Provision for Doubtful Accounts*

Collecting outstanding accounts receivable is critical to our success. Our primary source of collection risk is related to the portion of our charges for which the patient is responsible. The patients responsibility is typically between 10% and 15% of gross charges. We record an estimate of the provision for doubtful accounts in the period in which the revenue is recognized based on management s estimate of the net collectibility of the accounts receivable. Management estimates and monitors the net collectibility of accounts receivable based upon a variety of factors, including the analysis of payor mix, subsequent collection analysis and review of detailed agings of accounts receivable. Significant changes in our payor mix or business office operations could have a significant impact on our results of operations and cash flows.

*Self- Insurance Accruals*

From time to time, we are subject to professional liability, general liability and workers compensation claims or lawsuits in the ordinary course of business. To mitigate a portion of this risk, we maintain insurance for professional liability and general liability claims exceeding certain individual amounts and workers compensation claims exceeding certain individual and aggregate amounts. We estimate the self-insured retention portion of professional liability, general liability and workers compensation risks using third-party actuarial calculations that include historical claims data, demographic factors and other assumptions. The estimated accrual for professional liability, general liability and workers compensation claims could be significantly affected, if current and future occurrences differ from historical claims trends. While management monitors current claims closely and considers outcomes when estimating its insurance accruals, the complexity of the claims, the wide range of potential outcomes and changes in the legal climate often complicate our ability to make precise estimates.

*Impairment of Goodwill and Long-Lived Assets*

We review goodwill, long-lived assets and identifiable intangibles for impairment at least once a year and at any other time management identifies events or changes in circumstances that indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by comparing the carrying amount of an asset to the discounted present value of future net cash flows management expects the asset to generate. The computation of future net cash flows is often complex and includes subjective assumptions. If management determines that assets are impaired, then the impairment is equal to the amount by which the carrying amount of the assets exceeds the fair value of the assets, as determined by independent appraisals or estimates of discounted future cash flows.

**Table of Contents****Results of Operations**

The following table sets forth results of operations (in thousands) for the periods indicated and the percentage of net revenue represented by the respective financial line items:

	Year Ended December 31,					
	2001		2002		2003	
Net revenue	\$ 755,082	100.0%	\$ 903,387	100.0%	\$ 1,005,319	100.0%
Patient care costs	489,271	64.8	589,696	65.3	653,307	65.0
General and administrative expenses	64,530	8.5	78,079	8.6	90,249	9.0
Provision for doubtful accounts	20,290	2.7	23,501	2.6	26,200	2.6
Depreciation and amortization	38,945	5.2	40,432	4.5	44,905	4.4
Total operating costs and expenses	613,036	81.2	731,708	81.0	814,661	81.0
Income from operations	142,046	18.8	171,679	19.0	190,658	19.0
Interest expense, net	2,636	0.3	1,140	0.1	629	0.1
Minority interest	15,478	2.0	21,410	2.4	25,431	2.5
Income before income taxes	123,932	16.4	149,129	16.5	164,598	16.4
Provision for income taxes	47,331	6.3	56,669	6.3	62,542	6.2
Net income	\$ 76,601	10.1%	\$ 92,460	10.2%	\$ 102,056	10.2%

**Table of Contents****Year Ended December 31, 2003 Compared to Year Ended December 31, 2002**

*Net Revenue* Net revenue increased from \$903.4 million for the year ended December 31, 2002 to \$1,005.3 million for the year ended December 31, 2003, an increase of \$101.9 million, or 11.3%. This increase resulted primarily from a 7.8% increase in the number of treatments we performed from 3,019,675 in 2002 to 3,254,447 in 2003 and a 3.7% increase in the average patient revenue per dialysis treatment from \$297 in 2002 to \$308 in 2003. The growth in treatments was the result of the acquisition and development of various dialysis facilities and a 4.7% increase in same-market treatments for 2003 over 2002. We anticipate reductions in same-market treatment rate of growth during 2004. We estimate that approximately \$10 of the \$11 increase in revenue per treatment in 2003 was largely attributable to the rate increase to private payors that we implemented during the fourth quarter of 2002. The remaining \$1 per treatment increase was the net result of both favorable and unfavorable payor contract resolutions. During 2003 we experienced favorable payor contract resolutions of \$5 per treatment, which was offset by \$4 per treatments of unfavorable payor resolutions a portion of which relate to reduced reimbursement experienced with certain managed care contracts and reduced reimbursement in certain state Medicaid programs. Assuming a full year impact in these reductions, we expect our 2004 patient revenue per dialysis treatment to be negatively impacted by approximately \$5. Consistent with previous years we implemented a rate increase to private payors during the fourth quarter of 2003, and we believe this increase will offset most of the decrease noted above. Accordingly, we expect patient revenue per dialysis treatment to remain flat or increase slightly in 2004 as compared to 2003.

*Patient Care Costs.* Patient care costs consist of costs directly related to the care of patients, including direct labor, drugs and other medical supplies, and operational costs of facilities. Patient care costs increased from \$589.7 million for the year ended December 31, 2002 to \$653.3 million for the year ended December 31, 2003, an increase of 10.8%. This increase was due principally to the increase in the number of treatments performed during the period, which was reflected in corresponding increases in the use of labor, drugs and supplies. Patient care costs as a percentage of net revenue decreased from 65.3% in 2002 to 65.0% in 2003. Patient care costs per treatment increased 3.1% from \$195 in 2002 to \$201 in 2003. The increase in patient care costs per treatment was due to increases in the price of EPO, labor costs, the cost of insurance, increases in self-insurance accruals, and the utilization of certain ancillary drugs. Management believes that the Company will continue to face increases in the cost of labor and insurance in 2004.

*General and Administrative Expenses.* General and administrative expenses include corporate office costs and other costs not directly related to the care of patients, including facility administration, accounting, billing and information systems. General and administrative expenses increased from \$78.1 million for the year ended December 31, 2002 to \$90.2 million for the year ended December 31, 2003, an increase of 15.6%. This increase was due primarily to a \$5.4 million charge recorded in the first quarter of 2003 for a retirement benefit plan for our former chairman, chief executive officer and president that was adopted in January 2003. General and administrative expenses as percentage of revenue increased from 8.6% in 2002 to 9.0% in 2003. The charge for the retirement package accounted for substantially all of the increase in general and administrative expenses as a percentage of net revenue.

*Provision for Doubtful Accounts.* Management determines the provision for doubtful accounts as a function of payor mix, billing practices and other factors. We reserve for doubtful accounts in the period when the revenue is recognized based on management's estimate of the net collectibility of the accounts receivable. Management estimates the net collectibility of accounts receivable based upon a variety of factors. These factors include, but are not limited to, analyzing revenues generated from payor sources, performing subsequent collection testing and regularly reviewing detailed accounts receivable agings. Management makes adjustments to the allowance for doubtful accounts as necessary based on the results of management's reviews of the net collectibility of accounts receivable. The provision for doubtful accounts increased from \$23.5 million in 2002 to \$26.2 million in 2003, an increase of \$2.7 million, or 11.5%. The provision for doubtful accounts as a percentage of net revenue remained consistent in 2002 and 2003 at 2.6%.

*Depreciation and Amortization.* Depreciation and amortization increased from \$40.4 million for the year ended December 31, 2002 to \$44.9 million for the year ended December 31, 2003, an increase of 11.1%. This increase was due to the start-up of dialysis facilities, the normal replacement costs of dialysis facilities and equipment, the purchase of information systems and the amortization of separately identifiable intangible assets associated with acquisitions. Depreciation and amortization as a percentage of net revenue decreased slightly from 4.5% in 2002 to 4.4% in 2003.

**Table of Contents**

*Income from Operations.* Income from operations increased from \$171.7 million for the year ended December 31, 2002 to \$190.7 million for the year ended December 31, 2003, an increase of 11.1%. Income from operations as a percentage of net revenue remained consistent in 2002 and 2003 at 19.0%.

*Interest Expense, Net.* Interest expense decreased from \$1.1 million for the year-ended December 31, 2002 to \$629,000 for the year ended December 31, 2003. This decrease was the result of lower average borrowings in 2003. We expect substantially higher interest expense in 2004 as the result of borrowings associated with the planned acquisition of National Nephrology Associates and our previously announced plan to repurchase \$250.0 million of our common stock by March 31, 2004.

*Minority Interest.* Minority interest represents the proportionate equity interest of other owners of entities that are not wholly owned whose financial results are included in our consolidated results. Minority interest as a percentage of net revenue increased to 2.5% in 2003 from 2.4% in 2002. This increase was the result of continued financial improvements of our larger joint ventures, primarily those in Ohio, Oregon and Washington, as well as an increase in the number of facilities operated as joint ventures. As of December 31, 2003, we were the majority and controlling owner in 50 joint ventures compared to 36 as of December 31, 2002.

*Provision for Income Taxes.* Income tax expense increased from \$56.7 million in 2002 to \$62.5 million in 2003, an increase of \$5.9 million or 10.4%. The increase is a result of pre-tax earnings increasing by 10.4%. Our effective tax rate was 38.0% in both 2002 and 2003.

*Net Income.* Net income increased from \$92.5 million in 2002 to \$102.1 million in 2003, an increase of \$9.6 million or 10.4%. This increase was a result of the items discussed above.

**Year Ended December 31, 2002 Compared to Year Ended December 31, 2001**

*Net Revenue* Net revenue increased from \$755.1 million for the year ended December 31, 2001 to \$903.4 million for the year ended December 31, 2002, an increase of \$148.3 million, or 19.6%. This increase resulted primarily from a 12.4% increase in the number of treatments we performed from 2,686,181 in 2001 to 3,019,675 in 2002 and a 6.8% increase in the average patient revenue per dialysis treatment from \$278 in 2001 to \$297 in 2002. The growth in treatments was the result of the acquisition and development of various dialysis facilities and a 5.8% increase in same-market treatments for 2002 over 2001. We estimate that approximately \$10 of the \$19 per treatment increase was attributable to the rate increase to private payors that we implemented during the fourth quarter of 2001. The remaining \$9 per treatment increase was the result of favorable resolutions of various payor contract issues of \$4, and \$5 relating to the increase in the utilization of certain ancillary drugs.

*Patient Care Costs.* Patient care costs consist of costs directly related to the care of patients, including direct labor, drugs and other medical supplies, and operational costs of facilities. Patient care costs increased from \$489.3 million for the year ended December 31, 2001 to \$589.7 million for the year ended December 31, 2002, an increase of 20.5%. This increase was due principally to the increase in the number of treatments performed during the period, which was reflected in corresponding increases in the use of labor, drugs and supplies. Patient care costs as a percentage of net revenue increased from 64.8% in 2001 to 65.3% in 2002. Patient care costs per treatment increased 7.1% from \$182 in 2001 to \$195 in 2002. The increases in patient care costs as a percentage of net revenue and patient care costs per treatment were due to increases in the price of EPO, increased labor costs to address wage pressures in many of our markets, increases in the cost of insurance, increases in self-insurance accruals, the increase in utilization of certain ancillary drugs and the increased cost of the drug Heparin following a recall by its manufacturer.

*General and Administrative Expenses.* General and administrative expenses include corporate office costs and other costs not directly related to the care of patients, including facility administration, accounting, billing and information systems. General and administrative expenses increased from \$64.5 million for the year ended December 31, 2001 to \$78.1 million for the year ended December 31, 2002, an increase of 21.0%. General and administrative expenses as a percentage of net revenue increased from 8.5% in 2001 to 8.6% in 2002 primarily as a result of expenses incurred in connection with closing two dialysis facilities (one in Texas and one in Alabama) in 2002.

**Table of Contents**

*Provision for Doubtful Accounts.* Management determines the provision for doubtful accounts as a function of payor mix, billing practices and other factors. We reserve for doubtful accounts in the period when the revenue is recognized based on management's estimate of the net collectibility of the accounts receivable. Management estimates the net collectibility of accounts receivable based upon a variety of factors. These factors include, but are not limited to, analyzing revenues generated from payor sources, performing subsequent collection testing and regularly reviewing detailed accounts receivable agings. Management makes adjustments to the allowance for doubtful accounts as necessary based on the results of management's reviews of the net collectibility of accounts receivable. The provision for doubtful accounts increased from \$20.3 million in 2001 to \$23.5 million in 2002, an increase of \$3.2 million, or 15.8%. The provision for doubtful accounts as a percentage of net revenue decreased slightly from 2.7% in 2001 to 2.6% in 2002 as a result of improved collection efforts.

*Depreciation and Amortization.* Depreciation and amortization increased from \$38.9 million for the year ended December 31, 2001 to \$40.4 million for the year ended December 31, 2002, an increase of 3.8%. This increase was due to the start-up of dialysis facilities, the normal replacement costs of dialysis facilities and equipment, the purchase of information systems and the amortization of separately identifiable intangible assets associated with acquisitions. Depreciation and amortization as a percentage of net revenue decreased from 5.2% in 2001 to 4.5% in 2002, primarily as a result of the implementation of SFAS No. 142, under which we stopped amortizing goodwill effective January 1, 2002. For 2001, we recorded goodwill amortization of \$6.4 million.

*Income from Operations.* Income from operations increased from \$142.0 million for the year ended December 31, 2001 to \$171.7 million for the year ended December 31, 2002, an increase of 20.9%. Income from operations as a percentage of net revenue increased from 18.8% in 2001 to 19.0% in 2002 principally as a result of the factors discussed above.

*Interest Expense, Net.* Interest expense decreased from \$2.6 million for the year-ended December 31, 2001 to \$1.1 million for the year ended December 31, 2002. This decrease was principally the result of lower average borrowings in 2002, partially offset by costs incurred when we restructured our lines of credit in 2002.

*Minority Interest.* Minority interest represents the proportionate equity interest of other owners of entities that are not wholly owned whose financial results are included in our consolidated results. Minority interest as a percentage of net revenue increased to 2.4% in 2002 from 2.0% in 2001. This increase was the result of continued financial improvements of our larger joint ventures, primarily those in Ohio, Oregon and Washington, as well as an increase in the number of facilities operated as joint ventures.

*Provision for Income Taxes.* Income tax expense increased from \$47.3 million in 2001 to \$56.7 million in 2002, an increase of \$9.3 million or 19.7%. The increase is a result of pre-tax earnings increasing by 20.3%. Our effective tax rate decreased from 38.2% in 2001 to 38.0% in 2002. This decrease was primarily the result of eliminating goodwill amortization for financial reporting purposes as required by SFAS No. 142 while some goodwill continues to be amortized for income tax purposes.

*Net Income.* Net income increased from \$76.6 million in 2001 to \$92.5 million in 2002, an increase of \$15.9 million or 20.7%. This increase was a result of the items discussed above.

**Liquidity and Capital Resources**

Renal Care Group requires capital primarily to acquire and develop dialysis centers, to purchase property and equipment for existing centers, to repurchase shares of our common stock and to finance working capital needs. At December 31, 2003, our working capital was \$122.7 million; cash and cash equivalents were \$50.3 million; and our current ratio was 1.7 to 1.0. Our working capital increased during the year primarily as a result of the increase in operating cash flows.

Net cash provided by operating activities was \$186.5 million for the year ended December 31, 2003. Cash provided by operating activities consists of net income before depreciation and amortization expense, adjusted for changes in components of working capital, primarily accounts receivable. Net cash used in investing activities was \$78.5 million for the year ended December 31, 2003. Cash used in investing activities consisted primarily of \$63.8 million of purchases of property and equipment and \$14.2 million of cash paid for acquisitions, net of cash acquired. Net cash used in financing activities was \$96.1 million for

**Table of Contents**

the year ended December 31, 2003. Cash used in financing activities primarily reflects \$140.5 million in repurchases of our common stock, partially offset by \$51.8 million in net proceeds from the issuance of common stock as stock options were exercised.

In July 2002, we entered into two credit agreements with a group of banks totaling \$150.0 million consisting of a \$100.0 million Second Amended and Restated Loan Agreement (the Multi-Year Facility) and a \$50.0 million Loan Agreement (the 364-day Facility). The Multi-Year Facility had a final maturity of July 1, 2005, and the 364-day facility had a final maturity of June 30, 2004, based on an amendment made in June 2003. As of December 31, 2003 there were no amounts outstanding under the Multi-Year Facility or the 364-day Facility, and the Company had \$150.0 million available under these agreements.

On February 10, 2004, we entered into a new credit agreement (the 2004 Agreement) with a group of banks totaling up to \$700.0 million. The 2004 Agreement replaced the Multi-Year Facility and the 364-day Facility discussed above. This credit agreement has a \$150.0 million revolving credit facility, a committed \$325.0 million dollar term loan facility and a \$225.0 million incremental term loan facility. Our ability to borrow under the committed term loan facility expires in May 2004. All of these committed facilities have a final maturity of February 10, 2009. The credit agreement provides that \$175.0 million of the committed term loan facility may only be used to finance our acquisition of National Nephrology Associates. To the extent we do not use that amount to fund the acquisition, unborrowed amounts will increase the size of the incremental term loan facility. Borrowings under the incremental term loan facility are subject to obtaining commitments from the banks finalizing specific terms.

Borrowings under the revolving credit facility and \$150.0 million of the committed term loan facility may be used for acquisitions, repurchases of our stock, capital expenditures, working capital and general corporate purposes. Borrowings under the 2004 Agreement bear interest at variable rates determined by our leverage ratio. This variable rate debt instrument carries a degree of interest rate risk. Specifically, we will face higher interest costs on this debt if interest rates rise. Each of our wholly-owned subsidiaries has guaranteed all of our obligations under the 2004 Agreement. Further, our obligations under the 2004 Agreement, and our subsidiaries' obligations under their guarantees, are secured by a pledge of the equity interests we hold in each of our subsidiaries. The 2004 Agreement includes financial covenants that are customary based on the amount and duration of the agreement.

We intend to use this facility to complete our previously announced \$250.0 million share repurchase and our acquisition of National Nephrology Associates. Assuming we complete both of these initiatives we will have more than \$475.0 million in outstanding indebtedness. This indebtedness will include \$160.0 million in senior subordinated notes of National Nephrology Associates that we will assume in the acquisition. These notes bear interest at the rate of 9% per annum. As a result of this indebtedness, we will incur substantial interest expense in 2004.

A significant component of our growth strategy is the acquisition and development of dialysis facilities. There can be no assurance that we will be able to identify suitable acquisition candidates or to close acquisition transactions with them on acceptable terms. Management believes that existing cash and funds from operations, together with funds available under our new credit facility, will be sufficient to meet our acquisition, expansion, capital expenditure and working capital needs for the foreseeable future. However, in order to finance certain large strategic acquisition opportunities, we may need to incur additional short and long-term bank indebtedness or to issue equity or debt securities. The availability and terms of any future financing will depend on market and other conditions. There can be no assurance that we will be able to secure additional financing, if required, on acceptable terms.

We plan to make capital expenditures of between \$70.0 million and \$80.0 million, primarily for equipment replacement, expansion of existing dialysis facilities and construction of de novo facilities. We expect that these capital expenditures will be funded with cash provided by operating activities and our existing credit facilities. Management believes that capital resources available to us will be sufficient to meet the needs of our business, both on a short- and long-term basis.

Management, from time to time, determines the appropriateness of repurchasing its common stock in accordance with a repurchase plan initially authorized by the Board of Directors in October 2000. In 2001, we began repurchasing shares of our common stock by purchasing 100,000 shares of common stock for approximately \$3.1 million. In 2002, we repurchased 2.9

**Table of Contents**

million shares of our common stock for approximately \$90.9 million. In October 2003, we announced that the Board of Directors had approved an increase in the repurchase plan to allow the purchase of up to a total of \$450.0 million in common stock, and we announced that we intended to repurchase \$250.0 million in common stock between November 1, 2003 and March 31, 2004. During 2003, we repurchased 3.7 million shares of common stock for \$140.5 million. Through December 31, 2003, we had repurchased an aggregate of 6.6 million shares under the plan, for a total of approximately \$234.4 million. As of February 23, 2004, we had repurchased approximately \$181.9 million of our common stock between November 1, 2003 and that date, leaving \$68.1 million remaining of the \$250.0 million we intend to repurchase in early 2004.

The Securities and Exchange Commission has issued a financial reporting release, FR-61, *Commission Statement about Management's Discussion and Analysis of Financial Condition and Results of Operations*. This release encourages public companies to give investors additional information about funds that will be required to operate its business in the future under agreements that are in place today. In accordance with FR-61, the following table gives information about our existing contractual obligations. At December 31, 2003, we had no significant contingent commitments.

Contractual Obligations	Payments Due by Period (in thousands)				
	Total	Less than 1 year	1 - 3 years	3 - 5 years	After 5 years
Long-Term Obligations:					
Capital leases and long term debt	\$ 2,834	\$ 182	\$ 321	\$ 265	\$ 2,066
Operating leases	195,891	30,413	53,219	43,890	68,369
Medical director fee obligations	75,172	13,902	25,571	19,313	16,386
Total contractual cash obligations	\$273,897	\$44,497	\$79,111	\$63,468	\$86,821

**Newly Issued Accounting Standards**

In December 2002, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard No. 148, *Accounting for Stock-Based Compensation: Transition and Disclosure* (SFAS No. 148), which amends SFAS No. 123, *Accounting for Stock-Based Compensation* (SFAS No. 123). SFAS No. 148 provides alternative methods for Companies electing to implement the fair-value based method of accounting for stock-based employee compensation. The Statement also requires that certain disclosures be made in both annual and interim financial statements about the method of accounting and the related effect of the method used on reported results. The Company has adopted the disclosure requirements of SFAS No. 148 and SFAS No. 123, and accounts for its stock option plans in accordance with the provisions of Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, and does not utilize the fair-value method.

In December 2003, the FASB issued revised Interpretation No. 46, *Consolidation of Variable Interest Entities* (FIN 46). Until this interpretation, a company generally included another entity in its consolidated financial statements only if it controlled the entity through voting interests. FIN 46 requires a variable interest entity to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity's activities or entitled to receive a majority of the entity's residual returns. Application of FIN 46 is required during the fourth quarter of 2003 for interests in structures that are commonly referred to as special-purpose entities; immediately for all new entities created after February 1, 2003; and for all other types of variable interest entities in the first quarter of 2004. The effect of applying the initial consolidation provisions of FIN 46 on Renal Care Group's results of operations or financial position as of December 31, 2003 was not significant. We do not expect the application of the remaining consolidation provisions of FIN 46, as required in the first quarter of 2004, will have a material effect on Renal Care Group's results of operations or financial position.

In May 2003, the FASB issued SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity* (SFAS No. 150). This statement establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003, and the first interim period beginning after June 15, 2003. We

## **Table of Contents**

currently have no financial instruments that fall within the guidelines of the new requirements and, as such, there was no effect of adopting SFAS No. 150 on our results of operations or financial position.

### **Impact of Inflation**

A substantial portion of our net revenue is subject to reimbursement rates that are regulated by the federal government and do not automatically adjust for inflation. We are unable to increase the amount we receive for the services provided by our dialysis business that are reimbursed under or by reference to the Medicare composite rate. Increased operating costs due to inflation, such as labor and supply costs (including the cost of EPO), without a corresponding increase in reimbursement rates, may adversely affect our results of operations, financial condition and business.

### **Off-Balance Sheet Arrangements**

We have no off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

### **Item 7a. *Quantitative and Qualitative Disclosures About Market Risk***

#### **Market Risk**

Renal Care Group maintains all cash in United States dollars in highly liquid, interest-bearing, investment grade instruments with maturities of less than three months, which the Company considers cash equivalents; therefore, the Company has no market risk sensitive instruments.

#### **Interest Rate Risk**

On February 10, 2004, we entered a new credit agreement with a group of banks, which agreement has a total of \$475.0 million in committed facilities. Under the 2004 Agreement, outstanding balances have interest at rates that are adjusted on specific consolidated leverage ratios defined in the agreement. These variable rate debt instruments carry a degree of interest rate risk. Specifically, variable rate debt may result in higher costs to us if interest rates rise.

### **Item 8. *Financial Statements and Supplementary Data***

The consolidated financial statements and financial statement schedule in Part IV, Item 15(a) (1) and (2) of the report are incorporated by reference into this Item 8.

### **Item 9. *Changes In and Disagreements with Accountants on Accounting and Financial Disclosure***

None.

### **Item 9a. *Controls and Procedures***

Our Chief Executive Officer and Chief Financial Officer evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this report. Our Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this report, we maintain disclosure controls and procedures that provide reasonable assurance that information that we are required to disclose in the reports that we file or submit under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and our Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.



**Table of Contents**

There were no changes in our internal control over financial reporting that occurred during the quarter ended December 31, 2003 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Table of Contents**

**PART III**

**Item 10. *Directors and Executive Officers of the Company***

The information required by this item will appear in, and is incorporated by reference from, the sections entitled "Proposals for Stockholder Action - Proposal 1. Election of Directors" and "Management - Directors and Executive Officers" included in the Company's definitive Proxy Statement relating to the 2004 Annual Meeting of Stockholders.

**Item 11. *Executive Compensation***

The information required by this item will appear in the section entitled "Executive Compensation" included in the Company's definitive Proxy Statement relating to the 2004 Annual Meeting of Stockholders, which information, other than the Compensation Committee Report and Performance Graph required by Items 402(k) and (l) of Regulation S-K, is incorporated herein by reference.

**Item 12. *Security Ownership of Certain Beneficial Owners and Management***

The information required by this item will appear in, and is incorporated by reference from, the section entitled "Security Ownership of Directors, Officers and Principal Stockholders" included in the Company's definitive Proxy Statement relating to the 2004 Annual Meeting of Stockholders.

**Item 13. *Certain Relationships and Related Transactions***

The information required by this item will appear in, and is incorporated by reference from, the sections entitled "Compensation Committee Interlocks and Insider Participation" and "Certain Relationships and Related Transactions" included in the Company's definitive Proxy Statement relating to the 2004 Annual Meeting of Stockholders.

**Item 14. *Principal Accountant Fees and Services***

The information required by this item will appear in, and is incorporated by reference from, the section entitled "Auditors" included in the Company's definitive Proxy Statement relating to the 2004 Annual Meeting of Stockholders.

**Table of Contents****PART IV****Item 15. Exhibits, Financial Statement Schedules, and Reports on Form 8-K**

	<b><u>Page</u></b>
(a) Documents filed as part of this Report:	
(1) Consolidated Financial Statements	
Report of Independent Auditors	F-1
Consolidated Balance Sheets at December 31, 2002 and 2003	F-2
Consolidated Income Statements for the years ended December 31, 2001, 2002, and 2003	F-4
Consolidated Statements of Stockholders' Equity for the years ended December 31, 2001, 2002, and 2003	F-5
Consolidated Statements of Cash Flows for the years ended December 31, 2001, 2002, and 2003	F-6
Notes to Consolidated Financial Statements	F-8
(2) Consolidated Financial Statement Schedules	
Schedule II - Consolidated Schedule-Valuation and Qualifying Accounts	F-25
(3) The Exhibits are listed in the Index of Exhibits Required by Item 601 of Regulation S-K included herewith, which is incorporated herein by reference.	
(b) None.	

**Table of Contents**

**REPORT OF INDEPENDENT AUDITORS**

The Board of Directors  
Renal Care Group, Inc.

We have audited the accompanying consolidated balance sheets of Renal Care Group, Inc. as of December 31, 2002 and 2003, and the related consolidated income statements, statements of stockholders' equity, and statements of cash flows for each of the three years in the period ended December 31, 2003. Our audits also included the financial statement schedule listed in the Index at Item 15(a). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. 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 financial statements referred to above present fairly, in all material respects, the consolidated financial position of Renal Care Group, Inc. at December 31, 2002 and 2003 and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2003, in conformity with accounting principles generally accepted in the United States. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

/s/ ERNST & YOUNG LLP

Nashville, Tennessee  
February 13, 2004

F-1

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**Table of Contents****Renal Care Group, Inc.****Consolidated Balance Sheets  
(in thousands)**

	<b>December 31</b>	
	<b>2002</b>	<b>2003</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 38,359	\$ 50,295
Accounts receivable, less allowance for doubtful accounts of \$43,677 in 2002 and \$32,161 in 2003	152,440	173,679
Inventories	23,336	26,345
Prepaid expenses and other current assets	19,486	28,050
Income taxes receivable		1,910
Deferred income taxes	12,240	11,825
	<u>          </u>	<u>          </u>
Total current assets	245,861	292,104
Property, plant and equipment, net	202,972	224,397
Intangible assets, net	12,110	14,046
Goodwill	275,666	286,578
Other assets	3,514	2,748
	<u>          </u>	<u>          </u>
Total assets	\$740,123	\$819,873
	<u>          </u>	<u>          </u>

See accompanying notes to consolidated financial statements.

**Table of Contents****Renal Care Group, Inc.****Consolidated Balance Sheets  
(in thousands, except per share data)**

	December 31	
	2002	2003
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 33,655	\$ 36,795
Accrued compensation	32,066	40,619
Due to third-party payors	32,611	46,049
Income taxes payable	1,423	
Accrued expenses and other current liabilities	35,492	45,792
Current portion of long-term debt	133	182
	<u>          </u>	<u>          </u>
Total current liabilities	135,380	169,437
Long-term debt, net of current portion	10,161	2,652
Deferred income taxes	19,288	38,390
Other long-term liabilities		5,898
Minority interest	31,406	32,651
	<u>          </u>	<u>          </u>
Total liabilities	196,235	249,028
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, \$0.01 par value, 10,000 shares authorized, none issued		
Common stock, \$0.01 par value, 90,000 shares authorized, 51,176 and 53,643 shares issued at December 31, 2002 and 2003, respectively	512	536
Treasury stock, 2,983 and 6,641 shares of common stock at December 31, 2002 and 2003, respectively	(93,953)	(234,404)
Additional paid-in capital	309,355	374,683
Retained earnings	327,974	430,030
	<u>          </u>	<u>          </u>
Total stockholders' equity	543,888	570,845
	<u>          </u>	<u>          </u>
Total liabilities and stockholders' equity	\$ 740,123	\$ 819,873
	<u>          </u>	<u>          </u>

See accompanying notes to consolidated financial statements.

**Table of Contents****Renal Care Group, Inc.****Consolidated Income Statements**  
**(in thousands, except per share data)**

	Year Ended December 31		
	2001	2002	2003
Net revenue	\$755,082	\$903,387	\$1,005,319
Operating costs and expenses:			
Patient care costs	489,271	589,696	653,307
General and administrative expenses	64,530	78,079	90,249
Provision for doubtful accounts	20,290	23,501	26,200
Depreciation and amortization	38,945	40,432	44,905
	<u>613,036</u>	<u>731,708</u>	<u>814,661</u>
Income from operations	142,046	171,679	190,658
Interest expense, net	2,636	1,140	629
	<u>139,410</u>	<u>170,539</u>	<u>190,029</u>
Income before minority interest and income taxes	139,410	170,539	190,029
Minority interest	15,478	21,410	25,431
	<u>123,932</u>	<u>149,129</u>	<u>164,598</u>
Income before income taxes	123,932	149,129	164,598
Provision for income taxes	47,331	56,669	62,542
	<u>\$ 76,601</u>	<u>\$ 92,460</u>	<u>\$ 102,056</u>
Net income	<u>\$ 76,601</u>	<u>\$ 92,460</u>	<u>\$ 102,056</u>
Net income per share:			
Basic	\$ 1.59	\$ 1.89	\$ 2.11
	<u>\$ 1.52</u>	<u>\$ 1.82</u>	<u>\$ 2.05</u>
Diluted	<u>\$ 1.52</u>	<u>\$ 1.82</u>	<u>\$ 2.05</u>
Weighted average shares outstanding:			
Basic	48,113	48,978	48,479
	<u>50,433</u>	<u>50,767</u>	<u>49,835</u>
Diluted	<u>50,433</u>	<u>50,767</u>	<u>49,835</u>

See accompanying notes to consolidated financial statements.

**Table of Contents****Renal Care Group, Inc.****Consolidated Statements of Stockholders Equity**  
(in thousands)

	Common Stock Shares	Common Stock Amount	Treasury Stock Shares	Treasury Stock Amount	Additional Paid-In Capital	Retained Earnings	Total Stockholders Equity
Balance at December 31, 2000	47,087	\$ 471		\$	\$ 234,738	\$ 158,913	\$ 394,122
Net income						76,601	76,601
Common stock issued and related income tax benefit	2,510	25			42,562		42,587
Repurchase of common stock held in treasury			100	(3,059)			(3,059)
Balance at December 31, 2001	49,597	496	100	(3,059)	277,300	235,514	510,251
Net income						92,460	92,460
Common stock issued and related income tax benefit	1,579	16			32,055		32,071
Repurchase of common stock held in treasury			2,883	(90,894)			(90,894)
Balance at December 31, 2002	51,176	512	2,983	(93,953)	309,355	327,974	543,888
Net income						102,056	102,056
Common stock issued and related income tax benefit	2,467	24			65,328		65,352
Repurchase of common stock held in treasury			3,658	(140,451)			(140,451)
Balance at December 31, 2003	53,643	\$ 536	6,641	\$ (234,404)	\$ 374,683	\$ 430,030	\$ 570,845

See accompanying notes to consolidated financial statements.



**Table of Contents****Renal Care Group, Inc.****Consolidated Statements of Cash Flows**  
(in thousands)

	Year Ended December 31		
	2001	2002	2003
<b>OPERATING ACTIVITIES</b>			
Net income	\$ 76,601	\$ 92,460	\$ 102,056
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	38,945	40,432	44,905
Loss on sale of property and equipment	1,266	1,167	886
Income applicable to minority interest	15,478	21,410	25,431
Distributions to minority shareholders	(16,446)	(7,934)	(24,634)
Deferred income taxes	1,488	11,214	19,517
Changes in operating assets and liabilities, net of effects from acquisitions:			
Accounts receivable	(4,240)	(23,814)	(20,253)
Inventories	(2,832)	(6,587)	(2,754)
Prepaid expenses and other current assets	604	(902)	(8,564)
Accounts payable	2,247	5,369	3,140
Accrued compensation	2,625	18	8,553
Due to third-party payors	649	4,712	13,313
Accrued expenses and other current liabilities	5,168	12,747	8,838
Income taxes	11,648	18,331	10,217
Other long-term liabilities			5,898
Net cash provided by operating activities	133,201	168,623	186,549
<b>INVESTING ACTIVITIES</b>			
Proceeds from sale of property and equipment	1,078	218	2,270
Purchases of property and equipment	(65,672)	(61,551)	(63,762)
Cash paid for acquisitions, net of cash acquired	(38,403)	(40,495)	(14,154)
(Increase) decrease in other assets	(4,415)	4,408	(2,858)
Net cash used in investing activities	(107,412)	(97,420)	(78,504)
<b>FINANCING ACTIVITIES</b>			
Net (payments) borrowings under line of credit	(54,000)	7,394	(7,080)
Payments on long-term debt	(516)	(1,884)	(380)
Net proceeds from issuance of common stock	29,307	22,221	51,802
Repurchase of treasury shares	(3,059)	(90,894)	(140,451)
Proceeds from sale of minority interest investment		2,896	
Net cash used in financing activities	(28,268)	(60,267)	(96,109)
(Decrease) increase in cash and cash equivalents	(2,479)	10,936	11,936
Cash and cash equivalents, at beginning of year	29,902	27,423	38,359
Cash and cash equivalents, at end of year	\$ 27,423	\$ 38,359	\$ 50,295

See accompanying notes to consolidated financial statements.



**Table of Contents****Renal Care Group, Inc.****Consolidated Statements of Cash Flows  
(in thousands)**

	<b>Year Ended December 31</b>		
	<b>2001</b>	<b>2002</b>	<b>2003</b>
<b>DISCLOSURES OF CASH FLOW INFORMATION:</b>			
Cash paid during the year for:			
Interest	\$ 2,520	\$ 782	\$ 922
	<b>_____</b>	<b>_____</b>	<b>_____</b>
Income taxes	\$48,963	\$27,126	\$32,808
	<b>_____</b>	<b>_____</b>	<b>_____</b>
<b>DISCLOSURES OF BUSINESS ACQUISITIONS:</b>			
Fair value of assets acquired	\$39,108	\$41,478	\$14,388
Liabilities assumed	705	983	234
	<b>_____</b>	<b>_____</b>	<b>_____</b>
Cash paid for acquisitions, net of cash acquired	\$38,403	\$40,495	\$14,154
	<b>_____</b>	<b>_____</b>	<b>_____</b>

See accompanying notes to consolidated financial statements.

F-7

**Table of Contents**

**Renal Care Group, Inc.**

**Notes to Consolidated Financial Statements  
(dollars in thousands, except per share data)  
December 31, 2003**

**1. ORGANIZATION**

Renal Care Group, Inc. (the Company) provides dialysis services to patients with chronic kidney failure, also known as end-stage renal disease (ESRD). As of December 31, 2003, the Company provided dialysis and ancillary services to over 21,400 patients through 284 outpatient dialysis centers in 27 states. In addition to its outpatient dialysis center operations, as of December 31, 2003, the Company provided acute dialysis services through contractual relationships with more than 130 hospitals.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Basis of Presentation and Consolidation**

The consolidated financial statements include the accounts of the Company, its wholly-owned subsidiaries and its majority-owned subsidiaries and joint venture entities over which the Company exercises majority-voting control and for which control is other than temporary. All significant intercompany transactions and accounts are eliminated in consolidation.

**Use of Estimates**

Management has made a number of estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities to prepare these financial statements in conformity with accounting principles generally accepted in the United States. Actual results could differ from those estimates.

**Cash Equivalents**

The Company considers all highly-liquid investments with original maturities of three months or less to be cash equivalents. The Company places its cash in financial institutions that are federally insured and limits the amount of credit exposure with any one financial institution.

**Inventories**

Inventories consist of drugs, supplies and parts used in dialysis treatments and are stated at the lower of cost or market. Cost is determined using either the first-in, first-out method or the average cost method.

**Property, Plant and Equipment**

Property, plant and equipment are stated at cost. Depreciation is calculated on the straight-line method over the useful lives of the related assets, ranging from 3 to 40 years. Leasehold improvements are amortized using the straight-line method over the shorter of the related lease terms or the useful lives.

**Goodwill and Other Intangibles**

The Company adopted Statements of Financial Accounting Standards (SFAS) No. 142, *Goodwill and Other Intangible Assets* (SFAS No. 142), on January 1, 2002. In accordance with the transitional requirements of this statement, during 2001, the Company did not amortize goodwill or intangible assets with indefinite lives acquired after June 30, 2001. However, during 2001, the Company amortized goodwill and intangibles acquired prior to July 1, 2001 in accordance with Accounting Principles Board (APB) Opinion No. 16, *Business Combinations*. For periods subsequent to December 31,

## **Table of Contents**

2001, the Company did not amortize goodwill or intangible assets with indefinite lives in accordance with SFAS No. 142. As of December 31, 2002 and 2003, the carrying amount of goodwill was \$275,666 and \$286,578, respectively.

During 2001, separately identifiable intangible assets with definite lives, such as non-competition agreements, acquired after June 30, 2001 were amortized over the estimated useful life of such assets. For periods subsequent to December 31, 2001, all separately identifiable intangible assets, whether acquired before or after June 30, 2001, with definite lives were amortized over their respective useful lives.

### **Due to Third-Party Payors**

Amounts reflected as due to third-party payors include amounts received in excess of revenue recognized for specific billed charges. These amounts are commonly referred to as overpayments. Overpayments received from federally funded programs are reported to the federal program in accordance with the program's established procedures. The amounts remain in due to third-party payors until either a refund is made or until the amount is recouped by the federal payor. For overpayments received from non-federally funded payors, the Company uses various procedures to communicate and refund such amounts to the respective payor. Similar to the federally funded overpayments, these amounts remain in due to third-party payors until either a refund is made or the amount is recouped by the payor.

### **Minority Interest**

Minority interest represents the proportionate equity interest of other owners in the Company's consolidated entities that are not wholly owned. As of December 31, 2003 the Company was the majority and controlling owner in 50 joint ventures.

### **Stock Based Compensation**

In December 2002, the Financial Accounting Standards Board issued SFAS No. 148, *Accounting for Stock-Based Compensation-Transition and Disclosure* ( SFAS No. 148 ), which amended SFAS No. 123, *Accounting for Stock-Based Compensation* ( SFAS No. 123 ). SFAS No. 148 provides alternative methods of transition for a voluntary change to the fair value-based method of accounting for stock-based employee compensation and amends the disclosure requirements of SFAS No. 123 to require more prominent and more frequent disclosures in financial statements about the effects of stock-based compensation. SFAS No. 148 is effective for financial statements issued for fiscal years ending after December 15, 2002, and interim disclosure provisions are effective for financial reports containing financial statements for interim periods beginning after December 15, 2002. These consolidated financial statements and related notes include the disclosure requirements of SFAS No. 148. However, the Company has elected to account for its stock-based compensation plans under the intrinsic value-based method of accounting prescribed by APB Opinion No. 25, *Accounting for Stock Issued to Employees* ( APB Opinion No. 25 ), and does not utilize the fair value method.

### **Net Revenue**

Net revenue is recognized as services are provided at the estimated net realizable amount from Medicare, Medicaid, commercial insurers and other third-party payors. The Company's net revenue is largely derived from the following sources:

Outpatient hemodialysis;

Ancillary services associated with outpatient dialysis, primarily the administration of erythropoietin (EPO) and other drugs;

Home dialysis services;

Inpatient hemodialysis services provided to acute care hospitals and skilled nursing facilities;

Laboratory services; and

Management contracts with hospital-based medical university dialysis programs.

The Medicare and Medicaid programs, along with certain third-party payors, reimburse the Company at amounts that are different from the Company's established rates. Contractual adjustments represent the difference between the amounts billed for these

**Table of Contents**

services and the amounts that are reimbursable by third-party payors. A summary of the basis for reimbursement with these payors follows:

*Medicare*

The Company is reimbursed by the Medicare program predominantly on a prospective payment system for dialysis services. Under the prospective payment system, each facility receives a composite rate per treatment. The composite rate is subject to regional differences based on certain factors, including labor costs. Some drugs and other ancillary services are reimbursed on a fee for service basis.

*Medicaid*

Medicaid is a state-administered program with reimbursements varying by state. The Medicaid programs are separately administered in each state in which the Company operates, and they reimburse the Company predominantly on a prospective payment system for dialysis services rendered.

*Other*

Payments from commercial insurers, other third-party payors and patients are received pursuant to a variety of reimbursement arrangements. Generally payments from commercial insurers and other third-party payors are greater than those received from the Medicare and Medicaid programs.

Reimbursements from Medicare and Medicaid approximated 55%, 57% and 55% of net revenue for the years ended December 31, 2001, 2002 and 2003, respectively.

**Provision for Doubtful Accounts**

The provision for doubtful accounts is determined as a function of payor mix, billing practices, and other factors. The Company reserves for doubtful accounts in the period in which the revenue is recognized based on management's estimate of the net collectibility of the accounts receivable. Management estimates and monitors the net collectibility of accounts receivable based upon a variety of factors. These factors include, but are not limited to, analyzing revenues generated from payor sources, performing subsequent collection testing and regularly reviewing detailed accounts receivable agings.

**Income Taxes**

The Company accounts for income taxes under the asset and liability method. The Company recognizes deferred tax assets and liabilities for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which these temporary differences are expected to be recovered or settled. The effect of a change in tax rates on deferred tax assets and liabilities is recognized in income in the period that includes the enactment date for the change.

## **Table of Contents**

### **Self Insurance**

The Company is subject to professional liability, general liability and workers compensation claims or lawsuits in the ordinary course of business. Accordingly, the Company maintains insurance for professional liability and general liability claims exceeding certain individual amounts. Similarly, the Company maintains workers compensation insurance for claims exceeding certain individual and aggregate amounts. The Company estimates its self-insured retention portion of professional liability, general liability and workers compensation risks using third party actuarial calculations that include historical claims data, demographic factors and other assumptions.

### **Fair Value of Financial Instruments**

#### *Cash and Cash Equivalents*

The carrying amounts reported in the consolidated balance sheets for cash and cash equivalents approximate fair value.

#### *Accounts Receivable, Accounts Payable and Accrued Liabilities*

The carrying amounts reported in the consolidated balance sheets for accounts receivable, accounts payable and accrued liabilities approximate fair value. Accounts receivable are generally unsecured.

#### *Long-Term Debt*

Based upon the borrowing rates currently available to the Company, the carrying amounts reported in the consolidated balance sheets for long-term debt approximate fair value.

### **Concentration of Credit Risks**

The Company's primary concentration of credit risk exists within accounts receivable, which consist of amounts owed by various governmental agencies, insurance companies and private patients. Receivables from Medicare and Medicaid represented 45% and 46% of gross accounts receivable at December 31, 2002 and 2003, respectively. Concentration of credit risk relating to accounts receivable is limited to some extent by the diversity of the number of patients and payors and the geographic dispersion of the Company's operations.

The Company administers EPO to most of its patients to treat anemia, a medical complication frequently experienced by dialysis patients. Revenue from the administration of EPO was 25% of the net revenue of the Company for the year ended December 31, 2001, 23% of the net revenue of the Company for the year ended December 31, 2002 and 24% of the net revenue of the Company for the year ended December 31, 2003. EPO is produced by a single manufacturer.

### **Impairment of Goodwill and Long-Lived Assets to be Disposed Of**

The Company reviews goodwill, long-lived assets and separately identifiable intangible assets for impairment at least annually and whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of the assets to the present value of future net cash flows expected to be generated by the assets. If assets are identified as impaired, the impairment is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets as determined by independent appraisals or estimates of discounted future cash flows. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell. During the fourth quarter of 2003, the Company completed its annual impairment testing, and, as of December 31, 2003, in the opinion of management, there has been no impairment of goodwill, long-lived assets or separately identifiable intangible assets.

**Table of Contents****3. BUSINESS ACQUISITIONS****2003 Acquisitions**

During 2003, the Company completed three acquisitions, which were accounted for under the purchase method of accounting. The combined purchase price paid in these acquisitions was \$14,154 and consisted exclusively of cash. Each of the transactions involved the acquisition of assets of entities that provide care to ESRD patients through owned dialysis facilities. The acquired businesses either strengthened the Company's existing market share within a specific geographic area or provided the Company with an entrance into a new market.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition for the acquisitions completed in 2003:

Accounts receivable	\$ 986
Inventory	255
Property, plant and equipment, net	1,579
Intangible assets	656
Goodwill	10,912
	<hr/>
Total assets acquired	14,388
Total liabilities assumed	234
	<hr/>
Net assets acquired	\$ 14,154
	<hr/>

The Company began recording the results of operations for each of these acquired businesses at the effective date of the transaction. Goodwill resulting from these transactions amounted to \$10,912 and was not amortized during 2003 in accordance with the requirements of SFAS No. 142. All goodwill is expected to be deductible for tax purposes. Intangible assets typically represent the value assigned to certain contracts such as non-competition agreements and acute dialysis service agreements entered into in the transactions. These amounts are amortized over the lives of the contracts, which generally range from five to ten years.

**2002 Acquisitions**

During 2002, the Company completed eight acquisitions, which were accounted for under the purchase method of accounting. The combined purchase price paid in these acquisitions was \$40,495 and consisted exclusively of cash. Each of the transactions involved the acquisition of assets of entities that provide care to ESRD patients through owned dialysis facilities. The acquired businesses either strengthened the Company's existing market share within a specific geographic area or provided the Company with an entrance into a new market.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition for the acquisitions completed in 2002:

Accounts receivable	\$ 1,570
Inventory	457
Property, plant and equipment, net	3,329
Intangible assets	3,986
Goodwill	32,136
	<hr/>
Total assets acquired	41,478
Total liabilities assumed	983
	<hr/>
Net assets acquired	\$ 40,495
	<hr/>



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The Company began recording the results of operations for each of these acquired businesses at the effective date of the transaction. Goodwill resulting from these transactions amounted to \$32,136 and was not amortized during 2002 in

F-12

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**Table of Contents**

accordance with the requirements of SFAS No. 142. All goodwill is expected to be deductible for tax purposes. Intangible assets typically represent the value assigned to certain contracts such as non-competition agreements and acute dialysis service agreements entered into in the transactions. These amounts are amortized over the lives of the contracts, which generally range from five to ten years.

**2001 Acquisitions**

During 2001, the Company completed five acquisitions, which were accounted for under the purchase method of accounting. The combined purchase price paid in these acquisitions was \$38,403 and consisted exclusively of cash. Each of the transactions involved the acquisition of assets of entities that provide care to ESRD patients through owned dialysis facilities. The acquired businesses either strengthened the Company's existing market share within a specific geographic area or provided the Company with an entrance into a new market.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition for all five of the acquisitions completed in 2001:

Inventory	\$ 579
Property, plant and equipment, net	5,629
Intangible assets	1,675
Goodwill	30,325
Other assets	900
	<hr/>
Total assets acquired	39,108
Total liabilities assumed	705
	<hr/>
Net assets acquired	\$38,403
	<hr/>

The Company began recording the results of operations for each of these acquired businesses at the effective date of the transaction. Three of the five transactions were completed prior to July 1, 2001 and resulted in goodwill and other intangibles of \$6,428. This goodwill was amortized during 2001 using a 35-year blended useful life. The other two transactions were completed after June 30, 2001. Goodwill and other intangible assets resulting from these transactions was \$24,077 and was not amortized during 2001 in accordance with the requirements of SFAS No. 142. None of the goodwill from 2001 transactions was amortized during 2002. All goodwill is expected to be deductible for tax purposes. Intangible assets typically represent the value assigned to certain contracts such as non-competition agreements entered into in the transactions. These amounts are amortized over the lives of the contracts, which generally range from five to ten years.

**Pro Forma Data (unaudited)**

The following summary, prepared on a pro forma basis, combines the results of operations of the Company and the acquired businesses, as if each of the acquisitions had been consummated as of the beginning of each year below, giving effect to adjustments such as amortization of intangibles, interest expense and related income taxes.

	<u>2001</u>	<u>2002</u>	<u>2003</u>
Pro forma net revenue	\$ 794,409	\$ 919,244	\$ 1,013,965
	<hr/>	<hr/>	<hr/>
Pro forma net income	\$ 77,492	\$ 93,060	\$ 102,383
	<hr/>	<hr/>	<hr/>
Pro forma net income per share			
Basic	\$ 1.61	\$ 1.90	\$ 2.11
	<hr/>	<hr/>	<hr/>
Diluted	\$ 1.54	\$ 1.83	\$ 2.05
	<hr/>	<hr/>	<hr/>

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The unaudited pro forma results of operations are not necessarily indicative of what actually would have occurred if the acquisitions had been completed prior to the beginning of the periods presented.

F-13

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**Table of Contents****4. PROPERTY, PLANT AND EQUIPMENT**

Property, plant and equipment consist of the following:

	December 31,	
	2002	2003
Medical equipment	\$ 124,347	\$ 143,758
Computer software and equipment	58,285	57,718
Furniture and fixtures	24,532	27,027
Leasehold improvements	84,807	101,113
Buildings	24,862	23,511
Construction-in-progress	10,437	15,058
	<u>327,270</u>	<u>368,185</u>
Less accumulated depreciation	(124,298)	(143,788)
	<u>\$ 202,972</u>	<u>\$ 224,397</u>

Depreciation expense was \$30,836, \$38,191 and \$42,561 for the years ended December 31, 2001, 2002 and 2003, respectively.

**5. GOODWILL AND INTANGIBLE ASSETS**

In accordance with the requirements of SFAS No. 142, the Company discontinued amortizing goodwill effective January 1, 2002, and is required to disclose goodwill separately from other intangible assets in the balance sheet. Additionally, goodwill must be tested for impairment on a periodic basis. The Company completed its annual impairment testing and identified no impairments.

A reconciliation of previously reported net income and earnings per share to the pro forma amounts adjusted for the exclusion of goodwill amortization net of the related income tax effect follows:

	2001	Year Ended December 31, 2002	2003
Reported net income	\$76,601	\$ 92,460	\$102,056
Add: goodwill amortization, net of tax	3,956		
Pro forma adjusted net income	<u>\$80,557</u>	<u>\$ 92,460</u>	<u>\$102,056</u>
Reported basic earnings per share	\$ 1.59	\$ 1.89	\$ 2.11
Add: goodwill amortization, net of tax	0.08		
Pro forma adjusted basic earnings per share	<u>\$ 1.67</u>	<u>\$ 1.89</u>	<u>\$ 2.11</u>
Reported diluted earnings per share	\$ 1.52	\$ 1.82	\$ 2.05
Add: goodwill amortization, net of tax	0.08		
Pro forma adjusted diluted earnings per share	<u>\$ 1.60</u>	<u>\$ 1.82</u>	<u>\$ 2.05</u>

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Changes in the carrying amount of goodwill for the year ended December 31, 2003, are as follows:

Balance as of December 31, 2001	\$243,530
Goodwill acquired during the period	<u>32,136</u>
Balance as of December 31, 2002	275,666
Goodwill acquired during the period	<u>10,912</u>
Balance as of December 31, 2003	<u>\$286,578</u>

F-14

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**Table of Contents**

The Company's separately identifiable intangible assets, which consist of non-competition agreements and acute dialysis services agreements, are as follows:

	December 31,	
	2002	2003
Carrying amount	\$20,076	\$ 24,113
Accumulated amortization	(7,966)	(10,067)
Net	\$12,110	\$ 14,046

Separately identifiable intangible assets are being amortized over their useful lives, ranging from five to ten years. Amortization expense was \$2,241 and \$2,344 for the years ended December 31, 2002 and 2003, respectively. Estimated amortization expense for each of the next five fiscal years is as follows:

Year ending December 31,	Amount
2004	\$2,856
2005	2,856
2006	2,712
2007	2,308
2008	2,141

**6. LONG-TERM DEBT**

Long-term debt consists of the following:

	December 31,	
	2002	2003
Line of credit, bearing interest at LIBO rate (3.96% at December 31, 2002)	\$ 7,394	\$
Other	2,900	2,834
	10,294	2,834
Less current portion	133	182
	\$10,161	\$2,652

**Lines of Credit**

Effective July 1, 2002, the Company entered into two credit agreements with a group of banks totaling \$150,000 consisting of a \$100,000 Second Amended and Restated Loan Agreement (the "Multi-Year Facility") and a \$50,000 Loan Agreement (the "364-day Facility"). The Multi-Year Facility had a final maturity of July 1, 2005 and the 364-day Facility had a final maturity of June 30, 2004, based on an amendment made in June 2003. As of December 31, 2003 there were no amounts outstanding under the Multi-Year Facility or the 364-day Facility, and the Company had \$150,000 available under these agreements.

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Each of the Company's wholly-owned subsidiaries has guaranteed all of the obligations outstanding under the Multi-Year Facility and the 364-day Facility. Further, the Company's obligations under the credit facility, and the obligations of each of its subsidiaries under its guaranty, are secured by a pledge of the equity interests held by the Company in each of the subsidiaries. Financial covenants are customary based on the amount and duration of these commitments. The Company was in compliance with all such covenants at December 31, 2003.

On February 10, 2004, the Company entered into a new credit agreement (the 2004 Agreement) with a group of banks totaling up to \$700,000. The 2004 Agreement replaced the Multi-Year Facility and the 364-day Facility discussed

F-15

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**Table of Contents**

above. The 2004 Agreement has a \$150,000 revolving credit facility, a committed \$325,000 term loan facility and a \$225,000 incremental term loan facility. Our ability to borrow under the committed term loan facility expires in May 2004. All of the committed facilities have a final maturity of February 10, 2009. The 2004 Agreement provides that \$175,000 of the committed term loan facility may only be used to finance the Company's acquisition of National Nephrology Associates. To the extent the Company does not use that amount to fund the acquisition, unborrowed amounts will increase the size of the incremental term loan facility. Borrowings under the incremental term loan facility are subject to obtaining final commitments from the banks finalizing specific terms.

Borrowings under the revolving credit facility and \$150,000 of the committed term loan facility under the 2004 Agreement may be used for acquisitions, repurchases of Company common stock, capital expenditures, working capital and general corporate purposes. Borrowings under the 2004 Agreement bear interest at variable rates determined by the Company's leverage ratio. This variable rate debt instrument carries a degree of interest rate risk. Specifically, the Company will face higher interest costs on this debt if interest rates rise. Each of the Company's wholly-owned subsidiaries has guaranteed all of the Company's obligations under the 2004 Agreement. Further, the Company's obligations under the 2004 Agreement, and the Company's subsidiaries' obligations under their guarantees, are secured by a pledge of the equity interests the Company holds in each of its subsidiaries. The 2004 Agreement includes financial covenants that are customary based on the amount and duration of the agreement.

**Other**

The other long-term debt consists of notes maturing at various times through April 2015.

The aggregate maturities of long-term debt at December 31, 2003 are as follows:

2004	\$ 182
2005	227
2006	94
2007	119
2008	146
Thereafter	2,066
	<u>          </u>
	\$2,834
	<u>          </u>

**7. INCOME TAXES**

The provision for income taxes consists of the following:

	Year Ended December 31,		
	2001	2002	2003
Current:			
Federal	\$42,002	\$40,205	\$38,716
State and local	3,841	5,250	4,309
	<u>45,843</u>	<u>45,455</u>	<u>43,025</u>
Deferred:			
Federal	1,364	10,079	17,152
State and local	124	1,135	2,365
	<u>1,488</u>	<u>11,214</u>	<u>19,517</u>
Provision for income taxes	\$47,331	\$56,669	\$62,542





At December 31, 2003, the Company has net operating loss carryforwards of approximately \$231,000 for state income tax purposes that expire in years 2002 through 2022, and a capital loss carryforward of approximately \$2,200 that expires in 2006. The utilization of the state net operating loss carryforwards in future years is dependent upon the profitability of certain subsidiary corporations. The utilization of the capital loss carryforward requires capital gain income in the future. Therefore, the Company

**Table of Contents**

has recorded a valuation allowance of \$7,756 against the deferred tax asset attributable to the state net operating loss carryforwards and the capital loss carryforward, which represents an increase in the valuation allowance of \$1,715 in 2003.

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

Components of the Company's deferred tax liabilities and assets are as follows:

	<b>December 31,</b>	
	<b>2002</b>	<b>2003</b>
<b>Deferred tax assets:</b>		
Net operating loss carryforwards	\$ 5,282	\$ 6,928
Capital loss carryforward	759	828
Allowance for doubtful accounts	7,258	2,840
Accrued vacation and other accrued liabilities	9,367	11,770
Other	106	53
Less: valuation allowance	(6,041)	(7,756)
	<u>16,731</u>	<u>14,663</u>
<b>Deferred tax liabilities:</b>		
Depreciation	8,572	17,851
Amortization	12,788	22,629
Investments in partnerships	2,419	748
	<u>23,779</u>	<u>41,228</u>
Net deferred tax liability	<u>\$ (7,048)</u>	<u>\$ (26,565)</u>

The following is a reconciliation of the statutory federal and state income tax rates to the effective rates as a percentage of income before provision for income taxes as reported in the consolidated financial statements:

	<b>Year Ended December 31,</b>		
	<b>2001</b>	<b>2002</b>	<b>2003</b>
U.S. federal income tax rate	35.0%	35.0%	35.0%
State income tax, net of federal income tax benefit	2.5	1.2	1.7
Increase in valuation allowances	0.1	1.8	1.0
Other	0.6	—	0.3
Effective income tax rate	<u>38.2%</u>	<u>38.0%</u>	<u>38.0%</u>

**Table of Contents**

**8. STOCKHOLDERS EQUITY (in thousands, except per share amounts)**

**Stock Option Plans**

As of December 31, 2003, the Company had six stock option plans. The Company has also issued options, referred to in these financial statements as Free Standing Options outside of these plans. Options issued as Free Standing are for employees, officers, directors, and other key persons. Free Standing Options vest over various periods up to five years and have a term of ten years from the date of issuance.

Options issued under the 1999 and 1996 Employee Plans have similar terms and purposes. Specifically, options under each of these plans are available for grant to eligible employees and other key persons, the options generally vest over four to five years and have a term of ten years from the date of issuance. These plans were adopted in 1999 and 1996, and have 7,500 and 6,000 shares of common stock reserved for issuance, respectively.

Options issued under the Equity Compensation Plan ( Equity Plan ) are for eligible employees and other key persons. The options vest over periods up to three years and have a term of ten years from the date of issuance. This plan was adopted by Dialysis Centers of America, Inc. ( DCA ) in 1995, and there are 350 shares of common stock reserved for issuance. The Company merged with DCA in a pooling-of-interests transaction in February 1999.

Options issued under the 1994 Stock Option Plan ( 1994 Plan ) are for directors, officers and other key persons. These options vest over four years and the options have a term of ten years from the date of issuance. This plan was adopted in 1994 and there are 720 shares of common stock reserved for issuance.

Options issued under the Directors Plan are for non-management directors. These options vest immediately and have a term of ten years from the date of issuance. The plan was adopted in 1996 and there are 225 shares of common stock reserved for issuance.

Options issued under the RDM Plan are for directors, officers, and other key persons. These options vest immediately upon grant and have a term of 5 to 10 years from the date of issuance. The plan was adopted by Renal Disease Management by Physicians, Inc. ( RDM ) in 1997, and there are 109 shares of common stock reserved for issuance. The Company merged with RDM in a pooling-of-interests transaction in April 2000.

The Company has adopted the disclosure-only provisions of SFAS No. 123 and SFAS No. 148, but applies APB Opinion No. 25 and related interpretations in accounting for its plans. Therefore, compensation expense would generally be recorded only if on the date of grant the then-current market price of the underlying stock exceeded the exercise price.

**Table of Contents**

The following is a summary of option transactions during the period from January 1, 2001 through December 31, 2003:

	<u>Free Standing</u>	<u>1999 Employee Plan Plan</u>	<u>1996 Employee Plan Plan</u>	<u>Equity Plan</u>	<u>1994 Plan</u>	<u>Directors Plan</u>	<u>RDM Plan</u>	<u>Exercise Price Range</u>	<u>Weighted Average Exercise Price</u>
Balance at									
December 31, 2000	1,466	2,375	3,857	18	17	56	26	\$ 3.33 \$29.50	\$ 15.65
Granted	120	899				17		28.02 29.63	28.05
Exercised	(686)	(198)	(1,113)	(1)	(9)	(6)	(6)	3.33 25.58	13.39
Forfeited	(9)	(46)	(54)					8.00 28.02	18.07
Balance at									
December 31, 2001	891	3,030	2,690	17	8	67	20	3.33 29.63	18.27
Granted		1,920				11		28.30 32.70	28.41
Exercised	(273)	(486)	(704)			(5)	(6)	3.33 29.63	15.23
Forfeited	(1)	(64)	(55)					14.06 28.39	19.12
Balance at									
December 31, 2002	617	4,400	1,931	17	8	73	14	3.33 32.70	21.66
Granted		1,912				28		30.00 37.81	34.46
Exercised	(229)	(1,324)	(800)	(1)			(5)	3.33 29.03	20.80
Forfeited	(35)	(545)	(62)					15.94 34.65	27.53
Balance at									
December 31, 2003	353	4,443	1,069	16	8	101	9	\$ 3.33 \$37.81	\$ 25.70
Available for grant at									
December 31, 2003		946	189			107			
Exercisable at									
December 31, 2001	571	800	1,935	17	8	67	17		
Exercisable at									
December 31, 2002	428	1,216	1,720	16	8	73	13		
Exercisable at									
December 31, 2003	294	1,040	999	15	8	101	9		

The weighted-average fair value of options granted during 2001, 2002 and 2003 is \$12.40, \$11.55 and \$13.48, respectively.

**Table of Contents**

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

<b>Range of Exercise Prices</b>	<b>Number Outstanding as of December 31, 2003</b>	<b>Weighted Average Remaining Contractual Life</b>	<b>Weighted Average Exercise Price</b>	<b>Number Exercisable as of December 31, 2003</b>	<b>Weighted Average Exercise Price</b>
\$3.33 - \$18.25	1,703	4.76	\$ 14.39	1,390	\$ 14.01
\$19.36 - \$28.39	2,426	7.44	27.02	974	25.14
\$28.50 - \$34.65	1,653	9.43	33.86	85	30.30
\$34.89 - \$37.81	217	9.82	37.58	17	34.89
<b>\$3.33 - \$37.81</b>	<b>5,999</b>	<b>7.31</b>	<b>\$25.70</b>	<b>2,466</b>	<b>\$ 19.11</b>

Pro forma information regarding net income and net income per share is required by SFAS No. 123 and SFAS No. 148, and has been determined as if the Company had accounted for its employee stock options under the fair value method of that Statement. The fair value for these options was estimated at the date of grant using a Black-Scholes option pricing model with the following weighted-average assumptions:

	<b>Year Ended December 31,</b>		
	<b>2001</b>	<b>2002</b>	<b>2003</b>
Expected volatility	45.0%	40.0%	39.0%
Expected dividend yield	None	None	None
Risk-free interest rate	3.75%	3.75%	3.25%
Expected life of options	5years	5years	5years

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options, which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

**Table of Contents**

For purposes of pro forma disclosure, the estimated fair value of the options is amortized to expense over the option's vesting period. The Company's pro forma information follows:

	Year Ended December 31		
	2001	2002	2003
Net income, as reported	\$76,601	\$92,460	\$102,056
Add: stock-based compensation expense, net of related tax effects, included in the determination of net income as reported	338	380	424
Less: stock-based compensation expense, net of related tax effects, determined by the fair value-based method	(8,036)	(8,028)	(8,663)
Pro forma net income	\$68,903	\$84,812	\$93,817
Net income per share:			
Basic, as reported	\$ 1.59	\$ 1.89	\$ 2.11
Basic, pro forma	\$ 1.43	\$ 1.73	\$ 1.94
Diluted, as reported	\$ 1.52	\$ 1.82	\$ 2.05
Diluted, pro forma	\$ 1.37	\$ 1.67	\$ 1.88

The effect of applying SFAS No. 123 and SFAS No. 148 for providing pro forma disclosure is not likely to be representative of the effect on reported net income for future years.

**9. OPERATING LEASES**

The Company rents office and space for its dialysis facilities under lease agreements that are classified as operating leases for financial statement purposes. At December 31, 2003, future minimum rental payments under non-cancelable operating leases with terms of one year or more consist of the following:

2004	\$ 30,413
2005	27,766
2006	25,453
2007	23,242
2008	20,648
Thereafter	68,369
	<u>\$195,891</u>

Rent expense was \$22,624, \$27,074 and \$30,729 for the years ending December 31, 2001, 2002 and 2003, respectively.

**10. EMPLOYEE BENEFIT PLANS**

**Defined Contribution Plans**

The Company has qualified defined contribution plans covering substantially all employees that permit participants to make voluntary contributions. The Company pays all general and administrative expenses of the plans and makes matching contributions on behalf of the employees. The Company made contributions relating to these plans totaling \$1,960, \$2,518 and \$2,978 for the years ended December 31, 2001, 2002 and 2003, respectively.

**Defined Benefit Plan**

Effective January 29, 2003, the Company implemented a retirement benefit plan for Sam A. Brooks, the Company's former Chairman, Chief Executive Officer and President. Mr. Brooks died March 20, 2003. The plan provides that the Company will make 120 monthly payments of \$54 each to Mr. Brooks' beneficiary, beginning in April 2003. As a result, the Company recorded a \$5,350 charge representing the pre-tax net present value of such payments during the first quarter of 2003. As of December 31, 2003 the Company has accrued liabilities totaling \$5,019 related to this defined benefit plan.

F-21

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**Table of Contents****Employee Stock Purchase Plan**

Effective April 1996, the Company adopted an Employee Stock Purchase Plan ( Stock Purchase Plan ) to provide substantially all employees an opportunity to purchase shares of its common stock in amounts not to exceed 10% of eligible compensation or \$25 of common stock each calendar year. Annually, the participant's December 31 account balance is used to purchase shares of stock at the lesser of 85% of the fair market value of shares at the beginning of the year or December 31. A total of 85 shares are available for purchase under the plan. At December 31, 2002 and 2003, \$2,347 and \$3,055, respectively, were included in accrued wages and benefits relating to the Stock Purchase Plan.

**11. EARNINGS PER SHARE**

Basic net income per share is based on the weighted average number of common shares outstanding during the periods. Diluted net income per share is based on the weighted average number of common shares outstanding during the periods plus the effect of dilutive stock options and warrants calculated using the treasury stock method.

The following table sets forth the computation of basic and diluted net income per share.

	<u>2001</u>	<u>2002</u>	<u>2003</u>
Numerator:			
Numerator for basic and diluted net income per share	\$ 76,601	\$ 92,460	\$ 102,056
Denominator:			
Denominator for basic net income per share weighted-average shares	48,113	48,978	48,479
Effect of dilutive securities:			
Stock options	2,087	1,712	1,356
Warrants	233	77	
	<u>          </u>	<u>          </u>	<u>          </u>
Denominator for diluted net income per share-adjusted weighted-average shares and assumed conversions	50,433	50,767	49,835
	<u>          </u>	<u>          </u>	<u>          </u>
Basic net income per share	\$ 1.59	\$ 1.89	\$ 2.11
	<u>          </u>	<u>          </u>	<u>          </u>
Diluted net income per share	\$ 1.52	\$ 1.82	\$ 2.05
	<u>          </u>	<u>          </u>	<u>          </u>

**12. COMMITMENTS AND CONTINGENCIES**

On August 30, 2000, 19 patients were hospitalized and one patient died shortly after becoming ill while receiving treatment at one of the Company's dialysis centers in Youngstown, Ohio. One of the 19 hospitalized patients also died some time later. In March 2001, one of the affected patients sued the Company in Mahoning County, Ohio for injuries related to the August 30, 2000 illnesses. Additional suits have been filed, and as of December 31, 2003, a total of five suits were pending. The suits allege negligence, medical malpractice and product liability. Additional defendants are named in each of the suits. Additional defendants in some of the suits include the water system vendors who installed and maintained the water system in the dialysis center. Renal Care Group has denied the allegations and has filed cross-claims against the water system vendors. Renal Care Group intends to pursue these cross-claims vigorously. Management believes that Renal Care Group's insurance should be adequate to cover claims for these illnesses and does not anticipate a material adverse effect on the Company's consolidated financial position or results of operations.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. The Company believes that it is in compliance with all applicable laws and regulations governing the Medicare and Medicaid programs. The Company is not aware of any pending or threatened investigations involving allegations of potential noncompliance with applicable laws or regulations. While no regulatory inquiries have been made, compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid programs.





**Table of Contents**

The Company is involved in other litigation and regulatory investigations arising in the ordinary course of business. In the opinion of management, after consultation with legal counsel, these matters will be resolved without material adverse effect on the Company's consolidated financial position or results of operations.

The Company generally engages practicing board-certified or board-eligible nephrologists to serve as medical directors for its centers. Medical directors are responsible for the administration and monitoring of the Company's patient care policies, including patient education, administration of dialysis treatment, development programs and assessment of all patients. The Company pays medical director fees that are consistent with the fair market value of the required supervisory services. Such medical director agreements typically have a term of seven years with a three-year renewal option. As of December 31, 2003, estimated commitments for medical director fees for the year 2004 are \$13,902 and are \$61,270 over the remaining lives of the agreements.

**13. SUBSEQUENT EVENTS**

*Midwest Kidney Centers*

Effective January 1, 2004, the Company acquired certain operating assets and liabilities of Midwest Kidney Centers and several affiliated companies ( MKC ) for \$49,500 in consideration. Through this acquisition, the Company added approximately 825 patients and 13 dialysis facilities in central Illinois.

*National Nephrology Associates, Inc.*

On February 2, 2004, the Company announced the signing of a definitive agreement to acquire National Nephrology Associates, Inc. ( NNA ), a Nashville, Tennessee-based dialysis services provider. NNA owns and operates 87 outpatient dialysis facilities in 15 states and provides services to approximately 5,600 patients, as well as acute dialysis services to approximately 55 hospitals.

Under the terms of the agreement, the total consideration of \$345,000 will consist of a cash payment of approximately \$167,000 payable to NNA's equity holders and the assumption of NNA's outstanding debt, including its \$160,000 of 9% senior subordinated notes due 2011, and other indebtedness, including capital leases. Renal Care Group plans to finance the acquisition through the new 2004 Agreement as discussed in Note 6. Completion of the transaction, which is expected to close on or before March 31, 2004, is subject to customary conditions, including expiration of the waiting period under the Hart-Scott-Rodino Antitrust Improvements Act.

Following completion of the MKC acquisition and assuming completion of the NNA transaction, Renal Care Group will serve almost 28,000 patients at over 370 facilities in 30 states, in addition to providing acute dialysis services at more than 175 hospitals.

**Table of Contents****14. SELECTED QUARTERLY FINANCIAL DATA (unaudited)**

The following tables include, for 2002 and 2003, certain selected quarterly financial data. In the opinion of the Company's management this unaudited information has been prepared on the same basis as the audited information and includes all adjustments necessary to present fairly the information included therein. The operating results for any quarter are not necessarily indicative of results for any future period.

	<b>2002</b>			
	<b>First Quarter</b>	<b>Second Quarter</b>	<b>Third Quarter</b>	<b>Fourth Quarter</b>
Net revenue	\$ 206,678	\$ 222,169	\$ 231,542	\$ 242,998
Operating expenses	157,756	170,273	177,416	185,831
Depreciation and amortization	9,362	9,933	10,402	10,735
Income from operations	39,560	41,963	43,724	46,432
Interest expense, net	173	138	569	260
Minority interest	4,710	5,307	5,364	6,029
Income before income taxes	34,677	36,518	37,791	40,143
Provision for income taxes	13,184	13,876	14,361	15,248
Net income	\$ 21,493	\$ 22,642	\$ 23,430	\$ 24,895
Net income per share:				
Basic	\$ 0.43	\$ 0.46	\$ 0.48	\$ 0.52
Diluted	\$ 0.42	\$ 0.44	\$ 0.46	\$ 0.50
	<b>2003</b>			
	<b>First Quarter</b>	<b>Second Quarter</b>	<b>Third Quarter</b>	<b>Fourth Quarter</b>
Net revenue	\$ 242,143	\$ 247,061	\$ 253,835	\$ 262,280
Operating expenses	190,177	187,653	192,743	199,183
Depreciation and amortization	10,298	11,579	11,365	11,663
Income from operations	41,668	47,829	49,727	51,434
Interest expense, net	285	165	76	103
Minority interest	6,308	6,029	6,837	6,257
Income before income taxes	35,075	41,635	42,814	45,074
Provision for income taxes	13,323	15,822	16,269	17,128
Net income	\$ 21,752	\$ 25,813	\$ 26,545	\$ 27,946
Net income per share:				
Basic	\$ 0.45	\$ 0.53	\$ 0.54	\$ 0.58
Diluted	\$ 0.44	\$ 0.52	\$ 0.53	\$ 0.56

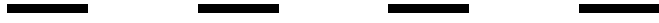


Table of Contents

## Schedule II

**Renal Care Group, Inc.**  
**Consolidated Schedule - Valuation and Qualifying Accounts**  
(in thousands)

	<u>Balance Beginning Of Period</u>	<u>Amount Charged to Expense</u>	<u>Write-Offs</u>	<u>Balance At End of Period</u>
Allowance for doubtful accounts:				
Year ended December 31, 2001	\$47,392	\$20,290	\$(22,422)	\$45,260
Year ended December 31, 2002	\$45,260	\$23,501	\$(25,084)	\$43,677
Year ended December 31, 2003	\$43,677	\$26,200	\$(37,716)	\$32,161

F-25

**Table of Contents**

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15 (d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Report on Form 10-K to be signed on its behalf by the undersigned, thereunto duly authorized in the City of Nashville, State of Tennessee, on the 4th day of March, 2004.

RENAL CARE GROUP, INC.

By: Gary A. Brukardt

\_\_\_\_\_  
Gary A. Brukardt  
*President and Chief Executive Officer*

45

**Table of Contents**

KNOW ALL MEN BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Gary A. Brukart and David M. Dill and either of them (with full power in each to act alone) as true and lawful attorneys-in-fact with full power of substitution, for him and in his name, place and stead, in any and all capacities, to sign any and all amendments to this Annual Report on Form 10-K, and to file the same, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that said attorneys-in-fact, or their substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this Annual Report on Form 10-K has been signed by the following persons in the capacities and on the dates indicated.

<u>/s/ Gary A. Brukart</u>	President, Chief Executive Officer and Director	March 4, 2004
Gary A. Brukart	(Principal Executive Officer)	
<u>/s/ David M. Dill</u>	Executive Vice President, Chief Financial Officer	March 4, 2004
David M. Dill	Treasurer (Principal Financial and Accounting Officer)	
<u>/s/ Peter J. Grua</u>	Director	March 4, 2004
Peter J. Grua		
<u>/s/ Joseph C. Hutts</u>	Director	March 4, 2004
Joseph C. Hutts		
<u>/s/ Harry R. Jacobson, M.D.</u>	Director	March 4, 2004
Harry R. Jacobson, M.D.		
<u>/s/ William P. Johnston</u>	Chairman of the Board Director	March 4, 2004
William P. Johnston		
<u>/s/ William V. Lapham</u>	Director	March 4, 2004
William V. Lapham		
<u>/s/ Thomas A. Lowery, M.D.</u>	Director	March 4, 2004
Thomas A. Lowery, M.D.		
<u>/s/ Stephen D. McMurray, M.D.</u>	Director	March 4, 2004
Stephen D. McMurray, M.D.		
<u>/s/ C. Thomas Smith</u>	Director	March 4, 2004
C. Thomas Smith		





**Table of Contents****EXHIBIT INDEX**

<b>Exhibit Number</b>	<b>Description of Exhibits</b>
3.1	Amended and Restated Certificate of Incorporation of the Company (1)
3.1.2	Certificate of Amendment of Certificate of Incorporation of the Company (2)
3.1.3	Certificate of Designation, Preferences, and Rights of Series A Junior Participating Preferred Stock of the Company (2)
3.1.4	Certificate of Amendment of Amended and Restated Certificate of Incorporation of the Company (10)
3.2	Amended and Restated Bylaws of the Company (1)
4.1	See Exhibits 3.1 and 3.2 for provisions of the Amended and Restated Certificate of Incorporation and Bylaws of the Company defining rights of holders of Common Stock of the Company (1)
4.2	Specimen stock certificate for the Common Stock of the Company (1)
4.3	Shareholder Rights Protection Agreement, dated May 2, 1997 between the Company and First Union National Bank of North Carolina, as Rights Agent (3)
10.1	Employment Agreement, effective as of December 15, 2003, between the Company and Raymond Hakim, M.D.*
10.2	Medical Director Services Agreement, dated February 12, 1996, between the Company and Indiana Dialysis Management, P.C. (4)
10.2.1	Amendment Number 1, to Medical Director Services Agreement, effective as of January 1, 1999, between the Company and Indiana Dialysis Management, P.C.
10.2.2	Amendment Number 2 to Medical Director Services Agreement, effective as of February 12, 2002, between the Company and Indiana Dialysis Management.
10.3	Medical Director Services Agreement, effective as of February 12, 2003, between the Company and Tyler Nephrology Associates, P.A.
10.4	Lease Agreement, dated February 12, 1996, among the Company and Thomas A. Lowery, M.D., James R. Cotton, M.D., Roy D. Gerard, M.D. and Kevin A. Curran, M.D., relating to property in Carthage, Texas (4)
10.5	Lease Agreement, dated February 12, 1996, among the Company and Thomas A. Lowery, M.D., James R. Cotton, M.D., Roy D. Gerard, M.D., and Kevin A. Curran, M.D., relating to property in Tyler, Texas (4)
10.6	Sublease Agreement, dated February 12, 1996, with Tyler Nephrology Associates, Inc. (4)
10.7	Dialysis Center Management Agreement, effective as of July 1, 2001, between Renal Care Group, Inc. and Vanderbilt University (23)
10.8	1996 Stock Option Plan for Outside Directors (1)*
10.9	Fourth Amended and Restated 1996 Stock Incentive Plan (5)*
10.10	Amended and Restated Employee Stock Purchase Plan (2)*
10.11	Employment Agreement, April 28, 2003, between the Company and Gary Brukardt (20)*



**Table of Contents**

Exhibit Number	Description of Exhibits
10.12	Loan Agreement dated as of July 1, 2002, among the Company, Bank of America, N.A., SunTrust Bank, AmSouth Bank, and Wells Fargo Bank, N.A. (16)
10.12.1	Second Amended and Restated Loan Agreement, dated as of July 1, 2002, among the Company, Bank of America, N.A., SunTrust Bank, AmSouth Bank, and Wells Fargo Bank. N.A.(16)
10.12.2	Second Amendment dated as of July 27, 2003 to the Loan Agreement, dated as of July 1, 2002, among the Company, Bank of America, N.A., SunTrust Bank, AmSouth Bank, and Wells Fargo Bank, N.A.(20)
10.12.3	Second Amendment to Second Amended and Restated Loan Agreement and Consent dated as of December 23, 2003
10.12.4	Third Amendment to Loan Agreement and Consent dated as of December 23, 2003
10.13	Stock Option Agreement, dated April 30, 1997, between the Company and Gary Brukardt (2)*
10.14	Asset Purchase Agreement with an effective date of February 1, 1997 among the Company, RCG Indiana, LLC, Eastern Indiana Kidney Center, Indiana Kidney Center, Indiana Kidney Center South, LLC, St. Vincent Dialysis Center, Saint Joseph Dialysis Center and Indiana Dialysis Services PC and Community Hospitals of Indiana, Inc., Seton Health Corporation of Central Indiana, Inc., Reid Hospital & Health Care Services, Inc., and Saint Joseph Hospital and Health Care Center of Kokomo, Indiana, Inc. and Indiana Dialysis Services, PC, Reid Hospital Physicians, Greenwood Dialysis Services, PC and certain individuals named on the signature pages thereto and Indiana Nephrology & Internal Medicine, P.C. (6)
10.15	Stock Option Agreement, dated May 22, 1998, between the Company and Gary A. Brukardt (7)*
10.16	Stock Option Agreement, dated May 22, 1998, between the Company and Raymond Hakim, M.D. (7)*
10.17	Stock Option Agreement, dated June 5, 1998, between the Company and Joseph C. Hutts (7)*
10.18	Stock Option Agreement, dated June 5, 1998, between the Company and Harry R. Jacobson, M.D. (7)*
10.19	Agreement No. 20010240, between Renal Care Group, Inc. and Amgen Inc. effective January 2, 2002 (The Company has requested confidential treatment of certain portions of this Exhibit.)(15)
10.19.1	Amendment #2 dated February 10, 2003 to Agreement No. 200010240 between Renal Care Group, Inc. and Amgen Inc. (The Company has requested confidential treatment of certain portions of this Exhibit.)(21)
10.20	Restricted Stock Award Agreement, dated January 25, 1999, between the Company and Harry R. Jacobson (8)*
10.21	Restricted Stock Award Agreement, dated January 25, 1999, between the Company and Stephen D. McMurray (8)*
10.22	Renal Care Group, Inc. 1999 Long-Term Incentive Plan (9)*
10.22.1	Amendment to the Renal Care Group, Inc. 1999 Long-Term Incentive Plan (12)*
10.22.2	Amended and Restated Renal Care Group, Inc. 1999 Long-Term Incentive Plan (19)*
10.23	Stock Option Agreement, dated August 30, 1999, between the Company and Gary A. Brukardt (11)*
10.24	Stock Option Agreement, dated August 30, 1999, between the Company and Raymond Hakim, M.D. (11)*

**Table of Contents**

Exhibit Number	Description of Exhibits
10.25	Stock Option Agreement, dated June 2, 1999, between the Company and Joseph C. Hutts (11)*
10.26	Stock Option Agreement, dated June 2, 1999, between the Company and Harry R. Jacobson, M.D. (11)*
10.27	Stock Option Agreement, dated July 22, 1999, between the Company and William V. Lapham (11)*
10.28	Stock Option Agreement, dated June 8, 2000, between the Company and Joseph C. Hutts (13)*
10.29	Stock Option Agreement, dated June 8, 2000, between the Company and Harry R. Jacobson, M.D.(13)*
10.30	Stock Option Agreement, dated June 8, 2000, between the Company and William V. Lapham(13)*
10.31	Stock Option Agreement, dated September 19, 2000, between the Company and Gary A. Brukardt(13)*
10.32	Stock Option Agreement, dated September 19, 2000, between the Company and Raymond Hakim, M.D.(13)*
10.33	Stock Option Agreement dated August 2, 2001 between the Company and Gary Brukardt(14)*
10.34	Stock Option Agreement dated August 2, 2001 between the Company and Raymond Hakim(14)*
10.35	Stock Option Agreement dated June 7, 2001 between the Company and Joseph C. Hutts(15)*
10.36	Stock Option Agreement dated June 7, 2001 between the Company and William V. Lapham(15)*
10.37	Form of Stock Option Agreement for stock option grants to executive employees under the Company's 1999 Long-Term Incentive Plan(17)
10.38	Form of Stock Option Agreement for stock option grants to non-management directors under the Company's 1996 Stock Option Plan for Outside Directors(17)
10.39	Medical Director Services Agreement, dated May 1, 2002, between the Company and Tyler Nephrology Associates, P.A.(18)
10.40	Medical Director Services Agreement, dated July 11, 2002 between the Company and Tyler Nephrology Associates, P.A.(18)
10.41	Renal Care Group Supplemental Benefit Plan(19)*
10.42	Plan Agreement dated February 25, 2003 between Renal Care Group, Inc. and Sam A. Brooks(19)*
10.42.1	Amendment #1 to Plan Agreement under the Renal Care Group, Inc. Supplemental Benefit Plan dated as of May 29, 2003(20)*
10.43	Form of Indemnity Agreement between the Company and directors and certain officers(19)
10.44	Employment Agreement, effective as of November 3, 2003, between the Company and David M. Dill*
10.45	Employment Agreement, effective as of November 30, 2003, between the Company and Timothy P. Martin*

**Table of Contents**

Exhibit Number	Description of Exhibits
10.46	Employment Agreement effective as of December 31, 2003 between the Company and Douglas B. Chappell*
21.1	List of subsidiaries of the Company
23.1	Consent of Ernst & Young LLP
24.1	Power of Attorney (contained on the signature page of this report)
31.1	Certification pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1* *	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2* *	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
(1)	Incorporated by reference to the Company's Registration Statement on Form S-1 (Reg. No. 333-80221) effective February 6, 1996.
(2)	Incorporated by reference to the Company's Form 10-Q for the quarter ended June 30, 1997 (Commission File No. 0-27640).
(3)	Incorporated by reference to the Company's Current Report on Form 8-K filed May 5, 1997 (Commission File No. 0-27640).
(4)	Incorporated by reference to the Company's Form 10-Q for the quarter ended March 31, 1996 (Commission File No. 0-27640).
(5)	Incorporated by reference to Appendix A to the Company's definitive Proxy Statement filed April 27, 1998 relating to the 1998 Annual Meeting of Stockholders (Commission File No. 0-27640).
(6)	Incorporated by reference to the Company's Form 10-K for the year ended December 31, 1996 (Commission File No. 0-27640).
(7)	Incorporated by reference to the Company's Form 10-Q for the quarter ended June 30, 1998 (Commission File No. 0-27640).
(8)	Incorporated by reference to the Company's Form 10-Q for the quarter ended March 31, 1999 (Commission File No. 0-27640).
(9)	Incorporated by reference to Appendix A to the Company's definitive Proxy Statement filed April 27, 1999 relating to the 1999 Annual Meeting of Stockholders (Commission File No. 0-27640).
(10)	Incorporated by reference to the Company's Form 10-Q for the quarter ended June 30, 1999 (Commission File No. 0-27640).
(11)	Incorporated by reference to the Company's Form 10-Q for the quarter ended September 30, 1999 (Commission File No. 0-27640).
(12)	Incorporated by reference to the Company's definitive Proxy Statement filed April 28, 2000 relating to the 2001 Annual Meeting of Stockholders (Commission File No. 0-27640).
(13)	Incorporated by reference to the Company's Form 10-K for the year ended December 31, 2000 (Commission File No. 0-27640).

**Table of Contents**

- (14) Incorporated by reference to the Company's Form 10-Q for the quarter ended September 30, 2001 (Commission File No. 0-27640).
- (15) Incorporated by reference to the Company's Form 10-K for the year ended December 31, 2001 (Commission File No. 0-27640).
- (16) Incorporated by reference to the Company's Form 10-Q for the quarter ended June 30, 2002 (Commission File No. 0-27640).
- (17) Incorporated by reference to the Company's Form 10-Q for the quarter ended September 30, 2002 (Commission File No. 0-27640).
- (18) Incorporated by reference to the Company's Form 10-K for the year ended December 31, 2002 (Commission File No. 0-27640).
- (19) Incorporated by reference to the Company's Form 10-Q for the quarter ended March 31, 2003 (Commission File No. 0-27640).
- (20) Incorporated by reference to the Company's Form 10-Q for the quarter ended June 30, 2003 (Commission File No. 0-27640).
- (21) Incorporated by reference to the Company's Form 10-Q for the quarter ended September 30, 2003 (Commission File No. 0-27640).

\* Management contract or executive compensation plan or arrangement.

\* In accordance with Release No. 34-47551, this exhibit is hereby furnished to the SEC as an accompanying document and is not deemed to be filed for purposes of Section 18 of the Securities Exchange Act of 1934 or otherwise subject to the liabilities of that Section, and it shall not be deemed incorporated by reference into any filing under the Securities Act of 1933.