SECURITIES AND EXCHANGE COMMISSION

FORM 10-K

Annual report pursuant to section 13 and 15(d)

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KINETIC CONCEPTS INC /TX/

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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K

(Mark One)

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 [FEE REQUIRED]
For the fiscal year ended December 31, 1997

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 [NO FEE REQUIRED]
For the transition period from_______________ to ________________

Commission file number 1-9913

KINETIC CONCEPTS, INC.

(Exact name of registrant as specified in its charter)

Texas	74-1891727
(State of incorporation)	(I.R.S. Employer Identification No.)
8023 Vantage Drive San Antonio, TX 78230	(210) 524-9000
(Address of principal executive offices and zip code)	(Registrant's telephone number)

Securities registered pursuant to Section 12(b) of the Act: NONE

Securities registered pursuant to Section 12(g) of the Act: NONE

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendments to this Form 10-K. [ ]

As of March 1, 1998, there were 17,713,152 shares of the Registrant's

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Common Stock outstanding, 17,613,152 of which were held by affiliates.

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TriaDyner, BariKarer, The V.A.C.r, PlexiPulser, PlexiPulse All-in-1 System TM, KinAirr III, First Stepr, FirstStepr Plus, FirstStepr Select, FirstStepr MRS, TheraPulser, BioDyner,

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BioDyner II, FluidAirr Plus, FluidAirr Elite, RotoRestr, Q2 Plusr, HomeKairr DMS, DynaPulser, FirstStepr TriCell, Impressionr, RotoRestr Delta, PediDyner, BariAirer, FirstStepr Select Heavy Duty, TriCellr, RIKr and AirWorksr Plus, are trademarks of the Company used in this Report. Kinetic Therapy SM, The Clinical Advantage SM, Genesis SM and Odyssey SM are service marks of the Company used in this Report.

CAUTINARY STATEMENT FOR PURPOSES OF THE "SAFE HARBOR" PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

The Private Securities Litigation Reform Act of 1995 provides a "safe harbor" for certain forward-looking statements. The forward-looking statements made in "Business", "Legal Proceedings" and "Management's Discussion and Analysis of Financial Condition and Results of Operations," which reflect management's best judgment based on market and other factors currently known, involve risks and uncertainties. When used in this Report, the words "estimate," "project," "anticipate," "expect," "intend," "believe" and similar expressions are intended to identify forward-looking statements. All of these forward-looking statements are based on estimates and assumptions made by management of the Company, which, although believed to be reasonable, are inherently uncertain. Therefore, undue reliance should not be placed upon such estimates and statements. No assurance can be given that any of such statements or estimates will be realized and actual results will differ from those contemplated by such forward-looking statements.

PART I

Item 1. Business

General

Kinetic Concepts, Inc. (the "Company" or "KCI") is a worldwide leader in innovative therapeutic systems which prevent and treat the complications of immobility that can result from disease, trauma, surgery or obesity. The Company's clinically effective therapeutic systems include specialty hospital beds, specialty mattress overlays and non-invasive medical devices combined with on-site patient care consultation by the Company's clinically-trained staff. The complications of immobility include pressure sores, pneumonia and circulatory problems which can increase patient treatment costs by as much as $75,000 and, if left untreated, can result in death. The Company's therapeutic systems can significantly improve clinical outcomes while reducing the cost of patient care by preventing these complications or accelerating the healing process, as well as by providing labor savings. The Company has also been successful in applying its therapeutic expertise to bring to market innovative medical devices that treat chronic wounds and help prevent blood clots.

The Company designs, manufactures, markets and services its products, many of which are proprietary. KCI's therapeutic systems are used to treat patients across all health care settings

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including acute care hospitals, extended care facilities and patients' homes. Health care providers generally prefer to rent rather than purchase the Company's products in order to avoid the ongoing service, storage and maintenance requirements and the high initial capital outlay associated with purchasing such products, as well as to receive the Company's high-quality clinical support. The Company can deliver its therapeutic systems to any major domestic trauma center within two hours of notice through its network of service centers.

Founded by James R. Leininger, M.D., an emergency room physician, to provide better care for his patients, the Company was incorporated in Texas in 1976. The Company's principal offices are located at 8023 Vantage Drive, San Antonio, Texas 78230 and its telephone number is (210) 524-9000.

On November 5, 1997, a substantial interest in the Company was acquired by certain affiliates of Fremont Partners L.P. ("Fremont") and Richard C. Blum & Associates, L.P. ("RCBA") (collectively, the "Investors") pursuant to the terms of a Transaction Agreement dated October 2, 1997, as amended by a letter agreement dated November 5, 1997 (as so amended, the "Transaction Agreement"). Under the terms of the Transaction Agreement, the Investors purchased approximately 7.8 million newly-issued shares of the Company's common stock. The proceeds of the stock purchase, together with proceeds from certain financings were used to purchase approximately 31.0 million shares of the Company's common stock from the selling shareholders and pay all related fees and expenses. The entities controlled by the Investors were subsequently merged with and into the Company, with the Company as the surviving corporation. Following the merger, Fremont, RCBA, Dr. James Leininger and Dr. Peter Leininger own approximately 7.0 million, 4.6 million, 5.9 million and 0.1 million common shares, respectively, representing 39.7%, 26.2%, 33.5% and 0.6% of the total shares outstanding. There are currently no other shareholders, however, members of management have retained, and have been granted, additional options to purchase shares.

Therapies

The Company's therapeutic systems deliver one or a combination of the following therapies:

Pressure Relief/Pressure Reduction. The Company's pressure relief and pressure reduction surfaces provide effective skin care therapy in the treatment of pressure sores, burns, skin grafts and other skin conditions and help prevent the formation of pressure sores which develop in certain immobile individuals. The Company's beds and mattress overlays reduce the amount of pressure at any point on a patient's skin by using surfaces supported by air, silicon beads, or a viscous fluid. Some of the products further promote healing through pulsation.

Pulmonary Care. The Company's pulmonary care systems provide Kinetic Therapy to help prevent and treat acute respiratory problems, such as pneumonia, by reducing the build-up of fluid in the lungs. The United States Centers for Disease Control (the "CDC") defines Kinetic Therapy as the lateral rotation of a patient by at least 40 degrees to each side (a continuous 80 degree arc). Some of the Company's products combine Kinetic Therapy with

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additional therapies such as percussion and pulsation which help loosen mucous buildup and promote circulation.

Bariatric Care. The Company offers a line of bariatric care products which are designed to accommodate obese individuals. These products are used generally for patients weighing from 300 to 600 pounds, but can accommodate patients weighing nearly 1,000 pounds. These individuals are often unable to fit into standard-sized beds and wheelchairs. The Company's most sophisticated bariatric care product can serve as a bed, chair, scale and x-ray table, helps patients enter and exit the bed, and contains other features which permit patients to be treated safely and with dignity. Moreover, treating obese patients is a significant staffing issue for many health care facilities because moving and handling these patients increases the risk of worker's compensation claims by such personnel. Management believes that these products enable health care personnel to treat these patients in a manner which is safer to hospital personnel than traditional methods, which can help reduce worker's compensation claims. Some of the bariatric products also address complications of immobility and obesity such as pressure sores.

Closure of Chronic Wounds. The Company is the provider of a patented, non-invasive device which uses negative pressure to promote the healing of chronic wounds. The negative pressure is applied through a proprietary foam dressing which draws the tissue together, stimulates blood flow, reduces swelling and decreases bacterial growth. The device heals wounds more quickly than traditional methods and has been effective at closing chronic wounds which have, in some cases, been open for years.

Circulatory Improvement. The Company offers a non-invasive device which improves blood circulation, decreases swelling in the lower extremities and reduces the incidence of blood clots. The therapy is accomplished by wrapping inflatable cuffs around a foot or leg and then automatically inflating and deflating them at prescribed intervals. The products are often used by individuals who have had hip or knee surgeries, diabetes, or other conditions which reduce circulation.

Corporate Organization

In 1997, the Company was organized into four operating divisions: KCI Therapeutic Services, Inc. ("KCI Therapeutic Services" or "KCTS"), KCI Home Care, KCI International, Inc. ("KCI International") and KCI New Technologies, Inc. ("NuTech"). At the beginning of 1998, the Company combined the operations of KCTS and KCI Home Care into a single business unit.

KCI Therapeutic Services

KCI Therapeutic Services provides a broad line of therapeutic specialty support surfaces to patients in acute and sub-acute facilities as well as extended care settings. This division consists of approximately 1,100 personnel, many of whom have a medical or clinical background. Sales are generated by a sales force of approximately 350 individuals who are responsible for new accounts in addition to the management and expansion of existing accounts. A portion of this sales force is focused exclusively on

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either the extended care market or the acute care market although the majority of the sales force is responsible for sales across both settings.

KCI Therapeutic Services has a national 24-hour, seven days-a-week customer service communications system which allows it to quickly and efficiently respond to its customers' needs. The Company distributes its specialty patient support surfaces to acute and extended care facilities through a network of 143 domestic service centers. The KCTS service centers are organized as profit centers and the general managers who supervise the service centers are responsible for both sales and service operations. Each center has an inventory of specialty beds and overlays which are delivered to the individual hospitals or extended care facilities on an as-needed basis.

The KCTS sales and support staff is comprised of approximately 250 employees with medical or clinical backgrounds. The principal responsibility of approximately 125 of these clinicians is making product rounds and participating in treatment protocols. These clinicians educate the hospital or long-term facility staff on issues related to patient treatment and assist in the establishment of protocols. The clinical staff makes approximately 200,000 patient rounds annually. KCTS accounted for approximately 65%, 64% and 61%, respectively, of the Company's total revenue in the years ended December 31, 1997, 1996 and 1995.

KCI Home Care

KCI has developed a continuum of products that address the unique demands of the home health care market. In January 1995, KCI Home Care started a transition from a combined direct/dealer distribution system to distributing its products through home medical equipment ("HME") dealers. The Company believes that selling products through the home care provider network gives it access to a larger patient population and improves the overall contribution from this business segment despite a reduction in per patient revenue. Subsequent to 1997, the Company has combined the operations of KCTS and KCI Home Care into a single business unit.

KCI International

KCI International offers the Company's therapies and services in 12 foreign countries including Germany, Austria, the United Kingdom, Canada, France, the Netherlands, Switzerland, Australia, Italy, Denmark, Sweden and Ireland. The Denmark office has recently been expanded to service all of Scandinavia. In addition, relationships with 75 independent distributors in Latin America, the Middle East, Asia and Eastern Europe allow KCI International to service the demands of a growing global market. KCI International accounted for approximately 23%, 25% and 25%, respectively, of the Company's total revenue in the years ended December 31, 1997, 1996 and 1995. See Note 13 of Notes to Consolidated Financial Statements for information on foreign and domestic operations.

NuTech

NuTech manufactures and markets the PlexiPulse and PlexiPulse

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All-in-1 System. The products are sold through a direct sales force and a limited number of independent distributors and rented through an alliance with MEDIQ/PRN, a national medical device rental company with a strong portfolio of national accounts. NuTech accounted for approximately 6% of the Company's total revenue in 1997.

Products

The Company's "Continuum of Care" is focused on treating wound care patients, pulmonary patients, large or obese patients and patients with circulatory problems by providing innovative, outcome driven therapies across multiple care settings. The Company's therapies include Pressure Relief/Pressure Reduction, Pulmonary Care, Bariatric Care, Closure of Chronic Wounds and Circulatory Improvement.

Pressure Relief/Pressure Reduction

The Company's pressure relief products include a variety of framed beds and overlays such as the KinAir III, TheraPulse, FluidAir Elite, HomeKair, First Step TriCell, DynaPulse, First Step Plus, First Step Select, AirWorks Plus, Impression, RIK mattress, and RIK overlay. The KinAir III has been shown to provide effective skin care therapy in the treatment of pressure sores, burns and post operative skin grafts and flaps, and to help prevent the formation of pressure sores and certain other complications of immobility. The TheraPulse provides a more aggressive form of treatment through continuous pulsating action which gently massages the skin to help promote capillary and lymphatic circulation in patients suffering from severe pressure sores, burns, skin grafts or flaps, swelling or circulation problems. The FluidAir Elite supports the patient on a low-pressure surface of air-fluidized silicon beads providing pressure relief for skin grafts or flaps, burns and pressure sores and also has built in scales. The HomeKair bed and TriCell overlay are low-cost pressure relief products designed to be easily transportable directly to a patient's home. The DynaPulse is a pulsating mattress replacement system that helps prevent pressure ulcers in patients at high risk for skin breakdown and can also be used to treat existing pressure ulcers. The First Step family of overlays is designed to provide pressure relief and help prevent pressure sores. AirWorks Plus is a low-cost overlay which has air chambers which assist in redistributing pressure for better skin care. Impression is a self-contained for-sale product for the prevention of pressure sores which is intended to replace standard hospital mattresses. The RIK mattress and the RIK overlay are non-powered products that provide pressure relief utilizing a patented viscous fluid and an anti-shear layer.

Pulmonary Care

The CDC defines Kinetic Therapy as lateral rotation of a patient by at least 40 degrees on each side (a continuous 80 degree arc). The Company believes Kinetic Therapy is essential to the prevention or effective treatment of pneumonia and other pulmonary complications in immobile patients. The Company's Kinetic Therapy products include the TriaDyne, RotoRest, RotoRest Delta, PediDyne, BioDyne II and Q2 Plus. The TriaDyne, introduced in mid-1995, provides patients in acute care settings with three distinct therapies on an air suspension surface. The TriaDyne applies

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Kinetic Therapy by rotating the patient up to 40 degrees to each side and provides an industry-first feature of simultaneously turning the patient's torso and lower body in opposite directions while keeping the patient positioned in the middle of the bed. The TriaDyne can also provide percussion therapy to the patient's chest to loosen mucous buildup in the lungs and pulsating therapy to promote capillary circulation. The TriaDyne is built on Stryker Corporation's critical care frame, which is well suited to an ICU environment. The TriaDyne offers several other novel features not available on other products. The RotoRest Delta is a specialty bed which can rotate a patient up to a 62 degree angle on each side for the treatment of pulmonary complications and prevention of pneumonia. The RotoRest has been shown to improve the care of patients suffering from multiple trauma, spinal cord injury, severe pulmonary complications, respiratory failure and deep vein thrombosis. The PediDyne, introduced in 1997, provides many of the benefits found in the TriaDyne to pediatric patients. The BioDyne II combines many of the therapeutic benefits of the KinAir III and the RotoRest and is used by patients suffering from pneumonia, coma, stroke and chronic neurological disorders.

Bariatric Care

The Company markets a line of therapeutic support surfaces and aids for patients suffering from obesity, a market that had previously been underserved. These products not only provide the proper support needed by obese patients, but also enable nurses to care for these patients in a dignified manner. Moreover, treating obese patients is a significant staffing issue for many health care facilities because moving and handling these patients increases the risk of worker's compensation claims by nurses. The use of the Company's bariatric products enables hospital staff to treat and move obese patients in a manner which is safer to hospital personnel while utilizing fewer hospital personnel. The most advanced product in this line is the BariKare, which can serve as a bed, chair, scale and x-ray table. This product is used generally for patients weighing from 300 to 600 pounds but can be used for patients who weigh up to nearly 1,000 pounds. The Company believes that the BariKare is the most advanced product of its type available today. In 1996, the Company also introduced the FirstStep Select Heavy Duty overlay which incorporates pressure-relieving therapy in a design that supports patients weighing up to 650 pounds. The Company recently introduced a new therapy-driven bariatric product, the BariAire. The BariAire provides pressure relief, patient turn assistance and step-down features designed for both patient comfort and nurse assistance.

Closure of Chronic Wounds

The Company manufactures and markets the Vacuum Assisted Closure device (the "V.A.C."), a non-invasive, active wound closure therapy that utilizes negative pressure. The V.A.C. promotes healing in wounds, pressure ulcers and grafts that frequently do not respond to traditional methods of treatment. Treatment protocols with the V.A.C. call for a proprietary foam material to be fitted and placed in or on top of a wound and covered with an airtight, occlusive dressing. The foam is attached to a separate vacuum pump. When activated, the vacuum pump creates a negative pressure in the wound that draws the tissue together. This vacuum

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action also stimulates blood flow on the surface of the wound, reduces edema and decreases bacterial colonization, all of which stimulate healing. The dressing material is replaced every 48 hours and fitted to accommodate the decreasing size of the wound over time. This is a significant improvement over the traditional method for treating wounds which requires the nursing staff to clean and dress a serious wound every 8 to 12 hours.

Circulatory Improvement

The PlexiPulse and PlexiPulse All-in-1 System are non-invasive vascular assistance devices that aid venous return by pumping blood from the lower extremities to help prevent deep vein thrombosis ("DVT") and re-establish microcirculation. The pumping action is created by compressing specific parts of the foot or calf with specially designed inflatable cuffs that are connected to a separate pump unit. The cuffs are wrapped around the foot and/or calf and are inflated in timed increments by the pump. The intermittent inflation compresses a group of veins in the lower limbs and boosts the velocity of blood flowing back toward the heart. This increased velocity has been proven to significantly decrease formation of DVT in non-ambulatory post-surgical and post-trauma patients. The PlexiPulse is effective in preventing DVT, reducing edema and improving lower limb blood circulation.

Competition

The Company believes that the principal competitive factors within its markets are product efficacy, clinical outcomes, service and cost of care. Furthermore, the Company believes that a national presence with full distribution capabilities is important to serve large, sophisticated national and regional health care group purchasing organizations ("GPOs") and providers.

The Company contracts with both proprietary hospital groups and voluntary GPOs. Proprietary groups own all of the hospitals which they represent and, as a result, can ensure compliance with a national agreement. Voluntary GPOs negotiate contracts on behalf of member hospital organizations but cannot ensure that their members will comply with the terms of a national agreement. Approximately 47% of the Company's total revenue during 1997 was generated under national agreements with proprietary groups and voluntary GPOs in the acute and extended care settings.

The Company competes on a national level with Hill-Rom, Kendall and Invacare and on a regional and local level with numerous other companies. The Company competes principally with Invacare in the home care segment. NuTech competes primarily with Kendall International in the foot and leg compression market. In the U.S. specialty surface market and certain international markets, the Company competes principally with Hill-Rom.

Market Outlook

The Company believes that it is well positioned to address the following factors affecting the market for health care products and services:

Uncertainty of Health Care Reform

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There are widespread efforts to control health care costs in the United States and abroad. As an example, the Balanced Budget Act of 1997 (the "BBA") significantly reduces federal spending on Medicare and Medicaid over the next five years by reducing annual payment updates to acute care hospitals, changing payment systems for both skilled nursing facilities and home health care services from cost-based to prospective payment systems, eliminating annual payment updates for durable medical equipment("DME"), and allowing states greater flexibility in controlling Medicaid costs at the state level. Until the Health Care Financing Administration ("HCFA") issues regulations implementing this legislation in 1998, the Company cannot reliably predict the timing of or the exact effect which these initiatives could have on the pricing and profitability of, or demand for, the Company's products. However, certain of the provisions of the BBA, such as the changes in the manner Medicare Part A reimburses skilled nursing facilities, may change the manner in which the Company's customers make renting and purchasing decisions and could have a material adverse effect on the Company. The Company also believes it is likely that efforts by governmental and private payors to contain costs through managed care and other efforts and to reform health systems will continue in the future.

Consolidation of Purchasing Entities

One of the most tangible results of the health care reform debate in the United States has been to cause health care providers to examine their cost structures and reassess the manner in which they provide health care services. This review, in turn, has led many health care providers to merge or consolidate with other members of their industry in an effort to reduce costs or achieve operating synergies. A substantial number of the Company's customers, including proprietary hospital groups, group purchasing organizations, hospitals, national nursing home companies and national home health care agencies, have been affected by this consolidation. An extensive service distribution network and broad product line is key to servicing the needs of these larger provider networks. In addition, the consolidation of health care providers often results in the renegotiation of contracts and in the granting of price concessions. Finally, as group purchasing organizations and integrated health care systems increase in size, each contract represents a greater concentration of market share and the adverse consequences of losing a particular contract increases considerably.

Reimbursement of Health Care Costs

The Company's products are rented and sold principally to hospitals, skilled nursing facilities and DME suppliers who receive reimbursement for the products and services they provide from various public and private third party payors, including Medicare, Medicaid and private insurance programs. The Company also acts as a Durable Medical Equipment Supplier under 42 U.S.C. 1395 et seq. and as such furnishes its products directly to customers and bills payors. As a result, the demand for the Company's products in any specific care setting is dependent in part on the reimbursement policies of the various payors in that setting. In order to be reimbursed, the products generally must be found to be reasonable and necessary for the treatment of medical conditions and must otherwise fall within the payor's list of covered services. For

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example, the Company is seeking to establish coverage and payment by Medicare Part A and Medicare Part B for the V.A.C., its chronic wound treatment product. Although clinical acceptance of this product has continued to increase, it has not been officially classified as a covered item by either Part A or Part B. In light of increased controls on Medicare spending, there can be no assurance on the outcome of future coverage or payment decisions for any of the Company's products by governmental or private payors. If providers, suppliers and other users of the Company's products and services are unable to obtain sufficient reimbursement for the provision of KCI products, a material adverse impact on the Company's business, financial condition or operations could result.

Fraud and Abuse Laws

The Company is subject to various federal and state laws pertaining to health care fraud and abuse including prohibitions on the submission of false claims and the payment or acceptance of kickbacks or other remuneration in return for the purchase or lease of Company products. The United States Department of Justice and the Office of the Inspector General of the United States Department of Health and Human Services launched an enforcement initiative which specifically targets the long term care, home health and DME industries. Sanctions for violating these laws include criminal penalties and civil sanctions, including fines and penalties, and possible exclusion from the Medicare, Medicaid and other federal health care programs. Although the Company believes its business arrangements comply with federal and state fraud and abuse laws, there can be no assurance that the Company's practices will not be challenged under these laws in the future or that such a challenge would not have a material adverse effect on the Company's business, financial condition or results of operations.

Patient demographics

U.S. Census Bureau statistics indicate that the 65-and over age group is the fastest growing population segment and is expected to exceed 75 million by the year 2010. Management of wounds and circulatory problems is crucial for elderly patients. These patients frequently suffer from deteriorating physical conditions and their wound problems are often exacerbated by incontinence and poor nutrition.

Obesity is increasingly being recognized as a serious medical complication. In 1994, approximately 650,000 patients in U.S. hospitals had a principal or secondary diagnosis of obesity. Obese patients tend to have limited mobility and thus are at risk for circulatory problems and skin breakdown. Treating obese patients is also a significant staffing issue for many health care facilities and a cause of worker's compensation claims among nurses.

Research and Development

The focus of the Company's research and development program has been to develop new products and make technological improvements to existing products. Since January 1994, the Company has introduced a number of new products including: the TriaDyne, the BariKare, the TriCell, the First Step Select Heavy Duty, the FluidAir Elite, the PlexiPulse All-in-1 System, the

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BariAire, the PediDyne and The V.A.C., a product developed from technology licensed to the Company. Expenditures for research and development represented approximately 2% of the Company's total expenditures in 1997. The Company intends to continue its research and development efforts.

Manufacturing

The Company's manufacturing processes for its specialty beds, mattress overlays, and medical devices include the manufacture of certain components, the purchase of certain other components from suppliers and the assembly of these components into a completed product. Mechanical components such as blower units, electrical displays and air flow controls consist of a variety of customized subassemblies which are purchased from suppliers and assembled by the Company. The Company believes it has an adequate source of supply for each of the components used to manufacture its products.

Patents and Trademarks

The Company seeks patent protection in the United States and abroad. As of December 31, 1997, the Company had 59 issued U.S. patents relating to its specialized beds, mattresses and related products. The Company also has 32 pending U.S. Patent applications. Many of the Company's specialized beds, products and services are offered under trademarks and service marks. The Company has 28 registered trademarks and service marks in the United States Patent and Trademark Office.

Employees

As of December 31, 1997, the Company had approximately 2,100 employees. The Company's employees are not represented by labor unions and the Company considers its employee relations to be good.

Government Regulation

United States. The Company's products are subject to regulation by numerous governmental authorities, principally the United States Food and Drug Administration ("FDA") and corresponding state and foreign regulatory agencies. Pursuant to the Federal Food, Drug, and Cosmetic Act, and the regulations promulgated thereunder, the FDA regulates the clinical testing, manufacture, labeling, distribution and promotion of medical devices. Noncompliance with applicable requirements can result in, among other things, fines, injunctions, civil penalties, recall or seizure of products, total or partial suspension of production, failure of the government to grant premarket clearance or premarket approval for devices, withdrawal of marketing clearances or approvals, and criminal prosecution. The FDA also has the authority to request repair, replacement or refund of the cost of any device manufactured or distributed by the Company that violates statutory or regulatory requirements.

In the United States, medical devices are classified into one of three classes (Class I, II or III) on the basis of the controls deemed necessary by the FDA to reasonably ensure their safety and effectiveness. Class I devices are subject to general controls (e.g., labeling, premarket notification, and adherence to Quality System Regulations) although many Class I devices are exempt from

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certain FDA requirements. Class II devices are subject to general and special controls (e.g., performance standards, postmarket surveillance, patient registries, and FDA guidelines). Generally, Class III devices are high risk devices that receive greater FDA scrutiny to ensure their safety and effectiveness (e.g., life-sustaining, life-supporting and implantable devices, or new devices which have been found not to be substantially equivalent to legally marketed devices). Before a new medical device can be introduced in the market, the manufacturer must generally obtain FDA clearance ("510(k) Clearance") or Premarket Approval ("PMA"). All of the Company's current products have been classified as Class I or Class II devices, which typically are legally marketed based upon 510(k) Clearance. The FDA has announced plans to evaluate its classification system and reclassify or exempt many devices that are currently classified as Class I devices. 510(k) Clearance will generally be granted if the submitted information establishes that the proposed device is "substantially equivalent" to a legally marketed medical device. The FDA recently has been requiring a more rigorous demonstration of substantial equivalence than in the past.

All devices manufactured or distributed by the Company are subject to pervasive and continuing regulation by the FDA and certain state agencies, including record keeping requirements and mandatory reporting of certain adverse experiences resulting from use of the devices. Labeling and promotional activities are subject to regulation by the FDA and, in certain circumstances, by the Federal Trade Commission. Current FDA enforcement policy prohibits the marketing of approved medical devices for unapproved uses and the FDA scrutinizes the advertising of medical devices to ensure that unapproved uses of medical devices are not promoted.

Manufacturers of medical devices for marketing in the United States are required to adhere to applicable regulations setting forth detailed Quality System Regulation ("QSR") (formerly Good Manufacturing Practices) requirements, which include design, testing, control and documentation requirements. Manufacturers must also comply with MDR requirements that a company report certain device-related incidents to the FDA. The Company is subject to routine inspection by the FDA and certain state agencies for compliance with QSR requirements, MDR requirements and other applicable regulations. The Company is also subject to numerous federal, state and local laws relating to such matters as safe working conditions, manufacturing practices, environmental protection, fire hazard control and disposal of hazardous or potentially hazardous substances. Changes in existing requirements or adoption of new requirements could have a material adverse effect on the Company's business, financial condition, and results of operations. There can be no assurance that the Company will not incur significant costs to comply with laws and regulations in the future or that laws and regulations will not have a material adverse effect upon the Company's business, financial condition or results of operations.

Fraud and Abuse Laws. The Company is subject to federal and state laws pertaining to health care fraud and abuse. In particular, certain federal and state laws prohibit manufacturers, suppliers, and providers from offering or giving or receiving kickbacks or other remuneration in connection with the ordering or recommending purchase or rental, of health care items and

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services. The federal anti-kickback statute provides both civil and criminal penalties for, among other things, offering or paying any remuneration to induce someone to refer patients to, or to purchase, lease, or order (or arrange for or recommend the purchase, lease, or order of), any item or service for which payment may be made by Medicare or certain federally-funded state health care programs (e.g., Medicaid). This statute also prohibits soliciting or receiving any remuneration in exchange for engaging in any of these activities. The prohibition applies whether the remuneration is provided directly or indirectly, overtly or covertly, in cash or in kind. Violations of the law can result in numerous sanctions, including criminal fines, imprisonment, and exclusion from participation in the Medicare and Medicaid programs.

These provisions have been broadly interpreted to apply to certain relationships between manufacturers and suppliers, such as the Company, and hospitals, skilled nursing facilities ("SNFs"), and other potential purchasers or sources of referral. Under current law, courts and the Office of Inspector General ("OIG") of the United States Department of Health and Human Services ("HHS") have stated, among other things, that the law is violated where even one purpose (as opposed to a primary or sole purpose) of a particular arrangement is to induce purchases or patient referrals.

The OIG has taken certain actions which suggest that arrangements between manufacturers/suppliers of durable medical equipment or medical supplies and SNFs (or other providers) may be under continued scrutiny. An OIG enforcement initiative, Operation Restore Trust ("ORT"), has targeted an investigation of fraud and abuse in a number of states (i.e., California, Florida, Illinois, New York, and Texas), focusing specifically on the long-term care, home health, and DME industries. ORT's funding has officially ended and the Inspector General has announced plans to implement an "ORT-Plus" program in other states in conjunction with other federal law enforcement bodies. Furthermore, in August 1995, the OIG issued a Special Fraud Alert describing certain relationships between SNFs and suppliers that the OIG viewed as abusive under the statute. These initiatives create an environment in the industry in which the Company operates in which there will continue to be significant scrutiny for compliance with federal and state fraud and abuse laws.

Several states also have referral, fee splitting and other similar laws that may restrict the payment or receipt of remuneration in connection with the purchase or rental of medical equipment and supplies. State laws vary in scope and have been infrequently interpreted by courts and regulatory agencies, but may apply to all health care items or services, regardless of whether Medicaid or Medicaid funds are involved.

The Company is also subject to federal and state laws prohibiting the presentation (or the causing to be presented) of claims for payment (by Medicare, Medicaid, or other third party payors) that are determined to be false, fraudulent, or for an item or service that was not provided as claimed. In one case, a major DME manufacturer paid more than $4 million to settle allegations that it had "caused to be presented" false Medicare claims through advice that its sales force allegedly gave to customers concerning the appropriate reimbursement coding for its products.

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ISO Certification. Due to the harmonization efforts of a variety of regulatory bodies worldwide, certification of compliance with the ISO 9000 series of International Standards ("ISO Certification") has become particularly advantageous and, in certain circumstances necessary for many companies in recent years. Beginning in June of 1998, ISO Certification is expected to be required for all manufacturers selling and distributing products within the European Economic Community. The Company received ISO Certification in the fourth quarter of 1997.

Other Laws. The Company owns and leases property that is subject to environmental laws and regulations. The Company also is subject to numerous federal, state and local laws and regulations relating to such matters as safe working conditions, manufacturing practices, fire hazard control and the handling and disposal of hazardous or potentially hazardous substances.

International Sales of medical devices outside of the United States are subject to regulatory requirements that vary widely from country to country. Premarket clearance or approval of medical devices is required by certain countries. The time required to obtain clearance or approval for sale in a foreign country may be longer or shorter than that required for clearance or approval by the FDA and the requirements may vary. Failure to comply with applicable regulatory requirements can result in loss of previously received approvals and other sanctions and could have a material adverse effect on the Company's business, financial condition or results of operations.

Reimbursement

The Company's products are rented and sold principally to hospitals, extended care facilities and HME providers who receive reimbursement for the products and services they provide from various public and private third-party payors, including the Medicare and Medicaid programs and private insurance plans. The Company also directly bills third party payors, including Medicare and Medicaid, and receives reimbursement from these payors. In such cases, Medicare beneficiaries are billed twenty percent for coinsurance. As a result, demand and payment for the Company's products is dependent in part on the reimbursement policies of these payors. The manner in which reimbursement is sought and obtained for any of the Company's products varies based upon the type of payor involved and the setting in which the product is furnished and utilized by patients.

Medicare. Medicare is a federally-funded program that reimburses the costs of health care furnished primarily to the elderly and disabled. Medicare is composed of two parts: Part A and Part B. The Medicare program has established guidelines for the coverage and reimbursement of certain equipment, supplies and support services. In general, in order to be reimbursed by Medicare, a health care item or service furnished to a Medicare beneficiary must be reasonable and necessary for the diagnosis or treatment of an illness or injury or to improve the functioning of a malformed body part. This has been interpreted to mean that the item or service must be safe and effective, not experimental or investigational (except under certain limited circumstances

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involving devices furnished pursuant to an FDA-approved clinical trial), and appropriate. Specific Medicare guidelines have not currently been established addressing under what circumstances, if any, Medicare coverage would be provided for the use of the PlexiPulse or the V.A C.

The methodology for determining the amount of Medicare reimbursement of the Company's products varies based upon, among other things, the setting in which a Medicare beneficiary receives health care items and services. The recently enacted BBA will significantly impact the manner in which Medicare reimbursement is funded over the next five years. Most of the Company's products are furnished in a hospital, skilled nursing facility or the beneficiary's home.

Hospital Setting. With the establishment of the prospective payment system in 1983, acute care hospitals are now generally reimbursed by Medicare for inpatient operating costs based upon prospectively determined rates. Under the prospective payment system ("PPS"), acute care hospitals receive a predetermined payment rate based upon the Diagnosis-Related Group ("DRG") into which each Medicare beneficiary is assigned, regardless of the actual cost of the services provided. Certain additional or "outlier" payments may be made to a hospital for cases involving unusually long lengths of stay or high costs. However, outlier payments based upon length of stay are gradually being phased out and will be eliminated effective with fiscal year 1998. Furthermore, pursuant to regulations issued in 1991, and subject to a ten-year transition period, the capital costs of acute care hospitals (such as the cost of purchasing or renting the Company's specialty beds) are also reimbursed by Medicare pursuant to an add-on to the DRG-based payment amount. Accordingly, acute care hospitals generally do not receive direct Medicare reimbursement under PPS for the distinct costs incurred in purchasing or renting the Company's products. Rather, reimbursement for these costs is deemed to be included within the DRG-based payments made to hospitals for the treatment of Medicare-eligible inpatients who utilize the products. Since PPS rates are predetermined, and generally paid irrespective of a hospital's actual costs in furnishing care, acute care hospitals have incentives to lower their inpatient operating costs by utilizing equipment and supplies that will reduce the length of inpatient stays, decrease labor, or otherwise lower their costs.

The principal manner in which the BBA impacts Medicare Part A in the acute care setting is that it has reduced the annual DRG payment updates to be paid over the next five years by more than $40.0 billion. In addition, the BBA authorizes HCFA to enact regulations which are designed to restrain certain hospital reimbursement activities which are perceived to be abusive or fraudulent.

Certain specialty hospitals (e.g., long-term care, rehabilitation and children hospitals) also use the Company's products. Such specialty hospitals currently are exempt from the PPS and, subject to certain cost ceilings, are reimbursed by Medicare on a reasonable cost basis for inpatient operating and capital costs incurred in treating Medicare beneficiaries. Consequently, long-term care hospitals may receive separate Medicare reimbursement for reasonable costs incurred in purchasing

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or renting the Company's products; however, Medicare reimbursement for such hospitals is expected to be reduced by $3.5 billion over the next five years. There can be no assurance that a prospective payment system will not be instituted for such hospitals in future legislation.

Skilled Nursing Facility Setting. Skilled Nursing Facilities ("SNFs") which purchase or rent the Company's products may be reimbursed directly under Medicare Part A for some portion of their incurred costs. Generally speaking, only the costs of treatment during the first 100 days of a qualifying spell of illness are subject to Medicare reimbursement. The costs incurred by SNFs in furnishing care to Medicare beneficiaries are categorized as either routine costs or ancillary costs. Routine costs are those costs which are incurred for items and services routinely furnished to all patients (e.g., general nursing services, items stocked in gross supply). Ancillary costs are considered those costs which are incurred for items or services ordered to treat a condition of a specific patient and which are not generally furnished to most patients. Ancillary costs are not subject to the routine cost limits. Given the current routine cost limits, SNFs may be more inclined to purchase or rent products which are reimbursed by Medicare as ancillary items or services than if these products were reimbursed as routine items or services. At present, the Company's specialty beds are classified under Medicare Part A as ancillary items. HCFA currently interprets the definition of ancillary items to include certain support surfaces such as low air loss mattress replacements, bed overlay systems and air fluidized therapy. Neither The V.A.C. nor the PlexiPulse have yet been classified as ancillary items when furnished in a SNF setting.

On July 1, 1998, the manner in which SNFs are reimbursed under Medicare Part A will change dramatically. On that date, reimbursement for SNFs under Medicare Part A will change from a cost-based system to a prospective payment system. The new payment system will be based on resource utilization groups ("RUGs"). Under the RUGs system, a SNF Medicare patient will be assigned to a RUGs category upon admission to the SNF. The RUGs category to which the patient will be assigned will depend upon the level of care and resources the patient requires. The SNF will receive a fixed per diem payment based upon the RUGs category assigned to each Medicare patient. The per diem payments made to the SNFs will be based upon a blend of their actual costs and a national average cost (which is subject to local wage-based adjustments). Initially, 75% of a SNF's per diem will be based on its costs and 25% of the per diem will be based on national average cost. At the end of a four-year phase-in period, all per diem payments will be based on the national average cost. Because the RUG's system provides SNFs with fixed cost reimbursement, SNFs may be less inclined than they have in the past to use products which had previously been reimbursed as ancillary costs. Because the Company believes its products are both cost effective and efficacious, the Company believes that it will be able to rent and sell its products effectively under the RUGs system.

Home Setting. The Company's products are also provided to Medicare beneficiaries in home care settings. Medicare reimburses beneficiaries, or suppliers accepting assignment, for the purchase or rental of DME for use in the beneficiary's home or a home for the aged (as opposed to use in a hospital or skilled nursing

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facility setting). So long as the Medicare Part B coverage criteria are met, certain of the Company's products, including air fluidized beds, air-powered floatation beds and alternating air mattresses, are reimbursed in the home setting under the DME category known as "Capped Rental Items." Pursuant to the fee schedule payment methodology for this category, Medicare pays a monthly rental fee (for a period not to exceed fifteen months) equal to 80% of the established allowable charge for the item. Guidelines concerning under what circumstances, if any, The V.A.C. or the PlexiPulse will be covered and reimbursed by DME have not been established. Under the BBA, there will be a five-year freeze on consumer price index updates for Medicare Part B Services in the home care setting.

Medicaid. The Medicaid program is a cooperative federal/state program that provides medical assistance benefits to qualifying low income and medically-needy persons. State participation in Medicaid is optional and each state is given discretion in developing and administering its own Medicaid program, subject to certain federal requirements pertaining to payment levels, eligibility criteria and minimum categories of services. The Medicaid program finances approximately 50% of all care provided in skilled nursing facilities nationwide. The Company sells or rents its products to SNFs for use in furnishing care to Medicaid recipients. SNFs, or the Company, may seek and receive Medicaid reimbursement directly from states for the incurred costs. However, the method and level of reimbursement, which generally reflects regionalized average cost structures and other factors, varies from state to state.

Private Payors. Many private payors, including indemnity insurers, employer group health insurance programs and managed care plans, presently provide coverage for the purchase and rental of the Company's products. The scope of coverage and payment policies varies among private payors. Furthermore, many such payors are investigating or implementing methods for reducing health care costs, such as the establishment of capitated or prospective payment systems.

The Company believes that government and private efforts to contain or reduce health care costs are likely to continue. These trends may lead third-party payors to deny or limit reimbursement for the Company's products, which could negatively impact the pricing and profitability of, or demand for, the Company's products.

Item 2. Properties

The Company's corporate headquarters are currently located in a 170,000 square foot building in San Antonio, Texas which was purchased by the Company in January 1992. The Company utilizes 89,000 square feet of the building with the remaining space being leased to unrelated entities.

The Company conducts its manufacturing, shipping, receiving and storage activities in a 153,000 square foot facility in San Antonio, Texas, which was purchased by the Company in January 1988. In 1989, the Company completed the construction of a 17,000 square foot addition to the facility which is utilized as office space. The Company also owns a 37,000 square foot building in San Antonio, Texas which houses the Company's engineering center and currently

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serves as the NuTech division headquarters. In 1992, the Company purchased a 35,000 square foot facility in San Antonio, Texas which is used for storage. The Company maintains additional storage at two leased facilities in San Antonio, Texas. In 1994, the Company purchased a facility in San Antonio, Texas which has been provided to a charitable organization to provide housing for families of cancer patients. The facility is built on 6.7 acres and consists of a 15,000 square foot building and a 2,500 square foot house. In June 1997, the Company acquired a 2.8 acre tract of land adjacent to its corporate headquarters. There are three buildings on the land which contain an aggregate of 40,000 square feet.

The Company leases approximately 143 domestic distribution centers, including each of its seven regional headquarters, which range in size from 1,500 to 18,000 square feet.

Item 3. Legal Proceedings

On February 21, 1992, Novamedix Limited ("Novamedix") filed a lawsuit against the Company in the United States District Court for the Western District of Texas. Novamedix manufactures the principal product which directly competes with the PlexiPulse. The suit alleges that the PlexiPulse infringes several patents held by Novamedix, that the Company breached a confidential relationship with Novamedix and a variety of ancillary claims. Novamedix seeks injunctive relief and monetary damages. Initial discovery in this case has been substantially completed. Although it is not possible to reliably predict the outcome of this litigation or the damages which could be awarded, the Company believes that its defenses to these claims are meritorious and that the litigation will not have a material adverse effect on the Company's business, financial condition or results of operations.

On August 16, 1995, the Company filed a civil antitrust lawsuit against Hillenbrand Industries, Inc. and one of its subsidiaries, Hill-Rom. The suit was filed in the United States District Court for the Western District of Texas. The suit alleges that Hill-Rom used its monopoly power in the standard hospital bed business to gain an unfair advantage in the specialty hospital bed business. Specifically, the allegations set forth in the suit include a claim that Hill-Rom required hospitals and purchasing groups to agree to exclusively rent specialty beds in order to receive substantial discounts on products over which they have monopoly power - hospital beds and head wall units. The suit further alleges that Hill-Rom engaged in activities which constitute predatory pricing and refusals to deal. Hill-Rom has filed an answer denying the allegations in the suit. Although discovery has not been completed and it is not possible to reliably predict the outcome of this litigation or the damages which might be awarded, the Company believes that its claims are meritorious.

On October 31, 1996, the Company received a counterclaim which had been filed by Hillenbrand Industries, Inc. in the antitrust lawsuit which the Company filed in 1995. The counterclaim alleges that the Company's antitrust lawsuit and other actions were designed to enable KCI to monopolize the specialty therapeutic surface market. Although it is not possible to reliably predict the outcome of this litigation, the Company believes that the counterclaim is without merit.

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On December 26, 1996, Hill-Rom, a subsidiary of Hillenbrand Industries, Inc., filed a lawsuit against the Company alleging that the Company's TriaDyne bed infringes a patent issued to Hill-Rom. This suit was filed in the United States District Court for the District of South Carolina. Based upon its preliminary investigation, the Company does not believe that the TriaDyne bed infringes any valid claims of the Hill-Rom patent or that this lawsuit will have a material adverse impact on the Company's business.

The Company is a party to several lawsuits arising in the ordinary course of its business, including three other lawsuits alleging patent infringement by the Company, and the Company is contesting adjustments proposed by the Internal Revenue Service to prior years' tax returns in Tax Court. Provisions have been made in the Company's financial statements for estimated exposures related to these lawsuits and adjustments. In the opinion of management, the disposition of these matters will not have a material adverse effect on the Company's business, financial condition or results of operations.

The manufacturing and marketing of medical products necessarily entails an inherent risk of product liability claims. The Company currently has certain product liability claims pending for which provision has been made in the Company's financial statements. Management believes that resolution of these claims will not have a material adverse effect on the Company's business, financial condition or results of operations. The Company has not experienced any significant losses due to product liability claims and management believes that the Company currently maintains adequate liability insurance coverage.

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

A special meeting of the shareholders of the Company was held on January 5, 1998 for the purpose of approving the Transaction Agreement. A total of 19,518,595 shares of the Company's Common Stock were entitled to vote at the meeting; 14,897,892 shares of common stock were voted in favor of approval of the Transaction Agreement and no shares of common stock were voted against approval.

PART II

Item 5. Market for Registrant's Common Equity and Related Stockholder Matters

The Company's common stock ("Common Stock") traded on The Nasdaq Stock Market under the symbol: KNCI until November 19, 1997, which was the date on which the Company delisted its common stock. The range of the high and low bid prices of the Common Stock for each of the quarters during the 1997 and 1996 fiscal years is presented below, through the last date that the Company's common

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stock was traded on a national exchange.

MARKET PRICES OF COMMON STOCK

	1997		1996	
	High	Low	High	Low
First Quarter	$15.750	$11.375	$13.875	$10.438
Second Quarter	18.375	13.500	17.375	13.125
Third Quarter	19.938	16.875	16.063	13.500
Fourth Quarter	19.500	18.125	15.000	11.875

The Company's Board of Directors declared quarterly cash dividends on the Common Stock in 1997 and 1996. The cash dividends totaled $0.1125 and $0.15 per common share in each of 1997 and 1996, respectively. The Company's credit agreements contain certain covenants which currently restrict the Company's ability to declare and pay cash dividends.

As of March 1, 1998, there were 4 holders of record of the Company's Common Stock. There is currently no established public trading market for the Company's Common Stock.

Item 6. Selected Financial Data

KINETIC CONCEPTS, INC. AND SUBSIDIARIES
SELECTED CONSOLIDATED FINANCIAL DATA
(in thousands, except per share data)

	Year Ended December 31,				
	1997	1996	1995	1994	1993
Consolidated Statements of Earnings Data:					
Revenue:					
Rental and service......	$247,890	$225,450	$206,653	$228,832	$232,250
Sales and other.........	59,026	44,431	36,790	40,814	36,622
Total revenue.........	306,916	269,881	243,443	269,646	268,872
Rental expenses...........	156,179	146,205	137,420	159,235	169,687
Cost of goods sold........	23,673	16,315	13,729	19,388	18,666
Gross profit..........	127,064	107,361	92,294	91,023	80,519
Selling, general and administrative expenses.	62,654	52,007	48,502	51,813	53,279
Unusual items (1).........	--	--	--	(84,868)	6,705
Recapitalization expense (2)	34,361	--	--	--	--
Operating earnings....	30,049	55,354	43,792	124,078	20,535
Interest income...........	2,263	9,332	5,063	1,318	2,911
Interest expense..........	(10,173)	(245)	(509)	(5,846)	(8,819)
Foreign currency loss.....	(1,106)	--	--	--	--
Earnings before income taxes, minority interest, extraord-					

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inary item and cumulative effect of changes in accounting principles......	21,033	64,441	48,346	119,550	14,627
Income taxes.............	8,403	25,454	19,905	55,949	7,175
Earnings before minority interest, extraordinary item and cumulative effects of changes in accounting principles	12,630	38,987	28,441	63,601	7,452
Minority interest in subsidiary loss (gain)..	(25)	--	--	40	560
Extraordinary item - debt extinguishment, net.....	--	--	--	--	(400)
Cumulative effect of change in accounting for inventory (3)...........	--	--	--	742	--
Cumulative effect of change in accounting for income taxes (4)...............	--	--	--	--	450
Net earnings..........	$ 12,605	$ 38,987	$ 28,441	$ 64,383	$ 8,062
Earnings per common share (5)...........	$ 0.33	$ 0.89	$ 0.64	$ 1.47	$ 0.18
Earnings per common share -- assuming dilution (5)........	$ 0.32	$ 0.86	$ 0.63	$ 1.46	$ 0.18
Average common shares:					
Basic (weighted average common shares)........	38,591	43,958	44,163	43,913	44,249
Diluted (weighted average out-standing shares)..	39,910	45,489	45,457	44,143	44,627
Cash flow provided by operations..............	$ 9,336	$ 62,167	$ 56,782	$ 96,451	$56,538
Cash dividends paid to common shareholders.....	$ 6,388	$ 6,607	$ 6,631	$ 6,588	$ 6,638
Cash dividends per share paid to common shareholders.................	$ .11	$ .15	$ .15	$ .15	$ .15
Consolidated Balance Sheet Data:					
Working capital.........	$ 96,365	$107,334	$109,413	$ 90,731	$ 60,907
Total assets............	$351,151	$253,393	$243,726	$232,731	$284,573
Long-term obligations --					

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noncurrent (6)	$530,213	$ --	$ --	$ 2,755	$101,889
Minority interest	$ --	$ --	$ --	$ --	$ 40
Other shareholders' equity (2)	$(275,698)	$211,078	$210,324	$185,423	$125,707

(1) Includes $81.6 million gain, net of legal expense, from the settlement of a patent infringement lawsuit. In addition, a $10.1 million pre-tax gain from the sale of the Company's Medical Services Division was recognized. The Company also recorded certain other unusual items related to planned dispositions of under-utilized rental assets and over-stocked inventories of $6.8 million.

(2) See Note 2 of Notes to Consolidated Financial Statements for information on the Company's recapitalization .

(3) On January 1, 1994, the Company changed its method of applying overhead to inventory. Historically, a single labor overhead rate and a single materials overhead rate were used in valuing ending inventory. Labor overhead was applied as labor was incurred while materials overhead was applied at the time of shipping. This change resulted in a cumulative earnings effect of $742,000.

(4) The Company adopted Statement of Financial Accounting Standards No. 109 "Accounting for Income Taxes" as of January 1, 1993 resulting in a cumulative earnings effect of $450,000.

(5) See Note 11 of Notes to Consolidated Financial Statements for information concerning the Company's reconciliation from basic to diluted average common shares and the calculations of net income per common share.

(6) See Notes 5 and 6 of Notes to Consolidated Financial Statements for information concerning the Company's borrowing arrangements and lease obligations.

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

General

The ongoing health care debate continues to create pressure on health care providers to control costs, provide cost effective therapies and improve patient outcomes. Industry trends resulting from these pressures include the accelerating migration of patients from acute care facilities into extended care (e.g., skilled nursing facilities and rehabilitation centers) and home care settings, and the consolidation of health care providers and national and regional group purchasing organizations. In August 1997, in an effort to reduce the federal deficit and lower overall federal healthcare expenditures, Congress passed the Balanced Budget Act, (the "BBA"). The BBA contains a number of provisions which will impact the federal reimbursement of health care costs and reduce projected payments under the Medicare system by $115 billion over the next five years. The majority of the savings are scheduled for the fourth and fifth years of this plan. The

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provisions include: (i) a reduction exceeding $30 billion in the level of payments made to acute care hospitals under Medicare Part A over the next five years (which will be funded primarily through a reduction in future consumer price index increases); (ii) a change, beginning July 1, 1998, in the manner in which skilled nursing facilities ("SNFs") are reimbursed from a cost based system to a prospective payment system whereby SNFs will receive an all inclusive, case-mix adjusted per diem payment for each of their Medicare patients; and (iii) a five-year freeze on consumer price index updates for Medicare Part B services in the home and the implementation of competitive bidding trials for five categories of home care products.

Less than 10% of the Company's revenues are received directly from the Medicare system. However, many of the health care providers who pay the Company for its products are reimbursed, either directly or indirectly, by the federal government under the Medicare system for the use of those products. The Company does not believe that the changes introduced by the BBA will have a substantial impact on its hospital customers or the dealers who distribute the Company's products in the home health care market. However, changes introduced by the BBA may have an impact on the manner in which the Company's extended care customers make purchasing and rental decisions. Under a fixed payment system, decisions on selecting the products and services used in patient care are generally based on clinical and cost-effectiveness.

Industry trends including pricing pressures, the consolidation of health care providers and national and regional group purchasing organizations and a shift in market demand toward lower-priced products such as mattress overlays have had the impact of reducing the Company's overall average daily rental rates on its individual products. These industry trends, together with the increasing migration of patients from acute care to extended and home care settings, have had the effect of reducing overall acute care market growth.

Expansion of the Company's national distribution network has allowed KCI to leverage a relatively fixed field cost structure across a broad range of patients and care settings which has resulted in improved operating margins. In addition, increasing demand for the Company's products in the extended and home care settings has increased utilization of certain of the Company's products which were originally developed for acute care settings. Because of cost pressures within the health care industry, patients are leaving the acute care setting sooner, thereby increasing the demand for the Company's products in the extended and home care settings.

Generally, the Company's customers prefer to rent rather than purchase the Company's products in order to avoid the ongoing service, storage and maintenance requirements and the high initial capital outlays associated with purchasing such products, as well as to receive the Company's high-quality clinical support. As a result, rental revenues are a high percentage of the Company's overall revenues. More recently, sales have increased as a portion of the Company's revenues. The Company believes this trend will continue because certain U.S. health care providers are purchasing products that are less expensive and easier to maintain such as medical devices, mattress overlays and mattress replacement

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systems. In addition, international health care providers tend to purchase therapeutic surfaces more often than U.S. health care providers.

Results of Operations

Year Ended December 31, 1997 Compared to Year Ended December 31, 1996

The following table sets forth, for the periods indicated, the percentage relationship of each item to total revenue as well as the change in each line item as compared to the prior year ($ in thousands):

	Year Ended December 31,			
	Revenue Relationship		Increase (Decrease)	
	1997	1996	$	Pct
Revenue:				
Rental and service.........	81%	84%	$ 22,440	10%
Sales and other............	19	16	14,595	33
	100%	100%	37,035	14
Rental expenses..............	51	54	9,974	7
Cost of goods sold...........	8	6	7,358	45
Gross profit............	41	40	19,703	18
Selling, general and administrative expenses......	20	19	10,647	20
Recapitalization costs.......	11	--	34,361	N/A
Operating earnings.......	10	21	(25,305)	(46)
Interest income..............	--	3	(7,069)	(76)
Interest expense.............	(3)	--	(9,928)	N/A
Foreign currency loss........	--	--	(1,106)	N/A
Earnings before income taxes and minority interest...............	7	24	(43,408)	(67)
Income taxes.................	3	10	17,051	67
Minority interest............	--	--	(25)	N/A
Net earnings............	4%	14%	$(26,382)	(68)%

The Company's revenue is derived from three primary markets. The following table sets forth, for the periods indicated, the amount of revenue derived from each of these markets ($ in millions):

	Year Ended December 31,	
	1997	1996

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Domestic specialty surfaces....	$198.7	$181.3
International surfaces.........	66.7	67.6
Medical devices................	39.2	20.4
Other..........................	2.3	0.6
Total revenue	$306.9	$269.9

Total Revenue: Total revenue in 1997 was $306.9 million, an increase of $37.0 million, or 13.7%, from $269.9 million in 1996. This increase was primarily attributable to growth in both the Company's domestic specialty surface and medical devices businesses. Domestic specialty surface revenue includes revenue from acute and extended care facilities as well as revenue from the home care setting. Revenue from the Company's domestic specialty surface business was $198.7 million, up $17.4 million, or 9.6%, from $181.3 million in the prior year due to therapy day growth in each of the wound care, pulmonary and bariatric markets combined with an overall increase in the average daily rental price of its products. Revenue from the Company's international surface business was $66.7 million compared to $67.6 million in the prior year, despite adverse foreign currency exchange fluctuations of approximately $6.4 million. Revenue from the Company's medical devices business of $39.2 million increased $18.8 million, or 92.2%, up from $20.4 million in the prior year, due substantially to growth in V.A.C. rentals in the United States.

Rental Expenses: Rental expenses consist largely of field personnel costs, depreciation of the Company's rental equipment and related facility costs. Rental expenses for 1997 totaled $156.2 million, an increase of $10.0 million, or 6.8%, from $146.2 million in the prior year. The addition of extended care sales representatives, new marketing programs and product costs associated with new and acquired therapies and technologies accounted for the majority of this increase. As a percentage of total revenue, 1997 rental expenses were 50.9%, down from 54.2% in the prior period. This decrease is primarily attributable to the increase in rental revenue, as the majority of the Company's rental or field expenses are relatively fixed.

Gross Profit: Gross profit in 1997 was $127.1 million, an increase of $19.7 million, or 18.4%, from $107.4 million in the year-ago period due substantially to higher revenue, combined with relatively fixed field expenses and improved sales volumes. Gross profit margin for 1997, as a percentage of total revenue, was 41.4%, up from 39.8% for the prior year. Rental margins improved to 37.0%, up 1.9 percentage points from 1996, while sales margins declined to 59.9%, from 63.3%, as the product mix shifted toward lower-margin overlays, particularly in the international home care setting.

Selling, General and Administrative Expenses: Selling, general and administrative (SG&A) expenses for 1997 were $62.7 million, an increase of $10.6 million, or 20.5%, from 1996. Key investments in marketing programs and information systems as well as higher legal and professional fees and provisions for uncollectible accounts receivable made up the majority of this increase. As a percentage of total revenue, SG&A expenses in 1997 were 20.4%, up slightly from 19.3% in the year-ago period.

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Recapitalization: During 1997, the Company recognized $34.4 million in fees and expenses resulting from the transactions associated with the Transaction Agreement (the "Recapitalization"). Recapitalization expenses consisted of compensation expense associated with employee stock option exercises and other incentives, commitment fees on unused credit facilities, legal and professional fees and other miscellaneous costs and expenses.

Operating Earnings: Operating earnings for 1997 were $30.0 million, a decrease of $25.3 million, or 45.7%, from 1996, due substantially to Recapitalization expenses of $34.4 million in 1997. Excluding the Recapitalization expenses, operating earnings for 1997 were $64.4 million, an increase of $9.1 million, or 16.4%, from $55.4 million in 1996. As a percentage of total revenue, the Company's operating margin, excluding the recapitalization expenses, improved to 21.0%, up from 20.5% in 1996.

Interest Income: Interest income earned during 1997 was $2.3 million, a $7.1 million decrease from 1996. The prior year interest income included $5.2 million of non-recurring interest income from the early repayment of all remaining notes receivables from the 1994 disposition of the Medical Services Division. The remainder of the variance is due to lower invested cash balances in 1997 as the Company funded five acquisitions during the year from existing cash reserves.

Interest Expense: Interest expense for the year was $10.2 million, an increase of $9.9 million from 1996. The majority of this increase was due to interest accrued on approximately $535.0 million of debt outstanding after completion of the Recapitalization.

Income Taxes: The Company's effective income tax rate for 1997 was 40.0% compared to 39.5% in 1996.

Net Earnings: Net earnings for 1997 were $12.6 million, or $0.32 per share, compared to 1996 net earnings of $39.0 million, or $0.86 per share. Excluding non-recurring items, net earnings for 1997 would have been $39.2 million, or $0.98 per share, compared to 1996 net earnings of $35.9 million, an increase of $3.3 million, or 9.2%. Higher revenue combined with controlled spending accounted for the earnings improvement.

Year Ended December 31, 1996 Compared to Year Ended December 31, 1995

The following table sets forth, for the periods indicated, the percentage relationship of each item to total revenue as well as the change in each line item as compared to the prior year ($ in thousands):

	Year Ended December 31,			
	Revenue Relationship		Increase (Decrease)	
	1996	1995	$	Pct

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Revenue:				
Rental and service	84%	85%	$18,797	9%
Sales and other	16	15	7,641	21
	100%	100%	26,438	11
Rental expenses	54	56	8,785	6
Cost of goods sold	6	6	2,586	19
Gross profit	40	38	15,067	16
Selling, general and administrative expenses	19	20	3,505	7
Operating earnings	21	18	11,562	26
Interest income	3	2	4,269	84
Interest expense	--	--	264	52
Earnings before income taxes	24	20	16,095	33
Income taxes	10	8	5,549	28
Net earnings	14%	12%	$10,546	37%

The Company's revenue is derived from three primary markets. The following table sets forth, for the periods indicated, the amount of revenue derived from each of these markets ($ in millions):

	Year Ended December 31,	
	1996	1995
Domestic specialty surfaces	$181.3	$163.0
International surfaces	67.6	60.7
Medical devices	20.4	17.1
Other	0.6	2.6
Total revenue	$269.9	$243.4

Total Revenue: Total revenue in 1996 was $269.9 million, an increase of $26.4 million or 10.9% from 1995. This increase was primarily attributable to growth in the Company's domestic specialty support surface business combined with international expansion and penetration. Domestic support surface revenue includes revenue from acute and extended care facilities as well as revenue from the home care segment. Revenue from domestic surfaces increased $18.3 million to $181.3 million in 1996, an increase of 11.2% compared to the prior year. The domestic revenue increase was due in large part to the continued success of KCI's TriaDyne TM, the Company's leading Kinetic Therapy product, combined with growth in extended care patient days and the addition of various new national accounts. Revenue from the Company's international specialty surface business increased $6.9 million, or 11.4%, to $67.6 million in 1996, despite adverse foreign currency exchange fluctuations of approximately $2 million. Strong sales in mattress

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overlay products accounted for more than half of this increase. Revenue growth in the German home care market and further penetration in various emerging markets, e.g., Switzerland and Australia, also contributed to international revenue growth.Revenue from the Company's two primary medical devices, PlexiPulse TM and The V.A.C. TM, was $20.4 million, an increase of $3.3 million, or 19.3%, from 1995. This increase was substantially due to the introduction of The V.A.C. TM in the United States as well as growth in V.A.C. revenue overseas.

In November 1996, the Company announced that it had been advised by Premier Purchasing Partners, L.P., that its bid to be the primary supplier for the newly combined group had been awarded to another vendor. Premier is a new voluntary group purchasing organization which was formed as a result of the merger of three separate group purchasing organizations. Revenue from hospitals within Premier for 1996 accounted for approximately 10% of the Company's total revenue. Because facilities within Premier are not committed to do business with the group's primary vendor, it is difficult to predict the ultimate effect of the new agreement on revenue and operating profits. For 1997, a substantial portion of the revenue from the Premier group was retained.

Rental Expenses: Rental expenses consist largely of field personnel costs, depreciation of the Company's rental equipment and related facility costs. Rental expenses for 1996 totaled $146.2 million, an increase of $8.8 million, or 6.4%, from the prior year. The addition of extended care sales representatives and international market expansion accounted for a majority of the increase. As a percentage of total revenue, 1996 rental expenses were 54.2%, down from 56.4% in the prior period. This decrease is due primarily to the 1996 revenue increase because most of the Company's rental or field expenses are relatively fixed in nature.

Gross Profit: Gross profit in 1996 was $107.4 million, an increase of $15.1 million, or 16.3%, from the year-ago period due substantially to higher revenue, as discussed previously, combined with relatively fixed field expenses. Gross profit margin for 1996, as a percentage of total revenue, was 39.8%, up from 37.9% for the prior year. Rental margins improved to 35.1%, up 1.6 percentage points from 1995, while sales margins improved slightly to 63.3%, from 62.7%, as the product mix continued to shift toward higher margin overlays and disposable products.

Selling, General and Administrative Expenses: SG&A expenses for 1996 were $52.0 million, an increase of $3.5 million, or 7.2%, from 1995. Total SG&A expenses for the prior year also included a $2.9 million non-recurring loss from the sale of the Financial Services Division in June 1995. Costs associated with international market expansion, improved information systems and marketing, legal and professional activities accounted for a substantial part of this increase. As a percentage of total revenue, SG&A expenses in 1996 were 19.3%, down slightly from 19.9% in the year-ago period.

Operating Earnings: Operating earnings for 1996 were $55.4 million, an increase of $11.6 million, or 26.4%, from 1995. The increase was due primarily to the growth in revenue combined with the implementation of various initiatives undertaken to improve efficiencies, e.g., new information systems. As a percentage of

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total revenue, the Company's operating margin improved to 20.5%, up more than two percent from 1995.

Net Interest Income: Net interest income for 1996 was $9.1 million, which included $5.2 million from the early repayment of all remaining notes receivable from the 1994 disposition of the Medical Services Division. The notes had an aggregate face value of $10 million and had been discounted to a carrying value of $3.2 million, excluding accrued interest. The notes were retired for approximately $9 million.

Income Taxes: The Company's effective income tax rate for 1996 was 39.5% compared to 41.2% in 1995. This decrease was primarily the result of implementing various tax planning initiatives both domestically and overseas.

Net Earnings: Net earnings for 1996 were $39.0 million, or $0.86 per share, compared to 1995 net earnings of $28.4 million, or $0.63 per share. Higher revenue and controlled spending, combined with the one-time increase in interest income and a lower overall tax rate accounted for the 37% earnings improvement. Average common and common equivalent shares outstanding were substantially unchanged year-to-year.

Financial Condition

Accounts receivable at December 31, 1997 were $81.2 million, an increase of $23.0 million, or 39.5%, from the prior year end. Approximately $5.4 million of this increase was due to receivables associated with purchase transactions during the year. In addition, VAC rentals and sales which will be paid through the Medicare and other third party programs increased receivables by $3.8 million as the Company continued its work towards establishment of a Medicare VAC Reimbursement Code. The remainder of this increase was due primarily to (i) revenue growth in extended care and home care markets which tend to have customers and payors who historically have paid over a longer cycle than acute care customers and (ii) growth in international receivables.

Inventories at December 31, 1997 increased $1.5 million, or 7.5%, to $21.6 million from the end of 1996, due primarily to the Ethos Medical Group, Ltd. and the RIK Medical L.L.C. acquisitions.

Prepaid expenses and other current assets at December 31, 1997 were $18.4 million, an increase of $11.6 million, or 169%, compared to the prior year. The majority of this increase was due to: (i) a current tax receivable of $6.2 million related to the refund of all 1997 Federal tax payments made and (ii) $3.0 million of assets to be sold to Dr. James Leininger in 1998.

Net property plant and equipment at December 31, 1997 was $75.4 million, an increase of $10.2 million, or 15.7%, from the prior year due, in part, to business acquisitions made during the year. Net capital expenditures in 1997 were $27.9 million and related primarily to new product additions to the Company's fleet of rental frames and surfaces.

Goodwill associated with the excess purchase price of acquisitions over net tangible and intangible assets acquired increased $32.4 million, or 239%, from December 31, 1996 due to

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the five acquisitions completed during 1997. The goodwill associated with these acquisitions is being amortized over periods ranging from 15 to 25 years. See Note 3 of Notes to Consolidated Financial Statements for further discussion of the Company's acquisition activities.

During 1997, KCI recorded loan issuance costs of $17.7 million associated with the Company's recapitalization. See Note 2 of Notes to Consolidated Financial Statements for further discussion of this item.

Accounts payable and accrued expenses were $40.4 million and $41.3 million, respectively, at December 31, 1997 compared to $4.0 million and $29.8 million, respectively, at the end of 1996. The increased liabilities relate primarily to payments to be made for shares of common stock not previously tendered as well as unpaid costs and expenses associated with the Recapitalization.

Deferred income taxes at December 31, 1997 were $10.0 million, an increase of $4.9 million from year-end 1996. The increase from the prior year is primarily due to accelerated tax depreciation on the TriaDyne TM fleet, as well as depreciation on assets subject to leveraged leases.

Income Taxes

The provision for deferred income taxes is based on the asset and liability method and represents the change in the deferred income tax accounts during the year. Under the asset and liability method of FAS 109, deferred income taxes are recognized for the future tax consequences attributable to the difference between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled.

At the end of 1997, the net impact of these timing issues resulted in a net deferred tax liability comprised of deferred tax liabilities totaling $23.6 million offset by deferred tax assets totaling $13.5 million.

Legal Proceedings

A description of the Company's legal proceedings is set forth under the caption "Item 3. Legal Proceedings".

Liquidity and Capital Resources

At December 31, 1997, the Company had current assets of $183.0 million and current liabilities of $86.6 million resulting in a working capital surplus of $96.4 million, compared to a surplus of $107.3 million at December 31, 1996.

In 1997, the Company made net capital expenditures of $27.9 million. The 1997 capital expenditures primarily relate to the Company's TriaDyne TM, TriCell TM and FluidAir TM products, various mattress overlay products and the design and development of new information systems. The Company's current budget for capital expenditures for 1998, other than acquisition expenditures, is

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$30.5 million and consists primarily of rental product additions. Other than commitments for new product inventory, including disposable "for sale" products, of $11.4 million, the Company has no material long-term capital commitments and can adjust the level of capital expenditures as circumstances dictate.

The Company's principal sources of liquidity are expected to be cash flow from operating activities and borrowings under the Senior Credit Facilities. It is anticipated that the Company's principal uses of liquidity will be to fund capital expenditures related to the Company's rental products, provide needed working capital, meet debt service requirements and finance the Company's strategic plans.

The Senior Credit Facilities total $400.0 million and consist of (i) a $50.0 million six-year Revolving Credit Facility, (ii) a $50.0 million six-year Acquisition Facility, (iii) a $120.0 million six-year amortizing Term Loan A, (iv) a $90.0 million seven-year amortizing Term Loan B and (v) a $90.0 million eight-year amortizing Term Loan C, (collectively, "the Term Loans"). The Term Loans were fully drawn to finance a portion of the Tender Offer. The Acquisition Facility was partially drawn to, in effect, finance the RIK Medical acquisition. The Acquisition Facility provides the Company with financing to pursue strategic acquisition opportunities. The Acquisition Facility will remain available to the Company for a period of three years at which time will begin to amortize over the remaining three years of the facility. The Company has utilized and will utilize borrowings under the Revolving Facility to help effect the Tender Offer, pay related fees and expenses, fund capital expenditures and meet working capital needs.

The Term Loans are payable in equal quarterly installments (1) subject to an amortization schedule as follows:

Year	Amount
1998	$ 4,800,000
1999	$ 8,800,000
2000	$16,800,000
2001	$31,800,000
2002	$31,800,000
2003	$36,800,000
2004	$85,500,000
2005	$83,700,000

(1) The first three quarterly principal installments for 2004 shall be $450,000 with the final installment for that year equal to $84,150,000. For 2005, the first three installments shall be equal to $225,000 and the final installment shall be equal to $83,025,000.

The Term Loans and the Notes are subject to customary terms, covenants and conditions which partially restrict the uses of future cash flows by the Company. The Company does not expect that these covenants and conditions will have a material adverse impact on its operations. At December 31, 1997, the Revolving Credit Facility and Acquisition Facility had balances of $24.5 million and $10 million, respectively. Correspondingly, the aggregate availability under these two facilities was $65.5 million.

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Indebtedness under the Senior Credit Facilities, including the Revolving Credit Facility (other than certain loans under the Revolving Credit Facility designated in foreign currency), the Term Loans and the Acquisition Facility initially bear interest at a rate based upon (i) the Base Rate (defined as the higher of (x) the rate of interest publicly announced by Bank of America as its "reference rate" and (y) the federal funds effective rate from time to time plus 0.50%), plus 1.25% in respect of the Tranche A Term Loans, the loans under the Revolving Credit Facility (the "Revolving Loans") and the loans under the Acquisition Facility (the "Acquisition Loans"), 1.50% in respect of the Tranche B Term Loans and 1.75% in respect of the Tranche C Term Loans, or at the Company's option, (ii) the Eurodollar Rate (as defined in the Senior Credit Facility Agreement) for one, two, three or six months, in each case plus 2.25% in respect of Tranche A Term Loans, Revolving Loans and Acquisition Loans, 2.50% in respect of Tranche B Term Loans and 2.75% in respect of the Tranche C Term Loans. Certain Revolving Loans designated in foreign currency will initially bear interest at a rate based upon the cost of funds for such loans, plus 2.25% or 2.50%, depending on the type of foreign currency. Performance-based reductions of the interest rates under the Term Loans, the Revolving Loans and the Acquisition Loans are available. Subsequent to December 31, 1997, the Company entered into a swap transaction whereby the interest rate on $150,000,000 of the term loans is fixed at 5.7575% through January 8, 2001.

Indebtedness of the Company under the Senior Credit Agreement is guaranteed by certain of the subsidiaries of the Company and is secured by (i) a first priority security interest in all, subject to certain customary exceptions, of the tangible and intangible assets of the Company and its domestic subsidiaries, including, without limitation, intellectual property and real estate owned by the Company and its subsidiaries, (ii) a first priority perfected pledge of all capital stock of the Company's domestic subsidiaries and (iii) a first priority perfected pledge of up to 65% of the capital stock of foreign subsidiaries owned directly by the Company or its domestic subsidiaries.

The Senior Credit Agreement requires the Company to meet certain financial tests, including minimum levels of EBITDA (as defined therein), minimum interest coverage, maximum leverage ratio and capital expenditures. The Bank Credit Agreement also contains covenants which, among other things, limit the incurrence of additional indebtedness, investments, dividends, loans and advances, capital expenditures, transactions with affiliates, asset sales, acquisitions, mergers and consolidations, prepayments of other indebtedness (including the Notes), liens and encumbrances and other matters customarily restricted in such agreements. The Company is in compliance with the applicable covenants at December 31, 1997.

The Senior Credit Agreement contains customary events of default, including payment defaults, breach of representations and warranties, covenant defaults, cross-defaults to certain other indebtedness, certain events of bankruptcy and insolvency, failures under ERISA plans, judgment defaults, failure of any guaranty, security document security interest or subordination provision supporting the Bank Credit Agreement to be in full force and effect and change of control of the Company.

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As part of the Recapitalization transactions, the Company issued $200.0 million of Senior Subordinated Notes (the "Notes") due 2007. The Notes are unsecured obligations of the Company, ranking subordinate in right of payment to all senior debt of the Company and will mature on November 1, 2007. Interest on the Notes accrues at the rate of 9 5/8% per annum and is payable semiannually in cash on each May 1 and November 1, commencing on May 1, 1998, to the persons who are registered Holders at the close of business on April 15 and October 15, respectively, immediately preceding the applicable interest payment date. Interest on the Notes accrues from and including the most recent date to which interest has been paid or, if no interest has been paid, from and including the date of issuance.

The Notes are not entitled to the benefit of any mandatory sinking fund. The Notes will be redeemable, at the Company's option, in whole at any time or in part from time to time, on and after November 1, 2002, upon not less than 30 nor more than 60 days' notice, at the following redemption prices (expressed as percentages of the principal amount thereof) if redeemed during the twelve-month period commencing on November 1 of the year set forth below, plus, in each case, accrued and unpaid interest thereon, if any, to the date of redemption.

Year	Percentage
2000.................................	104.813%
2001.................................	103.208%
2002.................................	101.604%
2005 and thereafter..................	100.000%

At any time, or from time to time, the Company may acquire a portion of the Notes through open-market purchases. Also, on or prior to November 1, 2000, the Company may, at its option, on one or more occasions use all or a portion of the net cash proceeds of one or more Equity Offerings (as defined) to redeem the Notes issued under the Indenture at a redemption price equal to 109.625% of the principal amount thereof plus accrued and unpaid interest thereon, if any, to the date of redemption; provided that at least 65% of the principal amount of Notes originally issued remains outstanding immediately after any such redemption. In order to effect the foregoing redemption with the proceeds of any Equity Offering, the Company shall make such redemption not more than 120 days after the consummation of any such Equity Offering. As used in this paragraph, "Equity Offering" means any offering of Qualified Capital Stock of the Company.

As of December 31, 1997 the entire $200.0 million of Senior Subordinated Notes was issued and outstanding.

During 1997, the Company generated $10.7 million in cash from operating activities compared to $62.2 million in the prior year, a decrease of $51.5 million. The decrease in operating cash flows resulted substantially from $34.4 million in fees and expenses associated with the Recapitalization, as well as an increase in accounts receivable as discussed previously. Excluding the effects of the Recapitalization, operating cash flows for 1997 would have been $37.3 million. Investment activities for 1997 used $68.1

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million, including net capital expenditures of $27.9 million and $41.2 million used to fund the five business acquisitions completed during 1997. Financing activities for 1997 provided $61.9 million consisting primarily of proceeds from common stock issuance and borrowings of notes payable and long-term obligations, partially offset by recapitalization costs to purchase treasury stock, finance stock option exercises and pay dividends. In 1997, the Company repurchased and retired approximately 258,000 shares of common stock under a program which authorized the Company to purchase up to 3 million shares.

At December 31, 1997, cash and cash equivalents totaling $61.81 million were available for general corporate purposes. Based upon the current level of operations, the Company believes that cash flow from operations and the availability under its lines of credit will be adequate to meet its anticipated requirements for debt repayment, working capital and capital expenditures through 1998.

Impact of Year 2000

The Year 2000 issue results from computer programs being written using two digits rather than four digits to define the date field. Certain of the Company's existing computer programs that have time-sensitive software may recognize a date using "00" as the year 1900 rather than the year 2000. This could result in system failure or miscalculations causing disruptions of operations, including, among other things, a temporary inability to process transactions or engage in similar normal business activities.

Based on a recent assessment, the Company determined that it would need to modify or replace key portions of its software so that its computer systems will function properly with respect to dates in the year 2000 and thereafter. The Company presently believes that through its conversion to the Oracle applications platform and with modifications to other existing software, the Year 2000 issue will not pose significant operational problems for its computer systems. However, if such modifications and conversions are not made properly or are not completed timely, the Year 2000 issue could have a material impact on the operations of the Company.

The Company has initiated formal communications with all of its significant suppliers and large customers to determine the extent to which the Company's interface systems are vulnerable to those third parties' failure to remediate their own Year 2000 issues. The Company's total Year 2000 project cost, and estimates to complete, include the estimated costs and time associated with the impact of third party Year 2000 issues based on presently available information. However, there can be no guarantee that the systems of other companies on which the Company's systems rely will be timely converted and would not have an adverse effect on the Company's systems. The Company has determined it has no exposure to contingencies related to the Year 2000 issue for the products it has sold.

The Company will utilize both internal and external resources to reprogram, or replace, and test the software for Year 2000 modifications. The Company anticipates completing the Year 2000 project by no later than March 31, 1999, which is prior to any anticipated impact on its operating systems. The total cost of the

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Year 2000 project is estimated at $6.5 million and is being funded through operating cash flows. Also, $5.5 million of this total will be used to purchase new software that will be capitalized and the remaining $1.0 million will be expensed as incurred. To date, the Company has incurred approximately $5.4 million ($900,000 expensed and $4.5 million capitalized for new software), related to the assessment of the Year 2000 issue, development of a modification plan, preliminary software modifications and purchase of new software, where necessary.

The costs of the project and the date on which the Company believes it will complete the Year 2000 modifications are based on management's best estimates, which were derived utilizing numerous assumptions of future events, including the continued availability of certain resources, third party modification plans and other factors. However, there can be no guarantee that these estimates will be achieved and actual results could differ materially from those anticipated. Specific factors that might cause such material differences include, but are not limited to, the availability and cost of personnel trained in this area, the ability to locate and correct all relevant computer codes and similar uncertainties.

Item 8. Financial Statements and Supplementary Data

KINETIC CONCEPTS, INC. AND SUBSIDIARIES
Consolidated Balance Sheets
(in thousands)

	December 31, 1997	December 31, 1996
ASSETS		
Current assets:		
Cash and cash equivalents	$ 61,754	$ 59,045
Accounts receivable, net	81,238	58,241
Inventories	21,553	20,042
Prepaid expenses and other	18,446	6,860
Total current assets	182,991	144,188
Net property, plant and equipment	75,434	65,224
Goodwill, less accumulated amortization of $13,989 in 1997 and $12,021 in 1996	45,899	13,541
Loan issuance cost, less accumulated amortization of $382 in 1997	17,346	--
Other assets, less accumulated amortization of $3,100 in 1997 and $5,614 in 1996	29,481	30,440
	$351,151	$253,393

LIABILITIES AND SHAREHOLDERS' EQUITY

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Current liabilities:		
Accounts payable	$ 40,353	$ 3,974
Accrued expenses	41,334	29,792
Current installments of long-term obligations	4,800	--
Current installments of capital lease obligations	139	118
Income tax payable	--	2,970
Total current liabilities	86,626	36,854
Long-term obligations, excluding current installments	529,901	--
Capital lease obligations, excluding current installments	312	396
Deferred income taxes, net	10,010	5,065
	626,849	42,315
Commitments and contingencies (Note 12)		
Shareholders' (deficit) equity:		
Common stock; issued and outstanding 17,471 in 1997 and 42,355 in 1996	17	42
Retained (deficit) earnings	(273,231)	210,816
Cumulative foreign currency translation adjustment	(2,484)	555
Notes receivable from officers	--	(335)
	(275,698)	211,078
	$351,151	$253,393

See accompanying notes to consolidated financial statements.

KINETIC CONCEPTS, INC. AND SUBSIDIARIES
Consolidated Statements of Earnings
(in thousands, except per share data)

	Year Ended December 31,		
	1997	1996	1995
Revenue:			
Rental and service	$247,890	$225,450	$206,653
Sales and other	59,026	44,431	36,790
Total revenue	306,916	269,881	243,443
Rental expenses	156,179	146,205	137,420
Cost of goods sold	23,673	16,315	13,729
	179,852	162,520	151,149

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Gross profit	127,064	107,361	92,294
Selling, general and administrative expenses	62,654	52,007	48,502
Recapitalization expenses	34,361	--	--
Operating earnings	30,049	55,354	43,792
Interest income	2,263	9,332	5,063
Interest expense	(10,173)	(245)	(509)
Foreign currency loss	(1,106)	--	--
Earnings before income taxes and minority interest	21,033	64,441	48,346
Income taxes	8,403	25,454	19,905
Earnings before minority interest	12,630	38,987	28,441
Minority interest in subsidiary gain	(25)	--	--
Net earnings	$ 12,605	$38,987	$28,441
Earnings per common share	$ 0.33	$ 0.89	$ 0.64
Earnings per common share - assuming dilution	$ 0.32	$ 0.86	$ 0.63
Average common shares:			
Basic (weighted average outstanding shares)	38,591	43,958	44,163
Diluted (weighted average outstanding shares)	39,910	45,489	45,457

See accompanying notes to consolidated financial statements.

KINETIC CONCEPTS, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows
(in thousands)

	Year Ended December 31,		
	1997	1996	1995
Cash flows from operating activities:			
Net earnings	$ 12,605	$ 38,987	$ 28,441
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Depreciation	21,091	20,301	20,882
Amortization	2,989	1,493	1,878
Provision for uncollectible accounts receivable	5,888	2,457	1,883
Loss on KCIFS and Medical Services dispositions	--	--	2,933

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Gain on early repayment of notes receivable........................	--	(5,180)	--
Change in assets and liabilities net of effects from purchase of subsidiaries and unusual items:			
Increase in accounts receivable, net	(24,920)	(4,626)	(2,695)
Decrease in notes receivable.......	--	3,187	6,014
Increase in inventories............	(13)	(1,034)	(998)
Increase in prepaid expenses and other...........................	(11,199)	(1,927)	(593)
Increase (decrease) in accounts payable..........................	392	1,525	(895)
Increase (decrease) in accrued expenses........................	1,896	3,349	(520)
Decrease in income taxes payable...	(2,970)	(1,056)	(3,999)
Increase in deferred income taxes, net............................	4,945	4,691	4,451
Net cash provided by operating activities................	10,704	62,167	56,782
Cash flows from investing activities:			
Additions to property, plant and equipment.........................	(27,672)	(27,783)	(36,104)
Decrease (increase) in inventory to be converted into equipment for short-term rental.................	(2,850)	700	(1,000)
Dispositions of property, plant and equipment.........................	2,620	5,400	3,231
Proceeds from sale of KCIFS and Medical services divisions.........	--	--	7,182
Excess principal repayment on discounted notes receivable........	--	5,180	--
Business acquired in purchase transactions, net of cash acquired.	(41,153)	(1,146)	--
Decrease in finance lease receivables, net...............................	--	--	339
Note paid (received) from principal shareholder.......................	--	10,000	(10,000)
Decrease (increase) in other assets..	939	(9,960)	(6,531)
Net cash used by investing activities................	(68,116)	(17,609)	(42,883)
Cash flows from financing activities:			
Borrowing (repayment) of notes payable and long-term obligations.............	534,701	--	(800)
Borrowing (repayment)of capital lease obligations.......................	(333)	457	(64)
Loan issuance costs.................	(17,734)	--	--
Proceeds from the exercise of stock options...........................	3,668	4,264	4,919
Purchase and retirement of treasury stock.............................	(3,827)	(35,241)	(2,849)
Cash dividends paid to shareholders..	(6,388)	(6,607)	(6,631)
Recapitalization costs-purchase of treasury stock....................	(631,606)	--	--
Recapitalization costs-proceeds from common stock issuance............	150,184	--	--
Recapitalization costs-fees and			

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expenses..........................	(8,626)	--	--
Recapitalization costs-amounts not yet paid..........................	41,652	--	--
Other...............................	253	(150)	(185)
Net cash provided (used) by financing activities.......	61,944	(37,277)	(5,610)
Effect of exchange rate changes on cash and cash equivalents................	(1,823)	(635)	869
Net increase in cash and cash equivalents...........................	2,709	6,646	9,158
Cash and cash equivalents, beginning of year...............................	59,045	52,399	43,241
Cash and cash equivalents, end of year.	$ 61,754	$59,045	$52,399

See accompanying notes to consolidated financial statements.

<TABLE>

KINETIC CONCEPTS, INC. AND SUBSIDIARIES
Consolidated Statements of Shareholders' (Deficit) Equity
Three Years Ended December 31, 1997
(in thousands, except per share data)

<CAPTION>

	Common Stock	Additional Paid-In Capital	Retained Earnings (Deficit)	Cumulative Foreign Currency Translation Adjustment	Treasury Stock	Notes Receivable from Officers for Exercise of Stock Options	Total Shareholders' Equity (Deficit)
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
Balances at December 31,1994.	$ 44	$10,053	$175,480	$ (154)	$ --	$ --	$185,423
Net earnings......	--	--	28,441	--	--	--	28,441
Exercise of stock options..........	--	4,024	--	--	--	(185)	3,839
Tax benefit realized from stock option plan......	--	895	--	--	--	--	895
Treasury stock purchased........	--	--	--	--	(2,849)	--	(2,849)
Treasury stock retired..........	--	(2,849)	--	--	2,849	--	--
Cash dividends on common stock-- $0.15 per share..	--	--	(6,631)	--	--	--	(6,631)
Foreign currency translation adjustment.......	--	--	--	1,206	--	--	1,206

Balances at

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December 31, 1995	44	12,123	197,290	1,052	--	(185)	210,324
Net earnings......	--	--	38,987	--	--	--	38,987
Exercise of stock options..........	--	2,098	--	--	--	(150)	1,948
Tax benefit realized from stock option plan.............	--	2,166	--	--	--	--	2,166
Treasury stock purchased........	--	--	--	--	(35,241)	--	(35,241)
Treasury stock retired..........	(2)	(16,387)	(18,854)	--	35,241	--	(2)
Cash dividends on common stock-- $0.15 per share..	--	--	(6,607)	--	--	--	(6,607)
Foreign currency translation adjustment.......	--	--	--	(497)	--	--	(497)
Balances at December 31, 1996	42	--	210,816	555	--	(335)	211,078
Net earnings......	--	--	12,605	--	--	--	12,605
Exercise of stock options..........	--	2,019	--	--	--	335	2,354
Tax benefit realized from stock option plan.............	--	1,567	--	--	--	--	1,567
Treasury stock retired..........	--	15,330	(19,157)	--	--	--	(3,827)
Cash dividends on common stock-- $0.11 per share..	--	--	(6,388)	--	--	--	(6,388)
Foreign currency translation adjustment.......	--	--	--	(3,039)	--	--	(3,039)
Purchase of treasury stock...	(32)	(18,916)	(612,658)	--	--	--	(631,606)
Proceeds from common stock issuance.........	7	--	150,177	--	--	--	150,184
Fees and expenses.	--	--	(8,626)	--	--	--	(8,626)
Balances at December 31, 1997	$ 17	$ --	$(273,231)	$(2,484)	$ --	$ --	$(275,698)

</TABLE>

See accompanying notes to consolidated financial statements.

KINETIC CONCEPTS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements

NOTE 1. Summary of Significant Accounting Policies

(a) Principles of Consolidation

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The consolidated financial statements include the accounts of Kinetic Concepts, Inc. ("KCI") and all subsidiaries (collectively, the "Company"). All significant intercompany balances and transactions have been eliminated in consolidation. Certain reclassifications of amounts related to prior years have been made to conform with the 1997 presentation.

(b) Nature of Operations and Customer Concentration

The Company designs, manufactures, markets and distributes therapeutic products, primarily specialty hospital beds, mattress overlays and medical devices that treat and prevent the complications of immobility. The principal markets for the Company's products are domestic and international health care providers, predominantly hospitals and extended care facilities throughout the U.S. and Western Europe. Receivables from these customers are unsecured.

The Company contracts with both proprietary hospital groups and voluntary group purchasing organizations ("GPOs"). Proprietary hospital groups own all of the hospitals which they represent and, as a result, can ensure complete compliance with an executed national agreement. Voluntary GPOs negotiate contracts on behalf of member hospital organizations but cannot ensure that their members will comply with the terms of an executed national agreement. Approximately 47% of the Company's revenue during 1997 was generated under national agreements with GPOs.

The Company operates directly in 12 foreign countries including Germany, Austria, the United Kingdom, Canada, France, the Netherlands, Switzerland, Australia, Sweden, Italy, Denmark and Ireland (see Note 13).

(c) Revenue Recognition

Service and rental revenue are recognized as services are rendered. Sales and other revenue are recognized when products are shipped. Through June 15, 1995, the Company leased certain medical equipment under long-term lease agreements which were accounted for as direct financing leases. Unearned interest was amortized to income over the term of the lease using the interest method (See Note 3).

(d) Cash and Cash Equivalents

The Company considers all highly liquid investments with an original maturity of ninety days or less to be cash equivalents.

(e) Fair Value of Financial Instruments

The carrying amount reported in the balance sheet for cash, accounts receivable, long-term securities, accounts payable, and long-term obligations approximates its fair value. The company estimates the fair value of long-term obligations by discounting

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the future cash flows of the respective instrument, using the Company's incremental rate of borrowing for a similar instrument.

(f) Inventories

Inventories are stated at the lower of cost (first-in, first-out) or market (net realizable value). Costs include material, labor and manufacturing overhead costs. Inventory expected to be converted into equipment for short-term rental has been reclassified to property, plant and equipment.

(g) Property, Plant and Equipment

Property, plant and equipment are stated at cost. Betterments which extend the useful life of the equipment are capitalized.

(h) Depreciation

Depreciation on property, plant and equipment is calculated on the straight-line method over the estimated useful lives (thirty to forty years for the buildings and between three and ten years for most of the Company's other property and equipment) of the assets.

(i) Goodwill

Goodwill represents the excess purchase price over the fair value of net assets acquired and is amortized over five to thirty-five years from the date of acquisition using the straight-line method.

The carrying value of goodwill is based on management's current assessment of recoverability. Management evaluates recoverability using both objective and subjective factors. Objective factors include management's best estimates of projected future earnings and cash flows and analysis of recent sales and earnings trends. Subjective factors include competitive analysis, technological advantage or disadvantage, and the Company's strategic focus.

(j) Other Assets

Other assets consist principally of patents, trademarks, long-term investments, cash and investments restricted for use by the Company's captive insurance company and the estimated residual value of assets subject to leveraged leases. Patents and trademarks are amortized over the estimated useful life of the respective asset using the straight-line method.

(k) Income Taxes

The Company recognizes certain transactions in different time periods for financial reporting and income tax purposes. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial

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statement carrying amounts of existing assets and liabilities and their respective tax bases. The provision for deferred income taxes represents the change in deferred income tax accounts during the year.

(l) Earnings Per Share

In 1997, the Financial Accounting Standard Board issued Statement No. 128, Earnings per Share. Statement 128 replaced the calculation of primary and fully diluted earning per share with basic and diluted earnings per share. Unlike primary earnings per share, basic earnings per share excludes any dilutive effects of options, warrants and convertible securities. Diluted earnings per share is very similar to the previously reported fully diluted earnings per share. All earnings per share amounts for all periods have been presented, and where appropriate, restated to conform to the Statement 128 requirements.

(m) Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(n) Insurance Programs

The Company established the KCI Employee Benefits Trust (the "Trust") as a self-insurer for certain risks related to the Company's U.S. employee health plan and certain other benefits. The Company funds the Trust based on the value of expected future payments, including claims incurred but not reported. The Company has purchased insurance which limits the Trust's liability under the benefit plans.

The Company's wholly-owned captive insurance company, KCI Insurance Company, Ltd. (the "Captive"), reinsures the primary layer of commercial general liability, workers' compensation and auto liability insurance for certain operating subsidiaries. Provisions for losses expected under these programs are recorded based upon estimates of the aggregate liability for claims incurred based on actuarial reviews. The Company has obtained insurance coverage for catastrophic exposures as well as those risks required to be insured by law or contract.

(o) Foreign Currency Translation

The functional currency for the majority of the Company's foreign operations is the applicable local currency. The translation of the applicable foreign currencies into U.S. dollars is performed for balance sheet accounts using the exchange rates in effect at the balance sheet date and for revenue and expense accounts using a weighted average exchange rate during the period.

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(p) Stock Options

During October 1995, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123 "Accounting for Stock-Based Compensation." The Statement allows companies to continue accounting for stock-based compensation under the provisions of APB Opinion 25, "Accounting for Stock Issued to Employees"; however, companies are encouraged to adopt a new accounting method based on the estimated fair value of employee stock options. Companies that do not follow the new fair value based method are required to provide expanded disclosures in footnotes to the financial statements. The Company has elected to continue accounting for stock-based compensation under the provisions of APB Opinion 25 and has provided the required disclosures (See Note 9).

(q) Research and Development

The focus of the Company's research and development program has been to develop new products and make technological improvements to existing products. Expenditures for research and development are expensed as incurred and represented approximately 2% of the Company's total expenditures in each of the years ended December 31, 1997, 1996 and 1995.

NOTE 2. Recapitalization

On November 5, 1997, a substantial interest in the Company was acquired by Fremont Partners L.P. ("Fremont") and Richard C. Blum & Associates, L.P. ("RCBA") (collectively, the "Investors"). The Company and the Investors entered into a Transaction Agreement dated as of October 2, 1997, as amended by a letter agreement dated November 5, 1997 (as so amended, the "Transaction Agreement") pursuant to which the Investors purchased 7,802,180 shares of newly-issued shares of the Company's common stock, $0.001 par value per share, at a price equal to $19.25 per share. The proceeds of the stock purchase, together with approximately $534.0 million of aggregate proceeds from certain financings, (see Note 5), were used to purchase approximately 31.0 million shares of the Company's common stock from the selling shareholders at a price of $19.25 per share, net to seller and pay all related fees and expenses.

Also pursuant to the Transaction Agreement, the Investors were subsequently merged with and into the Company, with the Company as the surviving corporation of the Merger. Following the Merger, Fremont, RCBA, Dr. James Leininger and Dr. Peter Leininger own 7,029,922, 4,644,010, 5,939,220 and 100,000 shares, respectively, representing 39.7%, 26.2%, 33.5% and 0.6% of the total shares outstanding. There are currently no other shareholders but certain members of management have retained, and/or have been granted, additional options to purchase shares. The transactions have been accounted for as a recapitalization and as such, a step-up of assets to fair market value was not required. The difference between the payment amount and the net book value of assets acquired and liabilities assumed was recorded as retained earnings as a cash distribution to the selling shareholders.

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During 1997, non-recurring costs in connection with the Recapitalization of approximately $34.4 million were incurred and expensed. Additionally, financing costs of approximately $17.7 million have been deferred and will be amortized over the lives of the new debt facilities.

NOTE 3. Acquisitions and Dispositions

On June 15, 1995, the Company sold KCI Financial Services ("KCIFS") to Cura Capital Corporation ("Cura") for cash under a Stock Purchase Agreement. Upon consummation of this transaction, Cura acquired all of the outstanding capital stock of KCIFS. Total proceeds from the sale were $7.2 million. This transaction resulted in a pre-tax loss of $2.9 million which is reflected in selling, general and administrative expenses in 1995. In addition, the Company and its affiliates agreed not to provide lease financing for medical equipment manufactured by third parties for a period of three years. KCIFS served as the leasing agent for Medical Services, certain assets of which were sold in September 1994. The operating results of KCIFS for 1995 were not material as compared to the overall results of the Company.

On February 1, 1997, the Company acquired the assets of H.F. Systems, Inc. of Los Angeles. H.F. Systems offers a complete line of therapeutic specialty support surfaces primarily to the California extended care marketplace. The Company acquired the assets of H.F. Systems in a single transaction for approximately $8.0 million in cash plus other consideration. H.F. Systems has been integrated into Kinetic Concepts' extensive distribution system and, as a result, the Company has benefited from the elimination of certain redundant expenses. H.F. Systems recorded revenue of approximately $7.0 million for 1996 and did not have a material impact on the Company's results of operations for 1997.

During 1997, the Company acquired 90% of the outstanding capital stock of Ethos Medical Group, Ltd. located in Athlone, Ireland, for approximately $2.8 million in cash plus other consideration. Ethos manufactures the Keene Roto Rest trauma bed and other medical devices and rents specialty support surfaces to caregivers throughout Ireland. Ethos Medical's operating results did not have a material impact on the Company's results of operations for 1997.

On July 31, 1997, the Company acquired the outstanding capital stock of Equi-Tron Mfg., Inc. located in Ontario, Canada, for approximately $3.2 million in cash plus other consideration. Equi-Tron Mfg., Inc. manufactures a line of products for bariatric patients used primarily in the home care market. The operating results of Equi-Tron Mfg., Inc. did not have a material impact on the Company's results of operations for 1997.

On October 1, 1997, the Company acquired substantially all of the assets of RIK Medical, L.L.C. ("RIK"), a Delaware limited liability company. The Company paid approximately $23.3 million in cash for the acquisition plus an earn-out of up to $2.0 million. RIK is a manufacturer of non-powered therapeutic support surfaces based in Boulder, Colorado. The RIK products incorporate several unique and patented components and features. The operating results

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of RIK Medical did not have a material impact on the Company's results of operations for 1997.

The 1997 acquisitions have been accounted for by the purchase method of accounting, and accordingly, the approximate purchase prices, shown above, have been allocated to the assets acquired and the liabilities assumed based on the estimated fair values at the dates of acquisition, with the excess of purchase prices over assigned asset values recorded as goodwill which the Company is amortizing over periods of 15-25 years. The results of operations of the acquisitions have been included in the Company's consolidated financial statements since the acquisition dates. Because the 1997 acquisitions are not material to the Company's financial position or results of operations, pro forma results of operations are not presented.

NOTE 4. Supplemental Balance Sheet Data

Accounts receivable consist of the following (in thousands):

	December 31, 1997	December 31, 1996
Trade accounts receivable..........	$88,509	$63,613
Employee and other receivables.....	3,933	2,160
	92,442	65,773
Less allowance for doubtful receivables.....................	11,204	7,532
	$81,238	$58,241

Inventories consist of the following (in thousands):

	December 31, 1997	December 31, 1996
Finished goods....................	$ 7,162	$ 5,586
Work in process...................	2,743	1,893
Raw materials, supplies and parts..	19,048	17,113
	28,953	24,592
Less amounts expected to be converted into equipment for short-term rental...............	7,400	4,550
	$21,553	$20,042

Net property, plant and equipment consist of the following (in thousands):

December 31,

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	1997	1996
Land	$ 649	$ 1,007
Buildings	16,693	14,254
Equipment for short-term rental	131,534	133,896
Machinery, equipment and furniture	40,551	36,821
Leasehold improvements	1,560	1,388
Inventory to be converted into equipment	7,400	4,550
	198,387	191,916
Less accumulated depreciation	122,953	126,692
	$ 75,434	$ 65,224

Accrued expenses consist of the following (in thousands):

	December	
	1997	1996
Payroll, commissions and related taxes	$15,454	$13,232
Insurance accruals	3,238	2,887
Other accrued expenses	22,642	13,673
	$41,334	$29,792

NOTE 5. Long-Term Obligations

Long-term obligations at December 31, 1997 consists of the following (in thousands):

Senior Credit Facilities:	
Revolving bank credit facility	$ 24,500
Acquisition credit facility	10,000
Term loans:	
Tranche A due 2003	120,000
Tranche B due 2004	90,000
Tranche C due 2005	90,000
	334,500
9 5/8% Senior Subordinated Notes Due 2007	200,000
	534,500
Less: Current installments	4,800
	529,700
Other	201
	$529,901

Senior Credit Facilities

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Indebtedness under the Senior Credit Facilities, including the Revolving Credit Facility (other than certain loans under the Revolving Credit Facility designated in foreign currency), the Term Loans and the Acquisition Facility initially bear interest at a rate based upon (i) the Base Rate (defined as the higher of (x) the rate of interest publicly announced by Bank of America as its "reference rate" and (y) the federal funds effective rate from time to time plus 0.50%), plus 1.25% in respect of the Tranche A Term Loans, the loans under the Revolving Credit Facility (the "Revolving Loans") and the loans under the Acquisition Facility (the "Acquisition Loans"), 1.50% in respect of the Tranche B Term Loans and 1.75% in respect of the Tranche C Term Loans, or at the Company's option, (ii) the Eurodollar Rate (as defined in the Sr. Credit Facility Agreement) for one, two, three or six months, in each case plus 2.25% in respect of Tranche A Term Loans, Revolving Loans and Acquisition Loans, 2.50% in respect of Tranche B Term Loans and 2.75% in respect of the Tranche C Term Loans. Certain Revolving Loans designated in foreign currency will initially bear interest at a rate based upon the cost of funds for such loans, plus 2.25% or 2.50%, depending on the type of foreign currency. Performance-based reductions of the interest rates under the Term Loans, the Revolving Loans and the Acquisition Loans are available. Subsequent to December 31, 1997, the Company entered into a swap transaction whereby the interest rate on $150,000,000 of the term loans is fixed at 5.7575% through January 8, 2001.

The Revolving Loans may be repaid and reborrowed. The Company is required to pay to the Banks under the Bank Credit Agreement a commitment fee initially equal to 0.50% per annum, payable in arrears on a quarterly basis, on the average daily unused portion of the Revolving Credit Facility and Acquisition Facility during such quarter. The Company is also required to pay to the Banks participating in the Revolving Credit Facility letter of credit fees equal to the applicable margin then in effect with respect to Eurodollar loans under the Revolving Credit Facility on the face amount of each letter of credit outstanding and to the Bank issuing a letter of credit a fronting fee of 0.25% on the average daily stated amount of each outstanding letter of credit issued by such Bank, in each case payable in arrears on a quarterly basis. Bank of America and Bankers Trust will receive and continue to receive such other fees as have been separately agreed upon. At December 31, 1997, the aggregate availability under the Revolving Credit and Acquisition Facilities was $65.5 million.

The Term Loans are subject to quarterly amortization payments commencing on March 31, 1998. Commitments under the Acquisition Facility will expire three years from the closing of the Bank Credit Agreement and the Acquisition Facility loans outstanding shall be repayable in equal quarterly amortization payments commencing March 31, 2001. In addition, the Bank Credit Agreement provides for mandatory repayments, subject to certain exceptions, of the Term Loans, the Acquisition Facility and/or the Revolving Credit Facility based on certain net asset sales outside the ordinary course of business of the Company and its subsidiaries, the net proceeds of certain debt and equity issuances and excess cash flows.

Indebtedness of the Company under the Senior Credit Agreement

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is guaranteed by certain of the subsidiaries of the Company and is secured by (i) a first priority security interest in all, subject to certain customary exceptions, of the tangible and intangible assets of the Company and its domestic subsidiaries, including, without limitation, intellectual property and real estate owned by the Company and its subsidiaries, (ii) a first priority perfected pledge of all capital stock of the Company's domestic subsidiaries and (iii) a first priority perfected pledge of up to 65% of the capital stock of foreign subsidiaries owned directly by the Company or its domestic subsidiaries.

The Senior Credit Agreement requires the Company to meet certain financial tests, including minimum levels of EBITDA (as defined therein), minimum interest coverage, maximum leverage ratio and capital expenditures. The Bank Credit Agreement also contains covenants which, among other things, limit the incurrence of additional indebtedness, investments, dividends, loans and advances, capital expenditures, transactions with affiliates, asset sales, acquisitions, mergers and consolidations, prepayments of other indebtedness (including the Notes), liens and encumbrances and other matters customarily restricted in such agreements. The Company is in compliance with the applicable covenants at December 31, 1997.

The Senior Credit Agreement contains customary events of default, including payment defaults, breach of representations and warranties, covenant defaults, cross-defaults to certain other indebtedness, certain events of bankruptcy and insolvency, failures under ERISA plans, judgment defaults, failure of any guaranty, security document security interest or subordination provision supporting the Bank Credit Agreement to be in full force and effect and change of control of the Company.

9 5/8% Senior Subordinated Notes Due 2007

The 9 5/8% Senior Subordinated Notes Due 2007 (the "Notes") are unsecured obligations of the Company, ranking subordinate in right of payment to all senior debt of the Company and will mature on November 1, 2007. Interest on the Notes accrues at the rate of 9 5/8% per annum and is payable semiannually in cash on each May 1 and November 1, commencing on May 1, 1998, to the persons who are registered Holders at the close of business on April 15 and October 15, respectively, immediately preceding the applicable interest payment date. Interest on the Notes accrues from and including the most recent date to which interest has been paid or, if no interest has been paid, from and including the date of issuance.

The Notes are not entitled to the benefit of any mandatory sinking fund. In addition, at any time, or from time to time, the Company may acquire a portion of the Notes through open-market purchases.

Redemption

Optional Redemption. The Notes will be redeemable, at the Company's option, in whole at any time or in part from time to time, on and after November 1, 2002, upon not less than 30 nor more than 60 days' notice, at the following redemption prices (expressed as percentages of the principal amount thereof) if redeemed during

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the twelve-month period commencing on November 1 of the year set forth below, plus, in each case, accrued and unpaid interest thereon, if any, to the date of redemption.

Year	Percentage
2000	104.813%
2001	103.208%
2002	101.604%
2005 and thereafter	100.000%

Optional Redemption upon Equity Offerings. At any time, or from time to time, on or prior to November 1, 2000, the Company may, at its option, on one or more occasions use all or a portion of the net cash proceeds of one or more Equity Offerings (as defined below) to redeem the Notes issued under the Indenture at a redemption price equal to 109.625% of the principal amount thereof plus accrued and unpaid interest thereon, if any, to the date of redemption; provided that at least 65% of the principal amount of Notes originally issued remains outstanding immediately after any such redemption. In order to effect the foregoing redemption with the proceeds of any Equity Offering, the Company shall make such redemption not more than 120 days after the consummation of any such Equity Offering.

Interest paid during 1997, 1996 and 1995 was approximately $5.1 million, $200,000 and $400,000, respectively.

As used in the preceding paragraph, "Equity Offering", means any offering of Qualified Capital Stock of the Company.

Future maturities of long-term debt at December 31, 1997 are as follows (in thousands):

Year	Amount
1998	$ 4,800
1999	$ 8,800
2000	$ 16,800
2001	$ 35,133
2002	$ 35,133
Thereafter	$433,834

NOTE 6. Leasing Obligations

The Company is obligated for equipment under various capital leases which expire at various dates during the next four years. At December 31, 1997, the gross amount of equipment under capital leases totaled $619,000 and related accumulated depreciation totaled $299,000.

The Company leases computer and telecommunications equipment, service vehicles, office space, various storage spaces and manufacturing facilities under noncancelable operating leases which expire at various dates over the next six years. Total rental expense for operating leases, net of sublease payments received, was $13.2 million, $13.5 million and $12.0 million for the years

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ended December 31, 1997, 1996 and 1995, respectively.

Future minimum lease payments under capital and noncancelable operating leases (with initial or remaining lease terms in excess of one year) as of December 31, 1997 are as follows (in thousands):

	Capital Leases	Operating Leases
1998	$216	$13,696
1999	173	7,500
2000	107	5,528
2001	1	3,966
2002	--	3,125
Later years	--	--
Total minimum lease payments	$497	$33,815
Less amount representing interest	46	
Present value of net minimum capital lease payments	451	
Less current portion	139	
Obligations under capital leases excluding current installments	$312	

NOTE 7. Income Taxes

Earnings before income taxes and minority interest consists of the following (in thousands):

	Year Ended December 31,		
	1997	1996	1995
Domestic	$12,493	$51,771	$37,542
Foreign	8,540	12,670	10,804
	$21,033	$64,441	$48,346

Income tax expense attributable to income from continuing operations consists of the following (in thousands):

	Year Ended December 31, 1997		
	Current	Deferred	Total
Federal	$ 145	$ 3,380	$ 3,525
State	19	1,105	1,124
International	3,549	205	3,754
	$ 3,713	$ 4,690	$ 8,403

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	Year Ended December 31, 1996		
	Current	Deferred	Total
Federal........................	$14,363	$ 4,464	$18,827
State..........................	2,569	552	3,121
International..................	3,831	(325)	3,506
	$20,763	$ 4,691	$25,454

	Year Ended December 31, 1995		
	Current	Deferred	Total
Federal........................	$ 8,148	$ 4,174	$12,322
State..........................	2,140	277	2,417
International..................	5,166	--	5,166
	$15,454	$ 4,451	$19,905

Income tax expense attributable to income from continuing operations differed from the amounts computed by applying the statutory tax rate of 35 percent to pre-tax income from continuing operations as a result of the following (in thousands):

	Year Ended December 31,		
	1997	1996	1995
Computed "expected" tax expense...	$7,353	$22,554	$16,921
Goodwill..........................	317	442	533
State income taxes, net of Federal benefit........................	731	2,028	1,571
Tax-exempt interest from municipal bonds..........................	(160)	(445)	--
Foreign income taxed at other than U.S. rates.....................	417	1,145	1,836
Utilization of foreign net operating loss carryforwards..............	(46)	(123)	(231)
Nonconsolidated foreign net operating loss..................	402	67	492
Foreign, other....................	(268)	(441)	(1,450)
Other, net........................	(343)	227	233
	$8,403	$25,454	$19,905

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 1997 and December 31, 1996 are presented below (in thousands):

	1997	1996

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Deferred Tax Assets:		
Accounts receivable, principally due to allowance for doubtful accounts	$ 3,311	$ 4,458
Intangible assets, deducted for book purposes but capitalized and amortized for tax purposes	617	1
Foreign net operating loss carryforwards	402	67
Net operating loss carryforwards	1,566	--
Inventories, principally due to additional costs capitalized for tax purposes pursuant to the Tax Reform Act of 1986	895	664
Legal fees, capitalized and amortized for tax purposes	533	670
Accrued liabilities	1,381	1,015
Foreign tax credits, available for carryback	3,321	--
Deferred foreign tax asset	120	325
Other	1,804	1,089
Total gross deferred tax assets	13,950	8,289
Less valuation allowance	(402)	(67)
Net deferred tax assets	13,548	8,222
Deferred Tax Liabilities:		
Plant and equipment, principally due to differences in depreciation and basis	(20,591)	(11,722)
Deferred state tax liability	(2,077)	(973)
Investments, principally due to differences in tax treatment of certain components	(804)	(506)
Other	(86)	(86)
Total gross deferred tax liabilities	(23,558)	(13,287)
Net deferred tax liability	$(10,010)	$ (5,065)

At December 31, 1997, the Company had $1.3 million of operating loss carryforwards available to reduce future taxable income of certain international subsidiaries. These loss carryforwards must be utilized within the applicable carryforward periods. A valuation allowance has been provided for the deferred tax assets related to loss carryforwards. Carryforwards of $630,000 can be used indefinitely and the remainder expire from 1998 through 2002. Additionally, the Company had a foreign tax credit of $3,097,000 which will be carried back to 1995 and 1996.

The Company anticipates that the reversal of existing taxable temporary differences and future income will provide sufficient taxable income to realize the tax benefit of the remaining deferred tax assets.

Income taxes paid during 1997, 1996 and 1995 were $12.1 million, $15.4 million and $15.1 million, respectively.

NOTE 8. Shareholders' Equity and Employee Benefit Plans

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Common Stock:

The Company is authorized to issue 100 million shares of Common Stock, $0.001 par value (the "Common Stock"). On November 5, 1997, a substantial interest in the Company was acquired by Fremont Partners L.P. ("Fremont") and Richard C. Blum & Associates, L.P. ("RCBA") (collectively, the "Investors"). The Company and the Investors entered into a Transaction Agreement dated as of October 2, 1997, as amended by a letter agreement dated November 5, 1997 (as so amended, the "Transaction Agreement") pursuant to which the Investors purchased 7,802,180 shares of newly-issued shares of the Company's common stock, $0.001 par value per share, at a price equal to $19.25 per share. The proceeds of the stock purchase, together with approximately $534.0 million of aggregate proceeds from certain financings, (see Note 5), were used to purchase approximately 31.0 million shares of the Company's common stock from the selling shareholders at a price of $19.25 per share, net to seller and pay all related fees and expenses. The number of shares of Common Stock issued and outstanding at the end of 1997 and 1996 was 17,486,000 and 42,355,000, respectively.

Treasury Stock:

In July, 1995, the Company's Board of Directors approved a program to repurchase up to 3,000,000 shares of its Common Stock. The Company repurchased approximately 258,000 shares during 1997 and 2,563,000 shares during 1996. In 1994, the Company's Board of Directors adopted a resolution to return all repurchased shares to the status of authorized but unissued shares. In accordance with this resolution, the Company retired 2,563,000 and 77,000 treasury shares in 1996 and 1995, respectively. In February 1997, the Company's Board of Directors approved a program which authorized the Company to purchase up to an additional 3 million shares. The Company repurchased no shares during 1997 under this program. Both programs were terminated in 1997 in connection with the November 1997 recapitalization transactions.

Preferred Stock:

The Company is authorized to issue up to 20.0 million shares of Redeemable Preferred Stock, par value $0.001 per share, in one or more series. As of December 31, 1997 and December 31, 1996, none were issued.

Employee Stock Ownership Plan:

The Company established an Employee Stock Ownership Plan (the "ESOP") covering employees of the Company who meet minimum age and length of service requirements. The ESOP enabled eligible employees to acquire a proprietary interest in the Company.

As of November 6, 1997, the ESOP was terminated and all shares of stock owned by the ESOP were tendered in connection with the November 1997 recapitalization transactions. Based on the number of shares allocated for the year, ESOP expense recorded during 1997, 1996 and 1995 amounted to $0, $0 and $263,000, respectively.

Investment Plan:

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The Company has an Investment Plan intended to qualify as a deferred compensation plan under Section 401(k) of the Internal Revenue Code of 1986. The Investment Plan is available to all domestic employees and the Company matches employee contributions up to a specified limit. In 1997, 1996 and 1995, the Company made matching contributions and charged to expense $950,000, $498,000 and $265,000, respectively.

NOTE 9. Stock Option Plans

In October 1995, the Financial Accounting Standards Board (FASB) issued Statement No. 123, "Accounting and Disclosure of Stock-Based Compensation." While the accounting standard encourages the adoption of a new fair-value method for expense recognition, Statement 123 allows companies to continue accounting for stock options and other stock-based awards as provided in Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" (APB 25). The Company has elected to follow the provisions of APB 25 and related interpretations in accounting for its stock options plans because, as discussed below, the alternative fair-value method prescribed by FASB Statement No. 123 requires the use of option valuation models that were not developed for use in valuing employee stock options. Under APB 25, because the exercise price of the Company's employee stock options generally equals the market price of the underlying stock on the date of grant, no compensation expense is recognized.

In December 1997, the Company's Board of Directors approved the 1997 Management Equity Plan. The maximum aggregate number of shares of no-par Common Stock that may be issued in connection with grants under the Management Equity Plan is approximately 1.2 million shares, subject to adjustment as provided for in the plan. The Management Equity Plan shall be administered, and grants determined, by a committee of the Board of Directors. The exercise price and term of options granted under the Management Equity Plan shall be determined by the committee, however, in no event shall the term of any option granted under the Management Equity Plan exceed seven (7) years. The Management Equity Plan supersedes all other stock option plans. As of December 31, 1997, all outstanding options granted under the superseded plans were 100% vested.

The 1997 Kinetic Concepts, Inc. Stock Incentive Plan (the "Stock Incentive Plan") was approved by the Company's Board of Directors on May 13, 1997 and covered an aggregate of 2.5 million shares of the Company's Common Stock. Under the Stock Incentive Plan, options were granted to employees (including officers), non-employee directors and consultants of the Company. The exercise price of the options was determined by a committee of the Board of Directors of the Company. The Stock Incentive Plan permitted the Board of Directors to declare the terms for payment when such options are exercised. Options under the Stock Incentive Plan were granted with a term not exceeding ten years. The Stock Incentive Plan was superseded by the 1997 Management Equity Plan.

The 1987 Kinetic Concepts, Inc. Key Contributor Stock Option Plan (the "Key Contributor Stock Option Plan") covered up to an aggregate of 5.75 million shares of the Company's Common Stock. Options were granted under the Key Contributor Stock Option Plan

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to employees (including officers), non-employee directors and consultants of the Company. The exercise price of the options was determined by a committee of the Board of Directors of the Company. The Key Contributor Stock Option Plan permitted the Board of Directors to declare the terms for payment when such options are exercised. Options under the Key Contributor Stock Option Plan were granted with a term not exceeding ten years. The Key Contributor Stock Option Plan expired April 13, 1997 and was succeeded by the 1997 Stock Incentive Plan.

The 1988 Kinetic Concepts, Inc. Directors Stock Option Plan (the "Directors Stock Option Plan") covered an aggregate of 300,000 shares of the Company's Common Stock and were granted to non-employee directors of the Company. The exercise price of options granted under the Directors Stock Option Plan was determined as the fair market value of the shares of the Company's Common Stock on the date that such option was granted. The Directors Stock Option Plan was succeeded by the 1997 Stock Incentive Plan.

The 1995 Kinetic Concepts, Inc. Senior Executive Management Stock Option Plan (the "Senior Executive Stock Option Plan") covered a total of 1.4 million shares of the Company's Common Stock and may be granted to certain senior executives of the Company at the recommendation of the Chief Executive Officer and discretion of the Company's Board of Directors. The exercise price for each share of common stock covered by an option was established by the Board of Directors but was not in any case less than the fair market value of the shares of common stock of the Company on the date of grant. Vesting of options granted was subject to certain terms and conditions. The Senior Executive Stock Option Plan was superseded by the 1997 Management Equity Plan .

Pro forma information regarding net income and earnings per share is required by Statement 123, 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 options granted during the three fiscal years ended December 31, 1997, 1996 and 1995, respectively, was estimated using a Black-Scholes option pricing model with the following weighted average assumptions: risk-free interest rates of 5.6%, 6.1% and 6.0% dividend yields of 1.1%, 0.9% and 2.1%, volatility factors of the expected market price of the Company's common stock of .30, .32 and .33, and a weighted-average expected option life of 5 years.

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 underlying 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.

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

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thousands except for earnings per share information):

	1997	1996	1995
Net Earnings as Reported......	$12,605	$38,987	$28,441
Pro Forma Net Earnings........	$11,319	$37,996	$28,238
Earnings Per Share as Reported			
Earnings per common share...	$ 0.33	$ 0.89	$ 0.64
Earnings per common share-- assuming dilution.........	$ 0.32	$ 0.86	$ 0.63
Pro Forma Earnings Per Share			
Earnings per common share...	$ 0.29	$ 0.86	$ 0.64
Earnings per common share-- assuming dilution.........	$ 0.28	$ 0.84	$ 0.62

The Company is not required to apply the method of accounting prescribed by Statement 123 to stock options granted prior to January 1, 1995. As a result, the pro forma compensation cost reflected above may not be representative of future results.

The following table summarizes information about stock options outstanding at December 31, 1997 (options in thousands):

Range of Exercise Prices	Options Outstanding at 12/31/97	Weighted Average Remaining Contract Life (yrs)	Weighted Average Exercise Price	Options Exercisable at 12/31/97	Weighted Average Exercise Price
$ 3.50 to $ 4.63	346	6.3	$ 4.17	346	$ 4.17
$ 5.00 to $ 9.50	182	6.6	$ 6.78	182	$ 6.78
$11.13 to $19.25	1,808	7.7	$16.86	852	$14.17
	2,336	7.4	$14.20	1,380	$10.69

A summary of the Company's stock option activity, and related information, for years ended December 31, 1997, 1996 and 1995 follows (options in thousands):

	1997		1996		1995	
	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
Options Oustanding- Beginning of Year	3,339	$ 8.68	2,833	$ 5.21	3,029	$ 4.50
Granted..........	1,708	$ 17.44	1,317	$14.47	873	$ 6.89
Exercised.........	(2,609)	$ 9.40	(628)	$ 5.05	(792)	$ 4.56

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Forfeited.........	(102)	$ 10.63	(183)	$ 9.34	(277)	$ 4.57
Options Outstanding- End of Year.....	2,336	$ 14.20	3,339	$ 8.68	2,833	$ 5.21
Exercisable at End of Year.........	1,380	$ 10.69	1,321	$ 7.07		
Weighted-Average Fair Value of Options Granted During the Year.		$ 6.39		$ 5.80		$ 2.19

Exercise prices for options outstanding as of December 31, 1997 ranged from $3.50 to $19.25. The weighted average remaining contractual life of those options is 7.4 years. The weighted average fair value of options granted during 1997 approximated the weighted average exercise price at the grant date.

Note 10. Other Assets

A summary of other long-term assets follows (in thousands):

	1997	1996
Investment in assets subject to leveraged leases.............	$16,069	$14,766
Information systems development projects........................	--	3,124
Investment in long-term securities	782	2,979
Intangible assets.................	4,096	3,710
Deposits and other................	11,634	11,475
	$32,581	$36,054
(Less) accumulated amortization...	(3,100)	(5,614)
	$29,481	$30,440

The Company acquired beneficial ownership of two Grantor Trusts in December 1996 and December 1994. Each Trust asset consists of a McDonnell Douglas DC-10 aircraft and three engines. In connection with the acquisition, KCI paid cash equity of $7.2 million and $7.6 million, respectively, and assumed non-recourse debt of $47.0 million and $51.8 million, respectively. The DC-10 aircrafts are on lease to the Federal Express Corporation through June 2012 and January 2012, respectively. Federal Express pays monthly rent to a third party who, in turn, pays this entire amount to the holders of the non-recourse certificated indebtedness, which is secured by the aircraft. Recourse to the certificate holders is limited to the Trust assets only.

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Long-term securities consist primarily of government backed securities held by the Company's wholly owned captive insurance company.

Note 11. Earnings Per Share

The following table sets forth the reconciliation from basic to diluted average common shares and the calculations of net income per common share. Net income for basic and diluted calculations do not differ (in thousands, except per share).

	1997	1996	1995
Net Income.....................	$12,605	$38,987	$28,441
Average Common Shares:			
Basic(weighted-average outstanding shares)..........	38,591	43,958	44,163
Dilutive potential common shares from stock options..................	1,319	1,531	1,294
Diluted (weighted-average outstanding shares)......	39,910	45,489	45,457
Earnings per common share......	$ 0.33	$ 0.89	$ 0.64
Earning per common share - assuming dilut...............	$ 0.32	0.86	0.63

NOTE 12. Commitments and Contingencies

On February 21, 1992, Novamedix Limited filed a lawsuit against the Company in the United States District Court for the Western District of Texas. Novamedix holds the patent rights to the principal product which directly competes with the PlexiPulse. The suit alleges that the PlexiPulse infringes several patents held by Novamedix, that the Company breached a confidential relationship with Novamedix and a variety of subsidiary claims. Novamedix seeks injunctive relief and monetary damages. A small amount of discovery remains. Although it is not possible to predict the outcome of this litigation or the damages which could be awarded, the Company believes that its defenses to these claims are meritorious and that the litigation will not have a material effect on the Company's business, financial condition or results of operations.

On August 16, 1995, the Company filed a civil antitrust lawsuit against Hillenbrand Industries, Inc. and one of its subsidiaries, Hill-Rom. The suit was filed in the United States District Court for the Western District of Texas. The suit alleges that Hill-Rom used its monopoly power in the standard hospital bed

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business to gain an unfair advantage in the specialty hospital bed business. Although discovery has not been completed and it is not possible to predict the outcome of this litigation or the damages which might be awarded, the Company believes that its claims are meritorious.

On October 31, 1996 the Company received a counterclaim which had been filed by Hillenbrand Industries, Inc. in the antitrust lawsuit which the Company filed in 1995. The counterclaim alleges that the Company's antitrust lawsuit and other actions were designed to enable Kinetic Concepts to monopolize the bed market. Although it is not possible to predict the outcome of this litigation, the Company believes that the counterclaim is without merit.

On December 26, 1996, Hill-Rom, a subsidiary of Hillenbrand Industries, Inc. filed a lawsuit against the Company alleging that the Company's TriaDyne bed infringes a patent issued to Hill-Rom in December 1996. This suit was filed in the United States District Court for the District of South Carolina. Substantive discovery in the case has not begun. Based upon its initial investigation, the Company does not believe that the TriaDyne bed infringes the Hill-Rom patent or that this lawsuit will materially impact the marketing of the TriaDyne bed. In the opinion of management, the disposition of these items will not have a material effect on the Company's business, financial condition or results of operations.

The Company is party to several lawsuits generally incidental to its business, including product claims and is contesting certain adjustments proposed by the Internal Revenue Service to prior years' tax returns. Provisions have been made in the accompanying financial statements for estimated exposures related to these lawsuits and adjustments. In the opinion of management, the disposition of these items will not have a material effect on the Company's business, financial condition or results of operations.

Other than commitments for new product inventory, including disposable "for sale" products, of $11.4 million, the Company has no material long-term capital commitments and can adjust the level of capital expenditures as circumstances dictate.

See discussion of the Company's self-insurance program at Note 1 and leases at Note 6.

NOTE 13. Segment and Geographic Information

The Company operates primarily in one industry segment: the distribution of specialty therapeutic beds and medical devices to select health care providers.

A summary of financial information by geographic area is as follows (in thousands):

	Year Ended December 31, 1997			
	Domestic	Foreign	Eliminations	Consolidated
Total revenue:				

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	Domestic	Foreign	Eliminations	Consolidated
Unaffiliated customers	$236,642	$70,274	$ --	$306,916
Intercompany transfers	5,838	--	(5,838)	--
Total.........	$242,480	$70,274	$ (5,838)	$306,916
Operating earnings......	$ 18,365	$12,184	$ (500)	$ 30,049
Total assets:				
Identifiable assets...	$244,374	$55,846	$(10,823)	$289,397
Corporate assets......				61,754
Total assets..				$351,151

Year Ended December 31, 1996

	Domestic	Foreign	Eliminations	Consolidated
Total revenue:				
Unaffiliated customers	$201,116	$68,765	$ --	$269,881
Intercompany transfers	7,272	--	(7,272)	--
Total.........	$208,388	$68,765	$(7,272)	$269,881
Operating earnings......	$ 40,810	$15,197	$ (653)	$ 55,354
Total assets:				
Identifiable assets...	$155,049	$49,622	$(10,323)	$194,348
Corporate assets......				59,045
Total assets..				$253,393

Year Ended December 31, 1995

	Domestic	Foreign	Eliminations	Consolidated
Total revenue:				
Unaffiliated customers	$182,754	$60,689	$ -	$243,443
Intercompany transfers	6,991	--	(6,991)	--
Total.........	$189,745	$60,689	$ (6,991)	$243,443
Operating earnings......	$ 33,779	$10,845	$ (832)	$ 43,792
Total assets:				
Identifiable assets...	$157,603	$43,787	$(10,063)	$191,327
Corporate assets......				52,399
Total assets..				$243,726

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Domestic intercompany transfers primarily represent shipments of equipment and parts to international subsidiaries. These intercompany shipments are made at transfer prices which approximate prices charged to unaffiliated customers and have been eliminated from consolidated net revenues. Corporate assets consist of cash and cash equivalents.

NOTE 14. Quarterly Financial Data (Unaudited)

The unaudited consolidated results of operations by quarter are summarized below:

	Year Ended December 31, 1997			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Revenue....................	$73,181	$75,031	$76,299	$ 82,405
Operating earnings (loss)..	$16,217	$16,223	$16,165	$(18,556)
Net earnings (loss)........	$10,003	$ 9,952	$ 9,948	$(17,298)
Per share:				
Earnings (loss) per common share........	$ 0.24	$ 0.24	$ 0.23	$ (0.63)
Earnings (loss) per common share - assuming dilution...	$ 0.23	$ 0.23	$ 0.23	$ (0.63)
Average common shares:				
Basic (Weighted average outstanding shares).............	42,401	42,317	42,447	27,248
Diluted (Weighted average outstanding shares)	43,763	43,806	44,091	28,213

Results for the fourth quarter of 1997 include recapitalization expenses of $34.4 million (See Note 2).

	Year Ended December 31, 1996			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Revenue....................	$67,587	$64,272	$67,970	$70,052
Operating earnings.........	$13,741	$12,721	$13,629	$15,263
Net earnings...............	$ 8,814	$ 8,187	$ 8,858	$13,128
Per share:				
Earnings per common share...............	$ 0.20	$ 0.18	$ 0.20	$ 0.30
Earnings per common share - assuming dilution............	$ 0.19	$ 0.18	$ 0.19	$ 0.30
Average common shares:				
Basic (Weighted average outstanding				

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shares)..............	44,320	44,307	43,966	43,087
Diluted (Weighted average outstanding shares)..............	45,967	46,459	45,553	44,474

Earnings per share for the full year may differ from the total of the quarterly earnings per share due to rounding differences.

NOTE 15. New Accounting Pronouncements

In June 1997, the Financial Accounting Standards Board ("FASB") issued Statement No. 130, "Reporting Comprehensive Income" which is effective for fiscal years beginning after December 15, 1997. This new pronouncement establishes standards for the reporting and display of comprehensive income and its components in a full set of general purpose financial statements. Under the provisions of Statement No. 130, all revenue, expenses, gains and losses recognized during the period are included in income, regardless of whether they are considered to be results of operations of the period. Items required by accounting standards to be reported as direct adjustments to paid-in-capital, retained earnings or other non-income equity accounts are not to be included as components of comprehensive income.The Company plans to adopt the provisions of Statement No. 130 effective with the fiscal year beginning January 1, 1998, and estimates that any impact on the Company's results of operations or financial position will not be material.

Also, effective for periods beginning after December 15, 1997, the FASB issued Statement No. 131, "Disclosures about Segments of an Enterprise and Related Information". This statement establishes standards for the way that public companies report information about operating segments in annual financial statements as well as interim financial reports. It also establishes standards for related disclosures about products and services, geographic areas and major customers. Operating segments are components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. The Company plans to adopt the provisions of Statement No. 131 effective with the fiscal year beginning January 1, 1998 and estimates that adoption of these provisions will not have a material adverse impact on the Company's financial position or results of operations.

During 1997, the Securities and Exchange Commission issued expanded disclosure requirements of accounting policies for derivative financial instruments and the exposure to market risk. The new rules require enhanced descriptions of specific aspects of a registrant's accounting policies for derivatives as well as qualitative and quantitative disclosures about each type of market risk. The increased policy disclosures on derivatives were effective for all public companies for periods ending after June 15, 1997. The qualitative and quantitative market risk disclosures must be provided in all filings that include audited financial statements for fiscal years ending after June 15, 1998. The

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Company expects compliance with these requirements will not have a material impact on the Company's consolidated results of operations, financial position, or cash flows.

NOTE 16. Guarantor Condensed Consolidating Financial Statements

Kinetic Concepts, Inc. issued $200 million in subordinated debt securities to finance a tender offer to purchase certain of its common shares outstanding. In connection with the issuance of these securities, certain of its subsidiaries (the guarantor subsidiaries) will serve as guarantors. Certain other subsidiaries (the nonguarantor subsidiaries) will not guarantee such debt.

The following tables present the condensed consolidating balance sheets of Kinetic Concepts, Inc. as a parent company, its guarantor subsidiaries and its nonguarantor subsidiaries as of December 31, 1997 and 1996 and the related condensed consolidating statements of earnings and cash flows for each year in the three-year period ended December 31, 1997.

Condensed Consolidating Guarantor, Non-Guarantor And
Parent Company Balance Sheet
December 31, 1997
(in thousands)

	Kinetic Concepts, Inc. Parent Company Borrower	Guarantor Sub-sidiaries	Non-Guarantor Sub-sidiaries	Reclassi-fications and Elimi-nations	Kinetic Concepts, Inc. and Sub-sidiaries
ASSETS					
Current assets:					
Cash and cash equivalents..............	$ --	$ 44,471	$ 17,316	$ (33)	$ 61,754
Accounts receivable, net.................	681	75,252	15,002	(9,697)	81,238
Inventories..........	16,716	3,056	9,547	(7,766)	21,553
Prepaid expenses and other.............	5,663	11,847	1,584	(648)	18,446
Total current assets.........	23,060	134,626	43,449	(18,144)	182,991
Net property, plant and equipment............	14,310	75,471	9,065	(23,412)	75,434
Goodwill, net..........	2,749	37,332	5,818	--	45,899
Loan issuance cost, net	0	17,346	--	--	17,346
Other assets, net......	6,055	23,298	127	1	29,481
Intercompany investments and advances...	264,135	228,016	1,017	(493,168)	--
Total assets.....	$310,309	$516,089	$ 59,476	$(534,723)	$351,151

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LIABILITIES AND CAPITAL ACCOUNTS

Accounts payable.......	$ 37,594	$ 595	$ 2,196	$ (32)	$ 40,353
Accrued expenses.......	12,714	23,429	5,691	(500)	41,334
Current installments on long-term obligations obligations	4,800	--	--	--	4,800
Intercompany payables..	--	181,147	9,761	(190,908)	--
Current installments of capital lease obligations.............	139	--	--	--	139
Income tax payable.....	--	1	648	(649)	--
Total current liabilities...	55,247	205,172	18,296	(192,089)	86,626
Long-term obligations excluding current installments........	529,700	201	--	--	529,901
Capital lease obligations, excluding current installments	256	--	56	--	312
Deferred income taxes, net.................	804	17,636	--	(8,430)	10,010
Total liabilities	586,007	223,009	18,352	(200,519)	626,849
Shareholders' (deficit) equity...............	(275,698)	293,080	41,124	(334,204)	(275,698)
Total liabilities and equity.....	$310,309	$516,089	$ 59,476	$(534,723)	$351,151

Condensed Consolidating Guarantor, Non-Guarantor And
Parent Company Balance Sheet
December 31, 1996
(in thousands)

	Kinetic Concepts, Inc. Parent Company Borrower	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Reclassifications and Eliminations	Kinetic Concepts, Inc. and Subsidiaries
ASSETS					
Current assets:					
Cash and cash equivalents.......	$ --	$ 50,286	$ 14,485	$ (5,726)	$ 59,045
Accounts receivable, net...............	5,174	46,585	13,072	(6,590)	58,241
Inventories.........	13,944	334	10,605	(4,841)	20,042
Prepaid expenses and other.............	2,677	3,214	969	--	6,860

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Total current assets........	21,795	100,419	39,131	(17,157)	144,188
Net property, plant and equipment...........	12,965	76,143	9,571	(33,455)	65,224
Goodwill, net.........	3,375	3,829	6,337	--	13,541
Other assets, net.....	10,848	21,470	325	(2,203)	30,440
Intercompany investments and advances..	279,773	200,399	--	(480,172)	--
Total assets....	$328,756	$402,260	$ 55,364	$(532,987)	$253,393
LIABILITIES AND CAPITAL ACCOUNTS					
Accounts payable......	$ 7,635	$ 509	$ 1,556	$ (5,726)	$ 3,974
Accrued expenses......	5,422	17,947	5,561	862	29,792
Intercompany payables.	102,044	48,272	9,894	(160,210)	--
Current installments of capital lease obligations.........	118	--	--	--	118
Income tax payable....	2,111	--	2,294	(1,435)	2,970
Total current liabilities	117,330	66,728	19,305	(166,509)	36,854
Capital lease obligations, excluding current installments	348	--	48	--	396
Deferred income taxes, net.................	--	12,120	--	(7,055)	5,065
Total liabilities	117,678	78,848	19,353	(173,564)	42,315
Shareholders' equity..	211,078	323,412	36,011	(359,423)	211,078
Total liabilities and equity....	$328,756	$402,260	$ 55,364	$(532,987)	$253,393

Condensed Consolidating Guarantor, Non-Guarantor And
Parent Company Statement of Earnings
For the year ended December 31, 1997
(in thousands)

	Kinetic Concepts, Inc. Parent Company Borrower	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Reclassifications and Eliminations	Historical Kinetic Concepts, Inc. and Subsidiaries
REVENUE:					
Rental and service....	$ --	$202,938	$ 44,952	$ --	$247,890
Sales and other.......	42,290	36,777	21,190	(41,231)	59,026

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Total revenue	42,290	239,715	66,142	(41,231)	306,916
Rental expenses.......	--	123,346	40,946	(8,113)	156,179
Cost of goods sold....	30,335	9,379	12,791	(28,832)	23,673
	30,335	132,725	53,737	(36,945)	179,852
Gross profit......	11,955	106,990	12,405	(4,286)	127,064
Selling, general and administrative expenses...........	8,796	44,090	9,768	--	62,654
Recapitalization expense............	--	34,361	--	--	34,361
Operating earnings	3,159	28,539	2,637	(4,286)	30,049
Interest income.......	278	1,527	458	--	2,263
Interest expense......	(9,736)	(1,176)	--	739	(10,173)
Foreign currency loss.	--	--	(1,106)	--	(1,106)
Earnings before income taxes and minority interest	(6,299)	28,890	1,989	(3,547)	21,033
Income tax............	(2,483)	11,169	1,381	(1,664)	8,403
Minority interest.....	--	--	25	--	25
Earnings before equity in earnings of subsidiaries....	(3,816)	17,721	583	(1,883)	12,605
Equity in earnings of subsidiaries.	16,421	583	--	(17,004)	--
Net earnings......	$ 12,605	$ 18,304	$ 583	$(18,887)	$ 12,605

Condensed Consolidating Guarantor, Non-Guarantor And
Parent Company Statement of Earnings
For the year ended December 31, 1996
(in thousands)

	Kinetic Concepts, Inc. Parent Company Borrower	Guarantor Sub-sidiaries	Non-Guarantor Sub-sidiaries	Reclassi-fications and Elimi-nations	Historical Kinetic Concepts, Inc. and Sub-sidiaries
REVENUE:					
Rental and service....	$ --	$176,135	$49,315	$ --	$225,450
Sales and other.......	54,716	10,989	18,768	(40,042)	44,431
Total revenue.....	54,716	187,124	68,083	(40,042)	269,881
Rental expenses.......	--	110,198	45,851	(9,844)	146,205
Cost of goods sold....	33,774	--	9,027	(26,486)	16,315

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	33,774	110,198	54,878	(36,330)	162,520
Gross profit......	20,942	76,926	13,205	(3,712)	107,361
Selling, general and administrative expenses...........	22,615	38,218	3,101	(11,927)	52,007
Operating earnings	(1,673)	38,708	10,104	8,215	55,354
Interest income.......	249	9,513	334	(764)	9,332
Interest expense......	(962)	(810)	--	1,527	(245)
Earnings before income taxes and minority interest........	(2,386)	47,411	10,438	8,978	64,441
Income tax...........	(788)	19,059	3,862	3,321	25,454
Earnings before equity in earnings of subsidiaries....	(1,598)	28,352	6,576	5,657	38,987
Equity in earnings of subsidiaries.	40,585	6,576	--	(47,161)	--
Net earnings......	$38,987	$ 34,928	$ 6,576	$(41,504)	$ 38,987

Condensed Consolidating Guarantor, Non-Guarantor And
Parent Company Statement of Earnings
For the year ended December 31, 1995
(in thousands)

	Kinetic Concepts, Inc. Parent Company Borrower	Guarantor Sub-sidiaries	Non-Guarantor Sub-sidiaries	Reclassi-fications and Elimi-nations	Historical Kinetic Concepts, Inc. and Sub-sidiaries
REVENUE:					
Rental and service....	$ --	$160,214	$46,439	$ --	$206,653
Sales and other.......	91,737	12,244	13,393	(80,584)	36,790
Total revenue.....	91,737	172,458	59,832	(80,584)	243,443
Rental expenses.......	--	134,137	40,453	(37,170)	137,420
Cost of goods sold....	47,258	2,869	6,517	(42,915)	13,729
	47,258	137,006	46,970	(80,085)	151,149
Gross profit......	44,479	35,452	12,862	(499)	92,294
Selling, general and administrative					

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expenses............	11,115	12,219	3,647	21,521	48,502
Operating earnings	33,364	23,233	9,215	(22,020)	43,792
Interest income.......	318	4,458	287	--	5,063
Interest expense......	(4,358)	1,737	--	2,112	(509)
Earnings before income taxes and minority interest........	29,324	29,428	9,502	(19,908)	48,346
Income tax............	11,436	11,477	4,751	(7,759)	19,905
Earnings before equity in earnings of subsidiaries....	17,888	17,951	4,751	(12,149)	28,441
Equity in earnings of subsidiaries.	10,554	4,751	--	(15,305)	--
Net earnings......	$ 28,442	$ 22,702	$ 4,751	$(27,454)	$ 28,441

Condensed Consolidating Guarantor, Non-Guarantor And
Parent Company Statement of Cash Flows
For year ended December 31, 1997
(in thousands)

	Kinetic Concepts, Inc. Parent Company Borrower	Guarantor Sub-sidiaries	Non-Guarantor Sub-sidiaries	Reclassi-fications and Elimi-nations	Kinetic Concepts, Inc. and Sub-sidiaries
Cash flows from operating activities:					
Net earnings...........	$ 12,605	$ 18,304	$ 583	$(18,887)	$ 12,605
Adjustments to reconcile net earn-ings to net cash provided by operat-ing activities.......	(19,424)	(5,196)	2,355	20,364	(1,901)
Net cash provided by operating activities	(6,819)	13,108	2,938	1,477	10,704
Cash flows from investing activities:					
Additions to property, plant and equipment......	(1,624)	(22,565)	(5,698)	2,215	(27,672)
Decrease in inventory to be converted into equipment for short-term rental.........	(2,850)	--	--	--	(2,850)

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Dispositions of property, plant and equipment.......	--	521	2,099	--	2,620
Businesses acquired in purchase transactions, net of cash aquired........	--	(38,266)	(2,886)	(1)	(41,153)
Decrease (increase) in other assets.....	4,583	1,709	2,990	(8,343)	939
	------	------	-----	-----	------
Net cash provided (used) by investing activities	109	(58,601)	(3,495)	(6,129)	(68,116)
Cash flows from financing activities:					
Borrowings (repayments) of notes payable and long-term obligations....	534,500	201	--	--	534,701
Borrowings (repayments) of capital lease obligations...	(71)	--	8	(270)	(333)
Loan issuance cost....	(6)	(17,728)	--	--	(17,734)
Proceeds from the excercise of stock options.............	3,668	--	--	--	3,668
Proceeds (payments) on intercompany investments and advances............	(71,983)	59,803	7,521	4,659	--
Purchase and retirement of treasury stock................	(3,827)	--	--	--	(3,827)
Cash dividends paid to shareholders.....	(6,388)	--	--	--	(6,388)
Recapitalization costs - purchase of treasury stock......	(631,606)	--	--	--	(631,606)
Recapitalization costs - proceeds from C/S issuance..	150,184	--	--	--	150,184
Recapitalization costs - fees and expenses...........	(8,626)	--	--	--	(8,626)
Recapitalization costs - amounts not yet paid...........	41,652	--	--	--	41,652
Other................	(787)	(2,598)	(4,141)	7,779	253
	-------	------	-----	------	------
Net cash provided by financing activities.................	6,710	39,678	3,388	12,168	61,944
Effect of exchange rate changes on cash and cash equivalents.....	--	--	--	(1,823)	(1,823)
	-------	------	-----	------	------
Net increase in cash and cash equivalents.	--	(5,815)	2,831	5,693	2,709
Cash and cash equivalents, beginning of year.................	--	50,286	14,485	(5,726)	59,045

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Cash and cash equivalents, end of year...	$ --	$44,471	$17,316	$ (33)	$61,754

Condensed Consolidating Guarantor, Non-Guarantor And
Parent Company Statement of Cash Flows
For year ended December 31, 1996
(in thousands)

	Kinetic Concepts, Inc. Parent Company Borrower	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Reclassifications and Eliminations	Kinetic Concepts, Inc. and Subsidiaries
Cash flows from operating activities:					
Net earnings...........	$ 38,987	$ 34,928	$ 6,576	$(41,504)	$ 38,987
Adjustments to reconcile net earnings to net cash provided by operating activities	(32,912)	24,267	(5,031)	36,856	23,180
Net cash provided by operating activities	6,075	59,195	1,545	(4,648)	62,167
Cash flows from investing activities:					
Additions to property, plant and equipment.......	(8,474)	(13,261)	(10,017)	3,969	(27,783)
Decrease in inventory to be converted into equipment for short-term rental.........	700	--	--	--	700
Dispositions of property, plant and plant and equipment.	--	132	5,268	--	5,400
Businesses acquired in purchase transactions, net of cash acquired.......	--	(1,146)	--	--	(1,146)
Excess principal repayment on discounted notes receivable..........	--	5,180	--	--	5,180
Note repaid from principal shareholder	--	10,000	--	--	10,000
Decrease (increase) in other assets.....	23	(6,796)	(1,227)	(1,960)	(9,960)
Net cash provided (used) by investing activities..................	(7,751)	(5,891)	(5,976)	2,009	(17,609)
Cash flows from financing activities:					

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Borrowings (repayments) of capital lease obligations...	466	--	(6)	(3)	457
Proceeds from the excercise of stock options.............	4,264	--	--	--	4,264
Proceeds (payments) on intercompany investments and advances............	39,442	(45,135)	5,565	128	--
Purchase and retirement of treasury stock...............	(35,241)	--	--	--	(35,241)
Cash dividends paid to shareholders.....	(6,607)	--	--	--	(6,607)
Other.................	(648)	975	(480)	3	(150)
Net cash provided (used) by financing activities..................	1,676	(44,160)	5,079	128	(37,277)
Effect of exchange rate changes on cash and cash equivalents......	--	--	--	(635)	(635)
Net increase in cash and cash equivalents..	--	9,144	648	(3,146)	6,646
Cash and cash equivalents, beginning of year..................	--	41,142	13,837	(2,580)	52,399
Cash and cash equivalents, end of year...	$ --	$50,286	$14,485	$(5,726)	$59,045

Condensed Consolidating Guarantor, Non-Guarantor And
Parent Company Statement of Cash Flows
For year ended December 31, 1995
(in thousands)

	Kinetic Concepts, Inc. Parent Company Borrower	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Reclassifications and Eliminations	Kinetic Concepts, Inc. and Subsidiaries
Cash flows from operating activities:					
Net earnings...........	$ 28,442	$ 22,702	$ 4,751	$(27,454)	$ 28,441
Adjustments to reconcile net earnings to net cash provided by operating activities.......	(16,632)	45,435	6,740	(7,202)	28,341
Net cash provided by operating activities	11,810	68,137	11,491	(34,656)	56,782
Cash flows from					

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investing activities:					
Additions to property, plant and equipment......	225	(65,148)	(7,632)	36,451	(36,104)
Increase in inventory to be converted into equipment for short-term rental........	(1,000)	--	--	--	(1,000)
Dispositions of property, plant and equipment......	209	669	2,353	--	3,231
Proceeds from sale of divisions..........	--	7,182	--	--	7,182
Decrease in finance lease receivable, net................	--	--	--	339	339
Decrease (increase) in other assets....	(5,012)	(9,002)	117	(2,634)	(16,531)
	------	------	------	-----	------
Net cash provided (used) by investing activities	(5,578)	(66,299)	(5,162)	34,156	(42,883)
Cash flows from financing activities:					
Borrowings (repayments) of notes payable and long-term obligations...	(95)	(7,805)	(68)	7,168	(800)
Borrowings (repayments) of capital lease obligations..	--	--	55	(119)	(64)
Proceeds from the excercise of stock options...........	4,919	--	--	--	4,919
Proceeds (payments) on intercompany investments and advances...........	(2,596)	15,433	(4,620)	(8,217)	--
Purchase and retirement of treasury stock..............	(2,849)	--	--	--	(2,849)
Cash dividends paid to shareholders....	(6,631)	--	--	--	(6,631)
Other................	1,020	(2,855)	1,203	447	(185)
	------	------	------	------	------
Net cash provided (used) by financing activities	(6,232)	4,773	(3,430)	(721)	(5,610)
Effect of exchange rate changes on cash and cash equivalents.....	--	--	--	869	869
	------	------	------	------	------
Net increase in cash and equivalents......	--	6,611	2,899	(352)	9,158
Cash and cash equivalents, beginning of year.................	--	34,531	10,938	(2,228)	43,241
	------	------	------	-----	------
Cash and cash equivalents, end of year...	$ --	$41,142	$13,837	$(2,580)	$52,399
	======	======	======	======	======

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Independent Auditors' Report

The Board of Directors and Shareholders
Kinetic Concepts, Inc.:

We have audited the accompanying consolidated balance sheet of Kinetic Concepts, Inc. and subsidiaries as of December 31, 1997 and the related consolidated statements of earnings, cash flows and shareholders' (deficit) equity for the year then ended. Our audit also included the financial statement schedule, as it relates to information for the year ended December 31, 1997, listed in the index at Item 14(a). These consolidated financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit. The consolidated financial statements for Kinetic Concepts, Inc. and subsidiaries for the years ended December 31, 1996 and 1995 were audited by other auditors whose report dated February 5, 1997, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with generally accepted auditing standards. 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 audit provides a reasonable basis for our opinion.

In our opinion, the 1997 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Kinetic Concepts, Inc. and subsidiaries as of December 31, 1997 and the results of their operations and their cash flows for the year ended December 31, 1997 in conformity with generally accepted accounting principles. 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

Ernst & Young LLP

San Antonio, Texas
February 6, 1998

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Independent Auditors' Report

The Board of Directors and Shareholders
Kinetic Concepts, Inc.:

We have audited the accompanying consolidated balance sheet of Kinetic Concepts, Inc. and subsidiaries as of December 31, 1996 and the related consolidated statements of earnings, cash flows and shareholders' equity for each of the years in the two-year period ended December 31, 1996. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Kinetic Concepts, Inc. and subsidiaries as of December 31, 1996, and the results of their operations and their cash flows for each of the years in the two-year period ended December 31, 1996, in conformity with generally accepted accounting principles.

/s/ KPMG PEAT MARWICK LLP

KPMG Peat Marwick LLP

San Antonio, Texas
February 5, 1997

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Independent Auditor's Report

The Board of Directors and Shareholders
Kinetic Concepts, Inc.:

Under date of February 5, 1997, we reported on the consolidated balance sheet of Kinetic Concepts, Inc. and subsidiaries as of December 31, 1996, and the related consolidated statements of earnings, shareholders' equity and cash flows for each of the years in the two-year period ended December 31, 1996. In connection with our audits of the aforementioned consolidated financial statements, we also have audited the related financial statement schedule as listed in Item 14 (a) (2) of Form 10-K. This financial statement schedule is the responsiblity of the Company's management. Our responsibility is to express an opinion on this financial statement schedule based on our audit.

In our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information see forth therein.

/s/ KPMG PEAT MARWICK LLP
KPMG Peat Marwick LLP

San Antonio, Texas
February 5, `997

Item 9. Changes in and Disagreements with Accountants on Accounting Matters and Financial Disclosure

Ernst & Young LLP was the Company's certifying accountant for the year ended December 31, 1997. On February 18, 1997, the Board of Directors of the Company, upon the recommendation of the Audit Committee, voted to engage the accounting firm of Ernst & Young LLP as the Company's certifying accountant for the year ending December 31, 1997. The Company's previous certifying accountant, KPMG Peat Marwick LLP, was notified on February 21, 1997 and its engagement was terminated effective upon the completion and filing of the Company's 1996 Annual Report on Form 10-K. On February 24, 1997, the Company notified Ernst & Young LLP that it would be engaged as the Company's certifying accountant for the 1997 fiscal year.

The reports of KPMG Peat Marwick LLP on the Company's

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financial statements for the two fiscal years ended December 31, 1995 and 1996 did not contain an adverse opinion or disclaimer of opinion and were not qualified or modified as to uncertainty, audit scope or accounting principles.

In connection with the audits of the Company's financial statements for each of the two fiscal years ended December 31, 1995 and 1996 and in the subsequent interim period through the date of dismissal, there were no disagreements with KPMG Peat Marwick LLP on any matters of accounting principles, financial statement disclosure or audit scope and procedures which, if not resolved to the satisfaction of KPMG Peat Marwick LLP, would have caused the firm to make reference to the matter in their report.

The change in certifying accountant came in response to a Request for Proposal issued by the Company in 1996. The newly engaged firm, Ernst & Young LLP, has been providing property and income tax planning services to the Company since 1995.

PART III

Item 10. Directors and Executive Officers of the Registrant

Set forth below are the names, ages and positions of the directors and executive officers of the Company, together with certain other key personnel.

Name	Age	Position
Robert Jaunich II	57	Chairman of the Board
Raymond R. Hannigan.......	58	Director, President and Chief Executive Officer
James R. Leininger M.D....	53	Director, Chairman Emeritus
James T. Farrell..........	33	Director
N. Colin Lind.............	41	Director
Jeffrey W. Ubben..........	36	Director
Dennis E. Noll............	43	Senior Vice President, General Counsel and Secretary
Christopher M. Fashek.....	48	President, KCI Therapeutic Services
Frank DiLazzaro...........	39	President, KCI International
Richard C. Vogel..........	43	Vice President and General Manager, NuTech
Michael J. Burke..........	50	Vice President, Manufacturing
Martin J. Landon..........	38	Vice President, Accounting and Corporate Controller

Robert Jaunich II became a director and Chairman of the Board after the consummation of the Tender Offer. Mr. Jaunich is a Managing Director of Fremont Partners where he shares management responsibility for the $605 million investment fund. He is also a Managing Director and a member of the Board of Directors and Executive Committee of The Fremont Group. Prior to joining the Fremont Group in 1991, he was Executive Vice President and a member of the Chief Executive Office of Jacobs Suchard AG, a Swiss-based chocolate, sugar confectionery and coffee company. He currently serves as a director of CNF Transportation, Inc. and as Chairman of

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the Managing General Partner of Crown Pacific Partners, L.P.

Raymond R. Hannigan joined the Company as its President and Chief Executive Officer in November 1994 and has served as a director of the Company since 1994. From January 1991 to November 1994, Mr. Hannigan was the President of the International Division of Sterling Winthrop Consumer Health Group (a pharmaceutical company with operations in over 40 countries), a wholly-owned subsidiary of Eastman Kodak. From May 1989 to January 1991, Mr. Hannigan was the President of Sterling Drug International.

James R. Leininger, M.D. is the founder of the Company and served as Chairman of the Board of Directors from 1976 until 1997. From January 1990 to November 1994, Dr. Leininger served as President and Chief Executive Officer of the Company. From 1975 until October 1986, Dr. James Leininger was also the Chairman of the Emergency Department of the Baptist Hospital System in San Antonio, Texas.

James T. Farrell became a director after the consummation of the Tender Offer. Mr. Farrell is a Managing Director of Fremont Partners. Before joining The Fremont Group in 1991, he was an associate at ESL Partners, a private investment partnership. In 1985, he began his career at Copley Real Estate Advisors. Mr. Farrell is a former director of Coldwell Banker Corporation. He also serves as a director of the nonprofit Pacific Research Institute.

N. Colin Lind became a director after the consummation of the Tender Offer. Mr. Lind is a Managing Director of Richard C. Blum & Associates, L.P. Before joining RCBA in 1986 he was a Vice President at R. H. Chappell Co., an investment concern focused on development stage companies, and was previously a Vice President of Research for two regional brokerage firms, Davis Skaggs, Inc. and Wheat First Securities. He has previously been a director of two public companies and seven venture capital backed companies.

Jeffrey Ubben became a director after the consummation of the Tender Offer. Mr. Ubben is a Managing Director of Richard C. Blum & Associates, L.P. Before joining RCBA in 1995 he was manager of the $5 billion Fidelity Value Fund and had been employed by Fidelity for a period of nine years.

Dennis E. Noll joined the Company in February 1992 as its Senior Corporate Counsel and was appointed Vice President, General Counsel and Secretary in January 1993. Mr. Noll was promoted to Senior Vice President in September 1995. Prior to joining the Company in February 1992, Mr. Noll was a shareholder of the law firm of Cox & Smith Incorporated.

Christopher M. Fashek joined the Company in February 1995 as President, KCTS. Prior to joining the Company, he served as General Manager, Sterling Winthrop, New Zealand since February 1993, and served as Vice President Sales of Sterling Health USA from 1989 until February 1993.

Frank DiLazzaro joined the Company in 1988 as General Manager, KCI Medical Canada. Mr. DiLazzaro served as Vice President, KCI International, Inc. from June 1989 to December 1992. Mr. DiLazzaro

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has served as President, KCI International, Inc. since January 1993 and was Vice President, Marketing from April 1993 to September 1995.

Richard C. Vogel joined the Company as its Vice President and General Manager, NuTech on July 1, 1996. From 1989 to 1996, Mr. Vogel served as Executive Vice President of Vestar, Inc., a California-based biotechnology company.

Michael J. Burke joined the Company in September 1995 as Vice President, Manufacturing. Prior to joining the Company, Mr. Burke worked for Sterling Winthrop, Inc., a Division of Eastman Kodak Company, for 25 years, where he served as Vice President, Manufacturing and as General Manager, Sterling Health HK/China since 1992.

Martin J. Landon joined the Company in May 1994 as Senior Director of Corporate Development and was promoted to Vice President, Accounting and Corporate Controller in October 1994. From 1987 to May 1994, Mr. Landon worked for Intelogic Trace, Inc., most recently serving as Vice President and Chief Financial Officer.

Item 11. Executive Compensation

SUMMARY COMPENSATION TABLE

		ANNUAL COMPENSATION			LONG-TERM COMPEN-SATION AWARDS	
Name and Principal Position	Year	Salary	Bonus	Other (1) Annual Com-pensation	Securi-ties Under-lying Options	All Other Compen-sation
Raymond R. Hannigan	1997	$300,000	$433,100		12,000	$5,583
Chief Executive	1996	275,000	175,000		12,000	4,888
Officer,& President	1995	250,000	172,000	$39,204	12,000	1,836
Christopher M. Fashek	1997	$206,750	$362,637		8,000	$2,256
President & Chief	1996	193,000	115,800		123,000	1,647
Executive Officer,	1995	180,758	77,760	$18,378	8,000	421
KCI Therapeutic Services, Inc.						
Frank DiLazzaro	1997	$181,000	$390,323		8,000	$1,409
President,	1996	168,000	86,000		78,000	884
KCI International, Inc.	1995	156,000	85,836		8,000	1,012

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Dennis E. Noll	1997	$177,688	$293,390		8,000	$1,623
Senior Vice-President,	1996	165,812	81,000		98,000	1,315
General Counsel &	1995	151,750	75,096		8,000	708
Secretary						
Michael J. Burke	1997	$172,000	$295,480		46,400	$2,259
Vice President,	1996	159,333	74,400		8,000	1,427
Manufacturing	1995	45,208	23,892	$18,275		

(1) The column entitled "Other Annual Compensation" includes monies paid to Messrs. Hannigan, Fashek and Burke in 1995 for reimbursement of relocation expenses. Except with respect to personal benefits received by such individuals in fiscal 1995, the personal benefits provided to each of the named executive officers under various Company programs did not exceed 10% of the individual's combined salary and bonus in any other year.

(2) The "All Other Compensation" column includes the Company's contribution to the Company's Employee Stock Ownership Plan which was credited in 1996, a Company contribution of $500 to the Company's 401(k) plan for the named individuals and a premium for term life insurance in an amount which varied depending on the age of the executive officer.

Item 11. Executive Compensation (continued)

OPTION GRANTS IN LAST FISCAL YEAR

The following table sets forth certain information concerning options granted during fiscal 1997 to the named executive officers:

<TABLE>

	Individual Grants				Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for Option Term	
Names	Number of Securities Under-lying Options Granted	% of Total Options Granted to Employees in Fiscal Year	Exercise Price	Expiration Date	5%(3)	10%(3)
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Raymond R. Hannigan..	12,000(1)	1.54%	$15.1250	05/13/07	$ 185,940	$ 391,500
	192,000(2)	20.31%	$19.2500	10/01/04	$1,480,320	$3,444,480
Christopher M. Fashek	8,000(1)	1.02%	$15.1250	05/13/07	$ 123,960	$ 261,000
	110,400(2)	11.68%	$19.2500	10/01/04	$ 851,184	$1,980,576
Frank DiLazzaro......	8,000(1)	1.02%	$15.1250	05/13/07	$ 123,960	$ 261,000
	80,000(2)	8.46%	$19.2500	10/01/04	$ 616,800	$1,435,200
Dennis E. Noll.......	8,000(1)	1.02%	$15.1250	05/13/07	$ 123,960	$ 261,000
	80,000(2)	8.46%	$19.2500	10/01/04	$ 616,800	$1,435,200

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Michael J. Burke.....	8,000(1)	1.02%	$15.1250	05/13/07	$ 123,960	$ 261,000
	38,400(2)	4.06%	$19.2500	10/01/04	$ 296,064	$ 688,896

</TABLE>

(1) The referenced options are fully vested and have a term of ten (10) years.

(2) The referenced options vest and became exercisable in twenty percent (20%) increments on November 5 of each year and have a term of seven (7) years.

(3) The information in these columns illustrates the value that might be realized upon the exercise of the options granted during fiscal 1997 assuming the specified compound rates of appreciation of Common Stock over the term of the options. The potential realizable value set forth in the columns of the foregoing table do not take into account certain provisions of the options providing for termination of an option following termination of employment, nontransferability or vesting requirements.

Item 11. Executive Compensation (continued)

AGGREGATED OPITON EXERCISES IN LAST FISCAL YEAR AND FY-END OPTION VALUE

The following table sets forth certain information concerning the options exercised by each named executive officer during fiscal 1997 and the number and value of the options held by the named executive officers at the end of the fiscal year ended December 31, 1997.

Name	Shares Acquired on Exercise	Value(1) Realized	Number of Underlying Unexercised Options at FY-End Exercisable/ Unexercisable	Value of Unexercised In-the-Money Options at FY-End Exercisable/ Unexercisable(2)
Raymond R. Hannigan (3)	736,000	$10,434,400	200,000 192,000	$2,651,500 --
Christopher M. Fashek	41,000	$ 512,750	139,800 110,400	$1,104,375 --
Frank DiLazzaro	10,000	$ 108,050	98,530 80,000	$ 800,568 --
Dennis E. Noll	123,700	$ 1,433,463	50,000 80,000	$ 331,250 --
Michael J. Burke	30,000	$ 303,750	106,000 38,400	$ 202,500 --

(1) The values are calculated by subtracting the exercise price from the value of the underlying Common Stock as of the date

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of exercise, which, in each instance, was $19.25.

(2) The Company's Common Stock is no longer publicly traded. For purposes of this calculation, the fair market value of the Common Stock was assumed to be $19.25 per share.

(3) Dr. James Leininger granted Mr. Hannigan an option in 1994 to purchase 440,000 shares of Common Stock at a purchase price of $5.74 per share. Mr. Hannigan purchased 340,000 of the shares of Common Stock subject to that option during 1997.

Item 12. Security Ownership of Certain Beneficial Owners and Management

SECURITIES HOLDINGS OF PRINCIPAL SHAREHOLDERS, DIRECTORS AND OFFICERS

Based upon information received upon request from the persons concerned, each person known to be the beneficial owner of more than five percent of the Company's outstanding common stock, each director, nominee for director, named executive officer (as defined on page 7 hereof) and all directors and executive officers of the Company as a group, owned beneficially as of March 1, 1998, the number and percentage of outstanding shares of Common Stock of the Company indicated in the following table:

	Shares of Common Stock Beneficially owned as of March 1, 1998 (1)	Percent of Class
James R. Leininger, M.D............. 8023 Vantage Drive San Antonio, TX 78230	5,939,220	31.1%
Fremont Partners L.P................ and certain related parties 50 Fremont Street, Suite 3700 San Francisco, CA 94105	7,029,922	36.8%
Richard C. Blum & Associates......... and certain related parties 909 Montgomery Street, Suite 400 San Francisco, CA 84133	4,644,010	24.3%
Raymond R. Hannigan(2)...............	200,000	1.0%
James T. Farrell (3).................	--	
Robert Jaunich II (3)................	--	
N. Colin Lind (4)....................	--	
Jeffrey W. Ubben (4).................	--	
Christopher M. Fashek(2).............	139,800	*
Frank DiLazzaro(2)...................	98,530	*
Dennis E. Noll(2)....................	50,000	*
Michael J. Burke(2)	106,000	*
All directors and executive officers as a group (17 persons)(5).........	785,438	4.1%

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* Less than one (1%) percent

(1) Except as otherwise indicated in the following notes, the persons named in the table directly own the number of shares indicated in the table and have the sole voting power and investment power with respect to all of such shares. Shares beneficially owned include options exercisable prior to April 29, 1998.

(2) The shares shown from Messers. Hannigan, Fashek, DiLazzaro, Noll and Burke include 200,000, 139,800, 98,530, 50,000 and 106,000 shares of Common Stock, respectively, which such persons have the right to acquire under stock options granted by the Company which are exercisable prior to April 29, 1998.

(3) Messrs. Farrell and Jaunich are managing directors of Fremont Partners, L.P. and certain of its related parties ("Fremont"). The Shares shown do not include the Shares beneficially owned by Fremont.

(4) Messrs. Lind and Ubben are managing directors of Richard C.Blum & Associates, L.P. and certain of its related parties ("RCBA"). The Shares shown do not include the Shares beneficially owned by RCBA.

(5) The shares shown include 65,800 shares of Common Stock which the directors and executive officers have the right to acquire under stock options granted by the Company which are exercisable prior to April 29, 1998.

Item 13. Certain Relationships and Related Transactions

On December 18, 1996, a company controlled by Dr. James Leininger acquired a tract of land (the "Property") from the Company for $395,000. The Property is comprised of approximately 2.2 acres and is adjacent to the Company's corporate headquarters. The purchase price was based on the aggregate cost of the Property to the Company (including acquisition expenses). The Company believes that the acreage was transferred to Dr. James Leininger at a price equal to its fair market value. In connection with the purchase of the Property, the Company loaned Dr. James Leininger $3,000,000 in February 1997 to develop the Property. The loan bore interest at a rate equal to the prime rate of Texas Commerce Bank. The loan was non-recourse to Dr. James Leininger but was secured by the Property, the improvements on the Property and 300,000 shares owned by Dr. James Leininger. Dr. Leininger repaid the loan in full on December 31, 1997.

Pursuant to the provisions of the Executive Committee Stock Ownership Policy, the Company loaned funds to Christopher M. Fashek, the President of KCI Therapeutic Services, Inc. (a division of the Company), Bianca A. Rhodes, the Company's Chief Financial Officer at the time and Dennis E. Noll, the Company's Senior Vice President and General Counsel. These loans were utilized by such executive officers to acquire Shares in order to meet the standards set forth in the Company's Executive Committee Stock Ownership Policy. The loans bore interest at the applicable federal rate established by the Internal Revenue Service and had a term of five

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years. The initial loans made to Mr. Fashek, Ms. Rhodes and Mr. Noll were $107,672, $170,672 and $86,310, respectively, and the outstanding balance of principal and accrued interest on such loans as of December 31, 1996 were $87,076, $166,003 and $81,888, respectively. Mr. Noll repaid his loan in February 1997. Ms. Rhodes repaid the principal amount of her loan in July 1997. Mr. Fashek repaid his loan on November 5, 1997. The Board has amended the Executive Committee Stock Ownership Policy to make the ownership thresholds in the policy voluntary and, as a result, the Company will not be making loans to executive officers under the policy in the future.

At its December meeting, the Company's Board of Directors agreed to sell Dr. James R. Leininger certain of the Company's non-operating assets. The assets included the vehicle driven by Dr. Leininger and the Company's ownership interest in the San Antonio Spurs, Bionumerick, Inc. and a small aircraft. The vehicle was sold to Dr. Leininger at its depreciated book value and the ownership interests were to be sold at their cost to the Company. The vehicle was transferred in January of 1998 and the ownership interests will be transferred by the end of the second quarter of 1998. The Company believes that the transfers will be made at prices equal to their fair market value.

PART IV

Item 14. Exhibits, Financial Statement Schedules, and Reports on Form 8-K

(a) The following documents are filed as part of this report:

1. Financial Statements

   The following consolidated financial statements are filed as a part of this report:

   Consolidated Balance Sheets as of December 31, 1997 and 1996

   Consolidated Statements of Earnings for the three years ended December 31, 1997, 1996 and 1995

   Consolidated Statements of Cash Flows for the three years ended December 31, 1997, 1996 and 1995

   Consolidated Statements of Shareholders'(Deficit)Equity for the three years ended December 31, 1997, 1996 and 1995

   Notes to Consolidated Financial Statements

   Independent Auditors' Report

2. Financial Statement Schedules

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The following consolidated financial statement schedules for each of the years in the three-year period ended December 31, 1997 are filed as part of this Report:

Independent Auditors' Report

Schedule VIII - Valuation and Qualifying Accounts - Years ended December 31, 1997, 1996 and 1995

All other schedules have been omitted as the required information is not present or is not present in amounts sufficient to require submission of the schedule, or because the information required is included in the financial statements and notes thereto.

3. Exhibits

The following exhibits are filed as a part of this Report:

Exhibit	Description
3.1	Restatement of Articles of Incorporation (filed as Exhibit 3.2 to the Company's Registration Statement on Form S-1, as amended (Registration No. 33-21353), and incorporated herein by reference).
3.2	Restated By-Laws of the Company (filed as Exhibit 3.3 to the Company's Registration Statement on Form S-1, as amended (Registration No. 33-21353), and incorporated herein by reference).
4.1	Specimen Common Stock Certificate of the Company (filed as Exhibit 4.1 to the Annual Report on Form 10-K for the year ended December 31, 1988, and incorporated herein by reference).
10.1	Agreement dated September 29, 1987, by and between the Company and Hill-Rom Company, Inc. (filed as Exhibit 10.7 to the Company's Registration Statement on Form S-1, as amended (Registration No. 33-21353), and incorporated herein by reference).
10.2	Employment and Non-Competition Agreement dated December 26, 1986, by and between the Company and James R. Leininger, M.D. (filed as Exhibit 10.10 to the Company's Registration Statement on Form S-1, as amended (Registration No. 33-21353), and incorporated herein by reference).

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10.3 Contract dated September 30, 1985, by and between Ryder Truck Rental, Inc. and the Company regarding the rental of delivery trucks (filed as Exhibit 10.23 to the Company's Registration Statement on Form S-1, as amended (Registration No. 33-21353), and incorporated herein by reference).

10.4 1988 Kinetic Concepts, Inc. Directors Stock Option Plan (filed as Exhibit 10.26 to the Company's Registration Statement on Form S-1, as amended (Registration No. 33-21353), and incorporated herein by reference).

10.5 Kinetic Concepts, Inc. Employee Stock Ownership Plan and Trust dated January 1, 1989 (filed as Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1989, and incorporated herein by reference).

10.6 1987 Key Contributor Stock Option Plan, as amended, dated October 27, 1989 (filed as Exhibit 10.9 to the Company's Annual Report on Form 10-K for the year ended December 31, 1989, and incorporated herein by reference).

10.7 Amendment No. 1 to Asset Purchase Agreement dated September 30, 1994 by and among Kinetic Concepts, Inc., a Texas corporation, KCI Therapeutic Services, Inc., a Delaware corporation, MEDIQ Incorporated, a Delaware corporation, PRN Holdings, Inc., a Delaware corporation and MEDIQ/PRN Life Support Services-I, Inc., a Delaware corporation (filed as Exhibit 2.2 to the Company's Form 8-K dated October 17, 1994, and incorporated herein by reference).

10.17 Credit Agreement dated as of May 8, 1995 by and among the Company and Bank of America National Trust and Savings Association, as Agent (filed as Exhibit 10 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 1995, and incorporated herein by reference).

10.18 Purchasing Agreement, dated February 1, 1994, between the Company, KCI Therapeutic Services, Inc. and Voluntary Hospitals of America, Inc.

10.19 Rental/Purchasing Agreement, dated April 1, 1993 between the Company, KCI Therapeutic Services, Inc. and AmHS Purchasing Partners, L.P.

10.20 KCI Management 1994 Incentive Program

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10.21 KCI Employee Benefits Trust Agreement

10.22 Letter, dated September 19, 1994, from the Company to Raymond R. Hannigan outlining the terms of his employment.

10.23 Letter, dated November 22, 1994, from the Company to Christopher M. Fashek outlining the terms of his employment.

10.24 Option Agreement, dated November 21, 1994, between Dr. James R. Leininger, Cecilia Leininger and Raymond R. Hannigan.

10.25 Option Agreement, dated August 23, 1995, between Dr. James R. Leininger, Cecilia Leininger and Bianca A. Rhodes.

10.26 Stock Purchase Agreement dated June 15, 1995 among KCI Financial Services, Inc., Kinetic Concepts, Inc., Cura Capital Corporation, MG Acquisition Corporation and the Principal Shareholders of Cura Capital Corporation (filed as Exhibit 10 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1995, and incorporated herein by reference).

10.27 Promissory Note dated August 21, 1995 in the principal amount of $10,000,000 payable to James R. Leininger, M.D. to the order of Kinetic Concepts, Inc., a Texas corporation (filed as Exhibit 2.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1995, and incorporated herein by reference).

10.28 Stock Pledge Agreement dated August 21, 1995 by and between James R. Leininger, M.D. and Kinetic Concepts, Inc., a Texas corporation (filed as Exhibit 2.3 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1995, and incorporated herein by reference).

10.29 Executive Committee Stock Ownership Plan (filed as Exhibit 10 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1995, and incorporated herein by reference).

10.30 Deferred Compensation Plan (filed as Exhibit 99.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1995 and incorporated herein by reference).

10.31 Kinetic Concepts, Inc. Senior Executive Stock Option Plan (filed as Exhibit 10.31 to the Company's Annual Report on Form 10-K for the

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year ended December 31, 1996, and incorporated herein by reference).

10.32 Form of Option Instrument with respect to Senior Executive Stock Option Plan (filed as Exhibit 10.32 to the Company's Annual Report on Form 10-K for the year ended December 31, 1996, and incorporated herein by reference).

*10.33 Kinetic Concepts Management Equity Plan effective October 1, 1997 (filed as Exhibit 10.33 on Form 10-K for the year ended December 31, 1997, and incorporated herein by reference).

16.1 Letter from KPMG Peat Marwick LLP to the Securities and Exchange Commission regarding agreement with statements made by Registrant under Item 9 of its Form 10-K dated March 28, 1997 (filed as Exhibit 16.1 to the Company's Annual Report on Form 10-K for the year ended December 31, 1996, and incorporated herein by reference).

* 22.1 List of Subsidiaries.

* 23.1 Consent by Ernst & Young dated March 27, 1998 to incorporation by reference of their report dated February 6, 1998 in Registration Statements on Form S-8 previously filed by the Company.

* 23.2 Consent by KPMG Peat Marwick dated March 30, 1998 to incorporation by reference of their report dated February 5, 1996 in Registration Statements on Form S-8 previously filed by the Company.

* 27.1 Financial Data Schedule

Note: (*) Exhibits filed herewith.

(b) Reports on Form 8-K

No reports on Form 8-K have been filed during the last quarter of the period covered by this report.

SIGNATURES

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Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of San Antonio, State of Texas on March 30, 1998.

KINETIC CONCEPTS, INC.

By: /S/ ROBERT JAUNICH II

Robert Jaunich II, Chairman
of the Board of Directors

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, this Registration Statement has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Date
By: /S/ ROBERT JAUNICH II Robert Jaunich II Chairman of the Board of Directors	March 30, 1998
By: /S/ RAYMOND R. HANNIGAN Raymond R. Hannigan Chief Executive Officer and President	March 30, 1998
By: /S/ MARTIN J. LANDON Martin J. Landon Vice President, Accounting and Corporate Controller (Principal Accounting Officer)	March 30, 1998

SIGNATURES (CONTINUED)

Signature	Date

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By: /S/ JAMES R. LEININGER,M.D. March 30, 1998

James R. Leininger M.D.
Director

By: /S/ JAMES T. FARRELL March 30, 1998

James T. Farrell
Director

By: /S/ N. COLIN LIND March 30, 1998

N. Colin Lind
Director

By: /S/ JEFFREY W. UBBEN March 30, 1998

Jeffrey W. Ubben
Director

Schedule VIII

KINETIC CONCEPTS, INC. AND SUBSIDIARIES
VALUATION AND QUALIFYING ACCOUNTS
(in thousands)

Three years ended December 31, 1997

Description	Balance at Beginning of Period	Additions Charged to Costs and Expenses	Additions Charged to Other Accounts	Deductions	12/31/95 Balance at End of Period
Allowance for doubtful accounts	$8,600	$1,883	$ --	$4,306	$ 6,177

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Description	Balance at Beginning of Period	Additions Charged to Costs and Expenses	Additions Charged to Other Accounts	Deductions	12/31/96 Balance at End of Period
Allowance for doubtful accounts	$6,177	$2,457	$ --	$1,102	$ 7,532

Description	Balance at Beginning of Period	Additions Charged to Costs and Expenses	Additions Charged to Other Accounts	Deductions	12/31/97 Balance at End of Period
Allowance for doubtful accounts	$7,532	$5,888	$ --	$2,216	$11,204

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KINETIC CONCEPTS, INC.
MANAGEMENT EQUITY PLAN
----

1. Purpose. The Kinetic Concepts, Inc. Management Equity Plan (the "Plan") is intended to provide an incentive to certain officers and key employees of Kinetic Concepts, Inc., a Texas corporation (the "Company"), and its Subsidiaries (as defined in Section 2) to remain in the employ of the Company and its Subsidiaries and to increase their interest in the success of the Company. The Plan provides an opportunity for participants to obtain a proprietary interest in the Company through the grant, offering or exchange of shares (the "Management Shares") of common stock, no par value, of the Company ("Common Stock") and the grant or exchange of nonqualified stock options (the "Nonqualified Stock Options"or the "Options"), to purchase shares of Common Stock. Management Shares and Options are sometimes referred to herein as "Awards".

2. Definitions. For purposes of the Plan, the following terms have the following meanings:

"Affiliate" means, with respect to any Person, any other Person directly or indirectly controlling, controlled by or under common control with, such Person. For purposes of this definition, "control" (including, with correlative meanings, the terms "controlling", "controlled by" or "under common control with"), as used with respect to any Person, shall mean the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of such Person, whether through the ownership of voting securities or by contract or otherwise.

"Agreement" means an agreement between the Company and an officer or key employee of the Company or any of its Subsidiaries providing for (i) the grant or sale to such officer or key employee of Management Shares or (ii) the grant to such officer or key employee of Options and signed by F Purchaser and B Purchaser to indicate such parties agreement to be bound by Sections 16 and 17 of the Plan.

"Applicable Management Share Value" as of any date of determination means the Applicable Value, provided, however, that if the Company is not a Public Company and such date falls prior to the fifth anniversary of the Effective Date, the Applicable Management Share Value shall not exceed the lesser of the Fair Market Value of such Management Share or

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$19.25 plus 7% compounded annually on each anniversary of the Tender Date.

"Applicable Option Share Value" as of any date of determination means the Applicable Value, provided, however, that if the Company is not a Public Company, such date falls prior to the fifth anniversary of the Effective Date and the Option Share was obtained through the exercise of an Exchange Option, the Applicable Option Share Value shall not exceed the lesser of (A) the Fair Market Value or (B) the sum of (1) $19.25 less the exercise price of such underlying Exchange Option (the "Spread") plus 7% of the Spread compounded annually on each anniversary of the Tender Date and (2) the exercise price of such Option plus 7% of the exercise price compounded annually on each anniversary of the date of exercise.

"Applicable Option Value" as of any date of determination means the Applicable Value, provided, however, that if the Company is not a Public Company, such date falls prior to the fifth anniversary of the Effective Date and the Option to be valued is an Exchange Option, the Applicable Value shall not exceed the lesser of (A) the Fair Market Value of the shares of Common Stock underlying such Exchange Option less the exercise price of such Exchange Option or (B) the Spread plus 7% of the Spread compounded annually on each anniversary of the Tender Date.

"Applicable Value" as of any date of determination means (i) if the Company is a Public Company, Public Value and (ii) if the Company is not a Public Company Fair Market Value.

"B Purchaser" means RCBA PURCHASER I, L.P.

"Beneficial owner" or "beneficially own" has the meaning given such term in Rule 13d-3 under the 1934 Act.

"Beneficiary" or "Beneficiaries" means the person(s) designated by a Participant or his Permitted Transferee in writing to the Company to receive payments pursuant to the Plan upon the death of a Participant or his Permitted Transferee. If no Beneficiary is so designated or if no Beneficiary is living at the time a payment is due pursuant to the Plan, payments shall be made to the estate of the Participant or Permitted Transferee. The Participant or Permitted Transferee, as the case may be, shall have the right to change the designated Beneficiaries from time to time by written instrument filed with the Committee in accordance with such rules as may be specified by the

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Committee.

"Board of Directors" means the Board of Directors of the Company.

"Call Right" means the right of the Company, exercisable in accordance with Section 10(a) following termination of a Participant's employment, (i) to purchase, and to cause a Participant or his Permitted Transferee to sell, Management Shares and Option Shares beneficially owned by such Participant or his Permitted Transferee and (ii) to cause a Participant to surrender for cancellation, in consideration of the payment provided for in Section 10(a), unexercised Vested Options granted to such Participant pursuant to the Plan.

"Cause" means, with respect to any Participant, (a) "cause" as defined in an employment agreement applicable to the Participant, or (b) in the case of a Participant who does not have an employment agreement that defines "cause": (i) any act or omission that constitutes a material breach by the Participant of any of his obligations under his employment agreement (if any) with the Company or any of its Subsidiaries , the applicable Agreement or any other material agreement with the Company or any of its Subsidiaries relating to the Participants employment with the Company after a written demand from a representative of the Company for substantial performance is delivered to him; (ii) the willful and continued failure or refusal of the Participant substantially to perform the material duties required of him as an employee of the Company or any of its Subsidiaries after a written demand from a representative of the Company for substantial performance is delivered to him; (iii) any willful material violation by the Participant of any federal or state law or regulation applicable to the business of the Company or any of its Subsidiaries or Affiliates, or the Participant's conviction of a felony, or any willful perpetration by the Participant of a common law fraud; or (iv) any other willful misconduct by the Participant which is materially injurious to the financial condition or business reputation of, or is otherwise materially injurious to, the Company or any of its Subsidiaries or Affiliates.

"Code" means the Internal Revenue Code of 1986, as amended.

"Commission" means the Securities and Exchange Commission.

"Committee" has the meaning assigned to such term in

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Section 3.

"Date of Grant" means the date of grant of an Award as set forth in the applicable Agreement.

"Exchange Option" means an Option that was originally granted under a Company plan other than the Plan and that was exchanged for an Option to purchase shares of Common Stock under the Plan.

"Effective Date" has the meaning assigned to such term in Section 19.

"Eligible Persons" means officers and key employees of the Company and its Subsidiaries.

"Encumbrance" means any lien, security interest, pledge, claim, option, right of first refusal, marital right or other encumbrance with respect to any share of Common Stock or any Option.

"Fair Market Value" means the value of a share of Common Stock as determined in good faith by the Board of Directors or, under the circumstances described in Section 11, as determined in a written report to the Company by an independent appraisal or investment banking firm selected by the Board of Directors. For purposes of the definition of "Fair Market Value", the value to be determined by the Board of Directors or such appraisal or investment banking firm shall be the price per share at which a share of Common Stock would trade on a national securities exchange, NASDAQ or a similar market, assuming full liquidity and the absence of any "takeover" or "change in control" premium.

"F Purchaser" means FREMONT PURCHASER II, INC.

"IPO" means a Public Offering that results in more than 20% of the outstanding Common Stock being traded on a national securities exchange, NASDAQ or a similar market.

"Involuntary Transfer" means a transfer of a Participant's Management Shares or Option Shares by operation of law including, without limitation, as a result of (i) a sale or other disposition by a trustee or debtor in possession appointed or retained in a bankruptcy case, (ii) a sale at any creditors' or judicial sale or (iii) a transfer arising out of a divorce or separation proceeding.

"Legended Certificate" means a certificate evidencing a number of shares of Common Stock issued in connection with an Award and imprinted with a legend to indicate that (i)

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such shares are subject to the restrictions on transfer set forth in the Plan and the applicable Agreement and (ii) if the offer and sale of such shares have not been registered under the 1933 Act, such shares may be sold only pursuant to a registration statement under the 1933 Act or an exemption from registration under the 1933 Act that the Company has determined is available for such sale.

"NASDAQ" means the National Association of Securities Dealers' Automated Quotation System.

"New Option" means an Option to that was originally granted under this Plan and was not the result of an exchange for an option to purchase shares of Common Stock granted under a Company option plan other than the Plan.

"1933 Act" means the Securities Act of 1933, as amended, and the rules and regulations of the Commission thereunder.

"1934 Act" means the Securities Exchange Act of 1934, as amended, and the rules and regulations of the Commission thereunder.

"Option Price" means, with respect to any Option, the exercise price per share of Common Stock, as determined by the Committee in its sole discretion and as set forth in the applicable Agreement.

"Option Shares" means the shares of Common Stock acquired by a Participant upon exercise of an Option.

"Outstanding", with respect to any share of Common Stock, means, as of any date of determination, all shares that have been issued on or prior to such date, other than shares repurchased or otherwise reacquired by the Company or any Affiliate thereof, on or prior to such date.

"Participant" means any Eligible Person who has been granted an Award.

"Permanent Disability", with respect to any Participant who is an employee of the Company or any of its Subsidiaries, shall be defined in the same manner as such term or a similar term is defined in an employment agreement applicable to the Participant or, in the case of a Participant who does not have an employment agreement that defines such term or a similar term, means that the Participant is unable to perform substantially all his duties as an employee of the Company or any of its Subsidiaries by reason of illness or incapacity for a period

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of more than six consecutive months, or six months in the aggregate during any 12-month period, established by medical evidence reasonably satisfactory to the Company.

"Permitted Transferee" means (A) with respect to outstanding shares of Common Stock held by any Participant, (i) the trustee or trustees of a trust revocable solely by such Participant, (ii) such Participant's guardian or conservator, (iii) any Person to whom such shares are transferred by will or the laws of descent and distribution, or (iv) any Person with respect to which the Board of Directors shall have adopted a resolution stating that the Board of Directors has no objection if a transfer of shares is made to such Person, and (B) with respect to Options, any Person (other than the Company) to whom an Option has been transferred in accordance with Section 8(a)(v).

"Person" means an individual, a partnership, a joint venture, a corporation, an association, a trust, an estate or other entity or organization, including a government or any department or agency thereof, or any group deemed to be a "person" under Section 14(d)(2) of the 1934 Act.

"Prime Rate" means the rate which Bank of America announces from time to time at its principal office as its prime lending rate for domestic commercial loans, the Prime Rate to change when and as such prime lending rate changes.

The Company shall be deemed to be a "Public Company" after it completes a Public Offering and the Company's Common Stock is traded on a national securities exchange or quoted on an automated quotation system.

"Public Offering" means an underwritten public offering of equity securities of the Company pursuant to an effective registration statement under the 1933 Act.

The "Public Value" of a share of Common Stock on a given date shall be the average closing price of a share of Common Stock on such national securities exchange on which such shares are traded or, in the event that the Common Stock is not listed for trading on a national securities exchange but is quoted on an automated quotation system, the average closing bid price per share of the Common Stock on such automated quotation system (the "Average Closing Price"), in either case for the 30-day period ending on such date. The Average Closing Price of a share of Common Stock shall be determined by dividing (i) by (ii), where (i) shall equal the sum of the closing prices for the Common Stock on each day that the Common Stock was traded and a closing price was reported on such national securities exchange or

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such automated quotation system, as the case may be, during the 30-day period, and (ii) shall equal the number of days on which the Common Stock was traded and a closing price was reported on such national securities exchange or such automated quotation system, as the case may be, during the 30-day period.

"Registrable Securities" means all shares of Common Stock held by Stockholders, and any common stock which may be issued or distributed in respect thereof, by way of any recapitalization.

"Registration Expenses" means all out-of-pocket expenses incident to the Company's performance of or compliance with Sections 14, 15 and 16, including, without limitation, all registration and filing fees (including filing fees with respect to the National Association of Securities Dealers, Inc.), all fees and expenses of complying with state securities or "blue sky" laws (including reasonable fees and disbursements of underwriters' counsel in connection with the preparation of any "blue sky" memorandum or survey), all printing expenses, all listing fees, all registrars' and transfer agents' fees, the fees and disbursements of counsel for the Company and of its independent public accountants, including, without limitation, the expenses of any special audits and/or "cold comfort" letters required by or incident to such performance and compliance, the reasonable fees and disbursements of one outside counsel retained by the holders of Registrable Securities being registered (which counsel shall be satisfactory to the holders of a majority of the Registrable Securities being registered), but excluding underwriting discounts and commissions and applicable transfer taxes, if any, which shall be borne by the sellers of the Registrable Securities being registered in all cases.

"Retirement", with respect to any Participant who is an employee of the Company or any of its Subsidiaries, means resignation or termination of employment after attainment of an age required for payment of an immediate pension pursuant to the terms of any qualified retirement plan maintained by the Company or any of its Subsidiaries in which the Participant participates; provided, however, that no resignation or termination prior to a Participant's sixty-fifth birthday shall be deemed a Retirement unless the Committee so determines in its sole discretion.

"Sale by Fremont/RCBA" means a sale of Common Stock that is not a Public Offering by either F Purchaser or B Purchaser that results in F Purchaser and B Purchaser together holding less than sixty-nine percent of the shares

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of Common Stock initially held by F Purchaser and B Purchaser on the Effective Date, as such number may be adjusted to reflect stock splits, reverse stock splits, stock dividends, acquisitions and the exercise of Options.

"Sale of Assets" means a sale (in one transaction or a series of transactions) by the Company of all or substantially all its business or assets (or both) to a third party that is not an Affiliate of the Company.

"Sale of Stock" means a sale (in one transaction or in a series of transactions) by the Company's stockholders of at least two-thirds of the outstanding Common Stock to a Third Party, including any merger with a Public Company following the consummation of which two-thirds or more of the voting securities of the surviving entity (which is a Public Company) in such merger are held by Third Parities.

"Subsidiary" means any corporation if 50% or more of the total combined voting power of all classes of stock is owned, either directly or indirectly, by the Company or another Subsidiary.

"Tender Date" means the last day of the Offer, as such term is defined in the transaction agreement between F Purchaser, B Purchaser and the Company.

"Third Party" means, with respect to any Participant, any Person, other than any Affiliate of (a) such Participant, (b) the Company and its Subsidiaries or (c) F Purchaser or B Purchaser.

"Valuation Date" means December 31 and June 30, or such other date that the Committee may from time to time select.

"Vested Options" means, as of any date, Options which by their terms are exercisable on such date.

3. Administration of the Plan.

(a) Members of the Committee. The Plan shall be administered, and Awards shall be granted hereunder, by a committee (the "Committee") of the Board of Directors comprised of at least three directors selected by the Board of Directors to administer the Plan. The composition of the Committee may, in the discretion of the Board of Directors, be adjusted to the extent required in order for the Company to rely on the exemptive relief provided under Rule 16b-3, as it may be amended from time to time, promulgated pursuant to Section 16 of the 1934 Act.

(b) Authority of the Committee. The Committee shall

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adopt such rules as it may deem appropriate in order to carry out the purpose of the Plan. All questions of interpretation, administration and application of the Plan shall be determined in good faith by a majority of the members of the Committee then in office, except that the Committee may authorize any one or more of its members, or any officer of the Company, to execute and deliver documents on behalf of the Committee. The determination of such majority shall be final and binding in all matters relating to the Plan.

4. Number of Shares Issued in Connection with Awards. The maximum aggregate number of shares of Common Stock that may be issued in connection with Awards granted under the Plan (together with any shares of Common Stock issued in connection with Management Shares and Options) is 6.5% of the initial shares of Common Stock outstanding as of the Effective Date, subject to adjustment as provided in Section 13. To the fullest extent permitted under Section 422 of the Code, if any Management Shares are forfeited or are repurchased by the Company, or if any Option expires or is surrendered without being exercised in full, such Management Shares or shares of Common Stock as to which such Option has not been exercised, as the case may be, may again be available for issuance in connection with future grants or offerings of Awards.

5. Eligible Persons. Awards may be granted or offered only to Eligible Persons. The Chief Executive Officer of the Company (the "CEO") will recommend for approval by the Board of Directors the individual Participants to whom Awards may be granted from among such class of Eligible Persons and to determine the number and form of Awards to be granted to each Participant.

6. Agreement. The terms and conditions of each grant or sale of Awards shall be embodied in an Agreement in a form approved by the Committee, which shall contain terms and conditions not inconsistent with the Plan and which shall incorporate the Plan by reference. Each Agreement shall: (a) state the date on which the Award was granted or sold, and (i) in the case of Options, set forth the number of Options being granted to the Participant and the applicable Option Price or Option Prices, and (ii) in the case of Management Shares, set forth the number of Management Shares being granted or offered to the Participant and, if applicable, the purchase price or other consideration for such Management Shares; (b) set forth the vesting schedule; (c) be signed by the recipient of the Award and a person designated by the Committee; and (d) be delivered to the recipient of the Award.

7. Restrictions on Transfer. No Management Share, Option or Option Share may be sold, transferred, assigned,

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pledged, or otherwise encumbered or disposed of to any third party other than the Company except as provided in the Plan or Award Agreement or to a Permitted Transferee. Each Permitted Transferee (other than the Company), by will, by the laws of descent and distribution or otherwise, of any Management Shares, Options or Option Shares shall, as a condition to the transfer thereof to such Permitted Transferee, execute an agreement pursuant to which it shall become a party to the Agreement applicable to the transferor. Each Permitted Transferee will succeed to the rights held under the Plan by the transferring Participant, to the extent that such rights are not limited in the Plan or the relevant Agreement.

8. Options.

(a) Terms of Options Generally. Options may be granted to any Eligible Person. Each Option shall entitle the Participant to whom such Option was granted to purchase, upon payment of the relevant Option Price, one share of Common Stock. Payment of the Option Price shall be made in cash, or, in the sole discretion of the Committee and to the extent provided in the applicable Agreement, in shares of Common Stock already owned by the Participant, in other property acceptable to the Committee or in any combination of cash, shares of Common Stock or such other property. Options granted under the Plan shall comply with the following terms and conditions:

(i) Option Price. Each Agreement relating to an Option shall specify the relevant Option Price.

(ii) Vesting.

(A) Vesting Schedule. The vesting schedule of each Option shall be set forth in the applicable Agreement.

(B) Acceleration of Vesting. In the event of a termination of a Participant's employment with the Company and its Subsidiaries by reason of death or Permanent Disability or Retirement, all Options granted to such Participant shall vest on the date of such termination. All Options shall immediately vest upon (i) completion of a Sale of Stock within three years from the Effective Date and (ii) completion of a Sale of Assets within three years from the Effective Date. Fifty percent of all unvested Options, proportionately per unvested installment per Participant, shall immediately vest upon (i) completion of an IPO within three years from the Effective Date or (ii) completion of a Sale by Fremont/RCBA within three years from the Effective Date.

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(iii) Duration of Options. Each Option shall be effective for such term as shall be determined by the Committee and set forth in the applicable Agreement; provided, however, that the term of any New Option shall not exceed 7 years from the Date of Grant.

(iv) Exercise Following Termination of Employment. Upon termination of a Participant's employment with the Company and its Subsidiaries for any reason, the Participant (or, in the case of the Participant's death, his Beneficiary) may exercise any Vested Option, subject to Section 8(b), at any time until the earlier of (A) 30 days (180 days upon a termination of employment or status due to death or Permanent Disability) following the date of such termination of employment or status (or, if a Vested Option may not be exercised on the date of such termination of employment or status because the conditions to exercise set forth in Section 8(b) are not satisfied, 30 days (180 days upon a termination of employment or status due to death or Permanent Disability) following the date on which the Company notifies the Participant that such conditions have been satisfied and that the Option may be exercised), and (B) exercise by the Company of its Call Right under Section 10(a), but in no event after the expiration of the Option under the provisions of clause (iii) above; provided, however, that the applicable Agreement may, subject to clause (iii) above, provide for a longer post-termination exercise period. Upon the expiration of such period or exercise of such Call Right, any such Vested Option not theretofore exercised shall be canceled, and the shares of Common Stock that had been subject thereto shall again be available for grants of further Awards under the Plan to the fullest extent permitted under Section 422 of the Code.

(v) Certain Restrictions. Options granted hereunder shall not be transferable by the Participant otherwise than to a Permitted Transferee. A Participant may transfer Exchange Options to a charity or charitable foundation (collectively, a "Charity"), subject to the approval of the Board of Directors, provided however, that the Exchange Options transferred shall represent more that than 4,000 Option Shares, as such number may be adjusted to reflect stock splits, reverse stock splits, stock dividends, and acquisitions. Upon completion of an IPO, Option Shares may be freely transferred as permitted by applicable laws and regulations.

(vi) Stockholder Rights. A Participant shall have no rights as a stockholder with respect to any shares of Common

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Stock issuable upon exercise of an Option until a certificate or certificates evidencing such shares shall have been issued to such Participant, and no adjustment shall be made for dividends or distributions or other rights in respect of any share for which the record date is prior to the date upon which the Participant shall become the holder of record thereof.

(vii) Dividends and Distributions. Any shares of Common Stock or other securities of the Company received by the Participant as a result of a stock dividend or other distribution in respect of Option Shares shall be subject to the same restrictions as such Option Shares.

(viii) Additional Terms and Conditions. Each Option granted hereunder, and any shares of Common Stock issued in connection with such Option, shall be subject to such additional terms and conditions not inconsistent with the Plan which are prescribed by the Committee and set forth in the applicable Agreement.

(b) Limitation on Exercise. An Option shall not be exercisable unless the offer and sale of the shares of Common Stock subject to the Option have been registered under the 1933 Act and qualified under applicable state "blue sky" laws, or the Company has determined that an exemption from registration under the 1933 Act and from qualification under such state "blue sky" laws is available.

(c) Issuance of Certificate. As soon as practicable following the exercise of any Options, a Legended Certificate evidencing the number of Option Shares issued in connection with such exercise shall be issued in the name of the Participant.

(d) Unvested Options. Upon termination of a Participant's employment with the Company and its Subsidiaries, all Options granted to such Participant which have not theretofore vested (and which do not vest by reason of such termination of employment or status) shall terminate and be canceled without any payment therefor.

9. Management Shares.

(a) Terms of Management Shares Generally. Management Shares may be granted or offered for sale to any Eligible Person. If Management Shares are offered for sale hereunder, the purchase price shall be payable in cash, or, in the sole discretion of the Committee and to the extent provided in the applicable Agreement, in shares of Common Stock already owned by the Participant, in other property acceptable to the Committee or in any combination of cash, shares of Common Stock or such other property. The

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Management Shares granted or offered for sale under the Plan shall comply with the following terms and conditions:

(i) Purchase Price; Offering Period. Management Shares may be granted for no consideration or offered for sale at a purchase price determined by the Committee in its sole discretion at the time of offering and set forth in the applicable Agreement. Any offer to sell Management Shares hereunder shall expire no later than 60 days following the date of such offer to an Eligible Person.

(ii) Stockholder Rights. A Participant shall have all rights of a stockholder as to the Management Shares, including the right to receive dividends and the right to vote in accordance with the Company's Certificate of Incorporation, subject to the restrictions set forth in the Plan and the applicable Agreement.

(iii) Dividends and Distributions. Any shares of Common Stock or other securities of the Company received by a Participant as a result of a stock distribution to holders of Management Shares or as a stock dividend on Management Shares shall be subject to the same restrictions as such Management Shares and all references to Management Shares hereunder shall be deemed to include such shares of Common Stock or other securities.

(iv) Additional Terms and Conditions. Each Management Share granted or offered for sale hereunder shall be subject to such additional terms and conditions not inconsistent with the Plan which are prescribed by the Committee and set forth in the applicable Agreement.

(v) Restrictions on Transfers. No Participant shall be permitted to transfer any Management Shares other than as expressly permitted by this Plan or the relevant Agreement. Upon the completion of an IPO, Management Shares may be freely transferred in accordance with all applicable laws and regulations.

(b) Issuance of Certificate. At the time of grant or sale of Management Shares to a Participant, a Legended Certificate evidencing the appropriate number of shares of Common Stock granted or sold to the Participant as Management Shares shall be issued in the name of the Participant.

10. Termination of Employment or Status; Involuntary Transfers.

(a) Company Call Right.

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(i) Exercise of Call Right. Unless the Committee in its sole discretion determines otherwise and so sets forth in the applicable Agreement, if prior to the completion of an IPO the employment of a Participant with the Company and its Subsidiaries terminates for any reason, or an Involuntary Transfer occurs, the Company shall have a Call Right, exercisable for a period of 60 days after the date of such termination or Involuntary Transfer, with respect to all of the Management Shares, Vested Options and Option Shares beneficially owned by such Participant and his Permitted Transferees. The Company may exercise such Call Right by giving written notice thereof to the Participant or his Permitted Transferee, as the case may be, prior to the expiration of such 60-day period. The Company's Call Right shall become null and void subsequent to the completion of an IPO.

(ii) Purchase Price. With respect to any exercise of a Call Right under this Section 10(a), (A) the purchase price per Management Share to be paid by the Company at the closing provided for in Section 10(c) shall be the Applicable Management Share Value, determined as of the first Valuation Date coincident with or following the date of termination of the Participant's employment or status or Involuntary Transfer, (B) the purchase price per Option Share to be paid by the Company at the closing provided for in Section 10(c) shall be the Applicable Option Share Value, determined as of the first Valuation Date coincident with or following the date of termination of the Participant's employment or status or Involuntary Transfer and (C) the consideration to be paid by the Company in respect of Vested Options surrendered for cancellation at the closing provided for in Section 10(c) shall be the Applicable Option Share Value determined as of the first Valuation Date coincident with or following the date of termination of the Participant's employment or Involuntary Transfer. The Company will give notice of the purchase price to be paid per Management Share or Option Share within a reasonable time from the date of determination of such price.

(b) Participant Put Right.

(i) Exercise of Put Right. To the extent provided in the applicable Agreement and subject to Section 10(b)(iii), if prior to the completion of an IPO the employment of a Participant with the Company and its Subsidiaries terminates for any reason, the Participant (or, in the case of the Participant's death, his Beneficiary) shall have a Put Right, exercisable for a period of 60 days after the date of such termination, with respect to all of the Management Shares, Vested Options and Option Shares beneficially owned

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by such Participant and his Permitted Transferees. The Participant may exercise such Put Right by giving written notice thereof to the Company prior to the expiration of such 60-day period. The Participants' Put Rights shall be null and void subsequent to the completion of an IPO.

(ii) Purchase Price. The Put Right purchase price per Management Share to be paid by the Company at the closing provided for in Section 10(c) shall be the Applicable Management Share Value, determined as of the first Valuation Date coincident with or following the date of termination of the Participant's employment or status. The Put Right purchase price per Option Share to be paid by the Company at the closing provided for in Section 10(c) shall be the Applicable Option Share Value, determined as of the first Valuation Date coincident with or following the date of termination of the Participant's employment or status. The consideration to be paid by the Company in respect of Vested Options surrendered for cancellation at the closing provided for in Section 10(c) shall be Applicable Option Value, determined as of the first Valuation Date coincident with or following the date of termination of the Participant's employment. The Company will give notice of the consideration to be paid per Management Share or Option Share within a reasonable time from the date of determination of such amount.

(iii) Anything in this Plan to the contrary notwithstanding, if, at any time, the Board of Directors shall determine, subject to the written opinion of the Appraiser (as hereinafter defined) referred to below, the Company is not financially capable of making some or all of the aggregate payments to be made thereafter pursuant to the exercise of Put Rights (the "Put Right Payments"), the Company shall have the right to defer such Put Right Payments but only on the terms hereinafter provided in this Section 10(b)(iii). In the event that the Board of Directors shall have made such determination with respect to the Company's financial capability, the Board of Directors shall, if so requested in writing by at least two Participants within 10 business days of the date that notice of such determination has been given (the "Request Period"), promptly retain an appraisal or investment banking firm, to be selected by the CEO and reasonably satisfactory to the Board of Directors (the "Appraiser"), to render a written opinion as to whether the Company has the financial capability to make any of, or any portion of, such Put Right Payments at such time as it would otherwise be required to make such Put Right Payments. If the Board of Directors' determination, or the Appraiser's written opinion, if so required, indicates that, at the time a Put Right Payment

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would otherwise be required to be made to a Participant, the Company would not have the financial capability to make any of the Put Right Payments that would otherwise then be required to be made, or shall have the financial capability to make only a portion of such Put Right Payments, then payments with respect to such Put Right Payments shall be made on the following basis: As of the first day following a determination by the Appraiser of lack of financial capability in respect of which Put Right Payments are required to be made or, if no request for an Appraiser's appraisal is made, on the day following the last day of the Request Period (each such date being hereinafter called a "Payout Date"), all unpaid amounts payable with respect to Put Rights exercised prior to such a date, shall be aggregated (the "Aggregate Payable Amount"), and the amount payable to each Participant shall be determined by multiplying the full amount owing to such Participant as of such date by a fraction, the numerator of which shall be the amount that the Company, as indicated by the Board of Directors' determination or the Appraiser's written opinion, shall then be financially capable of paying (which may be zero if, as indicated by the Board of Directors' determination or the Appraiser's written opinion, the Company is not financially capable of making any of the Put Right Payments then otherwise required to be made) and the denominator of which shall be the Aggregate Payable Amount. Elections to exercise Put Rights (or portions thereof) not satisfied pursuant to such pro rata payment shall be deemed revoked, and the remaining Awards (or portions thereof) with respect thereto shall thereafter be subject to the provisions of the Plan as if a Put Right election had not been made, provided, however that such Options will not be canceled pursuant to Section 8(a)(iv) or as a result of the expiration of such Options' term pursuant to Section 8(a)(iii). In acting pursuant to this Section 8, the Appraiser shall be entitled to the rights and immunities of an arbitrator.

(c) Election and Delivery Procedures.

(i) The closing of any exercise of any Call Right or Put Right pursuant to Section 10(a) or 10(b) shall take place at the offices of the Company, or such other place as may be mutually agreed, not less than 15 nor more than 30 days after the Valuation Date coincident with or following the relevant termination of employment. The exact date and time of closing shall be specified by the party exercising such Call Right or Put Right.

(ii) At such closing (the "Closing"), the Participant (or, following the Participant's death, the Participant's

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Beneficiary or Beneficiaries) shall deliver certificates for the shares of Common Stock to be sold to the Company duly endorsed, or accompanied by written instruments of transfer in form reasonably satisfactory to the Company duly executed, by such transferor, free and clear of any Encumbrances, and shall consent to the cancellation of the Vested Options to be surrendered, which Vested Options shall also be free and clear of any Encumbrances. The Company shall pay the applicable purchase price for shares of Common Stock and consideration for surrendered Vested Options in cash; provided, however, that such payment may be deferred under the circumstances, and to the extent, provided for in Section 12.

11. Appraisal. If, in connection with the determination of the Fair Market Value used to calculate the purchase price for shares of Common Stock and Vested Options upon the exercise of any Call Right or Put Right under Section 10(a) or 10(b), a Participant reasonably believes that the Board of Directors' determination of Fair Market Value (if applicable) is not reasonable, then such Participant may challenge the Board of Directors' determination of such Fair Market Value by giving written notice to the Board of Directors no later than 15 business days after receipt of notice of the purchase price per share which the Company intends to pay with respect to such shares of Common Stock and Vested Options. In such event, the Company shall engage at its own expense an appraisal or investment banking firm that is independent of the Company and its Subsidiaries and Affiliates and is knowledgeable in the valuation of companies engaged in a business similar to the business in which the Company is engaged to determine the Fair Market Value of the Common Stock for purposes of determining the purchase price; provided, however, that if such a determination has been made by such an appraisal or investment banking firm less than six months prior to the date as of which the Fair Market Value of the Common Stock is to be determined, the Company shall not be required to engage any such firm and shall instead rely on such earlier valuation; provided further, however, that the Company shall not rely on such earlier valuation if it determines in good faith that such earlier valuation no longer reflects Fair Market Value. Any such appraisal or investment banking firm engaged by the Company shall be selected by the Board of Directors and shall be reasonably satisfactory to such Participant. Such independent appraisal or investment banking firm's determination of Fair Market Value shall be conclusive and binding on the parties. Anything in this Section 11 to the contrary notwithstanding, if such an independent appraisal or investment banking firm is appointed, no payment shall be made in respect of the Participant's shares of Common Stock or Vested Options pending the determination of Fair Market Value by such firm, and payment of the purchase price shall instead be made no

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later than the tenth business day following receipt by the Company of the report of such firm establishing Fair Market Value. If the Fair Market Value so determined by the independent banking firm exceeds the Fair Market Value as determined by the Board of Directors by more than 10%, the costs of such firm shall be for the account of the Company; in all other cases, the costs of such firm shall be borne by the Participant, and the Company shall have the right to withhold such costs from any payment it makes in respect of its repurchase of shares of Common Stock or Vested Options from the Participant.

12. Legal Limitations. Anything in the Plan or any Agreement to the contrary notwithstanding, to the extent that the limitations or restrictions applicable to the Company or any Subsidiary under the laws of their respective jurisdictions of incorporation, the restrictions or limitations contained in the Certificate of Incorporation or By-laws of the Company or any Subsidiary or any other applicable law, rule or regulation or under the terms of any indebtedness for borrowed money of the Company or any Subsidiary prohibit the Company from making any payment required under the Plan or any applicable Agreement with respect to a share of Common Stock or Vested Option, then the Company shall not be obligated to make such payment at such time, and shall have the right to defer such payment until the Board of Directors reasonably determines that such limitations and restrictions no longer restrict the Company from making such deferred payment. Any amounts the payment of which is so deferred shall bear interest, compounded annually and calculated at a rate equal to the Prime Rate, and shall be paid (with interest) promptly after, and to the extent that, the Board of Directors determines that the limitations and restrictions referred to in the first sentence of this Section 12 no longer restrict such payment. Notwithstanding a deferral of payment in accordance with this Section 12 for shares of Common Stock or Vested Options in respect of which a Call Right or Put Right shall have been exercised, the closing of any exercise of such Call Right or Put Right shall take place as provided in Section 10(c) and the right of a Participant and his Permitted Transferees in respect of the shares of Common Stock and Vested Options subject to such Call Right or Put Right (other than the right to receive payment of amounts deferred in accordance with this Section 12) shall terminate as of such closing.

13. Effect of Certain Corporate Changes and Changes in Control.

(a) Dilution and Other Adjustments. In the event of a stock dividend or split, the Committee shall make the following adjustments as are necessary or advisable (the form of which shall be determined by the Committee in its sole discretion) to provide each Participant with a benefit equivalent to that which

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he would have been entitled to had such event not occurred: (i) adjust the number of Awards granted to each Participant and the number of Awards that may be granted generally pursuant to the Plan, (ii) adjust the Option Price of any Options, and (iii) make any other adjustments, or take such action, as the Committee, in its discretion, deems appropriate. Such adjustments shall be conclusive and binding for all purposes. In the event of a change in the Common Stock which is limited to a change in the designation thereof to "Capital Stock" or other similar designation, or to a change in the par value thereof, or from par value to no par value, without increase or decrease in the number of issued shares of Common Stock, the shares resulting from any such change shall be deemed to be Common Stock within the meaning of the Plan.

(b) Effect of Reorganization. In the event that (i) the Company is merged or consolidated with another corporation, (ii) all or substantially all the assets of the Company are acquired by another corporation, person or entity, (iii) the Company is reorganized, dissolved or liquidated (each such event in (i), (ii) or (iii) being hereinafter referred to as a "Reorganization Event") or (iv) the Board of Directors shall propose that the Company enter into a Reorganization Event, then the Committee shall make upon consummation of such Reorganization Event any or all of the adjustments described in Section 13(a) as are necessary or advisable in the sole discretion of the Committee to provide the Participant with a benefit equivalent to that which he would have been entitled to had such event not occurred.

14. Incidental Registration.

(a) Registration Process. If the Company at any time proposes to register any shares of Common Stock under the 1933 Act for sale in a Public Offering in the United States, whether or not for its own account, on a form and in a manner that would permit registration of Registrable Securities under the 1933 Act for Sale in such Public Offering, it will each such time give prompt written notice to all Participants holding Registrable Securities (including Option Stock issuable upon exercise of any Vested Options held by the Participants after giving effect to the accelerated vesting, if any, that would result as a consequence of such Public Offering) of its intention to do so, specifying the form and manner and the other relevant facts involved in such proposed registration (including, without limitation, the identity of the managing underwriter). Upon the written request of any such holder of Registrable Securities delivered to the Company within 30 days after such notice shall have been given to such holder (which request shall specify the Registrable Securities intended to be disposed of by such holder and the intended method of disposition thereof), the Company will

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use its best efforts to effect the registration under the Securities Act, as expeditiously as is reasonable, of all Registrable Securities that the Company has been so requested to register by the holders of Registrable Securities, to the extent requisite to permit the Sale of the Registrable Securities to be so registered in such Public Offering; provided, however, that:

(i) if, at any time after giving such written notice of its intention to register any of such shares of Common Stock proposed to be registered by the Company and prior to the effective date of the registration statement filed in connection with such registration, the Company shall determine for any reason not to register such shares of Common Stock, the Company may, at its election, give written notice of such determination to each holder of Registrable Securities that has requested to register Registrable Securities and thereupon the Company shall be relieved of its obligation to register any Registrable Securities in connection with such registration (but not from its obligation to pay the Registration Expenses in connection therewith to the extent provided in Section 14(b));

(ii) if the managing underwriter of such Public Offering shall advise the Company that, in its judgment, the number of shares of Common Stock proposed to be included in such Public Offering should be limited because the inclusion of Registrable Securities is likely to adversely impact the purchase price obtained for the shares of Common Stock proposed to be included in such Public Offering, then the Company will promptly advise each such holder of Registrable Securities thereof and may require, by written notice to each such holder accompanying such advice, that, to the extent necessary to meet such limitation, all holders of Registrable Securities proposing to sell shares of Common Stock in such Public Offering shall share pro rata in the number of shares of Common Stock to be excluded from such offering, such sharing to be based on the respective numbers of Registrable Securities as to which registration has been requested by such holders and that the distribution of such Registrable Securities as are so excluded be deferred (in case of a deferral as to a portion of such Registrable Securities, such portion to be allocated among such holders in proportion to the respective numbers of shares of Common Stock so requested to be registered by such holders) until the completion of the distribution of such shares of Common Stock and any other securities by such underwriters; and

(iii) the Company shall not be obligated to effect any registration of Registrable Securities under this Section 14 that is incidental to the registration of any of its shares of Common Stock or other securities in connection

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with any merger, acquisition, exchange offer, dividend reinvestment plan or stock option or other employee benefit plan.

(b) Registration Expenses. The Company will pay all Registration Expenses in connection with each registration of Registrable Securities effected by it pursuant to this Section 14.

15. Right to Participate in Certain Dispositions.

(a) Right to Participate. (i) So long as F Purchaser and B Purchaser together (for purposes of this Section 15 the "Founding Stockholders") shall own at least 40% of the outstanding shares of Common Stock, neither Founding Stockholder shall in any transaction or series of related transactions, directly or indirectly, sell or otherwise dispose of for value any shares of Common Stock held by it to any Third Party or Third Parties, unless the terms and conditions of such sale or other disposition shall include an offer to include, at the option of each of the Participants, in such sale or other disposition to the Third Party or Third Parties, the Pro Rata Portion (as hereinafter defined) of the shares of Common Stock, including Management Shares and Option Shares then owned (or issuable upon the exercise of any options owned) by each such Participant. For purposes of this Section 15, "Pro Rata Portion" means, with respect to each Participant, a number equal to the product of (a) the total number of shares of Common Stock then owned (or issuable upon the exercise of any Vested Options held after giving effect to the accelerated vesting, if any, that would result as a consequence of such sale or disposition) by such Participant, times (b) a fraction, the numerator of which shall be the total number of shares of Common Stock proposed to be sold by the Prospective Sellers (as such term is defined in Section 15(a)(ii)), and the denominator of which shall be the total number of shares of Common Stock owned (or issuable upon the exercise of any Vested Options held after giving effect to the accelerated vesting, if any, that would result as a consequence of such sale or disposition) by the Prospective Sellers (including such shares of Common Stock so proposed to be sold).

(ii) If, so long as the Founding Stockholders shall own at least 40% of the outstanding shares of Common Stock, either Founding Stockholder receives from a Third Party or Third Parties a bona fide offer or offers to purchase or otherwise acquire (for purposes of this Section 15, an "Offer") any shares of Common Stock held by such Founding Stockholder (for purposes of this Section 15, the "Offered Shares"), and such Founding Stockholder intends to pursue a sale of such shares of Common Stock to such Third Party or Third Parties, such Founding Stockholder (for purposes of this Section 15, the "Prospective Seller") shall

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provide written notice (for purposes of this Section 15, the "Offer Notice") of such Offer to each of the Participants not later than the tenth business day prior to the consummation of the sale or other disposition contemplated by the Offer. The Offer Notice shall identify the Offered Shares, the price offered for such Offered Shares, all other material terms and conditions of the Offer and, in the case of an Offer in which the consideration payable for shares of Common Stock consists in whole or in part of such other consideration as the Company may reasonably determine, such other consideration. The Participants shall have the right and option, for a period of 10 business days after the date the Offer Notice is given to such Participants (for purposes of this Section 15, the "Notice Period"), to notify the Prospective Seller of such Participant's interest in selling or otherwise disposing of up to the Pro Rata Portion of such Participant's shares of Common Stock pursuant to the Offer). Each Participant desiring to exercise such option shall, prior to the expiration of the Notice Period, provide the Prospective Seller with written notice (specifying the number of shares of Common Stock as to which such Participant has an interest in selling or otherwise disposing of pursuant to the Offer) (for purposes of this Section 15, a "Notice of Interest") and, deliver to the Prospective Seller (A) the certificate or certificates evidencing the shares of Common Stock to be sold or otherwise disposed of pursuant to such Offer by such Participant duly endorsed in blank or accompanied by written instruments of transfer in form satisfactory to the Prospective Seller executed by such Participant, (B) an instrument of assignment reasonably satisfactory to the Prospective Seller assigning, as of the consummation of the sale or other disposition to the Third Party or Third Parties, all such Participant's rights hereunder with respect to the shares of Common Stock to be sold or otherwise disposed of, and (C) a special irrevocable power-of-attorney authorizing the Prospective Seller to sell or otherwise dispose of such shares of Common Stock pursuant to the terms of the Offer and to take all such actions as shall be necessary or appropriate in order to consummate such sale or other disposition. Delivery of such certificate or certificates evidencing the shares of Common Stock to be sold, the instrument of assignment and the special irrevocable power-of-attorney authorizing the Prospective Seller to sell or otherwise dispose of such shares of Common Stock shall constitute an irrevocable election by such Participant to authorize and permit the Prospective Seller to sell such shares of Common Stock pursuant to the Offer. Each Participant that shall have delivered a Notice of Interest as provided in this Section 15(a)(ii) shall deliver the documents described in clauses (A) and (B) of the second preceding sentence at the closing of the sale of the Offered Shares.

(iii) Promptly after the consummation of the sale or other disposition of the shares of Common Stock of the

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Prospective Seller and the Participants to the Third Party or Third Parties pursuant to the Offer, the Prospective Seller shall remit to each of the Participants the total sales price of the shares of Common Stock of such Participants sold or otherwise disposed of pursuant thereto.

(iv) If at the end of the Notice Period any Participant shall not have given a Notice of Interest (and delivered all other required documents) with respect to some or all of the Pro Rata Portion of such Participant's shares of Common Stock, such Participant will be deemed to have waived all its rights under this Section 15 with respect to the sale or other disposition pursuant to the Offer of the portion of the Pro Rata Portion of the shares of Common Stock owned by such Participant with respect to which a Notice of Interest shall not have been given. If, at the end of the 120-day period following the giving of the Offer Notice, the Prospective Seller has not completed the sale of all the Offered Shares and the shares of Common Stock with respect to which Participants shall have given Notices of Interest pursuant to this Section 15, the Prospective Seller shall return to such Participants all certificates evidencing the unsold shares of Common Stock that such Participants delivered for sale or other disposition pursuant to this Section 15 and such Participants' related instruments of assignment and powers-of-attorney.

(v) Except as expressly provided in this Section 15, the Prospective Seller shall have no obligation to any Participant with respect to the sale or other disposition of any shares of Common Stock owned by such Participant in connection with this Section 15. Anything herein to the contrary notwithstanding and irrespective of whether any Notice of Interest shall have been given, the Prospective Seller shall have no obligation to any Participant to sell or otherwise dispose of any Offered Shares pursuant to this Section 15 or as a result of any decision by the Prospective Seller not to accept or consummate any Offer or sale or other disposition with respect to the Offered Shares (it being understood that any and all such decisions shall be made by the Prospective Seller in its sole discretion). No Participant shall be entitled to sell or otherwise dispose of shares of Common Stock directly or to any Third Party pursuant to an Offer (it being understood that all such sales and other dispositions shall be made only on the terms and pursuant to the procedures set forth in this Section 15).

(b) Anything in this Section 15 to the contrary notwithstanding, (i) the provisions of Section 15 will not be applicable to any sale of shares of Common Stock pursuant to a Public Offering, (ii) in the event that either Prospective Seller shall exercise the option referred to in Section 16 to require each of the Participants to participate in the sale of shares of Common Stock referred to therein, the Participants shall

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thereafter have no right pursuant to this Section 15 to participate in any such sale and (iii) all rights to participate conveyed by this Section 15 will become null and void upon an IPO. Nothing in this Section 15 shall affect any of the obligations of the Founding Stockholders under any other provision of this Plan.

16. Right to Compel Participation in Certain Sales.

(a) Compelled Participation. If either Founding Stockholder shall, individually or jointly, in any transaction or series of related transactions, directly or indirectly, (for purposes of this Section 16, collectively, the "Prospective Sellers") propose to sell to a Third Party or Third Parties for cash, cash equivalents or marketable securities all shares of Common Stock held by them (for purposes of this Section 16, the "Controlling Shares") to a Third Party or Third Parties (for purposes of this Section 16, an "Offer") and as a result of such sale such Third Party or Third Parties and all Affiliates of such Third Party or Third Parties would own a number of shares of Common Stock that constitutes a majority of the shares of Common Stock then outstanding, the Prospective Sellers may, at their option, require each of the Participants to sell all shares of Common Stock owned or held by such Participant to the Third Party or Third Parties, for the same consideration per share of Common Stock and otherwise on the same terms and conditions upon which the Prospective Sellers sell their shares of Common Stock.

(b) Compelled Sales Procedure. (i) the Prospective Sellers shall provide a written notice (for purposes of this Section 16, the "Offer Notice") of such Offer to each of the Participants no later than the tenth business day prior to the consummation of the sale contemplated by the Offer. The Offer Notice shall contain written notice on the exercise of the Prospective Sellers' rights pursuant to Section 16, setting forth the consideration per share of Common Stock to be paid by the Third Party or Third Parties and the other material terms and conditions of Offer. Within 10 business days following the date the Offer Notice is given, each of the Participants shall deliver to the Prospective Sellers (A) the certificate or certificates evidencing all the shares of Common Stock owned or held by such Participant duly endorsed in blank or accompanied by written instruments of transfer in form satisfactory to the Prospective Sellers executed by such Participant, and (B) a special irrevocable power- of-attorney authorizing the Prospective Sellers to sell such shares of Common Stock pursuant to the terms of the Offer and to take all such action as shall be necessary or appropriate in order to consummate such sale, provided, however, that if such delivery is not permitted by applicable law, such Participant shall deliver an uncondition agreement to deliver such shares of Common Stock pursuant to this Section 16(b) at the

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closing for such Offer against delivery to such Participant of the consideration therefor.

(ii) Promptly after the consummation of the sale of shares of Common Stock of the Prospective Sellers and the Participants to the Third Party or Third Parties pursuant to the Offer, the Prospective Sellers shall remit to each of the Participants the total sales price of the shares of Common Stock of such Participant sold pursuant thereto.

(iii) If, at the end of the 120-day period following the giving of the Offer Notice, the Prospective Sellers have not completed the sale of all the Controlling Shares and the shares of Common Stock delivered to the Prospective Sellers pursuant to Section 16(b)(i), the Prospective Sellers shall return to each of the Participants all certificates evidencing unsold shares of Common Stock that such Participant delivered for sale pursuant to this Section 16 and such Participant's related powers-of-attorney.

(iv) Except as expressly provided in this Section 16, the Prospective Sellers shall have no obligation to any Participant with respect to the sale or other disposition of any shares of Common Stock owned by such Participant in connection with this Section 16. Anything herein to the contrary notwithstanding, the Prospective Sellers shall have no obligation to any Participant to sell or otherwise dispose of any Controlling Shares pursuant to this Section 16 or as a result of any decision by the Prospective Sellers not to accept or consummate any Offer or sale with respect to the Controlling Shares (it being understood that any and all such decisions shall be made by the Prospective Sellers in their sole discretion). No Participant shall be entitled to sell shares of Common Stock directly to any Third Party pursuant to an Offer (it being understood that all such sales and other dispositions shall be made only on the terms and pursuant to the procedures set forth in this Section 16). Nothing in this Section 16 shall affect any of the obligations of either of the Founding Stockholders under any other provisions of this Plan.

(c) Anything in this Section 16 to the contrary notwithstanding, (i) the provisions of this Section 16 will not be applicable to any sale of shares of Common Stock pursuant to a Public Offering and (ii) all rights to compel sales under this Section 16 shall become null and void upon an IPO.

17. Miscellaneous.

(a) No Rights to Grants or Continued Employment or Engagement. No Participant shall have any claim or right to receive grants of Awards under the Plan. Neither the Plan nor

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any action taken or omitted to be taken hereunder shall be deemed to create or confer on any Participant any right to be retained in the employ of the Company or any Subsidiary or other Affiliate thereof, or to interfere with or to limit in any way the right of the Company or any Subsidiary or other Affiliate thereof to terminate the employment or engagement of such Participant at any time.

(b) Right of Company to Assign Rights and Delegate Duties. The Company shall have the right to assign any of its rights and delegate any of its duties hereunder to any of its Affiliates, provided, however, that such assignment shall not release the Company from any duty hereunder which remains unfulfilled by such an assignee.

(c) Tax Withholding. The Company and its Subsidiaries shall have the right to require any individual entitled to receive shares of Common Stock pursuant to an Award to remit to the Company, prior to the delivery of any certificates evidencing such shares, any amount sufficient to satisfy any federal, state or local tax withholding requirements. Prior to the Company's determination of such withholding liability, such individual may make an irrevocable election to satisfy, in whole or in part, such obligation to remit taxes by directing the Company to withhold shares of Common Stock that would otherwise be received by such individual. Such election may be denied by the Committee in its discretion, or may be made subject to certain conditions specified by the Committee, including, without limitation, conditions intended to avoid the imposition of liability against the individual under Section 16(b) of the 1934 Act. The Company and its Subsidiaries shall also have the right to deduct from all cash payments made pursuant to the Plan or any applicable Agreement any federal, state or local taxes required to be withheld with respect to such payment.

(d) No Restriction on Right of Company to Effect Corporate Changes. The Plan shall not affect in any way the right or power of the Company or its stockholders to make or authorize any or all adjustments, recapitalizations, reorganizations or other changes in the Company's capital structure or its business, or any merger or consolidation of the Company, or any issue of stock or of options, warrants or rights to purchase stock or of bonds, debentures, preferred or prior preference stocks whose rights are superior to or affect the Common Stock or the rights thereof or which are convertible into or exchangeable for Common Stock, or the dissolution or liquidation of the Company, or any sale or transfer of all or any part of its assets or business, or any other corporate act or proceeding, whether of a similar character or otherwise.

(e) 1934 Act. Notwithstanding anything contained in

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the Plan or any Agreement to the contrary, if the consummation of any transaction under the Plan would result in the possible imposition of liability on a Participant pursuant to Section 16(b) of the 1934 Act, the Committee shall have the right, in its sole discretion, but shall not be obligated, to defer such transaction to the extent necessary to avoid such liability, but in no event for a period in excess of 180 days.

(f) Registration of Plan. On the date, or as soon as practicable after, the Company becomes a Public Company, the Company shall file a form S-8 with respect to the Plan.

18. Amendment. The Board of Directors may at any time and from time to time alter, amend, suspend or terminate the Plan in whole or in part. No termination or amendment of the Plan may, without the consent of the Participant to whom any Awards shall previously have been granted, adversely affect the rights of such Participant in such Awards.

19. Effective Date. The Plan shall be effective as of the Effective Time of the Merger (the "Effective Date"), as such terms are defined in the transaction agreement between F Purchaser, B Purchaser and the Company.

20. Termination of the Plan. The Plan shall continue until terminated by the Board of Directors pursuant to Section 18, and no further Awards shall be made hereunder after the date of such termination.

21. Headings. The headings of sections and subsections herein are included solely for convenience of reference and shall not affect the meaning of any of the provisions of the Plan.

22. Governing Law. The Plan and all rights hereunder shall be governed by and construed in accordance with the laws of the State of Delaware without reference to rules relating to conflicts of law.

FREMONT PURCHASER II, INC. and RCBA PURCHASER I, L.P. acknowledge the Plan and agree to be bound by Section 10 thereof.

By:________________________	By:________________________
FREMONT PURCHASER II, INC.	RCBA PURCHASER I, L.P.
Name:	Name:
Title:	Title:

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KCI Subsidiaries
(Updated October 15, 1997)

KINETIC CONCEPTS, INC., a Texas corporation
(Tax ID #74-1891727) [Became a public company 6-7-88]

Subsidiaries:

1. KCI Therapeutic Services, Inc., a Delaware corporation
(Tax ID #74-2152396)

2. KCI New Technologies, Inc., a Delaware corporation
(Tax ID #74-2615226)

3. KCI Properties Limited, a Texas limited liability company
(Tax ID #74-2621178)

4. KCI Real Property Limited, a Texas limited liability company, d/b/a Premier Properties (Tax ID #74-2644430)

5. KCI Air, Inc., a Delaware corporation
(Tax ID #74-2765302)

6. Medical Retro Design, Inc., a Delaware corporation
(Tax ID #74-2652711)

7. KCI Clinical Systems, Inc., a Delaware corporation
(Tax ID #74-2675416) [DISSOLVED 09/22/97]

8. KCI Holding Company, Inc., a Delaware corporation
(Tax ID #74-2804102)

9. Plexus Enterprises, Inc., a Delaware corporation
(Tax ID #74-2814710)

10. The Kinetic Concepts Foundation, a Texas non-profit corporation (Tax ID# 74-282-2321)

11. KCI-RIK Acquisition Corp., a Delaware corporation
(Tax ID# ###-##-####)

12. KCI International, Inc., a Delaware corporation
(Tax ID #51-0307888)

    (a) KCI Medical Canada, Inc., a Canadian corporation

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(b) KCI Medical Ltd., a United Kingdom corporation (formerly Mediscus International Limited), name change effective October 31, 1995

NOTE: All assets of KCI Medical United Kingdom Limited and Mediscus Products Limited are being transferred to KCI Medical Limited effective January 1, 1996.

DORMANT UK COMPANIES:

(i) KCI Medical United Kingdom Limited
(ii) Mediscus Products Limited
(iii) Home-Care Medical Products Limited (formerly KCII Medical Limited)

NOTE: Home-Care Medical and KCII Medical swapped names in October, 1995. KCII Medical Limited was formerly Lingard Leasing.

(c) KCI Medical Holding GmbH (formerly KCI Handels GmbH)

(i) KCI Mediscus Produkte GmbH
(ii) KCI Therapie Gerate mbH (formerly Verwalt)

(d) Equipement Medical KCI, S.A.R.L., a French corporation

(e) KCI Medical B.V., a Netherlands corporation

(f) KCI Mediscus AG, a Swiss corporation

(g) KCI Mediscus Klinikausstattung Gesellschaft mbH with domicile in Vienna

(h) KCI Europe Holding B.V., a Netherlands corporation

(i) KCI International-Virgin Islands, Inc., a Virgin Islands corporation

(j) KCI Medica Espana, S.A., a Spanish corporation

(k) KCI Medical Australia PTY, Ltd., an Australian corporation

(l) KCI Medical S.r.l., an Italian corporation

(m) KCI Medical A/S, Denmark

(n) KCI Medical AB, Sweden

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(o) Ethos Medical Group Ltd., an Irish Company, Athlone, Ireland

(p) KCI Equi-Tron Inc., a Canadian corporation

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Consent of Independent Auditors

We consent to incorporation by reference in the Registration Statements (Form S-8) pertaining to the 1987 Kinetic Concepts, Inc. Key Contributor Stock Option Plan (No. 33-59667), the Senior Executive Stock Option Plan (No. 333-24195), the 1997 Employee Stock Purchase Plan (No. 333-24197) and the Kinetic Concepts, Inc. 1997 Stock Incentive Plan (No. 333-35345) of our report dated February 6, 1998, with respect to the consolidated financial statements and schedule of Kinetic Concepts, Inc. and Subsidiaries included in the Annual Report (Form 10-K) for the year ended December 31, 1997.

/s/ ERNST & YOUNG LLP

Ernst & Young LLP

San Antonio, Texas
March 27, 1998

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Independent Auditors' Consent

The Board of Directors
Kinetic Concepts, Inc.:

We consent to incorporation by reference in the Registration Statements (No. 33-59667, No. 333-24195, No. 333-24197 and No. 333-35345) on Form S-8 of Kinetic Concepts, Inc. and subsidiaries (the "Company") of our reports dated February 5, 1997, relating to the consolidated balance sheet of the Company as of December 31, 1996, and the related consolidated statements of earnings, shareholders' equity, and cash flows for each of the years in the two-year period ended December 31, 1996, and related financial statement schedule as of and for each of the years in the two-year period ended December 31, 1996, which reports appear in the December 31, 1997 annual report on Form 10-K of the Company.

/s/ KPMG PEAT MARWICK LLP

KPMG Peat Marwick LLP

San Antonio, Texas
March 30, 1998

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<OTHER-SE>	(275,715,108)
<TOTAL-LIABILITY-AND-EQUITY>	351,150,705
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<CGS>	23,673,210
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<INTEREST-EXPENSE>	10,172,835
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<INCOME-CONTINUING>	12,604,999
<DISCONTINUED>	0
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<EPS-DILUTED>	$0.32

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