FORM 10-Q

Quarterly report pursuant to sections 13 or 15(d)

Filing Date: **1996-11-14** | Period of Report: **1996-09-30**
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FILER

KINETIC CONCEPTS INC /TX/

CIK:**831967**| IRS No.: **741891727** | State of Incorp.:**TX** | Fiscal Year End: **1231**
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SIC: **2590** Miscellaneous furniture & fixtures

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SECURITIES AND EXCHANGE COMMISSION Washington, D.C. 20549

Form 10-Q

(Mark One)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly period ended September 30, 1996

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

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, Texas 78230	(210) 524-9000
(Address of principal executive offices and zip code)	(Registrant's phone number)

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 the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common Stock: 43,189,860 shares as of October 31, 1996

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

	September 30, 1996 (unaudited)	December 31, 1995
Assets:		
Current assets:		
Cash and cash equivalents.................	$ 66,981	$ 52,399
Accounts receivable, net..................	56,939	56,032
Inventories...............................	21,100	18,854
Note receivable from principal shareholder	--	10,291
Prepaid expenses and other assets.........	9,562	4,865
Total current assets..................	154,582	142,441
Net property, plant and equipment.........	65,388	62,276
Other notes receivable, net...............	3,187	3,187
Goodwill, net.............................	13,844	13,968
Other assets, net.........................	21,428	21,854
	$258,429	$243,726

Liabilities and Shareholders' Equity:

Current liabilities:

Accounts payable	$ 3,898	$ 2,512
Accrued expenses	29,058	26,490
Income taxes payable	4,591	4,026
Total current liabilities	37,547	33,028
Capital lease obligations	543	--
Deferred income taxes, net	1,389	374
	39,479	33,402
Shareholders' equity:		
Common stock; issued and outstanding 43,823 in 1996 and 44,331 in 1995	44	44
Additional paid-in capital	218	12,123
Retained earnings	218,162	197,290
Cumulative foreign currency translation adjustment	859	1,052
Notes receivable from officers	(333)	(185)
	218,950	210,324
	$258,429	$243,726

See accompanying notes to condensed consolidated financial statements.

ITEM 1. FINANCIAL STATEMENTS (CONTINUED)

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

	Three months ended September 30,		Nine months ended September 30,	
	1996	1995	1996	1995
Revenue:				
Rental and service	$56,638	$53,284	$167,523	$152,138
Sales and other	11,332	8,322	32,306	26,285
Total revenue	67,970	61,606	199,829	178,423

Rental expenses...............	36,405	34,057	109,263	102,009
Cost of goods sold...........	3,856	2,750	11,685	10,979
	------	------	-------	-------
	40,261	36,807	120,948	112,988
	------	------	-------	-------
Gross profit..............	27,709	24,799	78,881	65,435
Selling, general and administrative expenses.....	14,080	12,065	38,791	34,407
	------	------	-------	-------
Operating earnings........	13,629	12,734	40,090	31,028
Net interest income..........	1,063	2,406	2,937	3,496
	------	------	-------	-------
Earnings before income taxes..................	14,692	15,140	43,027	34,524
Income taxes..................	5,834	6,605	17,168	14,175
	------	------	-------	-------
Net earnings..............	$ 8,858	$ 8,535	$ 25,859	$20,349
	======	======	=======	======
Earnings per common and common equivalent share	$ 0.19	$ 0.19	$ 0.56	$ 0.45
	======	======	=======	======
Shares used in earnings per share computations	45,553	45,570	45,923	45,306
	======	======	======	======

See accompanying notes to condensed consolidated financial statements.

ITEM 1. FINANCIAL STATEMENTS (CONTINUED)

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

	Nine months ended September 30,	
	1996	1995
	---------	--------
Cash flows from operating activities:		
Net earnings....................................	$ 25,859	$ 20,349

Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	16,487	16,803
Provision for uncollectible accounts receivable	2,327	1,025
Loss on KCIFS disposition	--	2,933
Change in assets and liabilities:		
Decrease (increase) in accounts receivable	(3,159)	2,001
Decrease in notes receivable	--	5,343
Increase in inventories	(2,174)	(4,800)
Increase in prepaid and other assets	(4,696)	(1,219)
Increase in accounts payable	1,460	1,163
Increase in accrued expenses	2,604	526
Increase (decrease) in income taxes payable	968	(4,442)
Increase in deferred income taxes	613	4,469
Net cash provided by operating activities	40,289	44,151
Cash flows from investing activities:		
Additions to property, plant, and equipment	(18,287)	(25,190)
Decrease in inventory to be converted into equipment for short-term rental	(850)	(2,250)
Dispositions of property, plant, and equipment	1,400	516
Proceeds from KCIFS disposition	--	7,182
Decrease in finance lease receivables, net	--	339
Decrease (increase) in note receivable from principal shareholder	10,000	(10,000)
Increase in other assets	(961)	(4,333)
Net cash used by investing activities	(8,698)	(33,736)
Cash flows from financing activities:		
Repayments of note payable and long-term obligations	488	(860)
Proceeds from the exercise of stock options	4,694	2,708
Purchase and retirement of treasury stock	(16,599)	(1,251)
Cash dividends paid to shareholders	(4,988)	(4,971)
Other	(147)	--
Net cash used by financing activities	(16,552)	(4,374)
Effect of exchange rate changes on cash and cash equivalents	(457)	571
Net increase in cash and cash equivalents	14,582	6,612
Cash and cash equivalents, beginning of year	52,399	43,241
Cash and cash equivalents, end of period	$66,981	$49,853

Supplemental disclosure of cash flow information:		
Cash paid during the first nine months for:		
Interest..................................	112	362
Income taxes..............................	10,544	11,577

See accompanying notes to condensed consolidated financial statements.

ITEM 1. FINANCIAL STATEMENTS (CONTINUED)

KINETIC CONCEPTS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

(1) BASIS OF PRESENTATION

The financial statements presented herein include the accounts of Kinetic Concepts, Inc. and all subsidiaries (the "Company"). The foregoing financial information reflects all adjustments (consisting only of normal recurring adjustments) which are, in the opinion of management, necessary for a fair presentation of the financial position and results of operations for the interim periods presented. Interim period operating results are not necessarily indicative of the results to be expected for the full fiscal year.

(2) INVENTORY COMPONENTS

Inventories are stated at the lower of cost (first-in, firstout) or market (net realizable value). Inventories are comprised of the following (in thousands):

	September 30, 1996	December 31, 1995
Finished goods...................	$ 3,594	$ 2,890
Work in progress.................	2,607	1,040
Raw materials, supplies and parts	20,999	20,174
	27,200	24,104
Less amounts expected to be converted into equipment for short-term rental................	6,100	5,250
Total inventories...........	$21,100	$18,854

====== ======

(3) SHARES USED IN EARNINGS PER COMMON AND COMMON EQUIVALENT SHARE COMPUTATIONS

The weighted average number of common and common equivalent shares used in the computation of earnings per share is as follows (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	1996	1995	1996	1995
Average outstanding common shares............	43,966	44,238	44,209	44,144
Average common equivalent shares-dilutive effect of option shares............	1,587	1,332	1,714	1,162
Shares used in earnings per share computations...	45,553	45,570	45,923	45,306

ITEM 1. FINANCIAL STATEMENTS (CONTINUED)

KINETIC CONCEPTS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

Earnings per common and common equivalent share are computed by dividing net earnings by the weighted average number of common and dilutive common equivalent shares outstanding during the period. Dilutive common equivalent shares consist of stock options (using the treasury stock method). Earnings per share computed on a fully diluted basis is not presented as it is not significantly different from earnings per share computed on a primary basis.

(4) 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. Discovery in this case has been substantially completed. 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.

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' federal 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.

The Company maintains an investment in a Limited Partnership which invests in securities, primarily in small to mid-sized companies which have or may have the potential to provide quality products or services to healthcare organizations and providers. The Company's investment as of December 31, 1995 was $150,000; however, the Company is committed to invest a maximum of $1.5 million with the Partnership. The committed balance is callable by the General Partner, as needed by the Partnership, on 30 days prior written notice.

(5) NEW PRONOUNCEMENTS

Effective with the first quarter of 1996, the Company has adopted Statement of Financial Accounting Standards No. 121 "Accounting for the Impairment of Long-Lived Assets and for LongLived Assets to be Disposed of." Statement 121 requires that long-lived assets and certain identifiable intangibles to be held and used by an entity be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Adoption of this new pronouncement had no effect on the financial statements for the period.

KINETIC CONCEPTS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

During October 1995, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123 "Accounting for Stock-Based Compensation," effective for fiscal years beginning after December 15, 1995. The new 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 will be required to provide expanded disclosures in footnotes to the financial statements. The Company has elected to continue to account for its employee stock compensation plans as prescribed under APB Opinion 25 and will make the pro forma footnote disclosure of net income and earnings per share required by Statement 123 beginning with its financial statements for the year ended December 31, 1996.

(6) SUBSEQUENT EVENT

Subsequent to September 30, 1996, the Company negotiated the prepayment of all remaining notes received 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. The notes were retired during October 1996 for $8.75 million plus accrued interest through closing.

Independent Auditors' Report

The Board of Directors
Kinetic Concepts, Inc.:

We have reviewed the condensed consolidated balance sheet of Kinetic Concepts, Inc. and subsidiaries as of September 30, 1996, and the related condensed consolidated statements of earnings for the three and nine month periods ended September 30, 1996 and 1995 and the condensed consolidated statements of cash flows for the nine month periods ended September 30, 1996 and 1995. These condensed consolidated financial statements are the responsibility of the Company's management.

We conducted our review in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists principally of applying analytical review procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the condensed consolidated financial statements referred to above for them to be in conformity with generally accepted accounting principles.

We have previously audited, in accordance with generally accepted auditing standards, the consolidated balance sheet of Kinetic Concepts, Inc. and subsidiaries as of December 31, 1995, and the related consolidated statements of earnings, capital accounts, and cash flows for the year then ended (not presented herein); and in our report dated February 6, 1996, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 1995, is fairly presented, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ KPMG PEAT MARWICK LLP

KPMG Peat Marwick LLP

San Antonio, Texas
October 15, 1996

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Results of Operations

Third Quarter of 1996 Compared to Third Quarter of 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 third quarter of the prior year ($ in thousands):

	Three Months Ended September 30,			
	Revenue Relationship		Variance Increase (Decrease)	
	1996	1995	$	Pct
Revenue:				
Rental and service..........	83%	86%	$ 3,354	6%
Sales and other.............	17%	14%	3,010	36%
	100%	100%	6,364	10%
Rental expenses...............	54%	55%	2,348	7%
Cost of goods sold...........	5%	5%	1,106	40%
Gross profit...............	41%	40%	2,910	12%
Selling, general and administrative expenses.....	21%	19%	2,015	17%
Operating earnings..........	20%	21%	895	7%
Net interest income...........	2%	4%	(1,343)	(56%)
Earnings before income taxes	22%	25%	(448)	(3%)
Income taxes..................	9%	11%	(771)	(12%)
Net earnings................	13%	14%	$ 323	4%

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

	Three months ended September 30, 1996	1995
Acute/Extended........	$ 42.8	$ 38.9
Home Care.............	3.1	3.6
International.........	17.4	15.2
Medical Devices.......	4.6	3.8
Other.................	.1	.1
	$ 68.0	$ 61.6

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

Total revenue in the third quarter of 1996 increased by $6.4 million, or 10.3%, to $68.0 million from $61.6 million in the third quarter of 1995. Revenue from the Company's specialty patient surface business was $45.9 million, up $3.4 million, or 8.2%, from the third quarter of 1995. This increase was due to the success of the TriaDyne specialty bed and the addition of various national accounts which contributed to market share gains. In addition, the Company experienced significant growth in the extended care (nursing and rehabilitation) segment due to the addition of various new national accounts as well as the continuing growth of patients in these lower cost and lower acuity care settings. Revenue in the Home Care segment was down from the prior-year period primarily due to a change in Medicare reimbursement policy.

Revenue from the Company's international operations was $17.4 million, up 14.4% from the third quarter of 1995. On a local currency basis, excluding the effect of currency fluctuations, revenue increased by 10% compared to the 1995 quarter. Increased rental market penetration and increased sales contributed to the higher revenue.

Revenue from medical device operations increased approximately $700,000, or 18.8%, due substantially to the successful introduction of the V.A.C. therapy to the domestic market. Revenue from the PlexiPulse foot/calf compression device was consistent with the 1995 quarter as this product continues its transition toward a more salesoriented market. With the shift from rentals to sales, the Company has experienced additional pricing pressures on this product.

Rental expenses were 64.3% of rental revenue in the third quarter of 1996 compared to 63.9% in the third quarter of 1995. This increase is primarily attributable to increased field marketing costs and the shift towards sales in the medical devices segment. Field expenses in the medical devices segment remained flat year to year.

Gross profit increased $2.9 million, or 11.7%, to $27.7 million in the third quarter of 1996 from $24.8 million in the third quarter of 1995 due to the increase in revenue and controlled growth in rental expenses.

Selling, general and administrative expenses of $14.1 million increased $2.0 million from the third quarter of 1995. As a percentage of total revenue, selling, general and administrative expenses were at 21% in the third quarter of 1996 as compared with 19% in the third quarter of 1995. Items contributing to this increase include higher sales commissions, legal and professional fees, and marketing costs.

Operating earnings for the period increased $895,000, or 7.0%, to $13.6 million, resulting largely from the revenue growth described above.

Net interest income for the three months ended September 30, 1996 was $1.1 million compared to $2.4 million in the prior year. This decrease was due to interest recognized in 1995 on a note receivable obtained in the Medical Services sale which was repaid in 1995. Subsequent to September 30, 1996, the Company negotiated the prepayment of all remaining notes receivable from the sale of Medical Services. The notes, with an aggregate face value of $10 million, had been carried at a discounted book value of $3.2 million. See note(6) to the condensed consolidated financial statements for further discussion.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

The Company's effective income tax rate in the third quarter of 1996 was 39.7%, down from the prior year rate of 43.6% due primarily to implementation of various foreign tax strategies in the current year.

Net earnings increased $300,000, or 3.8%, to $8.9 million in the third quarter of 1996. This increase was due primarily to the change in revenue and income tax rates as discussed above.

First Nine Months of 1996 Compared to First Nine Months of 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 first nine months of the prior year ($ in thousands):

	Nine Months Ended September 30,			
	Revenue Relationship		Variance Increase (Decrease)	
	1996	1995	$	Pct
Revenue:				
Rental and service.........	84%	85%	$15,385	10%
Sales and other............	16%	15%	6,021	23%
	100%	100%	21,406	12%
Rental expenses..............	55%	57%	7,254	7%
Cost of goods sold..........	6%	7%	706	6%
Gross profit...............	39%	36%	13,446	21%
Selling, general and administrative expenses....	19%	19%	4,384	13%
Operating earnings.........	20%	17%	9,062	29%
Net interest income..........	2%	2%	(559)	(16%)
Earnings before income taxes	22%	19%	8,503	25%
Income taxes.................	9%	8%	2,993	21%
Net earnings.................	13%	11%	$ 5,510	27%

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

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

	Nine months ended September 30, 1996	Nine months ended September 30, 1995
Acute/Extended.....	$ 125.0	$ 108.5
Home Care..........	9.4	10.4
International......	51.6	44.7
Medical Devices....	13.6	11.7
Other (1)..........	.2	3.1
	$ 199.8	$ 178.4

(1) Consists of revenue of KCIFS, MRD and other sales in 1995.

Total revenue for the first nine months of 1996 increased by $21.4 million or 12.0%, to $199.8 million. Revenue from the Company's specialty patient surface business was $134.4 million, up $15.5 million, or 13.0%, from the nine months ended September 30, 1995. This increase was due to new product introductions, primarily the TriaDyne and BariKare, combined with increased patient days in the extended care market due, in part, to the addition of various national accounts. Revenue in the Home Care segment decreased $1.0 million from the prior-year period. Revenue from the Company's international operations was $51.6 million, up 15.4% from the nine months ended September 30, 1995. On a local currency basis, excluding exchange rate fluctuations, revenue from the international segment increased nearly 19%. Increased market penetration and increased sales contributed towards the higher revenue. Revenue from medical device operations in the first nine months of 1996 increased $1.9 million, or 16.2% compared to the prior year. The Company's VAC therapy device, launched earlier this year, accounted for substantially all of this increase.

Rental expenses were 65.2% of total rental revenue in the nine months ended September 30, 1996 compared to 67.1% in the nine months of 1995. This decrease is primarily attributable to the increase in rental revenue, as the majority of rental expenses are relatively fixed, combined with certain operating efficiencies.

Gross profit increased $13.4 million, or 20.6%, to $78.9 million in the nine months ended September 30, 1996 due primarily to the increase in revenue and controlled growth in rental expenses.

Selling, general and administrative expenses increased $4.4 million, or 12.7%, to $38.8 million in the first nine months of 1996 from $34.4 million in the first nine months of 1995. As a percentage of total revenue, selling, general and administrative expenses were at 19% in the first nine months ended September 30, 1996 which was comparable with the 19% in the first nine months of 1995. Investments in marketing programs, computer systems and higher legal and professional fees comprised the majority of the spending increase.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

Operating earnings for the period increased $9.1 million, or 29.2%, to $40.1 million compared to $31.0 million in the prior year resulting largely from the above-mentioned revenue growth.

Net interest income for the nine months ended September 30, 1996 was $2.9 million compared to $3.5 million in the prior year. This decrease was due to interest recognized on a note receivable obtained in a sale of assets in the prior year which was repaid in 1995.

The Company's effective income tax rate in the first nine months ended September 30, 1996 was 39.9% as compared to 41.1% in the first nine months of 1995.

Net earnings increased $5.5 million, or 27.1%, to $25.9 million in the first nine months of 1996. This increase was due to the relative decrease in rental expenses and the change in revenue as discussed above.

Impact of Inflation

The Company does not believe that inflation had a material impact on sales or expenses during the period. Increases in labor, raw materials or other operating costs, however, could significantly affect the Company's operations. The majority of these costs are relatively fixed in nature and the Company has generally been able to maintain margins despite changing prices or reimbursement rates.

Financial Condition

The change in revenue and expenses experienced by the Company during the nine months ended September 30, 1996 and other factors resulted in changes to the Company's balance sheet as follows:

Inventory at September 30, 1996 increased $2.2 million, or 11.9%, to $21.1 million from $18.9 million at December 31, 1995 primarily due to new product introductions and international market expansion. In late 1995, the Company began operations in both Italy and Scandinavia and inventory levels in Germany increased to support strong sales demand for the TheraCare and FirstStep mattress overlays. In addition, during the second quarter, the Company acquired a small mattress overlay manufacturer in the United Kingdom, Astec Medical Ltd., which carried inventory of approximately $400,000.

The note receivable from principal shareholder at December 31, 1995 of $10.3 million, including accrued interest, was collected in full during the first quarter of 1996.

Net property, plant and equipment at September 30, 1996 increased $3.1, or 5.0%, to $65.4 million from $62.3 million at December 31, 1995 due to additions to rental equipment and computer systems in excess of depreciation and dispositions. Net capital expenditures were $17.7 million during the first nine months of 1996 as the Company invested in new products for its rental fleet and new computer systems.

Additional paid-in capital decreased $11.9 million, or 98.2%, during the first nine months of 1996 due primarily to the purchase and retirement of approximately 1.1 million shares of common stock under a program which authorizes the Company to purchase up to 3 million shares of its stock.

Market Trends

The health care industry is facing various challenges, including increased pressure on health care providers to control costs, the accelerating migration of patients from acute care facilities into extended care (e.g. skilled nursing facilities and rehabilitation centers) and home care settings, the consolidation of health care providers and national and regional group purchasing organizations and the growing demand for clinically proven and cost effective therapies. In addition, Congress continues to debate federal health care expenditures in an attempt to slow the rate of growth of those expenditures. Recently, there have been heightened indications that the federal Medicare program will move towards a prospective payment system for skilled nursing facilities and that such a system may eventually be adopted for home care.

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 average daily rental rates on its products. These industry trends, together with the increasing migration of patients from acute care to extended and home care settings, have made the acute care market for the Company's products increasingly competitive. The Company expects these industry trends to continue. The Company has addressed these trends by increasing its marketing efforts beyond its existing base of more than 1000 acute care hospitals to market to an additional 2000 medium to large hospitals in which the Company has a relatively small presence. The Company further believes that the TriaDyne and BariKare beds have enabled it to further penetrate this market.

The Company contracts with both proprietary and voluntary group purchasing organizations ("GPO's"). Proprietary GPO's own all of the hospitals which they represent and, as a result, can ensure member compliance with an executed national agreement. Voluntary GPO's negotiate contracts on behalf of member hospital organizations but cannot ensure that their members will comply with the terms of an executed national agreement. The Company has a voluntary GPO agreement with American Healthcare Systems ("AMHS") which runs through March 31, 1998 and which accounted for approximately 7.5% of the Company's total revenue during the first nine months of 1996. Earlier this year, AMHS merged with Premier and the Sunhealth Alliance, to form the largest group purchasing organization in the U.S.

As a result of the merger, the Company has been informed that the AMHS, Premier and Sunhealth contracts, which together account for approximately 11% of total revenue, will be terminated as of January 1, 1997 and a contract for the new Premier organization has been put out for bid.

The Company believes that it has 30-35% of the existing Premier members under contract and that its principal competitor has 55-60% of the existing Premier members under contract. The entity who is awarded the contract will, in all probability, be able to convert a significant number of its competitor's customers.

However, because Premier is a voluntary group purchasing organization, such conversions will not happen immediately and the competing entity should be able to maintain a number of its existing customers. In order to do so, the competing entity may be required to offer better pricing or terms to its existing customers. If the Company is not awarded the Premier contract, the Company believes that it will be able to continue to grow its domestic specialty bed revenue base. This belief is based upon the fact that: i) the Company recently signed a proprietary group purchasing agreement with Tenet Healthcare Corporation, the second largest proprietary group purchasing organization in the United States, ii) the Company has recently been awarded a position in the VHA Opportunity Program, iii) the Company has been successful in converting a number of competitive accounts under its Acute 2000 marketing program and in the extended care market.

During 1996, sales have increased as a portion of the Company's revenue. 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 systems. In addition, international health care providers tend to purchase products more often than U.S. health care providers, and the Company's revenue from international operations represents an increasing portion of the Company's total revenue.

Legal Proceedings

The Company is party to several lawsuits arising in the ordinary course of its business and is contesting adjustments proposed by the Internal Revenue Service to prior years' tax returns. Provisions have been made in the Company's financial statements for estimated exposures related to these lawsuits and adjustments. See "Item 1. Financial Statements". In the opinion of management, the disposition of these items 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 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 currently maintains umbrella liability insurance coverage.

Liquidity and Capital Resources

During the nine months ended September 30, 1996, the Company generated net cash provided by operating activities of $40.3 million compared to $44.2 million in the prior year period. The decrease in operating cash flow resulted primarily from short-term swings in current assets, e.g. receivables, as net earnings were up $5.5 million from the year-ago period. Total net capital expenditures of $17.7 million through September 1996 were down $9.2 million, or 34.1%, from the prior year. Capital additions in 1995 included a significant investment related to the TriaDyne product launch.

At September 30, 1996, cash and cash equivalents totaling $67.0 million were available for general corporate purposes. Additionally, the Company maintains a Credit Agreement with a bank as an agent for itself and certain other financial institutions. The Credit Agreement currently permits borrowings of up to $50 million. At September 30, 1996, the entire amount of the Credit Agreement was available. The Company believes that current cash reserves combined with operating cash flows and available credit facilities during the next twelve month period will be sufficient to provide for new investments, e.g., business acquisitions, technology or equipment, and any working capital needed during the period.

Forward-looking Statements

This Report includes "forward-looking statements" within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. All statements other than statements of historical fact included in this report regarding the Company's financial position, business strategy, and plans and objectives of management for future operations, are forward-looking statements that involve risks and uncertainties. Although the Company believes that the expectations and assumptions reflected in such forward-looking statements are reasonable, it can give no assurance that such expectations and assumptions will prove to have been correct. In addition to the factors discussed above, among the factors that could cause actual results to differ materially from the Company's expectations ("Cautionary Statements") are the following: the impact of health care reform, significant changes in health care reimbursement (including the adoption of a prospective payment system for Medicare patients in skilled nursing facilities and the home), the loss or gain of a material national group purchasing account as a result of further industry consolidation or otherwise, a material change in foreign exchange rates and a material increase in the level of competition in the markets we serve.

PART II - OTHER INFORMATION

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) EXHIBITS

A list of all exhibits filed or included as part of this quarterly report on Form 10-Q is as follows:

EXHIBIT	BY REFERENCE	DESCRIPTION
15	Filed herewith	Letter from KPMG Peat Marwick LLP dated November 14, 1996
27	Filed herewith	Financial Data Schedule

(b) REPORTS ON FORM 8-K

No reports on Form 8-K have been filed during the quarter for which this report is filed.

SIGNATURES

Pursuant to the requirements 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.

KINETIC CONCEPTS, INC.
(REGISTRANT)

By: /s/ JAMES R. LEININGER, M.D.

James R. Leininger, M.D.
Chairman of the Board

By: /s/ RAYMOND R. HANNIGAN

Raymond R. Hannigan
President and Chief Executive Officer

By: /s/ BIANCA A. RHODES

Bianca A. Rhodes
Senior Vice President,
Chief Financial Officer and
Chief Accounting Officer

Date: November 14, 1996

Kinetic Concepts, Inc.
San Antonio, Texas

Gentlemen:

Re: Registration Statement Nos. 33-26673, 33-26674

With respect to the subject registration statements, we acknowledge our awareness of the use therein of our report dated October 15, 1996 related to our review of interim financial information.

Pursuant to Rule 436 (c) under the Securities Act of 1933, such report is not considered a part of a registration statement prepared or certified by an accountant or a report prepared or certified by an accountant within the meaning of sections 7 and 11 of the Act.

Very truly yours,

/s/ KPMG PEAT MARWICK LLP

KPMG Peat Marwick LLP

San Antonio, Texas
November 14, 1996

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