

MAGELLAN HEALTH SERVICES INC
Form 10-Q
April 27, 2012

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

FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended March 31, 2012

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 No. 1-6639**

MAGELLAN HEALTH SERVICES, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

58-1076937
(IRS Employer
Identification No.)

55 Nod Road, Avon, Connecticut
(Address of principal executive offices)

06001
(Zip code)

(860) 507-1900

(Registrant's telephone number, including area code)

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 twelve 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 No

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

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

(Do not check if a smaller
reporting company)

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

The number of shares of the registrant's Ordinary Common Stock outstanding as of March 31, 2012 was 27,312,812.

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MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES

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Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements.****MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS****(In thousands, except per share amounts)**

	December 31, 2011	March 31, 2012 (unaudited)
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 119,862	\$ 171,571
Restricted cash	185,794	184,942
Accounts receivable, less allowance for doubtful accounts of \$3,336 and \$3,729 at December 31, 2011 and March 31, 2012, respectively	121,606	133,712
Short-term investments (restricted investments of \$129,599 and \$130,666 at December 31, 2011 and March 31, 2012, respectively)	192,947	161,766
Deferred income taxes	35,138	34,926
Pharmaceutical inventory	39,567	43,069
Other current assets (restricted deposits of \$20,453 and \$22,322 at December 31, 2011 and March 31, 2012, respectively)	37,795	32,294
Total Current Assets	732,709	762,280
Property and equipment, net	118,022	120,220
Long-term investments (restricted investments of \$7,956 and \$2,471 at December 31, 2011 and March 31, 2012, respectively)	7,956	2,471
Other long-term assets	10,952	10,148
Goodwill	426,939	426,939
Other intangible assets, net	44,589	42,103
Total Assets	\$ 1,341,167	\$ 1,364,161
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	\$ 18,690	\$ 17,447
Accrued liabilities	106,809	81,328
Medical claims payable	137,973	166,232
Other medical liabilities	106,078	97,020
Total Current Liabilities	369,550	362,027
Deferred income taxes	18,509	20,702
Tax Contingencies	102,919	104,012
Deferred credits and other long-term liabilities	4,915	4,687
Total Liabilities	495,893	491,428
Preferred stock, par value \$.01 per share		
Authorized 10,000 shares Issued and outstanding none		
Ordinary common stock, par value \$.01 per share		
Authorized 100,000 shares at December 31, 2011 and March 31, 2012 Issued and outstanding 45,285 shares and 27,173 shares at December 31, 2011, respectively, and 45,425 and 27,313 shares at March 31, 2012, respectively	453	454
Multi-Vote common stock, par value \$.01 per share		
Authorized 40,000 shares Issued and outstanding none		
Other Stockholders' Equity:		
Additional paid-in capital	804,035	810,530
Retained earnings	824,205	844,995
Accumulated other comprehensive (loss) income	(150)	23

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Ordinary common stock in treasury, at cost, 18,112 shares and 18,112 shares at December 31, 2011 and March 31, 2012, respectively	(783,269)	(783,269)
Total Stockholders' Equity	845,274	872,733
Total Liabilities and Stockholders' Equity	\$ 1,341,167	\$ 1,364,161

See accompanying notes to consolidated financial statements.

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MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

FOR THE THREE MONTHS ENDED MARCH 31,

(Unaudited)

(In thousands, except per share amounts)

	2011	2012
Net revenue	\$ 692,755	\$ 773,213
Cost and expenses:		
Cost of care	433,700	505,293
Cost of goods sold	56,519	81,038
Direct service costs and other operating expenses(1)	131,567	136,589
Depreciation and amortization	13,952	14,781
Interest expense	471	600
Interest income	(815)	(412)
	635,394	737,889
Income before income taxes	57,361	35,324
Provision for income taxes	23,063	14,534
Net income	\$ 34,298	20,790
Net income per common share basic (See Note B)	\$ 1.04	\$ 0.76
Net income per common share diluted (See Note B)	\$ 1.02	\$ 0.75
Other comprehensive income		
Unrealized gains on available-for-sale securities(2)	97	173
Comprehensive income	\$ 34,395	\$ 20,963

(1) Includes stock compensation expense of \$4,778 and \$5,102 for the three months ended March 31, 2011 and 2012, respectively.

(2) Net of income tax provision of \$61 and \$111 for the three months ended March 31, 2011 and 2012, respectively.

See accompanying notes to consolidated financial statements.

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MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE THREE MONTHS ENDED MARCH 31,

(Unaudited)

(In thousands)

	2011	2012
Cash flows from operating activities:		
Net income	\$ 34,298	\$ 20,790
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	13,952	14,781
Non-cash interest expense	107	177
Non-cash stock compensation expense	4,778	5,102
Non-cash income tax (benefit) expense	(472)	3,017
Non-cash amortization on investments	3,228	1,760
Cash flows from changes in assets and liabilities, net of effects from acquisitions of businesses:		
Restricted cash	15,623	852
Accounts receivable, net	(6,144)	(12,106)
Pharmaceutical inventory	(17,878)	(3,502)
Other assets	14,448	6,437
Accounts payable and accrued liabilities	(25,792)	(26,724)
Medical claims payable and other medical liabilities	(10,122)	19,201
Other	3,242	(216)
Net cash provided by operating activities	29,268	29,569
Cash flows from investing activities:		
Capital expenditures	(10,090)	(14,505)
Purchase of investments	(179,772)	(61,977)
Maturity of investments	73,015	97,168
Acquisitions and investments in businesses, net of cash acquired	(274)	
Net cash (used in) provided by investing activities	(117,121)	20,686
Cash flows from financing activities:		
Proceeds from issuance of equity	20,000	
Payments to acquire treasury stock	(122,071)	
Proceeds from exercise of stock options and warrants	8,016	2,197
Other	(563)	(743)
Net cash (used in) provided by financing activities	(94,618)	1,454
Net (decrease) increase in cash and cash equivalents	(182,471)	51,709
Cash and cash equivalents at beginning of period	337,179	119,862
Cash and cash equivalents at end of period	\$ 154,708	\$ 171,571

See accompanying notes to consolidated financial statements.

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MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2012

(Unaudited)

NOTE A General

Basis of Presentation

The accompanying unaudited consolidated financial statements of Magellan Health Services, Inc., a Delaware corporation ("Magellan"), include the accounts of Magellan, its majority owned subsidiaries, and all variable interest entities ("VIEs") for which Magellan is the primary beneficiary (together with Magellan, the "Company"). The financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the Securities and Exchange Commission's (the "SEC") instructions to Form 10-Q. Accordingly, the financial statements do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments, consisting of normal recurring adjustments considered necessary for a fair presentation, have been included. The results of operations for the three months ended March 31, 2012 are not necessarily indicative of the results to be expected for the full year. All significant intercompany accounts and transactions have been eliminated in consolidation.

The Company has evaluated subsequent events for recognition or disclosure in our consolidated financial statements filed on this Form 10-Q and no events have occurred that require disclosure.

These unaudited consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements for the year ended December 31, 2011 and the notes thereto, which are included in the Company's Annual Report on Form 10-K filed with the SEC on February 28, 2012.

Business Overview

The Company is engaged in the specialty managed healthcare business. Through 2005, the Company predominantly operated in the managed behavioral healthcare business. As a result of certain acquisitions, the Company expanded into radiology benefits management and specialty pharmaceutical management during 2006, and into Medicaid administration during 2009. The Company provides services to health plans, insurance companies, employers, labor unions and various governmental agencies. The Company's business is divided into the following six segments, based on the services it provides and/or the customers that it serves, as described below.

Managed Behavioral Healthcare

Two of the Company's segments are in the managed behavioral healthcare business. This line of business generally reflects the Company's coordination and management of the delivery of behavioral healthcare treatment services that are provided through its contracted network of third-party treatment providers, which includes psychiatrists, psychologists, other behavioral health professionals, psychiatric hospitals, general medical facilities with psychiatric beds, residential treatment centers and other treatment facilities. The treatment services provided through the Company's provider network include outpatient programs (such as counseling or therapy), intermediate care programs (such as intensive outpatient programs and partial hospitalization services), inpatient treatment and crisis intervention services. The Company generally does not directly provide or own any provider of treatment services.

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MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

March 31, 2012

(Unaudited)

NOTE A General (Continued)

The Company provides its management services primarily through: (i) risk-based products, where the Company assumes all or a substantial portion of the responsibility for the cost of providing treatment services in exchange for a fixed per member per month fee, (ii) administrative services only ("ASO") products, where the Company provides services such as utilization review, claims administration and/or provider network management, but does not assume responsibility for the cost of the treatment services, and (iii) employee assistance programs ("EAPs") where the Company provides short-term outpatient behavioral counseling services.

The managed behavioral healthcare business is managed based on the services provided and/or the customers served, through the following two segments:

Commercial. The Managed Behavioral Healthcare Commercial segment ("Commercial") generally reflects managed behavioral healthcare services and EAP services provided under contracts with health plans and insurance companies for some or all of their commercial, Medicaid and Medicare members, as well as with employers, including corporations, governmental agencies, and labor unions. Commercial's contracts encompass risk-based, ASO and EAP arrangements.

Public Sector. The Managed Behavioral Healthcare Public Sector segment ("Public Sector") generally reflects services provided to recipients under Medicaid and other state sponsored programs under contracts with state and local governmental agencies. Public Sector contracts encompass either risk-based or ASO arrangements.

Radiology Benefits Management

The Radiology Benefits Management segment ("Radiology Benefits Management") generally reflects the management of the delivery of diagnostic imaging and other therapeutic services to ensure that such services are clinically appropriate and cost effective. The Company's radiology benefits management services currently are provided under contracts with health plans and insurance companies for some or all of their commercial, Medicaid and Medicare members. The Company also contracts with state and local governmental agencies for the provision of such services to Medicaid recipients. The Company offers its radiology benefits management services through risk-based contracts, where the Company assumes all or a substantial portion of the responsibility for the cost of providing diagnostic imaging services, and through ASO contracts, where the Company provides services such as utilization review and claims administration, but does not assume responsibility for the cost of the imaging services.

Drug Benefits Management

Two of the Company's segments are in the drug benefits management business. This line of business generally reflects the Company's clinical management of drugs paid under medical and pharmacy benefit programs. The Company's services include the coordination and management of the specialty drug spending for health plans, employers, and governmental agencies, and the management

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MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

March 31, 2012

(Unaudited)

NOTE A General (Continued)

of pharmacy programs for Medicaid and other state-sponsored programs. The two segments in this line of business are:

Specialty Pharmaceutical Management. The Specialty Pharmaceutical Management segment ("Specialty Pharmaceutical Management") comprises programs that manage specialty drugs used in the treatment of complex conditions such as, cancer, multiple sclerosis, hemophilia, infertility, rheumatoid arthritis, chronic forms of hepatitis and other diseases. Specialty pharmaceutical drugs represent high-cost injectible, infused, or oral drugs with sensitive handling or storage needs, many of which may be physician administered. Patients receiving these drugs require greater amounts of clinical support than those taking more traditional agents. Payors require clinical, financial and technological support to maximize the value delivered to their members using these expensive agents. The Company's specialty pharmaceutical management services are provided under contracts with health plans, insurance companies, employers, and governmental agencies for some or all of their commercial, Medicare and Medicaid members. The Company's specialty pharmaceutical services include: (i) contracting and formulary optimization programs; (ii) specialty pharmaceutical dispensing operations; and (iii) medical pharmacy management programs.

Medicaid Administration. The Medicaid Administration segment ("Medicaid Administration") generally reflects integrated clinical management services provided to the public sector to manage Medicaid pharmacy, mental health, and long-term care programs. The primary focus of the Company's Medicaid Administration unit involves providing pharmacy benefits administration ("PBA") and pharmacy benefits management ("PBM") services under contracts with health plans and public sector healthcare clients for Medicaid and other state sponsored program recipients. The Company's services include pharmacy point-of-sale claims processing systems and administration, drug utilization review, clinical prior authorization, utilization and formulary management services, Preferred Drug List programs, Maximum Allowable Cost programs, and drug rebate program services. Medicaid Administration's contracts encompass Fee-For-Service ("FFS") arrangements. In addition to Medicaid Administration's FFS contracts, effective September 1, 2010, Public Sector has subcontracted with Medicaid Administration to provide pharmacy benefits management services on a risk basis for one of Public Sector's customers.

Corporate

This segment of the Company is comprised primarily of operational support functions such as sales and marketing and information technology, as well as corporate support functions such as executive, finance, human resources and legal.

Summary of Significant Accounting Policies

Recent Accounting Pronouncements

In May 2011, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2011-04, "Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measuremen