MAGELLAN HEALTH SERVICES INC
Form 10-Q
October 27, 2011

Use these links to rapidly review the document
TABLE OF CONTENTS

Table of Contents

# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-Q

**(Mark One)**

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

**For the Quarterly Period Ended September 30, 2011**

**Or**

o **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** | **58-1076937** |
| (State or other jurisdiction of incorporation or organization) | (IRS Employer Identification No.) |
| **55 Nod Road, Avon, Connecticut** | **06001** |
| (Address of principal executive offices) | (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 ý No o

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 ý No o

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 ý | Accelerated filer o | Non-accelerated filer o<br>(Do not check if a smaller reporting company) | Smaller reporting company o |

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

The number of shares of the registrant's Ordinary Common Stock outstanding as of September 30, 2011 was 28,468,410.

Table of Contents

**FORM 10-Q**

**MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES**

**INDEX**

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, 2010 | September 30, 2011 (unaudited) |
|---|---|---|
| **ASSETS** | | |
| Current Assets: | | |
| Cash and cash equivalents | $ 337,179 | $ 142,365 |
| Restricted cash | 116,734 | 155,559 |
| Accounts receivable, less allowance for doubtful accounts of $1,985 and $2,286 at December 31, 2010 and September 30, 2011, respectively | 106,934 | 114,436 |
| Short-term investments (restricted investments of $114,903 and $140,707 at December 31, 2010 and September 30, 2011, respectively) | 189,530 | 240,753 |
| Deferred income taxes | 28,439 | 33,541 |
| Other current assets (restricted deposits of $21,302 and $21,716 at December 31, 2010 and September 30, 2011, respectively) | 79,671 | 72,460 |
| Total Current Assets | 858,487 | 759,114 |
| Property and equipment, net | 111,814 | 114,904 |
| Long-term investments (restricted investments of $84,950 and $13,396 at December 31, 2010 and September 30, 2011, respectively) | 94,974 | 13,396 |
| Deferred income taxes | 825 | |
| Other long-term assets | 2,396 | 10,036 |
| Goodwill | 426,939 | 426,939 |
| Other intangible assets, net | 53,997 | 47,268 |
| Total Assets | $ 1,549,432 | $ 1,371,657 |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | |
| Current Liabilities: | | |
| Accounts payable | $ 31,878 | $ 19,249 |
| Accrued liabilities | 105,776 | 108,836 |
| Medical claims payable | 142,671 | 140,976 |
| Other medical liabilities | 109,285 | 95,517 |
| Current maturities of long-term capital lease obligation | 559 | 559 |
| Total Current Liabilities | 390,169 | 365,137 |
| Deferred income taxes | | 11,164 |
| Tax contingencies | 117,599 | 109,066 |
| Deferred credits and other long-term liabilities | 2,649 | 6,725 |
| Total Liabilities | 510,417 | 492,092 |
| 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, 2010 and September 30, 2011 Issued and outstanding 43,687 shares and 33,782 shares at December 31, 2010, respectively, and 45,101 and 28,468 shares at September 30, 2011, respectively | 437 | 451 |
| Multi-Vote common stock, par value $.01 per share | | |

| | | | | |
|---|---|---|---|---|
| Authorized 40,000 shares Issued and outstanding none | | | | |
| Other Stockholders' Equity: | | | | |
| Additional paid-in capital | | 725,322 | | 794,845 |
| Retained earnings | | 694,582 | | 794,466 |
| Warrants outstanding | | 420 | | |
| Accumulated other comprehensive income (loss) | | 9 | | (293) |
| Ordinary common stock in treasury, at cost, 9,905 shares and 16,633 shares at December 31, 2010 and September 30, 2011, respectively | | (381,755) | | (709,904) |
| Total Stockholders' Equity | | 1,039,015 | | 879,565 |
| Total Liabilities and Stockholders' Equity | $ | 1,549,432 | $ | 1,371,657 |

See accompanying notes to consolidated financial statements.

3

Table of Contents

**MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF INCOME**

**(Unaudited)**

**(In thousands, except per share amounts)**

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | **2010** | **2011** | **2010** | **2011** |
| Net revenue | $ 750,319 | $ 686,843 | $ 2,220,030 | $ 2,077,936 |
| Cost and expenses: | | | | |
| Cost of care | 467,160 | 448,051 | 1,416,317 | 1,323,197 |
| Cost of goods sold | 55,071 | 57,636 | 166,138 | 167,559 |
| Direct service costs and other operating expenses(1) | 141,581 | 130,038 | 419,452 | 393,384 |
| Depreciation and amortization | 13,950 | 15,069 | 41,607 | 43,288 |
| Interest expense | 482 | 457 | 1,751 | 1,422 |
| Interest income | (846) | (592) | (2,466) | (2,265) |
| | 677,398 | 650,659 | 2,042,799 | 1,926,585 |
| Income before income taxes | 72,921 | 36,184 | 177,231 | 151,351 |
| Provision for income taxes | 28,137 | 4,829 | 71,500 | 51,467 |
| Net income | 44,784 | 31,355 | 105,731 | 99,884 |
| Other comprehensive income (loss) | 280 | (380) | 21 | (302) |
| Comprehensive income | $ 45,064 | $ 30,975 | $ 105,752 | $ 99,582 |
| Weighted average number of common shares outstanding basic (See Note B) | 33,450 | 29,900 | 33,715 | 31,406 |
| Weighted average number of common shares outstanding diluted (See Note B) | 34,171 | 30,438 | 34,345 | 31,988 |
| Net income per common share basic: | $ 1.34 | $ 1.05 | $ 3.14 | $ 3.18 |
| Net income per common share diluted: | $ 1.31 | $ 1.03 | $ 3.08 | $ 3.12 |

(1) Includes stock compensation expense of $3,596 and $4,425 for the three months ended September 30, 2010 and 2011, respectively, and $11,830 and $13,408 for the nine months ended September 30, 2010 and 2011, respectively.

See accompanying notes to consolidated financial statements.

Table of Contents

**MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**FOR THE NINE MONTHS ENDED SEPTEMBER 30,**

**(Unaudited)**

**(In thousands)**

| | 2010 | 2011 |
|---|---|---|
| **Cash flows from operating activities:** | | |
| Net income | $ 105,731 | $ 99,884 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 41,607 | 43,288 |
| Non-cash interest expense | 463 | 320 |
| Non-cash stock compensation expense | 11,830 | 13,408 |
| Non-cash income tax expense | 32,260 | (248) |
| Non-cash amortization (accretion) on investments | 6,851 | 9,660 |
| Cash flows from changes in assets and liabilities, net of effects from acquisitions of businesses: | | |
| Restricted cash | 62,413 | (38,825) |
| Accounts receivable, net | 10,279 | (8,439) |
| Other assets | (4,085) | (751) |
| Accounts payable and accrued liabilities | 889 | (10,216) |
| Medical claims payable and other medical liabilities | (14,085) | (15,463) |
| Other | 126 | 3,501 |
| Net cash provided by operating activities | 254,279 | 96,119 |
| **Cash flows from investing activities:** | | |
| Capital expenditures | (32,201) | (38,468) |
| Acquisitions and investments in businesses, net of cash acquired | | (376) |
| Purchase of investments | (235,420) | (210,890) |
| Maturity of investments | 154,979 | 231,093 |
| Net cash used in investing activities | (112,642) | (18,641) |
| **Cash flows from financing activities:** | | |
| Payments on long-term debt and capital lease obligations | (588) | |
| Payments to acquire treasury stock | (74,427) | (327,886) |
| Proceeds from issuance of equity | | 20,000 |
| Proceeds from exercise of stock options and warrants | 23,121 | 34,755 |
| Other | (1,611) | 839 |
| Net cash used in financing activities | (53,505) | (272,292) |
| Net increase (decrease) in cash and cash equivalents | 88,132 | (194,814) |
| Cash and cash equivalents at beginning of period | 196,507 | 337,179 |
| Cash and cash equivalents at end of period | $ 284,639 | $ 142,365 |

See accompanying notes to consolidated financial statements.

**MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**September 30, 2011**

**(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 nine months ended September 30, 2011 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, 2010 and the notes thereto, which are included in the Company's Annual Report on Form 10-K filed with the SEC on February 25, 2011.

***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 except as related to the Company's contract to provide managed behavioral healthcare services to

Table of Contents

**MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**September 30, 2011**

**(Unaudited)**

**NOTE A General (Continued)**

Medicaid recipients and other beneficiaries of the Maricopa County Regional Behavioral Health Authority (the "Maricopa Contract"). Under the Maricopa Contract, effective August 31, 2007 the Company was required to assume the operations of twenty-four behavioral health direct care facilities for a transitional period and to divest itself of these facilities over a two year period. All of the direct care facilities were divested as of December 31, 2009.

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 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.

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,

Table of Contents

**MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**September 30, 2011**

**(Unaudited)**

**NOTE A General (Continued)**

cancer, multiple sclerosis, hemophilia, infertility, rheumatoid arthritis, chronic forms of hepatitis and other diseases. Specialty pharmaceutical drugs represent high-cost injectible, infused, oral, or inhaled 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, 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; (iii) strategic consulting services; and (iv) 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") services under contracts with states to Medicaid and other state sponsored program recipients. 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 limited 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 January 2010, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update, ("ASU"), No. 2010-24, "Health Care Entities Presentation of Insurance Claims and Related Insurance Recoveries" ("ASU 2010-24"). ASU 2010-24 clarifies that a health care entity should not net insurance recoveries against a related claim liability. Additionally, the amount of the claim liability should be determined without consideration of insurance recoveries. This guidance is effective for fiscal years beginning after December 15, 2010. Accordingly, the Company adopted ASU 2010-24 on January 1, 2011. The adoption of this standard did not have a material impact on the consolidated financial statements.

In June 2011, the FASB issued ASU No. 2011-05, "Comprehensive Income (Topic 220): Presentation of Comprehensive Income" ("ASU 2011-05"). ASU 2011-05 requires an entity to present the total of comprehensive income, the components of net income, and the components of other

Table of Contents

**MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**September 30, 2011**

**(Unaudited)**

**NOTE A General (Continued)**

comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements and eliminates the option to present the components of other comprehensive income as part of the statement of equity. ASU 2011-05 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2011, with early adoption permitted. While the adoption of this guidance is expected to impact the Company's disclosures for annual and interim filings for the year ending December 31, 2012, it will not have an impact on the Company's results of operations or financial condition.

*Use of Estimates*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Significant estimates of the Company include, among other things, accounts receivable realization, valuation allowances for deferred tax assets, valuation of goodwill and intangible assets, medical claims payable, other medical liabilities, stock compensation assumptions, tax contingencies and legal liabilities. Actual results could differ from those estimates.

*Managed Care Revenue*

Managed care revenue, inclusive of revenue from the Company's risk, EAP and ASO contracts, is recognized over the applicable coverage period on a per member basis for covered members. The Company is paid a per member fee for all enrolled members, and this fee is recorded as revenue in the month in which members are entitled to service. The Company adjusts its revenue for retroactive membership terminations, additions and other changes, when such adjustments are identified, with the exception of retroactivity that can be reasonably estimated. The impact of retroactive rate amendments is generally recorded in the accounting period that terms to the amendment are finalized, and that the amendment is executed. Any fees paid prior to the month of service are recorded as deferred revenue. Managed care revenues approximated $610.3 million and $1,784.9 million for the three and nine months ended September 30, 2010, respectively, and $533.3 million and $1,627.9 million for the three and nine months ended September 30, 2011, respectively.

*Fee-For-Service and Cost-Plus Contracts*

The Company has certain FFS contracts, including cost-plus contracts, with customers under which the Company recognizes revenue as services are performed and as costs are incurred. Revenues from fee-for-service and cost-plus contracts approximated $47.0 million and $145.3 million for the three and nine months ended September 30, 2010, respectively, and $45.0 million and $131.3 million for the three and nine months ended September 30, 2011, respectively.

**MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**September 30, 2011**

**(Unaudited)**

**NOTE A General (Continued)**

*Block Grant Revenues*

The Maricopa Contract is partially funded by federal, state and county block grant money, which represents annual appropriations. The Company recognizes revenue from block grant activity ratably over the period to which the block grant funding applies. Block grant revenues were approximately $26.0 million and $82.8 million for the three and nine months ended September 30, 2010, respectively, and $31.8 million and $85.0 million for the three and nine months ended September 30, 2011, respectively.

*Dispensing Revenue*

The Company recognizes dispensing revenue, which includes the co-payments received from members of the health plans the Company serves, when the specialty pharmaceutical drugs are shipped. At the time of shipment, the earnings process is complete; the obligation of the Company's customer to pay for the specialty pharmaceutical drugs is fixed, and, due to the nature of the product, the member may neither return the specialty pharmaceutical drugs nor receive a refund. Revenues from the dispensing of specialty pharmaceutical drugs on behalf of health plans were $58.6 million and $178.3 million for the three and nine months ended September 30, 2010, respectively, and $61.8 million and $178.7 million for the three and nine months ended September 30, 2011, respectively.

*Performance-Based Revenue*

The Company has the ability to earn performance-based revenue under certain risk and non-risk contracts. Performance-based revenue generally is based on either the ability of the Company to manage care for its clients below specified targets, or on other operating metrics. For each such contract, the Company estimates and records performance-based revenue after considering the relevant contractual terms and the data available for the performance-based revenue calculation. Pro-rata performance-based revenue is recognized on an interim basis pursuant to the rights and obligations of each party upon termination of the contracts. Performance-based revenues were $2.9 million and $8.7 million for the three and nine months ended September 30, 2010, respectively, and $2.4 million and $15.6 million for the three and nine months ended September 30, 2011, respectively.

*Significant Customers*

Consolidated Company

The Maricopa Contract generated net revenues that exceeded, in the aggregate, ten percent of net revenues for the consolidated Company for the nine months ended September 30, 2010 and 2011.

Pursuant to the Maricopa Contract, the Company provides behavioral healthcare management and other related services to approximately 719,000 members in Maricopa County, Arizona. Under the Maricopa Contract, the Company is responsible for providing covered behavioral health services to persons eligible under Title XIX (Medicaid) and Title XXI (State Children's Health Insurance Program) of the Social Security Act, non-Title XIX and non-Title XXI eligible children and adults with a serious mental illness, and to certain non-Title XIX and non-Title XXI adults with behavioral health

**MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**September 30, 2011**

**(Unaudited)**

**NOTE A General (Continued)**

or substance abuse disorders. The Maricopa Contract began on September 1, 2007 and extends through September 30, 2013 unless sooner terminated by the parties. The State of Arizona has the right to terminate the Maricopa Contract for cause, as defined, upon ten days' notice with an opportunity to cure, and without cause immediately upon notice from the State. The Maricopa Contract generated net revenues of $602.4 million and $570.1 million for the nine months ended September 30, 2010 and 2011, respectively.

One of the Company's top ten customers during 2010 was WellPoint, Inc. The Company recorded net revenue from contracts with WellPoint, Inc. of $130.9 million for the nine months ended September 30, 2010. The Company's contracts with WellPoint, Inc. terminated on December 31, 2010.

Table of Contents

**MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**September 30, 2011**

**(Unaudited)**

**NOTE A General (Continued)**

By Segment

In addition to the Maricopa Contract previously discussed, the following customers generated in excess of ten percent of net revenues for the respective segment for the nine months ended September 30, 2010 and 2011 (in thousands):

| Segment | Term Date | 2010 | 2011 |
|---|---|---|---|
| **Commercial** | | | |
| Customer A | December 31, 2012 | $ 189,949 | $ 131,633 |
| Customer B | June 30, 2014 | 54,822 | 50,089 |
| Customer C | June 30, 2012 to November 30, 2013(1) | 40,303* | 82,695 |
| **Public Sector** | | | |
| Customer D | June 30, 2012(2) | 113,540 | 135,597 |
| **Radiology Benefits Management** | | | |
| WellPoint, Inc. | December 31, 2010(3) | 119,155 | |
| Customer E | November 30, 2012 to April 30, 2013(1) | 84,435 | 100,575 |
| Customer F | June 30, 2011 to November 30, 2011(1)(4) | 50,982 | 34,271 |
| Customer G | June 30, 2014 | 40,203 | 40,928 |
| Customer H | March 31, 2013 | 4,057* | 25,708 |
| **Specialty Pharmaceutical Management** | | | |
| Customer I | November 30, 2011 to March 31, 2012(1) | 65,421 | 64,731 |
| Customer J | September 1, 2011 to April 29, 2012(1) | 43,246 | 41,704 |
| Customer E | February 1, 2012 to April 30, 2013(1) | 26,937 | 19,499* |
| **Medicaid Administration** | | | |
| Customer K | December 4, 2011(4) | 23,531 | 22,193 |
| Customer L | September 30, 2013(5) | 6,647* | 61,543 |
| Customer M | September 30, 2011 to June 30, 2017(1) | 17,905 | 18,635 |
| Customer N | August 31, 2011 to June 30, 2013(1) | 16,357 | 13,689* |
| Customer O | June 30, 2013 to September 30, 2014(1) | 12,097 | 17,221 |

* Revenue amount did not exceed ten percent of net revenues for the respective segment for the period presented. Amount is shown for comparative purposes only.

(1) The customer has more than one contract. The individual contracts are scheduled to terminate at various points during the time period indicated above.

(2) Contract has options for the customer to extend the term for three additional one-year periods.

(3) The contract has terminated.

Table of Contents

**MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**September 30, 2011**

**(Unaudited)**

**NOTE A General (Continued)**

(4) The customer has informed the Company that this contract will not be renewed.

(5) This customer represents a subcontract with a Public Sector customer and is eliminated in consolidation.

Concentration of Business

The Company also has a significant concentration of business with various counties in the State of Pennsylvania (the "Pennsylvania Counties") which are part of the Pennsylvania Medicaid program, and with various areas in the State of Florida (the "Florida Areas") which are part of the Florida Medicaid program. Net revenues from the Pennsylvania Counties in the aggregate totaled $255.0 million and $265.1 million for the nine months ended September 30, 2010 and 2011, respectively. Net revenues from the Florida Areas in the aggregate totaled $106.0 million and $100.0 million for the nine months ended September 30, 2010 and 2011, respectively.

The Company's contracts with customers typically have terms of one to three years, and in certain cases contain renewal provisions (at the customer's option) for successive terms of between one and two years (unless terminated earlier). Substantially all of these contracts may be immediately terminated with cause and many of the Company's contracts are terminable without cause by the customer or the Company either upon the giving of requisite notice and the passage of a specified period of time (typically between 60 and 180 days) or upon the occurrence of other specified events. In addition, the Company's contracts with federal, state and local governmental agencies generally are conditioned on legislative appropriations. These contracts generally can be terminated or modified by the customer if such appropriations are not made.

*Fair Value Measurements*

The Company currently does not have non-financial assets and non-financial liabilities that are required to be measured at fair value on a recurring basis. Financial assets and liabilities are to be measured using inputs from the three levels of the fair value hierarchy, which are as follows:

Level 1 Inputs are unadjusted quoted prices in active markets for identical assets or liabilities that the Company has the ability to access at the measurement date.

Level 2 Inputs include quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (i.e., interest rates, yield curves, etc.), and inputs that are derived principally from or corroborated by observable market data by correlation or other means (market corroborated inputs).

Level 3 Unobservable inputs that reflect the Company's assumptions about the assumptions that market participants would use in pricing the asset or liability. The Company develops these inputs based on the best information available, including the Company's data.

Table of Contents

**MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**September 30, 2011**

**(Unaudited)**

**NOTE A General (Continued)**

In accordance with the fair value hierarchy described above, the following table shows the fair value of the Company's financial assets and liabilities that are required to be measured at fair value as of December 31, 2010 and September 30, 2011 (in thousands):

| | Fair Value Measurements | | | |
|---|---|---|---|---|
| | **Level 1** | **Level 2** | **Level 3** | **Total** |
| Cash and Cash Equivalents(1) | $ | $ 68,726 | $ | $ 68,726 |
| Restricted Cash(2) | | 72,698 | | 72,698 |
| Investments: | | | | |
| U.S. Government and agency securities | 2,179 | | | 2,179 |
| Obligations of government-sponsored enterprises(3) | | 10,138 | | 10,138 |
| Corporate debt securities | | 268,769 | | 268,769 |
| Certificates of deposit | | 750 | | 750 |
| Taxable municipal bonds | | 2,668 | | 2,668 |
| December 31, 2010 | $ 2,179 | $ 423,749 | $ | $ 425,928 |

| | **Level 1** | **Level 2** | **Level 3** | **Total** |
|---|---|---|---|---|
| Cash and Cash Equivalents(4) | $ | $ 7,732 | $ | $ 7,732 |
| Restricted Cash(5) | | 32,524 | | 32,524 |
| Investments: | | | | |
| U.S. Government and agency securities | 698 | | | 698 |
| Obligations of government-sponsored enterprises(6) | | 11,161 | | 11,161 |
| Corporate debt securities | | 242,090 | | 242,090 |
| Certificates of deposit | | 200 | | 200 |
| September 30, 2011 | $ 698 | $ 293,707 | $ | $ 294,405 |

(1) Excludes $268.5 million of cash held in bank accounts by the Company.

(2) Excludes $44.0 million of restricted cash held in bank accounts by the Company.

(3) Includes investments in notes issued by the Federal Home Loan Mortgage Corporation and the Federal Home Loan Bank.

(4) Excludes $134.7 million of cash held in bank accounts by the Company.

(5) Excludes $123.1 million of restricted cash held in bank accounts by the Company.

(6) Includes investments in notes issued by the Federal Home Loan Bank.

For the nine months ended September 30, 2011, the Company has not transferred any assets between fair value measurement levels.

Table of Contents

**MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**September 30, 2011**

**(Unaudited)**

**NOTE A General (Continued)**

All of the Company's investments are classified as "available-for-sale" and are carried at fair value. Securities which have been classified as Level 1 are measured using quoted market prices while those which have been classified as Level 2 are measured using quoted prices for similar assets and liabilities in active markets. The Company's policy is to classify all investments with contractual maturities within one year as current. Investment income is recognized when earned and reported net of investment expenses. Net unrealized holding gains or losses are excluded from earnings and are reported, net of tax, as "accumulated other comprehensive income (loss)" in the accompanying consolidated balance sheets and consolidated statements of income until realized, unless the losses are deemed to be other-than-temporary. Realized gains or losses, including any provision for other-than-temporary declines in value, are included in the consolidated statements of income.

If a debt security is in an unrealized loss position and the Company has the intent to sell the debt security, or it is more likely than not that the Company will have to sell the debt security before recovery of its amortized cost basis, the decline in value is deemed to be other-than-temporary and is recorded to other-than-temporary impairment losses recognized in income in the consolidated statements of income. For impaired debt securities that the Company does not intend to sell or it is more likely than not that the Company will not have to sell such securities, but the Company expects that it will not fully recover the amortized cost basis, the credit component of the other-than-temporary impairment is recognized in other-than-temporary impairment losses recognized in income in the consolidated statements of income and the non-credit component of the other-than-temporary impairment is recognized in other comprehensive income.

The credit component of an other-than-temporary impairment is determined by comparing the net present value of projected future cash flows with the amortized cost basis of the debt security. The net present value is calculated by discounting the best estimate of projected future cash flows at the effective interest rate implicit in the debt security at the date of acquisition. Cash flow estimates are driven by assumptions regarding probability of default, including changes in credit ratings, and estimates regarding timing and amount of recoveries associated with a default. Furthermore, unrealized losses entirely caused by non-credit related factors related to debt securities for which the Company expects to fully recover the amortized cost basis continue to be recognized in accumulated other comprehensive income.

As of December 31, 2010 and September 30, 2011, there were no unrealized losses that the Company believed to be other-than-temporary. No realized gains or losses were recorded for the nine

**MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**September 30, 2011**

**(Unaudited)**

**NOTE A General (Continued)**

months ended September 30, 2010 or 2011. The following is a summary of short-term and long-term investments at December 31, 2010 and September 30, 2011 (in thousands):

| | December 31, 2010 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
| U.S. Government and agency securities | $ 2,178 | $ 1 | $ | $ 2,179 |
| Obligations of government-sponsored enterprises(1) | 10,142 | 7 | (11) | 10,138 |
| Corporate debt securities | 268,739 | 245 | (215) | 268,769 |
| Certificates of deposit | 750 | | | 750 |
| Taxable municipal bonds | 2,680 | | (12) | 2,668 |
| Total investments at December 31, 2010 | $ 284,489 | $ 253 | $ (238) | $ 284,504 |

| | September 30, 2011 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
| U.S. Government and agency securities | $ 698 | $ | $ | $ 698 |
| Obligations of government-sponsored enterprises(2) | 11,160 | 4 | (3) | 11,161 |
| Corporate debt securities | 242,569 | 53 | (532) | 242,090 |
| Certificates of deposit | 200 | | | 200 |
| Total investments at September 30, 2011 | $ 254,627 | $ 57 | $ (535) | $ 254,149 |

(1) Includes investments in notes issued by the Federal Home Loan Mortgage Corporation and the Federal Home Loan Bank.

(2) Includes investments in notes issued by the Federal Home Loan Bank.

The maturity dates of the Company's investments as of September 30, 2011 are summarized below (in thousands):

| | Amortized Cost | Estimated Fair Value |
|---|---|---|
| 2011 | $ 92,150 | $ 92,062 |
| 2012 | 159,009 | 158,644 |
| 2013 | 3,468 | 3,443 |

| | | |
|---|---|---|
| Total investments at September 30, 2011 | $ 254,627 | $ 254,149 |

*Income Taxes*

The Company's effective income tax rates were 40.3 percent and 34.0 percent for the nine months ended September 30, 2010 and 2011, respectively. These rates differ from the federal statutory income

Table of Contents

**MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**September 30, 2011**

**(Unaudited)**

**NOTE A General (Continued)**

tax rate primarily due to state income taxes, permanent differences between book and tax income, and changes to recorded tax contingencies. The Company also accrues interest and penalties related to unrecognized tax benefits in its provision for income taxes. The effective income tax rate for the nine months ended September 30, 2011 is lower than the effective rate for the nine months ended September 30, 2010 mainly due to more significant reversals of tax contingencies in the current year as a result of closure of statutes of limitation.

The Company files a consolidated federal income tax return for the Company and its eighty percent or more owned subsidiaries, and the Company and its subsidiaries file income tax returns in various states and local jurisdictions. With few exceptions, the Company is no longer subject to state or local income tax assessments by tax authorities for years ended prior to December 31, 2007. Further, the statutes of limitation regarding the assessment of federal and certain state and local income taxes for the year ended December 31, 2007 expired during the current quarter. As a result, $9.6 million of unrecognized tax benefits (excluding interest costs) recorded as of December 31, 2010 was reversed in the current quarter as a result of statute expirations, $8.1 million of which is reflected as a discrete adjustment to the effective rate.

*Stock Compensation*

At December 31, 2010 and September 30, 2011, the Company had equity-based employee incentive plans, which are described more fully in Note 6 in the Company's Annual Report on Form 10-K for the year ended December 31, 2010. The Company recorded stock compensation expense of $3.6 million and $11.8 million for the three and nine months ended September 30, 2010, respectively, and $4.4 million and $13.4 million for the three and nine months ended September 30, 2011, respectively. Stock compensation expense recognized in the consolidated statements of income for the three and nine months ended September 30, 2010 and 2011 has been reduced for estimated forfeitures, estimated at five percent and four percent, respectively.

The weighted average grant date fair value of all stock options granted during the nine months ended September 30, 2011 was $12.94 as estimated using the Black-Scholes-Merton option pricing model, which also assumed an expected volatility of 29.9 percent based on the historical volatility of the Company's stock price.

The benefits of tax deductions in excess of recognized stock compensation expense are reported as a financing cash flow, rather than as an operating cash flow. In the nine months ended September 30, 2010 and 2011, $0 million and $2.1 million of benefits of such tax deductions related to stock compensation expense were realized and as such were reported as financing cash flows, respectively. For the nine months ended September 30, 2010 the change to additional paid in capital related to tax benefits (deficiencies) was $(0.8) million. For the nine months ended September 30, 2011, the change to additional paid in capital related to tax benefits (deficiencies) was $1.8 million which includes the $2.1 million of excess tax benefits offset by $(0.3) million of tax deficiencies.

Table of Contents

**MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**September 30, 2011**

**(Unaudited)**

**NOTE A General (Continued)**

Summarized information related to the Company's stock options for the nine months ended September 30, 2011 is as follows:

| | Options | Weighted Average Exercise Price |
|---|---|---|
| Outstanding, beginning of period | 3,775,586 | $ 39.27 |
| Granted | 1,120,716 | 49.25 |
| Forfeited | (29,306) | 42.98 |
| Exercised | (881,362) | 38.35 |
| Outstanding, end of period | 3,985,634 | 42.26 |
| Vested and expected to vest, end of period | 3,891,114 | 42.16 |
| Exercisable, end of period | 1,835,319 | $ 39.84 |

All of the Company's options granted during the nine months ended September 30, 2011 vest ratably on each anniversary date over the three years subsequent to grant, and all have a ten year life.

Summarized information related to the Company's nonvested restricted stock awards for the nine months ended September 30, 2011 is as follows:

| | Shares | Weighted Average Grant Fair Value |
|---|---|---|
| Outstanding, beginning of period | 22,309 | $ 39.23 |
| Awarded | 18,748 | 52.11 |
| Vested | (22,309) | 39.23 |
| Forfeited | | |
| Outstanding, ending of period | 18,748 | $ 52.11 |

Restricted stock awards granted during the nine months ended September 30, 2011 generally vest on the anniversary of the date of grant.

Table of Contents

**MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**September 30, 2011**

**(Unaudited)**

**NOTE A General (Continued)**

Summarized information related to the Company's nonvested restricted stock units for the nine months ended September 30, 2011 is as follows:

| | Shares | Weighted Average Grant Fair Value |
|---|---|---|
| Outstanding, beginning of period | 190,488 | $ 38.43 |
| Awarded | 112,543 | 49.10 |
| Vested | (90,853) | 37.50 |
| Forfeited | (2,856) | 45.12 |
| Outstanding, ending of period | 209,322 | $ 44.49 |

Restricted stock units granted during the nine months ended September 30, 2011 generally vest ratably on each anniversary date over the three years subsequent to grant.

*Long Term Debt and Capital Lease Obligations*

On April 28, 2010, the Company entered into an amendment to its credit facility with Deutsche Bank AG, Citibank, N.A., and Bank of America, N.A. that provided for an $80.0 million Revolving Loan Commitment for the issuance of letters of credit for the account of the Company with a sublimit of up to $30.0 million for revolving loans (the "2010 Credit Facility"). Borrowings under the 2010 Credit Facility mature on April 28, 2013. The 2010 Credit Facility is guaranteed by substantially all of the subsidiaries of the Company and is secured by substantially all of the assets of the Company and the subsidiary guarantors.

Under the 2010 Credit Facility, the annual interest rate on Revolving Loan borrowings is equal to (i) in the case of U.S. dollar denominated loans, the sum of a borrowing margin of 1.75 percent plus the higher of the prime rate or one-half of one percent in excess of the overnight "federal funds" rate, or (ii) in the case of Eurodollar denominated loans, the sum of a borrowing margin of 2.75 percent plus the Eurodollar rate for the selected interest period. The Company has the option to borrow in U.S. dollar denominated loans or Eurodollar denominated loans at its discretion. Letters of Credit issued under the Revolving Loan Commitment bear interest at the rate of 2.875 percent. The commitment commission on the 2010 Credit Facility is 0.50 percent of the unused Revolving Loan Commitment.

There were $0.6 million of capital lease obligations at December 31, 2010 and September 30, 2011, respectively, $44.9 million and $36.2 million of letters of credit outstanding at December 31, 2010 and September 30, 2011, respectively, and no Revolving Loan borrowings at December 31, 2010 or September 30, 2011.

**MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**September 30, 2011**

**(Unaudited)**

**NOTE B Net Income per Common Share**

The following tables reconcile income (numerator) and shares (denominator) used in the computations of net income per common share (in thousands, except per share data):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | **2010** | **2011** | **2010** | **2011** |
| Numerator: | | | | |
| Net income | $ 44,784 | $ 31,355 | $ 105,731 | $ 99,884 |
| Denominator: | | | | |
| Weighted average number of common shares outstanding basic | 33,450 | 29,900 | 33,715 | 31,406 |
| Common stock equivalents stock options | 475 | 446 | 389 | 487 |
| Common stock equivalents warrants | 157 | | 150 | |
| Common stock equivalents restricted stock | 6 | 4 | 13 | 10 |
| Common stock equivalents restricted stock units | 83 | 88 | 78 | 85 |
| Common stock equivalents employee stock purchase plan | | | | |
| Weighted average number of common shares outstanding diluted | 34,171 | 30,438 | 34,345 | 31,988 |
| Net income per common share basic | $ 1.34 | $ 1.05 | $ 3.14 | $ 3.18 |
| Net income per common share diluted | $ 1.31 | $ 1.03 | $ 3.08 | $ 3.12 |

The weighted average number of common shares outstanding for the three and nine months ended September 30, 2010 and 2011 were calculated using outstanding shares of the Company's Ordinary Common Stock. Common stock equivalents included in the calculation of diluted weighted average common shares outstanding for the three and nine months ended September 30, 2010 and 2011 represent stock options to purchase shares of the Company's Ordinary Common Stock, restricted stock awards and restricted stock units, stock to be purchased under the Employee Stock Purchase Plan and shares of Ordinary Common Stock related to certain warrants issued on January 5, 2004.

The Company had additional potential dilutive securities outstanding representing 1.2 million and 1.9 million options, respectively, for the three and nine months ended September 30, 2010, and 1.1 million and 0.9 million options for the three and nine months ended September 30, 2011, respectively, that were not included in the computation of dilutive securities because they were anti-dilutive for the period. Had these shares not been anti-dilutive, all of these shares would not have been included in the net income per common share calculation as the Company uses the treasury stock method of calculating diluted shares.

**NOTE C Business Segment Information**

The accounting policies of the Company's segments are the same as those described in Note A "General." The Company evaluates performance of its segments based on profit or loss from operations before stock compensation expense, depreciation and amortization, interest expense, interest

Table of Contents

**MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**September 30, 2011**

**(Unaudited)**

**NOTE C Business Segment Information (Continued)**

income, gain on sale of assets, special charges or benefits, and income taxes ("Segment Profit"). Management uses Segment Profit information for internal reporting and control purposes and considers it important in making decisions regarding the allocation of capital and other resources, risk assessment and employee compensation, among other matters. Effective September 1, 2010, Public Sector has subcontracted with Medicaid Administration to provide pharmacy benefits management services on a limited risk basis for one of Public Sector's customers. As such, revenue and cost of care related to this intersegment arrangement are eliminated. The Company's segments are defined above.

The following tables summarize, for the periods indicated, operating results by business segment (in thousands):

| Three Months Ended September 30, 2010 | Commercial | Public Sector | Radiology Benefits Management | Specialty Pharmaceutical Management | Medicaid Administration | Corporate and Elimination | Consolidated |
|---|---|---|---|---|---|---|---|
| Net revenue | $ 165,270 | $ 364,102 | $ 116,379 | $ 68,609 | $ 42,606 | $ (6,647) | $ 750,319 |
| Cost of care | (84,485) | (310,261) | (72,980) | | (6,081) | 6,647 | (467,160) |
| Cost of goods sold | | | | (55,071) | | | (55,071) |
| Direct service costs | (40,156) | (17,554) | (17,366) | (8,064) | (27,928) | | (111,068) |
| Other operating expenses | | | | | | (30,513) | (30,513) |
| Stock compensation expense(1) | 124 | 181 | 362 | 108 | 36 | 2,785 | 3,596 |
| Segment profit (loss) | $ 40,753 | $ 36,468 | $ 26,395 | $ 5,582 | $ 8,633 | $ (27,728) | $ 90,103 |

| Three Months Ended September 30, 2011 | Commercial | Public Sector | Radiology Benefits Management | Specialty Pharmaceutical Management | Medicaid Administration | Corporate and Elimination | Consolidated |
|---|---|---|---|---|---|---|---|
| Net revenue | $ 135,365 | $ 362,104 | $ 78,659 | $ 73,792 | $ 57,692 | $ (20,769) | $ 686,843 |
| Cost of care | (81,503) | (318,807) | (49,186) | | (19,324) | 20,769 | (448,051) |
| Cost of goods sold | | | | (57,636) | | | (57,636) |
| Direct service costs | (36,582) | (16,741) | (14,717) | (6,563) | (26,221) | | (100,824) |
| Other operating expenses | | | | | | (29,214) | (29,214) |
| Stock compensation expense(1) | 208 | 218 | 355 | 380 | 36 | 3,228 | 4,425 |
| Segment profit (loss) | $ 17,488 | $ 26,774 | $ 15,111 | $ 9,973 | $ 12,183 | $ (25,986) | $ 55,543 |

Table of Contents

**MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**September 30, 2011**

**(Unaudited)**

**NOTE C Business Segment Information (Continued)**

| Nine Months Ended September 30, 2010 | Commercial | Public Sector | Radiology Benefits Management | Specialty Pharmaceutical Management | Medicaid Administration | Corporate and Elimination | Consolidated |
|---|---|---|---|---|---|---|---|
| Net revenue | $ 487,954 | $ 1,081,581 | $ 331,099 | $ 204,740 | $ 121,303 | $ (6,647) | $ 2,220,030 |
| Cost of care | (265,740) | (930,932) | (220,211) | | (6,081) | 6,647 | (1,416,317) |
| Cost of goods sold | | | | (166,138) | | | (166,138) |
| Direct service costs | (115,340) | (50,559) | (47,605) | (19,537) | (94,555) | | (327,596) |
| Other operating expenses | | | | | | (91,856) | (91,856) |
| Stock compensation expense(1) | 556 | 554 | 1,123 | 365 | 76 | 9,156 | 11,830 |
| Segment profit (loss) | $ 107,430 | $ 100,644 | $ 64,406 | $ 19,430 | $ 20,743 | $ (82,700) | $ 229,953 |

| Nine Months Ended September 30, 2011 | Commercial | Public Sector | Radiology Benefits Management | Specialty Pharmaceutical Management | Medicaid Administration | Corporate and Elimination | Consolidated |
|---|---|---|---|---|---|---|---|
| Net revenue | $ 425,086 | $ 1,074,904 | $ 258,479 | $ 213,388 | $ 167,622 | $ (61,543) | $ 2,077,936 |
| Cost of care | (235,938) | (933,662) | (157,731) | | (57,409) | 61,543 | (1,323,197) |
| Cost of goods sold | | | | (167,559) | | | (167,559) |
| Direct service costs | (113,502) | (50,203) | (47,280) | (18,658) | (78,056) | | (307,699) |
| Other operating expenses | | | | | | (85,685) | (85,685) |
| Stock compensation expense(1) | 677 | 654 | 1,238 | 639 | 100 | 10,100 | 13,408 |
| Segment profit (loss) | $ 76,323 | $ 91,693 | $ 54,706 | $ 27,810 | $ 32,257 | $ (75,585) | $ 207,204 |

(1) Stock compensation expense is included in direct service costs and other operating expenses, however this amount is excluded from the computation of Segment Profit since it is managed on a consolidated basis.

The following table reconciles Segment Profit to income before income taxes (in thousands):