MAGELLAN HEALTH INC
Form 10-Q
November 09, 2016
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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 September 30, 2016

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, 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.)
4800 N. Scottsdale Rd, Suite 4400	
Scottsdale, Arizona	85251
(Address of principal executive offices)	(Zip code)

(602) 572 6050

(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

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 (Do not check if a smaller reporting company)	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 September 30, 2016 was 23,241,455.

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MAGELLAN HEALTH, INC. AND SUBSIDIARIES

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PART I—FINANCIAL INFORMATION

Item 1. Financial Statements.

MAGELLAN HEALTH, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(In thousands, except per share amounts)

	December 31, 2015	September 30, 2016 (Unaudited)
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 115,432	$ 164,427
Restricted cash	133,597	55,212
Accounts receivable, less allowance for doubtful accounts of $3,246 and $3,838 at December 31, 2015 and September 30, 2016 respectively	428,644	497,947
Short-term investments (restricted investments of $277,556 and $238,851 at December 31, 2015 and September 30, 2016 respectively)	322,339	308,215
Pharmaceutical inventory	50,749	61,174
Other current assets (restricted deposits of $27,752 and $42,795 at December 31, 2015 and September 30, 2016 respectively)	46,921	69,784
Total Current Assets	1,097,682	1,156,759
Property and equipment, net	174,745	169,831
Restricted long-term investments	3,826	5,708
Deferred income taxes	26,836	9,092
Other long-term assets	11,207	61,238
Goodwill	621,390	716,922
Other intangible assets, net	133,374	149,504
Total Assets	$ 2,069,060	$ 2,269,054
LIABILITIES, REDEEMABLE NON-CONTROLLING INTEREST AND STOCKHOLDERS’ EQUITY		
Current Liabilities:		
Accounts payable	$ 86,484	$ 79,009
Accrued liabilities	139,726	196,929
Short - term contingent consideration	91,623	926
Medical claims payable	250,449	199,154
Other medical liabilities	136,939	170,718
Current debt maturities and capital lease obligations	19,014	118,610
Total Current Liabilities	724,235	765,346
Long-term debt and capital lease obligations	238,295	419,198
Tax contingencies	12,677	12,589
Long-term contingent consideration	803	10,841
Deferred credits and other long-term liabilities	20,930	16,118
Total Liabilities	996,940	1,224,092
Redeemable non-controlling interest	5,937	4,168

Preferred stock, par value $.01 per share Authorized—10,000 shares at December 31, 2015 and September 30, 2016-Issued and outstanding-none	—	—
Ordinary common stock, par value $.01 per share Authorized—100,000 shares at December 31, 2015 and September 30, 2016-Issued and outstanding - 51,340 shares and 24,692 shares at December 31, 2015, respectively, and 51,718 and 23,242 shares at September 30, 2016, respectively	513	517
Multi-Vote common stock, par value $.01 per share Authorized—40,000 shares at December 31, 2015 and September 30, 2016-Issued and outstanding-none	—	—
Other Stockholders' Equity:		
Additional paid-in capital	1,124,013	1,162,613
Retained earnings	1,211,310	1,254,014
Accumulated other comprehensive loss	(262)	(153)
Ordinary common stock in treasury, at cost, 26,648 shares and 28,476 shares at December 31, 2015 and September 30, 2016, respectively	(1,269,391)	(1,376,197)
Total Stockholders' Equity	1,066,183	1,040,794
Total Liabilities, Redeemable Non-Controlling Interest and Stockholders' Equity	$ 2,069,060	$ 2,269,054

See accompanying notes to consolidated financial statements.

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MAGELLAN HEALTH, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME (LOSS)

(Unaudited)

(In thousands, except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2016	2015	2016
Net revenue:				
Managed care and other	$ 809,249	$ 751,589	$ 2,334,139	$ 2,127,911
PBM and dispensing	380,833	540,543	994,518	1,445,588
Total net revenue	1,190,082	1,292,132	3,328,657	3,573,499
Costs and expenses:				
Cost of care	596,323	480,243	1,686,939	1,410,403
Cost of goods sold	360,444	509,673	940,060	1,362,062
Direct service costs and other operating expenses (1)(2)(3)	220,586	229,094	616,491	635,627
Depreciation and amortization	26,721	26,885	75,239	77,472
Interest expense	1,654	3,038	4,933	6,780
Interest income	(631)	(741)	(1,597)	(2,116)
Total costs and expenses	1,205,097	1,248,192	3,322,065	3,490,228
(Loss) income before income taxes	(15,015)	43,940	6,592	83,271
(Benefit) provision for income taxes	(7,254)	18,631	2,866	43,259
Net (loss) income	(7,761)	25,309	3,726	40,012
Less: net income (loss) attributable to non-controlling interest	47	(200)	(397)	(2,692)
Net (loss) income attributable to Magellan Health, Inc.	$ (7,808)	$ 25,509	$ 4,123	$ 42,704
Net (loss) income per common share attributable to Magellan Health, Inc.:				
Basic (See Note B)	$ (0.31)	$ 1.11	$ 0.16	$ 1.83
Diluted (See Note B)	$ (0.31)	$ 1.06	$ 0.16	$ 1.75

(1) Includes stock compensation expense of $12,897 and $9,176 for the three months ended September 30, 2015 and 2016, respectively, and $40,593 and $27,573 for the nine months ended September 30, 2015 and 2016, respectively.

(2) Includes changes in fair value of contingent consideration of $29,738 and $313 for the three months ended September 30, 2015 and 2016, respectively, and $47,274 and $510 for the nine months ended September 30, 2015 and 2016, respectively.

(3) Includes impairment of intangible assets of $0 and $4,800 for the three and nine months ended September 30, 2016, respectively.

See accompanying notes to consolidated financial statements.

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MAGELLAN HEALTH, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Unaudited)

(In thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2016	2015	2016
Net (loss) income	$ (7,761)	$ 25,309	$ 3,726	$ 40,012
Other comprehensive (loss) income:				
Unrealized gains (losses) on available-for-sale securities (1)	53	(127)	29	109
Comprehensive (loss) income	(7,708)	25,182	3,755	40,121
Less: comprehensive income (loss) attributable to non-controlling interest	47	(200)	(397)	(2,692)
Comprehensive (loss) income attributable to Magellan Health, Inc.	$ (7,755)	$ 25,382	$ 4,152	$ 42,813

(1) Net of income tax provision (benefit) of $27 and $(78) for the three months ended September 30, 2015 and 2016, respectively, and $25 and $68 for the nine months ended September 30, 2015 and 2016, respectively.

See accompanying notes to consolidated financial statements.

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MAGELLAN HEALTH, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE NINE MONTHS ENDED SEPTEMBER 30,

(Unaudited)

(In thousands)

	2015	2016
Cash flows from operating activities:		
Net income	$ 3,726	$ 40,012
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	75,239	77,472
Non-cash impairment of intangible asset	—	4,800
Non-cash interest expense	297	385
Non-cash stock compensation expense	40,593	27,573
Non-cash income tax (benefit) provision	(1,018)	2,998
Non-cash amortization on investments	5,106	4,224
Cash flows from changes in assets and liabilities, net of effects from acquisitions of businesses:		
Restricted cash	79,959	78,958
Accounts receivable, net	(41,428)	(31,926)
Pharmaceutical inventory	(5,277)	(10,425)
Other assets	(48,653)	(72,374)
Accounts payable and accrued liabilities	(46,035)	23,342
Medical claims payable and other medical liabilities	59,819	(18,017)
Contingent consideration	59,223	(50,591)
Tax contingencies	(2,290)	(111)
Deferred credits and other long-term liabilities	(1,110)	(5,393)
Other	(26)	(57)
Net cash provided by operating activities	178,125	70,870
Cash flows from investing activities:		
Capital expenditures	(54,604)	(44,345)
Acquisitions and investments in businesses, net of cash acquired	(55,818)	(127,504)
Purchase of investments	(391,785)	(365,521)
Maturity of investments	283,619	373,694
Net cash used in investing activities	(218,588)	(163,676)
Cash flows from financing activities:		
Proceeds from issuance of debt	—	290,000
Payments to acquire treasury stock	(150,763)	(106,806)
Proceeds from exercise of stock options and warrants	50,074	10,933
Payments on long-term debt and capital lease obligations	(12,665)	(13,569)
Payments on contingent consideration	(8,932)	(40,559)
Tax benefit from exercise of stock options and vesting of stock awards	3,887	528

Other	408	1,274
Net cash (used in) provided by financing activities	(117,991)	141,801
Net (decrease) increase in cash and cash equivalents	(158,454)	48,995
Cash and cash equivalents at beginning of period	255,303	115,432
Cash and cash equivalents at end of period	$ 96,849	$ 164,427
Supplemental cash flow data:		
Non-cash investing activities:		
Property and equipment acquired under capital leases	$ 3,415	$ 4,193

See accompanying notes to consolidated financial statements.

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MAGELLAN HEALTH, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September, 30 2016

(Unaudited)

NOTE A—General

Basis of Presentation

The accompanying unaudited consolidated financial statements of Magellan Health, Inc., a Delaware corporation ("Magellan"), include Magellan and its subsidiaries (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 and nine months ended September 30, 2016 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.

These unaudited consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements for the year ended December 31, 2015 and the notes thereto, which are included in the Company's Annual Report on Form 10-K filed with the SEC on February 29, 2016.

Business Overview

The Company is engaged in the healthcare management business, and is focused on managing the fastest growing, most complex areas of health, including special populations, complete pharmacy benefits and other specialty areas of healthcare. The Company develops innovative solutions that combine advanced analytics, agile technology and clinical excellence to drive better decision making, positively impact health outcomes and optimize the cost of care for the members we serve. The Company provides services to health plans and other managed care organizations ("MCOs"), employers, labor unions, various military and governmental agencies and third party administrators ("TPAs").

Healthcare

Healthcare includes the Company's: (i) management of behavioral healthcare services and employee assistance program ("EAP") services, (ii) management of other specialty areas including diagnostic imaging and musculoskeletal management, and (iii) the integrated management of physical, behavioral and pharmaceutical healthcare for special populations, delivered through Magellan Complete Care ("MCC"). These special populations include individuals with serious mental illness ("SMI"), dual eligibles, long term services and supports and other populations with unique and often complex healthcare needs.

The Company's coordination and management of these healthcare services are provided through its comprehensive network of medical and behavioral health professionals, clinics, hospitals and ancillary service providers. This network of credentialed and privileged providers is integrated with clinical and quality improvement programs to improve access to care and enhance the healthcare experience for individuals in need of care, while at the same time making the cost of these services more affordable for our customers. The Company generally does not directly provide or own any provider of treatment services, although it does employ licensed behavioral health counselors to deliver non medical counseling under certain government contracts.

The Healthcare segment's commercial division serves a variety of customers, with services, inclusive of special population management, provided under contracts with health plans and accountable care organizations for some or all of their commercial, Medicaid and Medicare members, as well as with employers. The government division contracts with local, state and federal governmental agencies to provide services to recipients under Medicaid, Medicare and other government programs.

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MAGELLAN HEALTH, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

September, 30 2016

(Unaudited)

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 and (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.

Pharmacy Management

The Pharmacy Management segment ("Pharmacy Management") comprises products and solutions that provide clinical and financial management of pharmaceuticals paid under medical and pharmacy benefit programs. Pharmacy Management's services include: (i) pharmacy benefit management ("PBM") services; (ii) pharmacy benefit administration ("PBA") for state Medicaid and other government sponsored programs; (iii) pharmaceutical dispensing operations; (iv) clinical and formulary management programs; (v) medical pharmacy management programs; and (vi) programs for the integrated management of specialty drugs across both the medical and pharmacy benefit that treat complex conditions, regardless of site of service, method of delivery, or benefit reimbursement.

Pharmacy Management's services are provided under contracts with health plans, employers, MCOs, state Medicaid programs, Medicare Part D and other government agencies, and encompass risk based and fee for service ("FFS") arrangements. In addition, Pharmacy Management has subcontract arrangements to provide PBM services for certain Healthcare customers.

Corporate

This segment of the Company is comprised primarily of amounts not allocated to the Healthcare and Pharmacy Management segments that are largely associated with costs related to being a publicly traded company. In order to better represent the operations of the Company's segments, effective January 1, 2016, the Company began allocating operational and corporate support costs to the Healthcare and Pharmacy Management segments. These costs, which were historically reported in the Corporate segment, include operational support functions such as sales and marketing and information technology, as well as corporate support functions such as executive, finance and human resources. Prior period balances have been reclassified to reflect this change.

Summary of Significant Accounting Policies

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, "Revenue from Contracts with Customers (Topic 606)" ("ASU 2014-09"), which is a new comprehensive revenue recognition standard that will supersede virtually all existing revenue guidance under GAAP. In March 2016, the FASB issued ASU 2016-08, "Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)" ("ASU 2016-08"), which clarifies the implementation guidance on principal versus agent considerations. In April 2016, the FASB issued ASU No 2016-10, "Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing" ("ASU 2016-10"), which clarifies the performance obligations and licensing implementation guidance of ASU 2014-09. In July 2015, the FASB approved to defer the effective date of ASU 2014-09. The amendments in these ASUs are effective for annual and interim reporting periods of public entities beginning after December 15, 2017. The Company is currently assessing the potential impact this ASU will have on the Company's consolidated results of operations, financial position and cash flows.

In June 2014, the FASB issued ASU No. 2014 12, "Compensation—Stock Compensation (Topic 718): Accounting for Share Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved After the Requisite Service Period" ("ASU 2014 12"), which revises the accounting treatment for stock

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MAGELLAN HEALTH, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

September, 30 2016

(Unaudited)

compensation tied to performance targets. The amendments in this ASU are effective for annual and interim reporting periods beginning after December 15, 2015 and were adopted by the Company during the quarter ended March 31, 2016. The effect of this guidance was immaterial to the Company's consolidated results of operations, financial position and cash flows.

In August 2014, the FASB issued ASU No. 2014 15, "Presentation of Financial Statements—Going Concern (Subtopic 205 40)" ("ASU 2014 15"), which provides guidance in GAAP about management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures. This amendment should reduce diversity in the timing and content of footnote disclosures. This ASU is effective for the annual and interim reporting periods of beginning after December 15, 2016, with early adoption permitted. The guidance is not expected to materially impact the Company's consolidated results of operations, financial position and cash flows.

In February 2015, the FASB issued ASU No. 2015 02, "Amendments to the Consolidation Analysis" ("ASU 2015 02"), which amends certain requirements for determining whether a variable interest entity must be consolidated. The amendments in this ASU are effective for annual and interim reporting periods of public entities beginning after December 15, 2015 and were adopted by the Company during the quarter ended March 31, 2016. The effect of this guidance was immaterial to the Company's consolidated results of operations, financial position and cash flows.

In April 2015, the FASB issued ASU No. 2015-05, "Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer's Accounting for Fees Paid in a Cloud Computing Arrangement" ("ASU 2015-05"), which provides guidance to clarify the customer's accounting for fees paid in a cloud computing arrangement. The amendments in this ASU are effective for annual and interim reporting periods of public entities beginning after December 15, 2015 and were adopted by the Company on a prospective basis during the quarter ended March 31, 2016. The effect of this guidance was immaterial to the Company's consolidated results of operations, financial position and cash flows.

In July 2015, the FASB issued ASU No. 2015 11, "Inventory (Topic 330): Simplifying the Measurement of Inventory" ("ASU 2015 11"). The amendment under this ASU requires that an entity measure inventory at the lower of cost or net realizable value. This guidance is effective for annual and interim reporting periods of public entities beginning after December 15, 2016. The guidance is not expected to materially impact the Company's consolidated results of operations, financial position or cash flows.

In September 2015, the FASB issued ASU No. 2015 16, "Business Combinations (Topic 805): Simplifying the Accounting for Measurement Period Adjustments" ("ASU 2015 16"). The amendment under this ASU requires that an acquirer recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. The amendments in this ASU are effective for annual and interim reporting periods of public entities beginning after December 15, 2015 and were adopted by the Company during the quarter ended March 31, 2016. The effect of this guidance is immaterial to the Company's consolidated results of operations, financial position and cash flows.

In February 2016, the FASB issued ASU No. 2016 02, “Leases” (“ASU 2016 02”). This ASU amends the existing accounting standards for lease accounting, including requiring lessees to recognize most leases on their balance sheets. This guidance is effective for annual and interim reporting periods of public entities beginning after December 15, 2018, with early adoption permitted. The Company is currently assessing the potential impact this ASU will have on the Company’s consolidated results of operations, financial position and cash flows.

In March 2016, the FASB issued ASU No. 2016-09, “Compensation-Stock Compensation (Topic 718)” (“ASU 2016-09”). This ASU amends the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities and classification on the statement of cash flows. This guidance is effective for annual and interim reporting period of public entities beginning after December 15, 2016, with early adoption permitted. The Company is currently assessing the potential impact this ASU will have on the Company’s consolidated results of operations, financial position and cash flows.

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MAGELLAN HEALTH, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

September, 30 2016

(Unaudited)

In June 2016, the FASB issued ASU No. 2016-13, "Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments" ("ASU 2016-13"). This ASU amends the accounting on reporting credit losses for assets held at amortized cost basis and available for sale debt securities. This guidance is effective for annual and interim periods of public entities beginning after December 15, 2019, with early adoption permitted for fiscal years beginning after December 31, 2018. The Company is currently assessing the potential impact this ASU will have on the Company's consolidated results of operation, financial positions and cash flows.

In August 2016, the FASB issued ASU No. 2016-15, "Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments" ("ASU 2016-15"). This ASU makes eight targeted changes to how cash receipts and cash payments are presented and classified in the statement of cash flows. This guidance is effective for annual and interim periods of public entities beginning after December 15, 2017, with early adoption permitted. The Company is currently assessing the potential impact this ASU will have on the Company's consolidated results of operation, financial positions and cash flows.

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, contingent consideration, stock compensation assumptions, tax contingencies and legal liabilities. Actual results could differ from those estimates.

Managed Care and Other Revenue

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 in which 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 $689.5 million and $2,004.4 million for the three and nine months ended September 30, 2015, respectively and $576.8 million and $1,692.6 million for the three and nine months ended September 30, 2016, respectively.

Fee For Service, Fixed Fee and Cost Plus Contracts. The Company has certain contracts with customers under which the Company recognizes revenue as services are performed and as costs are incurred. This includes revenues received in relation to the Patient Protection and Affordable Care Act health insurer fee (“HIF fee”) billed on a cost reimbursement basis. Revenues from these contracts approximated $85.1 million and $248.7 million for the three and nine months ended September 30, 2015, respectively, and $143.7 million and $349.3 million for the three and nine months ended September 30, 2016, respectively.

Rebate Revenue. The Company administers a rebate program for certain clients through which the Company coordinates the achievement, calculation and collection of rebates and administrative fees from pharmaceutical manufacturers on behalf of clients. Each period, the Company estimates the total rebates earned based on actual volumes of pharmaceutical purchases by the Company’s clients, as well as historical and/or anticipated sharing percentages. The Company earns fees based upon the volume of rebates generated for its clients. The Company does not record as rebate revenue any rebates that are passed through to its clients. Total rebate revenues approximated $23.5 million and

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MAGELLAN HEALTH, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

September, 30 2016

(Unaudited)

$56.3 million for the three and nine months ended September 30, 2015, respectively, and $22.0 million and $63.1 million for the three and nine months ended September 30, 2016, respectively.

In relation to the Company’s PBM business, the Company administers rebate programs through which it receives rebates from pharmaceutical manufacturers that are shared with its customers. The Company recognizes rebates when the Company is entitled to them and when the amounts of the rebates are determinable. The amount recorded for rebates earned by the Company from the pharmaceutical manufacturers is recorded as a reduction of cost of goods sold.

PBM and Dispensing Revenue

Pharmacy Benefit Management Revenue. The Company recognizes PBM revenue, which consists of a negotiated prescription price (ingredient cost plus dispensing fee), co payments collected by the pharmacy and any associated administrative fees, when claims are adjudicated. The Company recognizes PBM revenue on a gross basis (i.e. including drug costs and co payments) as it is acting as the principal in the arrangement and is contractually obligated to its clients and network pharmacies, which is a primary indicator of gross reporting. In addition, the Company is solely responsible for the claims adjudication process, negotiating the prescription price for the pharmacy, collection of payments from the client for drugs dispensed by the pharmacy, and managing the total prescription drug relationship with the client’s members. If the Company enters into a contract where it is only an administrator, and does not assume any of the risks previously noted, revenue will be recognized on a net basis. PBM revenues approximated $327.1 million and $842.9 million for the three and nine months ended September 30, 2015, respectively, and $413.7 million and $1,110.7 million for the three and nine months ended September 30, 2016, 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 $53.7 million and $151.6 million for the three and nine months ended September 30, 2015, respectively, and $57.5 million and $167.2 million for the three and nine months ended September 30, 2016, respectively.

Medicare Part D. The Company is contracted with the Centers for Medicare and Medicaid Services (“CMS”) as a Prescription Drug Plan (“PDP”) to provide prescription drug benefits to Medicare beneficiaries. Net revenues include insurance premiums earned by the PDP, which includes a direct premium paid by CMS and a beneficiary premium paid by the PDP member. In cases of low-income members, the beneficiary premium may be subsidized by CMS. The Company recognizes insurance premium revenues on a monthly basis on a per member basis for covered members. In addition to these premiums, net revenues includes certain payments from the members based on the members’ actual prescription claims, including co-payments, coverage gap benefits, deductibles and co-insurance (collectively, “Member Responsibilities”). The Company receives a prospective subsidy payment from CMS each month to subsidize a portion of the Member Responsibilities for low-income members. If the prospective subsidy differs from actual prescription claims, the difference is recorded as either a receivable or payable on the consolidated balance sheets. The Company assumes no risk for the Member Responsibilities, including the portion subsidized by CMS. The Company recognizes revenues for Member Responsibilities, including the portion subsidized by CMS, on a gross basis as claims are adjudicated. The CMS also provides an annual risk corridor adjustment which compares the Company's actual drug costs incurred to the premiums received. Based on the risk corridor adjustment, the Company may receive additional premiums from CMS or may be required to refund CMS a portion of previously received premiums. The Company calculates the risk corridor adjustment on a quarterly basis and the amount is included in net revenues with a corresponding receivable or payable on the consolidated balance sheets. Medicare Part D revenues approximated $76.5 million and $192.0 million for the three and nine months ended September 30, 2016, including co-payments, which are included in PBM revenues above, of $7.2 million and $24.3 million for the three and nine months ended September 30, 2016, respectively.

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MAGELLAN HEALTH, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

September, 30 2016

(Unaudited)

Significant Customers

Customers exceeding ten percent of the consolidated Company's net revenues

The Company provides behavioral healthcare management and other related services to members in the state of Florida pursuant to contracts with the State of Florida (the "Florida Contracts"). The Company had behavioral healthcare contracts with various areas in the State of Florida (the "Florida Areas") which were part of the Florida Medicaid program. The State of Florida implemented a new system of mandated managed care through which Medicaid enrollees receive integrated healthcare services, and in 2014 phased out the behavioral healthcare programs under which the Florida Areas' contracts operated. The Company has a contract with the State of Florida to provide integrated healthcare services under the new program ("the Florida Medicaid Contract"). The Florida Medicaid Contract began on February 4, 2014 and extends through December 31, 2018, unless sooner terminated by the parties. The State of Florida has the right to terminate the Florida Medicaid Contract with cause, as defined, upon 24 hour notice and upon 30 days notice for any reason or no reason at all. The Florida Contracts generated net revenues of $324.1 million and $403.4 million for the nine months ended September 30, 2015 and 2016, respectively.

Through December 31, 2015, the Company provided behavioral healthcare management and other related services to members in the state of Iowa pursuant to contracts with the State of Iowa (the "Iowa Contracts"). The Iowa Contracts terminated on December 31, 2015. The Iowa Contracts generated net revenues of $394.8 million and $10.8 million for the nine months ended September 30, 2015 and 2016, respectively.

Customers exceeding ten percent of segment net revenues

In addition to the Florida Contracts and the Iowa Contracts 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, 2015 and 2016 (in thousands):

Segment	Term Date	2015	2016
Healthcare			
None			
Pharmacy Management			
Customer A	December 31, 2016 (1)	$ 241,556	$ 261,094

(1) A vast majority of this customer's revenues were generated from drug acquisition costs related to PBM services which terminated on September 1, 2016. The Company continues to provide specialty drug formulary management services to the customer and is in negotiations with the customer to extend this contract.

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 members under its contract with CMS. Net revenues from the Pennsylvania Counties in the aggregate totaled $294.9 million and $343.2 million for the nine months ended September 30, 2015 and 2016, respectively. Net revenues from members in relation to its contract with CMS in aggregate totaled $192.0 million for the nine months ended September 30, 2016.

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

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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 has certain assets and liabilities that are required to be measured at fair value on a recurring basis. These 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.

In accordance with the fair value hierarchy described above, the following table shows the fair value of the Company’s assets and liabilities that are required to be measured at fair value as of December 31, 2015 and September 30, 2016 (in thousands):

	December 31, 2015			
	Level 1	Level 2	Level 3	Total
Assets				
Cash and cash equivalents (1)	$ —	$ 6,009	$ —	$ 6,009
Restricted cash (2)	—	82,808	—	82,808
Investments:				
U.S. Government and agency securities	5,514	—	—	5,514
Obligations of government-sponsored enterprises (3)	—	50,525	—	50,525
Corporate debt securities	—	268,976	—	268,976
Certificates of deposit	—	1,150	—	1,150
Total assets held at fair value	$ 5,514	$ 409,468	$ —	$ 414,982
Liabilities				

Contingent consideration	$ —	$ —	$ 92,426	$ 92,426
Total liabilities held at fair value	$ —	$ —	$ 92,426	$ 92,426

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	September 30, 2016			
	Level 1	Level 2	Level 3	Total
Assets				
Cash and cash equivalents (4)	$ —	$ 57,940	$ —	$ 57,940
Restricted cash (5)	—	31,442	—	31,442
Investments:				
U.S. Government and agency securities	5,131	—	—	5,131
Obligations of government-sponsored enterprises (6)	—	42,127	—	42,127
Corporate debt securities	—	265,215	—	265,215
Certificates of deposit	—	1,450	—	1,450
Total assets held at fair value	$ 5,131	$ 398,174	$ —	$ 403,305
Liabilities				
Contingent consideration	$ —	$ —	$ 11,767	$ 11,767
Total liabilities held at fair value	$ —	$ —	$ 11,767	$ 11,767

(1) Excludes $109.4 million of cash held in bank accounts by the Company.
(2) Excludes $50.8 million of restricted cash held in bank accounts by the Company.
(3) Includes investments in notes issued by the Federal Home Loan Bank and Federal Farm Credit Banks.
(4) Excludes $106.5 million of cash held in bank accounts by the Company.
(5) Excludes $23.8 million of restricted cash held in bank accounts by the Company.
(6) Includes investments in notes issued by the Federal Home Loan Bank, Federal National Mortgage Association and Federal Farm Credit Banks.

For the nine months ended September 30, 2016, the Company has not transferred any assets between fair value measurement levels.

The carrying values of financial instruments, including accounts receivable, accounts payable and revolving loan borrowings, approximate their fair values due to their short-term maturities. The estimated fair value of the Company's term loans of $425.0 million as of September 30, 2016 was based on current interest rates for similar types of borrowings and is in Level 2 of the fair value hierarchy. The estimated fair values may not represent actual values of the financial instruments that could be realized as of the balance sheet date or that will be realized in the future.

All of the Company's investments are classified as "available-for-sale" and are carried at fair value.

The contingent consideration liability reflects the fair value of potential future payments related to the CDMI, LLC ("CDMI"), Cobalt Therapeutics, LLC ("Cobalt"), 4D Pharmacy Management Systems, Inc. ("4D"), The Management Group, LLC ("TMG") and Armed Forces Services Corporation ("AFSC") acquisitions. The CDMI purchase agreement provides for potential contingent payments up to a maximum aggregate amount of $165.0 million. The potential future payments are contingent upon CDMI meeting certain client retention, client conversion and gross profit milestones through December 31, 2016. As of September 30, 2016, there are remaining potential future payments of $65.0 million based on client conversion. Based on the Company's current projections, these potential payments will not be earned and no reserve has been established. The 4D purchase agreement provided for potential contingent payments up to a maximum aggregate amount of $30.0 million. The potential future payments were contingent upon the achievement of certain growth targets in the underlying dual eligible membership served by 4D during calendar year 2015 and the retention of certain business. The 4D contingent payments were finalized in 2016 and no future potential payments remain outstanding. The Cobalt, TMG and AFSC purchase agreements also provide for potential contingent payments of up to a maximum of $6.0 million, $15.0 million and $10.0 million, respectively. As of September 30, 2016,

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there are remaining potential future payments of $5.0 million, $15.0 million and $10.0 million for Cobalt, TMG and AFSC, respectively.

As of the balance sheet date, the fair value of contingent consideration is determined based on probabilities of payment, projected payment dates, discount rates, projected revenues, gross profits, client base, member engagement and new contract execution. The projected revenues, gross profits, client base, member engagement and new contract execution are derived from the Company's latest internal operational forecasts. The Company used a probability weighted discounted cash flow method to arrive at the fair value of the contingent consideration. Changes in the operational forecasts, probabilities of payment, discount rates or projected payment dates may result in a change in the fair value measurement. Any changes in the fair value measurement are reflected as income or expense in the consolidated statements of income (loss). As the fair value measurement for the contingent consideration is based on inputs not observed in the market, these measurements are classified as Level 3 measurements as defined by fair value measurement guidance.

For CDMI, the Company estimated undiscounted future contingent payments of $90.1 million as of December 31, 2015, which the Company settled in June 2016. For 4D, the Company estimated net undiscounted future contingent payments of $1.0 million as of December 31, 2015, which the Company settled in February 2016. For Cobalt, TMG and AFSC the unobservable inputs used in the fair value measurement include the discount rate, probabilities of payment and projected payment dates. For Cobalt, the Company estimated undiscounted future contingent payments of $1.7 million and $1.0 million as of December 31, 2015 and September 30, 2016, respectively. As of September 30, 2016, the fair value of the short-term contingent consideration for Cobalt was $0.9 million. For TMG and AFSC, the Company estimated undiscounted future contingent payments of $3.8 million and $9.0 million at the acquisition date, respectively, and $3.8 million and $9.0 million as of September 30, 2016, respectively. As of September 30, 2016, the fair value of the long-term contingent consideration for TMG and Cobalt was $2.5 million and $8.4 million

As of December 31, 2015, the fair value of the short-term and long-term contingent consideration was $91.6 million and $0.8 million, respectively, and is included in short-term contingent consideration and long-term contingent consideration, respectively, in the consolidated balance sheets. As of September 30, 2016, the fair value of the short-term and long-term contingent consideration was $0.9 million and $10.9 million, respectively, and is included in short-term contingent consideration and long-term contingent consideration, respectively, in the consolidated balance sheets. The change in the fair value of the contingent consideration was $29.7 million and $47.3 million for the three and nine months ended September 30, 2015, respectively, and $0.3 million and $0.5 million for the three and nine months ended September 30, 2016, respectively, which were recorded as direct service costs and other operating expenses in the consolidated statements of income (loss). The increases were mainly a result of changes in present value and the estimated undiscounted liability.

The following table summarizes the Company's liability for contingent consideration for the nine months ended (in thousands):

	September 30,

		2016
Balance as of beginning of period	$	92,426
Acquisition of TMG		2,244
Acquisition of AFSC		8,247
Changes in fair value		510
Payments		(91,660)
Balance as of end of period	$	11,767

Cash and Cash Equivalents

Cash equivalents are short-term, highly liquid interest-bearing investments with maturity dates of three months or less when purchased, consisting primarily of money market instruments. At September 30, 2016, the Company’s

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excess capital and undistributed earnings for the Company's regulated subsidiaries of $112.1 million are included in cash and cash equivalents.

Investments

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 (loss). 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 (loss) and the non credit component of the other than temporary impairment is recognized in other comprehensive income.

As of December 31, 2015 and September 30, 2016, there were no unrealized losses that the Company determined to be other than temporary. No realized gains or losses were recorded for the nine months ended September 30, 2015 or 2016. The following is a summary of short term and long term investments at December 31, 2015 and September 30, 2016 (in thousands):

	December 31, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Government and agency securities	$ 5,524	$ —	$ (10)	$ 5,514
Obligations of government-sponsored enterprises (1)	50,575	4	(54)	50,525
Corporate debt securities	269,340	—	(364)	268,976
Certificates of deposit	1,150	—	—	1,150
Total investments at December 31, 2015	$ 326,589	$ 4	$ (428)	$ 326,165

	September 30, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Government and agency securities	$ 5,129	$ 3	$ (1)	$ 5,131
Obligations of government-sponsored enterprises (2)	42,121	12	(6)	42,127

Corporate debt securities	265,470	2	(257)	265,215
Certificates of deposit	1,450	—	—	1,450
Total investments at September 30, 2016	$ 314,170	$ 17	$ (264)	$ 313,923

(1) Includes investments in notes issued by the Federal Home Loan Bank and Federal Farm Credit Banks.
(2) Includes investments in notes issued by the Federal Home Loan Bank, Federal National Mortgage Association and Federal Farm Credit Banks.

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The maturity dates of the Company’s investments as of September 30, 2016 are summarized below (in thousands):

	Amortized Cost	Estimated Fair Value
2016	$ 118,854	$ 118,821
2017	190,635	190,426
2018	4,681	4,676
Total investments at September 30, 2016	$ 314,170	$ 313,923

Income Taxes

The Company’s effective income tax rates were 43.5 percent and 51.9 percent for the nine months ended September 30, 2015 and 2016, respectively. These rates differ from the federal statutory income tax rate primarily due to state income taxes, permanent differences between book and tax income, and changes to recorded tax contingencies and valuation allowances. The Company also accrues interest and penalties related to uncertain tax positions in its provision for income taxes. The effective income tax rate for the nine months ended September 30, 2016 is higher than the effective rate for the nine months ended September 30, 2015 mainly due to valuation allowance increases in 2016 with respect to losses at AlphaCare of New York, Inc. (“AlphaCare”).

The Company files a consolidated federal income tax return with most of its eighty-percent or more controlled subsidiaries. The Company files a separate consolidated federal income tax return for AlphaCare and its parent, AlphaCare Holdings, Inc. The Company and its subsidiaries also file income tax returns in various state and local jurisdictions. The Company is no longer subject to federal income tax assessments for years ended prior to 2013 or, with few exceptions, to state or local income tax assessments for years ended prior to 2012. Further, the statutes of limitation regarding the assessment of 2012 federal and certain state and local income taxes expired during the quarter ended September 30, 2016 (“Current Year Quarter”). As a result, $1.6 million of tax contingency reserves recorded as of December 31, 2015 were reversed in the Current Year Quarter, of which $1.1 million is reflected as a discrete reduction to income tax expense and $0.5 million as a decrease to deferred tax assets. Additionally, $0.1 million of accrued interest was reversed in the Current Year Quarter and reflected as a reduction to income tax expense due to the closing of statutes of limitation on tax assessments.

Net Operating Loss Carryforwards

The Company has $2.4 million of federal net operating loss carryforwards (“NOLs”) available to reduce its federal consolidated taxable income in 2016 and subsequent years. These NOLs will expire in 2018 and 2019 if not used and are subject to examination and adjustment by the Internal Revenue Service (“IRS”). AlphaCare has $36.2 million of federal NOLs available to reduce its consolidated taxable income in 2016 and subsequent years. These NOLs will expire in 2033 through 2035 if not used and are subject to examination and adjustment by the IRS. The Company and its subsidiaries also have $136.4 million of state NOLs available to reduce state taxable income at certain subsidiaries in 2016 and subsequent years. Most of these state NOLs will expire in 2017 through 2035 if not used and are subject to examination and adjustment by the respective state tax authorities.

Deferred tax assets as of December 31, 2015 and September 30, 2016 are shown net of valuation allowances of $15.5 million and $19.7 million, respectively. These valuation allowances mostly relate to uncertainties regarding the eventual realization of the AlphaCare federal NOLs and certain state NOLs. Determination of the amount of deferred tax assets considered realizable requires significant judgment and estimation regarding the forecasts of future taxable income which are consistent with the plans and estimates the Company uses to manage the underlying businesses. Although consideration is also given to potential tax planning strategies which might be available to improve the realization of deferred tax assets, none were identified which were both prudent and reasonable. Future changes in the estimated realizable portion of deferred tax assets could materially affect the Company's financial condition and results of operations.

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Health Care Reform

The Patient Protection and the Affordable Care Act, as amended by the Health Care and Education Reconciliation Act of 2010 (collectively, the "Health Reform Law"), imposes a mandatory annual fee on health insurers for each calendar year beginning on or after January 1, 2014. The Company has obtained rate adjustments from customers which the Company expects will cover the direct costs of these fees and the impact from non deductibility of such fees for federal and state income tax purposes. To the extent the Company has such a customer that does not renew, there may be some impact due to taxes paid where the timing and amount of recoupment of these additional costs is uncertain. In the event the Company is unable to obtain rate adjustments to cover the financial impact of the annual fee, the fee may have a material impact on the Company. For 2015 and 2016, the HIF fees were $26.5 million and $26.5 million, respectively, which have been paid. Of these amounts, $6.7 million and $19.9 million was expensed in the three and nine months ended September 30, 2015, respectively, and $6.7 million and $19.9 million was expensed in the three and nine months ended September 30, 2016, respectively, which was included in direct service costs and other operating expenses in the consolidated statements of income (loss). The Company recorded revenues of $11.6 million and $34.0 million in the three and nine months ended September 30, 2015, respectively, and $11.0 million and $32.4 million in the three and nine months ended September 30, 2016, respectively, associated with the accrual for the reimbursement of the economic impact of the HIF fees from its customers.

Stock Compensation

At December 31, 2015 and September 30, 2016, 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, 2015. The Company recorded stock compensation expense of $12.9 million and $40.6 million for the three and nine months ended September 30, 2015 and $9.2 million and $27.6 million for the three and nine months ended September 30, 2016, respectively. Stock compensation expense recognized in the consolidated statements of income (loss) for the nine months ended September 30, 2015 and 2016 has been reduced for forfeitures, estimated at between zero and four percent for both periods.

The weighted average grant date fair value of all stock options granted during the nine months ended September 30, 2016 was $15.07 as estimated using the Black Scholes Merton option pricing model, which also assumed an expected volatility of 27.75 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, 2015 and 2016, $3.9 million and $0.5 million, respectively, of benefits of such tax deductions related to stock compensation expense were realized and as such were reported as financing cash flows. For the nine months ended September 30, 2015, the net change to additional paid in capital related to tax benefits (deficiencies) was $3.8 million, which includes $3.9 million of excess tax benefits offset by $(0.1) million of excess tax deficiencies. For the nine months ended September 30, 2016, the net change to additional paid in capital related to tax benefits (deficiencies) was $0.3 million, which includes $0.5 million of excess tax benefits offset by $(0.2) million of excess tax deficiencies.

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Summarized information related to the Company’s stock options for the nine months ended September 30, 2016 is as follows:

	Options	Weighted Average Exercise Price
Outstanding, beginning of period	2,939,840	$ 55.13
Granted	485,560	64.22
Forfeited	(100,368)	48.82
Exercised	(221,308)	56.94
Outstanding, end of period	3,103,724	$ 56.94
Vested and expected to vest at end of period	3,076,774	$ 56.89
Exercisable, end of period	1,816,352	$ 53.40

All of the Company’s options granted during the nine months ended September 30, 2016 vest ratably on each anniversary date over the three years subsequent to grant and have a ten year life.

Summarized information related to the Company’s nonvested restricted stock awards (“RSAs”) for the nine months ended September 30, 2016 is as follows:

	Shares	Weighted Average Grant Date Fair Value
Outstanding, beginning of period	1,109,622	$ 57.88
Awarded	76,134	65.84
Vested	(20,115)	67.12
Forfeited	—	—
Outstanding, ending of period	1,165,641	58.24

Summarized information related to the Company’s nonvested restricted stock units (“RSUs”) for the nine months ended September 30, 2016 is as follows:

	Shares	Weighted Average Grant Date Fair Value
Outstanding, beginning of period	231,088	$ 61.53
Awarded	51,521	64.87
Vested	(51,419)	63.77
Forfeited	(23,605)	63.47
Outstanding, ending of period	207,585	61.58

The vesting period for RSAs ranges from 12 months to 42 months. In general, RSUs vest ratably on each anniversary over the three years subsequent to grant. In addition, certain RSUs outstanding contain associated performance hurdle(s) that must be met in order for the awards to vest.

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Summarized information related to the Company's nonvested restricted performance stock units ("PSUs") for the nine months ended September 30, 2016 is as follows:

	Shares	Weighted Average Grant Date Fair Value
Outstanding, beginning of period	36,938	$ 85.00
Awarded	69,691	97.22
Vested	—	—
Forfeited	(3,652)	91.89
Outstanding, end of period	102,977	93.03

The weighted average estimated fair value of the PSUs granted in the nine months ended September 30, 2016 was $97.22, which was derived from a Monte Carlo simulation. Significant assumptions utilized in estimating the value of the awards granted include an expected dividend yield of 0%, a risk free rate of 1%, and expected volatility of 16% to 81% (average of 32%). The PSUs granted in the nine months ended September 30, 2016, will entitle the grantee to receive a number of shares of the Company's common stock determined over a three-year performance period ending on December 31, 2018 and vesting on March 3, 2019, the settlement date, provided the grantee remains in the service of the Company on the settlement date. The Company expenses the cost of these awards ratably over the requisite service period. The number of shares for which the PSUs will be settled will be a percentage of shares for which the award is targeted and will depend on the Company's total shareholder return (as defined below), expressed as a percentile ranking of the Company's total shareholder return as compared to the Company's peer group (as defined below). The number of shares for which the PSUs will be settled vary from zero to 200 percent of the shares specified in the grant. Total shareholder return is determined by dividing the average share value of the Company's common stock over the 30 trading days preceding January 1, 2019 by the average share value of the Company's common stock over the 30 trading days beginning on January 1, 2016, with a deemed reinvestment of any dividends declared during the performance period. The Company's peer group includes 56 companies which comprise the S&P Health Care Services Industry Index, which was selected by the compensation committee of the Company's board of directors and includes a range of healthcare companies operating in several business segments.

Long Term Debt and Capital Lease Obligations

On July 23, 2014, the Company entered into a $500.0 million Credit Agreement with various lenders that provides for Magellan Rx Management, Inc. (a wholly owned subsidiary of Magellan Health, Inc.) to borrow up to $250.0 million of revolving loans, with a sublimit of up to $70.0 million for the issuance of letters of credit for the account of the Company, and a term loan in an original aggregate principal amount of $250.0 million (the "2014 Credit Facility"). On December 2, 2015, the Company entered into an amendment to the 2014 Credit Facility under which Magellan Pharmacy Services, Inc. (a wholly owned subsidiary of Magellan Health, Inc.) became a party to the $500.0 million Credit Agreement as the borrower and assumed all of the obligations of Magellan Rx Management, Inc. The 2014 Credit Facility is guaranteed by substantially all of the non-regulated subsidiaries of the Company and will mature on

July 23, 2019; however, the Company holds an option to extend the 2014 Credit Facility for an additional one year period.

Under the 2014 Credit Facility, the annual interest rate on revolving and term loan borrowings is equal to (i) in the case of base rate loans, the sum of a borrowing margin ranging from 0.50 percent to 1.00 percent plus the higher of the prime rate, one-half of one percent in excess of the overnight “federal funds” rate, or the Eurodollar rate for one month plus 1.00 percent, or (ii) in the case of Eurodollar rate loans, the sum of a borrowing margin ranging from 1.50 percent to 2.00 percent plus the Eurodollar rate for the selected interest period. The Company has the option to borrow in base rate loans or Eurodollar rate loans at its discretion, with the borrowing margin for these loans adjusted from time to time based on the Company’s total leverage ratio. Letters of credit issued bear interest equal to the borrowing margin for

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Eurodollar loans that ranges from 1.50 percent to 2.00 percent, with the commitment commission on the unused revolving loan commitment ranging from 0.20 percent to 0.35 percent. These letter of credit and commitment commission rates are adjusted from time to time based on the Company's total leverage ratio.

Under the 2014 Credit Facility, on September 30, 2014, the Company completed a draw-down of the $250.0 million term loan (the "2014 Term Loan"). The borrowings have been maintained as a Eurodollar loan. The 2014 Term Loan is subject to certain quarterly amortization payments. As of September 30, 2016 the remaining balance on the 2014 Term Loan was $225.0 million. The 2014 Term Loan will mature on July 23, 2019. As of September 30, 2016, the 2014 Term Loan bore interest at a rate of 1.625 percent plus the London Interbank Offered Rate ("LIBOR"), which was equivalent to a total interest rate of approximately 2.149 percent. For the nine months ended September 30, 2016, the weighted average interest rate was approximately 1.979 percent.

On June 27, 2016, the Company entered into a $200.0 million Credit Agreement with various lenders that provides for a $200.0 million term loan (the "2016 Term Loan") to Magellan Pharmacy Services, Inc. (the "2016 Credit Facility"). The 2016 Credit Facility is guaranteed by substantially all of the non-regulated subsidiaries of the Company and will mature on December 29, 2017.

Under the 2016 Credit Facility, the annual interest rate on the term loan is equal to (i) in the case of base rate loans, the sum of a borrowing margin ranging from 0.25 percent to 0.75 percent plus the higher of the prime rate, one-half of one percent in excess of the overnight "federal funds" rate, or the Eurodollar rate for one month plus 1.00 percent, or (ii) in the case of Eurodollar rate loans, the sum of a borrowing margin ranging from 1.25 percent to 1.75 percent plus the Eurodollar rate for the selected interest period. The Company has the option to borrow in base rate loans or Eurodollar rate loans at its discretion, with the borrowing margin for these loans adjusted from time to time based on the Company's total leverage ratio.

The borrowings under the 2016 Term Loan have been maintained as a Eurodollar loan. As of September 30, 2016 the remaining balance on the 2016 Term Loan was $200.0 million and bore interest at a rate of approximately 1.375 percent plus the London Interbank Offered Rate ("LIBOR"), which was equivalent to a total interest rate of approximately 1.899 percent. During the period the term loan was outstanding, from June 27, 2016 through September 30, 2016, the weighted average interest rate was approximately 1.866 percent.

As of September 30, 2016, the contractual maturities of the term loans under the 2014 Credit Facility and the 2016 Credit Facility were as follows: 2016—$6.3 million; 2017—$225.0 million; 2018—$25.0 million; and 2019—$168.7 million. The Company had $33.4 million and $33.7 million of letters of credit outstanding at December 31, 2015 and September 30, 2016, respectively. The Company had no revolving loan borrowings at December 31, 2015. Beginning in April 2016, due to the timing of working capital needs, the Company has borrowed from the revolving loan under the 2014 Credit Facility. The revolving loan borrowings have been in the form of Eurodollar rate loans and totaled $90.0 million at September 30, 2016. As of November 7, 2016, the Company has revolving loans totaling $65.0 million, resulting in $151.3 million of revolving loans available under the 2014 Credit Facility.

There were $24.4 million and $24.4 million of capital lease obligations at December 31, 2015 and September 30, 2016, respectively. Included in long-term debt and capital lease obligations as of December 31, 2015 and September 30, 2016 are deferred loan issuance costs of $1.4 million and $1.5 million, respectively.

Goodwill

The Company is required to test its goodwill for impairment on at least an annual basis and more frequently if indicators of impairment exist. The Company has selected October 1 as the date of its annual impairment test. Goodwill for each of the Company's reporting units at December 31, 2015 and September 30, 2016 were as follows (in thousands):

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(Unaudited)

	December 31, 2015	September 30, 2016
Commercial	$ 242,255	$ 242,255
Government	18,363	113,895
Pharmacy Management	360,772	360,772
Total	$ 621,390	$ 716,922

The changes in the carrying amount of goodwill for the years ended December 31, 2015 and the nine months ended September 30, 2016 are reflected in the table below (in thousands):

	December 31, 2015	September 30, 2016
Balance as of beginning of period	$ 566,106	$ 621,390
Acquisition of 4D	49,136	—
Acquisition of AFSC	—	82,310
Other acquisitions and measurement period adjustments	6,148	13,222
Balance as of end of period	$ 621,390	$ 716,922

Intangible Assets

The Company reviews other intangible assets for impairment when events or changes in circumstances occur which may potentially impact the estimated useful life of the intangible assets. During the second quarter of 2016, the Company recognized $4.8 million in impairment charges, which are reflected in direct service costs and other operating expenses in the consolidated statements of income (loss) and reported within the Healthcare segment. The fair value of the impairment was determined using the income method, which resulted in the full impairment of the customer agreement intangible asset recorded in conjunction with the AlphaCare acquisition.

The following is a summary of intangible assets at December 31, 2015 and September 30, 2016, and the estimated useful lives for such assets (in thousands):

	December 31, 2015			
Asset	Estimated Useful Life	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Customer agreements and lists	2.5 to 18 years	$ 274,790	$ (148,795)	$ 125,995

Provider networks and other	1 to 16 years	16,663	(9,284)	7,379
		$ 291,453	$ (158,079)	$ 133,374

	September 30, 2016			
Asset	Estimated Useful Life	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Customer agreements and lists	2.5 to 18 years	$ 314,246	$ (174,152)	$ 140,094
Provider networks and other	1 to 16 years	17,647	(11,267)	6,380
AFSC trade name	indefinite	3,030	—	3,030
		$ 334,923	$ (185,419)	$ 149,504

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MAGELLAN HEALTH, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

September, 30 2016

(Unaudited)

Amortization expense was $8.1 million and $21.7 million for the three and nine months ended September 30, 2015, respectively, and $7.8 million and $22.5 million for the three and nine months ended September 30, 2016, respectively. The Company estimates amortization expense will be $30.0 million, $26.8 million, $23.8 million, $23.2 million and $22.1 million for the years ended December 31, 2016, 2017, 2018, 2019, and 2020, respectively.

Redeemable Non Controlling Interest

As of September 2016, the Company held an equity interest of approximately 84% in AlphaCare Holdings. The other shareholders of AlphaCare Holdings have the right to exercise put options, requiring the Company to purchase up to 50% of the remaining shares prior to January 1, 2017, provided certain membership levels are attained. After December 31, 2016, the other shareholders of AlphaCare Holdings have the right to exercise put options requiring the Company to purchase all or any portion of the remaining shares. In addition, after December 31, 2016, the Company has the right to purchase all remaining shares. Non controlling interests with redemption features, such as put options, that are not solely within the Company's control are considered redeemable non controlling interests. Redeemable non controlling interest is considered to be temporary and is therefore reported in a mezzanine level between liabilities and stockholders' equity on the Company's consolidated balance sheet at the greater of the initial carrying amount adjusted for the non controlling interest's share of net income or loss or its redemption value. The carrying value of the non controlling interest as of December 31, 2015 and September 30, 2016 was $5.9 million and $4.2 million, respectively. The $1.7 million decrease in carrying value is a result of operating losses, partially offset by the impact of additional capital provided by the Company. The Company evaluates the redemption value on a quarterly basis. If the redemption value is greater than the carrying value, the Company adjusts the carrying amount of the non controlling interest to equal the redemption value at the end of each reporting period. Under this method, this is viewed at the end of the reporting period as if it were also the redemption date for the non controlling interest. The Company will reflect redemption value adjustments in the earnings per share ("EPS") calculation if redemption value is in excess of the carrying value of the non controlling interest. As of September 30, 2016, the carrying value of the non controlling interest exceeded the redemption value and therefore no adjustment to the carrying value was required.

Reclassifications

Certain prior year amounts have been reclassified to conform with the current year presentation.

In order to better represent the operations of the Company's segments, effective January 1, 2016, the Company began allocating operational and corporate support costs to the Healthcare and Pharmacy Management segments. For comparative presentation, the Company applied the allocation methodology retrospectively and reclassified direct service costs and other between segments for the three and nine months ended September 30, 2015. The impact of these reclassifications are disclosed in Note C—"Business Segment Information".

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MAGELLAN HEALTH, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

September, 30 2016

(Unaudited)

NOTE B—Net Income per Common Share Attributable to Magellan Health, Inc.

The following table reconciles income attributable to common shareholders (numerator) and shares (denominator) used in the computations of net income per share attributable to common shareholders (in thousands, except per share data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2016	2015	2016
Numerator:				
Net (loss) income attributable to Magellan Health, Inc.	$ (7,808)	$ 25,509	$ 4,123	$ 42,704
Denominator:				
Weighted average number of common shares outstanding—basic	24,892	23,052	25,297	23,394
Common stock equivalents—stock options	—	235	360	282
Common stock equivalents—RSAs	—	679	640	615
Common stock equivalents—RSUs	—	25	34	26
Common stock equivalents—PSUs	—	10	39	23
Common stock equivalents—employee stock purchase plan	—	4	2	3
Weighted average number of common shares outstanding—diluted	24,892	24,005	26,372	24,343
Net (loss) income attributable to Magellan Health, Inc. per common share—basic	$ (0.31)	$ 1.11		