CENTENE CORP
Form 10-Q
October 27, 2015

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2015
OR

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

For the transition period from to

Commission file number: 001-31826

CENTENE CORPORATION
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	42-1406317 (I.R.S. Employer Identification Number)
7700 Forsyth Boulevard St. Louis, Missouri (Address of principal executive offices)	63105 (Zip Code)

Registrant's telephone number, including area code:

(314) 725-4477

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "small reporting company” in Rule 12b-2 of the Exchange Act. Large accelerated filer x Accelerated filer o Non-accelerated filer o (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 x

As of October 16, 2015, the registrant had 119,202,788 shares of common stock outstanding.

CENTENE CORPORATION
QUARTERLY REPORT ON FORM 10-Q
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CAUTIONARY STATEMENT ON FORWARD-LOOKING STATEMENTS

All statements, other than statements of current or historical fact, contained in this filing are forward-looking statements. We have attempted to identify these statements by terminology including “believe,” “anticipate,” “plan,” “expect,” “estimate,” “intend,” “seek,” “target,” “goal,” “may,” “will,” “would,” “could,” “should,” “can,” “continue” and other similar expressions in connection with, among other things, any discussion of future operating or financial performance. In particular, these statements include statements about our market opportunity, our growth strategy, competition, expected activities and future acquisitions, including our proposed merger with Health Net, Inc. (Health Net) (Proposed Merger), investments and the adequacy of our available cash resources. These statements may be found in the various sections of this filing, including those entitled “Management's Discussion and Analysis of Financial Condition and Results of Operations,” Part II, Item 1A. “Risk Factors,” and Part II, Item 1 “Legal Proceedings.” Readers are cautioned that matters subject to forward-looking statements involve known and unknown risks and uncertainties, including economic, regulatory, competitive and other factors that may cause our or our industry’s actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by these forward-looking statements. These statements are not guarantees of future performance and are subject to risks, uncertainties and assumptions.

All forward-looking statements included in this filing are based on information available to us on the date of this filing and we undertake no obligation to update or revise the forward-looking statements included in this filing, whether as a result of new information, future events or otherwise, after the date of this filing. Actual results may differ from projections or estimates due to a variety of important factors applicable to both us and Health Net, including but not limited to:

- our ability to accurately predict and effectively manage health benefits and other operating expenses and reserves;
- competition;
- membership and revenue projections;
- timing of regulatory contract approval;
- changes in healthcare practices;
- changes in federal or state laws or regulations, including the Patient Protection and Affordable Care Act and the Health Care and Education Affordability Reconciliation Act and any regulations enacted thereunder;
- changes in expected contract start dates;
- changes in expected closing dates, estimated purchase price and accretion for acquisitions;
- inflation;
- foreign currency fluctuations;
- provider and state contract changes;
- new technologies;
- advances in medicine;
- reduction in provider payments by governmental payors;
- major epidemics;
- disasters and numerous other factors affecting the delivery and cost of healthcare;
- the expiration, cancellation or suspension of our or Health Net's managed care contracts by federal or state governments (including but not limited to Medicare and Medicaid);
- the outcome of our or Health Net's pending legal proceedings;
- availability of debt and equity financing, on terms that are favorable to us;
- changes in economic, political and market conditions;
- the ultimate closing date of the Proposed Merger;
- the possibility that the expected synergies and value creation from the Proposed Merger will not be realized, or will not be realized within the expected time period;
- the risk that acquired businesses will not be integrated successfully;

- disruption from the Proposed Merger making it more difficult to maintain business and operational relationships;
- the risk that unexpected costs related to the Proposed Merger will be incurred;
- the possibility that the Proposed Merger does not close, including, but not limited to, due to the failure to satisfy the closing conditions thereto; and
- the risk that financing for the Proposed Merger may not be available on favorable terms.

This list of important factors is not intended to be exhaustive. We discuss certain of these matters more fully, as well as certain risk factors that may affect our business operations, financial condition and results of operations, in our filings with the Securities and Exchange Commission, including our annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K.

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Other Information

The discussion in Part I, Item 2. "Management’s Discussion and Analysis of Financial Condition and Results of Operations" under the heading "Results of Operations" contains financial information for new and existing businesses. Existing businesses are primarily state markets, significant geographic expansion in an existing state or product that we have managed for four complete quarters. New businesses are primarily new state markets, significant geographic expansion in an existing state or product that conversely, we have not managed for four complete quarters.

Item 1A “Risk Factors” of Part II of this filing contains a further discussion of these and other important factors that could cause actual results to differ from expectations. We disclaim any current intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. Due to these important factors and risks, we cannot give assurances with respect to our future premium levels or our ability to control our future medical costs.

Non-GAAP Financial Presentation

The Company is providing certain non-GAAP financial measures in this report as the Company believes that these figures are helpful in allowing individuals to more accurately assess the ongoing nature of the Company's operations and measure the Company's performance more consistently. The Company uses the presented non-GAAP financial measures internally to allow management to focus on period-to-period changes in the Company's core business operations. Therefore, the Company believes that this information is meaningful in addition to the information contained in the GAAP presentation of financial information. The presentation of this additional non-GAAP financial information is not intended to be considered in isolation or as a substitute for the financial information prepared and presented in accordance with GAAP.

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PART I
FINANCIAL INFORMATION

ITEM 1. Financial Statements.
CENTENE CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In millions, except share data)
(Unaudited)

	September 30, 2015	December 31, 2014
ASSETS		
Current assets:		
Cash and cash equivalents	$1,665	$1,610
Premium and related receivables	1,281	912
Short term investments	162	177
Other current assets	488	335
Total current assets	3,596	3,034
Long term investments	1,992	1,280
Restricted deposits	106	100
Property, software and equipment, net	488	445
Goodwill	849	754
Intangible assets, net	161	120
Other long term assets	130	91
Total assets	$7,322	$5,824
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Medical claims liability	$2,144	$1,723
Accounts payable and accrued expenses	1,035	768
Return of premium payable	313	236
Unearned revenue	66	168
Current portion of long term debt	5	5
Total current liabilities	3,563	2,900
Long term debt	1,276	874
Other long term liabilities	274	159
Total liabilities	5,113	3,933
Commitments and contingencies		
Redeemable noncontrolling interests	156	148
Stockholders' equity:		
Preferred stock, $0.001 par value; authorized 10,000,000 shares; no shares issued or outstanding at September 30, 2015 and December 31, 2014	—	—
Common stock, $.001 par value; authorized 200,000,000 shares; 124,940,103 issued and 119,201,560 outstanding at September 30, 2015, and 124,274,864 issued and 118,433,416 outstanding at December 31, 2014	—	—
Additional paid-in capital	909	840
Accumulated other comprehensive loss	(2)	(1)
Retained earnings	1,247	1,003
Treasury stock, at cost (5,738,543 and 5,841,448 shares, respectively)	(103)	(98)
Total Centene stockholders' equity	2,051	1,744

Noncontrolling interest	2	(1)
Total stockholders’ equity	2,053	1,743
Total liabilities and stockholders’ equity	$7,322	$5,824

The accompanying notes to the consolidated financial statements are an integral part of these statements.

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CENTENE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(In millions, except share data)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Revenues:				
Premium	$4,983	$3,780	$13,974	$10,182
Service	480	379	1,434	1,070
Premium and service revenues	5,463	4,159	15,408	11,252
Premium tax and health insurer fee	358	193	1,050	584
Total revenues	5,821	4,352	16,458	11,836
Expenses:				
Medical costs	4,433	3,390	12,475	9,093
Cost of services	413	327	1,234	935
General and administrative expenses	464	334	1,309	951
Premium tax expense	274	161	794	492
Health insurer fee expense	54	32	161	94
Total operating expenses	5,638	4,244	15,973	11,565
Earnings from operations	183	108	485	271
Other income (expense):				
Investment and other income	8	6	27	18
Interest expense	(11)	(9)	(32)	(25)
Earnings from continuing operations, before income tax expense	180	105	480	264
Income tax expense	87	27	234	107
Earnings from continuing operations, net of income tax expense	93	78	246	157
Discontinued operations, net of income tax expense of $0, $0, $0, and $1, respectively	1	1	—	2
Net earnings	94	79	246	159
(Earnings) loss attributable to noncontrolling interests	(1)	3	(2)	5
Net earnings attributable to Centene Corporation	$93	$82	$244	$164
Amounts attributable to Centene Corporation common shareholders:				
Earnings from continuing operations, net of income tax expense	$92	$81	$244	$162
Discontinued operations, net of income tax expense	1	1	—	2
Net earnings	$93	$82	$244	$164
Net earnings per common share attributable to Centene Corporation:				
Basic:				
Continuing operations	$0.77	$0.69	$2.05	$1.40
Discontinued operations	0.01	0.01	—	0.01
Basic earnings per common share	$0.78	$0.70	$2.05	$1.41
Diluted:				
Continuing operations	$0.75	$0.67	$1.99	$1.35

Discontinued operations	0.01	0.01	—	0.02
Diluted earnings per common share	$0.76	$0.68	$1.99	$1.37
Weighted average number of common shares outstanding:				
Basic	119,121,524	117,226,968	118,970,853	115,912,304
Diluted	123,131,810	121,363,750	122,904,476	119,873,398

The accompanying notes to the consolidated financial statements are an integral part of these statements.

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CENTENE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF COMPREHENSIVE EARNINGS
(In millions)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Net earnings	$94	$79	$246	$159
Reclassification adjustment, net of tax	—	—	—	—
Change in unrealized gain on investments, net of tax	2	(3)	3	2
Foreign currency translation adjustments	—	—	(4)	—
Other comprehensive earnings	2	(3)	(1)	2
Comprehensive earnings	96	76	245	161
Comprehensive (earnings) loss attributable to noncontrolling interests	(1)	3	(2)	5
Comprehensive earnings attributable to Centene Corporation	$95	$79	$243	$166

The accompanying notes to the consolidated financial statements are an integral part of this statement.

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CENTENE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
(In millions, except share data)
(Unaudited)

Nine Months Ended September 30, 2015

	Centene Stockholders' Equity								
	Common Stock					Treasury Stock			
	$.001 Par Value Shares	Amt	Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	$.001 Par Value Shares	Amt	Non controlling Interest	Total
Balance, December 31, 2014	124,274,864	$—	$ 840	$ (1)	$ 1,003	5,841,448	$(98)	$ (1)	$ 1,743
Comprehensive Earnings:									
Net earnings	—	—	—	—	244	—	—	—	244
Change in unrealized gain on investments, net of $1 tax	—	—	—	3	—	—	—	—	3
Foreign currency translation	—	—	—	(4)	—	—	—	—	(4)
Total comprehensive earnings									243
Common stock issued for acquisition		—	8	—	—	(247,580)	4	—	12
Common stock issued for employee benefit plans	665,239	—	6	—	—	—	—	—	6
Common stock repurchases	—	—	—	—	—	144,675	(9)	—	(9)
Stock compensation expense	—	—	48	—	—	—	—	—	48
Excess tax benefits from stock compensation	—	—	7	—	—	—	—	—	7
Contribution from noncontrolling interest	—	—	—	—	—	—	—	2	2
Reclassification to redeemable noncontrolling interest	—	—	—	—	—	—	—	1	1
Balance, September 30, 2015	124,940,103	$—	$ 909	$ (2)	$ 1,247	5,738,543	$(103)	$ 2	$ 2,053

The accompanying notes to the consolidated financial statements are an integral part of this statement.

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CENTENE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In millions)
(Unaudited)

	Nine Months Ended September 30, 2015	2014
Cash flows from operating activities:		
Net earnings	$246	$159
Adjustments to reconcile net earnings to net cash provided by operating activities		
Depreciation and amortization	82	65
Stock compensation expense	48	35
Deferred income taxes	(14)	(65)
Gain on settlement of contingent consideration	(37)	—
Goodwill and intangible adjustment	28	—
Changes in assets and liabilities		
Premium and related receivables	(360)	(243)
Other current assets	(103)	(25)
Other assets	(40)	(51)
Medical claims liabilities	394	476
Unearned revenue	(104)	54
Accounts payable and accrued expenses	209	427
Other long term liabilities	101	17
Other operating activities	7	4
Net cash provided by operating activities	457	853
Cash flows from investing activities:		
Capital expenditures	(101)	(69)
Purchases of investments	(1,077)	(738)
Sales and maturities of investments	418	320
Proceeds from asset sale	7	—
Investments in acquisitions, net of cash acquired	(16)	(94)
Net cash used in investing activities	(769)	(581)
Cash flows from financing activities:		
Proceeds from exercise of stock options	5	6
Proceeds from borrowings	1,305	1,385
Payment of long term debt	(910)	(1,118)
Excess tax benefits from stock compensation	7	7
Common stock repurchases	(9)	(6)
Contribution from noncontrolling interest	2	5
Debt issue costs	(4)	(6)
Payment of contingent consideration obligation	(29)	—
Net cash provided by financing activities	367	273
Net increase in cash and cash equivalents	55	545
Cash and cash equivalents, beginning of period	1,610	1,038
Cash and cash equivalents, end of period	$1,665	$1,583
Supplemental disclosures of cash flow information:		
Interest paid	$28	$18
Health insurer fee paid	$213	$126
Income taxes paid	$229	$167
Equity issued in connection with acquisitions	$12	$190

The accompanying notes to the consolidated financial statements are an integral part of these statements.

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CENTENE CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in millions, except share data)
(Unaudited)

1. Basis of Presentation

Basis of Presentation

The accompanying interim financial statements have been prepared under the presumption that users of the interim financial information have either read or have access to the audited financial statements included in the Form 10-K for the fiscal year ended December 31, 2014. The unaudited interim financial statements herein have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, footnote disclosures which would substantially duplicate the disclosures contained in the December 31, 2014 audited financial statements have been omitted from these interim financial statements where appropriate. In the opinion of management, these financial statements reflect all adjustments, consisting only of normal recurring adjustments, which are necessary for a fair presentation of the results of the interim periods presented.

Certain 2014 amounts in the notes to the consolidated financial statements have been reclassified to conform to the 2015 presentation. These reclassifications have no effect on net earnings or stockholders' equity as previously reported.

On February 2, 2015, the Board of Directors declared a two-for-one split of Centene's common stock in the form of a 100% stock dividend distributed February 19, 2015 to stockholders of record on February 12, 2015. All share and per share information presented in this Form 10-Q has been adjusted for the two-for-one stock split.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued an Accounting Standards Update (ASU) which supersedes existing revenue recognition standards with a single model unless those contracts are within the scope of other standards (e.g., an insurance entity's insurance contracts). Under the new standard, recognition of revenue occurs when a customer obtains control of promised goods or services in an amount that reflects the consideration which the entity expects to receive in exchange for those goods or services. In addition, the standard requires disclosure of the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. In August 2015, the FASB issued an ASU which deferred the effective date of the new revenue standard by one year. The new effective date is for annual and interim periods beginning after December 15, 2017. Early adoption is permitted. The Company is currently evaluating the effect of the new revenue recognition guidance.

In April 2015, the FASB issued an ASU which changes the presentation of debt issuance costs in financial statements. Under the new standard, debt issuance costs are presented in the balance sheet as a direct deduction of the related debt liability rather than as an asset. Amortization of the cost is reported as interest expense. The new standard is effective for annual and interim periods beginning after December 15, 2015 and early adoption is permitted. The Company elected to adopt this guidance beginning in the first quarter of 2015 and has applied the new standard retrospectively to all prior periods. The reclassification of debt issuance costs impacted the Consolidated Balance Sheets by decreasing both Other Long Term Assets and Long Term Debt by $14 million at December 31, 2014 and $15 million at September 30, 2015. These reclassifications have no effect on net earnings or stockholders' equity as previously reported.

In May 2015, the FASB issued an ASU which expands the disclosure requirements for insurance companies that issue short-duration contracts. The new standard will increase the level of disclosure around the Company's Medical Claims

Liability to include the following: claims development by year; claim frequency; a rollforward of the claims liability; and a description of methods and assumptions used for determining the liability. It is effective for annual periods beginning after December 15, 2015 and interim periods beginning after December 15, 2016. Early adoption is permitted. The Company is currently evaluating the effect of the new disclosure requirements.

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In September 2015, the FASB issued an ASU which simplifies the accounting for measurement-period adjustments in business combinations. Under the new standard, an acquirer must recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. Additionally, the acquirer must present separately on the face of the income statement, or disclose in the notes, the portion of the amount recorded in the current-period earnings by line item that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date. It is effective for annual and interim periods beginning after December 15, 2016. Early adoption is permitted. The Company elected to adopt this guidance in the current fiscal quarter.

2. Health Net, Inc. Merger

On July 2, 2015, the Company announced that the Company and two direct, newly formed subsidiaries of the Company had entered into a definitive merger agreement with Health Net, Inc. (Health Net) under which the Company will acquire all of the issued and outstanding shares of Health Net. Under the terms of the agreement, at the closing of the transaction, Health Net stockholders (with limited exceptions) would receive 0.622 of a validly issued, fully paid, non-assessable share of Centene common stock and $28.25 in cash for each share of Health Net common stock. The transaction is valued at approximately $6.8 billion (based on the Centene closing stock price on July 1, 2015), including the assumption of debt.

The transaction is expected to close in early 2016 and is subject to approvals by relevant state insurance and healthcare regulators and other customary closing conditions. In August 2015, the Company announced the early termination of the waiting period required under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended. In October 2015, the Company and Health Net announced the transaction was approved by both the Centene and Health Net stockholders. The Company expects to fund the cash portion of the acquisition through a combination of existing cash on hand and debt financing.

3. Acquisitions and Redeemable Noncontrolling Interest

Acquisitions

Community Health Solutions of America, Inc.

In July 2014, the Company completed a transaction whereby Community Health Solutions of America, Inc. assigned its contract with the Louisiana Department of Health and Hospitals under the Bayou Health Shared Savings Program to the Company's subsidiary, Louisiana Healthcare Connections (LHC). The fair value of consideration transferred included the present value of the estimated contingent consideration, subject to membership retained by LHC in the first quarter of 2015. The fair value of contingent consideration was $18 million at December 31, 2014. During the first quarter of 2015, the Company determined the amount of the actual contingent consideration to be $8 million. A gain of $10 million related to the settlement of the obligation was recorded in General and Administrative expense.

LiveHealthier, Inc.

In January 2015, the Company acquired the remaining 79% of LiveHealthier, Inc. (LiveHealthier) for $28 million, bringing its total ownership to 100%. LiveHealthier is a provider of technology and service-based health management solutions. The fair value of consideration of $28 million consists of cash paid of $11 million, Centene common stock issued at closing of $13 million, and the fair value of estimated contingent consideration of $4 million to be paid in cash over a three year period. The contingent consideration will not exceed $9 million.

The Company's allocation of fair value resulted in goodwill of $26 million and other identifiable intangible assets of $15 million. The goodwill is not deductible for income tax purposes. The acquisition is recorded in the Managed Care segment.

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Fidelis SecureCare of Michigan, Inc.

In May 2015, the Company acquired 100% of Fidelis SecureCare of Michigan, Inc. (Fidelis) a subsidiary of Concerto Healthcare, for $57 million. Fidelis was previously selected by the Michigan Department of Community Health to provide integrated healthcare services to members who are dually eligible for Medicare and Medicaid in Macomb and Wayne counties. The fair value of consideration of $57 million consists of initial cash consideration of $7 million and the fair value of estimated contingent consideration of $50 million. The contingent consideration is based on duals membership and revenue per member during the first year of the contract (July 2015 - June 2016), including reconciliation payments settled over a two year period. The contingent consideration fair value is estimated based on expected membership during the first year of the contract as well as estimated revenue per member reflecting both member mix and risk adjustment. The Company's allocation of fair value resulted in goodwill of $29 million and other identifiable intangible assets of $23 million. 100% of the goodwill is deductible for income tax purposes. The acquisition is recorded in the Managed Care segment.

During the third quarter of 2015, the Company experienced higher than anticipated opt-out rates and member attrition in the dual demonstration program, resulting in lower than expected membership and lower blended premium rates. As a result, the fair value of estimated contingent consideration was reduced to $23 million, and the Company recorded a gain of $27 million in general and administrative expenses. In connection with the lower membership and revenue outlook, the Company conducted an impairment analysis of the identifiable intangible assets and goodwill, resulting in a reduction of goodwill and intangible assets of $28 million which was recorded in general and administrative expenses. At September 30, 2015, the Company had goodwill of $15 million and other identifiable intangible assets of $7 million remaining on the balance sheet.

Agate Resources, Inc.

In September 2015, the Company completed the acquisition of Agate Resources, Inc. (Agate) for $120 million. Agate is a diversified holding company that offers primarily Medicaid and other healthcare products and services to Oregon residents. The fair value of consideration of $120 million consists of initial cash consideration of $93 million, the present value of future cash payments of $18 million to be paid out over a three year period, and the fair value of estimated contingent consideration of $9 million. A portion of the contingent consideration is based on the achievement of underwriting targets and will be paid in cash over a three year period; the remainder is based on the receipt of a retrospective rate adjustment and is expected to be settled in cash in the fourth quarter of 2015.

The Company's preliminary allocation of fair value resulted in goodwill of $51 million and other identifiable intangible assets of $34 million. The Company has not finalized the allocation of the fair value of assets and liabilities. The goodwill is not deductible for income tax purposes. The acquisition is recorded in the Managed Care segment.

Redeemable Noncontrolling Interest

In January 2015, the Company sold 25% of its ownership in Celtic Insurance Company for $7 million. No gain or loss was recognized on the sale of the ownership interest. Celtic Insurance Company is included in the Managed Care segment. In connection with the sale of the ownership interest, the Company entered into a put agreement with the noncontrolling interest holder, allowing the noncontrolling interest holder to put its interest back to the Company beginning in 2022. As a result of put option agreements, the noncontrolling interest is considered redeemable and is classified in the Redeemable Noncontrolling Interest section of the consolidated balance sheets.

A reconciliation of the changes in the Redeemable Noncontrolling Interests is as follows ($ in millions):

Balance, December 31, 2014	$ 148
Fair value of redeemable noncontrolling interest sold	7

Reclassification to redeemable noncontrolling interest	(1)
Net earnings attributable to redeemable noncontrolling interests	2
Balance, September 30, 2015	$ 156

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4. Short term and Long term Investments, Restricted Deposits

Short term and long term investments and restricted deposits by investment type consist of the following ($ in millions):

	September 30, 2015				December 31, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$468	$2	$—	$470	$393	$1	$(2)	$392
Corporate securities	837	4	(4)	837	556	2	(2)	556
Restricted certificates of deposit	9	—	—	9	6	—	—	6
Restricted cash equivalents	78	—	—	78	79	—	—	79
Municipal securities	489	2	(2)	489	174	1	—	175
Asset-backed securities	186	—	—	186	180	—	—	180
Residential mortgage-backed securities	75	2	—	77	84	1	—	85
Commercial mortgage-backed securities	26	—	—	26	—	—	—	—
Cost and equity method investments	72	—	—	72	68	—	—	68
Life insurance contracts	16	—	—	16	16	—	—	16
Total	$2,256	$10	$(6)	$2,260	$1,556	$5	$(4)	$1,557

The Company’s investments are classified as available-for-sale with the exception of life insurance contracts and certain cost and equity method investments. The Company’s investment policies are designed to provide liquidity, preserve capital and maximize total return on invested assets with the focus on high credit quality securities. The Company limits the size of investment in any single issuer other than U.S. treasury securities and obligations of U.S. government corporations and agencies. As of September 30, 2015, 38% of the Company’s investments in securities recorded at fair value that carry a rating by S&P or Moody’s were rated AAA/Aaa, 62% were rated AA-/Aa3 or higher, and 88% were rated A-/A3 or higher. At September 30, 2015, the Company held certificates of deposit, life insurance contracts and cost and equity method investments which did not carry a credit rating.

The Company's residential mortgage-backed securities are all issued by the Federal National Mortgage Association, Government National Mortgage Association or Federal Home Loan Mortgage Corporation, which carry implicit or explicit guarantees of the U.S. government. The Company's commercial mortgage-backed securities are primarily senior tranches with a weighted average rating of AA+ and a weighted average duration of 2.0 years at September 30, 2015.

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The fair value of available-for-sale investments with gross unrealized losses by investment type and length of time that individual securities have been in a continuous unrealized loss position were as follows ($ in millions):

	September 30, 2015				December 31, 2014			
	Less Than 12 Months		12 Months or More		Less Than 12 Months		12 Months or More	
	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$—	$68	$—	$16	$—	$72	$(2)	$180
Corporate securities	(3)	317	(1)	41	(2)	311	—	1
Municipal securities	(1)	120	(1)	5	—	20	—	7
Asset-backed securities	—	68	—	13	—	70	—	10
Residential mortgage-backed securities	—	—	—	—	—	18	—	—
Total	$(4)	$573	$(2)	$75	$(2)	$491	$(2)	$198

As of September 30, 2015, the gross unrealized losses were generated from 202 positions out of a total of 680 positions. The change in fair value of fixed income securities is a result of movement in interest rates subsequent to the purchase of the security.

For each security in an unrealized loss position, the Company assesses whether it intends to sell the security or if it is more likely than not the Company will be required to sell the security before recovery of the amortized cost basis for reasons such as liquidity, contractual or regulatory purposes. If the security meets this criterion, the decline in fair value is other-than-temporary and is recorded in earnings. The Company does not intend to sell these securities prior to maturity and it is not likely that the Company will be required to sell these securities prior to maturity; therefore, there is no indication of other-than-temporary impairment for these securities.

During the nine months ended September 30, 2015, the Company recognized $8 million of income from equity method investments.

The contractual maturities of short term and long term investments and restricted deposits are as follows ($ in millions):

	September 30, 2015				December 31, 2014			
	Investments		Restricted Deposits		Investments		Restricted Deposits	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
One year or less	$162	$162	$95	$95	$176	$177	$92	$92
One year through five years	1,613	1,616	11	11	1,121	1,121	8	8
Five years through ten years	268	268	—	—	121	120	—	—
Greater than ten years	107	108	—	—	38	39	—	—
Total	$2,150	$2,154	$106	$106	$1,456	$1,457	$100	$100

Actual maturities may differ from contractual maturities due to call or prepayment options. Asset-backed and mortgage-backed securities are included in the one year through five years category, while cost and equity method investments and life insurance contracts are included in the five years through ten years category. The Company has an option to redeem at amortized cost substantially all of the securities included in the greater than ten years category listed above.

The Company continuously monitors investments for other-than-temporary impairment. Certain investments have experienced a decline in fair value due to changes in credit quality, market interest rates and/or general economic conditions. The Company recognizes an impairment loss for cost and equity method investments when evidence demonstrates that it is other-than-temporarily impaired. Evidence of a loss in value that is other-than-temporary may include the absence of an ability to recover the carrying amount of the investment or the inability of the investee to sustain a level of earnings that would justify the carrying amount of the investment.

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5. Fair Value Measurements

Assets and liabilities recorded at fair value in the consolidated balance sheets are categorized based upon observable or unobservable inputs used to estimate fair value. Level inputs are as follows:

Level Input:	Input Definition:
Level I	Inputs are unadjusted, quoted prices for identical assets or liabilities in active markets at the measurement date.
Level II	Inputs other than quoted prices included in Level I that are observable for the asset or liability through corroboration with market data at the measurement date.
Level III	Unobservable inputs that reflect management's best estimate of what market participants would use in pricing the asset or liability at the measurement date.

The following table summarizes fair value measurements by level at September 30, 2015, for assets and liabilities measured at fair value on a recurring basis ($ in millions):

	Level I	Level II	Level III	Total
Assets				
Cash and cash equivalents	$1,665	$—	$—	$1,665
Investments available for sale:				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$437	$14	$—	$451
Corporate securities	—	837	—	837
Municipal securities	—	489	—	489
Asset-backed securities	—	186	—	186
Residential mortgage-backed securities	—	77	—	77
Commercial mortgage-backed securities	—	26	—	26
Total investments	$437	$1,629	$—	$2,066
Restricted deposits available for sale:				
Cash and cash equivalents	$78	$—	$—	$78
Certificates of deposit	9	—	—	9
U.S. Treasury securities and obligations of U.S. government corporations and agencies	19	—	—	19
Total restricted deposits	$106	$—	$—	$106
Other long term assets: Interest rate swap agreements	$—	$18	$—	$18
Total assets at fair value	$2,208	$1,647	$—	$3,855

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The following table summarizes fair value measurements by level at December 31, 2014, for assets and liabilities measured at fair value on a recurring basis ($ in millions):

	Level I	Level II	Level III	Total
Assets				
Cash and cash equivalents	$1,610	$—	$—	$1,610
Investments available for sale:				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$360	$17	$—	$377
Corporate securities	—	556	—	556
Municipal securities	—	175	—	175
Asset-backed securities	—	180	—	180
Residential mortgage-backed securities	—	85	—	85
Commercial mortgage-backed securities	—	—	—	—
Total investments	$360	$1,013	$—	$1,373
Restricted deposits available for sale:				
Cash and cash equivalents	$79	$—	$—	$79
Certificates of deposit	6	—	—	6
U.S. Treasury securities and obligations of U.S. government corporations and agencies	15	—	—	15
Total restricted deposits	$100	$—	$—	$100
Other long term assets: Interest rate swap agreements	$—	$11	$—	$11
Total assets at fair value	$2,070	$1,024	$—	$3,094

The Company periodically transfers U.S. Treasury securities and obligations of U.S. government corporations and agencies between Level I and Level II fair value measurements dependent upon the level of trading activity for the specific securities at the measurement date. The Company's policy regarding the timing of transfers between Level I and Level II is to measure and record the transfers at the end of the reporting period. At September 30, 2015, there were less than $1 million of transfers from Level I to Level II and $2 million of transfers from Level II to Level I. The Company utilizes matrix pricing services to estimate fair value for securities which are not actively traded on the measurement date. The Company designates these securities as Level II fair value measurements. The aggregate carrying amount of the Company's life insurance contracts and other non-majority owned investments, which approximates fair value, was $88 million and $84 million as of September 30, 2015 and December 31, 2014, respectively.

6. Health Insurance Marketplace

The Affordable Care Act (ACA) established risk spreading premium stabilization programs effective January 1, 2014 for the Health Insurance Marketplace product. These programs, commonly referred to as the "three Rs," include a permanent risk adjustment program, a transitional reinsurance program, and a temporary risk corridor program. Additionally, the ACA established a minimum annual medical loss ratio for the Health Insurance Marketplace. Each of the three R programs are taken into consideration to determine if the Company's estimated annual medical costs are less than the minimum loss ratio and require an adjustment to Premium revenue to meet the minimum medical loss ratio.

In June 2015, CMS released final results on reinsurance and risk-adjustment for the 2014 plan year. These final results had an insignificant impact to the Company for the 2014 plan year.

The Company's receivables (payables) for each of these programs are as follows ($ in millions):

	September 30, 2015	December 31, 2014

Risk adjustment	$(77)	$(44)
Reinsurance	14	11
Risk corridor	(31)	(9)
Minimum medical loss ratio	(14)	(6)

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7. Debt

Debt consists of the following ($ in millions):

	September 30, 2015	December 31, 2014
$425 million 5.75% Senior notes, due June 1, 2017	$428	$429
$500 million 4.75% Senior notes, due May 15, 2022	500	300
Fair value of interest rate swap agreements	18	11
Senior notes	946	740
Revolving credit agreement	275	75
Mortgage notes payable	68	70
Capital leases	7	8
Debt issuance costs	(15)	(14)
Total debt	1,281	879
Less current portion	(5)	(5)
Long term debt	$1,276	$874

Senior Notes

In January 2015, the Company issued an additional $200 million of 4.75% Senior Notes ($200 Million Add-on Notes) at par. The $200 Million Add-on Notes were offered as additional debt securities under the indenture governing the $300 million of 4.75% Senior Notes issued in April 2014. In connection with the January 2015 issuance, the Company entered into interest rate swap agreements for a notional amount of $200 million at a floating rate of interest based on the three month LIBOR plus 2.88%. Gains and losses due to changes in the fair value of the interest rate swap completely offset changes in the fair value of the hedged portion of the underlying debt and are recorded as an adjustment to the $200 Million Add-on Notes.

The indentures governing both the $425 million notes due 2017 and the $500 million notes due 2022 contain non-financial and financial covenants, including requirements of a minimum fixed charge coverage ratio.

Interest Rate Swaps

The Company uses interest rate swap agreements to convert a portion of its interest rate exposure from fixed rates to floating rates to more closely align interest expense with interest income received on its cash equivalent and variable rate investment balances. The Company has $750 million of notional amount of interest rate swap agreements consisting of $250 million which are scheduled to expire on June 1, 2017 and $500 million that are scheduled to expire May 15, 2022. Under the Swap Agreements, the Company receives a fixed rate of interest and pays an average variable rate of the three month LIBOR plus 2.85% adjusted quarterly. At September 30, 2015, the weighted average rate was 3.16%.

The Swap Agreements are formally designated and qualify as fair value hedges and are recorded at fair value in the Consolidated Balance Sheet in other assets or other liabilities. Gains and losses due to changes in fair value of the interest rate swap agreements completely offset changes in the fair value of the hedged portion of the underlying debt. Therefore, no gain or loss has been recognized due to hedge ineffectiveness. Offsetting changes in fair value of both the interest rate swaps and the hedged portion of the underlying debt both were recognized in interest expense in the Consolidated Statement of Operations. The Company does not hold or issue any derivative instrument for trading or speculative purposes.

Revolving Credit Agreement

The Company has an unsecured $500 million revolving credit facility. Borrowings under the agreement bear interest based upon LIBOR rates, the Federal Funds Rate or the Prime Rate. The agreement has a maturity date of June 1, 2018, provided it will mature 90 days prior to the maturity date of the Company's 5.75% Senior Notes due 2017 if such notes are not refinanced (or extended), certain financial conditions are not met, or the Company does not carry $100 million of unrestricted cash. As of September 30, 2015, the Company had $275 million of borrowings outstanding under the agreement with a weighted average interest rate of 3.01%.

The agreement contains non-financial and financial covenants, including requirements of minimum fixed charge coverage ratios, maximum debt-to-EBITDA ratios and minimum tangible net worth. The Company is required to not exceed a maximum debt-to-EBITDA ratio of 3.0 to 1.0. As of September 30, 2015, there were no limitations on the availability under the revolving credit agreement as a result of the debt-to-EBITDA ratio.

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Letters of Credit & Surety Bonds

The Company had outstanding letters of credit of $46 million as of September 30, 2015, which were not part of the revolving credit facility. The Company also had letters of credit for $52 million (valued at September 30, 2015 conversion rate), or €46 million, representing its proportional share of the letters of credit issued to support Ribera Salud’s outstanding debt, which are a part of the revolving credit facility. Collectively, the letters of credit bore interest at 1.55% as of September 30, 2015. The Company had outstanding surety bonds of $304 million as of September 30, 2015.

8. Earnings Per Share

The following table sets forth the calculation of basic and diluted net earnings per common share ($ in millions, except per share data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Earnings attributable to Centene Corporation:				
Earnings from continuing operations, net of tax	$92	$81	$244	$162
Discontinued operations, net of tax	1	1	—	2
Net earnings	$93	$82	$244	$164
Shares used in computing per share amounts:				
Weighted average number of common shares outstanding	119,121,524	117,226,968	118,970,853	115,912,304
Common stock equivalents (as determined by applying the treasury stock method)	4,010,286	4,136,782	3,933,623	3,961,094
Weighted average number of common shares and potential dilutive common shares outstanding	123,131,810	121,363,750	122,904,476	119,873,398
Net earnings per common share attributable to Centene Corporation:				
Basic:				
Continuing operations	$0.77	$0.69	$2.05	$1.40
Discontinued operations	0.01	0.01	—	0.01
Basic earnings per common share	$0.78	$0.70	$2.05	$1.41
Diluted:				
Continuing operations	$0.75	$0.67	$1.99	$1.35
Discontinued operations	0.01	0.01	—	0.02
Diluted earnings per common share	$0.76	$0.68	$1.99	$1.37

The calculation of diluted earnings per common share for the three and nine months ended September 30, 2015 excludes the impact of 28,716 and 84,644 shares, respectively, related to anti-dilutive restricted stock and restricted stock units. The calculation of diluted earnings per common share for the three and nine months ended September 30, 2014 excludes the impact of 47,520 shares and 117,756 shares, respectively, related to anti-dilutive restricted stock and restricted stock units.

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9. Segment Information

Centene operates in two segments: Managed Care and Specialty Services. The Managed Care segment consists of Centene's health plans including all of the functions needed to operate them. The Specialty Services segment consists of Centene's specialty companies offering auxiliary healthcare services and products.

Segment information for the three months ended September 30, 2015, follows ($ in millions):

	Managed Care	Specialty Services	Eliminations	Consolidated Total
Premium and service revenues from external customers	$4,922	$541	$—	$5,463
Premium and service revenues from internal customers	24	1,274	(1,298)	—
Total premium and service revenues	$4,946	$1,815	$(1,298)	$5,463
Earnings from operations	$138	$45	$—	$183

Segment information for the three months ended September 30, 2014, follows ($ in millions):

	Managed Care	Specialty Services	Eliminations	Consolidated Total
Premium and service revenues from external customers	$3,730	$429	$—	$4,159
Premium and service revenues from internal customers	16	806	(822)	—
Total premium and service revenues	$3,746	$1,235	$(822)	$4,159
Earnings from operations	$80	$28	$—	$108

Segment information for the nine months ended September 30, 2015, follows ($ in millions):

	Managed Care	Specialty Services	Eliminations	Consolidated Total
Premium and service revenues from external customers	$13,812	$1,596	$—	$15,408
Premium and service revenues from internal customers	73	3,525	(3,598)	—
Total premium and service revenues	$13,885	$5,121	$(3,598)	$15,408
Earnings from operations	$358	$127	$—	$485

Segment information for the nine months ended September 30, 2014, follows ($ in millions):

	Managed Care	Specialty Services	Eliminations	Consolidated Total
Premium and service revenues from external customers	$9,925	$1,327	$—	$11,252
Premium and service revenues from internal customers	42	2,121	(2,163)	—
Total premium and service revenues	$9,967	$3,448	$(2,163)	$11,252
Earnings from operations	$188	$83	$—	$271

10. Contingencies

On July 5, 2013, the Company's subsidiary, Kentucky Spirit Health Plan, Inc. (Kentucky Spirit), terminated its contract with the Commonwealth of Kentucky (the Commonwealth). Kentucky Spirit believes it had a contractual right to terminate the contract and filed a lawsuit in Franklin Circuit Court seeking a declaration of this right. The Commonwealth has alleged that Kentucky Spirit's exit constitutes a material breach of contract. The Commonwealth seeks to recover substantial damages and to enforce its rights under Kentucky Spirit's $25 million performance bond. The Commonwealth's attorneys have asserted that the Commonwealth's expenditures due to Kentucky Spirit's departure range from $28 million to $40 million plus interest, and that the associated CMS expenditures range from $92 million to $134 million. Kentucky Spirit disputes the Commonwealth's alleged damages, and is pursuing its own litigation claims for damages against the Commonwealth.

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On February 6, 2015, the Kentucky Court of Appeals affirmed a Franklin Circuit Court ruling that Kentucky Spirit does not have a contractual right to terminate the contract early. The Court of Appeals also found that the contract's liquidated damages provision "is applicable in the event of a premature termination of the Contract term." On September 8, 2015, Kentucky Spirit filed a motion for discretionary review seeking Kentucky Supreme Court review of the finding that Kentucky Spirit's departure constituted a breach of contract. On October 9, 2015, the Commonwealth filed a response opposing discretionary review.

Kentucky Spirit also filed a lawsuit in April 2013, amended in October 2014, in Franklin Circuit Court seeking damages against the Commonwealth for losses sustained due to the Commonwealth's alleged breaches. On December 9, 2014, the Franklin Circuit Court denied the Commonwealth's motion for partial summary judgment on Kentucky Spirit's damages claims. On March 15, 2015, the Franklin Circuit Court denied the Commonwealth's motion to stay discovery and ordered that discovery proceed on those claims.

On May 26, 2015, the Commonwealth issued a demand for indemnification to its actuarial firm, for "all defense costs, and any resultant monetary awards in favor of Kentucky Spirit, arising from or related to Kentucky Spirit's claims which are predicated upon the alleged omissions and errors in the Data Book and the certified actuarially sound rates." On August 19, 2015, the actuarial firm moved to intervene in the litigation. The Franklin Circuit Court granted the actuarial firm's motion on September 8, 2015 and ordered a forty-five day stay of all pretrial proceedings in order for the firm to review the record. Also, on August 19, 2015, the actuarial firm filed a petition seeking a declaratory judgment that it is not liable to the Commonwealth for indemnification related to the claims asserted by Kentucky Spirit against the Commonwealth. On October 5, 2015, the Commonwealth filed an answer to the actuarial firm's petition and asserted counterclaims/cross-claims against the firm.

On March 9, 2015, the Secretary of the Kentucky Cabinet for Health and Family Services (CHFS) issued a determination letter finding that Kentucky Spirit owed the Commonwealth $40 million in actual damages plus prejudgment interest at 8 percent. On March 18, 2015, in a letter to the Kentucky Finance and Administration Cabinet (FAC), Kentucky Spirit contested CHFS' jurisdiction to make such a determination. The FAC did not issue a decision within the required 120 days. On August 13, 2015, Kentucky Spirit filed a declaratory judgment action against the Commonwealth in Franklin Circuit Court seeking a declaration that the Commonwealth may not purport to issue a decision against Kentucky Spirit awarding damages to itself when the matter is already before the Kentucky courts, and that the Commonwealth has waived its claims against Kentucky Spirit for damages arising out of the contract.

The resolution of the Kentucky litigation matters may result in a range of possible outcomes. If Kentucky Spirit prevails on its claims, it would be entitled to damages. If the Commonwealth prevails, a liability to the Commonwealth could be recorded. The Company is unable to estimate the ultimate outcome resulting from the Kentucky litigation. As a result, the Company has not recorded any receivable or any liability for potential damages under the contract as of September 30, 2015. While uncertain, the ultimate resolution of the pending litigation could have a material effect on the financial position, cash flow or results of operations of the Company in the period it is resolved or becomes known.

Excluding the Kentucky matters discussed above, the Company is also routinely subjected to legal proceedings in the normal course of business. While the ultimate resolution of such matters in the normal course of business is uncertain, the Company does not expect the results of any of these matters individually, or in the aggregate, to have a material effect on its financial position, results of operations or cash flows.

11. Subsequent Event

In October 2015, the Company's stockholders approved a proposal to increase the Company's authorized shares of common stock from 200 million to 400 million.

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ITEM 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations.

The following discussion of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and the related notes included elsewhere in this filing. The discussion contains forward-looking statements that involve known and unknown risks and uncertainties, including those set forth under Part II, Item 1A. “Risk Factors” of this Form 10-Q.

OVERVIEW

In 2013, we classified the operations for Kentucky Spirit Health Plan (KSHP) as discontinued operations for all periods presented in our consolidated financial statements. The following discussion and analysis, with the exception of cash flow information, is presented in the context of continuing operations unless otherwise identified.

On February 2, 2015, the Board of Directors declared a two-for-one split of Centene's common stock in the form of a 100% stock dividend distributed February 19, 2015 to stockholders of record on February 12, 2015. All share and per share information presented in this Form 10-Q has been adjusted for the two-for-one stock split.

Key financial metrics for the third quarter of 2015 are summarized as follows:

- Quarter-end managed care membership of 4.8 million, an increase of 933,600 members, or 24% year over year.