HEALTHWAYS, INC
Form 10-Q
November 08, 2016

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

FORM 10-Q

[x] 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 Number 000-19364

HEALTHWAYS, INC.
(Exact Name of Registrant as Specified in its Charter)

Delaware	62-1117144
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

701 Cool Springs Boulevard, Franklin, TN 37067
(Address of Principal Executive Offices) (Zip Code)

615-614-4929
(Registrant's Telephone Number, Including Area Code)

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes 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, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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

As of October 31, 2016, there were outstanding 38,683,375 shares of the registrant's common stock, par value $.001 per share ("common stock").

1

Healthways, Inc.
Form 10-Q
Table of Contents

			Page
Part I			
	Item 1.	Financial Statements	3
	Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	28
	Item 3.	Quantitative and Qualitative Disclosures About Market Risk	43
	Item 4.	Controls and Procedures	43
Part II			
	Item 1.	Legal Proceedings	44
	Item 1A.	Risk Factors	45
	Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	47
	Item 3.	Defaults Upon Senior Securities	47
	Item 4.	Mine Safety Disclosures	47
	Item 5.	Other Information	47
	Item 6.	Exhibits	48

Part I

Item 1. Financial Statements

HEALTHWAYS, INC.
CONSOLIDATED BALANCE SHEETS
(In thousands)
(Unaudited)

ASSETS

	September 30, 2016	December 31, 2015
Current assets:		
Cash and cash equivalents	$ 727	$ 233
Accounts receivable, net	56,718	50,608
Prepaid expenses	3,410	7,662
Other current assets	1,028	2,508
Income taxes receivable	175	257
Deferred tax asset	—	7,717
Current assets held for sale within discontinued operations	—	65,802
Total current assets	62,058	134,787
Property and equipment:		
Leasehold improvements	12,478	27,674
Computer equipment and related software	23,844	33,496
Furniture and office equipment	11,217	13,512
Capital projects in process	418	1,089
	47,957	75,771
Less: accumulated depreciation	(39,636)	(53,753)
	8,321	22,018
Other assets	6,700	509
Cash convertible notes hedges	73,869	12,632
Intangible assets, net	29,136	29,526
Long-term deferred tax asset	69,785	—
Goodwill, net	334,680	336,974
Long-term assets held for sale within discontinued operations	—	176,478
Total assets	$ 584,549	$ 712,924

See accompanying notes to the consolidated financial statements.

HEALTHWAYS, INC.
CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share data)
(Unaudited)

LIABILITIES AND STOCKHOLDERS' EQUITY

	September 30, 2016	December 31, 2015
Current liabilities:		
Accounts payable	$25,181	$21,184
Accrued salaries and benefits	15,520	7,240
Accrued liabilities	36,165	28,384
Deferred revenue	182	125
Contract billings in excess of earned revenue	587	101
Current portion of long-term debt	52,654	23,308
Current portion of long-term liabilities	8,209	6,204
Current liabilities held for sale within discontinued operations	—	75,644
Total current liabilities	138,498	162,190
Long-term debt	197,774	208,289
Long-term deferred tax liability	—	23,617
Cash conversion derivative	73,869	12,632
Other long-term liabilities	11,836	25,606
Stockholders' equity:		
Preferred stock $.001 par value, 5,000,000 shares authorized, none outstanding	—	—
Common stock $.001 par value, 120,000,000 shares authorized, 37,749,070 and 36,079,446 shares outstanding, respectively	37	36
Additional paid-in capital	320,079	302,488
(Accumulated deficit) retained earnings	(126,352)	9,659
Treasury stock, at cost, 2,254,953 shares in treasury	(28,182)	(28,182)
Accumulated other comprehensive loss	(3,135)	(4,087)
Total Healthways, Inc. stockholders' equity	162,447	279,914
Non-controlling interest	125	676
Total stockholders' equity	162,572	280,590
Total liabilities and stockholders' equity	$584,549	$712,924

See accompanying notes to the consolidated financial statements.

HEALTHWAYS, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(In thousands, except earnings (loss) per share data)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Revenues	$125,049	$ 113,536	$376,065	$338,610
Cost of services (exclusive of depreciation and amortization of $1,334, $1,504, $4,548, and $4,404, respectively, included below)	89,153	78,954	269,411	236,361
Selling, general & administrative expenses	10,406	6,419	29,924	26,512
Depreciation and amortization	1,603	1,866	5,352	5,595
Restructuring and related charges	1,129	—	1,170	—
Operating income	22,758	26,297	70,208	70,142
Interest expense	4,833	4,914	13,115	13,286
Income before income taxes	17,925	21,383	57,093	56,856
Income tax expense	13,126	8,423	13,126	22,460
Net income from continuing operations	4,799	12,960	43,967	34,396
Income (loss) from discontinued operations, net of income tax expense (benefit)	49,075	(22,103)	(179,482)	(46,336)
Net income (loss)	53,874	(9,143)	(135,515)	(11,940)
Less: net income (loss) attributable to non-controlling interest	80	(117)	496	(420)
Net income (loss) attributable to Healthways, Inc.	$53,794	$ (9,026)	$(136,011)	$(11,520)
Earnings (loss) per share attributable to Healthways, Inc. - basic:				
Continuing operations	$0.13	$ 0.36	$1.21	$0.96
Discontinued operations	$1.32	$ (0.61)	$(4.94)	$(1.28)
Earnings (loss) per share attributable to Healthways, Inc. - diluted:				
Continuing operations	$0.12	$ 0.35	$1.17	$0.93
Discontinued operations	$1.28	$ (0.60)	$(4.80)	$(1.25)
Comprehensive income (loss)	$54,096	$ (10,442)	$(134,411)	$(14,494)
Less: comprehensive income (loss) attributable to non-controlling interest	1	(284)	648	(582)
Comprehensive (loss) income attributable to Healthways, Inc.	$54,095	$ (10,158)	$(135,059)	$(13,912)
Weighted average common shares and equivalents:				
Basic	37,037	35,939	36,441	35,756
Diluted	38,421	36,514	37,505	36,853

See accompanying notes to the consolidated financial statements.

HEALTHWAYS, INC.
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY
For the Nine Months Ended September 30, 2016
(In thousands)
(Unaudited)

	Preferred Stock	Common Stock	Additional Paid-in Capital	(Accumulated Deficit) Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Loss	Non-controlling Interest	Total
Balance, December 31, 2015	$ —	$ 36	$ 302,488	$ 9,659	$ (28,182)	$ (4,087)	$ 676	$ 280,590
Net loss attributable to Healthways, Inc.	—	—	—	(136,011)	—	—	—	(136,011)
Net income attributable to non-controlling interest	—	—	—	—	—	—	496	496
Other comprehensive income (loss), net of tax:								
Net change in fair value of interest rate swaps, net of income tax benefit of $111	—	—	—	—	—	170	—	170
Foreign currency translation adjustment	—	—	—	—	—	782	152	934
Total other comprehensive income	—	—	—	—	—	952	152	1,104
Total comprehensive income (loss)	—	—	—	(136,011)	—	952	648	(134,411)
Exercise of stock options	—	1	8,746	—	—	—	—	8,747
Tax effect of stock options and restricted stock units	—	—	(6,714)	—	—	—	—	(6,714)
Share-based employee compensation expense	—	—	15,367	—	—	—	—	15,367
Issuance of CareFirst Warrants	—	—	192	—	—	—	—	192
Settlement of noncontrolling interest	—	—	—	—	—	—	(1,199)	(1,199)

Balance, September 30, 2016	$ —	$ 37	$ 320,079	$ (126,352)	$ (28,182)	$ (3,135)	$ 125	$ 162,572

See accompanying notes to the consolidated financial statements.

HEALTHWAYS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Nine Months Ended September 30,	
	2016	2015
Cash flows from operating activities:		
Net income from continuing operations	$43,967	$34,396
Net loss from discontinued operations	(179,482)	(46,336)
Adjustments to reconcile net income (loss) to net cash flows provided by operating activities, net of business acquisitions:		
Depreciation and amortization	30,319	37,099
Amortization of deferred loan costs	1,645	1,481
Amortization of debt discount	5,618	5,308
Share-based employee compensation expense	15,367	7,539
Loss on sale of MeYou Health	4,826	—
Loss on sale of TPHS business	190,946	—
Equity in (income) loss from joint ventures	(271)	20,443
Deferred income taxes	(89,013)	(8,046)
Decrease in accounts receivable, net	1,837	1,828
Decrease in other current assets	5,548	558
(Decrease) increase in accounts payable	(3,698)	1,281
Decrease in accrued salaries and benefits	(10,419)	(6,518)
Increase (decrease) in other current liabilities	1,568	(7,216)
Other	(5,642)	(2,990)
Net cash flows provided by operating activities	13,116	38,827
Cash flows from investing activities:		
Acquisition of property and equipment	(12,860)	(26,390)
Investment in joint venture	(1,298)	(6,075)
Proceeds from sale of MeYou Health	5,156	—
Payments related to sale of TPHS business	(27,469)	—
Other	(787)	(851)
Net cash flows used in investing activities	(37,258)	(33,316)
Cash flows from financing activities:		
Proceeds from issuance of long-term debt	396,491	461,456
Payments of long-term debt	(385,188)	(468,334)
Exercise of stock options	8,747	2,464
Deferred loan costs	(424)	—
Proceeds from non-controlling interest	—	1,615
Repurchase of common stock	—	(1,833)
Change in cash overdraft and other	2,556	1,005
Net cash flows provided by (used in) financing activities	22,182	(3,627)
Effect of exchange rate changes on cash	817	(1,884)
Less: net decrease in discontinued operations cash and cash equivalents	(1,637)	(7)

Net increase in cash and cash equivalents	494	7
Cash and cash equivalents, beginning of period	233	516
Cash and cash equivalents, end of period	$727	$523

See accompanying notes to the consolidated financial statements.

HEALTHWAYS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

(1) Basis of Presentation

Our financial statements and accompanying notes are prepared in accordance with generally accepted accounting principles in the United States ("U.S. GAAP"). In our opinion, the accompanying consolidated financial statements of Healthways, Inc. and its wholly-owned subsidiaries (collectively, "Healthways," the "Company," or such terms as "we," "us," or "our") reflect all adjustments consisting of normal, recurring accruals necessary for a fair statement. We have reclassified certain items in prior periods to conform to current classifications.

Our results from continuing operations do not include the results of the total population health services ("TPHS") business, which we sold on July 31, 2016. The TPHS business included our partnerships with Blue Zones, LLC and Dr. Dean Ornish (the Blue Zones Project by Healthways™ and Dr. Ornish's Program for Reversing Heart Disease™), the results of our joint venture with Gallup, Inc. ("Gallup") (see Note 8), our Navvis business, our MeYouHealth business and international operations, including our joint venture with SulAmerica. We sold the TPHS business, excluding Navvis and MeYouHealth, which had been previously sold separately to other buyers (see Notes 3 and 4). Results of operations for the TPHS business have been classified as discontinued operations for all periods presented in the condensed consolidated financial statements.

On March 11, 2015, we formed a joint venture with SulAmérica, one of the largest independent insurers in Brazil, to sell total population health services to the Brazilian market. With its contribution, SulAmérica acquired a 49% interest in the joint venture, Healthways Brasil Servicos de Consultoria LTDA ("Healthways Brazil"). We determined that our interest in Healthways Brazil represented a controlling financial interest and, therefore, prior to selling the TPHS business, consolidated the financial statements of Healthways Brazil and presented a noncontrolling interest for the portion owned by SulAmérica. The net assets and results of operations of Healthways Brazil are included within discontinued operations in the accompanying consolidated financial statements.

We have omitted certain financial information that is normally included in financial statements prepared in accordance with U.S. GAAP but that is not required for interim reporting purposes. You should read the accompanying consolidated financial statements in conjunction with the financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2015.

(2) Recent Relevant Accounting Standards

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standard Update ("ASU") No. 2014-09, which creates Accounting Standards Codification ("ASC") Topic 606, "Revenue from Contracts with Customers" ("ASC Topic 606") and supersedes ASC Topic 605, "Revenue Recognition." The provisions of ASC Topic 606 provide for a single comprehensive principles-based standard for the recognition of revenue across all industries and expanded disclosure about the nature, amount, timing and uncertainty of revenue, as well as certain additional quantitative and qualitative disclosures. The standard is effective for annual periods beginning after December 15, 2017, including interim periods within those years. We are currently evaluating the impact of adopting ASC Topic 606.

In August 2014, the FASB issued ASU No. 2014-15, "Presentation of Financial Statements – Going Concern: Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern," which requires management to evaluate whether there is substantial doubt about the entity's ability to continue as a going concern and, if so, provide certain footnote disclosures. This ASU is effective for annual periods ending after December 15, 2016, including interim reporting periods thereafter. We do not anticipate that adopting this standard will have an impact on the financial statements and are currently evaluating the potential impact to our footnote disclosures.

In April 2015, the FASB issued ASU No. 2015-03, "Simplifying the Presentation of Debt Issuance Costs," which requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of the related debt liability, consistent with debt discounts. This ASU was adopted in the first quarter of 2016 and has been applied on a retrospective basis to all periods presented. The adoption of this standard resulted in debt issuance costs being presented as a direct deduction from the carrying amount of the related debt liability and totaled $2.9 million and $4.1 million as of September 30, 2016 and December 31, 2015, respectively.

In November 2015, the FASB issued ASU No. 2015-17, "Income Taxes: Balance Sheet Classification of Deferred Taxes" ("ASU 2015-17"), which simplifies the presentation of deferred income taxes by eliminating the separate classification of deferred income tax liabilities and assets into current and noncurrent amounts in the consolidated balance sheet. The amendments in ASU 2015-17 require that all deferred tax liabilities and assets be classified as noncurrent in the consolidated balance sheet. This ASU was adopted in the first quarter of 2016 and is presented prospectively.

In February 2016, the FASB issued ASU No. 2016-02, "Leases" ("ASU 2016-02"), which requires that lessees recognize assets and liabilities for leases with lease terms greater than twelve months in the statement of financial position. ASU 2016-02 also requires improved disclosures to help users of financial statements better understand the amount, timing and uncertainty of cash flows arising from leases. The update is effective for fiscal years beginning after December 15, 2018, including interim reporting periods within those years. We are currently evaluating the impact the adoption of ASU 2016-02 will have on our financial position, results of operations and cash flows.

In March 2016, the FASB Issued ASU No. 2016-09, "Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting" ("ASU 2016-09"). ASU 2016-09 changes how companies account for certain aspects of share-based payment awards to employees, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. The standard is effective for interim and annual reporting periods beginning after December 15, 2016, although early adoption is permitted. We are currently assessing how the adoption of ASU 2016-09 will impact our our financial position, results of operations and cash flows.

In August 2016, the FASB issued ASU No. 2016-15, "Statement of Cash Flows" (Topic 230) ("ASU 2016-15"). ASU No. 2016-15 addresses how certain cash receipts and cash payments are presented and classified in the statement of cash flows. ASU No. 2016-15 is effective in the first quarter of 2018, with early adoption permitted, and is to be applied using a retrospective approach. The company is currently evaluating the potential effects of adopting the provisions of ASU No. 2016-15.

(3) Discontinued Operations

On July 27, 2016, we entered into a Membership Interest Purchase Agreement (the "Purchase Agreement") with Sharecare, Inc. ("Sharecare"), and Healthways SC, LLC ("Healthways SC"), a newly formed Delaware limited liability company and wholly owned subsidiary of the Company, pursuant to which Sharecare acquired the TPHS business, which closed July 31, 2016 ("Closing").

Upon the completion of the transactions contemplated by the Purchase Agreement (the "Closing"), Sharecare delivered to the Company an Adjustable Convertible Equity Right (the "ACER") with an initial face value of $30.0 million, which will be convertible into shares of common stock of Sharecare 24 months after the Closing, at an initial conversion price of $249.87 per share, subject to customary adjustment for stock splits, stock dividends and other reorganizations of Sharecare. Additionally, pursuant to the Purchase Agreement, we paid Sharecare $25.0 million in cash at the Closing to fund projected losses of the TPHS business during the year following the Closing (the "Transition Year"). Pursuant to Sharecare's acquisition of the TPHS business, our ownership interest in the joint venture with Gallup was transferred to Sharecare. We agreed with Sharecare to be responsible for two-thirds of the remaining payment obligations in respect of the purchase price to be paid in connection with Sharecare's acquisition of additional membership interest in the joint venture. This obligation is currently expected to result in aggregate payments by us of approximately $4.2 million, payable in five equal quarterly installments beginning in the fourth quarter of the 2016 calendar year and ending in the fourth quarter of the 2017 calendar year.

The Purchase Agreement provided for post-closing adjustments based on (i) net working capital (which may result in a cash payment by the Company to Sharecare in the event of a net working capital deficit, or an increase in the face amount of the ACER in the event of a net working capital surplus), (ii) negative cash flows of the TPHS business

during the Transition Year in excess of $25.0 million (which may result in a reduction in the face amount of the ACER up to a maximum reduction of $20.0 million), and (iii) any successful claims for indemnification by Sharecare (which may result in a reduction in the face amount of the ACER, unless the Company elects, in its sole discretion, to satisfy any such successful claims with cash payments).

We recorded the ACER net of the $20.0 million face value maximum negative cash flow adjustment, or $10.0 million face value, at its estimated fair value of $2.7 million as of Closing. We have classified this amount as an equity receivable included in other assets. We will record the $20.0 million face value contingent portion of the ACER at its estimated fair value as of the date the contingency is resolved, expected to be approximately 12 months from Closing. As of September 30, 2016, we recorded an estimate of the net working capital adjustment (a surplus), which increased the estimated fair value of the ACER to $6.0 million. The working capital adjustment is subject to the review process defined in the Purchase Agreement.

The terms of the Purchase Agreement also impacted other existing contractual commitments, including the elimination of the minimum fee requirements under our technology services outsourcing agreement with HP Enterprise Services, LLC.

Effective July 31, 2016, in connection with the Closing, the Company and CareFirst Holdings, LLC ("CareFirst"), agreed to terminate the Investment Agreement (discussed in Note 7). In connection with the Closing, all of the Commercial Agreements (defined in Note 7) between the Company and CareFirst relating to the TPHS business were transferred to Healthways SC that, effective at the Closing, became a wholly-owned subsidiary of Sharecare. As a result, CareFirst will no longer have the opportunity to earn CareFirst Warrants in respect of the periods following the Closing. The Convertible Note, the Registration Rights Agreement and the CareFirst Warrants previously issued to CareFirst were not affected by the termination of the Investment Agreement.

The following table presents the aggregate carrying amounts of the major classes of assets and liabilities related to the disposition of the TPHS business:

(in thousands)	December 31, 2015
Cash and cash equivalents	$ 1,637
Accounts receivable, net	57,587
Prepaid expenses	2,545
Other current assets	2,722
Income taxes receivable	819
Deferred tax asset	492
Property and equipment	133,982
Long-term deferred tax asset	—
Other assets	10,705
Intangible assets, net	31,791
Total assets	$ 242,280
Accounts payable	$ 19,851
Accrued salaries and benefits	14,380
Accrued liabilities	21,690
Deferred revenue	6,931
Contract billings in excess of earned revenue	12,792
Total liabilities	$ 75,644

The following table presents financial results of the TPHS business included in "income (loss) from discontinued operations" for the three and nine months ended September 30, 2016 and 2015.

(in thousands)	Three Months Ended September 30, 2016	Three Months Ended September 30, 2015	Nine Months Ended September 30, 2016	Nine Months Ended September 30, 2015
Revenues	$**23,146**	$82,846	$151,897	$245,707
Cost of services	28,971	80,099	172,968	242,786
Selling, general & administrative expenses	5,954	7,567	18,069	25,331
Depreciation and amortization	3,392	10,372	24,967	31,504
Restructuring and related charges	264	1,752	8,688	1,752
Equity in income (loss) from joint ventures	(32)	(19,602)	243	(20,443)
Pretax loss on discontinued operations	(15,467)	(36,546)	(72,552)	(76,109)
Pretax loss on sale of MeYou Health business	—	—	(4,826)	—
Pretax loss on sale of TPHS business	(42,209)	—	(200,564)	—
Total pretax loss on discontinued operations	(57,676)	(36,546)	(277,942)	(76,109)
Income tax expense (benefit)	(106,751)	(14,443)	(98,460)	(29,773)
Income (loss) from discontinued operations, net of income tax expense (benefit)	$49,075	$(22,103)	$(179,482)	$(46,336)

The depreciation, amortization and significant operating and investing non-cash items of the discontinued operations were as follows:

(in thousands)	Nine Months Ended September 30, 2016	Nine Months Ended September 30, 2015
Depreciation and amortization on discontinued operations	$24,967	$ 31,504
Capital expenditures on discontinued operations	10,258	23,311
Share-based compensation on discontinued operations	10,165	2,039

(4) Goodwill

The change in carrying amount of goodwill during the year ended December 31, 2015 and the nine months ended September 30, 2016 is shown below:

(in thousands)	
Balance, December 31, 2014	338,800
Navvis sale	(1,826)
Balance, December 31, 2015	336,974
MeYou Health sale	(2,294)
Balance, September 30, 2016	$334,680

In November 2015, we sold Navvis Healthcare, LLC, a provider of healthcare consulting and advisory services, for $4.4 million in cash, which resulted in a gain of $1.9 million.

In June 2016, we sold the assets of MeYou Health, LLC, a wholly owned subsidiary of the Company that was engaged in the business of developing and delivering certain digital health applications, for $5.5 million in cash and additional contingent consideration up to $1.5 million, which resulted in a loss of $4.8 million. This loss is included in losses from discontinued operations in our consolidated statements of comprehensive income (loss) for the three and nine months ended September 30, 2016.

No goodwill was allocated to the disposal group in connection with the sale of the TPHS business.

As of September 30, 2016 and December 31, 2015, the gross amount of goodwill totaled $517.0 million and $519.3 million, respectively, and we had accumulated impairment losses of $182.4 million.

(5) Share-Based Compensation

We currently have four types of share-based awards outstanding to our employees and directors: stock options, restricted stock units, restricted stock and market stock units. We believe that our share-based awards align the interests of our employees and directors with those of our stockholders.

We estimate share-based compensation expense based on the number of awards expected to vest, after consideration of expected forfeitures and estimated vesting of performance-based stock units. We recognize share-based compensation expense for the market stock units if the requisite service period is rendered, even if the market condition is never satisfied. For the three and nine months ended September 30, 2016, we recognized share-based compensation costs of $10.0 million and $15.4 million, respectively, of which $8.4 million and $10.2 million, respectively, are in discontinued operations and include the acceleration of vesting of all unvested stock options, market stock units and restricted stock units held by two former senior executives as of Closing who had accepted employment with Sharecare. For the three and nine months ended September 30, 2015, we recognized share-based compensation costs of $1.7 million and $7.5 million, respectively.

A summary of our stock options as of September 30, 2016 and changes during the nine months then ended is presented below:

Options	Shares (000s)	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (years)	Aggregate Intrinsic Value ($000s)
Outstanding at January 1, 2016	2,122	$ 13.34		
Granted	—	—		
Exercised	(775)	11.45		
Forfeited	(30)	13.93		
Expired	(101)	21.30		
Outstanding at September 30, 2016	1,216	13.88	5.01	$ 16,151
Exercisable at September 30, 2016	1,019	$ 13.96	4.72	$ 13,583

There were no stock options granted during the nine months ended September 30, 2016.

The following table shows a summary of our restricted stock and restricted stock units as of September 30, 2016, as well as activity during the nine months then ended:

	Restricted Stock and Restricted Stock Units	
Nonvested Shares	Shares (000s)	Weighted-Average Grant Date Fair Value
Nonvested at January 1, 2016	1,618	$ 12.35
Granted	946	12.09
Vested	(798)	13.63
Forfeited	(502)	12.54
Nonvested at September 30, 2016	1,264	$ 13.11

Market stock units granted during the three months ended September 30, 2016 have a multi-year performance period ending in 2019 and vest three years from the grant date.

The following table shows a summary of our market stock units as of September 30, 2016, as well as activity during the nine months then ended:

	Market Stock Units	
	Shares (000s)	Weighted-Average Grant Date Fair Value
Nonvested at January 1, 2016	474	$ 6.53
Granted	328	10.67
Vested	(221)	10.38
Forfeited	(142)	5.81
Nonvested at September 30, 2016	439	$ 9.46

(6) Income Taxes

For the three months ended September 30, 2016, we had an effective income tax rate from continuing operations of 73.2%, compared to an effective income tax rate of 39.4% for the three months ended September 30, 2015. During the three months ended September 30, 2016, we recorded an income tax benefit of $9.6 million related to a reversal of a domestic deferred tax asset valuation allowance initially recorded in the fourth quarter of 2015. We believe that projected core earnings of the remaining Network Solutions business will be sufficient to utilize the net operating losses within the expiration period. We recorded $15.6 million of incremental tax expense during the three months ended September 30, 2016 related to the first half of 2016, a period in which no income tax provision was recorded due to tax benefits on losses generated by discontinued operations.

For the nine months ended September 30, 2016, we had an effective tax income tax rate from continuing operations of 23.0%, compared to an effective income tax rate of 39.5% for the nine months ended September 30, 2015, primarily due to an income tax benefit of $9.6 million recognized during the nine months ended September 30, 2016 related to the reversal of a domestic deferred tax asset valuation allowance initially recorded in the fourth quarter of 2015.

At September 30, 2016, we also made the determination to release substantially all of the valuation allowance on deferred tax assets generated from net operating losses incurred by the TPHS business for the period from January 1, 2016 through Closing. We retained a valuation allowance of approximately $10.0 million on deferred tax assets related to capital losses incurred in the sale of the TPHS business as well as on deferred tax assets in certain foreign jurisdictions.

During the nine months ended September 30, 2016, we recorded an increase of $1.1 million to the valuation allowance on certain deferred tax assets in the U.S. Federal and state jurisdictions, as well as in certain foreign jurisdictions. At September 30, 2016, we had approximately $191.7 million of federal loss carryforwards and approximately $209.3 million of state loss carryforwards.

We file income tax returns in the U.S. Federal jurisdiction and various state and foreign jurisdictions. Tax years remaining subject to examination in these major jurisdictions include 2013 to present.

(7) Long-Term Debt

The Company's long-term debt, net of unamortized deferred loan costs, consisted of the following at September 30, 2016 and December 31, 2015:

(in thousands)	September 30, 2016	December 31, 2015
Cash Convertible Notes, net of unamortized discount	$ 135,912	$ 130,296
CareFirst Convertible Note	20,000	20,000
Fifth Amended Credit Agreement:		
Term Loan	65,000	80,000
Revolver	30,700	—
Capital lease obligations and other	1,667	5,374
	253,279	235,670
Less: deferred loan costs	(2,851)	(4,073)
	250,428	231,597
Less: current portion	(52,654)	(23,308)
	$ 197,774	$ 208,289

Credit Facility

On June 8, 2012, we entered into the Fifth Amended and Restated Revolving Credit and Term Loan Agreement (as amended, the "Fifth Amended Credit Agreement"). As amended in August 2016 and further described below, the Fifth Amended Credit Agreement provides us with a $125 million revolving credit facility that includes a swingline sub facility of $20 million and a $75 million sub facility for letters of credit. The Fifth Amended Credit Agreement also provides a $200 million term loan facility, $65 million of which remained outstanding at September 30, 2016, and an uncommitted incremental accordion facility of $100 million.

Borrowings under the Fifth Amended Credit Agreement generally bear interest at variable rates based on a margin or spread in excess of either (1) the one-month, two-month, three-month or six-month rate (or with the approval of affected lenders, nine-month or twelve-month rate) for Eurodollar deposits ("LIBOR", which may not be less than zero), or (2) the greatest of (a) the SunTrust Bank prime lending rate, (b) the federal funds rate plus 0.50% and (c) one-month LIBOR plus 1.00% (the "Base Rate"), as selected by the Company. The LIBOR margin varies between 1.75% and 3.00%, and the Base Rate margin varies between 0.75% and 2.00%, depending on our leverage ratio. The Fifth Amended Credit Agreement also provides for an annual fee ranging between 0.30% and 0.50% of the unused commitments under the revolving credit facility. Extensions of credit under the Fifth Amended Credit Agreement are secured by guarantees from all of the Company's active domestic subsidiaries and by security interests in substantially all of the Company's and such subsidiaries' assets.

On August 4, 2016, we entered into the Eighth Amendment to the Fifth Amended Credit Agreement (the "Eighth Amendment"). The Eighth Amendment (1) extends the expiration date of the Company's revolving credit facility and the maturity date of the Company's term loan facility under the Fifth Amended Credit Agreement from June 8, 2017 to June 8, 2018 (the "Extended Maturity Date") and (2) amends the definition of "Consolidated EBITDA" to include an add-back for certain non-cash gains and losses and to take into account certain financial consequences of the sale by the Company of its TPHS business to Sharecare pursuant to the terms of the Purchase Agreement. The Eighth Amendment contemplated that some lenders might not agree to the Extended Maturity Date and preserved June 8, 2017 as the non-extended maturity date (the "Non-Extended Maturity Date") for such lenders. Lenders holding $45.3 million of the revolving commitments and $25.4 million of outstanding term loans did not consent to the Extended Maturity Date. On the Non-Extended Maturity Date, the revolving commitments of non-consenting revolving lenders will terminate and any outstanding term loans and revolving loans owed to non-consenting lenders must be paid in full. The outstanding revolving loans under the revolving credit facility held by consenting lenders must be paid in

full on June 8, 2018. We are required to repay term loans in quarterly principal installments aggregating 2.500% of the original aggregate principal amount of the term loans ($5.0 million) during each of the remaining quarters prior to maturity on June 8, 2018, at which time the entire unpaid principal balance of the term loans held by consenting lenders is due and payable.

The impact of the Eighth Amendment on the maturity of our debt is reflected in our balance sheet. As of September 30, 2016, availability under the revolving credit facility totaled $86.6 million.

The Fifth Amended Credit Agreement contains financial covenants that require us to maintain, as defined, specified ratios or levels of (1) total funded debt to EBITDA and (2) fixed charge coverage. The Fifth Amended Credit Agreement contains various other affirmative and negative covenants that are typical for financings of this type. Among other things, the Fifth Amended Credit Agreement limits repurchases of our common stock and the amount of dividends that we can pay to holders of our common stock.

1.50% Cash Convertible Senior Notes Due 2018

On July 16, 2013, we completed the issuance of $150.0 million aggregate principal amount of cash convertible senior notes due 2018 (the "Cash Convertible Notes"), which bear interest at a rate of 1.50% per year, payable semiannually in arrears on January 1 and July 1 of each year, beginning on January 1, 2014. The Cash Convertible Notes will mature on July 1, 2018, unless earlier repurchased or converted into cash in accordance with their terms prior to such date. At the option of the holders, the Cash Convertible Notes are convertible into cash based on the conversion rate set forth below only upon occurrence of certain triggering events as defined in the Indenture dated as of July 8, 2013 by and between the Company and U.S. Bank National Association, none of which had occurred as of September 30, 2016. Accordingly, we have classified the Cash Convertible Notes as long-term debt at September 30, 2016 and December 31, 2015. The Cash Convertible Notes are not convertible into our common stock or any other securities under any circumstances. The initial cash conversion rate is approximately 51.38 shares of our common stock per $1,000 principal amount of Cash Convertible Notes (equivalent to an initial conversion price of approximately $19.46 per share of common stock). The Cash Convertible Notes are our senior unsecured obligations and rank senior in right of payment to any of our indebtedness that is expressly subordinated in right of payment to the Cash Convertible Notes. As a result of this transaction, we recognized deferred loan costs of approximately $3.9 million, which are being amortized over the term of the Cash Convertible Notes using the effective interest method.

Although the Cash Convertible Notes are not currently convertible, the Cash Convertible Notes will become convertible into cash during any calendar quarter (and only during such calendar quarter) if the last reported sale price of our common stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter is greater than or equal to approximately $25.30 per share.

The cash conversion feature of the Cash Convertible Notes (the "Cash Conversion Derivative") requires bifurcation from the Cash Convertible Notes in accordance with FASB ASC Topic 815, "Derivatives and Hedging" ("ASC Topic 815"), and is recorded in other long-term liabilities as a derivative liability and carried at fair value. The fair value of the Cash Conversion Derivative at the time of issuance of the Cash Convertible Notes was $36.8 million, which was recorded as a debt discount for purposes of accounting for the debt component of the Cash Convertible Notes. The debt discount is being amortized over the term of the Cash Convertible Notes using the effective interest method. For the nine months ended September 30, 2016, we recorded $5.6 million of interest expense related to the amortization of the debt discount based upon an effective interest rate of 5.7%. The net carrying amount of the Cash Convertible Notes at September 30, 2016 and December 31, 2015 was $135.9 million and $130.3 million, respectively, net of the unamortized discount of $14.1 million and $19.7 million, respectively.

In connection with the issuance of the Cash Convertible Notes, we entered into privately negotiated convertible note hedge transactions (the "Cash Convertible Notes Hedges"), which are cash-settled and are intended to reduce our exposure to potential cash payments that we would be required to make if holders elect to convert the Cash Convertible Notes at a time when our stock price exceeds the conversion price. The initial cost of the Cash Convertible Notes Hedges was $36.8 million. The Cash Convertible Notes Hedges are recorded in other assets as a derivative asset under FASB ASC Topic 815 and are carried at fair value. See Note 9 for additional information regarding the Cash Convertible Notes Hedges and the Cash Conversion Derivative and their fair values as of

September 30, 2016.

In July 2013, we also sold separate privately negotiated warrants (the "Warrants") initially relating, in the aggregate, to a notional number of shares of our common stock underlying the Cash Convertible Notes Hedges. The Warrants have an initial strike price of approximately $25.95 per share, which effectively increases the conversion price of the Cash Convertible Notes to a 60% premium to our stock price on July 1, 2013. The Warrants will be net share settled by issuing a number of shares of our common stock per Warrant corresponding to the excess of the market price per share of our common stock (as measured on each warrant exercise date under the terms of the Warrants) over the applicable strike price of the Warrants. The Warrants meet the definition of derivatives under the guidance in ASC Topic 815; however, because these instruments have been determined to be indexed to our own stock and meet the criteria for equity classification under ASC Topic 815, the Warrants have been accounted for as an adjustment to our additional paid-in-capital.

If the market value per share of our common stock exceeds the strike price of the Warrants, the Warrants will have a dilutive effect on net income per share, and the "treasury stock" method will be used in calculating the dilutive effect on earnings per share.

CareFirst Convertible Note

On October 1, 2013, we entered into an Investment Agreement (the "Investment Agreement") with CareFirst Holdings, LLC ("CareFirst"), which was in addition to certain commercial agreements between us and CareFirst relating to, among other things, disease management and care coordination services (the "Commercial Agreements"). Pursuant to the Investment Agreement, we issued to CareFirst a convertible subordinated promissory note in the aggregate original principal amount of $20 million (the "CareFirst Convertible Note") for a purchase price of $20 million. The CareFirst Convertible Note bears interest at a rate of 4.75% per year, payable quarterly in arrears on March 31, June 30, September 30 and December 31 of each calendar year, beginning on December 31, 2013. The CareFirst Convertible Note may be prepaid only under limited circumstances and upon the terms and conditions specified therein. If the CareFirst Convertible Note has not been fully converted or redeemed in accordance with its terms, it will mature on October 1, 2019. The CareFirst Convertible Note is subordinate in right of payment to the prior payment in full of (a) all of our indebtedness under the Fifth Amended Credit Agreement (as defined below) and (b) any other of our senior debt, which currently includes only the Cash Convertible Notes.

The CareFirst Convertible Note is convertible into shares of our common stock at the conversion rate determined by dividing (a) the sum of the portion of the principal to be converted and accrued and unpaid interest with respect to such principal by (b) the conversion price equal to $22.41 per share of our common stock. The conversion price is subject to adjustment for stock splits, stock dividends, recapitalizations, reorganizations, reclassifications and similar events. In October 2016, subsequent to the third quarter of 2016, CareFirst elected to convert the full amount of the CareFirst Convertible Note into 892,458 shares of our common stock with a conversion price equal to $22.41 per share.

CareFirst had an opportunity to earn warrants to purchase shares of our common stock ("CareFirst Warrants") based on achievement of certain quarterly thresholds (the "Revenue Thresholds") for revenue derived from both the Commercial Agreements and from new business to us from third parties as a result of an introduction or referral to us by CareFirst (collectively, the "Quarterly Revenue"). If the Quarterly Revenue was greater than or equal to the applicable Revenue Threshold for any quarter ending on or prior to September 30, 2017, then we would issue to CareFirst a certain number of warrants exercisable for the number of shares of our common stock ("CareFirst Warrant Shares") determined in accordance with the terms of the Investment Agreement unless (i) CareFirst elected to receive a cash payment in accordance with the terms of the Investment Agreement or (ii) there was a change of control. The aggregate number of CareFirst Warrant Shares in any single 12-month period beginning on October 1, 2013 could not exceed 400,000, and the aggregate number of CareFirst Warrant Shares issuable pursuant to the Investment Agreement could not exceed 1,600,000.

Also on October 1, 2013, in connection with the execution of the Investment Agreement, we entered into a Registration Rights Agreement (the "Registration Rights Agreement") with CareFirst, pursuant to which we agreed to use commercially reasonable efforts to cause any registration statement covering an underwritten offering of our common stock for our own account or for the account of any holder of our common stock (other than a registration statement on Form S-4 or Form S-8 or any successor thereto) to include those registrable common shares that any holder of such registrable common shares has requested to be registered.

Effective July 31, 2016, in connection with the consummation of the sale of the TPHS business (as discussed in Note 3), the Investment Agreement was terminated, and all of the Commercial Agreements between the Company and CareFirst relating to the TPHS business were transferred to an entity that, effective at the Closing, became a wholly-owned subsidiary of Sharecare, the buyer of the TPHS business. As a result, CareFirst no longer has the opportunity to earn the CareFirst Warrants in respect of the periods following the Closing. The Convertible Note, the Registration Rights Agreement and the CareFirst Warrants previously issued to CareFirst were not affected by the termination of the Investment Agreement. As of July 31, 2016, we had issued 630,586 CareFirst Warrants at a weighted average exercise price of $15.61, 39,903 of which were issued in 2016. In September 2016, CareFirst exercised its right to convert 590,683 CareFirst Warrants for a total of 218,162 shares of our common stock in accordance with the terms of the Investment Agreement.

(8) Commitments and Contingencies

Summary

We are subject to contractual disputes, claims and legal proceedings that arise from time to time in the ordinary course of our business. While we are unable to estimate a range of potential losses, we do not believe that any of the legal proceedings pending against us as of the date of this report, some of which are expected to be covered by insurance policies, will have a material adverse effect on our financial statements. As these matters are subject to inherent uncertainties, our view of these matters may change in the future.

Contractual Commitments

In October 2012 we entered into a joint venture agreement with Gallup (the "Gallup Joint Venture") that required us to make payments over a five year period beginning January 2013. Pursuant to Sharecare's acquisition of the TPHS business, our ownership interest in the Gallup Joint Venture was transferred to Sharecare. We agreed with Sharecare to be responsible for two-thirds of the remaining payment obligations in respect of the purchase price to be paid in connection with Sharecare's acquisition of additional membership interest in the joint venture. This obligation is currently expected to result in aggregate payments by us of approximately $4.2 million, payable in five equal quarterly installments beginning in the fourth quarter of the 2016 calendar year and ending in the fourth quarter of 2017. The financial impact of the strategic relationship with Gallup and the Gallup Joint Venture are reflected in discontinued operations for all periods presented as each of these are a part of the sold TPHS business.

In May 2011, we entered into a ten-year applications and technology services outsourcing agreement with HP that contained minimum fee requirements. As a result of the sale of TPHS, the minimum fee requirements under our technology services outsourcing agreement with HP were eliminated.

(9) Fair Value Measurements

We account for certain assets and liabilities at fair value. Fair value is defined as the price that would be received upon sale of an asset or paid upon transfer of a liability in an orderly transaction between market participants at the measurement date, assuming the transaction occurs in the principal or most advantageous market for that asset or liability.

Fair Value Hierarchy

The hierarchy below lists three levels of fair value based on the extent to which inputs used in measuring fair value are observable in the market. We categorize each of our fair value measurements in one of these three levels based on the lowest level input that is significant to the fair value measurement in its entirety. These levels are:

Level 1: Quoted prices in active markets for identical assets or liabilities;

Level 2: Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-based valuation techniques in which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities; and

Level 3: Unobservable inputs that are supported by little or no market activity and typically reflect management's estimates of assumptions that market participants would use in pricing the asset or liability.

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

In the third quarter of 2015, we observed factors causing a decline in future revenue projections as an indicator of an other than temporary impairment of the Gallup Joint Venture investment. Accordingly, we estimated the fair value of our investment using a discounted cash flow model. Estimating fair value requires significant judgments, including management's estimate of future cash flows, which is dependent on internal forecasts, estimation of the long-term growth rate for the joint venture, the useful life over which cash flows will occur, and determination of the weighted average cost of capital.

Based on our estimate of fair value prior to the disposition of the TPHS business, we determined that the present value of our remaining contractual cash obligations in the Gallup Joint Venture exceeded the estimated fair value, resulting in the recognition of a liability associated with the forward option to acquire additional membership interest (the "Gallup Derivative"). The Gallup Derivative was recorded as a derivative liability which has been reflected in our discontinued operations prior to the sale of the TPHS business in accordance with FASB ASC Topic 815 and was carried at fair value. Upon the sale of the TPHS business, we remain obligated for two-thirds of the remaining payment obligations in respect of the purchase price to be paid in connection with the acquisition of additional membership interest in the Gallup Joint Venture as discussed in Note 8 above.

Assets and Liabilities Measured at Fair Value

The following tables present our assets and liabilities measured at fair value at September 30, 2016, and December 31, 2015:

(In $000s) September 30, 2016	Level 2	Level 3	Gross Fair Value	Netting[(1)]	Net Fair Value
Assets:					
Cash Convertible Notes Hedges	—	73,869	73,869	—	73,869
Liabilities:					
Interest rate swap agreements	117	—	117	—	117
Cash Conversion Derivative	—	73,869	73,869	—	73,869

(In $000s) December 31, 2015	Level 2	Level 3	Gross Fair Value	Netting[(1)]	Net Fair Value
Assets:					
Foreign currency exchange contracts	$284	$—	$284	$ (26)	$258
Cash Convertible Notes Hedges	—	12,632	12,632	—	12,632
Liabilities:					
Foreign currency exchange contracts	$48	$—	$48	$ (26)	$22
Interest rate swap agreements	397	—	397	—	397
Cash Conversion Derivative	—	12,632	12,632	—	12,632
Gallup Derivative	—	6,339	6,339	—	6,339

(1) This column reflects the impact of netting derivative assets and liabilities by counterparty when a legally enforceable master netting agreement exists.

The fair values of forward foreign currency exchange contracts are valued using broker quotations of similar assets or liabilities in active markets. The fair values of interest rate swap agreements are primarily determined based on the present value of future cash flows using internal models and third-party pricing services with observable inputs, including interest rates, yield curves and applicable credit spreads. The fair values of the Cash Convertible Notes Hedges, the Cash Conversion Derivative and the Gallup Derivative are measured using Level 3 inputs because these instruments are not actively traded. The Cash Convertible Notes Hedges and the Cash Conversion Derivative are valued using an option pricing model that uses observable and unobservable market data for inputs, such as expected time to maturity of the derivative instruments, the risk-free interest rate, the expected volatility of our common stock and other factors. The Gallup Derivative was valued as the difference in the present value of our remaining cash commitments and the fair value of such commitments. The Cash Convertible Notes Hedges and the Cash Conversion Derivative were designed such that changes in their fair values would offset one another, with minimal impact to the consolidated statements of comprehensive income (loss). Therefore, the sensitivity of changes in the unobservable inputs to the option pricing model for such instruments is mitigated.

The following table presents our financial instruments measured at fair value on a recurring basis using unobservable inputs (Level 3):

$000s)	Balance at December 31, 2015	Purchases of Level 3 Instruments	Settlements of Level 3 Instruments	Gains/(Losses) Included in Earnings	Balance at September 30, 2016
Cash Convertible Notes Hedges	$ 12,632	$ —	$ —	$ 61,237	$ 73,869
Cash Conversion Derivative	(12,632)	—	—	(61,237)	(73,869)
Gallup Derivative	(6,339)	—	6,339	—	—

The gains and losses included in earnings noted above represent the change in the fair value of these financial instruments and are recorded each period in the consolidated statements of comprehensive income (loss). The gains and losses on the Cash Convertible Notes Hedges and Cash Conversion Derivative have been recorded as selling, general and administrative expenses, and the settlement on the Gallup Derivative has been recorded as a part of discontinued operations.

Fair Value of Other Financial Instruments

In addition to interest rate swap agreements, the Cash Convertible Notes Hedges and the Cash Conversion Derivative, the estimated fair values of which are disclosed above, the estimated fair value of each class of financial instruments at September 30, 2016 was as follows:

Cash and cash equivalents – The carrying amount of $0.7 million approximates fair value because of the short maturity of those instruments (less than three months).

Long-term debt – The estimated fair value of outstanding borrowings under the Fifth Amended Credit Agreement, which includes a revolving credit facility and a term loan facility (see Note 7), and the Cash Convertible Notes are determined based on the fair value hierarchy as discussed above. The revolving credit facility and the term loan facility are not actively traded and therefore are classified as Level 2 valuations based on the market for similar instruments. The estimated fair value is based on the average of the prices set by the issuing bank given current market conditions and is not necessarily indicative of the amount we could realize in a current market exchange. The estimated fair value and carrying amount of outstanding borrowings under the Fifth Amended Credit Agreement at September 30, 2016 are $95.7 million and $95.7 million, respectively.

The Cash Convertible Notes are actively traded and therefore are classified as Level 1 valuations. The estimated fair value at September 30, 2016, was $217.8 million, which is based on the last traded price of the Cash Convertible Notes on September 30, 2016, and the par value was $150.0 million. The carrying amount of the Cash Convertible Notes at September 30, 2016, was $135.9 million, which is net of the debt discount discussed in Note 7.

The CareFirst Convertible Note was issued at its fair value of $20.0 million on October 1, 2013. It is not actively traded and is not based upon either an observable market, other than the market for our common stock, or on an observable index and is therefore classified as a Level 3 valuation. At September 30, 2016, the carrying amount of the CareFirst Convertible Note of $20.0 million approximated fair value. In October 2016, subsequent to the third quarter of 2016, CareFirst elected to convert the full amount of the CareFirst Convertible Note into shares of our common stock with a conversion price equal to $22.41 per share.

(10) Derivative Investments and Hedging Activities

We use derivative instruments to manage risks related to interest, the Cash Convertible Notes, and, prior to the sale of the TPHS business, foreign currencies and the fair value of the Gallup Derivative. We account for derivatives in accordance with ASC Topic 815, which establishes accounting and reporting standards requiring that certain derivative instruments be recorded on the balance sheet as either an asset or liability measured at fair value. Additionally, changes in the derivative's fair value will be recognized currently in earnings unless specific hedge accounting criteria are met. As permitted under our master netting arrangements, the fair value amounts of our interest rate swaps and prior foreign currency options and/or forward contracts are presented on a net basis by counterparty in the consolidated balance sheets.

Derivative Instruments Designated as Hedging Instruments

Cash Flow Hedges

Derivative instruments that are designated and qualify as cash flow hedges are recorded at estimated fair value in the consolidated balance sheets, with the effective portion of the gains and losses being reported in accumulated other comprehensive income or loss ("accumulated OCI"). Cash flow hedges for all periods presented consist solely of interest rate swap agreements, which effectively modify our exposure to interest rate risk by converting a portion of our floating rate debt to fixed rate obligations, thus reducing the impact of interest rate changes on future interest expense. Under these agreements, we receive a variable rate of interest based on LIBOR (as defined in Note 7), and we pay a fixed rate of interest with an interest rate of 1.480% plus a spread (see Note 7). We maintain an interest rate swap agreement with a current notional amount of $50.0 million and a termination date of December 30, 2016. Gains and losses on these interest rate swap agreements are reclassified to interest expense in the same period during which the hedged transaction affects earnings or the period in which all or a portion of the hedge becomes ineffective. As of September 30, 2016, we expected to reclassify $0.05 million of net losses on interest rate swap agreements from accumulated OCI to interest expense within the next twelve months due to the scheduled payment of interest associated with our debt.

The following table shows the effect of our cash flow hedges on the consolidated balance sheets during the three and nine months ended September 30, 2016 and 2015:

(In $000s)	For the Three Months Ended		For the Nine Months Ended	
Derivatives in Cash Flow Hedging Relationships	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
Loss related to effective portion of derivatives recognized in accumulated OCI, gross of tax effect	$14	$ 105	$109	$ 360
Loss related to effective portion of derivatives reclassified from accumulated OCI to interest expense, gross of tax effect	$(126)	$ (91)	$(390)	$ (285)

Gains and losses representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in current earnings. During the three and nine months ended September 30, 2016 and 2015, there were no gains or losses on cash flow hedges recognized in our consolidated statements of comprehensive income (loss) resulting from hedge ineffectiveness.

Derivative Instruments Not Designated as Hedging Instruments

Our Cash Conversion Derivative, Cash Convertible Notes Hedges and prior to July 31, 2016,Gallup Derivative and foreign currency options and/or forward contracts, do not qualify for hedge accounting treatment under U.S. GAAP and are measured at fair value, with gains and losses recognized immediately in the consolidated statements of comprehensive income (loss). Other than the Gallup Derivative described in Note 9, these derivative instruments not designated as hedging instruments did not have a material impact on our consolidated statements of comprehensive income (loss) for the three and nine months ended September 30, 2016 and 2015.

The Cash Conversion Derivative is accounted for as a derivative liability and carried at fair value. In order to offset the risk associated with the Cash Conversion Derivative, we entered into Cash Convertible Notes Hedges, which are cash-settled and are intended to reduce our exposure to potential cash payments that we would be required to make if holders elect to convert the Cash Convertible Notes at a time when our stock price exceeds the conversion price. The Cash Convertible Notes Hedges are accounted for as a derivative asset and carried at fair value.

Prior to July 31, 2016 and the sale of the TPHS business, the Gallup Derivative was accounted for as a derivative liability and carried at fair value.

The gains and losses resulting from a change in fair values of the Cash Conversion Derivative and the Cash Convertible Notes Hedges are reported in the consolidated statements of comprehensive income (loss). The settlement on the Gallup Derivative has been recorded as a part of discontinued operations.

(In $000s)	Three Months Ended September 30, 2016	Nine Months Ended September 30, 2016	Statements of Comprehensive Income (Loss) Classification
Cash Convertible Notes Hedges:			
Net unrealized gain (loss)	$ 67,399	61,237	Selling, general and administrative expenses
Cash Conversion Derivative:			
Net unrealized gain (loss)	$ (67,399)	(61,237)	Selling, general and administrative expenses
Gallup Derivative:			
Net gain	4,823	4,823	Loss from discontinued operations

Prior to the sale of the TPHS business, we also entered into foreign currency options and/or forward contracts in order to minimize our earnings exposure to fluctuations in foreign currency exchange rates. Our foreign currency exchange contracts required current period mark-to-market accounting, with any change in fair value being recorded each period in the consolidated statements of comprehensive income (loss) in selling, general and administrative expenses. We do not execute transactions or hold derivative financial instruments for trading or other purposes.

Financial Instruments

The estimated gross fair values of derivative instruments at September 30, 2016 and December 31, 2015, excluding the impact of netting derivative assets and liabilities when a legally enforceable master netting agreement exists, were as follows:

(In $000s)	September 30, 2016		December 31, 2015			
	Interest rate swap agreements	Cash Convertible Notes Hedges and Cash Conversion Derivative	Foreign currency exchange contracts	Interest rate swap agreements	Cash Convertible Notes Hedges and Cash Conversion Derivative	Gallup Derivative
Assets:						
Derivatives not designated as hedging instruments:						
Other current assets	$ —	$ —	$284	$ —	$ —	$ —
Other assets	—	73,869	—	—	12,632	—
Total assets	$ —	$ 73,869	$284	$ —	$ 12,632	$ —
Liabilities:						
Derivatives not designated as hedging instruments:						