HealthSpring, Inc.
Form 10-Q
August 04, 2009

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

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

For the Quarterly Period Ended June 30, 2009

Commission File Number: 001-32739

HealthSpring, Inc.

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**20-1821898**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
9009 Carothers Parkway **Suite 501** **Franklin, Tennessee**	**37067**
(Address of Principal Executive Offices)	(Zip Code)

(615) 291-7000

(Registrant s Telephone Number, Including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 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 þ No o

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

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 smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ	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 þ

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

	Outstanding at July 31, 2009
Common Stock, Par Value $0.01 Per Share	**57,578,469 Shares**

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Part I FINANCIAL INFORMATION

Item 1: Financial Statements

HEALTHSPRING, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except share data)
(unaudited)

	June 30, 2009	December 31, 2008
Assets		
Current assets:		
Cash and cash equivalents	$ 295,010	$ 282,240
Accounts receivable, net	139,741	74,398
Investment securities available for sale	3,049	3,259
Investment securities held to maturity	24,812	24,750
Funds due for the benefit of members	38,617	40,212
Deferred income taxes	6,303	4,198
Prepaid expenses and other	9,438	6,560
Total current assets	516,970	435,617
Investment securities available for sale	24,095	30,463
Investment securities held to maturity	32,330	20,086
Property and equipment, net	26,397	26,842
Goodwill	590,016	590,016
Intangible assets, net	212,775	221,227
Restricted investments	15,379	11,648
Risk corridor receivable from CMS	21,839	
Other	17,592	8,878
Total assets	$ 1,457,393	$ 1,344,777
Liabilities and Stockholders Equity		
Current liabilities:		
Medical claims liability	$ 221,459	$ 190,144
Accounts payable, accrued expenses and other current liabilities	25,800	35,050
Risk corridor payable to CMS	2,656	1,419
Current portion of long-term debt	28,724	32,277
Total current liabilities	278,639	258,890
Deferred income taxes	85,406	89,615
Long-term debt, less current portion	222,611	235,736
Funds held for the benefit of members	51,934	
Other long-term liabilities	9,726	9,658
Total liabilities	648,316	593,899
Stockholders equity:		
	581	578

Common stock, $0.01 par value, 180,000,000 shares authorized, 58,106,776 shares issued and 54,911,801 outstanding at June 30, 2009, 57,811,927 shares issued and 54,619,488 outstanding at December 31, 2008		
Additional paid in capital	509,579	504,367
Retained earnings	347,673	295,170
Accumulated other comprehensive loss, net of tax	(1,423)	(1,955)
Treasury stock, at cost, 3,194,975 shares at June 30, 2009 and 3,192,439 shares at December 31, 2008	(47,333)	(47,282)
Total stockholders equity	809,077	750,878
Total liabilities and stockholders equity	$ 1,457,393	$ 1,344,777

See accompanying notes to condensed consolidated financial statements.

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HEALTHSPRING, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(in thousands, except share data)
(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	**2008**	**2009**	**2008**
Revenue:				
Premium revenue	$ 671,450	$ 554,667	$ 1,306,046	$ 1,095,558
Management and other fees	9,987	8,842	19,956	15,850
Investment income	1,106	3,365	2,656	8,175
Total revenue	682,543	566,874	1,328,658	1,119,583
Operating expenses:				
Medical expense	558,403	436,157	1,088,002	880,339
Selling, general and administrative	62,306	55,979	134,557	118,879
Depreciation and amortization	7,642	6,985	15,166	14,233
Interest expense	3,970	4,590	8,251	9,993
Total operating expenses	632,321	503,711	1,245,976	1,023,444
Income before income taxes	50,222	63,163	82,682	96,139
Income tax expense	(18,331)	(22,941)	(30,179)	(34,859)
Net income	$ 31,891	$ 40,222	$ 52,503	$ 61,280
Net income per common share:				
Basic	$ 0.59	$ 0.72	$ 0.96	$ 1.09
Diluted	$ 0.58	$ 0.72	$ 0.96	$ 1.09
Weighted average common shares outstanding:				
Basic	54,497,780	55,863,208	54,490,155	56,361,007
Diluted	54,770,212	55,959,111	54,794,251	56,460,143

See accompanying notes to condensed consolidated financial statements.

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HEALTHSPRING, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
Cash flows from operating activities:		
Net income	$ 52,503	$ 61,280
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	15,166	14,233
Stock-based compensation	5,158	4,485
Amortization of deferred financing cost	1,203	1,241
Equity in earnings of unconsolidated affiliate	(103)	(200)
Deferred tax benefit	(6,585)	(3,468)
Increase (decrease) in cash due to:		
Accounts receivable	(75,159)	(122,813)
Prepaid expenses and other current assets	(2,734)	(446)
Medical claims liability	31,315	41,504
Accounts payable, accrued expenses, and other current liabilities	(9,246)	15,837
Risk corridor payable to/receivable from CMS	(20,602)	(17,930)
Other	654	(995)
Net cash used in operating activities	(8,430)	(7,272)
Cash flows from investing activities:		
Additional consideration paid on acquisition	(910)	
Purchases of property and equipment	(5,502)	(3,838)
Purchases of investment securities	(28,687)	(31,758)
Maturities of investment securities	23,174	40,115
Purchases of restricted investments	(10,123)	(4,510)
Maturities of restricted investments	6,392	3,951
Distributions to affiliates		124
Net cash (used in) provided by investing activities	(15,656)	4,084
Cash flows from financing activities:		
Funds received for the benefit of the members	325,004	249,014
Funds withdrawn for the benefit of members	(271,476)	(219,838)
Payments on long-term debt	(16,678)	(17,371)
Proceeds from stock options exercised	6	288
Purchase of treasury stock		(28,344)
Net cash provided by (used in) financing activities	36,856	(16,251)
Net increase (decrease) in cash and cash equivalents	12,770	(19,439)

Cash and cash equivalents at beginning of period	282,240	324,090
Cash and cash equivalents at end of period	$ 295,010	$ 304,651
Supplemental disclosures:		
Cash paid for interest	$ 7,329	$ 8,346
Cash paid for taxes	$ 37,749	$ 33,909

See accompanying notes to condensed consolidated financial statements

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HEALTHSPRING, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

(1) Organization and Basis of Presentation

HealthSpring, Inc., a Delaware corporation (the Company), was organized in October 2004 and began operations in March 2005 in connection with a recapitalization transaction accounted for as a purchase. The Company is one of the country s largest coordinated care plans whose primary focus is on Medicare, the federal government sponsored health insurance program for United States citizens aged 65 and older, qualifying disabled persons, and persons suffering from end-stage renal disease. Through its health maintenance organization (HMO) and regulated insurance subsidiaries, the Company operates Medicare Advantage health plans in the states of Alabama, Florida, Illinois, Mississippi, Tennessee, and Texas and offers Medicare Part D prescription drug plans on a national basis. The Company also provides management services to health plans and physician partnerships.

The accompanying condensed consolidated financial statements are unaudited and should be read in conjunction with the consolidated financial statements and notes thereto of HealthSpring, Inc. as of and for the year ended December 31, 2008, included in the Company s Annual Report on Form 10-K for the year ended December 31, 2008 as filed with the Securities and Exchange Commission (the SEC) on February 25, 2009 (the 2008 Form 10-K).

The accompanying unaudited condensed consolidated financial statements reflect the Company s financial position as of June 30, 2009, the Company s results of operations for the three and six months ended June 30, 2009 and 2008 and cash flows for the six months ended June 30, 2009 and 2008. Certain 2008 amounts have been reclassified to conform to the 2009 presentation.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X of the Securities Exchange Act of 1934, as amended (the Exchange Act). Accordingly, certain information and footnote disclosures normally included in complete financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to the rules and regulations applicable to interim financial statements. In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all adjustments (including normally recurring accruals) necessary to present fairly the Company s financial position at June 30, 2009, and its results of operations for the three and six months ended June 30, 2009 and 2008, and its cash flows for the six months ended June 30, 2009 and 2008.

The results of operations for the 2009 interim period are not necessarily indicative of the operating results that may be expected for the year ending December 31, 2009. Subsequent events have been evaluated through August 4, 2009, the date of the issuance of the Company s condensed consolidated financial statements.

The preparation of the condensed consolidated financial statements requires management of the Company to make a number of estimates and assumptions relating to the reported amount of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the period. The most significant item subject to estimates and assumptions is the actuarial calculation for obligations related to medical claims. Other significant items subject to estimates and assumptions include the Company s estimated risk adjustment payments receivable from The Centers for Medicare & Medicaid Services (CMS), the valuation of goodwill and intangible assets, the useful life of definite-lived assets, the valuation of debt securities carried at fair value, and certain amounts recorded related to the Part D program. Actual results could differ significantly from those estimates. Illiquid credit markets and volatile equity markets, among other things, have increased the uncertainty inherent in certain estimates and assumptions. As future events and their effects cannot be determined with precision, actual results could differ significantly from these estimates. Changes in estimates resulting from continuing changes in the economic environment will be reflected in the financial statements in future periods.

The Company s HMO and regulated insurance subsidiaries are restricted from making distributions without appropriate regulatory notifications and approvals or to the extent such distributions would put them out of compliance with statutory net worth requirements or requirements under the Company s credit facilities. At June 30, 2009, $337.0 million of the Company s $394.7 million of cash, cash equivalents, investment securities and restricted investments were held by the Company s HMO and regulated insurance subsidiaries and subject to these dividend restrictions.

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HEALTHSPRING, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

(2) Recently Adopted Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard (SFAS) No. 157, Fair Value Measurements (SFAS No. 157). SFAS No. 157 establishes a common definition for fair value to be applied to GAAP requiring use of fair value, establishes a framework for measuring fair value, and expands disclosure about such fair value measurements. SFAS No. 157 is effective for financial assets and financial liabilities for fiscal years beginning after November 15, 2007. Issued in February 2008, FASB Staff Position (FSP) 157-1 Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13 removed leasing transactions accounted for under Statement 13 and related guidance from the scope of SFAS No. 157. FSP 157-2 Partial Deferral of the Effective Date of Statement 157 (FSP 157-2), deferred the effective date of SFAS No. 157 for all nonfinancial assets and nonfinancial liabilities to fiscal years beginning after November 15, 2008. The implementation of SFAS No. 157 for financial assets and financial liabilities, effective January 1, 2008, did not have a material impact on the Company s consolidated financial position and results of operations. The adoption of this statement for nonfinancial assets and nonfinancial liabilities, effective January 1, 2009, did not have a material impact on the Company s financial statements.

In December 2007, the FASB issued SFAS No. 141 (Revised 2007), Business Combinations (SFAS No. 141(R)). SFAS No. 141(R) will significantly change the accounting for business combinations. Under SFAS No. 141(R), an acquiring entity will be required to recognize all the assets acquired and liabilities assumed in a transaction at the acquisition-date fair value with limited exceptions. SFAS No. 141(R) also includes a substantial number of new disclosure requirements. SFAS No. 141(R) applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008, which is the year beginning January 1, 2009 for us. The adoption of this statement did not have a material effect on the Company s financial statements. The provisions of SFAS No. 141(R) will only impact the Company if it is party to a business combination that is consummated after January 1, 2009.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51 (SFAS No. 160). This statement improves the relevance, comparability, and transparency of the financial information that a reporting entity provides in its consolidated financial statements by establishing accounting and reporting standards that require all entities to report noncontrolling (minority) interests in subsidiaries as equity in the consolidated financial statements. Additionally, SFAS No. 160 requires that entities provide sufficient disclosures that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. SFAS No. 160 affects those entities that have an outstanding noncontrolling interest in one or more subsidiaries or that deconsolidate a subsidiary. SFAS No. 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. The Company adopted SFAS No. 160 effective January 1, 2009. The adoption of this statement did not impact the Company s financial statements.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities (SFAS No. 161). SFAS No. 161 requires enhanced disclosures about an entity s derivative and hedging activities and is effective for the Company as of the first quarter of fiscal 2009. The adoption of this statement as of January 1, 2009 required additional disclosures related to renewal or extension assumptions, but did not have a material impact on the Company s financial statements.

In April 2008, the FASB issued FSP No. FAS 142-3, Determination of the Useful Life of Intangible Assets (FSP No. FAS 142-3), which amends the list of factors an entity should consider in developing renewal or extension assumptions used in determining the useful life of recognized intangible assets under SFAS No. 142, Goodwill and Other Intangible Assets . The new guidance applies to (1) intangible assets that are acquired individually or with a group of other assets and (2) intangible assets acquired in both business combinations and asset acquisitions. Under FSP No. FAS 142-3, companies estimating the useful life of a recognized intangible asset must consider their historical experience in renewing or extending similar arrangements or, in the absence of historical experience, must consider assumptions that market participants would use about renewal or extension. For the Company, this FSP requires certain additional disclosures beginning January 1, 2009 and application to useful life estimates prospectively for intangible assets acquired after December 31, 2008. The adoption of this FSP did not have a material impact on the Company s financial statements.

HEALTHSPRING, INC. AND SUBSIDIARIES
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In April 2009, the FASB issued FSP FAS No. 107-1 and APB 28-1, Interim Disclosures about Fair Value of Financial Instruments (FSP 107-1 and APB 28-1). FSP 107-1 and APB 28-1 require disclosures about fair value of financial instruments for interim reporting periods as well as in annual financial statements. The adoption of FSP 107-1 and APB 28-1 as of the quarter ending June 30, 2009 required additional disclosures, but did not have a material impact on the Company s financial statements.

In April 2009, the FASB issued FSP No. 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly , (FSP 157-4). FSP 157-4 provides additional guidance to highlight and expand on the factors that should be considered in estimating fair value when there has been a significant decrease in market activity for a financial asset. This FSP also requires new disclosures relating to fair value measurement inputs and valuation techniques (including changes in inputs and valuation techniques). The adoption of FSP 157-4, as of the quarter ending June 30, 2009 did not impact the Company s financial statements.

In April 2009, the FASB issued FSP No. FAS 115-2 and FAS 124-2, Recognition and Presentation of Other-Than-Temporary Impairments (FSP 115-2 and FAS 124-2). FSP 115-2 and FAS 124-2 amends current other-than-temporary impairment guidance in GAAP for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities in the financial statements. This FSP does not amend existing recognition and measurement guidance related to other-than-temporary impairments of equity securities. The FSP applies to fixed maturity securities only and requires separate display of losses related to credit deterioration and losses related to other market factors. The adoption of FSP 115-2 and FAS 124-2, as of June 30, 2009 did not impact the Company s financial statements.

In June 2009, the FASB issued SFAS No. 165, Subsequent Events (SFAS No. 165). SFAS No. 165 establishes general standards for accounting for and disclosure of events that occur after the balance sheet date but before financial statements are available to be issued (subsequent events). More specifically, SFAS No. 165 sets forth the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition in the financial statements, identifies the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements and the disclosures that should be made about events or transactions that occur after the balance sheet date. See Note 1, Organization and Basis of Presentation for the related disclosures. The adoption of SFAS No. 165 in the second quarter of 2009 did not impact the Company s financial statements.

(3) Accounts Receivable

Accounts receivable at June 30, 2009 and December 31, 2008 consisted of the following (in thousands):

	June 30, 2009	December 31, 2008
Medicare premium receivables	$ 100,265	$ 31,535
Rebates	37,350	25,603
Due from providers	13,468	17,409
Other	2,004	1,871
	$ 153,087	$ 76,418
Allowance for doubtful accounts	(3,530)	(2,020)
Total (including non-current receivables)	$ 149,557	$ 74,398

Medicare premium receivables at June 30, 2009 include $94.0 million for receivables from CMS related to the accrual of retroactive risk adjustment payments (including $9.8 million which will not be paid until the second half of 2010 and which is classified as non-current and included in other assets on the Company s balance sheet). Subsequent to June 30, 2009, the Company received retroactive risk payments from CMS of $88.2 million, consisting of the Initial CMS Settlement (as defined below) for the 2009 plan year and Final CMS Settlement (as defined below) amounts for the 2008 plan year.

The Company s Medicare premium revenue is subject to adjustment based on the health risk of its members. This process for adjusting premiums is referred to as the CMS risk adjustment payment methodology. Under the risk adjustment payment

HEALTHSPRING, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

methodology, coordinated care plans must capture, collect, and report diagnosis code information to CMS. After reviewing the respective submissions, CMS establishes the payments to Medicare plans generally at the beginning of the calendar year, and then adjusts premiums on two separate occasions on a retroactive basis.

The first retroactive risk premium adjustment for a given fiscal year generally occurs during the third quarter of such fiscal year. This initial settlement (the Initial CMS Settlement) represents the updating of risk scores for the current year based on updated diagnoses from the prior year. CMS then issues a final retroactive risk premium adjustment settlement for that fiscal year in the following year (the Final CMS Settlement).

All such estimated amounts are periodically updated as additional diagnosis code information is reported to CMS and are adjusted to actual amounts when the ultimate settlements are known to the Company.

During the 2009 second quarter, the Company updated its estimated Final CMS Settlement payment amounts for 2008 as a result of receiving notification in July 2009 from CMS of Final CMS Settlements for 2008. The change in estimate related to the 2008 plan year resulted in an additional $7.9 million of premium revenue in the second quarter of 2009. The impact of the change in estimate during 2009 relating to the 2008 plan year on net income, after the expense for risk sharing with providers and income tax expense, for the three and six months ended June 30, 2009, was $2.6 million and $2.1 million, respectively. Similarly, the impact of the change in estimate related to the 2007 plan year resulted in an additional $17.3 million and $29.3 million of premium revenue for the three and six months ended June 30, 2008, respectively. The resulting impact of such changes on net income, after the expense for risk sharing with providers and income tax expense, for the three and six months ended June 30, 2008, was $8.1 million and $13.4 million, respectively.

Rebates for drug costs represent estimated rebates owed to the Company from prescription drug companies. The Company has entered into contracts with certain drug manufacturers which provide for rebates to the Company based on the utilization of specific prescription drugs by the Company s members. Accounts receivable relating to unpaid health plan enrollee premiums are recorded during the period the Company is obligated to provide services to enrollees and do not bear interest. The Company does not have any off-balance sheet credit exposure related to its health plan enrollees. Due from providers primarily includes management fees receivable as well as amounts owed to the Company for the refund of certain medical expenses paid by the Company under risk sharing agreements.

(4) Investment Securities

There were no investment securities classified as trading as of June 30, 2009 or December 31, 2008. Investment securities available for sale classified as current assets are as follows (in thousands):

	June 30, 2009				December 31, 2008			
	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Estimated Fair Value	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Estimated Fair Value
Municipal bonds	$ 3,021	28		3,049	$ 3,195	64		3,259

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(unaudited)

Investment securities available for sale classified as non-current assets are as follows (in thousands):

	June 30, 2009				December 31, 2008			
	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Estimated Fair Value	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Estimated Fair Value
Municipal bonds	$ 21,151	345	(39)	21,457	$ 24,874	262	(206)	24,930
Corporate debt securities	2,638			2,638	5,533			5,533
	$ 23,789	345	(39)	24,095	$ 30,407	262	(206)	30,463

Investment securities held to maturity classified as current assets are as follows (in thousands):

	June 30, 2009				December 31, 2008			
	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Estimated Fair Value	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Estimated Fair Value
U.S. Treasury securities	$ 2,632	5		2,637	$ 3,649	22		3,671
Municipal bonds	1,786	18		1,804	1,738	7		1,745
Government agencies	11,077	62		11,139	10,761	134		