

MOLINA HEALTHCARE INC

Form 10-Q

November 05, 2009

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

Form 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2009

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: 001-31719

Molina Healthcare, Inc.

(Exact name of registrant as specified in its charter)

Delaware

*(State or other jurisdiction of
incorporation or organization)*

13-4204626

*(I.R.S. Employer
Identification No.)*

200 Oceangate, Suite 100

Long Beach, California

(Address of principal executive offices)

90802

(Zip Code)

(562) 435-3666

(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 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 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 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

Accelerated filer

Non-accelerated filer

Smaller reporting
company

(Do not check if a smaller
reporting company)

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

The number of shares of the issuer's Common Stock, par value \$0.001 per share, outstanding as of October 30, 2009, was approximately 25,550,000.

MOLINA HEALTHCARE, INC.
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Preferred stock, \$0.001 par value; 20,000 shares authorized, no shares issued and outstanding		
Additional paid-in capital (1)	127,317	170,681
Accumulated other comprehensive loss	(1,665)	(2,310)
Retained earnings (1)	419,094	383,754
Treasury stock, at cost; 1,201 shares at December 31, 2008		(20,390)
Total stockholders' equity	544,772	531,762
	\$ 1,224,005	\$ 1,148,068

(1) The Company's consolidated financial position as of December 31, 2008, has been recast to reflect adoption of FASB Accounting Standards Codification (ASC) Subtopic 470-20, *Debt with Conversion and Other Options*. The cumulative adjustments to reduce retained earnings were \$3.4 million as of January 1, 2009.

See accompanying notes.

Table of Contents**CONSOLIDATED STATEMENTS OF INCOME**

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2009	2008 (1)	2009	2008 (1)
	(Amounts in thousands, except net income per share)			
	(Unaudited)			
Revenue:				
Premium revenue	\$ 914,805	\$ 791,554	\$ 2,697,796	\$ 2,282,345
Investment income	1,707	4,775	7,336	17,517
Total revenue	916,512	796,329	2,705,132	2,299,862
Expenses:				
Medical care costs	792,771	669,355	2,333,865	1,936,531
General and administrative expenses	97,635	88,030	283,216	253,196
Depreciation and amortization	9,832	8,515	28,468	24,997
Total expenses	900,238	765,900	2,645,549	2,214,724
Gain on retirement of convertible senior notes			1,532	
Operating income	16,274	30,429	61,115	85,138
Interest expense ⁽¹⁾	(3,279)	(3,120)	(9,917)	(9,913)
Income before income taxes ⁽¹⁾	12,995	27,309	51,198	75,225
Provision for income taxes ⁽¹⁾	4,431	10,829	15,858	30,447
Net income ⁽¹⁾	\$ 8,564	\$ 16,480	\$ 35,340	\$ 44,778
Net income per share ⁽¹⁾ :				
Basic	\$ 0.34	\$ 0.60	\$ 1.36	\$ 1.60
Diluted ⁽²⁾	\$ 0.33	\$ 0.60	\$ 1.36	\$ 1.59
Weighted average shares outstanding:				
Basic	25,539	27,449	25,944	27,971
Diluted ⁽²⁾	25,630	27,582	26,058	28,087

(1) The Company's consolidated statements of income for the three and nine months ended September 30,

2008, have been recast to reflect adoption of ASC Subtopic 470-20. This resulted in additional interest expense of \$1.2 million (\$0.03 per diluted share) for the three months ended September 30, 2008, and \$3.5 million (\$0.08 per diluted share) for the nine months ended September 30, 2008.

- (2) Potentially dilutive shares issuable pursuant to the Company's 2007 offering of convertible senior notes were not included in the computation of diluted net income per share because to do so would have been anti-dilutive for the three and nine month periods ended September 30, 2009, and 2008, respectively.

See accompanying notes.

Table of Contents**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008(1)	2009	2008 (1)
	(Amounts in thousands) (Unaudited)		(Amounts in thousands) (Unaudited)	
Net income (1)	\$ 8,564	\$ 16,480	\$ 35,340	\$ 44,778
Other comprehensive income (loss), net of tax:				
Unrealized gain (loss) on investments	37	(1,562)	645	(4,809)
Other comprehensive income (loss)	37	(1,562)	645	(4,809)
Comprehensive income (1)	\$ 8,601	\$ 14,918	\$ 35,985	\$ 39,969

(1) The Company's consolidated statements of comprehensive income for the three and nine months ended September 30, 2008, have been recast to reflect adoption of ASC Subtopic 470-20.

See accompanying notes.

Table of Contents**CONSOLIDATED STATEMENTS OF CASH FLOWS**

	Nine Months Ended September 30, 2009 2008 (1) (Amounts in thousands) (Unaudited)	
Operating activities		
Net income (1)	\$ 35,340	\$ 44,778
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	28,468	24,997
Unrealized gain on trading securities	(3,509)	
Loss on rights agreement	3,204	
Gain on purchase and retirement of convertible senior notes	(1,532)	
Non-cash interest on convertible senior notes (1)	3,563	3,497
Amortization of deferred financing costs (1)	1,040	1,076
Deferred income taxes	2,322	(7,410)
Tax deficiency from employee stock compensation recorded as additional paid-in capital	(704)	(247)
Stock-based compensation	5,730	5,769
Changes in operating assets and liabilities:		
Receivables	(15,567)	(58,223)
Prepaid expenses and other current assets	454	(1,881)
Medical claims and benefits payable	10,672	(12,819)
Accounts payable and accrued liabilities	(6,140)	(666)
Deferred revenue	61,381	(20,951)
Income taxes	5,561	1,809
Net cash provided by (used in) operating activities	130,283	(20,271)
Investing activities		
Purchases of equipment	(28,390)	(28,314)
Purchases of investments	(127,335)	(181,377)
Sales and maturities of investments	149,770	188,896
Increase in restricted investments	(4,198)	(7,491)
Cash paid in business purchase transaction	(10,900)	(1,000)
Increase in other assets	(1,877)	(578)
(Decrease) increase in other long-term liabilities	(8,788)	4,211
Net cash used in investing activities	(31,718)	(25,653)
Financing activities		
Treasury stock purchases	(27,712)	(32,237)
Purchase and retirement of convertible senior notes	(9,653)	
Excess tax benefits from employee stock compensation	26	43
Proceeds from exercise of stock options and employee stock purchases	1,081	1,490

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Net cash used in financing activities	(36,258)	(30,704)
Net increase (decrease) in cash and cash equivalents	62,307	(76,628)
Cash and cash equivalents at beginning of period	387,162	459,064
Cash and cash equivalents at end of period	\$ 449,469	\$ 382,436

(1) The Company's consolidated statement of cash flows for the nine months ended September 30, 2008, has been recast to reflect adoption of ASC Subtopic 470-20.

See accompanying notes.

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	Nine Months Ended September 30, 2009 2008 (Amounts in thousands) (Unaudited)	
Supplemental cash flow information		
Cash paid during the period for:		
Income taxes	\$ 19,954	\$ 36,127
Interest	\$ 4,254	\$ 3,945
Schedule of non-cash investing and financing activities:		
Unrealized gain (loss) on investments	\$ 936	\$ (7,833)
Deferred taxes	(291)	3,024
Net unrealized gain (loss) on investments	\$ 645	\$ (4,809)
Retirement of common stock used for stock-based compensation	\$ 920	\$ 512
Accrued purchases of equipment	\$ 366	\$ 541
Retirement of treasury stock	\$ 48,102	\$ 29,966
Details of business purchase transaction:		
Fair value of assets acquired	\$ 10,900	\$ 2,262
Common stock issued to seller		(1,262)
Net cash paid in business purchase transaction	\$ 10,900	\$ 1,000
Business purchase transactions adjustments:		
Other assets	\$ 9,000	\$
Accounts payable and accrued liabilities	16,100	1,265
Deferred taxes		65
Goodwill and intangible assets, net	\$ 25,100	\$ 1,330

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MOLINA HEALTHCARE, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
September 30, 2009

1. Basis of Presentation

Organization and Operations

Molina Healthcare, Inc. is a multi-state managed care organization participating exclusively in government-sponsored health care programs for low-income persons, such as the Medicaid program and the Children's Health Insurance Program, or CHIP. We also serve a small number of low-income Medicare members. We conduct our business primarily through 10 licensed health plans in the states of California, Florida, Michigan, Missouri, Nevada, New Mexico, Ohio, Texas, Utah, and Washington. The health plans are locally operated by our respective wholly owned subsidiaries in those 10 states, each of which is licensed as a health maintenance organization, or HMO. Effective December 31, 2009, we will no longer serve members in Nevada.

Consolidation and Interim Financial Information

The condensed consolidated financial statements include the accounts of Molina Healthcare, Inc. and all majority-owned subsidiaries. In the opinion of management, all adjustments considered necessary for a fair presentation of the results as of the date and for the interim periods presented have been included. Except as described below, such adjustments consist of normal recurring adjustments. All significant intercompany balances and transactions have been eliminated in consolidation. The condensed consolidated results of operations for the current interim period are not necessarily indicative of the results for the entire year ending December 31, 2009. Financial information related to subsidiaries acquired during any year is included only for the period subsequent to their acquisition.

The unaudited condensed consolidated interim financial statements have been prepared under the assumption that users of the interim financial data have either read or have access to our audited consolidated financial statements for the fiscal year ended December 31, 2008. Accordingly, certain disclosures that would substantially duplicate the disclosures contained in the December 31, 2008 audited consolidated financial statements have been omitted. These unaudited condensed consolidated interim financial statements should be read in conjunction with our December 31, 2008 audited financial statements.

In preparing the accompanying unaudited condensed consolidated financial statements, we have evaluated subsequent events through November 5, 2009, the date of issuance of the financial statements.

Effective January 1, 2009, we adopted FASB Accounting Standards Codification (ASC) Subtopic 470-20, *Debt with Conversion and Other Options*. This change in accounting treatment has been applied retrospectively to prior periods, and resulted in additional interest expense of \$1.2 million (\$0.03 per diluted share) for the three months ended September 30, 2008, and \$3.5 million (\$0.08 per diluted share) for the nine months ended September 30, 2008. The cumulative adjustments to reduce retained earnings were \$3.4 million as of January 1, 2009, and \$0.6 million as of January 1, 2008. For a comprehensive discussion of the application of ASC Subtopic 470-20, and its impact to the accompanying financial statements, see Note 11, Convertible Senior Notes.

2. Significant Accounting Policies

Investments

Our investments are principally held in debt securities, which are grouped into three separate categories for accounting and reporting purposes: available-for-sale securities, held-to-maturity securities, and trading securities. Available-for-sale securities are recorded at fair value and unrealized gains and losses, if any, are recorded in stockholders' equity as other comprehensive income, net of applicable income taxes. Held-to-maturity securities are recorded at amortized cost, which approximates fair value, and unrealized holding gains or losses are not generally recognized. Realized gains and losses and unrealized losses judged to be other than temporary with respect to available-for-sale and held-to-maturity securities are included in the determination of net income. Trading securities are recorded at fair value, and holding gains and losses are recognized in net income.

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Except for restricted investments and certain student loan portfolios (the auction rate securities), our debt securities are designated as available-for-sale and are carried at fair value. The cost of securities sold is determined using the specific-identification method, on an amortized cost basis. Fair values of securities are generally based on quoted prices in active markets.

Our investment policy requires that all of our investments have final maturities of ten years or less (excluding auction rate and variable rate securities where interest rates may be periodically reset), and that the average maturity be four years or less. Investments and restricted investments are subject to interest rate risk and will decrease in value if market rates increase. Declines in interest rates over time will reduce our investment income.

In general, our available-for-sale securities are classified as current assets without regard to the securities contractual maturity dates because they may be readily liquidated. During 2008, our auction rate securities were classified as non-current assets. During the fourth quarter of 2008, certain auction rate securities were designated as trading securities. For comprehensive discussions of the fair value and classification of our current and non-current investments, including auction rate securities, see Note 5, Fair Value Measurements, and Note 6, Investments.

Income Taxes

We record accruals for uncertain tax positions by applying a two-step process. First, we determine whether it is more likely than not that a tax position will be sustained upon examination. In the second step, a tax position that meets the more-likely-than-not recognition threshold is measured to determine the amount of benefit to recognize in the financial statements.

Our accrual for unrecognized tax benefits decreased \$10.7 million to \$1.0 million as of September 30, 2009, from \$11.7 million as of December 31, 2008. This accrual is included in Other long-term liabilities in the accompanying condensed consolidated balance sheets. Approximately \$9.7 million of the decrease in our accrual for unrecognized tax benefits was recorded during the three months ended June 30, 2009, as (a) a gross discrete tax benefit of \$3.8 million (\$3.6 million net of tax), (b) a reduction in deferred tax assets of \$5.2 million, and (c) an increase in taxes payable of \$0.7 million. An additional \$1.0 million decrease in our accrual for unrecognized tax benefits was recorded during the three months ended September 30, 2009. The aggregate \$10.7 million decrease during the nine months ended September 30, 2009 was primarily related to settling certain tax examinations and voluntarily electing to change certain tax accounting methods. Approximately \$0.8 million of the \$1.0 million in unrecognized tax benefits at September 30, 2009 would affect our effective tax rate, if recognized. We anticipate a decrease of \$0.4 million to our liability for unrecognized tax benefits within the next twelve-month period.

Our continuing practice is to recognize interest and/or penalties related to unrecognized tax benefits in income tax expense. Our accrual for the payment of interest relating to unrecognized tax benefits decreased \$1.3 million (\$0.8 million net of tax) to \$0.1 million as of September 30, 2009, from \$1.4 million as of December 31, 2008. The accrual for interest on unrecognized tax benefits decreased as a result of the decrease in the accrual for unrecognized tax benefits as described above.

Recent Accounting Pronouncements

In June 2009, the FASB issued ASC Topic 105, *Generally Accepted Accounting Principles*, which establishes the FASB Accounting Standards Codification as the source of authoritative accounting principles recognized by the FASB to be applied in the preparation of financial statements in conformity with generally accepted accounting principles. ASC Topic 105 explicitly recognizes rules and interpretive releases of the Securities and Exchange Commission (SEC) under federal securities laws as authoritative generally accepted accounting principles (GAAP) for SEC registrants. ASC Topic 105 became effective on September 15, 2009; we have updated and will update all existing GAAP references to the new codification references for all current and future filings.

On August 28, 2009, the FASB issued Accounting Standards Update (ASU) No. 2009-05, *Measuring Liabilities at Fair Value* (ASU 2009-05). ASU 2009-05 provides additional guidance clarifying the measurement of liabilities at fair value. ASU 2009-05 is effective in fourth quarter 2009 for a calendar-year entity. We are currently evaluating the impact of ASU 2009-05 on our financial position, results of operations, cash flows, and disclosures.

On September 23, 2009, the FASB ratified Emerging Issues Task Force Issue No. 08-1, *Revenue Arrangements with Multiple Deliverables* (EITF 08-1). EITF 08-1 updates the current guidance pertaining to multiple-element revenue arrangements included in ASC Subtopic 605-25, which originated primarily from EITF

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00-21, also titled Revenue Arrangements with Multiple Deliverables. EITF 08-1 will be effective for annual reporting periods beginning January 1, 2011 for calendar-year entities. We are currently evaluating the impact of EITF 08-1 on our financial position, results of operations, cash flows, and disclosures.

Other recent accounting pronouncements issued by the FASB (including its Emerging Issues Task Force), the AICPA, and the SEC did not, or are not believed by management to, have a material impact on our present or future consolidated financial statements.

3. Earnings per Share

The denominators for the computation of basic and diluted earnings per share are calculated as follows:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2009	2008	2009	2008
	(In thousands)			
Shares outstanding at the beginning of the period	25,529	27,453	26,725	28,444
Weighted average number of treasury shares purchased		(20)	(865)	(549)
Weighted average number of shares issued under employee stock plans	10	16	84	76
Denominator for basic earnings per share	25,539	27,449	25,944	27,971
Dilutive effect of employee stock options and restricted stock (1)	91	133	114	116
Denominator for diluted earnings per share (2)	25,630	27,582	26,058	28,087

(1) Options to purchase common shares are included in the calculation of diluted earnings per share when their exercise prices are below the average fair value of the common shares for each of the periods presented. For the three months ended September 30, 2009, and 2008, there were approximately

618,000 and 333,000 antidilutive weighted options, respectively. For the nine months ended September 30, 2009, and 2008, there were approximately 622,000 and 348,000 antidilutive weighted options, respectively. Restricted shares are included in the calculation of diluted earnings per share when their grant date fair values are below the average fair value of the common shares for each of the periods presented. For the three months ended September 30, 2009, and 2008, there were approximately 232,000, and 2,000 antidilutive weighted restricted shares, respectively. For the nine months ended September 30, 2009, and 2008, there were

approximately
28,000, and
35,000
antidilutive
weighted
restricted
shares,
respectively.

- (2) Potentially dilutive shares issuable pursuant to our convertible senior notes were not included in the computation of diluted earnings per share because to do so would have been anti-dilutive for the three and nine months ended September 30, 2009 and 2008.

4. Stock-Based Compensation

At September 30, 2009, we had employee equity incentives outstanding under two plans: (1) the 2002 Equity Incentive Plan; and (2) the 2000 Omnibus Stock and Incentive Plan (from which equity incentives are no longer awarded). Charged to general and administrative expenses, total stock-based compensation expense for the three and nine months ended September 30, 2009 and 2008 was as follows:

	Three Months Ended September 30, 2009		Nine Months Ended September 30, 2008	
	2009	2008	2009	2008
	(In thousands)			
Restricted stock awards	\$ 1,787	\$ 1,480	\$ 4,661	\$ 3,687
Stock options (including shares issued under our employee stock purchase plan)	485	702	1,069	2,082
Total stock-based compensation expense	\$ 2,272	\$ 2,182	\$ 5,730	\$ 5,769

As of September 30, 2009, there was \$16.5 million of total unrecognized compensation expense related to non-vested restricted stock awards, which we expect to be recognized over a weighted-average period of 2.8 years. Also as of September 30, 2009, there was \$1.1 million of unrecognized compensation expense related to non-vested stock options, which we expect to recognize over a weighted-average period of 1.5 years.

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Non-vested restricted stock and restricted stock unit activity for the nine months ended September 30, 2009 is summarized below:

	Weighted Average Grant Date
&n	