

CENTENE CORP  
Form 10-Q  
October 23, 2012

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549

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FORM 10-Q

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(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, 2012  
OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

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Commission file number: 001-31826

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

Delaware 42-1406317  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification Number)

7700 Forsyth Boulevard  
St. Louis, Missouri 63105  
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code:

(314) 725-4477

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). x Yes " No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "small reporting

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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 12, 2012, the registrant had 51,633,824 shares of common stock outstanding.

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CENTENE CORPORATION  
 QUARTERLY REPORT ON FORM 10-Q  
 TABLE OF CONTENTS

	PAGE
Part I	
Financial Information	
Item 1. <u>Financial Statements</u>	<u>1</u>
<u>Consolidated Balance Sheets as of September 30, 2012 and December 31, 2011 (unaudited)</u>	<u>1</u>
<u>Consolidated Statements of Operations for the Three and Nine Months Ended September 30, 2012 and 2011 (unaudited)</u>	<u>2</u>
<u>Consolidated Statements of Comprehensive Earnings for the Three and Nine Months Ended September 30, 2012 and 2011 (unaudited)</u>	<u>3</u>
<u>Consolidated Statement of Stockholders' Equity for the Nine Months Ended September 30, 2012 (unaudited)</u>	<u>4</u>
<u>Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2012 and 2011 (unaudited)</u>	<u>5</u>
<u>Notes to the Consolidated Financial Statements (unaudited)</u>	<u>6</u>
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>13</u>
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	<u>24</u>
Item 4. <u>Controls and Procedures</u>	<u>24</u>
Part II	
Other Information	
Item 1. <u>Legal Proceedings</u>	<u>25</u>
Item 1A. <u>Risk Factors</u>	<u>25</u>
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>38</u>
Item 6. <u>Exhibits</u>	<u>39</u>
<u>Signatures</u>	<u>40</u>

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Table of Contents

CAUTIONARY STATEMENT ON FORWARD-LOOKING STATEMENTS

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

All forward-looking statements included in this filing are based on information available to us on the date of this filing and we undertake no obligation to update or revise the forward-looking statements included in this filing, whether as a result of new information, future events or otherwise, after the date of this filing. Actual results may differ from projections or estimates due to a variety of important factors, including:

- our ability to accurately predict and effectively manage health benefits and other operating expenses;
- competition;
- membership and revenue projections;
- timing of regulatory contract approval;
- changes in healthcare practices;
- changes in federal or state laws or regulations, including the Patient Protection and Affordable Care Act and the Health Care and Education Affordability Reconciliation Act and any regulations enacted thereunder;
- changes in expected contract start dates;
- inflation;
- provider and state contract changes;
- new technologies;
- reduction in provider payments by governmental payors;
- major epidemics;
- disasters and numerous other factors affecting the delivery and cost of healthcare;
- the expiration, cancellation or suspension of our Medicaid managed care contracts by state governments;
- availability of debt and equity financing, on terms that are favorable to us; and
- general economic and market conditions.

Non-GAAP Financial Presentation

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



Table of ContentsPART I  
FINANCIAL INFORMATIONITEM 1. Financial Statements.  
CENTENE CORPORATION AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS  
(In thousands, except share data)  
(Unaudited)

	September 30, 2012	December 31, 2011
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$796,621	\$573,698
Premium and related receivables	316,123	157,450
Short-term investments	139,920	130,499
Other current assets	123,841	78,363
Total current assets	1,376,505	940,010
Long-term investments	559,714	506,140
Restricted deposits	33,509	26,818
Property, software and equipment, net	381,781	349,622
Goodwill	256,288	281,981
Intangible assets, net	21,375	27,430
Other long-term assets	61,764	58,335
Total assets	\$2,690,936	\$2,190,336
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Medical claims liability	\$919,032	\$607,985
Premium deficiency reserve	63,000	—
Accounts payable and accrued expenses	162,778	216,504
Unearned revenue	131,967	9,890
Current portion of long-term debt	3,337	3,234
Total current liabilities	1,280,114	837,613
Long-term debt	391,973	348,344
Other long-term liabilities	61,785	67,960
Total liabilities	1,733,872	1,253,917
Commitments and contingencies		
Stockholders' equity:		
Common stock, \$.001 par value; authorized 100,000,000 shares; 54,405,296 issued and 51,632,704 outstanding at September 30, 2012, and 53,586,726 issued and 50,864,618 outstanding at December 31, 2011	54	54
Additional paid-in capital	458,741	421,981
Accumulated other comprehensive income:		
Unrealized gain on investments, net of tax	6,702	5,761
Retained earnings	557,759	564,961
Treasury stock, at cost (2,772,592 and 2,722,108 shares, respectively)	(59,277	) (57,123
Total Centene stockholders' equity	963,979	935,634
Noncontrolling interest	(6,915	) 785
Total stockholders' equity	957,064	936,419

Total liabilities and stockholders' equity	\$2,690,936	\$2,190,336
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The accompanying notes to the consolidated financial statements are an integral part of these statements.

1

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Table of ContentsCENTENE CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except share data)

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Revenues:				
Premium	\$2,184,061	\$1,239,464	\$5,853,469	\$3,640,829
Service	28,403	25,817	84,062	81,629
Premium and service revenues	2,212,464	1,265,281	5,937,531	3,722,458
Premium tax	235,657	36,754	333,484	110,948
Total revenues	2,448,121	1,302,035	6,271,015	3,833,406
Expenses:				
Medical costs	2,036,999	1,053,320	5,370,080	3,091,007
Cost of services	21,744	20,229	66,897	60,717
General and administrative expenses	181,073	142,934	512,322	427,067
Premium tax expense	235,946	37,005	333,872	111,668
Impairment loss	—	—	28,033	—
Total operating expenses	2,475,762	1,253,488	6,311,204	3,690,459
Earnings (loss) from operations	(27,641 )	48,547	(40,189 )	142,947
Other income (expense):				
Investment and other income	23,244	2,697	32,580	9,379
Debt extinguishment costs	—	—	—	(8,488 )
Interest expense	(4,855 )	(4,572 )	(14,393 )	(15,523 )
Earnings (loss) from operations, before income tax expense	(9,252 )	46,672	(22,002 )	128,315
Income tax expense (benefit)	(9,547 )	18,459	(6,068 )	49,216
Net earnings (loss)	295	28,213	(15,934 )	79,099
Noncontrolling interest	(3,524 )	(774 )	(8,732 )	(2,007 )
Net earnings (loss) attributable to Centene Corporation	\$3,819	\$28,987	\$(7,202 )	\$81,106
Net earnings (loss) per common share attributable to Centene Corporation:				
Basic earnings (loss) per common share	\$0.07	\$0.58	\$(0.14 )	\$1.62
Diluted earnings (loss) per common share	\$0.07	\$0.55	\$(0.14 )	\$1.55
Weighted average number of common shares outstanding:				
Basic	51,584,860	50,345,512	51,393,345	50,089,845
Diluted	53,806,197	52,620,350	51,393,345	52,320,906

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



Table of ContentsCENTENE CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENT OF COMPREHENSIVE EARNINGS

(In thousands)

(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2012	2011	2012	2011
Net earnings (loss)	\$295	\$28,213	\$(15,934 )	\$79,099
Reclassification adjustment, net of tax	1,023	195	1,495	415
Change in unrealized gains on investments, net of tax	(163 )	(900 )	(554 )	(361 )
Other comprehensive earnings (loss)	860	(705 )	941	54
Comprehensive earnings (loss)	1,155	27,508	(14,993 )	79,153
Comprehensive earnings (loss) attributable to the noncontrolling interest	(3,524 )	(774 )	(8,732 )	(2,007 )
Comprehensive earnings (loss) attributable to Centene Corporation	\$4,679	\$28,282	\$(6,261 )	\$81,160

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

Table of Contents

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

Nine Months Ended September 30, 2012

	Centene Stockholders' Equity					Treasury Stock		Non controlling Interest	Total
	Common Stock		Additional Paid-in Capital	Accumulated Other Comprehensive Income	Retained Earnings	Treasury Stock			
	\$.001 Par Value Shares	Amt						\$.001 Par Value Shares	Amt
Balance, December 31, 2011	53,586,726	\$54	\$421,981	\$5,761	\$564,961	2,722,108	\$(57,123)	\$785	\$936,419
Comprehensive Earnings:									
Net earnings (loss)	—	—	—	—	(7,202 )	—	—	(8,732 )	(15,934 )
Change in unrealized investment gain, net of \$623 tax	—	—	—	941	—	—	—	—	941
Total comprehensive earnings (loss)									(14,993 )
Common stock issued for employee benefit plans	818,570	—	12,297	—	—	—	—	—	12,297
Common stock repurchases	—	—	—	—	—	50,484	(2,154 )	—	(2,154 )
Stock compensation expense	—	—	18,417	—	—	—	—	—	18,417
Excess tax benefits from stock compensation	—	—	6,046	—	—	—	—	—	6,046
Contribution from noncontrolling interest	—	—	—	—	—	—	—	1,032	1,032
Balance, September 30, 2012	54,405,296	\$54	\$458,741	\$6,702	\$557,759	2,772,592	\$(59,277)	\$(6,915 )	\$957,064

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

Table of ContentsCENTENE CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Nine Months Ended September	
	30,	
	2012	2011
Cash flows from operating activities:		
Net earnings (loss)	\$(15,934	) \$79,099
Adjustments to reconcile net earnings (loss) to net cash provided by operating activities		
Depreciation and amortization	49,892	43,055
Stock compensation expense	18,417	13,263
Impairment loss	28,033	—
Gain on sale of investment in convertible note	(17,880	) —
Gain on sale of investments, net	(1,460	) (213 )
Debt extinguishment costs	—	8,488
Deferred income taxes	(19,318	) (223 )
Changes in assets and liabilities		
Premium and related receivables	(139,414	) (13,306 )
Other current assets	(23,487	) (6,667 )
Other assets	1,918	(1,230 )
Medical claims liabilities	374,046	40,476
Unearned revenue	122,077	(65,183 )
Accounts payable and accrued expenses	(59,872	) (11,414 )
Other operating activities	(9,736	) 3,528
Net cash provided by operating activities	307,282	89,673
Cash flows from investing activities:		
Capital expenditures	(70,601	) (56,938 )
Purchases of investments	(501,958	) (201,145 )
Sales and maturities of investments	434,009	180,124
Investments in acquisitions, net of cash acquired	—	(3,192 )
Net cash used in investing activities	(138,550	) (81,151 )
Cash flows from financing activities:		
Proceeds from exercise of stock options	11,686	13,582
Proceeds from borrowings	215,000	419,183
Payment of long-term debt	(177,422	) (415,475 )
Excess tax benefits from stock compensation	6,049	1,632
Common stock repurchases	(2,154	) (1,280 )
Contribution from noncontrolling interest	1,032	569
Debt issue costs	—	(9,242 )
Net cash provided by financing activities	54,191	8,969
Net increase in cash and cash equivalents	222,923	17,491
Cash and cash equivalents, beginning of period	573,698	434,166
Cash and cash equivalents, end of period	\$796,621	\$451,657
Supplemental disclosures of cash flow information:		
Interest paid	\$12,127	\$16,097
Income taxes paid	\$34,001	\$49,996

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

5

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Table of Contents

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

## 1. Basis of Presentation

The accompanying interim financial statements have been prepared under the presumption that users of the interim financial information have either read or have access to the audited financial statements included in the Form 10-K for the fiscal year ended December 31, 2011. The unaudited interim financial statements herein have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, footnote disclosures, which would substantially duplicate the disclosures contained in the December 31, 2011 audited financial statements, have been omitted from these interim financial statements where appropriate. In the opinion of management, these financial statements reflect all adjustments, consisting only of normal recurring adjustments, which are necessary for a fair presentation of the results of the interim periods presented.

Certain 2011 amounts in the consolidated financial statements have been reclassified to conform to the 2012 presentation. These reclassifications have no effect on net earnings or stockholders' equity as previously reported.

The Company reclassified certain Medical Costs and General & Administrative Expenses beginning with its financial results for the year ended December 31, 2011, as well as prior periods to conform to the current presentation, to more closely align to the National Association of Insurance Commissioners definition. For the three months ended September 30, 2011, the net impact of the reclassification increased Medical Costs and decreased General & Administrative Expense by \$24,734. For the nine months ended September 30, 2011, the net impact of the reclassification increased Medical Costs and decreased General & Administrative Expense by \$69,607.

## 2. Short-term and Long-term Investments and Restricted Deposits

Short-term and long-term investments and restricted deposits by investment type consist of the following:

	September 30, 2012				December 31, 2011			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$60,177	\$760	\$(6 )	\$60,931	\$29,014	\$638	\$(13 )	\$29,639
Corporate securities	257,161	5,844	(6 )	262,999	186,018	3,762	(751 )	189,029
Restricted certificates of deposit	5,891	—	—	5,891	5,890	—	—	5,890
Restricted cash equivalents	13,150	—	—	13,150	13,775	—	—	13,775
Municipal securities:								
General obligation	91,259	1,649	—	92,908	126,806	2,828	(26 )	129,608
Pre-refunded	16,529	130	—	16,659	33,247	465	—	33,712

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Revenue	85,281	1,804	(25 )	87,060	118,507	2,387	(34 )	120,860
Variable rate demand notes	92,225	—	—	92,225	64,658	—	—	64,658
Asset backed securities	74,126	1,294	—	75,420	51,779	430	(17 )	52,192
Cost and equity method investments	10,958	—	—	10,958	9,395	—	—	9,395
Life insurance contracts	14,942	—	—	14,942	14,699	—	—	14,699
Total	\$721,699	\$11,481	\$(37 )	\$733,143	\$653,788	\$10,510	\$(841 )	\$663,457

6

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Table of Contents

The Company's investments are classified as available-for-sale with the exception of life insurance contracts and certain cost and equity method investments. The Company's investment policies are designed to provide liquidity, preserve capital and maximize total return on invested assets with the focus on high credit quality securities. The Company limits the size of investment in any single issuer other than U.S. treasury securities and obligations of U.S. government corporations and agencies. As of September 30, 2012, 38% of the Company's investments in securities recorded at fair value that carry a rating by Moody's or S&P were rated AAA, 68% were rated AA- or higher, and 99% were rated A- or higher. At September 30, 2012, the Company held certificates of deposit, life insurance contracts and cost and equity method investments which did not carry a credit rating.

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

	September 30, 2012				December 31, 2011			
	Less Than 12 Months		12 Months or More		Less Than 12 Months		12 Months or More	
	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$(4	) \$1,196	\$(2	) \$202	\$(13	) \$2,184	\$—	\$—
Corporate securities	(6	) 5,295	—	—	(751	) 23,040	—	—
Municipal securities:								
General obligation	—	—	—	—	(26	) 3,710	—	—
Revenue	(25	) 1,825	—	—	(34	) 12,597	—	—
Asset backed securities	—	—	—	—	(17	) 20,417	—	—
Total	\$(35	) \$8,316	\$(2	) \$202	\$(841	) \$61,948	\$—	\$—

As of September 30, 2012, the gross unrealized losses were generated from 8 positions out of a total of 376 positions. The decline in fair value of fixed income securities is a result of movement in interest rates subsequent to the purchase of the security.

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

The contractual maturities of short-term and long-term investments and restricted deposits are as follows:

	September 30, 2012				December 31, 2011			
	Investments		Restricted Deposits		Investments		Restricted Deposits	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
One year or less	\$138,508	\$139,920	\$33,108	\$33,151	\$129,232	\$130,499	\$19,666	\$19,666
	423,533	432,717	358	358	406,140	413,953	7,085	7,152

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One year through five years								
Five years through ten years	37,331	37,444	—	—	34,945	34,961	—	—
Greater than ten years	88,860	89,553	—	—	56,720	57,226	—	—
Total	\$688,232	\$699,634	\$33,466	\$33,509	\$627,037	\$636,639	\$26,751	\$26,818

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



Table of Contents

Realized gains and losses are determined on the basis of specific identification or a first-in, first-out methodology, if specific identification is not practicable. The Company's gross recorded realized gains and losses were as follows:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2012	2011	2012	2011
Gains	\$1,475	\$107	\$1,483	\$240
Losses	(12	) (1	) (23	) (27
Net realized gains	\$1,463	\$106	\$1,460	\$213

During the third quarter of 2012, the company recognized \$1,463 in net gains primarily as a result of the liquidation of \$75,468 of investments held by the Georgia health plan in order to meet short-term liquidity needs due to the delays in premium receipts.

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

Investment amortization of \$8,676 and \$7,545 was recorded in the nine months ended September 30, 2012 and 2011, respectively.

### 3. Fair Value Measurements

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

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

Table of Contents

The following table summarizes fair value measurements by level at September 30, 2012, for assets and liabilities measured at fair value on a recurring basis:

	Level I	Level II	Level III	Total
Assets				
Cash and cash equivalents	\$796,621	—	—	\$796,621
Investments available for sale:				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$34,409	\$12,054	—	\$46,463
Corporate securities	—	262,999	—	262,999
Municipal securities:				
General obligation	—	92,908	—	92,908
Pre-refunded	—	16,659	—	16,659
Revenue	—	87,060	—	87,060
Variable rate demand notes	—	92,225	—	92,225
Asset backed securities	—	75,420	—	75,420
Total investments	\$34,409	\$639,325	—	\$673,734
Restricted deposits available for sale:				
Cash and cash equivalents	\$13,150	—	—	\$13,150
Certificates of deposit	5,891	—	—	5,891
U.S. Treasury securities and obligations of U.S. government corporations and agencies	13,958	\$510	—	14,468
Total restricted deposits	\$32,999	\$510	—	\$33,509
Other long-term assets: Interest rate swap contract	—	\$17,196	—	\$17,196
Total assets at fair value	\$864,029	\$657,031	—	\$1,521,060

The following table summarizes fair value measurements by level at December 31, 2011, for assets and liabilities measured at fair value on a recurring basis:

	Level I	Level II	Level III	Total
Assets				
Cash and cash equivalents	\$573,698	—	—	\$573,698
Investments available for sale:				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$17,091	\$5,395	—	\$22,486
Corporate securities	—	189,029	—	189,029
Municipal securities:				
General obligation	—	129,608	—	129,608
Pre-refunded	—	33,712	—	33,712
Revenue	—	120,860	—	120,860
Variable rate demand notes	—	64,658	—	64,658
Asset backed securities	—	52,192	—	52,192
Total investments	\$17,091	\$595,454	—	\$612,545
Restricted deposits available for sale:				
Cash and cash equivalents	\$13,775	—	—	\$13,775
Certificates of deposit	5,890	—	—	5,890