
**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, 2019**

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 No. **1-6639**

MAGELLAN HEALTH, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

4801 E. Washington Street

Phoenix, Arizona

(Address of principal executive offices)

58-1076937

(IRS Employer
Identification No.)

85034

(Zip code)

(800) 642-1716

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, par value \$0.01 per share	MGLN	The NASDAQ Global Market

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 twelve 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 every Interactive Data File required to be submitted 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, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer", "accelerated filer", "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 Magellan Health Inc.'s common stock outstanding as of September 30, 2019 was 24,468,993.

PART I—FINANCIAL INFORMATION**Item 1. Financial Statements.**

MAGELLAN HEALTH, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In thousands, except per share amounts)

	December 31, 2018	September 30, 2019 (Unaudited)
ASSETS		
Current Assets:		
Cash and cash equivalents (\$160,967 and \$171,047 restricted at December 31, 2018 and September 30, 2019, respectively)	\$ 272,308	\$ 376,703
Accounts receivable, net	756,059	812,741
Short-term investments (\$363,840 and \$322,515 restricted at December 31, 2018 and September 30, 2019, respectively)	382,582	336,057
Pharmaceutical inventory	40,818	48,373
Other current assets (\$43,401 and \$42,161 restricted at December 31, 2018 and September 30, 2019, respectively)	95,400	87,098
Total Current Assets	1,547,167	1,660,972
Property and equipment, net	150,748	141,506
Long-term investments (\$2,854 and \$6,484 restricted at December 31, 2018 and September 30, 2019, respectively)	3,161	7,606
Deferred income taxes	3,411	2,618
Other long-term assets	24,530	129,086
Goodwill	1,018,156	1,018,156
Other intangible assets, net	231,883	181,777
Total Assets	<u>\$ 2,979,056</u>	<u>\$ 3,141,721</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	\$ 72,077	\$ 92,362
Accrued liabilities	231,356	307,210
Short-term contingent consideration	8,000	123
Medical claims payable	393,547	430,345
Other medical liabilities	169,639	144,838
Current debt, finance lease and deferred financing obligations	24,274	3,546
Total Current Liabilities	898,893	978,424
Long-term debt, finance lease and deferred financing obligations	728,608	695,164
Deferred income taxes	11,167	15,088
Tax contingencies	16,478	16,228
Long-term contingent consideration	2,124	—
Deferred credits and other long-term liabilities	36,483	74,345
Total Liabilities	1,693,753	1,779,249
Preferred stock, par value \$.01 per share		
Authorized—10,000 shares at December 31, 2018 and September 30, 2019-Issued and outstanding-none	—	—
Common stock, par value \$.01 per share		
Authorized—100,000 shares at December 31, 2018 and September 30, 2019-Issued and outstanding-53,536 and 23,935 shares at December 31, 2018, respectively, and 54,131 and 24,469 shares at September 30, 2019, respectively	535	541
Other Stockholders' Equity:		
Additional paid-in capital	1,326,645	1,371,718
Retained earnings	1,419,449	1,454,623
Accumulated other comprehensive (loss) income	(324)	317
Treasury stock, at cost, 29,601 and 29,662 shares at December 31, 2018 and September 30, 2019, respectively	(1,461,002)	(1,464,727)
Total Stockholders' Equity	1,285,303	1,362,472
Total Liabilities and Stockholders' Equity	<u>\$ 2,979,056</u>	<u>\$ 3,141,721</u>

See accompanying notes to consolidated financial statements.

MAGELLAN HEALTH, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

(In thousands, except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2019	2018	2019
Net revenue:				
Managed care and other	\$ 1,235,787	\$ 1,303,936	\$ 3,670,890	\$ 3,811,058
PBM	617,719	525,005	1,798,616	1,545,708
Total net revenue	<u>1,853,506</u>	<u>1,828,941</u>	<u>5,469,506</u>	<u>5,356,766</u>
Costs and expenses:				
Cost of care	938,031	1,013,006	2,802,506	2,956,853
Cost of goods sold	571,145	482,277	1,689,229	1,433,257
Direct service costs and other operating expenses (1)(2)	265,471	266,322	793,700	804,680
Depreciation and amortization	33,047	34,157	97,302	98,355
Interest expense	8,990	9,007	26,034	27,255
Interest and other income	(4,139)	(4,970)	(9,978)	(14,965)
Total costs and expenses	<u>1,812,545</u>	<u>1,799,799</u>	<u>5,398,793</u>	<u>5,305,435</u>
Income before income taxes	40,961	29,142	70,713	51,331
Provision for income taxes	13,816	7,868	18,565	16,013
Net income	<u>27,145</u>	<u>21,274</u>	<u>\$ 52,148</u>	<u>\$ 35,318</u>
Net income per common share:				
Basic (See Note B)	\$ 1.11	\$ 0.87	\$ 2.13	\$ 1.46
Diluted (See Note B)	\$ 1.09	\$ 0.86	\$ 2.06	\$ 1.44
Other comprehensive income				
Unrealized gains (losses) on available-for-sale securities(3)	194	(98)	7	641
Comprehensive income	<u>\$ 27,339</u>	<u>\$ 21,176</u>	<u>\$ 52,155</u>	<u>\$ 35,959</u>

- (1) Includes stock compensation expense of \$9,320 and \$4,811 for the three months ended September 30, 2018 and 2019, respectively, and \$27,405 and \$19,832 for the nine months ended September 30, 2018 and 2019, respectively.
- (2) Includes changes in fair value of contingent consideration of \$148 and \$4 for the three months ended September 30, 2018 and 2019, respectively, and \$451 and \$(2,001) for the nine months ended September 30, 2018 and 2019, respectively.
- (3) Net of income tax provision (benefit) of \$61 and \$(31) for the three months ended September 30, 2018 and 2019, respectively, and \$3 and \$201 for the nine months ended September 30, 2018 and 2019, respectively.

See accompanying notes to consolidated financial statements.

MAGELLAN HEALTH, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

(Unaudited)

(In thousands)

	Common Stock		Common Stock In Treasury		Additional Paid in Capital	Retained Earnings	Accumulated Other Comprehensive (Loss) Income	Total Stockholders' Equity
	Shares	Amount	Shares	Amount				
Balance at June 30, 2018	53,475	\$ 535	(28,920)	\$ (1,412,785)	\$ 1,311,316	\$ 1,420,271	\$ (567)	\$ 1,318,770
Stock compensation expense	—	—	—	—	9,320	—	—	9,320
Exercise of stock options	22	—	—	—	1,111	—	—	1,111
Issuance of equity	29	—	—	—	2,429	—	—	2,429
Repurchase of stock	—	—	(351)	(27,218)	—	—	—	(27,218)
Net income	—	—	—	—	—	27,145	—	27,145
Other comprehensive income—other	—	—	—	—	—	—	194	194
Balance at September 30, 2018	<u>53,526</u>	<u>\$ 535</u>	<u>(29,271)</u>	<u>\$ (1,440,003)</u>	<u>\$ 1,324,176</u>	<u>\$ 1,447,416</u>	<u>\$ (373)</u>	<u>\$ 1,331,751</u>
Balance at June 30, 2019	54,063	\$ 541	(29,662)	\$ (1,464,727)	\$ 1,364,693	\$ 1,433,348	\$ 415	\$ 1,334,270
Stock compensation expense	—	—	—	—	4,811	—	—	4,811
Exercise of stock options	—	—	—	—	5	—	—	5
Issuance of equity	68	—	—	—	2,209	—	—	2,209
Repurchase of stock	—	—	—	—	—	—	—	—
Net income	—	—	—	—	—	21,274	—	21,274
Other comprehensive (loss)—other	—	—	—	—	—	1	(98)	(97)
Balance at September 30, 2019	<u>54,131</u>	<u>\$ 541</u>	<u>(29,662)</u>	<u>\$ (1,464,727)</u>	<u>\$ 1,371,718</u>	<u>\$ 1,454,623</u>	<u>\$ 317</u>	<u>\$ 1,362,472</u>
Balance at December 31, 2017	52,973	\$ 530	(28,771)	\$ (1,397,962)	\$ 1,274,811	\$ 1,399,495	\$ (380)	\$ 1,276,494
Stock compensation expense	—	—	—	—	27,405	—	—	27,405
Exercise of stock options	401	4	—	—	22,583	—	—	22,587
Issuance of equity	152	1	—	—	(623)	—	—	(622)
Repurchase of stock	—	—	(500)	(42,041)	—	—	—	(42,041)
Net income	—	—	—	—	—	52,148	—	52,148
Other comprehensive income—other	—	—	—	—	—	—	7	7
Adoption of ASC 606	—	—	—	—	—	(4,227)	—	(4,227)
Balance at September 30, 2018	<u>53,526</u>	<u>\$ 535</u>	<u>(29,271)</u>	<u>\$ (1,440,003)</u>	<u>\$ 1,324,176</u>	<u>\$ 1,447,416</u>	<u>\$ (373)</u>	<u>\$ 1,331,751</u>
Balance at December 31, 2018	53,536	\$ 535	(29,601)	\$ (1,461,002)	\$ 1,326,645	\$ 1,419,449	\$ (324)	\$ 1,285,303
Stock compensation expense	—	—	—	—	19,832	—	—	19,832
Exercise of stock options	389	5	—	—	23,479	—	—	23,484
Issuance of equity	206	1	—	—	1,762	—	—	1,763
Repurchase of stock	—	—	(61)	(3,725)	—	—	—	(3,725)
Net income	—	—	—	—	—	35,318	—	35,318
Other comprehensive income—other	—	—	—	—	—	—	641	641
Adoption of ASC 842	—	—	—	—	—	(144)	—	(144)
Balance at September 30, 2019	<u>54,131</u>	<u>\$ 541</u>	<u>(29,662)</u>	<u>\$ (1,464,727)</u>	<u>\$ 1,371,718</u>	<u>\$ 1,454,623</u>	<u>\$ 317</u>	<u>\$ 1,362,472</u>

See accompanying notes to consolidated financial statements.

MAGELLAN HEALTH, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE NINE MONTHS ENDED SEPTEMBER 30,

(Unaudited)

(In thousands)

	2018	2019
Cash flows from operating activities:		
Net income	\$ 52,148	\$ 35,318
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	97,302	98,355
Non-cash interest expense	919	1,069
Non-cash stock compensation expense	27,405	19,832
Non-cash income tax provision	1,814	4,567
Non-cash amortization on investments	1,404	(509)
Changes in assets and liabilities, net of effects from acquisitions of businesses:		
Accounts receivable, net	(160,904)	(54,261)
Pharmaceutical inventory	(3,090)	(7,555)
Other assets	(60,008)	(35,714)
Accounts payable and accrued liabilities	(13,781)	83,976
Medical claims payable and other medical liabilities	73,667	11,997
Contingent consideration	451	(3,754)
Tax contingencies	100	(251)
Deferred credits and other long-term liabilities	16,497	(9,566)
Other	93	919
Net cash provided by operating activities	<u>34,017</u>	<u>144,423</u>
Cash flows from investing activities:		
Capital expenditures	(51,244)	(44,234)
Acquisitions and investments in businesses, net of cash acquired	(402)	(320)
Purchases of investments	(453,007)	(391,062)
Proceeds from maturities and sales of investments	400,683	434,493
Net cash used in investing activities	<u>(103,970)</u>	<u>(1,123)</u>
Cash flows from financing activities:		
Payments to acquire treasury stock	(41,039)	(4,124)
Proceeds from exercise of stock options	22,587	20,653
Payments on debt, finance lease and deferred financing obligations	(75,043)	(50,950)
Payments on contingent consideration	—	(6,247)
Other	(1,020)	1,763
Net cash used in financing activities	<u>(94,515)</u>	<u>(38,905)</u>
Net (decrease) increase in cash and cash equivalents	<u>(164,468)</u>	<u>104,395</u>
Cash and cash equivalents at beginning of period	398,732	272,308
Cash and cash equivalents at end of period	<u>\$ 234,264</u>	<u>\$ 376,703</u>
Supplemental cash flow data:		
Non-cash investing activities:		
Assets acquired under finance leases and deferred financing	<u>\$ 19,545</u>	<u>\$ 3,302</u>

See accompanying notes to consolidated financial statements.

MAGELLAN HEALTH, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2019
(Unaudited)

NOTE A—General

Basis of Presentation

The accompanying unaudited consolidated financial statements of Magellan Health, Inc., a Delaware corporation (“Magellan”), include Magellan and its subsidiaries (together with Magellan, the “Company”). The financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the Securities and Exchange Commission’s (the “SEC”) instructions to Form 10-Q. Accordingly, the financial statements do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments, consisting of normal recurring adjustments considered necessary for a fair presentation, have been included. The results of operations for the three and nine months ended September 30, 2019 are not necessarily indicative of the results to be expected for the full year. All significant intercompany accounts and transactions have been eliminated in consolidation.

These unaudited consolidated financial statements should be read in conjunction with the Company’s audited consolidated financial statements for the year ended December 31, 2018 and the notes thereto, which are included in the Company’s Annual Report on Form 10-K filed with the SEC on February 28, 2019.

Business Overview

The Company is a leader within the healthcare management business, and is focused on delivering innovative specialty solutions for the fastest growing, most complex areas of health, including special populations, complete pharmacy benefits, and other specialty carve-out areas of healthcare. The Company develops innovative solutions that combine advanced analytics, agile technology and clinical excellence to drive better decision making, positively impact members’ health outcomes and optimize the cost of care for the customers we serve. The Company provides services to health plans and other managed care organizations (“MCOs”), employers, labor unions, various military and governmental agencies and third party administrators (“TPAs”). Magellan operates three segments: Healthcare, Pharmacy Management and Corporate.

Healthcare

The Healthcare segment “Healthcare” consists of two reporting units – Behavioral & Specialty Health and Magellan Complete Care (“MCC”).

The Behavioral & Specialty Health reporting unit’s customers include health plans, accountable care organizations (“ACOs”), employers, the United States military and various federal government agencies for whom Magellan provides carve-out management services for behavioral health, employee assistance plans (“EAP”) and other areas of specialty healthcare including diagnostic imaging, musculoskeletal management, cardiac and physical medicine. These management services can be applied broadly across commercial, Medicaid and Medicare populations, or on a more targeted basis for our health plans and ACO customers. The Behavioral & Specialty Health unit also includes Magellan’s carve-out behavioral health contracts with various state Medicaid agencies.

The MCC reporting unit contracts with state Medicaid agencies and the Centers for Medicare and Medicaid Services (“CMS”) to manage care for beneficiaries under various Medicaid and Medicare programs. MCC manages a wide range of services from total medical cost to carve out long-term support services. MCC largely focuses on managing care for special populations including individuals with serious mental illness (“SMI”), dual eligibles, aged, blind and disabled (“ABD”) and other populations with unique and often complex healthcare needs.

Magellan’s coordination and management of these healthcare and long-term support services are provided through its comprehensive network of medical and behavioral health professionals, clinics, hospitals, skilled nursing facilities, home care agencies and ancillary service providers. This network of credentialed providers is integrated with clinical and quality improvement programs to improve access to care and enhance the healthcare experience for individuals in need of care, while at the same time making the cost of these services more affordable for our customers.

MAGELLAN HEALTH, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
September 30, 2019
(Unaudited)

The Company generally does not directly provide or own any provider of treatment services, although it does employ licensed behavioral health counselors to deliver non-medical counseling under certain government contracts.

The Company provides its Healthcare management services primarily through: (i) risk-based products, where the Company assumes all or a substantial portion of the responsibility for the cost of providing treatment services in exchange for a fixed PMPM fee, or (ii) administrative services only (“ASO”) products, where the Company provides services such as utilization review, claims administration and/or provider network management, but does not assume full responsibility for the cost of the treatment services, in exchange for an administrative fee and, in some instances, a gain share.

Pharmacy Management

The Pharmacy Management segment (“Pharmacy Management”) is comprised of products and solutions that provide clinical and financial management of pharmaceuticals paid under both the medical and the pharmacy benefit. Pharmacy Management’s services include: (i) pharmacy benefit management (“PBM”) services, including pharmaceutical dispensing operations; (ii) pharmacy benefit administration (“PBA”) for state Medicaid and other government sponsored programs; (iii) clinical and formulary management programs; (iv) medical pharmacy management programs; and (v) programs for the integrated management of specialty drugs across both the medical and pharmacy benefit that treat complex conditions, regardless of site of service, method of delivery, or benefit reimbursement.

These services are available individually, in combination, or in a fully integrated manner. The Company markets its pharmacy management services to health plans, employers, third party administrators, managed care organizations, state governments, Medicare Part D, and other government agencies, exchanges, brokers and consultants. In addition, the Company will continue to upsell its pharmacy products to its existing customers and market its pharmacy solutions to the Healthcare customer base.

Pharmacy Management contracts with its customers for services using risk-based, gain share or ASO arrangements. In addition, Pharmacy Management provides services to the Healthcare segment for its MCC business.

Corporate

This segment of the Company is comprised primarily of amounts not allocated to the Healthcare and Pharmacy Management segments that are largely associated with costs related to being a publicly traded company.

MAGELLAN HEALTH, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
September 30, 2019
(Unaudited)

Summary of Significant Accounting Policies

Recent Accounting Pronouncements

In February 2016, the FASB issued ASU No. 2016-02, "Leases" ("ASU 2016-02"). This ASU amends the existing accounting standards for lease accounting, including requiring lessees to recognize most leases on their balance sheets. The FASB also issued various ASUs which subsequently amended ASU 2016-02. These amendments and ASU 2016-02, collectively known as Accounting Standard Codification 842 ("ASC 842"), are effective for annual and interim reporting periods of public entities beginning after December 15, 2018. The Company adopted ASC 842 on a modified retrospective basis on January 1, 2019. The Company applied the transition method which does not require adjustments to comparative periods nor requires modified disclosures in those comparative periods. In addition, the Company elected the package of practical expedients, the practical expedient which permits combining lease and non-lease components (which was applicable to our real estate leases) and the short-term lease practical expedient. The Company implemented new leasing software capable of producing the data to prepare the required accounting and disclosures prescribed by ASC 842. Adoption of ASC 842 resulted in the recognition of right-of-use ("ROU") assets and lease liabilities of \$59.8 million and \$67.9 million, respectively as of January 1, 2019. The adoption of ASC 842 did not have a material impact on the Company's consolidated results of operations or cash flows.

The cumulative effect of the change to our consolidated January 1, 2019 balance sheet for the adoption of ASC 842 was as follows (in thousands):

	Balance at December 31, 2018	Adjustments Due to ASC 842	Balance at January 1, 2019
Assets			
Deferred income taxes	\$ 3,411	\$ 51	\$ 3,462
Other long-term assets	24,530	59,820	84,350
Total Assets	2,979,056	59,871	3,038,927
Liabilities and Stockholders' Equity			
Accrued liabilities	231,356	13,018	244,374
Total Current Liabilities	898,893	13,018	911,911
Deferred credits and other long-term liabilities	36,483	46,999	83,482
Total Liabilities	1,693,753	60,017	1,753,770
Retained earnings	1,419,449	(144)	1,419,305
Total Stockholders' Equity	1,285,303	(144)	1,285,159
Total Liabilities and Stockholders' Equity	2,979,056	59,871	3,038,927

MAGELLAN HEALTH, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
September 30, 2019
(Unaudited)

In June 2016, the FASB issued ASU No. 2016-13, “Financial Instruments–Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments” (“ASU 2016-13”). This ASU amends the accounting on reporting credit losses for assets held at amortized cost basis and available for sale debt securities. This guidance is effective for annual and interim periods of public entities beginning after December 15, 2019, with early adoption permitted for fiscal years beginning after December 31, 2018. The Company is currently assessing the potential impact this ASU will have on the Company’s consolidated results of operation, financial position and cash flows.

In January 2017, the FASB issued ASU No. 2017-04, “Intangibles–Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment” (“ASU 2017-04”). The amendments in this ASU eliminate the requirement to calculate the implied fair value of goodwill to measure a goodwill impairment charge. This guidance is effective for annual and interim periods of public entities beginning after December 15, 2019, with early adoption permitted. The Company is currently assessing the potential impact this ASU will have on the Company’s consolidated results of operations, financial position and cash flows.

In August 2018, the FASB issued ASU No. 2018-15, “Intangibles–Goodwill and Other–Internal-Use Software (Subtopic 350-40): Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract” (“ASU 2018-15”). This ASU aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software. This guidance is effective for annual and interim periods of public entities beginning after December 15, 2019, with early adoption permitted. The Company is currently assessing the potential impact this ASU will have on the Company’s consolidated results of operations, financial position and cash flows.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Significant estimates of the Company can include, among other things, valuation of goodwill and intangible assets, medical claims payable, other medical liabilities, stock compensation assumptions, tax contingencies and legal liabilities. In addition, the Company also makes estimates in relation to revenue recognition under ASC 606 which are explained in more detail in “*Revenue Recognition*” below. Actual results could differ from those estimates.

MAGELLAN HEALTH, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
September 30, 2019
(Unaudited)

Revenue Recognition

Virtually all of the Company's revenues are derived from business in North America. The following tables disaggregate our revenue for the three and nine months ended September 30, 2019 by major service line, type of customer and timing of revenue recognition (in thousands):

	Three Months Ended September 30, 2019			
	Healthcare	Pharmacy Management	Elimination	Total
Major Service Lines				
Behavioral & Specialty Health				
Risk-based, non-EAP	\$ 383,386	\$ —	\$ (76)	\$ 383,310
EAP risk-based	80,076	—	—	80,076
ASO	57,535	9,475	(42)	66,968
Magellan Complete Care				
Risk-based, non-EAP	697,321	—	—	697,321
ASO	15,768	—	—	15,768
PBM, including dispensing	—	495,759	(47,081)	448,678
Medicare Part D	—	76,327	—	76,327
PBA	—	35,768	—	35,768
Formulary management	—	23,976	—	23,976
Other	—	749	—	749
Total net revenue	<u>\$ 1,234,086</u>	<u>\$ 642,054</u>	<u>\$ (47,199)</u>	<u>\$ 1,828,941</u>
Type of Customer				
Government	\$ 940,971	\$ 215,197	\$ —	\$ 1,156,168
Non-government	293,115	426,857	(47,199)	672,773
Total net revenue	<u>\$ 1,234,086</u>	<u>\$ 642,054</u>	<u>\$ (47,199)</u>	<u>\$ 1,828,941</u>
Timing of Revenue Recognition				
Transferred at a point in time	\$ —	\$ 572,086	\$ (47,081)	\$ 525,005
Transferred over time	1,234,086	69,968	(118)	1,303,936
Total net revenue	<u>\$ 1,234,086</u>	<u>\$ 642,054</u>	<u>\$ (47,199)</u>	<u>\$ 1,828,941</u>

MAGELLAN HEALTH, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
September 30, 2019
(Unaudited)

	Nine Months Ended September 30, 2019			
	Healthcare	Pharmacy Management	Elimination	Total
Major Service Lines				
Behavioral & Specialty Health				
Risk-based, non-EAP	\$ 1,145,785	\$ —	\$ (219)	\$ 1,145,566
EAP risk-based	256,989	—	—	256,989
ASO	170,733	27,945	(215)	198,463
Magellan Complete Care				
Risk-based, non-EAP	1,999,254	—	—	1,999,254
ASO	46,220	—	—	46,220
PBM, including dispensing	—	1,469,151	(132,953)	1,336,198
Medicare Part D	—	209,510	—	209,510
PBA	—	103,220	—	103,220
Formulary management	—	59,585	—	59,585
Other	—	1,761	—	1,761
Total net revenue	<u>\$ 3,618,981</u>	<u>\$ 1,871,172</u>	<u>\$ (133,387)</u>	<u>\$ 5,356,766</u>
Type of Customer				
Government	\$ 2,740,006	\$ 624,569	\$ —	\$ 3,364,575
Non-government	878,975	1,246,603	(133,387)	1,992,191
Total net revenue	<u>\$ 3,618,981</u>	<u>\$ 1,871,172</u>	<u>\$ (133,387)</u>	<u>\$ 5,356,766</u>
Timing of Revenue Recognition				
Transferred at a point in time	\$ —	\$ 1,678,661	\$ (132,953)	\$ 1,545,708
Transferred over time	3,618,981	192,511	(434)	3,811,058
Total net revenue	<u>\$ 3,618,981</u>	<u>\$ 1,871,172</u>	<u>\$ (133,387)</u>	<u>\$ 5,356,766</u>

Per Member Per Month (“PMPM”) Revenue. Almost all of the Healthcare revenue and a small portion of the Pharmacy Management revenue is paid on a PMPM basis. PMPM revenue is inclusive of revenue from the Company’s risk, EAP and ASO contracts and primarily relates to managed care contracts for services such as the provision of behavioral healthcare, specialty healthcare, pharmacy management, or fully integrated healthcare services. PMPM contracts generally have a term of one year or longer, with the exception of government contracts where the customer can terminate with as little as 30 days’ notice for no significant penalty. All managed care contracts have a single performance obligation that constitutes a series for the provision of managed healthcare services for a population of enrolled members for the duration of the contract. The transaction price for PMPM contracts is entirely variable as it primarily includes PMPM fees associated with unspecified membership that fluctuates throughout the contract. In certain contracts, PMPM fees also include adjustments for things such as performance incentives, performance guarantees and risk shares. The Company generally estimates the transaction price using an expected value methodology and amounts are only included in the net transaction price to the extent that it is probable that a significant reversal of cumulative revenue will not occur once any uncertainty is resolved. The majority of the Company’s net PMPM transaction price relates specifically to its efforts to transfer the service for a distinct increment of the series (e.g. day or month) and is recognized as revenue in the month in which members are entitled to service. The remaining transaction price is recognized over the contract period (or portion of the series to which it specifically relates) based upon estimated membership as a measure of progress.

Under certain government contracts, our risk scores are compared with the overall average risk scores for the relevant state and market pool. Generally, if our risk score is below the average risk score we are required to make a risk adjustment payment into the risk pool, and if our risk score is above the average risk score we will receive a risk adjustment payment from the risk pool. Risk adjustments can have a positive or negative retroactive impact to rates.

Pharmacy Benefit Management Revenue. The Company’s customers for PBM business, including pharmaceutical dispensing operations, are generally comprised of MCOs, employer groups and health plans. PBM

MAGELLAN HEALTH, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
September 30, 2019
(Unaudited)

relationships generally have an expected term of one year or longer. A master services arrangement (“MSA”) is executed by the Company and the customer, which outlines the terms and conditions of the PBM services to be provided. When a member in the customer’s organization submits a prescription, a claim is created which is presented for approval. The acceptance of each individual claim creates enforceable rights and obligations for each party and represents a separate contract. For each individual claim, the performance obligations are limited to the processing and adjudication of the claim, or dispensing of the products purchased. Generally, the transaction price for PBM services is explicitly listed in each contract and does not represent variable consideration. The Company recognizes PBM revenue, which consists of a negotiated prescription price (ingredient cost plus dispensing fee), co-payments and any associated administrative fees, when claims are adjudicated or the drugs are shipped. The Company recognizes PBM revenue on a gross basis (i.e. including drug costs and co-payments) as it is acting as the principal in the arrangement, controls the underlying service, and is contractually obligated to its clients and network pharmacies, which is a primary indicator of gross reporting. In addition, the Company is solely responsible for the claims adjudication process, negotiating the prescription price for the pharmacy, collection of payments from the client for drugs dispensed by the pharmacy, and managing the total prescription drug relationship with the client’s members. If the Company enters into a contract where it is only an administrator, and does not assume any of the risks previously noted, revenue will be recognized on a net basis. For dispensing, at the time of shipment, the earnings process is complete; the obligation of the Company’s customer to pay for the specialty pharmaceutical drugs is fixed, and, due to the nature of the product, the member may neither return the specialty pharmaceutical drugs nor receive a refund.

Medicare Part D. The Company is contracted with CMS as a Prescription Drug Plan (“PDP”) to provide prescription drug benefits to Medicare beneficiaries. The accounting for Medicare Part D revenue is primarily the same as that for PBM, as previously discussed. However, there is certain variable consideration present only in Medicare Part D arrangements. The Company estimates the annual amount of variable consideration using a most likely amount methodology, which is allocated to each reporting period based upon actual utilization as a percentage of estimated utilization for the year. Amounts estimated throughout the year for interim reporting are substantially resolved and fixed as of December 31st, the end of the plan year.

Pharmacy Benefit Administration Revenue. The Company provides Medicaid pharmacy services to states and other government sponsored programs. PBA contracts are generally multi-year arrangements but include language regarding early termination for convenience without material penalty provisions that results in enforceable rights and obligations on a month-to-month basis. In PBA arrangements, the Company is generally paid a fixed fee per month to provide PBA services. In addition, some PBA contracts contain upfront fees that constitute a material right. For contracts without an upfront fee, there is a single performance obligation to stand ready to provide the PBA services required for the contracted period. The Company believes that the customer receives the PBA benefits each day from access to the claims processing activities, and has concluded that a time-based measure is appropriate for recognizing PBA revenue. For contracts with an upfront fee, the material right represents an additional performance obligation. Amounts allocated to the material right are initially recorded as a contract liability and recognized as revenue over the anticipated period of benefit of the material right, which generally ranges from 2 to 10 years.

Formulary Management Revenue. The Company administers formulary management programs for certain clients through which the Company coordinates the achievement, calculation and collection of rebates and administrative fees from pharmaceutical manufacturers on behalf of clients. Formulary management contracts generally have a term of one year or longer. All formulary management contracts have a single performance obligation that constitutes a series for the provision of rebate services for a drug, with utilization measured and settled on a quarterly basis, for the duration of the arrangement. The Company retains its administrative fee and/or a percentage of rebates that is included in its contract with the client from collecting the rebate from the manufacturer. While the administrative fee and/or the percentage of rebates retained is fixed, there is an unknown quantity of pharmaceutical purchases (utilization) during each quarter, therefore, the transaction price itself is variable. The Company uses the expected value methodology to estimate the total rebates earned each quarter based on estimated volumes of pharmaceutical purchases by the Company’s clients during the quarter, as well as historical and/or anticipated retained rebate percentages. The Company does not record as rebate revenue any rebates that are passed through to its clients.

In relation to the Company’s PBM business, the Company administers rebate programs through which it receives rebates from pharmaceutical manufacturers that are shared with its customers. The Company recognizes rebates

MAGELLAN HEALTH, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
September 30, 2019
(Unaudited)

when the Company is entitled to them and when the amounts of the rebates are determinable. The amount recorded for rebates earned by the Company from the pharmaceutical manufacturers is recorded as a reduction of cost of goods sold.

Government EAP Risk-Based Revenue. The Company has certain contracts with federal customers for the provision of various managed care services, which are classified as EAP risk-based business. These contracts are generally multi-year arrangements. The Company's federal contracts are reimbursed on either a fixed fee basis or a cost reimbursement basis. The performance obligation on a fixed fee contract is to stand ready to provide the staffing required for the contracted period. For fixed fee contracts, the Company believes the invoiced amount corresponds directly with the value to the customer of the Company's performance completed to date, therefore, the Company is utilizing the "right to invoice" practical expedient, with revenue recognition in the amount for which the Company has the right to invoice.

The performance obligation on a cost reimbursement contract is to stand ready to provide the activity or services purchased by the customer, such as the operation of a counseling services group or call center. The performance obligation represents a series for the duration of the arrangement. The reimbursement rate is fixed per the contract; however, the level of activity (e.g., number of hours, number of counselors or number of units) is variable. A majority of the Company's cost reimbursement transaction price relates specifically to its efforts to transfer the service for a distinct increment of the series (e.g. day or month) and is recognized as revenue when the portion of the series for which it relates has been provided (i.e. as the Company provides hours, counselors or units of service).

In accordance with ASC 606-10-50-13, the Company is required to include disclosure on its remaining performance obligations as of the end of the current reporting period. Due to the nature of the contracts in the Company's PBM and Part D business, these reporting requirements are not applicable. The majority of the Company's remaining contracts meet certain exemptions as defined in ASC 606-10-50-14 through 606-10-50-14A, including (i) performance obligation is part of a contract that has an original expected duration of one year or less; (ii) the right to invoice practical expedient; and (iii) variable consideration related to unsatisfied performance obligations that is allocated entirely to a wholly unsatisfied promise to transfer a distinct service that forms part of a single performance obligation, and the terms of that variable consideration relate specifically to our efforts to transfer the distinct service, or to a specific outcome from transferring the distinct service. For the Company's contracts that pertain to these exemptions: (i) the remaining performance obligations primarily relate to the provision of managed healthcare services to the customers' membership; (ii) the estimated remaining duration of these performance obligations ranges from the remainder of the current calendar year to three years; and (iii) variable consideration for these contracts primarily includes net PMPM fees associated with unspecified membership that fluctuates throughout the contract.

Accounts Receivable, Contract Assets and Contract Liabilities

Accounts receivable, contract assets and contract liabilities consisted of the following (in thousands, except percentages):

	December 31, 2018	September 30, 2019	\$ Change	% Change
Accounts receivable	\$ 786,395	\$ 862,821	\$ 76,426	9.7%
Contract assets	4,647	26,151	21,504	462.8%
Contract liabilities - current	16,853	7,452	(9,401)	(55.8%)
Contract liabilities - long-term	13,441	11,301	(2,140)	(15.9%)

Accounts receivable, which are included in accounts receivable, other current assets and other long-term assets on the consolidated balance sheets, increased by \$76.4 million, mainly due to timing of receipts. Contract assets, which are included in other current assets on the consolidated balance sheets, increased by \$21.5 million, mainly due to the timing of accrual of certain performance incentives. Contract liabilities – current, which are included in accrued liabilities on the consolidated balance sheets, decreased by \$9.4 million, mainly due to the timing of receipts related to January 2019 revenues. Contract liabilities – long-term, which are included in deferred credits and other long-term liabilities on the consolidated balance sheets, decreased by \$2.1 million, mainly due to certain balances which became current.

MAGELLAN HEALTH, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
September 30, 2019
(Unaudited)

During the three months ended September 30, 2019, the Company recognized revenue of \$2.6 million that was included in current contract liabilities at June 30, 2019. During the nine months ended September 30, 2019, the Company recognized revenue of \$15.9 million that was included in current contract liabilities at December 31, 2018. The estimated timing of recognition of amounts included in contract liabilities at September 30, 2019 are as follows: 2019—\$4.6 million; 2020—\$3.7 million; 2021—\$3.0 million; 2022 and beyond—\$7.5 million. During the three and nine months ended September 30, 2019, the revenue the Company recognized related to performance obligations that were satisfied, or partially satisfied, in previous periods were not material.

The Company's accounts receivable consists of amounts due from customers throughout the United States. Collateral is generally not required. A majority of the Company's contracts have payment terms in the month of service, or within a few months thereafter. The timing of payments from customers from time to time generate contract assets or contract liabilities; however, these amounts are immaterial.

Significant Customers

Customers exceeding ten percent of the consolidated Company's net revenues

The Company has contracts with the Commonwealth of Virginia (the "Virginia Contracts"). The Company began providing Medicaid managed long-term services and supports to enrollees in the Commonwealth Coordinated Care Plus ("CCC Plus") program on August 1, 2017. The CCC Plus contract expires annually on December 31, and automatically renews annually on January 1 for a period of five calendar years, with potential of up to five 12-month extensions. The Commonwealth of Virginia has the right to terminate the CCC Plus contract with cause at any time and for convenience upon 90 days' notice. On August 1, 2018, the Company began providing integrated healthcare services to Medicaid enrollees in the Commonwealth of Virginia under the Medallion 4.0/FAMIS Managed Care Program ("Medallion"). The initial term of the Medallion contract is from August 1, 2018 through June 30, 2019, with six 12-month renewal options. The Medallion contract has been renewed through June 30, 2020. The Commonwealth of Virginia has the right to terminate the Medallion contract with cause at any time and for convenience upon 180 days' notice. The Virginia Contracts generated net revenues of \$344.1 million and \$614.1 million for the nine months ended September 30, 2018 and 2019, respectively.

The Company had a contract with the State of New York (the "New York Contract") to provide integrated managed care services to Medicaid and Medicare enrollees in the State of New York. The Company's New York Contract terminated on December 31, 2016; however, the Company, along with other participating managed care plans in the state, continues to provide services while a new contract is being finalized. The Company began recognizing revenue in relation to the New York Contract on January 1, 2014 as a result of the acquisition of AlphaCare Holdings, Inc. The Company's revenues under the New York Contracts increased starting on November 1, 2017 as a result of the acquisition of SWH Holdings, Inc. The New York Contracts generated net revenues of \$534.5 million and \$623.4 million for the nine months ended September 30, 2018 and 2019, respectively.

The Company has contracts with the Commonwealth of Massachusetts (the "Massachusetts Contracts") to provide integrated managed care services to Medicaid and Medicare enrollees in the Commonwealth of Massachusetts. Medicaid services are provided under a Senior Care Options contract ("SCO Contract") which began on January 1, 2016 and extends through December 31, 2020, with the potential for up to five additional one year extensions. The Commonwealth of Massachusetts may terminate the contract with cause without prior notice and upon 180 days' notice without cause. Medicare services are provided under a one-year contract with CMS. The CMS contract currently extends through December 31, 2019. The Company began recognizing revenue in relation to the Massachusetts Contracts on November 1, 2017 as a result of the acquisition of SWH Holdings, Inc. The Massachusetts Contracts generated net revenues of \$506.2 million and \$541.9 million for the nine months ended September 30, 2018 and 2019, respectively.

MAGELLAN HEALTH, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
September 30, 2019
(Unaudited)

Customers exceeding ten percent of segment net revenues

In addition to the Massachusetts Contract, New York Contract and Virginia Contract previously discussed, the following customers generated in excess of ten percent of net revenues for the respective segment for the nine months ended September 30, 2018 and 2019 (in thousands):

Segment	Term Date	2018	2019
Healthcare			
Customer A	December 31, 2023	\$ 482,372	\$ 166,348 *
Pharmacy Management			
Customer B	March 31, 2021	259,514	259,826

* Revenue amount did not exceed 10 percent of net revenues for the respective segment for the year presented. Amount is shown for comparative purposes only.

Concentration of Business

The Company also has a significant concentration of business with various counties in the State of Pennsylvania (the "Pennsylvania Counties") which are part of the Pennsylvania Medicaid program, with members under its contract with CMS and with various agencies and departments of the United States federal government. Net revenues from the Pennsylvania Counties in the aggregate totaled \$410.9 million and \$410.2 million for the nine months ended September 30, 2018 and 2019, respectively. Net revenues from members in relation to its contracts with CMS in aggregate totaled \$321.3 million and \$209.5 million for the nine months ended September 30, 2018 and 2019, respectively. As of December 31, 2018 and September 30, 2019, the Company had \$131.0 million and \$154.7 million, respectively, in net receivables associated with Medicare Part D from CMS and other parties related to this business. Net revenues from contracts with various agencies and departments of the United States federal government in aggregate totaled \$235.3 million and \$226.8 million for the nine months ended September 30, 2018 and 2019, respectively.

The Company's contracts with customers typically have stated terms of one to three years, and in certain cases contain renewal provisions (at the customer's option) for successive terms of between one and two years (unless terminated earlier). Substantially all of these contracts may be immediately terminated with cause and many of the Company's contracts are terminable without cause by the customer or the Company either upon the giving of requisite notice and the passage of a specified period of time (typically between 30 and 180 days) or upon the occurrence of other specified events. In addition, the Company's contracts with federal, state and local governmental agencies generally are conditioned on legislative appropriations. These contracts generally can be terminated or modified by the customer if such appropriations are not made.

Leases

The Company leases certain office space, distribution centers, land and equipment. We assess our contracts to determine if it contains a lease. This assessment is based on (i) the right to control the use of an identified asset; (ii) the right to obtain substantially all of the economic benefits from the use of the identified asset; and (iii) the right to use the identified asset. The Company elected the short-term lease practical expedient; thus, leases with an initial term of twelve months or less are not capitalized and the expense is recognized on a straight-line basis. Most leases include one or more options to renew, with renewal terms that can extend the lease from one to ten years. The exercise of renewal options are at the sole discretion of the Company. Renewal options that the Company is reasonably certain to accept are recognized as part of the ROU asset.

MAGELLAN HEALTH, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
September 30, 2019
(Unaudited)

Operating leases are included in other long-term assets, accrued liabilities and deferred credits and other long-term liabilities in the consolidated balance sheets. Finance leases are included in property and equipment, current debt, capital lease deferred financing obligations and long-term debt, capital lease and deferred financing obligations in the consolidated balance sheets.

ROU assets represent our right to use an underlying asset for the lease term and lease liabilities represent our obligation to make lease payments per the lease. Operating lease ROU assets and liabilities are recognized at lease commencement date based on the present value of lease payments over the lease term. As the rate implicit in most of our leases is not readily determinable, the Company used its incremental borrowing rate to determine the present value of lease payments.

The following table shows the components of lease expenses for the three and nine months ended September 30, 2019 (in thousands):

	Three Months Ended September 30, 2019	Nine Months Ended September 30, 2019
Operating lease cost	\$ 3,644	\$ 13,026
Finance lease cost:		
Amortization of right-of-use asset	1,028	2,986
Interest on lease liabilities	613	1,247
Total finance lease cost	1,641	4,233
Short-term lease cost	329	993
Variable lease cost	869	2,433
Total lease cost	6,483	20,685
Sublease income	(162)	(362)
Net lease cost	<u>\$ 6,321</u>	<u>\$ 20,323</u>

The following table shows the components of the lease assets and liabilities as of September 30, 2019 (in thousands):

	September 30, 2019
Operating leases:	
Other long-term assets	\$ 51,545
Accrued liabilities	\$ 13,250
Deferred credits and other long-term liabilities	46,619
Total operating lease liabilities	<u>\$ 59,869</u>
Finance leases:	
Property and equipment, net	<u>\$ 13,730</u>
Current debt, finance lease and deferred financing obligations	\$ 4,177
Long-term debt, finance lease and deferred financing obligations	14,949
Total finance lease liabilities	<u>\$ 19,126</u>

MAGELLAN HEALTH, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
September 30, 2019
(Unaudited)

The maturity dates of the Company's leases as of September 30, 2019 are summarized below (in thousands):

	September 30, 2019
2019	\$ 4,708
2020	17,630
2021	17,027
2022	15,954
2023	11,745
2024 and beyond	14,023
Total lease payments	81,087
Less interest	(2,092)
Present value of lease liabilities	<u>\$ 78,995</u>

The following table shows the weighted average remaining lease term and discount rate as of September 30, 2019:

	September 30, 2019
Weighted average remaining lease term	
Operating leases	4.55
Finance leases	4.94
Weighted average discount rate	
Operating leases	4.78%
Finance leases	4.52%

Supplemental cash flow information relating to leases is as follows (in thousands):

	Nine Months Ended September 30, 2019
Cash paid for amounts included in the measurement of lease liabilities:	
Operating cash flows from operating leases	\$ 13,195
Operating cash flows from finance leases	3,128
Financing cash flows from finance leases	624
Right-of-use asset obtained in exchange for new lease obligation	
Operating leases	3,306
Finance leases	—

Fair Value Measurements

The Company has certain assets and liabilities that are required to be measured at fair value on a recurring basis. These assets and liabilities are to be measured using inputs from the three levels of the fair value hierarchy, which are as follows:

Level 1—Inputs are unadjusted quoted prices in active markets for identical assets or liabilities that the Company has the ability to access at the measurement date.

MAGELLAN HEALTH, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
September 30, 2019
(Unaudited)

Level 2—Inputs include quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (i.e., interest rates, yield curves, etc.), and inputs that are derived principally from or corroborated by observable market data by correlation or other means (market corroborated inputs).

Level 3—Unobservable inputs that reflect the Company’s assumptions about the assumptions that market participants would use in pricing the asset or liability. The Company develops these inputs based on the best information available, including the Company’s data.

In accordance with the fair value hierarchy described above, the following table shows the fair value of the Company’s assets and liabilities that are required to be measured at fair value as of December 31, 2018 and September 30, 2019 (in thousands):

	December 31, 2018			
	Level 1	Level 2	Level 3	Total
<i>Assets</i>				
Cash and cash equivalents (1)	\$ —	\$ 263,462	\$ —	\$ 263,462
<i>Investments:</i>				
U.S. Government and agency securities	67,815	—	—	67,815
Obligations of government-sponsored enterprises (2)	—	5,229	—	5,229
Corporate debt securities	—	292,049	—	292,049
Certificates of deposit	—	20,650	—	20,650
Total assets held at fair value	<u>\$ 67,815</u>	<u>\$ 581,390</u>	<u>\$ —</u>	<u>\$ 649,205</u>
<i>Liabilities</i>				
Contingent consideration	\$ —	\$ —	\$ 10,124	\$ 10,124
Total liabilities held at fair value	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 10,124</u>	<u>\$ 10,124</u>
September 30, 2019				
	Level 1	Level 2	Level 3	Total
<i>Assets</i>				
Cash and cash equivalents (3)	\$ —	\$ 359,211	\$ —	\$ 359,211
<i>Investments:</i>				
U.S. Government and agency securities	73,529	—	—	73,529
Corporate debt securities	—	244,979	—	244,979
Certificates of deposit	—	25,155	—	25,155
Total assets held at fair value	<u>\$ 73,529</u>	<u>\$ 629,345</u>	<u>\$ —</u>	<u>\$ 702,874</u>
<i>Liabilities</i>				
Contingent consideration	\$ —	\$ —	\$ 123	\$ 123
Total liabilities held at fair value	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 123</u>	<u>\$ 123</u>

(1) Excludes \$8.8 million of cash held in bank accounts by the Company.

(2) Includes investments in notes issued by the Federal Home Loan Bank, Federal Farm Credit Banks and Federal National Mortgage Association.

(3) Excludes \$17.5 million of cash held in bank accounts by the Company.

For the nine months ended September 30, 2019, the Company has not transferred any assets between fair value measurement levels.

The carrying values of financial instruments, including accounts receivable, accounts payable and revolving loan borrowings, approximate their fair values due to their short-term maturities. The fair value of the Notes (as defined below) of \$399.5 million as of September 30, 2019 was determined based on quoted market prices and would be

MAGELLAN HEALTH, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
September 30, 2019
(Unaudited)

classified within Level 1 of the fair value hierarchy. The estimated fair value of the Company's term loan of \$285.0 million as of September 30, 2019 was based on current interest rates for similar types of borrowings and is in Level 2 of the fair value hierarchy. The estimated fair values may not represent actual values of the financial instruments that could be realized as of the balance sheet date or that will be realized in the future.

All of the Company's investments are classified as "available-for-sale" and are carried at fair value.

As of the balance sheet date, the fair value of contingent consideration is determined based on probabilities of payment, projected payment dates, discount rates, projected operating income, member engagement and new contract execution. The Company used a probability weighted discounted cash flow method to arrive at the fair value of the contingent consideration. As the fair value measurement for the contingent consideration is based on inputs not observed in the market, these measurements are classified as Level 3 measurements as defined by fair value measurement guidance. The unobservable inputs used in the fair value measurement include the discount rate, probabilities of payment and projected payment dates.

As of December 31, 2018 and September 30, 2019, the Company estimated undiscounted future contingent payments of \$10.6 million and \$0.1 million, respectively. As of September 30, 2019, the aggregate amount of the future potential contingent consideration payment is \$0.1 million which is projected to be paid in 2020.

As of December 31, 2018, the fair value of the short-term and long-term contingent consideration was \$8.0 million and \$2.1 million, respectively, and is included in short-term contingent consideration and long-term contingent consideration, respectively, in the consolidated balance sheets. As of September 30, 2019, the fair value of the short-term contingent consideration was \$0.1 million and is included in short-term contingent consideration in the consolidated balance sheets.

The change in the fair value of the contingent consideration was \$0.1 million and \$0.5 million for the three and nine months ended September 30, 2018, respectively, and \$0.0 million and \$(2.0) million for the three and nine months ended September 30, 2019, respectively, which were recorded as direct service costs and other operating expenses in the consolidated statements of comprehensive income.

The following table summarizes the Company's liability for contingent consideration for the nine months ended September 30, 2019 (in thousands):

	September 30, 2019
Balance as of beginning of period	\$ 10,124
Changes in fair value	(2,001)
Payments	(8,000)
Balance as of end of period	<u>\$ 123</u>

Cash and Cash Equivalents

Cash equivalents are short-term, highly liquid interest-bearing investments with maturity dates of three months or less when purchased, consisting primarily of money market instruments. Bank overdrafts are reflected within accounts payable on the balance sheets. There were no bank overdrafts at December 31, 2018. At September 30, 2019, the Company had \$0.1 million in bank overdrafts. At September 30, 2019, the Company's excess capital and undistributed earnings for the Company's regulated subsidiaries of \$105.4 million are included in cash and cash equivalents.

Investments

If a debt security is in an unrealized loss position and the Company has the intent to sell the debt security, or it is more likely than not that the Company will have to sell the debt security before recovery of its amortized cost basis, the decline in value is deemed to be other-than-temporary and is recorded to other-than-temporary impairment losses recognized in income in the consolidated statements of comprehensive income. For impaired debt securities that the Company does not intend to sell or it is more likely than not that the Company will not have to sell such securities, but

MAGELLAN HEALTH, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
September 30, 2019
(Unaudited)

the Company expects that it will not fully recover the amortized cost basis, the credit component of the other-than-temporary impairment is recognized in other-than-temporary impairment losses recognized in net income and the non-credit component of the other-than-temporary impairment is recognized in other comprehensive income in the consolidated statements of comprehensive income.

As of December 31, 2018 and September 30, 2019, there were no material unrealized losses that the Company determined to be other-than-temporary. No realized gains or losses were recorded for the nine months ended September 30, 2018 or 2019. The following is a summary of short-term and long-term investments at December 31, 2018 and September 30, 2019 (in thousands):

	December 31, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Government and agency securities	\$ 67,870	\$ 17	\$ (72)	\$ 67,815
Obligations of government-sponsored enterprises (1)	5,257	—	(28)	5,229
Corporate debt securities	292,392	6	(349)	292,049
Certificates of deposit	20,650	—	—	20,650
Total investments at December 31, 2018	<u>\$ 386,169</u>	<u>\$ 23</u>	<u>\$ (449)</u>	<u>\$ 385,743</u>

	September 30, 2019			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Government and agency securities	\$ 73,424	\$ 106	\$ (1)	\$ 73,529
Corporate debt securities	244,667	348	(36)	244,979
Certificates of deposit	25,155	—	—	25,155
Total investments at September 30, 2019	<u>\$ 343,246</u>	<u>\$ 454</u>	<u>\$ (37)</u>	<u>\$ 343,663</u>

- (1) Includes investments in notes issued by the Federal Home Loan Bank, Federal National Mortgage Association and Federal Farm Credit Banks.

The maturity dates of the Company's investments as of September 30, 2019 are summarized below (in thousands):

	Amortized Cost	Estimated Fair Value
2019	\$ 100,525	\$ 100,577
2020	237,735	238,095
2021	4,986	4,991
Total investments at September 30, 2019	<u>\$ 343,246</u>	<u>\$ 343,663</u>

Income Taxes

The Company's effective income tax rates were 26.3 percent and 31.2 percent for the nine months ended September 30, 2018 and 2019, respectively. These rates differ from the federal statutory income tax rate primarily due to state income taxes, permanent differences between book and tax income, and changes to recorded tax contingencies. The Company also accrues interest and penalties related to uncertain tax positions in its provision for income taxes. The effective income tax rate for the nine months ended September 30, 2018 is lower than the effective income tax rate for the nine months ended September 30, 2019 primarily due to permanent differences related to stock compensation expense.

The Company files a consolidated federal income tax return with its eighty-percent or more controlled subsidiaries. The Company and its subsidiaries also file income tax returns in various state and local jurisdictions. The Company is no longer subject to federal income tax assessments for years ended prior to 2016 or to state or local income

MAGELLAN HEALTH, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
September 30, 2019
(Unaudited)

tax assessments for years ended prior to 2015. Further, the statutes of limitation regarding the assessment of 2015 federal and certain state and local income taxes expired during the quarter ended September 30, 2019 (“Current Year Quarter”). As a result, \$1.7 million of tax contingency reserves recorded as of December 31, 2018 were reversed in the Current Year Quarter, of which \$1.4 million is reflected as a discrete reduction to income tax expense and \$0.3 million as a decrease to deferred tax assets. Additionally, \$0.2 million of accrued interest was reversed in the Current Year Quarter and reflected as a reduction to income tax expense due to the closing of statutes of limitation on tax assessments.

During 2018, the Internal Revenue Service (“IRS”) began examinations of the following federal consolidated income tax returns: (i) the Company for the year ended December 31, 2015, (ii) SWH Holdings, Inc. for the year ended December 31, 2016, and (iii) AlphaCare Holdings for the year ended December 31, 2016. The IRS has concluded its review of all three returns. In resolution of the examination of the Company’s 2015 return, the Company paid federal taxes of \$0.3 million in the quarter ended September 30, 2018. The Company received “no change” letters regarding the examinations of the AlphaCare Holdings and SWH Holdings returns during the quarters ended March 31, 2019 and June 30, 2019, respectively.

Net Operating Loss Carryforwards

The Company has \$27.7 million of federal net operating loss carryforwards (“NOLs”) available to reduce consolidated taxable income in 2019 and subsequent years. These NOLs (including \$27.1 million incurred by AlphaCare prior to its membership in the Magellan consolidated group) will expire in 2019 through 2035 if not used and are subject to examination and adjustment by the IRS. In addition, the Company’s utilization of these NOLs is subject to limitations under the Internal Revenue Code as to the timing and use. At this time, the Company does not believe these limitations will restrict the Company’s ability to use any federal NOLs before they expire. The Company and its subsidiaries also have \$88.2 million of NOLs available to reduce state and local taxable income at certain subsidiaries in 2019 and subsequent years. Most of these NOLs will expire in 2019 through 2038 if not used and are subject to examination and adjustment by the respective tax authorities. In addition, the Company’s utilization of certain of these NOLs is subject to limitations as to the timing and use. Other than those considered in determining the valuation allowances discussed below, the Company does not believe these limitations will restrict the Company’s ability to use any of these state and local NOLs before they expire.

Deferred tax assets as of December 31, 2018 and September 30, 2019 are shown net of valuation allowances of \$1.5 million and \$1.7 million, respectively. These valuation allowances mostly relate to uncertainties regarding the eventual realization of certain state NOLs. Reversals of valuation allowances are recorded in the period they occur, typically as reductions to income tax expense. Determination of the amount of deferred tax assets considered realizable requires significant judgment and estimation regarding the forecasts of future taxable income which are consistent with the plans and estimates the Company uses to manage the underlying businesses. Although consideration is also given to potential tax planning strategies which might be available to improve the realization of deferred tax assets, none were identified which were both prudent and reasonable. The Company believes taxable income expected to be generated in the future will be sufficient to support realization of the Company’s deferred tax assets, as reduced by valuation allowances. This determination is based upon earnings history and future earnings expectations.

Health Care Reform

The Patient Protection and the Affordable Care Act, as amended by the Health Care and Education Reconciliation Act of 2010 (collectively, the “Health Reform Law”), imposes a mandatory annual fee on health insurers for each calendar year beginning on or after January 1, 2014. The Company has obtained rate adjustments from customers which the Company expects will cover the direct costs of these fees and the impact from non-deductibility of such fees for federal and state income tax purposes. To the extent the Company has such a customer that does not renew, there may be some impact due to taxes paid where the timing and amount of recoupment of these additional costs is uncertain. In the event the Company is unable to obtain rate adjustments to cover the financial impact of the annual fee, the fee may have a material impact on the Company. On January 23, 2018, the United States Congress passed the Continuing Resolution which imposed a one-year moratorium on the HIF fee, suspending its application for 2019. For 2018 the HIF fee was \$29.9 million which was paid in 2018.

MAGELLAN HEALTH, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
September 30, 2019
(Unaudited)

Stock Compensation

At December 31, 2018 and September 30, 2019, the Company had equity-based employee incentive plans, which are described more fully in Note 6 in the Company's Annual Report on Form 10-K for the year ended December 31, 2018, which was filed with the SEC on February 28, 2019. The Company recorded stock compensation expense of \$9.3 million and \$27.4 million for the three and nine months ended September 30, 2018, respectively, and \$4.8 million and \$19.8 million for the three and nine months ended September 30, 2019, respectively. Stock compensation expense recognized in the consolidated statements of comprehensive income for the three and nine months ended September 30, 2018 and 2019 has been reduced for forfeitures, estimated at between zero and four percent for all periods.

The weighted average grant date fair value of all stock options granted during the nine months ended September 30, 2019 was \$20.64 as estimated using the Black-Scholes-Merton option pricing model, which also assumed an expected volatility of 35.07 percent based on the historical volatility of the Company's stock price.

For the nine months ended September 30, 2018 the benefit of tax deductions in excess of recognized stock compensation expense (net of deficiencies) was \$5.0 million and was included as a reduction of tax expense. For the nine months ended September 30, 2019 the tax on deficiencies (net of the tax deductions in excess of recognized stock compensation expense) was \$1.6 million and was included as an increase to income tax expense.

Summarized information related to the Company's stock options for the nine months ended September 30, 2019 is as follows:

	Options	Weighted Average Exercise Price
Outstanding, beginning of period	2,352,609	\$ 68.10
Granted	416,624	66.13
Forfeited	(60,475)	81.60
Exercised	(389,368)	60.31
Outstanding, end of period	<u>2,319,390</u>	<u>\$ 68.70</u>
Vested and expected to vest at end of period	<u>2,303,496</u>	<u>\$ 68.67</u>
Exercisable, end of period	<u>1,500,864</u>	<u>\$ 64.42</u>

All of the Company's options granted during the nine months ended September 30, 2019 vest ratably on each anniversary date over the three years subsequent to grant and have a ten year life.

Summarized information related to the Company's nonvested restricted stock awards ("RSAs") for the nine months ended September 30, 2019 is as follows:

	Shares	Weighted Average Grant Date Fair Value
Outstanding, beginning of period	11,795	\$ 89.05
Awarded	41,905	65.60
Vested	(13,939)	85.99
Forfeited	—	—
Outstanding, ending of period	<u>39,761</u>	65.40

MAGELLAN HEALTH, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
September 30, 2019
(Unaudited)

Summarized information related to the Company's nonvested restricted stock units ("RSUs") for the nine months ended September 30, 2019 is as follows:

	Shares	Weighted Average Grant Date Fair Value
Outstanding, beginning of period	156,750	\$ 86.68
Awarded	186,325	66.57
Vested	(68,993)	81.95
Forfeited	(18,563)	80.75
Outstanding, ending of period	<u>255,519</u>	73.72

Grants of RSAs vest on the anniversary of the grant. In general, RSUs vest ratably on each anniversary over the three years subsequent to grant.

Summarized information related to the Company's nonvested restricted performance stock units ("PSUs") for the nine months ended September 30, 2019 is as follows:

	Shares	Weighted Average Grant Date Fair Value
Outstanding, beginning of period	209,019	\$ 103.38
Awarded	83,087	100.31
Vested	(43,109)	97.12
Forfeited	(12,157)	97.12
Outstanding, end of period	<u>236,840</u>	103.76

The weighted average estimated fair value of the PSUs granted in the nine months ended September 30, 2019 was \$100.31, which was derived from a Monte Carlo simulation. Significant assumptions utilized in estimating the value of the awards granted include an expected dividend yield of 0%, a risk free rate of 2.51%, and expected volatility of 19% to 82% (average of 36%). The PSUs granted in the nine months ended September 30, 2019, will entitle the grantee to receive a number of shares of the Company's common stock determined over a three-year performance period ending on December 31, 2021 and vesting on March 5, 2022, the settlement date, provided the grantee remains in the service of the Company on the settlement date. The Company expenses the cost of these awards ratably over the requisite service period. The number of shares for which the PSUs will be settled is calculated as a percentage of the award target and will depend on the Company's total shareholder return (as defined below), expressed as a percentile ranking of the Company's total shareholder return as compared to the Company's peer group (as defined below). The number of shares for which the PSUs will be settled varies from zero to 200 percent of the shares specified in the grant. Total shareholder return is determined by dividing the average share value of the Company's common stock over the 30 trading days preceding January 1, 2022 by the average share value of the Company's common stock over the 30 trading days beginning on January 1, 2019, with a deemed reinvestment of any dividends declared during the performance period. The Company's peer group includes 48 companies which comprise the S&P Health Care Services Industry Index, which was selected by the compensation committee of the Company's board of directors and includes a range of healthcare companies operating in several business segments.

Long-Term Debt and Finance Lease Obligations

Senior Notes

On September 22, 2017, the Company completed the public offering of \$400.0 million aggregate principal amount of its 4.400% Senior Notes due 2024 (the "Notes"). The Notes are governed by an indenture, dated as of

MAGELLAN HEALTH, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
September 30, 2019
(Unaudited)

September 22, 2017 (the “Base Indenture”), between the Company, as issuer, and U.S. Bank National Association, as trustee, as supplemented by a first supplemental indenture, dated as of September 22, 2017 (the “First Supplemental Indenture” together, with the Base Indenture, the “Indenture”), between the Company, as issuer, and U.S. Bank National Association, as trustee. The Notes were issued at a discount and had a carrying value of \$399.3 million and \$399.4 million as of December 31, 2018 and September 30, 2019, respectively.

The Notes bear interest payable semiannually in cash in arrears on March 22 and September 22 of each year, commencing on March 22, 2018, which rate is subject to an interest rate adjustment upon the occurrence of certain credit rating events. The Notes mature on September 22, 2024. The Indenture provides that the Notes are redeemable at the Company’s option, in whole or in part, at any time on or after July 22, 2024, at a redemption price equal to 100% of the principal amount of the Notes being redeemed plus accrued and unpaid interest thereon to, but excluding, the redemption date.

The Indenture also contains certain covenants which restrict the Company’s ability to, among other things, create liens on its and its subsidiaries’ assets; engage in sale and lease-back transactions; and engage in a consolidation, merger or sale of assets.

Credit Agreement

On September 22, 2017, the Company entered into a credit agreement with various lenders that provides for a \$400.0 million senior unsecured revolving credit facility and a \$350.0 million senior unsecured term loan facility to the Company, as the borrower (the “2017 Credit Agreement”). On August 13, 2018, the Company entered into an amendment to the 2017 Credit Agreement, which extended the maturity date by one year. On February 27, 2019, the Company entered into a second amendment to the 2017 Credit Agreement, which amended the total leverage ratio covenant, and which was necessary in order for us to remain in compliance with the terms of the 2017 Credit Agreement. The 2017 Credit Agreement is scheduled to mature on September 22, 2023.

Under the 2017 Credit Agreement, the annual interest rate on the loan borrowing is equal to (i) in the case of base rate loans, the sum of an initial borrowing margin of 0.500 percent plus the higher of the prime rate, one-half of one percent in excess of the overnight “federal funds” rate, or the Eurodollar rate for one month plus 1.000 percent, or (ii) in the case of Eurodollar rate loans, the sum of an initial borrowing margin of 1.500 percent plus the Eurodollar rate for the selected interest period. The borrowing margin is subject to adjustment based on the Company’s debt rating as provided by certain rating agencies. The Company has the option to borrow in base rate loans or Eurodollar rate loans at its discretion. The commitment commission on the revolving credit facility under the 2017 Credit Agreement is 0.200 percent of the unused revolving credit commitment, which rate shall be subject to adjustment based on the Company’s debt rating as provided by certain rating agencies. For the nine months ended September 30, 2019, the weighted average interest rate was approximately 4.2225 percent.

In August 2019, the Company made voluntary term loan repayments of \$30.0 million. As of September 30, 2019, the contractual maturities of the term loan under the 2017 Credit Agreement were as follows: 2019—\$0.0 million; 2020—\$0.0 million; 2021—\$9.4 million; 2022—\$17.5 million; and 2023—\$258.1 million. Due to the timing of working capital needs, the Company will periodically borrow from the revolving loan under the 2017 Credit Agreement. At December 31, 2018 and September 30, 2019, the Company had no revolving loan borrowings. At September 30, 2019, the Company had a borrowing capacity of \$400.0 million under the 2017 Credit Agreement. Included in long-term debt, capital lease and deferred financing obligations are deferred loan and bond issuance costs as of December 31, 2018 and September 30, 2019 of \$5.9 million and \$6.1 million, respectively.

Letter of Credit Agreement

On August 22, 2017, the Company entered into a Continuing Agreement for Standby Letters of Credit with The Bank of Tokyo-Mitsubishi UFJ, Ltd. (“BTMU”), as issuer (the “L/C Agreement”), under which BTMU, at its sole discretion, may provide stand-by letter of credit to the Company. The Company had letters of credit outstanding under the L/C Agreement as of December 31, 2018 and September 30, 2019 of \$66.1 million and \$66.4 million, respectively.

MAGELLAN HEALTH, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
September 30, 2019
(Unaudited)

Finance Lease and Deferred Financing Obligations

There were \$21.7 million and \$19.1 million of finance lease obligations at December 31, 2018 and September 30, 2019, respectively. There were \$9.5 million and \$0.0 million of deferred financing obligations at December 31, 2018 and September 30, 2019, respectively. The Company's finance lease and deferred financing obligations represent amounts due under leases for certain properties, computer software (acquired prior to the prospective adoption of ASU 2015-05 on January 1, 2016) and equipment. The recorded gross cost of finance lease assets was \$51.9 million and \$56.0 million at December 31, 2018 and September 30, 2019, respectively.

NOTE B—Net Income per Common Share Attributable to Magellan Health, Inc.

The following table reconciles income attributable to common shareholders (numerator) and shares (denominator) used in the computations of net income per share attributable to common shareholders (in thousands, except per share data) for the three and nine months ended September 30:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2019	2018	2019
Numerator:				
Net income	\$ 27,145	\$ 21,274	\$ 52,148	\$ 35,318
Denominator:				
Weighted average number of common shares outstanding—basic	24,433	24,426	24,451	24,159
Common stock equivalents—stock options	413	124	630	129
Common stock equivalents—RSAs	2	4	19	6
Common stock equivalents—RSUs	26	36	42	25
Common stock equivalents—PSUs	49	114	171	123
Common stock equivalents—employee stock purchase plan	5	4	3	5
Weighted average number of common shares outstanding—diluted	24,928	24,708	25,316	24,447
Net income per common share—basic	\$ 1.11	\$ 0.87	\$ 2.13	\$ 1.46
Net income per common share—diluted	\$ 1.09	\$ 0.86	\$ 2.06	\$ 1.44

The weighted average number of common shares outstanding for the three and nine months ended September 30, 2018 and 2019 were calculated using outstanding shares of the Company's common stock. Common stock equivalents included in the calculation of diluted weighted average common shares outstanding for the three and nine months ended September 30, 2018 and 2019 represent stock options to purchase shares of the Company's common stock, RSAs, RSUs, PSUs and stock purchased under the Employee Stock Purchase Plan.

The Company had additional potential dilutive securities outstanding representing 0.6 million and 0.4 million options for the three and nine months ended September 30, 2018, respectively, and 1.1 million and 1.1 million options for the three and nine months ended September 30, 2019, respectively, that were not included in the computation of dilutive securities because they were anti-dilutive for the period. Had these shares not been anti-dilutive, all of these shares would not have been included in the net income attributable to common shareholder per common share calculation as the Company uses the treasury stock method of calculating diluted shares.

NOTE C—Business Segment Information

The accounting policies of the Company's segments are the same as those described in Note A—"General." The Company evaluates performance of its segments based on profit or loss from operations before stock compensation expense, depreciation and amortization, interest expense, interest and other income, changes in the fair value of contingent consideration recorded in relation to acquisitions, gain on sale of assets, special charges or benefits, and income taxes ("Segment Profit"). Management uses Segment Profit information for internal reporting and control purposes and considers it important in making decisions regarding the allocation of capital and other resources, risk assessment and employee compensation, among other matters. Healthcare subcontracts with Pharmacy Management to

MAGELLAN HEALTH, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
September 30, 2019
(Unaudited)

provide pharmacy benefits management services for certain of Healthcare’s customers. In addition, Pharmacy Management provides pharmacy benefits management for the Company’s employees covered under its medical plan. As such, revenue, cost of goods sold and direct service costs and other related to these arrangements are eliminated. The Company’s segments are defined in Note A—“General.”

The following tables summarize, for the periods indicated, operating results by business segment (in thousands):

	Healthcare	Pharmacy Management	Corporate and Elimination	Consolidated
Three Months Ended September 30, 2018				
Managed care and other revenue	\$ 1,176,439	\$ 59,500	\$ (152)	\$ 1,235,787
PBM revenue	—	665,734	(48,015)	617,719
Cost of care	(938,031)	—	—	(938,031)
Cost of goods sold	—	(618,463)	47,318	(571,145)
Direct service costs and other	(179,022)	(74,491)	(11,958)	(265,471)
Stock compensation expense (1)	2,165	1,359	5,796	9,320
Changes in fair value of contingent consideration (1)	148	—	—	148
Segment Profit (Loss)	<u>\$ 61,699</u>	<u>\$ 33,639</u>	<u>\$ (7,011)</u>	<u>\$ 88,327</u>

	Healthcare	Pharmacy Management	Corporate and Elimination	Consolidated
Three Months Ended September 30, 2019				
Managed care and other revenue	\$ 1,234,086	\$ 69,968	\$ (118)	\$ 1,303,936
PBM revenue	—	572,086	(47,081)	525,005
Cost of care	(1,013,006)	—	—	(1,013,006)
Cost of goods sold	—	(528,500)	46,223	(482,277)
Direct service costs and other	(178,538)	(79,842)	(7,942)	(266,322)
Stock compensation expense (1)	2,202	1,669	940	4,811
Changes in fair value of contingent consideration (1)	4	—	—	4
Segment Profit (Loss)	<u>\$ 44,748</u>	<u>\$ 35,381</u>	<u>\$ (7,978)</u>	<u>\$ 72,151</u>

	Healthcare	Pharmacy Management	Corporate and Elimination	Consolidated
Nine Months Ended September 30, 2018				
Managed care and other revenue	\$ 3,488,928	\$ 182,410	\$ (448)	\$ 3,670,890
PBM revenue	—	1,940,726	(142,110)	1,798,616
Cost of care	(2,802,506)	—	—	(2,802,506)
Cost of goods sold	—	(1,827,327)	138,098	(1,689,229)
Direct service costs and other	(543,258)	(221,018)	(29,424)	(793,700)
Stock compensation expense (1)	7,857	4,252	15,296	27,405
Changes in fair value of contingent consideration (1)	451	—	—	451
Segment Profit (Loss)	<u>\$ 151,472</u>	<u>\$ 79,043</u>	<u>\$ (18,588)</u>	<u>\$ 211,927</u>

MAGELLAN HEALTH, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
September 30, 2019
(Unaudited)

	Healthcare	Pharmacy Management	Corporate and Elimination	Consolidated
Nine Months Ended September 30, 2019				
Managed care and other revenue	\$ 3,618,981	\$ 192,511	\$ (434)	\$ 3,811,058
PBM revenue	—	1,678,661	(132,953)	1,545,708
Cost of care	(2,956,853)	—	—	(2,956,853)
Cost of goods sold	—	(1,563,910)	130,653	(1,433,257)
Direct service costs and other	(535,676)	(238,253)	(30,751)	(804,680)
Stock compensation expense (1)	6,396	5,465	7,971	19,832
Changes in fair value of contingent consideration (1)	(2,001)	—	—	(2,001)
Segment Profit (Loss)	<u>\$ 130,847</u>	<u>\$ 74,474</u>	<u>\$ (25,514)</u>	<u>\$ 179,807</u>

- (1) Stock compensation expense, changes in the fair value of contingent consideration recorded in relation to acquisitions and impairment of intangible assets are included in direct service costs and other operating expenses; however, these amounts are excluded from the computation of Segment Profit.

The following table reconciles income before income taxes to Segment Profit (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2019	2018	2019
Income before income taxes	\$ 40,961	\$ 29,142	\$ 70,713	\$ 51,331
Stock compensation expense	9,320	4,811	27,405	19,832
Changes in fair value of contingent consideration	148	4	451	(2,001)
Depreciation and amortization	33,047	34,157	97,302	98,355
Interest expense	8,990	9,007	26,034	27,255
Interest and other income	(4,139)	(4,970)	(9,978)	(14,965)
Segment Profit	<u>\$ 88,327</u>	<u>\$ 72,151</u>	<u>\$ 211,927</u>	<u>\$ 179,807</u>

NOTE D—Commitments and Contingencies

Legal

The Company's operating activities entail significant risks of liability. From time to time, the Company is subject to various actions and claims arising from the acts or omissions of its employees, network providers or other parties. In the normal course of business, the Company receives reports relating to deaths and other serious incidents involving patients whose care is being managed by the Company. Such incidents occasionally give rise to malpractice, professional negligence and other related actions and claims against the Company or its network providers. Many of these actions and claims received by the Company seek substantial damages and, therefore, require the Company to incur significant fees and costs related to their defense.

The Company is also subject to or party to certain class actions and other litigation and claims relating to its operations or business practices. The Company has recorded reserves that, in the opinion of management, are adequate to cover litigation, claims or assessments that have been or may be asserted against the Company, and for which the outcome is probable and reasonably estimable. Management believes that the resolution of such litigation and claims will not have a material adverse effect on the Company's financial condition or results of operations; however, there can be no assurance in this regard.

A Pharmacy Management segment network provider and the Company are currently in dispute regarding pricing and associated calculations pertaining to network reconciliations for a multi-year period. Depending upon the resolution of the dispute, the Company could incur liability to this provider. The unrecorded, potential loss related to these network reconciliations is estimated to range from \$0 to \$20 million. The ultimate resolution of this matter, if unfavorable, could be material to the Company's results of operations.

MAGELLAN HEALTH, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
September 30, 2019
(Unaudited)

Regulatory Issues

The managed healthcare industry is subject to numerous laws and regulations. The subjects of such laws and regulations cover, but are not limited to, matters such as licensure, accreditation, government healthcare program participation requirements, information privacy and security, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Over the past several years, government activity has increased with respect to investigations and/or allegations concerning possible violations of fraud and abuse and false claims statutes and/or regulations by healthcare organizations and insurers. Entities that are found to have violated these laws and regulations may be excluded from participating in government healthcare programs, subjected to fines or penalties or required to repay amounts received from the government for previously billed patient services. Compliance with such laws and regulations can be subject to future government review and interpretation, as well as regulatory actions unknown or unasserted at this time.

In addition, regulators of certain of the Company's subsidiaries may exercise certain discretionary rights under regulations including increasing their supervision of such entities, requiring additional restricted cash or other security or seizing or otherwise taking control of the assets and operations of such subsidiaries.

The Company is subject to certain federal laws and regulations in connection with its contracts with the federal government. These laws and regulations affect how the Company conducts business with its federal agency customers and may impose added costs on its business. The Company's failure to comply with federal procurement laws and regulations could cause it to lose business, incur additional costs and subject it to a variety of civil and criminal penalties and administrative sanctions, including termination of contracts, forfeiture of profits, harm to reputation, suspension of payments, fines, and suspension or debarment from doing business with federal government agencies. The Company's wholly owned subsidiary, Armed Forces Services Corporation ("AFSC"), conducts business with federal agency customers and federal contractors to such agencies. The Company is investigating, with the assistance of outside counsel, matters relating to compliance by AFSC with Small Business Administration ("SBA") regulations and other federal laws applicable to government contractors and has reported findings to the SBA and the Department of Defense, including facts indicating violations of SBA regulations and other federal laws, such as the Anti-Kickback Act, by former AFSC executives, none of which was disclosed to Magellan prior to its acquisition of AFSC. The Company is voluntarily responding to government requests for further information regarding the Company's investigation. Contingencies, if any, arising from the results of this investigation and self-reporting could require us to record balance sheet liabilities or accrue expenses, the amount of which we are not able to currently estimate. While the Company believes that it has responded appropriately by self-reporting findings regarding matters that incepted prior to its acquisition of AFSC in order to mitigate the risk of adverse consequences, should the SBA, Department of Defense and/or other federal agencies seek to hold the Company or AFSC responsible for the reported conduct, we may be required to pay damages and/or penalties and AFSC could be suspended or debarred from government contracting. AFSC generated approximately 2% of the Company's total revenue for the year ended December 31, 2018 and nine months ended September 30, 2019.

Stock Repurchases

On October 26, 2015, the Company's board of directors approved a stock repurchase plan which authorized the Company to purchase up to \$200 million of its outstanding common stock through October 26, 2017 (the "2015 Repurchase Program"). On July 26, 2017, the Company's board of directors approved an extension of the 2015 Repurchase Program through October 26, 2018. On May 24, 2018, the Company's board of directors approved an increase of \$200 million to the current \$200 million stock repurchase plan which will now authorize the Company to purchase up to \$400 million of its outstanding common stock under the 2015 Repurchase Program. As of September 30, 2019, the remaining capacity under the 2015 Repurchase Program was \$186.3 million. The board also extended the program from October 22, 2018 to October 22, 2020. Stock repurchases under the programs may be carried out from time to time in open market transactions (including blocks) or in privately negotiated transactions. The timing of repurchases and the actual amount purchased will depend on a variety of factors including the market price of the Company's shares, general market and economic conditions, and other corporate considerations. Repurchases may be made pursuant to plans intended to comply with Rule 10b5-1 under the Securities Exchange Act of 1934, which could allow the Company to purchase its shares during periods when it otherwise might be prevented from doing so under

MAGELLAN HEALTH, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
September 30, 2019
(Unaudited)

insider trading laws or because of self-imposed trading blackout periods. Repurchases are expected to be funded from working capital and anticipated cash from operations. The repurchase authorization does not require the purchase of a specific number of shares and is subject to suspension or termination by the Company's board of directors at any time.

Pursuant to the 2015 Stock Repurchase Program, the Company made purchases as follows (aggregate cost excludes broker commissions and is reflected in millions):

<u>Period</u>	<u>Total Number of Shares Purchased</u>	<u>Average Price Paid per Share</u>	<u>Aggregate Cost</u>
October 26, 2015 - December 31, 2015	345,044	\$ 53.46	\$ 18.4
January 1, 2016 - December 31, 2016	1,828,183	58.40	106.8
January 1, 2017 - December 31, 2017	280,140	77.67	21.8
January 1, 2018 - December 31, 2018	844,872	74.59	63.0
January 1, 2019 - September 30, 2019	60,901	61.15	3.7
	<u>3,359,140</u>		<u>\$ 213.7</u>

The Company made no share repurchases from October 1, 2019 through October 25, 2019.

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

Business Overview

The Company is engaged in the healthcare management business, and is focused on meeting needs in areas of healthcare that are fast growing, highly complex and high cost, with an emphasis on special population management. The Company provides services to health plans and other MCOs, employers, labor unions, various military and governmental agencies, TPAs, consultants and brokers. The Company’s business is divided into three segments, based on the services it provides and/or the customers that it serves. See Item 1—“Business” for more information on the Company’s business segments.

Recent Developments

On October 31, 2019, the Board announced the appointment of Kenneth J. Fasola, 60, as Chief Executive Officer of the Company, and member of the Board, effective November 14, 2019. In connection with his appointment as Chief Executive Officer, on October 31, 2019, Mr. Fasola and the Company entered into an employment agreement, attached as Exhibit 10.1 to the Company’s current report on Form 8-K, which was filed on October 31, 2019. As previously disclosed, Barry Smith will step down as a member of the Board and Chief Executive Officer of the Company, effective as of November 14, 2019.

Results of Operations

The following table summarizes, for the periods indicated, consolidated operating results (in thousands):

	Three Months Ended			Nine Months Ended		
	September 30,		Change	September 30,		Change
Consolidated Results	2018	2019	'18 vs '19	2018	2019	'18 vs '19
Statement of Operations Data:						
Net revenue	\$ 1,853,506	\$ 1,828,941	(1.3%)	\$ 5,469,506	\$ 5,356,766	(2.1%)
Cost of Care	938,031	1,013,006	8.0%	2,802,506	2,956,853	5.5%
Cost of goods sold	571,145	482,277	(15.6%)	1,689,229	1,433,257	(15.2%)
Direct service costs and other operating expenses (1)(2)	265,471	266,322	0.3%	793,700	804,680	1.4%
Depreciation and amortization	33,047	34,157	3.4%	97,302	98,355	1.1%
Interest expense	8,990	9,007	0.2%	26,034	27,255	4.7%
Interest and other income	(4,139)	(4,970)	20.1%	(9,978)	(14,965)	50.0%
Income before income taxes	40,961	29,142	(28.9%)	70,713	51,331	(27.4%)
(Benefit) provision for income taxes	13,816	7,868	(43.1%)	18,565	16,013	(13.7%)
Net income	\$ 27,145	\$ 21,274	(21.6%)	\$ 52,148	\$ 35,318	(32.3%)

- (1) Includes stock compensation expense of \$9,320 and \$4,811 for the three months ended September 30, 2018 and 2019, respectively, and \$27,405 and \$19,832 for the nine months ended September 30, 2018 and 2019, respectively.
- (2) Includes changes in fair value of contingent consideration of \$148 and \$4 for the three months ended September 30, 2018 and 2019, respectively, and \$451 and \$(2,001) for the nine months ended September 30, 2018 and 2019, respectively.

Quarter ended September 30, 2019 (“Current Year Quarter”) compared to Quarter ended September 30, 2018 (“Prior Year Quarter”)

Net revenue, Cost of care, Cost of goods sold and Direct service costs and other operating expenses

Net revenue, cost of care, cost of goods sold and direct service costs and other operating expense variances are addressed within the segment results that follow.

[Table of Contents](#)

Depreciation and amortization

Depreciation and amortization expense increased by 3.4 percent or \$1.1 million from the Prior Year Quarter to the Current Year Quarter, primarily due to normal asset additions after the Prior Year Quarter.

Interest expense

Interest expense was consistent with the Prior Year Period.

Interest and other income

Interest income increased by \$0.8 million from the Prior Year Quarter to the Current Year Quarter primarily due to higher yields.

Income taxes

The Company's effective income tax rates were 33.7 percent and 27.0 percent for the Prior Year Quarter and Current Year Quarter, respectively. The effective income tax rate for the Current Year Quarter is lower than the effective income tax rate for the Prior Year Quarter mainly due to the permanent differences related to the non-deductible health insurer fee in the Prior Year Quarter. The effective income tax rate for the Current Year Quarter approximates the federal and state statutory rates although it is net of an increase for limitations on the deduction of executive compensation and a decrease for the reversal of state tax contingencies from the closing of statutes of limitation on tax assessments.

Nine months ended September 30, 2019 ("Current Year Period") compared to nine months ended September 30, 2018 ("Prior Year Period")

Net revenue, Cost of care, Cost of goods sold and Direct service costs and other operating expenses

Net revenue, cost of care, cost of goods sold and direct service costs and other operating expense variances are addressed within the segment results that follow.

Depreciation and amortization

Depreciation and amortization expense increased by 1.1 percent or \$1.1 million from the Prior Year Period, mainly due to normal asset additions after the Prior Year Period.

Interest expense

Interest expense increased by \$1.2 million from the Prior Year Period to the Current Year Period primarily due to higher interest rates.

Interest and other income

Interest income increased by \$5.0 million from the Prior Year Period to the Current Year Period primarily due to higher yields.

Income taxes

The Company's effective income tax rates were 26.3 percent and 31.2 percent for the Prior Year Period and Current Year Period, respectively. The effective income tax rate for the Prior Year Period is lower than the effective income tax rate for the Current Year Period mainly due to an increase in the Current Year Period permanent differences related to stock compensation expense, partially offset by the permanent difference in the Prior Year Period for the non-deductible health insurer fee. The effective income tax rate for the Current Year Period is higher than the federal and state statutory rates primarily due to limitations on the deduction of executive compensation.

Segment Results

The Company manages and measures operational performance through three segments: Healthcare, Pharmacy Management and Corporate. The Company evaluates performance of its segments based on Segment Profit. Management uses Segment Profit information for internal reporting and control purposes and considers it important in

making decisions regarding the allocation of capital and other resources, risk assessment and employee compensation, among other matters. Stock compensation expense and changes in fair value of contingent consideration recorded in relation to acquisitions are included in direct service costs and other operating expenses; however, these amounts are excluded from the computation of Segment Profit.

Healthcare

The Healthcare segment includes the Company's: (i) management of behavioral healthcare services and EAP services, (ii) management of other specialty areas including diagnostic imaging and musculoskeletal management, and (iii) the integrated management of physical, behavioral and pharmaceutical healthcare for special populations, delivered through Magellan Complete Care. The Healthcare segment's Behavioral & Specialty Health division provides management services to health plans, accountable care organizations, employers, state Medicaid agencies, the United States military and various federal government agencies for whom Magellan provides carve-out management services for behavioral health, employee assistance plans, and other areas of specialty healthcare including diagnostic imaging, musculoskeletal management, cardiac, and physical medicine. The MCC division contracts with state Medicaid agencies and CMS to manage care for beneficiaries under various Medicaid and Medicare programs.

The following table summarizes, for the periods indicated, operating results for the Healthcare segment (in thousands):

Healthcare Segment Results	Three Months Ended			Nine Months Ended		
	September 30,		Change '18 vs '19	September 30,		Change '18 vs '19
	2018	2019		2018	2019	
Behavioral & Specialty Health revenue						
Risk-based, non-EAP	\$ 377,615	\$ 383,386	1.5%	\$ 1,128,743	\$ 1,145,785	1.5%
EAP risk-based	79,854	80,076	0.3%	265,787	256,989	(3.3%)
ASO	65,326	57,535	(11.9%)	189,241	170,733	(9.8%)
Magellan Complete Care revenue						
Risk-based, non-EAP	639,584	697,321	9.0%	1,863,771	1,999,254	7.3%
ASO	14,060	15,768	12.1%	41,386	46,220	11.7%
Managed care and other revenue	1,176,439	1,234,086	4.9%	3,488,928	3,618,981	3.7%
Cost of care	938,031	1,013,006	8.0%	2,802,506	2,956,853	5.5%
	238,408	221,080	(7.3%)	686,422	662,128	(3.5%)
Direct service costs and other	179,022	178,538	(0.3%)	543,258	535,676	(1.4%)
	59,386	42,542	(28.4%)	143,164	126,452	(11.7%)
Stock compensation expense	2,165	2,202	1.7%	7,857	6,396	(18.6%)
Changes in fair value of contingent consideration	148	4		451	(2,001)	
Segment Profit	\$ 61,699	\$ 44,748	(27.5%)	\$ 151,472	\$ 130,847	(13.6%)
Direct service cost as % of revenue	15.2%	14.5%		15.6%	14.8%	
MLR Behavioral & Specialty Health risk	87.7%	89.2%		87.0%	87.5%	
MLR Behavioral & Specialty Health EAP risk	68.2%	69.4%		68.8%	67.3%	
MLR Magellan Complete Care risk	86.4%	88.2%		87.8%	89.1%	
Membership						
Behavioral & Specialty Health						
Risk (1)				12,325	12,017	(2.5%)
EAP risk				15,140	14,359	(5.2%)
ASO				26,551	26,478	(0.3%)
Magellan Complete Care						
Risk				144	152	5.6%
ASO				22	24	9.1%
				54,182	53,030	(2.1%)

- (1) May include some duplicate count of membership for customers that contract with Magellan for both behavioral and other specialty management services.

Current Year Quarter compared to the Prior Year Quarter

Managed care and other revenue

Net revenue increased by 4.9 percent or \$57.6 million from the Prior Year Quarter to the Current Year Quarter. The increase in revenue is primarily due to favorable rate and membership changes of \$146.3 million, new contracts implemented after (or during) the Prior Year Quarter of \$32.5 million, program changes of \$21.0 million, unfavorable retroactive rate and membership adjustments in the Prior Year Quarter of \$7.0 million, favorable retroactive rate adjustments of \$4.9 million, and other net favorable variances of \$14.6 million. These increases partially offset by terminated contracts of \$138.7 million, customer settlements and other contract changes in the Prior Year Quarter of \$18.3 million, net revenue recorded for HIF fees in the Prior Year Quarter of \$7.7 million and the revenue impact of net favorable prior period medical claims development recorded in Prior Year Quarter of \$4.0 million.

Cost of care

Cost of care increased by 8.0 percent or \$75.0 million from the Prior Year Quarter to the Current Year Quarter. The increase is primarily due to increased membership of \$115.3 million, the care cost for new contracts implemented after (or during) the Prior Year Quarter of \$24.5 million, program changes of \$20.2 million, net favorable prior period medical claims development recorded in the Prior Year Quarter of \$6.2 million, net unfavorable prior period medical claims development recorded in the Current Year Quarter of \$1.0 million and care trends and other net unfavorable variances of \$25.4 million. These increases were partially offset by terminated contracts of \$117.6 million. For our behavioral specialty health contracts, cost of care as a percentage of risk revenue (excluding EAP business) increased from 87.7 percent in Prior Year Quarter to 89.2 percent in the Current Year Quarter mainly due to increased utilization. For our MCC contracts, cost of care increased as a percentage of risk revenue from 86.4 percent in the Prior Year Quarter to 88.2 percent in the Current Year Quarter mainly due to net revenue recorded for HIF fees and favorable customer settlements in the Prior Year Quarter.

Direct service costs and other

Direct service costs decreased 0.3 percent or \$0.5 million from the Prior Year Quarter to the Current Year Quarter, and decreased as a percentage of revenue from 15.2 percent in the Prior Year Quarter to 14.5 percent in the Current Year Quarter primarily due to increased revenue from program changes and favorable rate changes.

Current Year Period compared to the Prior Year Period

Managed care and other revenue

Net revenue increased by 3.7 percent or \$130.1 million from the Prior Year Period to the Current Year Period. The increase in revenue is primarily due to new contracts implemented after (or during) the Prior Year Period of \$229.7 million, favorable rate and membership changes of \$188.1 million, program changes of \$70.2 million, favorable retroactive rate adjustments of \$3.3 million in the Current Year Period, unfavorable retroactive membership and rate adjustments in the Prior Year Period of \$6.9 million and other net favorable variances of \$9.2 million. These increases were partially offset by terminated contracts of \$330.7 million, customer settlements and other contract changes in the prior period of \$21.6 million, net revenue recorded for HIF fees in the Prior Year Period of \$23.0 million and the revenue impact of net favorable prior period medical claims development recorded in the Prior Year Period of \$2.0 million.

Cost of care

Cost of care increased by 5.5 percent or \$154.3 million from the Prior Year Period to the Current Year Period. The increase is primarily due to the care cost for new contracts implemented after (or during) the Prior Year Period of \$180.4 million, increased membership of \$81.0 million, program changes of \$61.4 million, net favorable prior period medical claims recorded in the Prior Year Period of \$9.7 million, and care trends and other net unfavorable variances of \$117.1 million. These increases were partially offset by terminated contracts of \$271.3 million and net favorable prior period medical claims development in the Current Year Period of \$24.0 million. For our behavioral specialty health

contracts, cost of care as a percentage of risk revenue (excluding EAP business) increased from 87.0 percent in the Prior Year Period to 87.5 percent in the Current Year Period, mainly due to increased utilization and business mix. For our MCC contracts, cost of care as a percentage of risk revenue increased from 87.8 percent in the Prior Year Period to 89.1 percent in the Current Year Period mainly due to net revenue recorded for HIF fees and customer settlements in the Prior Year Period, and business mix.

Direct service costs and other

Direct service costs decreased by 1.4 percent or \$7.6 million from the Prior Year Period to the Current Year Period primarily due to HIF fees in the Prior Year Period and terminated contracts, partially offset by new business growth. Direct service costs decreased as a percentage of revenue from 15.6 percent in the Prior Year Period to 14.8 percent in the Current Year Period, primarily due to HIF fees in the Prior Year Period, and increased revenue from program changes and favorable rate changes.

Pharmacy Management

The Pharmacy Management segment comprises products and solutions that provide clinical and financial management of pharmaceuticals paid under medical and pharmacy benefit programs. Pharmacy Management's services include: (i) PBM services; (ii) PBA for state Medicaid and other government sponsored programs; (iii) pharmaceutical dispensing operations; (iv) clinical and formulary management programs; (v) medical pharmacy management programs; and (vi) programs for the integrated management of specialty drugs. Pharmacy Management's services are provided under contracts with health plans, employers, state Medicaid programs, Medicare Part D and other government agencies.

The following table summarizes, for the periods indicated, operating results for the Pharmacy Management segment (in thousands, except state count):

Pharmacy Segment Results	Three Months Ended		Change	Nine Months Ended		Change
	September 30,			September 30,		
	2018	2019	'18 vs '19	2018	2019	'18 vs '19
Formulary management	\$ 16,601	\$ 23,976	44.4%	\$ 55,326	\$ 59,585	7.7%
PBA and other	42,899	45,992	7.2%	127,084	132,926	4.6%
Managed care and other revenue	59,500	69,968	17.6%	182,410	192,511	5.5%
PBM, including dispensing	549,508	495,759	(9.8%)	1,619,431	1,469,151	(9.3%)
Medicare Part D	116,226	76,327	(34.3%)	321,295	209,510	(34.8%)
PBM revenue	665,734	572,086	(14.1%)	1,940,726	1,678,661	(13.5%)
Total net revenue	725,234	642,054	(11.5%)	2,123,136	1,871,172	(11.9%)
Cost of goods sold	618,463	528,500	(14.5%)	1,827,327	1,563,910	(14.4%)
	106,771	113,554	6.4%	295,809	307,262	3.9%
Direct service costs and other	74,491	79,842	7.2%	221,018	238,253	7.8%
	32,280	33,712	4.4%	74,791	69,009	(7.7%)
Stock compensation expense	1,359	1,669	22.8%	4,252	5,465	28.5%
Segment Profit	<u>\$ 33,639</u>	<u>\$ 35,381</u>	5.2%	<u>\$ 79,043</u>	<u>\$ 74,474</u>	(5.8%)
Direct service cost as % of revenue	10.3%	12.4%		10.4%	12.7%	
COGS as % of PBM revenue	92.9%	92.4%		94.2%	93.2%	
Pharmacy Operational Statistics						
Adjusted commercial network claims				22,795	20,811	
Adjusted PBA claims				53,005	59,347	
Total adjusted claims				75,800	80,158	
Generic dispensing rate				87.5%	86.6%	
Commercial PBM covered lives				2,052	1,793	
Medical pharmacy covered lives				13,993	13,997	
Total states and DC that participate in PBA				27	27	

Current Year Quarter compared to the Prior Year Quarter

Managed care and other revenue

Managed care and other revenue increased by 17.6 percent or \$10.5 million from the Prior Year Quarter to the Current Year Quarter primarily due to increased formulary management revenue of \$7.5 million, increased government pharmacy revenue of \$2.4 million and other net favorable variances of \$0.6 million.

PBM revenue

PBM revenue decreased by 14.1 percent or \$93.6 million from the Prior Year Quarter to the Current Year Quarter. The decrease is primarily due to lower revenue from terminated contracts of \$83.4 million and net decreased membership and utilization of \$40.3 million. These decreases were partially offset by new business of \$25.2 million, and other net favorable variances of \$4.9 million.

Cost of goods sold

Cost of goods sold decreased by 14.5 percent or \$90.0 million from the Prior Year Quarter to the Current Year Quarter. This decrease is primarily due to terminated contracts of \$81.7 million and net decreased membership and utilization of \$35.8 million. These decreases were partially offset by new contracts of \$23.7 million and other unfavorable variances of \$3.8 million. As a percentage of the portion of net revenue that relates to PBM, cost of goods sold decreased from 92.9 percent in the Prior Year Quarter to 92.4 percent in the Current Year Quarter, mainly due to business mix.

Direct service costs and other

Direct service costs increased by 7.2 percent or \$5.4 million from the Prior Year Quarter to the Current Year Quarter primarily due to higher discretionary benefits. Direct service costs increased as a percentage of revenue from 10.3 percent in the Prior Year Quarter to 12.4 percent in the Current Year Quarter primarily due to a net decrease in revenue and an increase in discretionary benefits.

Current Year Period compared to Prior Year Period

Managed care and other revenue

Managed care and other revenue increased by 5.5 percent or \$10.1 million from the Prior Year Period to the Current Year Period primarily due to increased formulary management revenue of \$3.8 million, increased government pharmacy revenue of \$3.1 million, increased medical pharmacy management revenue of \$2.1 million and other net favorable variances of \$1.1 million.

PBM revenue

PBM revenue decreased by 13.5 percent or \$262.1 million from the Prior Year Period to the Current Year Period. The decrease is primarily due to lower revenue from terminated contracts of \$249.7 million and net decreased membership and utilization of \$90.3 million. These decreases were partially offset by new business of \$70.6 million and other net favorable variances of \$7.3 million.

Cost of goods sold

Cost of goods sold decreased by 14.4 percent or \$263.4 million from the Prior Year Period to the Current Year Period. This decrease is primarily due to terminated contracts of \$246.1 million, and net decreased membership and utilization of \$85.6 million. These decreases were partially offset by new contracts of \$66.8 million and other net unfavorable variances of \$1.5 million. As a percentage of the portion of net revenue that relates to PBM, cost of goods sold decreased from 94.2 percent in the Prior Year Period to 93.2 percent in the Current Year Period, mainly due to business mix.

Direct service costs and other

Direct service costs decreased by 7.8 percent or \$17.2 million from the Prior Year Period to the Current Year

[Table of Contents](#)

Period primarily due to higher discretionary benefits and corporate allocations. Direct service costs increased as a percentage of revenue from 10.4 percent in the Prior Year Period to 12.7 percent in the Current Year Period mainly due to a net decrease in revenue and an increase in discretionary benefits.

Corporate Segment

The Corporate segment of the Company is comprised primarily of amounts not allocated to the Healthcare and Pharmacy Management segments, and that are largely associated with costs related to being a publicly traded company.

The following table summarizes, for the periods indicated, operating results for the Corporate segment (in thousands):

Corporate Segment & Eliminations	Three Months Ended		Change	Nine Months Ended		Change
	September 30,			September 30,		
	2018	2019	'18 vs '19	2018	2019	'18 vs '19
Managed care and other revenue	\$ (152)	\$ (118)	(22.4%)	\$ (448)	\$ (434)	(3.1%)
PBM revenue	(48,015)	(47,081)	(1.9%)	(142,110)	(132,953)	(6.4%)
Cost of goods sold	47,318	46,223	(2.3%)	138,098	130,653	(5.4%)
	(849)	(976)	15.0%	(4,460)	(2,734)	(38.7%)
Direct service costs and other	11,958	7,942	(33.6%)	29,424	30,751	4.5%
	(12,807)	(8,918)	(30.4%)	(33,884)	(33,485)	(1.2%)
Stock compensation expense	5,796	940	(83.8%)	15,296	7,971	(47.9%)
Segment Loss	<u>\$ (7,011)</u>	<u>\$ (7,978)</u>	13.8%	<u>\$ (18,588)</u>	<u>\$ (25,514)</u>	37.3%

Current Year Quarter compared to the Prior Year Quarter

The Corporate segment loss increased by 13.8 percent or \$1.0 million from the Prior Year Quarter to the Current Year Quarter primarily due to higher discretionary benefits. As a percentage of revenue, the Corporate segment loss was 0.4 percent in the Prior Year Quarter and in the Current Year Quarter.

Current Year Period compared to the Prior Year Period

The Corporate segment loss increased by 37.3 percent or \$6.9 million from the Prior Year Period to the Current Year Period primarily due to higher discretionary benefits. As a percentage of revenue, the Corporate segment loss increased from 0.3 percent in the Prior Year Period to 0.5 percent in the Current Year Period primarily due to net decreased revenue, mainly from terminated contracts, and higher discretionary benefits.

Inter segment revenues and expenses

Healthcare subcontracts with Pharmacy Management to provide pharmacy benefits management services for certain of Healthcare's customers. In addition, Pharmacy Management provides pharmacy benefits management for the Company's employees covered under its medical plan. As such, revenue, cost of goods sold and direct service costs and other related to these arrangements are eliminated within the Corporate segment.

Non-GAAP Measures

The Company reports its financial results in accordance with GAAP; however, the Company's management also assesses business performance and makes business decisions regarding the Company's operations using certain non-GAAP measures.

In addition to Segment Profit, as defined above, the Company also uses adjusted net income attributable to Magellan ("Adjusted Net Income") and adjusted net income per common share attributable to Magellan on a diluted basis ("Adjusted EPS"). Adjusted Net Income and Adjusted EPS reflect certain adjustments made for acquisitions completed after January 1, 2013 to exclude non-cash stock compensation expense resulting from restricted stock purchases by sellers, changes in the fair value of contingent consideration, amortization of identified acquisition intangibles, as well as impairment of identified acquisition intangibles. The Company believes these non-GAAP measures provide a more useful comparison of the Company's underlying business performance from period to period

[Table of Contents](#)

and are more representative of the earnings capacity of the Company. Non-GAAP financial measures disclosed, such as Segment Profit, Adjusted Net Income and Adjusted EPS, should not be considered a substitute for, or superior to, financial measures determined or calculated in accordance with GAAP.

The following table reconciles income before income taxes to Segment Profit (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2019	2018	2019
Income before income taxes	\$ 40,961	\$ 29,142	\$ 70,713	\$ 51,331
Stock compensation expense	9,320	4,811	27,405	19,832
Changes in fair value of contingent consideration	148	4	451	(2,001)
Depreciation and amortization	33,047	34,157	97,302	98,355
Interest expense	8,990	9,007	26,034	27,255
Interest and other income	(4,139)	(4,970)	(9,978)	(14,965)
Segment Profit	<u>\$ 88,327</u>	<u>\$ 72,151</u>	<u>\$ 211,927</u>	<u>\$ 179,807</u>

The following table reconciles Adjusted Net Income to net income (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2019	2018	2019
Net income	\$ 27,145	\$ 21,274	\$ 52,148	\$ 35,318
Adjusted for acquisitions starting in 2013				
Stock compensation expense	—	—	530	—
Changes in fair value of contingent consideration	148	4	451	(2,001)
Amortization of acquired intangibles	12,079	12,272	36,676	36,817
Tax impact	(3,220)	(3,304)	(9,577)	(9,261)
Adjusted Net Income	<u>\$ 36,152</u>	<u>\$ 30,246</u>	<u>\$ 80,228</u>	<u>\$ 60,873</u>

The following table reconciles Adjusted EPS to net income per common share—diluted:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2019	2018	2019
Net income per common share—diluted	\$ 1.09	\$ 0.86	\$ 2.06	\$ 1.44
Adjusted for acquisitions starting in 2013				
Stock compensation expense	—	—	0.02	—
Changes in fair value of contingent consideration	0.01	—	0.02	(0.08)
Amortization of acquired intangibles	0.48	0.50	1.45	1.51
Tax impact	(0.13)	(0.13)	(0.38)	(0.38)
Adjusted EPS	<u>\$ 1.45</u>	<u>\$ 1.23</u>	<u>\$ 3.17</u>	<u>\$ 2.49</u>

The Company believes these non-GAAP measures provide a useful comparison of the Company's underlying business performance from period to period and are more representative of the earnings capacity of the Company. Non-GAAP financial measures we disclose, such as Segment Profit, Adjusted Net Income and Adjusted EPS, should not be considered a substitute for, or superior to, financial measures determined or calculated in accordance with GAAP.

Outlook—Results of Operations

The Company's Segment Profit and net income are subject to significant fluctuations from period to period. These fluctuations may result from a variety of factors such as those set forth under Item 2—"Forward-Looking Statements" as well as a variety of other factors including: (i) changes in utilization levels by enrolled members of the Company's risk-based contracts, including seasonal utilization patterns; (ii) contractual adjustments and settlements; (iii) retrospective membership adjustments; (iv) timing of implementation of new contracts, enrollment changes and contract terminations; (v) pricing adjustments upon contract renewals (and price competition in general); (vi) the timing

of acquisitions; (vii) changes in estimates regarding medical costs and IBNR; (viii) the timing of recognition of pharmacy revenues, including rebates and Medicare Part D; and (ix) changes in the estimates of contingent consideration.

A portion of the Company's business is subject to rising care costs due to an increase in the number and frequency of covered members seeking healthcare services and higher costs of such services. Many of these factors are beyond the Company's control. Future results of operations will be heavily dependent on management's ability to obtain customer rate increases that are consistent with care cost increases and/or to reduce operating expenses.

Interest Rate Risk. Changes in interest rates affect interest income earned on the Company's cash equivalents and investments, as well as interest expense on the variable interest rate borrowings under the 2017 Credit Agreement. In addition, interest rates on the Notes is subject to adjustment upon the occurrence of certain credit rating events. Based on the amount of cash equivalents and investments, the borrowing levels under the 2017 Credit Agreement and the principal amount of the Notes as of September 30, 2019, a hypothetical 10 percent increase or decrease in the interest rate associated with these instruments, with all other variables held constant, would not materially affect the Company's future earnings and cash outflows.

Historical—Liquidity and Capital Resources

Operating Activities. The Company reported net cash provided by operating activities of \$34.0 million and \$144.4 million for the Prior Year Period and Current Year Period, respectively. The \$110.4 million increase in operating cash flows from the Prior Year Period is mainly attributable to favorable working capital changes and lower tax payments, partially offset by lower segment profit.

The net favorable impact of working capital changes between periods totaled \$113.6 million. For the Prior Year Period, operating cash flows were impacted by net unfavorable working capital changes of \$116.9 million, mainly attributable to an increase in accounts receivables and payment of the HIF fee totaling \$29.9 million. For the Current Year Period, operating cash flows were impacted by net unfavorable working capital changes of \$3.3 million, mainly attributable to timing.

Tax payments for the Current Year Period decreased \$28.3 million from the Prior Year Period. Segment Profit for the Current Period decreased \$32.1 million from the Prior Year Period.

Investing Activities. The Company utilized \$51.2 million and \$44.2 million during the Prior Year Period and the Current Year Period, respectively, for capital expenditures. The additions related to hard assets (equipment, furniture, and leaseholds) and capitalized software for the Prior Year Period were \$19.2 million and \$32.0 million, respectively, as compared to additions for the Current Year Period related to hard assets and capitalized software of \$11.4 million and \$32.8 million, respectively.

During the Prior Year Period the Company used \$52.3 million for the net purchase of "available-for-sale" securities. During the Current Year Period the Company received \$43.4 million for the net maturity of "available-for-sale" securities.

Financing Activities. During the Prior Year Quarter, the Company paid \$65.6 million on debt obligations, \$41.0 million for the repurchase of treasury stock under the Company's share repurchase program, \$9.5 million on capital lease obligations and had other net unfavorable items of \$1.0 million. In addition, the Company received \$22.6 million from the exercise of stock options.

During the Current Year Period, the Company paid \$44.4 million on debt obligations, \$6.2 million for payments on contingent consideration, \$4.1 million for the repurchase of treasury stock under the Company's share repurchase program and \$6.6 million on finance lease obligations. In addition, the Company received \$20.6 million from the exercise of stock options and had other net favorable items of \$1.6 million.

Outlook—Liquidity and Capital Resources

Liquidity. The Company may draw on the 2017 Credit Agreement as required to meet working capital needs associated with the timing of receivables and payables, fund share repurchases or support acquisition activities. The

Company currently expects to have adequate liquidity to satisfy its existing financial commitments over the periods in which they will become due. The Company plans to maintain its current investment strategy of investing in a diversified, high quality, liquid portfolio of investments and continues to closely monitor the financial markets. The Company estimates that it has no risk of any material permanent loss on its investment portfolio; however, there can be no assurance the Company will not experience any such losses in the future.

Stock Repurchases. On October 26, 2015, the Company's board of directors approved a stock repurchase plan which authorized the Company to purchase up to \$200 million of its outstanding common stock through October 26, 2017. On July 26, 2017, the Company's board of directors approved an extension of the 2015 Repurchase Program through October 26, 2018. On May 24, 2018, the Company's board of directors approved an increase of \$200 million to the current \$200 million stock repurchase plan which will now authorize the Company to purchase up to \$400 million of its outstanding common stock. The board also extended the program from October 22, 2018 to October 22, 2020. As of September 30, 2019, the remaining capacity under the 2015 Repurchase Program was \$186.3 million. See Note D—"Commitments and Contingencies" for more information on the Company's share repurchase program.

Off-Balance Sheet Arrangements. As of September 30, 2019, the Company has no material off-balance sheet arrangements.

Credit Agreement. On September 22, 2017, the Company entered into the 2017 Credit Agreement with various lenders that provides for a \$400.0 million senior unsecured revolving credit facility and a \$350.0 million senior unsecured term loan facility to the Company, as the borrower. On August 13, 2018, the Company entered into an amendment to the 2017 Credit Agreement, which extended the maturity date by one year. On February 27, 2019, the Company entered into a second amendment to the 2017 Credit Agreement, which amended the total leverage ratio covenant, and which was necessary in order for the Company to remain in compliance with the terms of the 2017 Credit Agreement. The 2017 Credit Agreement is scheduled to mature on September 22, 2023. See Note A—"General" for more information on the 2017 Credit Agreement.

Restrictive Covenants in Debt Agreements. The 2017 Credit Agreement contains covenants that potentially limit management's discretion in operating the Company's business by, in certain circumstances, restricting or limiting the Company's ability, among other things, to:

- incur or guarantee additional indebtedness or issue preferred or redeemable stock;
- pay dividends and make other distributions;
- repurchase equity interests;
- make certain advances, investments and loans;
- enter into sale and leaseback transactions;
- create liens;
- sell and otherwise dispose of assets;
- acquire or merge or consolidate with another company; and
- enter into some types of transactions with affiliates.

These restrictions could adversely affect the Company's ability to finance future operations or capital needs or engage in other business activities that may be in the Company's interest.

The 2017 Credit Agreement also requires the Company to comply with specified financial ratios and tests. Failure to do so, unless waived by the lenders under the 2017 Credit Agreement pursuant to its terms, or amended, would result in an event of default under the 2017 Credit Agreement. As of September 30, 2019, the Company was in compliance with all covenants, including financial covenants, under the 2017 Credit Agreement.

Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Significant estimates of the Company can include, among other things, valuation of goodwill and intangible assets, medical claims payable, other medical liabilities, stock compensation assumptions, tax contingencies and legal liabilities. In addition, the Company also makes estimates in relation to revenue recognition under ASC 606 which are explained in more detail in Note A—“General – Revenue Recognition.” Actual results could differ from those estimates. Except as noted above, the Company’s critical accounting policies are summarized in the Company’s Annual Report on Form 10-K, filed with the SEC on February 28, 2019.

Forward-Looking Statements

This Form 10-Q includes “forward-looking statements” within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. Although the Company believes that its plans, intentions and expectations as reflected in such forward-looking statements are reasonable, it can give no assurance that such plans, intentions or expectations will be achieved. Prospective investors are cautioned that any such forward-looking statements are not guarantees of future performance and involve risks and uncertainties, and that actual results may differ materially from those contemplated by such forward-looking statements. Important factors currently known to management that could cause actual results to differ materially from those in forward-looking statements include:

- the Company’s inability to renegotiate or extend expiring customer contracts, or the termination of customer contracts;
- the Company’s inability to integrate acquisitions in a timely and effective manner;
- changes in business practices of the industry, including the possibility that certain of the Company’s managed care customers could seek to provide managed healthcare services directly to their subscribers, instead of contracting with the Company for such services, particularly as a result of further consolidation in the managed care industry and especially regarding managed healthcare customers that have already done so with a portion of their membership;
- the impact of changes in the contracting model for Medicaid contracts, including certain changes in the contracting model used by states for managed healthcare services contracts relating to Medicaid lives;
- the Company’s ability to accurately predict and control healthcare costs, and to properly price the Company’s services;
- the Company’s ability to accurately underwrite and control healthcare costs associated with its expansion into clinically integrated management of special populations eligible for Medicaid and Medicare, including individuals with serious mental illness and other unique high-cost populations;
- the Company’s ability to maintain or secure cost-effective healthcare provider contracts;
- the Company’s ability to maintain relationships with key pharmacy providers, vendors and manufacturers;
- fluctuation in quarterly operating results due to seasonal and other factors;
- the Company’s dependence on government spending for managed healthcare, including changes in federal, state and local healthcare policies;
- restrictive covenants in the Company’s debt instruments;

[Table of Contents](#)

- present or future state regulations and contractual requirements that the Company provide financial assurance of its ability to meet its obligations;
- the impact of the competitive environment in the managed healthcare services industry which may limit the Company's ability to maintain or obtain contracts, as well as its ability to maintain or increase its rates;
- the impact of healthcare reform legislation;
- the Mental Health and Substance Abuse Benefit Parity Law and Regulations;
- government regulation;
- proposed changes to current Federal law and regulations;
- noncompliance with regulations;
- the Company's participation in Medicare Part D is subject to government regulation;
- failure to maintain satisfactory Medicare and Medicaid quality performance measures;
- the unauthorized disclosure of sensitive or confidential member or other information;
- a breach or failure in the Company's operational security systems or infrastructure, or those of third parties with which it does business;
- risk associated with outsourcing services and functions to third parties;
- the possible impact of additional regulatory scrutiny and liability associated with the Company's Pharmacy Management segment;
- the inability to realize the value of goodwill and intangible assets;
- pending or future actions or claims for professional liability;
- claims brought against the Company that either exceed the scope of the Company's liability coverage or result in denial of coverage;
- class action suits and other legal proceedings;
- negative publicity;
- the impact of governmental investigations;
- the impact of varying economic and market conditions on the Company's investment portfolio;
- the state of the national economy and adverse changes in economic conditions;
- the Company's ability to successfully implement its margin improvement initiatives and plans;
- tax matters, including changes in corporate tax rates, disagreements with taxing authorities and imposition of new taxes; and
- the impact to contingent consideration as a result of changes in operational forecasts and probabilities of payment.

Further discussion of factors currently known to management that could cause actual results to differ materially from those in forward-looking statements is set forth under the heading “Risk Factors” in Item 1A of Magellan’s Annual Report on Form 10-K for the year ended December 31, 2018. When used in this Quarterly Report on Form 10-Q, the words “estimate,” “anticipate,” “expect,” “believe,” “should,” and similar expressions are intended to be forward-looking statements. Magellan undertakes no obligation to update or revise forward-looking statements to reflect changed assumptions, the occurrence of unanticipated events or changes to future operating results over time, except as required by law.

Item 3. Quantitative and Qualitative Disclosures about Market Risk.

Changes in interest rates affect interest income earned on the Company’s cash equivalents and investments, as well as interest expense on the variable interest rate borrowings under the 2017 Credit Agreement. In addition, interest rates on the Notes is subject to adjustment upon the occurrence of certain credit rating events. Based on the amount of cash equivalents and investments, the borrowing levels under the 2017 Credit Agreement and the principal amount of the Notes as of September 30, 2019, a hypothetical 10 percent increase or decrease in the interest rate associated with these instruments, with all other variables held constant, would not materially affect the Company’s future earnings and cash outflows.

Item 4. Controls and Procedures

a) The Company’s management evaluated, with the participation of the Company’s principal executive and principal financial officers, the effectiveness of the Company’s disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act), as of September 30, 2019. Based on their evaluation, the Company’s principal executive and principal financial officers concluded that the Company’s disclosure controls and procedures were effective as of September 30, 2019.

b) Under the supervision and with the participation of management, including the Company’s principal executive and principal financial officers, the Company has determined that there has been no change in the Company’s internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) that occurred during the Company’s quarter ended September 30, 2019 that has materially affected, or is reasonably likely to materially affect, the Company’s internal control over financial reporting.

PART II—OTHER INFORMATION

Item 1. Legal Proceedings.

The Company’s operating activities entail significant risks of liability. From time to time, the Company is subject to various actions and claims arising from the acts or omissions of its employees, network providers or other parties. In the normal course of business, the Company receives reports relating to deaths and other serious incidents involving patients whose care is being managed by the Company. Such incidents occasionally give rise to malpractice, professional negligence and other related actions and claims against the Company or its network providers. Many of these actions and claims received by the Company seek substantial damages and, therefore, require the Company to incur significant fees and costs related to their defense.

The Company is also subject to or party to certain class actions and other litigation and claims relating to its operations or business practices. In the opinion of management, the Company has recorded reserves that are adequate to cover litigation, claims or assessments that have been or may be asserted against the Company, and for which the outcome is probable and reasonably estimable. Management believes that the resolution of such litigation and claims will not have a material adverse effect on the Company’s financial condition or results of operations; however, there can be no assurance in this regard.

Item 1A. Risk Factors.

There has been no material change in our risk factors as disclosed in Part I—Item 1A—“Risk Factors” of the Company’s Annual Report on Form 10-K for the year ended December 31, 2018, which was filed with the SEC on February 28, 2019.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

The Company’s board of directors has previously authorized a series of stock repurchase plans. Stock repurchases for each such plan could be executed through open market repurchases, privately negotiated transactions, accelerated share repurchases or other means. The board of directors authorized management to execute stock repurchase transactions from time to time and in such amounts and via such methods as management deemed appropriate. Each stock repurchase program could be limited or terminated at any time without prior notice.

On October 26, 2015, the Company’s board of directors approved a stock repurchase plan which authorized the Company to purchase up to \$200 million of its outstanding common stock through October 26, 2017. On July 26, 2017, the Company’s board of directors approved an extension of the 2015 Repurchase Program through October 22, 2018. On May 24, 2018, the Company’s board of directors approved an increase of \$200 million to the current \$200 million stock repurchase plan which will now authorize the Company to purchase up to \$400 million of its outstanding common stock. The board also extended the program from October 22, 2018 to October 22, 2020. The Company made no repurchases during the three months ended September 30, 2019. As of September 30, 2019, the Company had approximately \$186.3 million remaining available for future repurchases under the current plan. The Company made no share repurchases from October 1, 2019 through October 25, 2019.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

None.

Item 5. Other Information.

None.

Item 6. Exhibits.

See Exhibit Index.

Exhibit Index

<u>Exhibit Number</u>	<u>Description of Exhibit</u>
*10.1	Letter Agreement dated August 26, 2019 between the Company and Barry M. Smith.
*10.2	Restricted Stock Award Agreement dated August 26, 2019 between the Company and Steven J. Shulman.
*10.3	Employment Agreement, dated October 31, 2019, between the Company and Kenneth Fasola, which was filed as Exhibit 10.1 to the Company's current report on Form 8-K, which was filed on October 31, 2019 and is incorporated herein by reference.
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished).
32.2	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished).
101	The following materials from the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2019 formatted in Inline Extensible Business Reporting Language (iXBRL): (i) the cover page, (ii) the Consolidated Statements of Comprehensive Income, (iii) the Consolidated Balance Sheets, (iv) the Consolidated Statements of Changes in Stockholders' Equity, (v) the Consolidated Statements of Cash Flows and (vi) related notes.
104	Cover Page Interactive Data File – The cover page interactive data file does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document.
	<hr/> <p>* Constitutes a management contract, compensatory plan or arrangement.</p>

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: November 1, 2019

Magellan Health, Inc.
(Registrant)

By: /s/ Jonathan N. Rubin
 Jonathan N. Rubin
 Chief Financial Officer
 (Principal Financial Officer and Duly Authorized Officer)



August 23, 2019

Barry M. Smith
6508 N. Desert Fairway Drive
Paradise Valley, AZ 85253

Dear Barry:

As an acknowledgement of your contributions to Magellan and willingness to facilitate the successful transition of your role, this letter is to extend to you the opportunity to participate in the Magellan Health, Inc. (the “Company”) 2019 Incentive Compensation Plan (the “ICP”) if your employment terminates prior to the payment of bonuses pursuant to the ICP to other employees of the Company. To be eligible for an award under the ICP, you must remain employed with the Company until a new Chief Executive Officer is appointed by the Board of Directors of the Company (the “Termination Date”) and subject to the terms and conditions outlined below.

- **Good Standing** – You must remain in good standing with the Company through the Termination Date, as determined at the discretion of the Board of Directors of the Company.
- **Award Calculation** – Your ICP award will be calculated based on the terms of the 2019 ICP Plan, including performance against the Plan’s predefined metrics. If your Termination Date is prior to January 1, 2020, your award will be pro-rated for the days you were employed during 2019.
- **Payment and Withholding** – If you are eligible to receive an award, you will receive payment in a lump sum less withholdings for applicable federal and state taxes and any appropriate payroll deductions at the same time as all participants in the ICP regardless of your Termination Date.

If you are in agreement with these terms and conditions, please sign below.

Sincerely,

/s/ G. Scott MacKenzie

/s/ Barry M. Smith
Barry M. Smith

August 23, 2019
Date

Exhibit 10.2

MAGELLAN HEALTH, INC.
2016 MANAGEMENT INCENTIVE PLAN
RESTRICTED STOCK AWARD AGREEMENT

As of August 26, 2019

SECTION 1. GRANT OF RESTRICTED SHARES.

(a) **GRANT.** On the terms and conditions set forth in this Agreement, effective as of the date hereof (the “DATE OF GRANT”), Magellan Health, Inc. (the “COMPANY” as further defined below) grants to the Grantee referred to on the signature page hereof (i) 21,753 shares (the “RESTRICTED SHARES”) of Ordinary Common Stock, \$ 0.01 par value per share, of the Company (“ORDINARY COMMON STOCK”). Certificates representing the Restricted Shares shall be issued to Grantee with a restrictive legend prohibiting transfer until they become vested as provided herein and in the Plan; the certificates representing the Restricted Shares may also be legended as may be required to comply with subsection 3(c) below.

(b) **2016 MANAGEMENT INCENTIVE PLAN DEFINED TERMS.** The Restricted Shares are granted under and subject to the terms of the Company’s 2016 Management Incentive Plan, as amended and supplemented from time to time (the “PLAN”), which is incorporated herein by this reference. Certain capitalized terms used herein are defined in Section 9 below but terms used herein, if not defined herein, shall have the same meaning for purposes hereof as provided by the Plan.

SECTION 2. FORFEITURE OF RESTRICTED SHARES.

(a) **FORFEITURE OF UNVESTED RESTRICTED SHARES.** The Restricted Shares shall not be Transferable until vested in accordance with subsection 2(b), except as provided by subsection 3(b), and shall be forfeited, and returned by Grantee, in accordance with the Plan upon termination of Grantee’s Service unless earlier vested in accordance with subsection 2(b).

(b) **VESTING.** The Restricted Shares shall vest on August 26, 2020 provided that the Grantee’s Service has not terminated prior to such date. Notwithstanding the preceding sentence, the Restricted Shares shall earlier vest immediately upon the first to occur of (i) a Change of Control of the Company or (ii) Grantee’s death or Disability.

(c) **LAPSE OF RESTRICTIONS ON RESTRICTED SHARES.** Subject to subsections 3(c) below, upon the vesting of the Restricted Shares, the Grantee shall be free to dispose of the Restricted Shares in any manner and at any time without restriction.

SECTION 3. TRANSFER OF RESTRICTED SHARES.

(a) **TRANSFERS GENERALLY PROHIBITED.** Except as otherwise provided in subsection 3(b) below, until vested in accordance with Section 2, the Restricted Shares shall not be sold or otherwise Transferred, provided that, even though vested, any sale or other Transfer of Restricted Shares shall be subject to subsections 3(c) below.

(b) CERTAIN TRANSFERS PERMITTED. Notwithstanding the foregoing provisions of this Section 3, the Restricted Shares, even though not vested, may be Transferred in the event of the Grantee's death, by will or the laws of descent and distribution or by a written beneficiary designation accepted by the Company upon authorization of the Board of Directors, and as otherwise permitted under the Plan; provided, however, that in any such case the Restricted Shares so Transferred shall remain subject in the hands of the transferee to the restrictions on Transfer provided hereby and all other terms hereof.

(c) FIDUCIARY AND SECURITIES LAW RESTRICTIONS. As a director of the Company, Grantee may be subject to restrictions on his or her ability to sell or otherwise Transfer Restricted Shares by reason of being a fiduciary for the Company or by reason of federal or state securities laws and/or the policies regarding transactions in securities of the Company from time to time adopted by the Company and applicable to Grantee in connection therewith. Nothing contained herein shall relieve Grantee of any restriction on sale or other Transfer of Restricted Shares provided thereby and any other restrictions on sale or other Transfer of Restricted Shares provided herein (including in the Plan) shall be in addition to and not in lieu of any other restrictions provided thereby.

(d) MODIFICATIONS TO COMPLY WITH SECTION 409A. To the extent applicable, this Agreement shall be interpreted in accordance with Section 409A of Code and Department of Treasury regulations and other interpretive guidance issued thereunder, including without limitation any such regulations or guidance that may be issued after the Date of Grant. Notwithstanding any provision of the Agreement to the contrary, in the event that the Board of Directors or an authorized officer of the Company determines that any amounts will be immediately taxable to Grantee under Section 409A of the Code and related Department of Treasury guidance (or subject the Grantee to a penalty tax) in connection with the grant or vesting of the Restricted Shares or any other provision of this Agreement or the Plan, the Company may (a) adopt such amendments to this agreement, including amendments to this Agreement (having prospective or retroactive effect), that the Board of Directors or authorized officer determines necessary to comply with the requirements of Section 409A of the Code and/or (b) take such other actions as the Board of Directors or authorized officer determines to be necessary or appropriate to comply with the requirements of Section 409A of the Code and related Department of Treasury guidance, including such Department of Treasury guidance and other interpretive materials as may be issued after the Date of Grant.

SECTION 4. MISCELLANEOUS PROVISIONS.

(a) NOTIFICATION. Any notification required by the terms of this Agreement shall be given in writing and shall be deemed effective upon personal delivery to the President, Treasurer, General Counsel, Secretary or any Assistant Secretary of the Company or five Business Days upon deposit with the United States Postal Service, by registered or certified mail, with postage and fees prepaid addressed to the Company. A notice shall be addressed to the Company at its principal executive office, marked to the attention of the Corporate Secretary, and to the Grantee at the address that he or she most recently provided to the Company.

(b) ENTIRE AGREEMENT. This Agreement and the Plan constitute the entire contract between the parties hereto with regard to the subject matter hereof and supersede any other agreements, representations or understandings (whether oral or written and whether express or implied) which relate to the subject matter hereof.

(c) WAIVER. No waiver of any breach or condition of this Agreement shall be deemed to be a waiver of any other or subsequent breach or condition whether of like or different nature.

(d) SUCCESSORS AND ASSIGNS. The provisions of this Agreement shall inure to the benefit of, and be binding upon, the Company and its successors and assigns and upon the Grantee, the Grantee's personal representatives, heirs, legatees and other permitted transferees, whether or not any such person shall have become a party to this Agreement and have agreed in writing to be joined herein and be bound by the terms hereof.

(e) CHOICE OF LAW. This Agreement shall be governed by, and construed in accordance with, the laws of the State of Delaware, as such laws are applied to contracts entered into and performed in such State.

SECTION 5. DEFINITIONS.

- (a) "AGREEMENT" shall mean this Restricted Stock Award Agreement.
- (b) "BOARD OF DIRECTORS" shall mean the Board of Directors of the Company, as constituted from time to time.
- (c) "CODE" shall mean the Internal Revenue Code of 1986, as amended and as the same may be amended from time to time, and the regulations promulgated thereunder.
- (d) "CHANGE IN CONTROL" shall mean:
 - (i) any "person," as such term is used in Sections 3(a)(9) and 13(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), becomes a "beneficial owner," as such term is used in Rule 13d-3 promulgated under the Exchange Act, of 50% or more of the Voting Stock (as defined below) of the Company;
 - (ii) the majority of the Board of Directors of the Company consists of individuals other than "Continuing Directors," which shall mean the members of the Board on the date hereof;
 - (iii) the Board of Directors of the Company adopts and, if required by law or the certificate of incorporation of the Corporation, the shareholders approve the dissolution of the Company or a plan of liquidation or comparable plan providing for the disposition of all or substantially all of the Company's assets;
 - (iv) all or substantially all of the assets of the Company are disposed of pursuant to a merger, consolidation, share exchange, reorganization or other transaction unless the shareholders of the Company immediately prior to such merger, consolidation, share exchange, reorganization or other transaction beneficially own, directly or indirectly, in substantially the same proportion as they previously owned the Voting Stock or other ownership interests of the Company, a majority of the Voting Stock or other ownership interests of the entity or entities, if any, that succeed to

the business of the Company; or

- (v) the Company merges or combines with another company and, immediately after the merger or combination, the shareholders of the Company immediately prior to the merger or combination own, directly or indirectly, 50% or less of the Voting Stock of the successor company, provided that in making such determination there shall be excluded from the number of shares of Voting Stock held by such shareholders, but not from the Voting Stock of the successor company, any shares owned by Affiliates of such other company who were not also Affiliates of the Company prior to such merger or combination.
- (e) "COMPANY" shall mean Magellan Health, Inc. a Delaware Corporation, and any successor thereto.
- (f) "DATE OF GRANT" shall mean August 26, 2019.
- (g) "DISABILITY" shall have the meaning ascribed thereto in the Plan.
- (h) "EXCHANGE ACT" shall mean the Securities Exchange Act of 1934, as amended and as the same may be amended from time to time and any successor statute, and the rules and regulations promulgated thereunder.
- (i) "GRANTEE" shall mean Steven J. Shulman.
- (j) "PARENT" shall mean a "parent corporation" as defined in Section 424(e) of the Code.
- (k) "PLAN" shall mean the MAGELLAN HEALTH, INC. 2016 Management Incentive Plan.
- (l) "SECURITIES ACT" shall mean the Securities Act of 1933, as amended and as the same may be amended from time to time, and any successor statute, and the rules and regulations promulgated thereunder.
- (m) "SERVICE" shall mean service as a director of the Company.
- (n) "SHARE" shall mean a share of Ordinary Common Stock of the Company, as the same may generally be exchanged for or changed into any other share of capital stock or other security of the Company.
- (o) "SUBSIDIARY" shall mean a "subsidiary corporation" as defined in Section 424(f) of the Code.
- (p) "TRANSFER" shall mean, with respect to the Restricted Shares, any sale, assignment, transfer, alienation, conveyance, gift, bequest by will or under intestacy laws, pledge, lien encumbrance or other disposition, with or without consideration, of all or part of such share, or of any beneficial interest therein, now or hereafter owned by the Grantee, including by execution, attachment, levy or similar process.

In consideration of the foregoing and intending to be legally bound hereby, the Company and the Grantee named below have executed this Agreement as of the date first above written.

MAGELLAN HEALTH, INC.

By: /s/ G. Scott MacKenzie

Name: G. Scott MacKenzie

Title: Chairman, Compensation Committee

GRANTEE:

/s/ Steven J. Shulman

Steven J. Shulman

5

Exhibit 31.1

CERTIFICATIONS

I, Barry M. Smith, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Magellan Health, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Barry M. Smith

Barry M. Smith

Chief Executive Officer

CERTIFICATIONS

I, Jonathan N. Rubin, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Magellan Health, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Jonathan N. Rubin
Jonathan N. Rubin
Chief Financial Officer

Date: November 1, 2019

**Certification Required by Rule 13a-14(b) and 18 U.S.C. Section 1350
(as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002)**

I, Barry M. Smith, as Chief Executive Officer of Magellan Health, Inc. (the "Company"), certify, pursuant to 18 U.S.C. Section 1350 (as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002), that to my knowledge:

- (1) the accompanying Quarterly Report on Form 10-Q of the Company for the quarterly period ended September 30, 2019 (the "Report"), fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Barry M. Smith
Barry M. Smith
Chief Executive Officer

Date: November 1, 2019

Exhibit 32.2

**Certification Required by Rule 13a-14(b) and 18 U.S.C. Section 1350
(as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002)**

I, Jonathan N. Rubin, as Chief Financial Officer of Magellan Health, Inc. (the "Company"), certify, pursuant to 18 U.S.C. Section 1350 (as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002), that to my knowledge:

- (1) the accompanying Quarterly Report on Form 10-Q of the Company for the quarterly period ended September 30, 2019 (the "Report"), fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Jonathan N. Rubin
Jonathan N. Rubin
Chief Financial Officer

Date: November 1, 2019
