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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**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 June 30, 2018**

**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)

**4800 N. Scottsdale Rd, Suite 4400  
Scottsdale, Arizona**

(Address of principal executive offices)

**58-1076937**

(IRS Employer  
Identification No.)

**85251**

(Zip code)

**(602) 572-6050**

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 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 and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See definition 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

(Do not check if a  
smaller reporting company)

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 the registrant's Ordinary Common Stock outstanding as of June 30, 2018 was 24,555,149.

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**FORM 10-Q**  
**MAGELLAN HEALTH, INC. AND SUBSIDIARIES**  
**INDEX**

	<b>Page No.</b>
	<b><u>PART I — Financial Information:</u></b>
<a href="#">Item 1:</a>	<a href="#">Financial Statements</a> 2
	<a href="#">Consolidated Balance Sheets—December 31, 2017 and June 30, 2018</a> 2
	<a href="#">Consolidated Statements of Income—For the Three and Six Months Ended June 30, 2017 and 2018</a> 3
	<a href="#">Consolidated Statements of Comprehensive Income—For the Three and Six Months Ended June 30, 2017 and 2018</a> 4
	<a href="#">Consolidated Statements of Cash Flows—For the Six Months Ended June 30, 2017 and 2018</a> 5
	<a href="#">Notes to Consolidated Financial Statements</a> 6
<a href="#">Item 2:</a>	<a href="#">Management’s Discussion and Analysis of Financial Condition and Results of Operations</a> 29
<a href="#">Item 3:</a>	<a href="#">Quantitative and Qualitative Disclosures about Market Risk</a> 41
<a href="#">Item 4:</a>	<a href="#">Controls and Procedures</a> 42
	<b><u>PART II — Other Information:</u></b>
<a href="#">Item 1:</a>	<a href="#">Legal Proceedings</a> 43
<a href="#">Item 1A:</a>	<a href="#">Risk Factors</a> 43
<a href="#">Item 2:</a>	<a href="#">Unregistered Sales of Equity Securities and Use of Proceeds</a> 43
<a href="#">Item 3:</a>	<a href="#">Defaults Upon Senior Securities</a> 44
<a href="#">Item 4:</a>	<a href="#">Mine Safety Disclosures</a> 44
<a href="#">Item 5:</a>	<a href="#">Other Information</a> 44
<a href="#">Item 6:</a>	<a href="#">Exhibits</a> 44
<a href="#">Exhibit Index</a>	45
<a href="#">Signatures</a>	46

**PART I—FINANCIAL INFORMATION**

**Item 1. Financial Statements.**

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

	<b>December 31, 2017</b>	<b>June 30, 2018 (Unaudited)</b>
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents (\$229,013 and \$73,494 restricted at December 31, 2017 and June 30, 2018, respectively)	\$ 398,732	\$ 246,109
Accounts receivable, net	660,775	839,773
Short-term investments (\$219,111 and \$341,007 restricted at December 31, 2017 and June 30, 2018, respectively)	310,578	412,770
Pharmaceutical inventory	40,945	50,333
Other current assets (\$41,121 and \$47,949 restricted at December 31, 2017 and June 30, 2018, respectively)	72,323	119,164
<b>Total Current Assets</b>	<b>1,483,353</b>	<b>1,668,149</b>
Property and equipment, net	158,638	160,702
Long-term investments (\$17,287 and \$20,478 restricted at December 31, 2017 and June 30, 2018, respectively)	17,287	20,478
Deferred income taxes	813	1,554
Other long-term assets	22,567	30,909
Goodwill	1,006,288	1,014,321
Other intangible assets, net	268,288	243,646
<b>Total Assets</b>	<b>\$ 2,957,234</b>	<b>\$ 3,139,759</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current Liabilities:		
Accounts payable	\$ 74,300	\$ 76,458
Accrued liabilities	193,635	268,258
Short-term contingent consideration	6,892	7,062
Medical claims payable	327,625	397,550
Other medical liabilities	177,002	183,222
Current debt and capital lease obligations	112,849	90,546
<b>Total Current Liabilities</b>	<b>892,303</b>	<b>1,023,096</b>
Long-term debt and capital lease obligations	740,888	734,503
Deferred income taxes	12,298	10,928
Tax contingencies	14,226	15,058
Long-term contingent consideration	1,925	2,058
Deferred credits and other long-term liabilities	19,100	35,346
<b>Total Liabilities</b>	<b>1,680,740</b>	<b>1,820,989</b>
Preferred stock, par value \$.01 per share		
Authorized—10,000 shares at December 31, 2017 and June 30, 2018-Issued and outstanding-none	—	—
Ordinary common stock, par value \$.01 per share		
Authorized—100,000 shares at December 31, 2017 and June 30, 2018-Issued and outstanding-52,973 and 24,202 shares at December 31, 2017, respectively, and 53,475 and 24,555 shares at June 30, 2018, respectively	530	535
Other Stockholders' Equity:		
Additional paid-in capital	1,274,811	1,311,316
Retained earnings	1,399,495	1,420,271
Accumulated other comprehensive loss	(380)	(567)
Treasury stock, at cost, 28,771 and 28,920 shares at December 31, 2017 and June 30, 2018, respectively	(1,397,962)	(1,412,785)
<b>Total Stockholders' Equity</b>	<b>1,276,494</b>	<b>1,318,770</b>
<b>Total Liabilities and Stockholders' Equity</b>	<b>\$ 2,957,234</b>	<b>\$ 3,139,759</b>

See accompanying notes to consolidated financial statements.

**MAGELLAN HEALTH, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF INCOME****(Unaudited)****(In thousands, except per share amounts)**

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2018	2017	2018
Net revenue:				
Managed care and other	\$ 821,699	\$ 1,215,340	\$ 1,551,039	\$ 2,435,103
PBM	597,440	595,583	1,173,723	1,180,897
Total net revenue	1,419,139	1,810,923	2,724,762	3,616,000
Costs and expenses:				
Cost of care	583,264	935,814	1,065,318	1,864,475
Cost of goods sold	562,355	558,419	1,104,988	1,118,084
Direct service costs and other operating expenses (1)(2)	231,372	259,152	452,858	528,229
Depreciation and amortization	27,731	33,848	54,707	64,255
Interest expense	4,900	8,678	9,048	17,044
Interest and other income	(1,071)	(3,363)	(2,020)	(5,839)
Total costs and expenses	1,408,551	1,792,548	2,684,899	3,586,248
Income before income taxes	10,588	18,375	39,863	29,752
Provision for income taxes	5,661	4,824	17,467	4,749
Net income	4,927	13,551	22,396	25,003
Less: net loss attributable to non-controlling interest	(573)	—	(851)	—
Net income attributable to Magellan	\$ 5,500	\$ 13,551	\$ 23,247	\$ 25,003
Net income attributable to Magellan per common share:				
Basic (See Note B)	\$ 0.24	\$ 0.55	\$ 1.01	\$ 1.02
Diluted (See Note B)	\$ 0.23	\$ 0.53	\$ 0.97	\$ 0.98

(1) Includes stock compensation expense of \$11,371 and \$10,439 for the three months ended June 30, 2017 and 2018, respectively, and \$21,511 and \$18,085 for the six months ended June 30, 2017 and 2018, respectively.

(2) Includes changes in fair value of contingent consideration of \$252 and \$70 for the three months ended June 30, 2017 and 2018, respectively, and \$203 and \$303 for the six months ended June 30, 2017 and 2018, respectively.

See accompanying notes to consolidated financial statements.

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

(Unaudited)

(In thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2018	2017	2018
Net income	\$ 4,927	\$ 13,551	\$ 22,396	\$ 25,003
Other comprehensive income:				
Unrealized gain (loss) on available-for-sale securities (1)	22	132	1	(187)
Comprehensive income	4,949	13,683	22,397	24,816
Less: comprehensive loss attributable to non-controlling interest	(573)	—	(851)	—
Comprehensive income attributable to Magellan	<u>\$ 5,522</u>	<u>\$ 13,683</u>	<u>\$ 23,248</u>	<u>\$ 24,816</u>

(1) Net of income tax provision (benefit) of \$14 and \$42 for the three months ended June 30, 2017 and 2018, respectively, and \$2 and \$(59) for the six months ended June 30, 2017 and 2018, respectively.

See accompanying notes to consolidated financial statements.

**MAGELLAN HEALTH, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**FOR THE SIX MONTHS ENDED JUNE 30,**  
**(Unaudited)**  
**(In thousands)**

	<u>2017</u>	<u>2018</u>
<b>Cash flows from operating activities:</b>		
Net income	\$ 22,396	\$ 25,003
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	54,707	64,255
Non-cash interest expense	578	614
Non-cash stock compensation expense	21,511	18,085
Non-cash income tax benefit	(1,520)	(100)
Non-cash amortization on investments	2,094	1,171
Changes in assets and liabilities, net of effects from acquisitions of businesses:		
Accounts receivable, net	(21,859)	(179,350)
Pharmaceutical inventory	(1,188)	(9,388)
Other assets	(21,974)	(57,398)
Accounts payable and accrued liabilities	(59,372)	50,322
Medical claims payable and other medical liabilities	5,978	89,932
Contingent consideration	203	303
Tax contingencies	764	721
Deferred credits and other long-term liabilities	1,882	16,884
Other	(364)	69
Net cash provided by operating activities	<u>3,836</u>	<u>21,123</u>
<b>Cash flows from investing activities:</b>		
Capital expenditures	(26,797)	(37,132)
Acquisitions and investments in businesses, net of cash acquired	(3,200)	—
Purchase of investments	(238,814)	(334,250)
Maturity of investments	233,143	227,446
Net cash used in investing activities	<u>(35,668)</u>	<u>(143,936)</u>
<b>Cash flows from financing activities:</b>		
Proceeds from issuance of debt	200,000	—
Payments to acquire treasury stock	(5,000)	(14,323)
Proceeds from exercise of stock options	5,946	21,476
Payments on debt and capital lease obligations	(190,978)	(33,912)
Other	(1,311)	(3,051)
Net cash provided by (used in) financing activities	<u>8,657</u>	<u>(29,810)</u>
Net decrease in cash and cash equivalents	(23,175)	(152,623)
Cash and cash equivalents at beginning of period	304,508	398,732
Cash and cash equivalents at end of period	<u>\$ 281,333</u>	<u>\$ 246,109</u>
<b>Supplemental cash flow data:</b>		
Non-cash investing activities:		
Property and equipment acquired under capital leases	<u>\$ 2,418</u>	<u>\$ 4,623</u>

See accompanying notes to consolidated financial statements.

**MAGELLAN HEALTH, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**June 30, 2018**  
**(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 six months ended June 30, 2018 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, 2017 and the notes thereto, which are included in the Company’s Annual Report on Form 10-K filed with the SEC on March 1, 2018.

***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 – Commercial and Government.

The Commercial reporting unit’s customers include health plans, accountable care organizations (“ACOs”), and employers 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 are applied to a health plan’s or ACO’s entire book of business including commercial, Medicaid and Medicare members or targeted complex populations.

The Government reporting unit contracts with local, state and federal governmental agencies to provide services to recipients under Medicaid, Medicare and other government programs. For certain contracts, the management of total medical cost, as well as long term support services, for special populations is delivered through Magellan Complete Care (“MCC”). These special populations include individuals with serious mental illness (“SMT”), dual eligibles, aged, blind and disabled (“ABD”) and other populations with unique and often complex healthcare needs. In addition, the Company’s management services include behavioral health and EAP.

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. 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.

**MAGELLAN HEALTH, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**June 30, 2018**  
**(Unaudited)**

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 per member per month 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.

***Summary of Significant Accounting Policies***

***Recent Accounting Pronouncements***

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2014-09, “Revenue from Contracts with Customers (Topic 606)” (“ASU 2014-09”). The FASB also issued various ASUs which subsequently amended ASU 2014-09. These amendments and ASU 2014-09, collectively known as Accounting Standard Codification 606 (“ASC 606”), were adopted on a modified retrospective basis in the quarter ended March 31, 2018. The Company applied the standard to contracts not completed at the date of initial application. The Company recognized the cumulative effect of initially applying the new revenue standard as an adjustment to the opening balance of retained earnings. The comparative information has not been restated and continues to be reported under the accounting standards in effect for those periods. For contracts that were modified before January 1, 2018 the Company has not retrospectively restated the contracts for those modifications in accordance with the contract modification guidance, instead the Company reflected the aggregate effect of those modifications when identifying the satisfied and unsatisfied performance obligations, determining the transaction price and allocating the transaction price to the satisfied and unsatisfied performance obligation. Given the nature of our arrangements, the Company does not believe the use of this practical expedient had a significant impact on the results of our adoption.

A majority of our managed care revenue continues to be recognized over the applicable coverage period on a per member basis for covered members. In addition, a majority of the PBM revenue continues to be recognized as the claims are adjudicated or when the drugs are dispensed. The main impacts of ASC 606 to the Company’s business relate to the timing of revenue recognition in relation to upfront fees in certain PBA contracts, as well as performance



**MAGELLAN HEALTH, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**June 30, 2018**  
**(Unaudited)**

incentive, performance guarantee and risk share arrangements. Some of the Company's PBA contracts contain upfront fees, which under ASC 605 were amortized over the life of the contract. Under ASC 606, these upfront fees constitute a material right and are amortized over the anticipated life of the customer. Certain contracts include performance incentive, performance guarantee and risk share arrangements, which under ASC 605 were recorded based on calculations using the current period's data. Under ASC 606, the revenues are recognized on a probability weighted approach based on anticipated outcomes for the performance period. In addition, under ASC 606 the accounting for material rights in relation to some of the Company's government contracts will impact the consolidated balance sheets for interim reporting periods.

The cumulative effect of changes made to our consolidated January 1, 2018 balance sheet for the adoption of ASU 2014-09 were as follows (in thousands):

	Balance at December 31, 2017	Adjustments Due to ASC 606	Balance at January 1, 2018
<b>Assets</b>			
Other current assets	\$ 72,323	\$ (667)	\$ 71,656
Total Current Assets	1,483,353	(667)	1,482,686
Deferred income taxes	813	1,335	2,148
Other long-term assets	22,567	(1,333)	21,234
Total Assets	2,957,234	(665)	2,956,569
<b>Liabilities and Stockholders' Equity</b>			
Accrued liabilities	193,635	(2,182)	191,453
Total Current Liabilities	892,303	(2,182)	890,121
Deferred credits and other long-term liabilities	19,100	5,744	24,844
Total Liabilities	1,680,740	3,562	1,684,302
Retained earnings	1,399,495	(4,227)	1,395,268
Total Stockholders' Equity	1,276,494	(4,227)	1,272,267
Total Liabilities and Stockholders' Equity	2,957,234	(665)	2,956,569

The impact of the adoption of ASC 606 on our consolidated balance sheet as of June 30, 2018 was as follows (in thousands):

	As Reported	Adjustments	Balance Without ASC 606 Adoption
<b>Assets</b>			
Accounts receivable	\$ 839,773	\$ (17,972)	\$ 821,801
Other current assets	119,164	(445)	118,719
Total Current Assets	1,668,149	(18,417)	1,649,732
Other long-term assets	30,909	9,199	40,108
Total Assets	3,139,759	(9,218)	3,130,541
<b>Liabilities and Stockholders' Equity</b>			
Accrued liabilities	268,258	(11,127)	257,131
Other medical liabilities	183,222	50	183,272
Total Current Liabilities	1,023,096	(11,077)	1,012,019
Deferred credits and other long-term liabilities	35,346	(6,835)	28,511
Total Liabilities	1,820,989	(17,912)	1,803,077
Retained earnings	1,420,271	8,694	1,428,965
Total Stockholders' Equity	1,318,770	8,694	1,327,464
Total Liabilities and Stockholders' Equity	3,139,759	(9,218)	3,130,541

**MAGELLAN HEALTH, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**June 30, 2018**  
**(Unaudited)**

The impact of the adoption of ASC 606 on our consolidated income statement for the three months ended June 30, 2018 was as follows (in thousands):

	<b>As Reported</b>	<b>Adjustments</b>	<b>Balance Without ASC 606 Adoption</b>
Managed care and other	\$ 1,215,340	\$ (1,203)	\$ 1,214,137
PBM	595,583	1,749	597,332
Total net revenue	1,810,923	546	1,811,469
Income before income taxes	18,375	546	18,921
Provision for income taxes	4,824	143	4,967
Net income	13,551	403	13,954
Net income attributable to Magellan	13,551	403	13,954

The impact of the adoption of ASC 606 on our consolidated income statement for the six months ended June 30, 2018 was as follows (in thousands):

	<b>As Reported</b>	<b>Adjustments</b>	<b>Balance Without ASC 606 Adoption</b>
Managed care and other	\$ 2,435,103	\$ (3,955)	\$ 2,431,148
PBM	1,180,897	8,199	1,189,096
Total net revenue	3,616,000	4,244	3,620,244
Income before income taxes	29,752	4,244	33,996
Provision for income taxes	4,749	1,112	5,861
Net income	25,003	3,132	28,135
Net income attributable to Magellan	25,003	3,132	28,135

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. This guidance is effective for annual and interim reporting periods of public entities beginning after December 15, 2018, with early adoption permitted. The Company is currently assessing the impact this ASU, but believes the effect of this ASU will have a material effect on the Company's consolidated balance sheets.

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.

#### *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 include, among other things, accounts receivable realization, valuation allowances for deferred tax assets, valuation of goodwill and

**MAGELLAN HEALTH, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**June 30, 2018**  
**(Unaudited)**

intangible assets, medical claims payable, other medical liabilities, contingent consideration, stock compensation assumptions, tax contingencies and legal liabilities. In addition, the Company makes significant 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.

*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 six months ended June 30, 2018 by major service line, type of customer and timing of revenue recognition (in thousands):

	<b>Three Months Ended June 30, 2018</b>			
	<b>Healthcare</b>	<b>Pharmacy Management</b>	<b>Elimination</b>	<b>Total</b>
<b>Major Service Lines</b>				
<b>Commercial</b>				
Risk-based, non-EAP	\$ 238,272	\$ —	\$ (114)	\$ 238,158
EAP risk-based	12,335	—	—	12,335
ASO	51,111	8,529	(37)	59,603
<b>Government</b>				
Risk-based, non-EAP	750,162	—	—	750,162
EAP risk-based	78,940	—	—	78,940
ASO	24,068	—	—	24,068
PBM, including dispensing	—	536,131	(47,211)	488,920
Medicare Part D	—	106,663	—	106,663
PBA	—	33,088	—	33,088
Formulary management	—	18,348	—	18,348
Other	—	638	—	638
<b>Total net revenue</b>	<b>\$ 1,154,888</b>	<b>\$ 703,397</b>	<b>\$ (47,362)</b>	<b>\$ 1,810,923</b>
<b>Type of Customer</b>				
Government	\$ 853,170	\$ 229,948	\$ —	\$ 1,083,118
Non-government	301,718	473,449	(47,362)	727,805
<b>Total net revenue</b>	<b>\$ 1,154,888</b>	<b>\$ 703,397</b>	<b>\$ (47,362)</b>	<b>\$ 1,810,923</b>
<b>Timing of Revenue Recognition</b>				
Transferred at a point in time	\$ —	\$ 642,794	\$ (47,211)	\$ 595,583
Transferred over time	1,154,888	60,603	(151)	1,215,340
<b>Total net revenue</b>	<b>\$ 1,154,888</b>	<b>\$ 703,397</b>	<b>\$ (47,362)</b>	<b>\$ 1,810,923</b>

**MAGELLAN HEALTH, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**June 30, 2018**  
**(Unaudited)**

	Six Months Ended June 30, 2018			
	Healthcare	Pharmacy Management	Elimination	Total
<b>Major Service Lines</b>				
<b>Commercial</b>				
Risk-based, non-EAP	\$ 472,663	\$ —	\$ (114)	\$ 472,549
EAP risk-based	24,756	—	—	24,756
ASO	103,680	15,829	(182)	119,327
<b>Government</b>				
Risk-based, non-EAP	1,502,652	—	—	1,502,652
EAP risk-based	161,177	—	—	161,177
ASO	47,561	—	—	47,561
PBM, including dispensing	—	1,069,923	(94,095)	975,828
Medicare Part D	—	205,069	—	205,069
PBA	—	66,634	—	66,634
Formulary management	—	38,725	—	38,725
Other	—	1,722	—	1,722
<b>Total net revenue</b>	<b>\$ 2,312,489</b>	<b>\$ 1,397,902</b>	<b>\$ (94,391)</b>	<b>\$ 3,616,000</b>
<b>Type of Customer</b>				
Government	\$ 1,711,390	\$ 457,997	\$ —	\$ 2,169,387
Non-government	601,099	939,905	(94,391)	1,446,613
<b>Total net revenue</b>	<b>\$ 2,312,489</b>	<b>\$ 1,397,902</b>	<b>\$ (94,391)</b>	<b>\$ 3,616,000</b>
<b>Timing of Revenue Recognition</b>				
Transferred at a point in time	\$ —	\$ 1,274,992	\$ (94,095)	\$ 1,180,897
Transferred over time	2,312,489	122,910	(296)	2,435,103
<b>Total net revenue</b>	<b>\$ 2,312,489</b>	<b>\$ 1,397,902</b>	<b>\$ (94,391)</b>	<b>\$ 3,616,000</b>

*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 per member per month 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.

*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 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

**MAGELLAN HEALTH, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**June 30, 2018**  
**(Unaudited)**

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 the Centers for Medicare and Medicaid ("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 31<sup>st</sup>, 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 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.

**MAGELLAN HEALTH, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**June 30, 2018**  
**(Unaudited)**

*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 government 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 per member per month 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):

	<b>January 1,</b>				
	<b>2018</b>	<b>June 30,</b>	<b>2018</b>	<b>\$ Change</b>	<b>% Change</b>
Accounts receivable	\$ 679,269	\$ 864,674	\$ 185,405	27.3%	
Contract assets	8,564	14,339	5,775	67.4%	
Contract liabilities - current	14,299	75,552	61,253	428.4%	
Contract liabilities - long-term	12,303	12,612	309	2.5%	

Accounts receivable, which are included in accounts receivable, other current assets and other long-term assets on the consolidated balance sheets, increased by \$185.4 million, mainly due to timing. Contract assets, which are included in other current assets on the consolidated balance sheets, increased by \$5.8 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, increased by \$61.3 million, mainly due to the timing of receipts related to July 2018 revenues and the timing of material rights generated for some of the Company's government contracts. Contract liabilities – long-term, which are included in deferred credits and other long-term liabilities on the consolidated balance sheets, increased by \$0.3 million, mainly due to receipts for which recognition will be long-term.

**MAGELLAN HEALTH, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**June 30, 2018**  
**(Unaudited)**

During the three months ended June 30, 2018, the Company recognized revenue of \$59.2 million that was included in current contract liabilities at March 31, 2018. During the six months ended June 30, 2018, the Company recognized revenue of \$70.5 million that was included in current contract liabilities at January 1, 2018. The estimated timing of recognition of amounts included in contract liabilities at June 30, 2018 are as follows: 2018—\$70.9 million; 2019—\$6.1 million; 2020—\$2.6 million; 2021 and beyond—\$8.6 million. During the three and six months ended June 30, 2018, the revenue the Company recognized related to performance obligations that were satisfied, or partially satisfied, in previous periods was 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 a contract with the State of Florida to provide integrated healthcare services to Medicaid enrollees in the state of Florida (the "Florida Contract"). The Florida Contract began on February 4, 2014 and extends through December 31, 2018, unless sooner terminated by the parties. The State of Florida has the right to terminate the Florida Contract with cause, as defined, upon 24 hour notice and upon 30 days notice for any reason or no reason at all. The Florida Contract generated net revenues of \$300.1 million and \$307.9 million for the six months ended June 30, 2017 and 2018, respectively.

On July 14, 2017, the State of Florida issued an Invitation to Negotiate for a new contract for its Medicaid managed care program to replace the current contract with the Company and to be effective January 1, 2019. On April 24, 2018 the Company was notified by the Florida Agency for Health Care Administration ("AHCA") that the Company was not selected to negotiate a new contract to serve as a vendor for its Medicaid managed care program. The Company filed a protest with AHCA.

*Customers exceeding ten percent of segment net revenues*

In addition to the Florida Contract, previously discussed, the following customers generated in excess of ten percent of net revenues for the respective segment for the six months ended June 30, 2017 and 2018 (in thousands):

Segment	Term Date	2017	2018
<b>Healthcare</b>			
Customer A	(1)	\$ 79,247	\$ 356,573
Customer B	December 31, 2018 to December 31, 2020 (2)	—	330,910
<b>Pharmacy Management</b>			
Customer C	March 31, 2019	184,364	176,650

- (1) The Company, along with other participating managed care plans in this state, continues to provide services while a new contract is being finalized.
- (2) The customer has more than one contract. The individual contracts are scheduled to terminate at various points during the time period indicated above.

*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

**MAGELLAN HEALTH, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**June 30, 2018**  
**(Unaudited)**

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 \$232.4 million and \$275.3 million for the six months ended June 30, 2017 and 2018, respectively. Net revenues from members in relation to its contracts with CMS in aggregate totaled \$236.1 million and \$205.1 million for the six months ended June 30, 2017 and 2018, respectively. As of December 31, 2017 and June 30, 2018, the Company had \$131.5 million and \$119.8 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 \$177.5 million and \$165.8 million for the six months ended June 30, 2017 and 2018, 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.

*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.

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.



**MAGELLAN HEALTH, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**June 30, 2018**  
**(Unaudited)**

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, 2017 and June 30, 2018 (in thousands):

	December 31, 2017			Total
	Level 1	Level 2	Level 3	
<i>Assets</i>				
Cash and cash equivalents (1)	\$ —	\$ 284,064	\$ —	\$ 284,064
<i>Investments:</i>				
U.S. Government and agency securities	28,231	—	—	28,231
Obligations of government-sponsored enterprises (2)	—	22,088	—	22,088
Corporate debt securities	—	269,788	—	269,788
Taxable municipal bonds	—	5,000	—	5,000
Certificates of deposit	—	2,758	—	2,758
<b>Total assets held at fair value</b>	<b>\$ 28,231</b>	<b>\$ 583,698</b>	<b>\$ —</b>	<b>\$ 611,929</b>
<i>Liabilities</i>				
Contingent consideration	\$ —	\$ —	\$ 8,817	\$ 8,817
<b>Total liabilities held at fair value</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ 8,817</b>	<b>\$ 8,817</b>

	June 30, 2018			Total
	Level 1	Level 2	Level 3	
<i>Assets</i>				
Cash and cash equivalents (3)	\$ —	\$ 215,843	\$ —	\$ 215,843
<i>Investments:</i>				
U.S. Government and agency securities	52,716	—	—	52,716
Obligations of government-sponsored enterprises (2)	—	13,026	—	13,026
Corporate debt securities	—	345,394	—	345,394
Certificates of deposit	—	22,112	—	22,112
<b>Total assets held at fair value</b>	<b>\$ 52,716</b>	<b>\$ 596,375</b>	<b>\$ —</b>	<b>\$ 649,091</b>
<i>Liabilities</i>				
Contingent consideration	\$ —	\$ —	\$ 9,120	\$ 9,120
<b>Total liabilities held at fair value</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ 9,120</b>	<b>\$ 9,120</b>

(1) Excludes \$114.7 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 \$30.3 million of cash held in bank accounts by the Company.

For the six months ended June 30, 2018, 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 \$389.2 million as of June 30, 2018 was determined based on quoted market prices and would be classified within Level 1 of the fair value hierarchy. The estimated fair value of the Company's term loan of \$336.9 million as of June 30, 2018 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.

**MAGELLAN HEALTH, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**June 30, 2018**  
**(Unaudited)**

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, 2017 and June 30, 2018, the Company estimated undiscounted future contingent payments of \$9.9 million and \$9.8 million, respectively. As of June 30, 2018, the aggregate amounts and projected dates of future potential contingent consideration payments were \$7.2 million in 2018 and \$2.6 million in 2020.

As of December 31, 2017, the fair value of the short-term and long-term contingent consideration was \$6.9 million and \$1.9 million, respectively, and is included in short-term contingent consideration and long-term contingent consideration, respectively, in the consolidated balance sheets. As of June 30, 2018, the fair value of the short-term and long-term contingent consideration was \$7.1 million and \$2.0 million, respectively, and is included in short-term contingent consideration and long-term contingent consideration, respectively, in the consolidated balance sheets.

The change in the fair value of the contingent consideration was \$0.3 million and \$0.2 million for the three and six months ended June 30, 2017, respectively, and \$0.1 million and \$0.3 million for the three and six months ended June 30, 2018, respectively, which were recorded as direct service costs and other operating expenses in the consolidated statements of income. The increases during 2018 were mainly a result of changes in present value.

The following table summarizes the Company's liability for contingent consideration for the six months ended June 30, 2018 (in thousands):

	<b>June 30, 2018</b>
Balance as of beginning of period	\$ 8,817
Changes in fair value	303
Payments	—
Balance as of end of period	<u>\$ 9,120</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. At June 30, 2018, the Company's excess capital and undistributed earnings for the Company's regulated subsidiaries of \$115.8 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 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 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 income in the consolidated statements of income and the non-credit component of the other-than-temporary impairment is recognized in other comprehensive income.

As of December 31, 2017 and June 30, 2018, there were no material unrealized losses that the Company determined to be other-than-temporary. No realized gains or losses were recorded for the six months ended

**MAGELLAN HEALTH, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**June 30, 2018**  
**(Unaudited)**

June 30, 2017 or 2018. The following is a summary of short-term and long-term investments at December 31, 2017 and June 30, 2018 (in thousands):

	December 31, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Government and agency securities	\$ 28,313	\$ —	\$ (82)	\$ 28,231
Obligations of government-sponsored enterprises (1)	22,139	—	(51)	22,088
Corporate debt securities	270,154	1	(367)	269,788
Taxable municipal bonds	5,000	—	—	5,000
Certificates of deposit	2,758	—	—	2,758
Total investments at December 31, 2017	<u>\$ 328,364</u>	<u>\$ 1</u>	<u>\$ (500)</u>	<u>\$ 327,865</u>

	June 30, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Government and agency securities	\$ 52,838	\$ —	\$ (122)	\$ 52,716
Obligations of government-sponsored enterprises (1)	13,079	—	(53)	13,026
Corporate debt securities	345,965	5	(576)	345,394
Certificates of deposit	22,112	—	—	22,112
Total investments at June 30, 2018	<u>\$ 433,994</u>	<u>\$ 5</u>	<u>\$ (751)</u>	<u>\$ 433,248</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 June 30, 2018 are summarized below (in thousands):

	Amortized Cost	Estimated Fair Value
2018	\$ 205,329	\$ 205,104
2019	228,665	228,144
Total investments at June 30, 2018	<u>\$ 433,994</u>	<u>\$ 433,248</u>

*Income Taxes*

The Company's effective income tax rates were 43.8 percent and 16.0 percent for the six months ended June 30, 2017 and 2018, 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 and valuation allowances. 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 six months ended June 30, 2018 is lower than the effective rate for the six months ended June 30, 2017 primarily due to the reduction of the U.S. corporate income tax rate from 35 percent to 21 percent and more significant tax deductions in 2018 in excess of recognized stock compensation expense. The 2018 decreases attributable to the statutory rate reduction and stock compensation expense outweighed the rate increase related to the non-deductible health insurer fee that was reinstated in 2018.

The Company files a consolidated federal income tax return with its eighty-percent or more controlled subsidiaries. The Company previously filed separate consolidated federal income tax returns for AlphaCare of New York, Inc. ("AlphaCare") and its parent, AlphaCare Holdings, Inc. ("AlphaCare Holdings"). During 2017, AlphaCare and AlphaCare Holdings became members of the Magellan federal consolidated group. The Company and its subsidiaries also file income tax returns in various state and local jurisdictions. With few exceptions, the Company is no longer subject to federal, state or local income tax assessments for years ended prior to 2014.

**MAGELLAN HEALTH, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**June 30, 2018**  
**(Unaudited)**

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. Although the IRS has made no tax assessments on any of these returns, the examinations could lead to proposed adjustments to the reported tax liabilities. Under the terms of the SWH Holdings, Inc. Agreement and Plan of Merger, the previous owners of SWH Holdings, Inc. provided the Company with an indemnification with respect to any such pre-acquisition period tax liabilities.

The Tax Cuts and Jobs Act (the “Tax Act”) was enacted in 2017 and included a number of changes impacting the Company, most notably a reduction of the U.S. corporate income tax rate from 35 percent to 21 percent that was effective January 1, 2018. The legislation also provided for the acceleration of depreciation on certain assets placed in service after September 27, 2017, as well as prospective changes which began in 2018, including additional limitations on the deduction of executive compensation.

Staff Accounting Bulletin No. 118 allows registrants to include reasonable estimates as provisional amounts and provides a measurement period by which the accounting must be completed. The measurement period ends when a registrant has obtained, prepared, and analyzed the information that was needed in order to complete the accounting requirements under ASC Topic 740 but under no circumstances is the measurement period to extend beyond one year from the enactment date (i.e. December 22, 2018).

The Company did not identify any items for which a reasonable estimate of the income tax effects of the Tax Act could not be determined as of December 31, 2017. The Company included the provisional tax impacts related to the remeasurement of deferred tax assets and liabilities in its consolidated financial statements for the year ended December 31, 2017. No changes were made to those provisional balances in the current year. The Company will continue to analyze the Tax Act and additional technical and interpretive guidance on the Tax Act from the government and will complete its accounting no later than December 22, 2018.

The ultimate impact may differ from these provisional amounts, possibly materially, due to, among other things, additional analysis, changes in interpretations and assumptions the Company has made, additional regulatory guidance that may be issued, and actions the Company may take as a result of the Tax Act. Additionally, any changes to the tax basis for temporary differences between the estimates in these statements and the 2017 federal return when filed by the Company will result in a corresponding adjustment to the remeasurement of deferred taxes as of the enactment date of the Tax Act. Any such adjustments will be recorded to tax expense in the quarter of 2018 when the analysis is complete.

*Net Operating Loss Carryforwards*

The Company has \$38.8 million of federal net operating loss carryforwards (“NOLs”) available to reduce consolidated taxable income in 2018 and subsequent years. These NOLs (including \$37.6 million incurred by AlphaCare prior to its membership in the Magellan consolidated group) will expire in 2018 through 2036 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 \$93.7 million of NOLs available to reduce state and local taxable income at certain subsidiaries in 2018 and subsequent years. These NOLs will expire in 2018 through 2037 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. At this time, 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, 2017 and June 30, 2018 are shown net of valuation allowances of \$2.4 million. These valuation allowances mostly relate to uncertainties regarding the eventual realization of certain state NOLs.

**MAGELLAN HEALTH, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**June 30, 2018**  
**(Unaudited)**

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. The Consolidated Appropriations Act of 2016 imposed a one-year moratorium on the Patient Protection and Affordable Care Act health insurer fee ("HIF"), suspending its application for 2017. The HIF fee went back into effect for 2018, however, on January 23, 2018 the United States Congress passed the Continuing Resolution which imposed another one-year moratorium on the HIF fee, suspending its application for 2019. For 2018 the HIF fee is expected to be \$29.9 million which is included in accrued liabilities in the consolidated balance sheets.

*Stock Compensation*

At December 31, 2017 and June 30, 2018, 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, 2017, which was filed with the SEC on March 1, 2018. The Company recorded stock compensation expense of \$11.4 million and \$21.5 million for the three and six months ended June 30, 2017, respectively, and \$10.4 million and \$18.1 million for the three and six months ended June 30, 2018, respectively. Stock compensation expense recognized in the consolidated statements of income for the three and six months ended June 30, 2017 and 2018 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 six months ended June 30, 2018 was \$25.67 as estimated using the Black-Scholes-Merton option pricing model, which also assumed an expected volatility of 28.21 percent based on the historical volatility of the Company's stock price.

For the six months ended June 30, 2017 and 2018, the benefit of tax deductions in excess of recognized stock compensation expense (net of deficiencies) was \$1.0 million and \$4.9 million, respectively, which were reported as a reduction to income tax expense.

**MAGELLAN HEALTH, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**June 30, 2018**  
**(Unaudited)**

Summarized information related to the Company's stock options for the six months ended June 30, 2018 is as follows:

	2018	
	Options	Weighted Average Exercise Price
Outstanding, beginning of period	2,458,237	\$ 61.50
Granted	425,456	99.02
Forfeited	(44,651)	74.78
Exercised	(379,589)	56.58
Outstanding, end of period	2,459,453	\$ 68.51
Vested and expected to vest at end of period	2,440,741	\$ 68.38
Exercisable, end of period	1,483,866	\$ 59.99

All of the Company's options granted during the six months ended June 30, 2018 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 six months ended June 30, 2018 is as follows:

	Shares	Weighted Average Grant Date Fair Value
Outstanding, beginning of period	31,102	\$ 68.00
Awarded	11,795	89.05
Vested	(31,102)	68.00
Forfeited	—	—
Outstanding, ending of period	11,795	89.05

Summarized information related to the Company's nonvested restricted stock units ("RSUs") for the six months ended June 30, 2018 is as follows:

	Shares	Weighted Average Grant Date Fair Value
Outstanding, beginning of period	163,289	\$ 66.46
Awarded	109,348	99.45
Vested	(82,207)	65.54
Forfeited	(13,082)	80.95
Outstanding, ending of period	177,348	86.16

The vesting period for RSAs ranges from 12 months to 24 months. In general, RSUs vest ratably on each anniversary over the three years subsequent to grant.

**MAGELLAN HEALTH, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**June 30, 2018**  
**(Unaudited)**

Summarized information related to the Company's nonvested restricted performance stock units ("PSUs") for the six months ended June 30, 2018 is as follows:

	<u>2018</u>	
	<u>Shares</u>	<u>Weighted Average Grant Date Fair Value</u>
Outstanding, beginning of period	202,315	\$ 84.63
Awarded	80,502	141.61
Vested	(33,592)	85.00
Forfeited	(1,865)	97.25
Outstanding, end of period	<u>247,360</u>	<u>103.03</u>

The weighted average estimated fair value of the PSUs granted in the six months ended June 30, 2018 was \$141.61, 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 2.37%, and expected volatility of 20% to 82% (average of 35%). The PSUs granted in the six months ended June 30, 2018, 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, 2020 and vesting on March 5, 2021, 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, 2021 by the average share value of the Company's common stock over the 30 trading days beginning on January 1, 2018, with a deemed reinvestment of any dividends declared during the performance period. The Company's peer group includes 49 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 Capital 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 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 as of December 31, 2017 and June 30, 2018.

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.

**MAGELLAN HEALTH, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**June 30, 2018**  
**(Unaudited)**

*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”). The 2017 Credit Agreement is scheduled to mature on September 22, 2022.

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 six months ended June 30, 2018, the weighted average interest rate was approximately 3.392 percent.

As of June 30, 2018, the contractual maturities of the term loan under the 2017 Credit Agreement were as follows: 2018—\$8.8 million; 2019—\$17.5 million; 2020—\$17.5 million; 2021—\$17.5 million; and 2022—\$275.6 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, 2017 and June 30, 2018, the Company had revolving loan borrowings of \$92.5 million and \$70.0 million, respectively. The Company had \$17.6 million of letters of credit outstanding at June 30, 2018 under the 2017 Credit Agreement. At June 30, 2018, the Company had a borrowing capacity of \$312.4 million under the 2017 Credit Agreement. Included in long-term debt and capital lease obligations are deferred loan and bond issuance costs as of December 31, 2017 and June 30, 2018 of \$6.6 million and \$6.0 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, 2017 and June 30, 2018 of \$26.5 million and \$48.5 million, respectively.

*Capital Lease Obligations*

There were \$22.9 million and \$24.9 million of capital lease obligations at December 31, 2017 and June 30, 2018, respectively. The Company’s capital lease 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.



**MAGELLAN HEALTH, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**June 30, 2018**  
**(Unaudited)**

**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 six months ended June 30:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2018	2017	2018
<b>Numerator:</b>				
Net income attributable to Magellan	\$ 5,500	\$ 13,551	\$ 23,247	\$ 25,003
<b>Denominator:</b>				
Weighted average number of common shares outstanding—basic	23,108	24,569	23,060	24,460
Common stock equivalents—stock options	399	669	436	738
Common stock equivalents—RSAs	439	33	421	28
Common stock equivalents—RSUs	30	23	56	50
Common stock equivalents—PSUs	61	111	62	232
Common stock equivalents—employee stock purchase plan	1	2	2	2
Weighted average number of common shares outstanding—diluted	24,038	25,407	24,037	25,510
Net income attributable to Magellan per common share—basic	\$ 0.24	\$ 0.55	\$ 1.01	\$ 1.02
Net income attributable to Magellan per common share—diluted	\$ 0.23	\$ 0.53	\$ 0.97	\$ 0.98

The weighted average number of common shares outstanding for the three and six months ended June 30, 2017 and 2018 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 six months ended June 30, 2017 and 2018 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 0.8 million and 0.7 million options for the three and six months ended June 30, 2017, respectively, and 0.5 million and 0.3 million for the three and six months ended June 30, 2018, 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 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.”

**MAGELLAN HEALTH, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**June 30, 2018**  
**(Unaudited)**

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

	Healthcare	Pharmacy Management	Corporate and Elimination	Consolidated
<b>Three Months Ended June 30, 2017</b>				
Managed care and other revenue	\$ 755,270	\$ 66,659	\$ (230)	\$ 821,699
PBM revenue	—	631,932	(34,492)	597,440
Cost of care	(583,264)	—	—	(583,264)
Cost of goods sold	—	(595,446)	33,091	(562,355)
Direct service costs and other	(145,914)	(74,953)	(10,505)	(231,372)
Stock compensation expense (1)	3,106	5,684	2,581	11,371
Changes in fair value of contingent consideration (1)	252	—	—	252
Less: non-controlling interest segment loss (2)	(568)	—	(1)	(569)
Segment profit (loss)	<u>\$ 30,018</u>	<u>\$ 33,876</u>	<u>\$ (9,554)</u>	<u>\$ 54,340</u>

	Healthcare	Pharmacy Management	Corporate and Elimination	Consolidated
<b>Three Months Ended June 30, 2018</b>				
Managed care and other revenue	\$ 1,154,888	\$ 60,603	\$ (151)	\$ 1,215,340
PBM revenue	—	642,794	(47,211)	595,583
Cost of care	(935,814)	—	—	(935,814)
Cost of goods sold	—	(603,951)	45,532	(558,419)
Direct service costs and other	(177,990)	(70,941)	(10,221)	(259,152)
Stock compensation expense (1)	2,742	1,408	6,289	10,439
Changes in fair value of contingent consideration (1)	70	—	—	70
Segment profit (loss)	<u>\$ 43,896</u>	<u>\$ 29,913</u>	<u>\$ (5,762)</u>	<u>\$ 68,047</u>

	Healthcare	Pharmacy Management	Corporate and Elimination	Consolidated
<b>Six Months Ended June 30, 2017</b>				
Managed care and other revenue	\$ 1,420,646	\$ 130,839	\$ (446)	\$ 1,551,039
PBM revenue	—	1,238,678	(64,955)	1,173,723
Cost of care	(1,065,318)	—	—	(1,065,318)
Cost of goods sold	—	(1,167,283)	62,295	(1,104,988)
Direct service costs and other	(284,882)	(150,806)	(17,170)	(452,858)
Stock compensation expense (1)	5,765	11,414	4,332	21,511
Changes in fair value of contingent consideration (1)	203	—	—	203
Less: non-controlling interest segment profit (loss) (2)	(845)	—	(2)	(847)
Segment profit (loss)	<u>\$ 77,259</u>	<u>\$ 62,842</u>	<u>\$ (15,942)</u>	<u>\$ 124,159</u>

**MAGELLAN HEALTH, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**June 30, 2018**  
**(Unaudited)**

	Healthcare	Pharmacy Management	Corporate and Elimination	Consolidated
<b>Six Months Ended June 30, 2018</b>				
Managed care and other revenue	\$ 2,312,489	\$ 122,910	\$ (296)	\$ 2,435,103
PBM revenue	—	1,274,992	(94,095)	1,180,897
Cost of care	(1,864,475)	—	—	(1,864,475)
Cost of goods sold	—	(1,208,864)	90,780	(1,118,084)
Direct service costs and other	(364,236)	(146,527)	(17,466)	(528,229)
Stock compensation expense (1)	5,692	2,893	9,500	18,085
Changes in fair value of contingent consideration (1)	303	—	—	303
Segment profit (loss)	<u>\$ 89,773</u>	<u>\$ 45,404</u>	<u>\$ (11,577)</u>	<u>\$ 123,600</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.
- (2) The non-controlling portion of AlphaCare's segment loss is excluded from the computation of Segment Profit.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2018	2017	2018
Income before income taxes	\$ 10,588	\$ 18,375	\$ 39,863	\$ 29,752
Stock compensation expense	11,371	10,439	21,511	18,085
Changes in fair value of contingent consideration	252	70	203	303
Non-controlling interest segment loss	569	—	847	—
Depreciation and amortization	27,731	33,848	54,707	64,255
Interest expense	4,900	8,678	9,048	17,044
Interest and other income	(1,071)	(3,363)	(2,020)	(5,839)
Segment Profit	<u>\$ 54,340</u>	<u>\$ 68,047</u>	<u>\$ 124,159</u>	<u>\$ 123,600</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. 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.

**MAGELLAN HEALTH, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**June 30, 2018**  
**(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. As previously disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2017, the Company's wholly owned subsidiary, 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 Defense Health Agency, 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. 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 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 3% and 2% of the Company's total net revenues for the year ended December 31, 2017 and six months ended June 30, 2018, respectively.

*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 June 30, 2018, the remaining capacity under the 2015 Repurchase Program was \$238.2 million. The board also extended the program from October 26, 2018 to October 26, 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 insider trading laws or because of self-imposed trading blackout periods. Repurchases are expected to be funded from working capital and

**MAGELLAN HEALTH, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**June 30, 2018**  
**(Unaudited)**

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 - June 30, 2018	163,532	90.62	14.8
	<u>2,616,899</u>		<u>\$ 161.8</u>

The Company made additional open market purchases of 37,032 shares of the Company's common stock at an aggregate cost of \$3.6 million (excluding broker commissions) during the period from July 1, 2018 through July 20, 2018.

**NOTE E—Acquisitions**

*Acquisition of SWH Holdings, Inc.*

Pursuant to the July 13, 2017 Agreement and Plan of Merger (the "SWH Agreement"), on October 31, 2017 the Company acquired (the "SWH Acquisition") all of the outstanding equity interests of SWH Holdings, Inc. ("SWH"). SWH is a healthcare company focused on serving complex, high-risk populations, providing Medicare and Medicaid dual-eligible benefits to members in Massachusetts and New York.

As consideration for the SWH Acquisition, the Company paid \$400.0 million in cash, inclusive of a \$10.0 million payment based on SWH's Medicare plan in Massachusetts receiving a Centers for Medicare & Medicaid Services 2018 Star Rating of at least 4, subject to adjustments as provided in the SWH Agreement.

The Company's estimated fair values of SWH's assets acquired and liabilities assumed at the date of acquisition are determined based on certain valuations and analyses that have yet to be finalized, and accordingly, the assets acquired and liabilities assumed are subject to adjustment once the analyses are completed. In addition, the amount recognized for deferred tax liabilities may be impacted by the determination of these items. The Company will make appropriate adjustments to the purchase price allocation prior to the completion of the measurement period as required. During the six months ended June 30, 2018, the Company made measurement period adjustments of \$7.9 million to increase the goodwill related to the SWH acquisition. The measurement period adjustments were to increase current liabilities.

The Company reports the results of operations of SWH in its Healthcare segment. As of June 30, 2018, the Company established a working capital receivable of \$0.2 million that was reflected as a reduction to the transaction price.

## **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 Note A—“General” for more information on the Company’s business segments.

### ***Summarized Results***

Summarized below are the key financial highlights for the quarter ended June 30, 2018 (“Current Year Quarter”). For additional information see the “Results of Operations” section, which discusses both consolidated and segment results in more detail:

- Net revenue increased 27.6 percent over the three months ended June 30, 2017 (“Prior Year Quarter”) to \$1.8 billion.
- Income before taxes increased by 73.5 percent from the Prior Year Quarter to \$18.4 million.
- Net income attributable to Magellan increased by 146.4 percent from the Prior Year Quarter to \$13.6 million.
- Segment profit<sup>1</sup> increased 25.2 percent over the Prior Year Quarter to \$68.0 million.
- Adjusted net income<sup>1</sup> was \$23.3 million, an increase of 65.2 percent from the Prior Year Quarter.

<sup>1</sup> see Non-GAAP Measures section for a discussion of these non-GAAP financial measures and a reconciliation to the most comparable GAAP item.

### ***Key Developments and Accomplishments***

- On May 24, 2018 the Company’s board of directors approved an additional \$200 million to the current \$200 million stock repurchase plan which will now authorize the Company to purchase up to \$400 million. The board also extended the end date for and additional two years until October 22, 2020.
- In May, the Company announced that it had been named to the annual Fortune 500 list of America’s largest corporations by revenue for the first time in the Company’s history.

**Results of Operations**

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

<b>Consolidated Results</b>	<b>Three Months Ended</b>		<b>Change</b>	<b>Six Months Ended</b>		<b>Change</b>
	<b>June 30,</b>			<b>June 30,</b>		
	<b>2017</b>	<b>2018</b>	<b>17 vs '18</b>	<b>2017</b>	<b>2018</b>	<b>'17 vs '18</b>
<b>Statement of Operations Data:</b>						
Net revenue	\$ 1,419,139	\$ 1,810,923	27.6%	\$ 2,724,762	\$ 3,616,000	32.7%
Cost of Care	583,264	935,814	60.4%	1,065,318	1,864,475	75.0%
Cost of goods sold	562,355	558,419	(0.7%)	1,104,988	1,118,084	1.2%
Direct service costs and other operating expenses (1)(2)	231,372	259,152	12.0%	452,858	528,229	16.6%
Depreciation and amortization	27,731	33,848	22.1%	54,707	64,255	17.5%
Interest expense	4,900	8,678	77.1%	9,048	17,044	88.4%
Interest and other income	(1,071)	(3,363)	214.0%	(2,020)	(5,839)	189.1%
Income before income taxes	10,588	18,375	73.5%	39,863	29,752	(25.4%)
Provision (benefit) for income taxes	5,661	4,824	(14.8%)	17,467	4,749	(72.8%)
Net income	4,927	13,551	175.0%	22,396	25,003	11.6%
Less: net loss attributable to non-controlling interest	(573)	—	(100.0%)	(851)	—	(100.0%)
<b>Net income attributable to Magellan</b>	<b>\$ 5,500</b>	<b>\$ 13,551</b>	<b>146.4%</b>	<b>\$ 23,247</b>	<b>\$ 25,003</b>	<b>7.6%</b>

(1) Includes stock compensation expense of \$11,371 and \$10,439 for the three months ended June 30, 2017 and 2018, respectively, and \$21,511 and \$18,085 for the six months ended June 30, 2017 and 2018, respectively.

(2) Includes changes in fair value of contingent consideration of \$252 and \$70 for the three months ended June 30, 2017 and 2018, respectively, and \$203 and \$303 for the six months ended June 30, 2017 and 2018, respectively.

*Current Year Quarter compared to 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.

*Depreciation and amortization*

Depreciation and amortization expense increased by 22.1 percent or \$6.1 million from the Prior Year Quarter to the Current Year Quarter, primarily due to asset additions after the Prior Year Quarter and acquisition activity.

*Interest expense*

Interest expense increased by \$3.8 million from the Prior Year Quarter to the Current Year Quarter primarily due to an increase in outstanding debt balances and higher interest rates.

*Interest and other income*

Interest income increased by \$2.3 million from the Prior Year Quarter to the Current Year Quarter primarily due to higher yields and an increase in invested balances.

*Income taxes*

The Company's effective income tax rates were 53.5 percent and 26.3 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 Prior Year Quarter mainly due to the decrease in the U.S. corporate income tax rate, more significant tax deductions in the Current Year Quarter in excess of recognized stock compensation expense and valuation allowance increases in the Prior Year Quarter with respect to AlphaCare.

## [Table of Contents](#)

*Six months ended June 30, 2018 (“Current Year Period”) compared to the six months ended June 30, 2017 (“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 17.5 percent or \$9.5 million from the Prior Year Period to the Current Year Period, primarily due to asset additions after the Prior Year Period and acquisition activity.

#### *Interest expense*

Interest expense increased by \$8.0 million from the Prior Year Period to the Current Year Period primarily due to an increase in outstanding debt balances and higher interest rates.

#### *Interest and other income*

Interest income increased by \$3.8 million from the Prior Year Period to the Current Year Period primarily due to higher yields and an increase in invested balances.

#### *Income taxes*

The Company’s effective income tax rates were 43.8 percent and 16.0 percent for the Prior Year Period and Current Year Period, respectively. The effective income tax rate for the Current Year Period is lower than the Prior Year Period mainly due to the decrease in the U.S. corporate income tax rate and more significant tax deductions in the Current Year Period in excess of recognized stock compensation expense.

### ***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. The non-controlling portion of AlphaCare’s Segment Profit (Loss) is also 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 commercial division provides management services to health plans, accountable care organizations and employers. The government division contracts with local, state and federal governmental agencies to provide services to recipients under Medicaid, Medicare and other government programs.



[Table of Contents](#)

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

	Three Months Ended			Six Months Ended		
	June 30,		Change	June 30,		Change
<b>Healthcare Segment Results</b>	2017	2018	'17 vs '18	2017	2018	'17 vs '18
Commercial risk-based, non-EAP	\$ 263,319	\$ 238,272	(9.5%)	\$ 465,298	\$ 472,663	1.6%
Government risk-based, non-EAP	318,013	750,162	135.9%	614,474	1,502,652	144.5%
EAP risk-based	100,000	91,275	(8.7%)	197,900	185,933	(6.0%)
Commercial ASO	50,283	51,111	1.6%	95,625	103,680	8.4%
Government ASO	23,655	24,068	1.7%	47,349	47,561	0.4%
Managed care and other revenue	755,270	1,154,888	52.9%	1,420,646	2,312,489	62.8%
Cost of care	583,264	935,814	60.4%	1,065,318	1,864,475	75.0%
	172,006	219,074	27.4%	355,328	448,014	26.1%
Direct service costs and other	145,914	177,990	22.0%	284,882	364,236	27.9%
	26,092	41,084	57.5%	70,446	83,778	18.9%
Stock compensation expense	3,106	2,742	(11.7%)	5,765	5,692	(1.3%)
Changes in fair value of contingent consideration	252	70	(72.2%)	203	303	49.3%
Less: non-controlling interest segment loss	(568)	—	(100.0%)	(845)	—	(100.0%)
Segment profit	\$ 30,018	\$ 43,896	46.2%	\$ 77,259	\$ 89,773	16.2%
Direct service cost as % of revenue	19.3%	15.4%		20.1%	15.8%	
MLR commercial risk	89.9%	85.2%		87.5%	84.6%	
MLR government risk	87.1%	89.3%		84.3%	88.9%	
MLR EAP risk	69.5%	69.2%		70.6%	69.1%	
<b>Membership</b>						
Commercial risk (1)				12,362	11,815	(4.4%)
Government risk				526	575	9.3%
EAP risk				14,100	14,890	5.6%
Commercial ASO (1)				27,433	26,193	(4.5%)
Government ASO				1,062	893	(15.9%)
				55,483	54,366	(2.0%)

- (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 52.9 percent or \$399.6 million from the Prior Year Quarter to the Current Year Quarter. The increase in revenue is mainly due to revenue for Senior Whole Health acquired on October 31, 2017 of \$301.4 million, contracts implemented after (or during) the Prior Year Quarter of \$144.8 million, higher membership partially offset by net unfavorable rate changes of \$18.0 million, net revenue recorded for HIF fees in the Current Year Quarter of \$7.2 million and unfavorable retroactive rate adjustments in the Prior Year Quarter of \$4.1 million. These increases were partially offset by net retroactive program changes in the Prior Year Quarter of \$40.3 million, terminated contracts of \$20.6 million, the revenue impact of unfavorable prior period medical claims development recorded in the Prior Year Quarter of \$6.7 million, program changes of \$6.2 million, unfavorable retroactive rate and membership adjustments in the Current Year Quarter of \$1.8 million and other net unfavorable variances of \$0.3 million.

*Cost of care*

Cost of care increased by 60.4 percent or \$352.6 million from the Prior Year Quarter to the Current Year Quarter. The increase is primarily due to the care cost for Senior Whole Health of \$264.6 million, new contracts implemented after (or during) the Prior Year Quarter of \$139.6 million, increased membership partially offset by lower

## [Table of Contents](#)

care associated with net unfavorable rate changes of \$15.7 million and other net unfavorable variances of \$14.9 million. These increases were partially offset by net retroactive program changes in the Prior Year Quarter of \$37.2 million, terminated contracts of \$19.4 million, net favorable prior period medical claims development recorded in the Current Year Quarter of \$9.5 million, net unfavorable prior period medical claims development recorded in the Prior Year Quarter of \$8.2 million and program changes of \$7.9 million. For our commercial contracts, cost of care as a percentage of risk revenue (excluding EAP business) decreased as a percentage of risk revenue (excluding EAP business) from 89.9 percent in Prior Year Quarter to 85.2 percent in the Current Year Quarter primarily due to the favorable care development, terminated contracts, and business mix. For our government contracts, cost of care increased as a percentage of risk revenue (excluding EAP business) from 87.1 percent in the Prior Year Quarter to 89.3 percent in the Current Year Quarter mainly due to new business and business mix.

### *Direct service costs and other*

Direct service costs increased by 22.0 percent or \$32.1 million from the Prior Year Quarter to the Current Year Quarter primarily due to costs related to Senior Whole Health, costs to support new business and HIF fees in the Current Year Quarter; increases were partially offset by the impact of terminated contracts. Direct service costs decreased as a percentage of revenue from 19.3 percent in the Prior Year Quarter to 15.4 percent in the Current Year Quarter, mainly due to increased revenue from acquisition activity and business growth partially offset by terminated contracts.

### *Current Year Period compared to the Prior Year Period*

#### *Managed care and other revenue*

Net revenue increased by 62.8 percent or \$891.8 million from the Prior Year Period to the Current Year Period. The increase in revenue is mainly due to revenue for Senior Whole Health acquired on October 31, 2017 of \$609.1 million, contracts implemented after (or during) the Prior Year Period of \$298.1 million, higher membership partially offset by net unfavorable rate changes of \$39.5 million, net revenue recorded for HIF fees in the Current Year Period of \$15.0 million, the revenue impact of favorable prior period care development recorded in the Prior Year Period of \$5.3 million, performance incentives of \$2.8 million and a performance penalty in the Prior Year Period of \$2.2 million. These increases were partially offset by terminated contracts of \$37.0 million, net retroactive program changes in the Prior Year Period of \$20.9 million, program changes of \$11.6 million, retroactive profit share in the Prior Year Period of \$3.3 million, unfavorable retroactive membership and rate adjustments in the Current Year Period of \$2.6 million, favorable retroactive rate adjustments in the Prior Year Period of \$2.2 million, customer settlements in the Prior Year Period of \$2.0 million and other net unfavorable variances of \$0.6 million.

#### *Cost of care*

Cost of care increased by 75.0 percent or \$799.2 million from the Prior Year Period to the Current Year Period. The increase is mainly due to care cost for Senior Whole Health of \$524.8 million, new contracts implemented after (or during) the Prior Year Period of \$286.2 million, increased membership partially offset by lower care associated with net unfavorable rate changes of \$37.7 million, net favorable prior period medical claims development recorded in the Prior Year Period of \$9.1 million and other net unfavorable variances of \$23.5 million. These increases were partially offset by terminated contracts of \$37.2 million, net retroactive program changes recorded in the Prior Year Period of \$19.2 million, program changes of \$14.9 million, favorable prior period medical claims development recorded in the Current Year Period of \$7.2 million and customer settlements of \$3.6 million. For our commercial contracts, cost of care as a percentage of risk revenue (excluding EAP business) decreased as a percentage of risk revenue (excluding EAP business) from 87.5 percent in the Prior Year Period to 84.6 percent in the Current Year Period, mainly due to revenue growth from new business partially offset by terminated contracts. For our government contracts, cost of care increased as a percentage of risk revenue (excluding EAP business) from 84.3 percent in the Prior Year Period to 88.9 percent in the Current Year Period primarily due to new business, favorable care development in the Prior Year Period, care trends, and business mix.

### *Direct service costs and other*

Direct service costs increased by 27.9 percent or \$79.4 million from the Prior Year Period to the Current Year Period primarily due to costs related to Senior Whole Health, costs to support new business and HIF fees in the Current Year Period. Direct service costs decreased as a percentage of revenue from 20.1 percent in the Prior Year Period to

[Table of Contents](#)

15.8 percent in the Current Year Period, mainly due to increased revenue from business growth and acquisition activity partially offset by terminated contracts.

**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, MCOs, 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):

<b>Pharmacy Segment Results</b>	<b>Three Months Ended</b>			<b>Six Months Ended</b>		
	<b>June 30,</b>	<b>June 30,</b>	<b>Change</b>	<b>June 30,</b>	<b>June 30,</b>	<b>Change</b>
	<b>2017</b>	<b>2018</b>	<b>'17 vs '18</b>	<b>2017</b>	<b>2018</b>	<b>'17 vs '18</b>
Formulary management	\$ 21,200	\$ 18,348	(13.5%)	\$ 43,500	\$ 38,725	(11.0%)
PBA and other	45,459	42,255	(7.0%)	87,339	84,185	(3.6%)
Managed care and other revenue	66,659	60,603	(9.1%)	130,839	122,910	(6.1%)
PBM, including dispensing	507,432	536,131	5.7%	1,002,578	1,069,923	6.7%
Medicare Part D	124,500	106,663	(14.3%)	236,100	205,069	(13.1%)
PBM revenue	631,932	642,794	1.7%	1,238,678	1,274,992	2.9%
Total net revenue	698,591	703,397	0.7%	1,369,517	1,397,902	2.1%
Cost of goods sold	595,446	603,951	1.4%	1,167,283	1,208,864	3.6%
	103,145	99,446	(3.6%)	202,234	189,038	(6.5%)
Direct service costs and other	74,953	70,941	(5.4%)	150,806	146,527	(2.8%)
	28,192	28,505	1.1%	51,428	42,511	(17.3%)
Stock compensation expense	5,684	1,408	(75.2%)	11,414	2,893	(74.7%)
Segment profit	\$ 33,876	\$ 29,913	(11.7%)	\$ 62,842	\$ 45,404	(27.7%)
Direct service cost as % of revenue	10.7%	10.1%		11.0%	10.5%	
COGS as % of PBM revenue	94.2%	94.0%		94.2%	94.8%	
<b>Pharmacy Operational Statistics</b>						
Adjusted commercial network claims				14,400	15,097	
Adjusted PBA claims				36,100	35,515	
Total adjusted claims				50,500	50,612	
Generic dispensing rate				87.1%	87.6%	
Commercial PBM covered lives				1,900	2,036	
Medical pharmacy covered lives				13,300	13,733	
Total states and DC that participate in PBA				26	27	

*Current Year Quarter compared to the Prior Year Quarter*

*Managed care and other revenue*

Managed care and other revenue decreased by 9.1 percent or \$6.1 million from the Prior Year Quarter to the Current Year Quarter mainly due to decreased formulary management revenue of \$2.8 million, lower revenue in government pharmacy of \$1.2 million and other net unfavorable variances of \$2.1 million.

[Table of Contents](#)

*PBM revenue*

PBM revenue increased by 1.7 percent or \$10.9 million from the Prior Year Quarter to the Current Year Quarter. This increase is primarily due to new contracts implemented after (or during) the Prior Year Quarter of \$37.5 million and other net increases of \$0.3 million. These favorable variances were partially offset by net decreased membership and utilization of \$12.2 million, lower revenue in government pharmacy of \$6.0 million, terminated contracts of \$5.5 million, network guarantee penalty in the Current Year Quarter of \$1.5 million and lower revenue of \$1.7 million in the Current Year Quarter due to timing differences caused by the implementation of ASC 606.

*Cost of goods sold*

Cost of goods sold increased by 1.4 percent or \$8.5 million from the Prior Year Quarter to the Current Year Quarter. This increase is primarily due to new contracts implemented after (or during) the Prior Year Quarter of \$36.1 million and other increases of \$0.3 million. These increases were partially offset by net decreased membership and utilization of \$12.8 million, government pharmacy of \$5.9 million, terminated contracts of \$5.3 million and timing of network management initiatives in the Current Year Quarter of \$3.9 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 Quarter to 94.0 percent in the Current Year Quarter, mainly due to business mix.

*Direct service costs and other*

Direct service costs decreased by 5.4 percent or \$4.0 million from the Prior Year Quarter to the Current Year Quarter, primarily due to a decrease in stock compensation. Direct service costs decreased as a percentage of revenue from 10.7 percent in the Prior Year Quarter to 10.1 percent in the Current Year Quarter, mainly due to an increase in revenue from business growth and business mix.

*Current Year Period compared to the Prior Year Period*

*Managed care and other revenue*

Managed care and other revenue decreased by 6.1 percent or \$7.9 million from the Prior Year Period to the Current Year Period mainly due to decreased formulary management revenue of \$4.8 million, lower government pharmacy of \$1.8 million, terminated contracts of \$0.9 million and other net unfavorable variances of \$1.5 million, partially offset by new contracts implemented after (or during) the Prior Year Period of \$1.1 million.

*PBM revenue*

PBM revenue increased by 2.9 percent or \$36.3 million from the Prior Year Period to the Current Year Period. This increase is primarily due to new contracts implemented after (or during) the Prior Year Period of \$68.2 million. This favorable variance was partially offset by terminated contracts of \$11.5 million, lower revenue of \$8.2 million in the Current Year Period due to timing differences caused by the implementation of ASC 606, lower government pharmacy revenue of \$7.1 million, net decreased membership and utilization of \$3.3 million, network guarantee penalty in the Current Year Period of \$1.1 million and other net unfavorable variances of \$0.7 million.

*Cost of goods sold*

Cost of goods sold increased by 3.6 percent or \$41.6 million from the Prior Year Period to the Current Year Period. This increase is primarily due to new contracts implemented after (or during) the Prior Year Period of \$65.4 million and other net increases of \$0.8 million. These increases were partially offset by terminated contracts of \$10.9 million, government pharmacy of \$7.0 million and net decreased membership and utilization of \$6.7 million. As a percentage of the portion of net revenue that relates to PBM, cost of goods sold increased from 94.2 percent in the Prior Year Period to 94.8 percent in the Current Year Period, mainly due to business mix.

*Direct service costs and other*

[Table of Contents](#)

Direct service costs decreased by 2.8 percent or \$4.3 million from the Prior Year Period to the Current Year Period, primarily due to a decrease in stock compensation partially offset by higher costs to support new business. Direct service costs decreased as a percentage of revenue from 11.0 percent in the Prior Year Period to 10.5 percent in the Current Year Period, mainly due to an increase in revenue from business growth and business mix.

**Corporate Segment**

The Corporate 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.

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

<b>Corporate Segment &amp; Eliminations</b>	<b>Three Months Ended</b>		<b>Change</b>	<b>Six Months Ended</b>		<b>Change</b>
	<b>June 30,</b>			<b>June 30,</b>		
	<b>2017</b>	<b>2018</b>	<b>'17 vs '18</b>	<b>2017</b>	<b>2018</b>	<b>'17 vs '18</b>
Managed care and other revenue	\$ (230)	\$ (151)	(34.3%)	\$ (446)	\$ (296)	(33.6%)
PBM revenue	(34,492)	(47,211)	36.9%	(64,955)	(94,095)	44.9%
Cost of goods sold	33,091	45,532	37.6%	62,295	90,780	45.7%
	(1,631)	(1,830)	12.2%	(3,106)	(3,611)	16.3%
Direct service costs and other	10,505	10,221	(2.7%)	17,170	17,466	1.7%
	(12,136)	(12,051)	(0.7%)	(20,276)	(21,077)	4.0%
Stock compensation expense	2,581	6,289	143.7%	4,332	9,500	119.3%
Less: non-controlling interest segment loss	(1)	—	(100.0%)	(2)	—	(100.0%)
Segment loss	\$ (9,554)	\$ (5,762)	(39.7%)	\$ (15,942)	\$ (11,577)	(27.4%)

*Current Year Quarter compared to the Prior Year Quarter*

The Corporate segment loss decreased by 39.7 percent or \$3.8 million from the Prior Year Quarter to the Current Year Quarter, mainly due to lower discretionary benefits. As a percentage of revenue, the Corporate segment loss decreased from 0.7 percent in the Prior Year Quarter to 0.3 percent in the Current Year Quarter, mainly due to increased revenue from business growth and lower discretionary benefits.

*Current Year Period compared to the Prior Year Period*

The Corporate segment loss decreased by 27.4 percent or \$4.4 million from the Prior Year Period to the Current Year Period, mainly due to lower discretionary benefits. As a percentage of revenue, the Corporate segment loss decreased from 0.6 percent in the Prior Year Period to 0.3 percent in the Current Year Period, mainly due to increased revenue from business growth and lower 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

[Table of Contents](#)

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 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 June 30,		Six Months Ended June 30,	
	2017	2018	2017	2018
Income before income taxes	\$ 10,588	\$ 18,375	\$ 39,863	\$ 29,752
Stock compensation expense	11,371	10,439	21,511	18,085
Changes in fair value of contingent consideration	252	70	203	303
Non-controlling interest segment loss	569	—	847	—
Depreciation and amortization	27,731	33,848	54,707	64,255
Interest expense	4,900	8,678	9,048	17,044
Interest and other income	(1,071)	(3,363)	(2,020)	(5,839)
Segment Profit	\$ 54,340	\$ 68,047	\$ 124,159	\$ 123,600

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2018	2017	2018
Net income attributable to Magellan	\$ 5,500	\$ 13,551	\$ 23,247	\$ 25,003
Adjusted for acquisitions starting in 2013				
Stock compensation expense relating to acquisitions	4,906	268	9,758	530
Changes in fair value of contingent consideration	252	70	203	303
Amortization of acquired intangibles	8,315	12,726	16,766	24,597
Tax impact	(4,888)	(3,344)	(9,767)	(6,357)
Adjusted Net Income	\$ 14,085	\$ 23,271	\$ 40,207	\$ 44,076

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2018	2017	2018
Net income per common share attributable to Magellan—diluted	\$ 0.23	\$ 0.53	\$ 0.97	\$ 0.98
Adjusted for acquisitions starting in 2013				
Stock compensation expense relating to acquisitions	0.20	0.01	0.40	0.02
Changes in fair value of contingent consideration	0.01	—	0.01	0.01
Amortization of acquired intangibles	0.35	0.51	0.70	0.97
Tax impact	(0.20)	(0.13)	(0.41)	(0.25)
Adjusted EPS	\$ 0.59	\$ 0.92	\$ 1.67	\$ 1.73

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 and other pharmacy 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 claims incurred but not reported ("IBNR"); and (viii) 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.

*Care Trends.* The Company expects that same-store normalized cost of care trend for the 12 month forward outlook to be 3 to 7 percent for commercial products and 0 to 2 percent for government business.

*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 June 30, 2018, 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 \$3.8 million for the Prior Year Period and net cash provided by operating activities of \$21.1 million for the Current Year Period. The \$17.3 million increase in operating cash flows from the Prior Year Period to the Current Year Period is mainly attributable to decreased tax payments and other net favorable working capital changes.

Tax payments for the Current Year Period decreased \$16.3 million from the Prior Year Period. The net favorable impact of working capital changes between periods totaled \$1.0 million, which were attributable to timing related to receivables and payables.

*Investing Activities.* The Company utilized \$26.8 million and \$37.1 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 \$7.8 million and \$19.0 million, respectively, as compared to additions for the Current Year Period related to hard assets and capitalized software of \$12.4 million and \$24.7 million, respectively.

During the Prior Year Period and the Current Year Period the Company used \$5.7 million and \$106.8 million, respectively, for the net purchase of "available-for-sale" securities. During the Prior Year Period, the Company used net cash of \$3.2 million related to investments in businesses and the acquisition of Veridicus.

*Financing Activities.* During the Prior Year Period, the Company paid \$187.5 million on debt obligations, \$5.0 million for the repurchase of treasury stock under the Company's share repurchase program, \$3.5 million on capital lease obligations and had other net unfavorable items of \$1.3 million. In addition, the Company received \$200.0 million from the issuance of debt and \$6.0 million from the exercise of stock options.

During the Current Year Period, the Company paid \$31.2 million on debt obligations, \$14.3 million for the repurchase of treasury stock under the Company's share repurchase program, \$2.7 million on capital lease obligations

and had other net unfavorable items of \$3.1 million. In addition, the Company received \$21.5 million from the exercise of stock options.

***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 26, 2018 to October 26, 2020. See Note D—“*Commitments and Contingencies*” for more information on the Company’s share repurchase program.

*Off-Balance Sheet Arrangements.* As of June 30, 2018, 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. The 2017 Credit Agreement is scheduled to mature on September 22, 2022. 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, would result in an



event of default 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 include, among other things, accounts receivable realization, valuation allowances for deferred tax assets, valuation of goodwill and intangible assets, medical claims payable, other medical liabilities, stock compensation assumptions, tax contingencies, legal liabilities and contingent consideration payable. Actual results could differ from those estimates. Except as noted below, the Company's critical accounting policies are summarized in the Company's Annual Report on Form 10-K, filed with the SEC on March 1, 2018.

### ***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;
- the Company's participation in Medicare Part D is subject to government regulation;
- 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;
- 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; 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, 2017. 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 June 30, 2018, 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 Rules 13a-15(e) under the Exchange Act), as of June 30, 2018. Based on their evaluation, the Company's principal executive and principal financial officers concluded that the Company's disclosure controls and procedures were not effective due to the existence of a previously reported material weakness in internal control over financial reporting at AFSC, which we acquired on July 1, 2016, and which operates as a component of our Healthcare segment. The material weakness was identified and discussed in "Part II – Item 9A – Controls and Procedures" of our Annual Report on Form 10-K which was filed with the SEC on March 1, 2018.

Notwithstanding the identified material weakness, management, including our CEO (principal executive officer) and CFO (principal financial officer), believes the consolidated financial statements included in this Form 10-Q fairly represent in all material respects our financial condition, results of operations and cash flows at and for the periods presented in accordance with U.S. GAAP.

AFSC was acquired on July 1, 2016 and generated about 3% and 2% of our total net revenues for the year ended December 31, 2017 and six months ended June 30, 2018, respectively. Prior to 2017, AFSC was not included in assessments of the effectiveness of our internal control over financial reporting as the SEC rules provide companies one year to assess controls at an acquired entity. Accordingly, within the 2017 period, we performed our first comprehensive assessment of the design and effectiveness of internal controls at AFSC and determined that AFSC's internal control over financial reporting was ineffective as of December 31, 2017. Specifically, AFSC did not adequately identify, design and implement appropriate process-level controls for its processes, including AFSC's contract accounting and information technology general controls. There were no material errors in the financial results or balances identified as a result of the control deficiencies, and there was no restatement of prior period financial statements and no change in previously released financial results were required as the result of these control deficiencies.

We are actively engaged in remediation to address the material weakness reported as of December 31, 2017. The remediation efforts we are implementing include the enhanced and revised design of existing financial reporting controls related to financial close process, billing, contract accounting and information technology general controls at AFSC.

We believe these measures will remediate the material weakness identified above and will strengthen our internal control over financial reporting for the AFSC operations. We currently are targeting to complete the implementation of the control enhancements during 2018. We will test the ongoing operating effectiveness of the new controls subsequent to implementation, and consider the material weakness remediated after the applicable remedial controls and information technology general controls operate effectively for a sufficient period of time.

If the remedial measures described above are insufficient to address the material weakness described above, or are not implemented timely, or additional deficiencies arise in the future, material misstatements in our interim or annual financial statements may occur in the future.

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 June 30, 2018 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, 2017, which was filed with the SEC on March 1, 2018.

**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 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 26, 2018 to October 26, 2020. Pursuant to this program, the Company made open market purchases during the three months ended June 30, 2018 as follows (approximate dollar value of shares that may yet to be purchased under the plan is reflected in millions):

Period	Total number of Shares	Average Price Paid	Total Number of Shares Purchased as Part of Publicly	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans(1)
	Purchased	per Share(1)	Announced Plans or Programs	(2)
April 1-30, 2018	7,575	\$ 81.84	7,575	\$ 52.4
May 1-31, 2018	93,056	88.43	93,056	244.2
June 1-30, 2018	62,901	94.93	62,901	238.2
	<u>163,532</u>		<u>163,532</u>	

(1) Excludes amounts that could be used to repurchase shares acquired under the Company’s equity incentive plans to satisfy withholding tax obligations of employees and non-employee directors upon the vesting of restricted stock units.

(2) Excludes broker commissions.

The Company made additional open market purchases of 37,032 shares of the Company’s common stock at an aggregate

[Table of Contents](#)

cost of \$3.6 million (excluding broker commissions) during the period from July 1, 2018 through July 20, 2018.

**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**

<b><u>Exhibit Number</u></b>	<b><u>Description of Exhibit</u></b>
31.1	<a href="#">Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</a>
31.2	<a href="#">Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</a>
32.1	<a href="#">Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished).</a>
32.2	<a href="#">Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished).</a>
101	The following materials from the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2018 formatted in Extensible Business Reporting Language (XBRL): (i) the Consolidated Statements of Income, (ii) the Consolidated Statements of Comprehensive Income, (iii) the Consolidated Balance Sheets, (iv) the Consolidated Statements of Cash Flows and (v) related notes.



## 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 reporting 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*

Date: July 27, 2018

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## 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 reporting 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: July 27, 2018

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**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 June 30, 2018 (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: July 27, 2018

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**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 June 30, 2018 (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: July 27, 2018

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