HUMANA INC
Form 10-Q
May 03, 2011
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2011

OR

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

For the transition period from ______ to ______

Commission file number 1-5975

HUMANA INC.

(Exact name of registrant as specified in its charter)

Delaware	**61-0647538**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification Number)**

500 West Main Street

Louisville, Kentucky 40202

(Address of principal executive offices, including zip code)

(502) 580-1000

(Registrant s telephone number, including area code)

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

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

Indicate by checkmark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	x	Accelerated filer	¨
Non-accelerated filer	¨	Smaller reporting company	¨

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

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

Class of Common Stock	Outstanding at March 31, 2011
$0.16 2/3 par value	**168,394,377 shares**

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CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

	March 31, 2011	December 31, 2010
	(in thousands, except share amounts)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 1,756,041	$ 1,673,137
Investment securities	7,420,959	6,872,767
Receivables, less allowance for doubtful accounts of $75,337 in 2011 and $51,470 in 2010:	1,219,347	959,018
Securities lending invested collateral	31,139	49,636
Other current assets	669,288	583,141
Total current assets	11,096,774	10,137,699
Property and equipment, net	819,729	815,337
Long-term investment securities	1,568,090	1,499,672
Goodwill	2,576,208	2,567,809
Other long-term assets	1,099,259	1,082,736
Total assets	$ 17,160,060	$ 16,103,253
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Benefits payable	$ 3,940,058	$ 3,469,306
Trade accounts payable and accrued expenses	1,916,602	1,624,832
Book overdraft	252,073	409,385
Securities lending payable	36,997	55,693
Unearned revenues	219,004	185,410
Total current liabilities	6,364,734	5,744,626
Long-term debt	1,666,447	1,668,849
Future policy benefits payable	1,530,064	1,492,855
Other long-term liabilities	371,837	272,867
Total liabilities	9,933,082	9,179,197
Commitments and contingencies		
Stockholders equity:		
Preferred stock, $1 par; 10,000,000 shares authorized; none issued	0	0
Common stock, $0.16 2/3 par; 300,000,000 shares authorized; 191,607,107 shares issued at March 31, 2011 and 190,244,741 shares issued at December 31, 2010	31,935	31,707
Capital in excess of par value	1,825,405	1,737,207
Retained earnings	5,844,177	5,529,001
Accumulated other comprehensive income	108,808	120,584
Treasury stock, at cost, 23,212,730 shares at March 31, 2011 and 21,795,051 shares at December 31, 2010	(583,347)	(494,443)
Total stockholders equity	7,226,978	6,924,056

Total liabilities and stockholders equity	$ 17,160,060	$ 16,103,253

See accompanying notes to condensed consolidated financial statements.

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CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

	For the three months ended March 31, 2011	2010
	(in thousands, except per share results)	
Revenues:		
Premiums	$ 8,766,291	$ 8,161,863
Services	334,942	133,020
Investment income	89,485	85,455
Total revenues	9,190,718	8,380,338
Operating expenses:		
Benefits	7,344,754	6,817,382
Operating costs	1,255,843	1,060,857
Depreciation and amortization	66,109	58,859
Total operating expenses	8,666,706	7,937,098
Income from operations	524,012	443,240
Interest expense	27,228	26,314
Income before income taxes	496,784	416,926
Provision for income taxes	181,608	158,158
Net income	$ 315,176	$ 258,768
Basic earnings per common share	$ 1.88	$ 1.54
Diluted earnings per common share	$ 1.86	$ 1.52

See accompanying notes to condensed consolidated financial statements.

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	For the three months ended March 31, 2011	2010
	(in thousands)	
Cash flows from operating activities		
Net income	$ 315,176	$ 258,768
Adjustments to reconcile net income to net cash provided by operating activities:		
Net realized capital gains	(3,926)	(8,694)
Stock-based compensation	29,775	27,339
Depreciation and amortization	75,491	62,756
Provision (benefit) for deferred income taxes	27,352	(20,862)
Changes in operating assets and liabilities, net of effect of businesses acquired:		
Receivables	(260,329)	(280,978)
Other assets	(110,920)	(29,177)
Benefits payable	470,752	484,459
Other liabilities	204,176	246,068
Unearned revenues	33,594	6,767
Other, net	14,311	8,205
Net cash provided by operating activities	795,452	754,651
Cash flows from investing activities		
Acquisitions, net of cash acquired	(5,000)	0
Purchases of property and equipment	(70,481)	(39,028)
Purchases of investment securities	(1,186,574)	(1,525,349)
Maturities of investment securities	398,800	433,788
Proceeds from sales of investment securities	153,832	545,166
Change in securities lending collateral	18,696	58,206
Net cash used in investing activities	(690,727)	(527,217)
Cash flows from financing activities		
Receipts from CMS contract deposits	613,909	438,108
Withdrawals from CMS contract deposits	(430,949)	(266,649)
Change in securities lending payable	(18,696)	(58,206)
Change in book overdraft	(157,312)	(138,426)
Common stock repurchases	(88,904)	(7,670)
Excess tax benefit from stock-based compensation	5,131	734
Proceeds from stock option exercises and other	55,000	5,080
Net cash used in financing activities	(21,821)	(27,029)
Increase in cash and cash equivalents	82,904	200,405
Cash and cash equivalents at beginning of period	1,673,137	1,613,588
Cash and cash equivalents at end of period	$ 1,756,041	$ 1,813,993

Supplemental cash flow disclosures:				
Interest payments	$	11,100	$	10,486
Income tax payments, net	$	76,215	$	5,210

See accompanying notes to condensed consolidated financial statements.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Unaudited

1. BASIS OF PRESENTATION

The accompanying condensed consolidated financial statements are presented in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the disclosures normally required by accounting principles generally accepted in the United States of America, or those normally made in an Annual Report on Form 10-K. For further information, the reader of this Form 10-Q should refer to our Form 10-K for the year ended December 31, 2010, that was filed with the Securities and Exchange Commission, or the SEC, on February 17, 2011. References throughout this document to we, us, our, Company, and Humana mean Humana Inc. and its subsidiaries.

The preparation of our condensed consolidated financial statements in accordance with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. The areas involving the most significant use of estimates are the estimation of benefits payable, the impact of risk sharing provisions related to our Medicare and TRICARE contracts, the valuation and related impairment recognition of investment securities, and the valuation and related impairment recognition of long-lived assets, including goodwill. These estimates are based on knowledge of current events and anticipated future events, and accordingly, actual results may ultimately differ materially from those estimates. Refer to Note 2 to the consolidated financial statements included in our Form 10-K for the year ended December 31, 2010 for information on accounting policies that the Company considers in preparing its consolidated financial statements.

The financial information has been prepared in accordance with our customary accounting practices and has not been audited. In our opinion, the information presented reflects all adjustments necessary for a fair statement of interim results. All such adjustments are of a normal and recurring nature.

Realignment of Business Segments

During the first quarter of 2011, we realigned our business segments to reflect our evolving business model. We are managing and reporting our operating results using the following segments: Retail, Employer Group, and Health and Well-Being Services. We also disclose results for Other Businesses. Historical segment information has been restated to reflect the effect of this change. Our segment information is more fully described herein in Note 13.

As a result of changing our reportable segments, we also changed the classification of certain revenues and costs. Beginning January 1, 2011, costs of certain health and well-being services were reclassified as benefits expense including costs incurred by our wholly-owned home delivery pharmacy from transactions with our members that were historically classified as selling, general and administrative (and now titled operating costs), as well as depreciation and amortization expenses. The effect of this reclassification is to account for the cost of providing these benefits to our members similarly whether the services are provided via a third party provider or internally through a stand-alone subsidiary. Likewise, co-share amounts from our members associated with our wholly-owned home delivery pharmacy operations, historically classified as other revenue, are now classified as a reduction of benefits expense. The remaining items previously classified as other revenue, primarily consisting of patient service revenue associated with our newly acquired Concentra Inc. subsidiary, were combined with our previous administrative services fee revenue and are now classified as services revenue. Prior period amounts have been reclassified to conform to the new presentation. These adjustments had no impact on net income, cash flows or equity. Further, none of these adjustments impacted our regulated subsidiaries.

Depreciation and amortization expense associated with certain businesses in our Health and Well-Being Services segment delivering benefits to our members, primarily associated with our pharmacy operations are now included with benefits expense. The amount of this expense was $9.4 million and $3.9 million for the three months ended March 31, 2011 and 2010, respectively.

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Unaudited

2. RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In January 2010, the Financial Accounting Standards Board, or FASB, issued new guidance that expanded and clarified existing disclosures about fair value measurements. Under the new guidance, we are required to disclose additional information about movements of assets among the three-tier fair value hierarchy, present separately (that is, on a gross basis) information about purchases, sales, issuances, and settlements of financial instruments in the reconciliation of fair value measurements using significant unobservable inputs (Level 3), and expand disclosures regarding the determination of fair value measurements. We adopted the new disclosure provisions during the year ended December 31, 2010, except for the gross disclosures regarding purchases, sales, issuances and settlements in the roll forward of activity in Level 3 fair value measurements which we adopted with the filing of our Form 10-Q for the three months ended March 31, 2011 as provided herein in Note 5.

There are no other recently issued accounting standards that apply to us or that will have a material impact on our condensed consolidated financial statements.

3. ACQUISITIONS

On December 21, 2010, we acquired Concentra Inc., or Concentra, a health care company based in Addison, Texas, for cash consideration of $804.7 million. During the first quarter of 2011, we accrued $3.7 million related to the final determination of working capital that existed at the acquisition date and recorded immaterial adjustments to the acquisition date fair value of Concentra s net tangible assets acquired with a corresponding adjustment to goodwill. The $3.7 million final working capital adjustment was paid to the sellers in April 2011. Through its affiliated clinicians, Concentra delivers occupational medicine, urgent care, physical therapy, and wellness services to workers and the general public through its operation of medical centers and worksite medical facilities. The Concentra acquisition provides us entry into the primary care space on a national scale, offering additional means for achieving health and wellness solutions and providing an expandable platform for growth with a management team experienced in physician asset management and alternate site care. The total consideration of $808.4 million exceeded our estimated fair value of the net tangible assets acquired by approximately $724.5 million, of which we allocated $188.0 million to other intangible assets and $536.5 million to goodwill. The goodwill was assigned to the Health and Well-Being Services segment. The other intangible assets, which primarily consist of customer relationships and trade name, have a weighted average useful life of 13.7 years. Approximately $57.9 million of the acquired goodwill is deductible for tax purposes. The purchase price allocation is preliminary, subject to completion of valuation analyses, including, for example, refining assumptions used to calculate the fair value of other intangible assets.

The results of operations and financial condition of Concentra have been included in our consolidated statements of income and consolidated balance sheets from the acquisition date. In connection with the acquisition, we recognized approximately $14.9 million of acquisition-related costs, primarily banker and other professional fees, as operating costs in the fourth quarter of 2010. The proforma financial information assuming the acquisition had occurred as of January 1, 2009 was not material to our results of operations.

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4. INVESTMENT SECURITIES

Investment securities classified as current and long-term were as follows at March 31, 2011 and December 31, 2010, respectively:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
		(in thousands)		
March 31, 2011				
U.S. Treasury and other U.S. government corporations and agencies:				
U.S. Treasury and agency obligations	$ 750,015	$ 11,473	$ (1,907)	$ 759,581
Mortgage-backed securities	1,902,967	44,091	(3,163)	1,943,895
Tax-exempt municipal securities	2,414,164	36,099	(42,353)	2,407,910
Mortgage-backed securities:				
Residential	53,384	406	(1,519)	52,271
Commercial	366,018	15,017	(861)	380,174
Asset-backed securities	141,048	1,589	(32)	142,605
Corporate debt securities	3,178,491	133,507	(14,718)	3,297,280
Redeemable preferred stock	5,333	0	0	5,333
Total debt securities	$ 8,811,420	$ 242,182	$ (64,553)	$ 8,989,049
December 31, 2010				
U.S. Treasury and other U.S. government corporations and agencies:				
U.S. Treasury and agency obligations	$ 697,816	$ 14,412	$ (615)	$ 711,613
Mortgage-backed securities	1,614,569	49,783	(1,173)	1,663,179
Tax-exempt municipal securities	2,439,659	37,294	(43,619)	2,433,334
Mortgage-backed securities:				
Residential	58,017	545	(2,675)	55,887
Commercial	306,291	14,911	(171)	321,031
Asset-backed securities	148,068	1,727	(44)	149,751
Corporate debt securities	2,906,228	139,793	(13,710)	3,032,311
Redeemable preferred stock	5,333	0	0	5,333
Total debt securities	$ 8,175,981	$ 258,465	$ (62,007)	$ 8,372,439

We participate in a securities lending program where we loan certain investment securities for short periods of time in exchange for collateral, consisting of cash or U.S. Government securities, initially equal to at least 102% of the fair value of the investment securities on loan. Investment securities with a fair value of $35.9 million at March 31, 2011 and $54.0 million at December 31, 2010 were on loan as of those respective dates. At March 31, 2011, all collateral from lending our investment securities was in the form of cash which has been reinvested in money market funds.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Unaudited

Gross unrealized losses and fair values aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position were as follows at March 31, 2011 and December 31, 2010, respectively:

	Less than 12 months		12 months or more		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
			(in thousands)			
March 31, 2011						
U.S. Treasury and other U.S. government corporations and agencies:						
U.S. Treasury and agency obligations	$ 210,233	$ (1,907)	$ 0	$ 0	$ 210,233	$ (1,907)
Mortgage-backed securities	420,312	(2,997)	5,841	(166)	426,153	(3,163)
Tax-exempt municipal securities	1,098,079	(32,622)	97,544	(9,731)	1,195,623	(42,353)
Mortgage-backed securities:						
Residential	2,861	(37)	28,268	(1,482)	31,129	(1,519)
Commercial	66,207	(756)	1,479	(105)	67,686	(861)
Asset-backed securities	6,653	(7)	7,186	(25)	13,839	(32)
Corporate debt securities	606,688	(12,066)	20,936	(2,652)	627,624	(14,718)
Total debt securities	$ 2,411,033	$ (50,392)	$ 161,254	$ (14,161)	$ 2,572,287	$ (64,553)
December 31, 2010						
U.S. Treasury and other U.S. government corporations and agencies:						
U.S. Treasury and agency obligations	$ 141,766	$ (615)	$ 0	$ 0	$ 141,766	$ (615)
Mortgage-backed securities	110,358	(1,054)	5,557	(119)	115,915	(1,173)
Tax-exempt municipal securities	1,168,221	(33,218)	97,809	(10,401)	1,266,030	(43,619)
Mortgage-backed securities:						
Residential	0	0	32,671	(2,675)	32,671	(2,675)
Commercial	0	0	2,752	(171)	2,752	(171)
Asset-backed securities	17,069	(42)	283	(2)	17,352	(44)
Corporate debt securities	383,677	(9,572)	31,464	(4,138)	415,141	(13,710)
Total debt securities	$ 1,821,091	$ (44,501)	$ 170,536	$ (17,506)	$ 1,991,627	$ (62,007)

Approximately 96% of our debt securities were investment-grade quality at March 31, 2011, with an average credit rating of AA- by S&P. Most of the debt securities that were below investment-grade were rated BB, the higher end of the below investment-grade rating scale. At March 31, 2011, 14% of our tax-exempt municipal securities were pre-refunded, generally with U.S. government and agency securities, and 25% of our tax-exempt securities were insured by bond insurers and had an equivalent S&P credit rating of AA exclusive of the bond insurers guarantee. Our investment policy limits investments in a single issuer and requires diversification among various asset types.

The recoverability of our residential and commercial mortgage-backed securities is supported by factors such as seniority, underlying collateral characteristics and credit enhancements. Our residential and commercial mortgage-backed securities at March 31, 2011 primarily were composed of senior tranches having high credit support, with 99% of the collateral consisting of prime loans. The average credit rating of all commercial mortgage-backed securities was AA+ at March 31, 2011.

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All issuers of securities we own that were trading at an unrealized loss at March 31, 2011 remain current on all contractual payments. After taking into account these and other factors previously described, we believe these unrealized losses primarily were caused by an increase in market interest rates and tighter liquidity conditions in the current markets than when the securities were purchased. At March 31, 2011, we did not intend to sell the securities with an unrealized loss position in accumulated other comprehensive income, and it is not likely that we will be required to sell these securities before recovery of their amortized cost basis. As a result, we believe that the securities with an unrealized loss were not other-than-temporarily impaired at March 31, 2011.

The detail of realized gains (losses) related to investment securities and included with investment income was as follows for the three months ended March 31, 2011 and 2010:

	For the three months ended March 31,	
	2011	2010
	(in thousands)	
Gross realized gains	$ 4,576	$ 19,913
Gross realized losses	(650)	(11,219)
Net realized gains	$ 3,926	$ 8,694

There were no material other-than-temporary impairments for the three months ended March 31, 2011 or 2010.

The contractual maturities of debt securities available for sale at March 31, 2011, regardless of their balance sheet classification, are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
	(in thousands)	
Due within one year	$ 253,766	$ 255,623
Due after one year through five years	1,925,294	1,980,504
Due after five years through ten years	2,323,716	2,382,235
Due after ten years	1,845,227	1,851,742
Mortgage and asset-backed securities	2,463,417	2,518,945
Total debt securities	$ 8,811,420	$ 8,989,049

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Unaudited

5. FAIR VALUE

Financial Assets

The following table summarizes our fair value measurements at March 31, 2011 and December 31, 2010, respectively, for financial assets measured at fair value on a recurring basis:

		Fair Value Measurements Using		
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
		(in thousands)		
March 31, 2011				
Cash equivalents	$ 1,684,869	$ 1,684,869	$ 0	$ 0
Debt securities:				
U.S. Treasury and other U.S. government corporations and agencies:				
U.S. Treasury and agency obligations	759,581	0	759,581	0
Mortgage-backed securities	1,943,895	0	1,943,895	0
Tax-exempt municipal securities	2,407,910	0	2,356,587	51,323
Mortgage-backed securities:				
Residential	52,271	0	52,271	0
Commercial	380,174	0	380,174	0
Asset-backed				