CENTENE CORP
Form 10-Q
October 28, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

(Mark One)
[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2014
OR

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

For the transition period from to

Commission file number: 001-31826

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

Delaware (State or other jurisdiction of incorporation or organization)	42-1406317 (I.R.S. Employer Identification Number)
7700 Forsyth Boulevard St. Louis, Missouri (Address of principal executive offices)	63105 (Zip Code)

Registrant’s telephone number, including area code:

(314) 725-4477

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer”, “accelerated filer” and “small reporting company" in Rule 12b-2 of the Exchange Act. Large accelerated filer x Accelerated filer o Non-accelerated filer o (do not check if a smaller reporting company) Smaller reporting company o

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

As of October 17, 2014, the registrant had 58,668,982 shares of common stock outstanding.

CENTENE CORPORATION
QUARTERLY REPORT ON FORM 10-Q
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CAUTIONARY STATEMENT ON FORWARD-LOOKING STATEMENTS

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

All forward-looking statements included in this filing are based on information available to us on the date of this filing and we undertake no obligation to update or revise the forward-looking statements included in this filing, whether as a result of new information, future events or otherwise, after the date of this filing. Actual results may differ from projections or estimates due to a variety of important factors, including but not limited to:

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

Other Information

The discussion in Part I, Item 2. "Management’s Discussion and Analysis of Financial Condition and Results of Operations" under the heading "Results of Operations" contains financial information for new and existing businesses. Existing businesses are primarily state markets, significant geographic expansion in an existing state or product that we have managed for four complete quarters. New businesses are primarily new state markets, significant geographic expansion in an existing state or product that conversely, we have not managed for four complete quarters.

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PART I
FINANCIAL INFORMATION

ITEM 1. Financial Statements.
CENTENE CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In thousands, except share data)
(Unaudited)

	September 30, 2014	December 31, 2013
ASSETS		
Current assets:		
Cash and cash equivalents of continuing operations	$1,523,596	$974,304
Cash and cash equivalents of discontinued operations	59,376	63,769
Total cash and cash equivalents	1,582,972	1,038,073
Premium and related receivables	685,188	428,570
Short term investments	166,993	102,126
Other current assets	319,700	217,661
Other current assets of discontinued operations	12,858	13,743
Total current assets	2,767,711	1,800,173
Long term investments	1,108,261	791,900
Restricted deposits	99,727	46,946
Property, software and equipment, net	424,229	395,407
Goodwill	753,060	348,432
Intangible assets, net	127,297	48,780
Other long term assets	140,429	59,357
Long term assets of discontinued operations	25,631	38,305
Total assets	$5,446,345	$3,529,300
LIABILITIES AND STOCKHOLDERS’ EQUITY		
Current liabilities:		
Medical claims liability	$1,588,798	$1,111,709
Accounts payable and accrued expenses	926,780	375,862
Unearned revenue	94,961	38,191
Current portion of long term debt	5,131	3,065
Current liabilities of discontinued operations	18,623	30,294
Total current liabilities	2,634,293	1,559,121
Long term debt	949,720	665,697
Other long term liabilities	80,371	60,015
Long term liabilities of discontinued operations	411	1,028
Total liabilities	3,664,795	2,285,861
Commitments and contingencies		
Redeemable noncontrolling interest	140,499	—
Stockholders’ equity:		
Common stock, $.001 par value; authorized 200,000,000 shares; 61,357,390 issued and 58,666,797 outstanding at September 30, 2014, and 58,673,215 issued and 55,319,239 outstanding at December 31, 2013	61	59
Additional paid-in capital	811,752	594,326
Accumulated other comprehensive loss	(605)	(2,620)

Retained earnings	896,385	731,919
Treasury stock, at cost (2,690,593 and 3,353,976 shares, respectively)	(74,690)	(89,643)
Total Centene stockholders' equity	1,632,903	1,234,041
Noncontrolling interest	8,148	9,398
Total stockholders' equity	1,641,051	1,243,439
Total liabilities and stockholders' equity	$5,446,345	$3,529,300

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

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CENTENE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except share data)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Revenues:				
Premium	$3,780,256	$2,613,567	$10,182,201	$7,415,518
Service	378,833	112,497	1,070,036	251,290
Premium and service revenues	4,159,089	2,726,064	11,252,237	7,666,808
Premium tax and health insurer fee	192,772	69,504	583,212	264,781
Total revenues	4,351,861	2,795,568	11,835,449	7,931,589
Expenses:				
Medical costs	3,390,090	2,293,616	9,092,644	6,582,445
Cost of services	327,232	100,479	935,404	218,844
General and administrative expenses	333,878	249,028	950,432	675,783
Premium tax expense	160,744	68,453	491,691	262,188
Health insurer fee expense	31,985	—	94,640	—
Total operating expenses	4,243,929	2,711,576	11,564,811	7,739,260
Earnings from operations	107,932	83,992	270,638	192,329
Other income (expense):				
Investment and other income	5,676	4,757	17,652	13,099
Interest expense	(9,282)	(6,603)	(24,909)	(20,261)
Earnings from continuing operations, before income tax expense	104,326	82,146	263,381	185,167
Income tax expense	26,696	32,280	106,125	72,937
Earnings from continuing operations, net of income tax expense	77,630	49,866	157,256	112,230
Discontinued operations, net of income tax expense (benefit) of $(142), $(620), $1,311, and $(970), respectively	1,521	(952)	2,368	(1,394)
Net earnings	79,151	48,914	159,624	110,836
Noncontrolling interest	(3,469)	(459)	(4,842)	(1,023)
Net earnings attributable to Centene Corporation	$82,620	$49,373	$164,466	$111,859
Amounts attributable to Centene Corporation common shareholders:				
Earnings from continuing operations, net of income tax expense	$81,099	$50,325	$162,098	$113,253
Discontinued operations, net of income tax expense (benefit)	1,521	(952)	2,368	(1,394)
Net earnings	$82,620	$49,373	$164,466	$111,859
Net earnings (loss) per common share attributable to Centene Corporation:				
Basic:				
Continuing operations	$1.38	$0.92	$2.80	$2.10
Discontinued operations	0.03	(0.02)	0.04	(0.02)
Basic earnings per common share	$1.41	$0.90	$2.84	$2.08
Diluted:				

Continuing operations	$1.34	$0.88	$2.70	$2.02
Discontinued operations	0.02	(0.01)	0.04	(0.02)
Diluted earnings per common share	$1.36	$0.87	$2.74	$2.00
Weighted average number of common shares outstanding:				
Basic	58,613,484	54,679,660	57,956,152	53,863,779
Diluted	60,681,875	56,933,056	59,936,699	55,956,421

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

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CENTENE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF COMPREHENSIVE EARNINGS
(In thousands)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Net earnings	$79,151	$48,914	$159,624	$110,836
Reclassification adjustment, net of tax	(109)	(94)	(206)	(621)
Change in unrealized gain (loss) on investments, net of tax	(2,376)	2,310	2,555	(6,413)
Foreign currency translation adjustments, net of tax	(334)	—	(334)	—
Other comprehensive earnings (loss)	(2,819)	2,216	2,015	(7,034)
Comprehensive earnings	76,332	51,130	161,639	103,802
Comprehensive earnings (loss) attributable to the noncontrolling interest	(3,469)	(459)	(4,842)	(1,023)
Comprehensive earnings attributable to Centene Corporation	$79,801	$51,589	$166,481	$104,825

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

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

Nine Months Ended September 30, 2014

	Centene Stockholders' Equity								
	Common Stock					Treasury Stock			
	$.001 Par Value Shares	Amt	Additional Paid-in Capital	Accumulated Other Comprehensive Loss	Retained Earnings	$.001 Par Value Shares	Amt	Non controlling Interest	Total
Balance, December 31, 2013	58,673,215	$59	$594,326	$ (2,620)	$731,919	3,353,976	$(89,643)	$9,398	$1,243,439
Comprehensive Earnings:									
Net earnings	—	—	—	—	164,466	—	—	(1,250)	163,216
Change in unrealized investment loss, net of $1,294 tax	—	—	—	2,349	—	—	—	—	2,349
Foreign currency translation, net of $(143) tax				(334)					(334)
Total comprehensive earnings									165,231
Common stock issued for acquisition	2,243,217	2	169,825	—	—	(746,369)	20,585	—	190,412
Common stock issued for employee benefit plans	440,958	—	6,085	—	—	—	—	—	6,085
Common stock repurchases	—	—	—	—	—	82,986	(5,632)	—	(5,632)
Stock compensation expense	—	—	34,613	—	—	—	—	—	34,613
Excess tax benefits from stock compensation	—	—	6,903	—	—	—	—	—	6,903
Balance, September 30, 2014	61,357,390	$61	$811,752	$ (605)	$896,385	2,690,593	$(74,690)	$8,148	$1,641,051

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

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CENTENE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Nine Months Ended September 30, 2014	2013
Cash flows from operating activities:		
Net earnings	$159,624	$110,836
Adjustments to reconcile net earnings to net cash provided by operating activities		
Depreciation and amortization	65,008	50,220
Stock compensation expense	34,613	27,252
Deferred income taxes	(64,931)	1,626
Changes in assets and liabilities		
Premium and related receivables	(243,032)	(58,587)
Other current assets	(24,678)	(19,133)
Other assets	(51,625)	(65,397)
Medical claims liabilities	476,414	103,895
Unearned revenue	54,000	7,976
Accounts payable and accrued expenses	427,128	48,840
Other operating activities	21,213	4,142
Net cash provided by operating activities	853,734	211,670
Cash flows from investing activities:		
Capital expenditures	(68,528)	(46,383)
Purchases of investments	(738,474)	(666,016)
Sales and maturities of investments	319,711	451,034
Investments in acquisitions, net of cash acquired	(94,154)	(62,773)
Net cash used in investing activities	(581,445)	(324,138)
Cash flows from financing activities:		
Proceeds from exercise of stock options	5,472	7,674
Proceeds from borrowings	1,385,000	30,000
Payment of long-term debt	(1,117,576)	(40,842)
Proceeds from stock offering	—	15,225
Excess tax benefits from stock compensation	6,903	1,140
Common stock repurchases	(5,632)	(5,677)
Contribution from noncontrolling interest	5,407	5,864
Debt issue costs	(6,475)	(3,587)
Net cash provided by financing activities	273,099	9,797
Effect of exchange rate changes on cash and cash equivalents	(489)	—
Net increase (decrease) in cash and cash equivalents	544,899	(102,671)
Cash and cash equivalents, beginning of period	1,038,073	843,952
Cash and cash equivalents, end of period	$1,582,972	$741,281
Supplemental disclosures of cash flow information:		
Interest paid	$17,902	$16,738
Health insurer fee paid	126,187	—
Income taxes paid	167,283	40,921
Equity issued in connection with acquisition	190,412	75,425

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

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

1. Basis of Presentation

The accompanying interim financial statements have been prepared under the presumption that users of the interim financial information have either read or have access to the audited financial statements included in the Form 10-K for the fiscal year ended December 31, 2013. The unaudited interim financial statements herein have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, footnote disclosures which would substantially duplicate the disclosures contained in the December 31, 2013 audited financial statements have been omitted from these interim financial statements where appropriate. In the opinion of management, these financial statements reflect all adjustments, consisting only of normal recurring adjustments, which are necessary for a fair presentation of the results of the interim periods presented.

Certain 2013 amounts in the notes to the consolidated financial statements have been reclassified to conform to the 2014 presentation. These reclassifications have no effect on net earnings or stockholders' equity as previously reported.

2. Acquisitions

U.S. Medical Management

In January 2014, the Company acquired 68% of U.S. Medical Management, LLC (USMM), a management services organization and provider of in-home health services for high acuity populations, for $213,664 in total consideration. The transaction consideration was financed through a combination of $132,686 of Centene common stock and $80,978 of cash.

The total fair value of 100% of USMM on the date of acquisition was $352,348 ($213,664 for the Company's interest and $138,684 for the redeemable noncontrolling interest). The Company's preliminary allocation of fair value resulted in goodwill of $283,081 and other identifiable intangible assets of $78,390. Approximately 45% of the goodwill is deductible for income tax purposes. The Company has not finalized the allocation of the fair value of assets and liabilities. The acquisition is recorded in the Specialty Services segment.

In connection with the acquisition, the Company entered into call and put agreements with the noncontrolling interest holder to purchase the noncontrolling interest at a later date. Under these agreements, the Company may purchase or be required to purchase up to the total remaining interests in USMM over a period beginning in 2015 and continuing through 2017. Under certain circumstances, the agreements may be extended through 2020. At the Company's sole option, up to 50% of the consideration to be issued for the purchase of the additional interests under these agreements may be funded with shares of the Company's common stock.

As a result of the put option agreement, the noncontrolling interest is considered redeemable and is classified in the Redeemable Noncontrolling Interest section of the consolidated balance sheets. The noncontrolling interest was initially measured at fair value using the binomial lattice model as of the acquisition date. The Company has elected to accrete changes in the redemption value through additional paid-in capital over the period from the date of issuance to the earliest redemption date following the effective interest method.

A reconciliation of the changes in the Redeemable Noncontrolling Interest is as follows:

Balance, December 31, 2013	$—

Fair value of noncontrolling interest at acquisition	138,684
Contribution from noncontrolling interest	5,407
Net losses attributable to noncontrolling interest	(3,592)
Balance, September 30, 2014	$ 140,499

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Community Health Solutions of America, Inc.

In July 2014, the Company completed a transaction whereby Community Health Solutions of America, Inc. assigned its contract with the Louisiana Department of Health and Hospitals under the Bayou Health Shared Savings Program to the Company's subsidiary, Louisiana Healthcare Connections (LHC).

The fair value of consideration transferred of $133,791 consists of the following: cash paid of $14,061; Centene common stock (746,369 shares) issued at closing of $58,135; the present value of additional cash consideration to be paid upon announcement of the Bayou Health Reprocurement winners of $41,929, and; the present value of the estimated contingent consideration subject to membership retained by LHC in the first quarter of 2015 of $19,666. The contingent consideration will not exceed $28,200.

The Company's preliminary allocation of fair value resulted in goodwill of $121,691 and other identifiable intangible assets of $12,100. Approximately 100% of the goodwill is deductible for income tax purposes. The Company has not finalized the allocation of the fair value of assets and liabilities. The acquisition is recorded in the Managed Care segment.

Ribera Salud S.A.

In July 2014, the Company purchased a noncontrolling interest in Ribera Salud S.A. (Ribera Salud), a Spanish health management group for $16,984. Centene is a 50% joint shareholder with Ribera Salud's remaining investor, Banco Sabadell S.A. The Company is accounting for its investment using the equity method of accounting. Any basis difference between the Company's share of underlying net assets and the purchase price will be attributable to certain intangible assets and will be accreted into earnings over their useful lives.

Upon closing, the Company executed letters of credit for $60,889 (valued at the September 30, 2014 conversion rate), or €48,000, representing its proportional share of the letters of credit issued to support Ribera Salud’s outstanding debt.

3. Discontinued Operations: Kentucky Spirit Health Plan

In October 2012, the Company notified the Kentucky Cabinet for Health and Family Services (Cabinet) that it was exercising a contractual right that it believes allowed the Company to terminate its Medicaid managed care contract with the Commonwealth of Kentucky (Commonwealth) effective July 5, 2013. As of July 6, 2013, our subsidiary, Kentucky Spirit Health Plan (KSHP), ceased serving Medicaid members in Kentucky. Refer to Note 12, Contingencies, in the Notes to the Consolidated Financial Statements for further information regarding litigation between the Company and the Cabinet.

The results of operations of KSHP are presented as discontinued operations for all periods presented. The assets, liabilities and results of operations of KSHP are classified as discontinued operations for all periods presented beginning in 2011. KSHP was previously reported in the Managed Care segment.

During the nine months ended September 30, 2014, the Company received $8,000 of dividends from KSHP. KSHP had remaining statutory capital of approximately $79,000 at September 30, 2014, which, subject to future dividends, will be transferred to unregulated cash upon regulatory approval.

Operating results for the discontinued operations are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013

Revenues	$—	$8,084	$—	$243,900
Earnings (loss) before income taxes	1,379	(1,572)	3,679	(2,364)
Net earnings (loss)	1,521	(952)	2,368	(1,394)

The net earnings from discontinued operations for the three months ended September 30, 2014 includes the reversal of the expense previously recorded for the health insurer fee of $1,788.

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Assets and liabilities of the discontinued operations are as follows:

	September 30, 2014	December 31, 2013
Current assets	$72,234	$77,512
Long term investments and restricted deposits	25,631	38,305
Assets of discontinued operations	$97,865	$115,817
Medical claims liability	$11,847	$27,637
Accounts payable and accrued expenses	6,776	2,657
Other liabilities	411	1,028
Liabilities of discontinued operations	$19,034	$31,322

4. Short-term and Long-term Investments, Restricted Deposits

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

	September 30, 2014				December 31, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$329,439	$246	$(4,273)	$325,412	$246,085	$245	$(7,494)	$238,836
Corporate securities	489,304	2,815	(990)	491,129	293,912	2,782	(608)	296,086
Restricted certificates of deposit	5,892	—	—	5,892	5,891	—	—	5,891
Restricted cash equivalents	78,995	—	—	78,995	26,642	—	—	26,642
Municipal securities:								
General obligation	49,467	422	(14)	49,875	54,003	555	(136)	54,422
Pre-refunded	4,955	46	(16)	4,985	10,835	82	—	10,917
Revenue	100,312	768	(58)	101,022	68,801	545	(292)	69,054
Variable rate demand notes	11,700	—	—	11,700	28,575	—	—	28,575
Asset backed securities	185,270	389	(143)	185,516	138,803	579	(332)	139,050
Mortgage backed securities	46,023	753	—	46,776	33,974	—	(83)	33,891
Cost and equity method investments	58,051	—	—	58,051	22,239	—	—	22,239
Life insurance contracts	15,628	—	—	15,628	15,369	—	—	15,369
Total	$1,375,036	$5,439	$(5,494)	$1,374,981	$945,129	$4,788	$(8,945)	$940,972

The Company’s investments are classified as available-for-sale with the exception of life insurance contracts and certain cost and equity method investments. The Company’s investment policies are designed to provide liquidity, preserve capital and maximize total return on invested assets with the focus on high credit quality securities. The

Company limits the size of investment in any single issuer other than U.S. treasury securities and obligations of U.S. government corporations and agencies. The Company's mortgage backed securities are issued by the Federal National Mortgage Association and carry guarantees by the U.S. government. As of September 30, 2014, 48% of the Company’s investments in securities recorded at fair value that carry a rating by S&P or Moody’s were rated AAA/Aaa, 60% were rated AA-/Aa3 or higher, and 90% were rated

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A-/A3 or higher. At September 30, 2014, the Company held certificates of deposit, life insurance contracts and cost and equity method investments which did not carry a credit rating.

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

	September 30, 2014				December 31, 2013			
	Less Than 12 Months		12 Months or More		Less Than 12 Months		12 Months or More	
	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$(204)	$62,910	$(4,069)	$178,270	$(6,188)	$172,365	$(1,307)	$26,454
Corporate securities	(972)	195,027	(18)	983	(400)	52,725	(207)	5,020
Municipal securities:								
General obligation	—	—	(14)	3,456	(72)	3,480	(63)	2,426
Pre-refunded	(16)	1,022	—	—	—	—	—	—
Revenue	(24)	2,356	(34)	3,395	(292)	27,789	—	—
Asset backed securities	(62)	41,911	(81)	10,046	(333)	37,689	—	—
Mortgage backed securities	—	—	—	—	(83)	33,891	—	—
Total	$(1,278)	$303,226	$(4,216)	$196,150	$(7,368)	$327,939	$(1,577)	$33,900

As of September 30, 2014, the gross unrealized losses were generated from 91 positions out of a total of 332 positions. The change in fair value of fixed income securities is a result of movement in interest rates subsequent to the purchase of the security.

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

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

	September 30, 2014				December 31, 2013			
	Investments		Restricted Deposits		Investments		Restricted Deposits	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
One year or less	$166,251	$166,993	$91,716	$91,731	$101,537	$102,126	$40,633	$40,637
One year through five years	953,321	952,591	7,999	7,996	609,755	610,589	6,301	6,309
Five years through ten years	123,875	123,175	—	—	157,003	151,221	—	—
Greater than ten years	31,874	32,495	—	—	29,900	30,090	—	—
Total	$1,275,321	$1,275,254	$99,715	$99,727	$898,195	$894,026	$46,934	$46,946

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

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

5. Fair Value Measurements

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

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

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The following table summarizes fair value measurements by level at September 30, 2014, for assets and liabilities measured at fair value on a recurring basis:

	Level I	Level II	Level III	Total
Assets				
Cash and cash equivalents	$1,523,596	$—	$—	$1,523,596
Investments available for sale:				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$270,857	$39,715	$—	$310,572
Corporate securities	—	491,129	—	491,129
Municipal securities:				
General obligation	—	49,875	—	49,875
Pre-refunded	—	4,985	—	4,985
Revenue	—	101,022	—	101,022
Variable rate demand notes	—	11,700	—	11,700
Asset backed securities	—	185,516	—	185,516
Mortgage backed securities	—	46,776	—	46,776
Total investments	$270,857	$930,718	$—	$1,201,575
Restricted deposits available for sale:				
Cash and cash equivalents	$78,995	$—	$—	$78,995
Certificates of deposit	5,892	—	—	5,892
U.S. Treasury securities and obligations of U.S. government corporations and agencies	14,840	—	—	14,840
Total restricted deposits	$99,727	$—	$—	$99,727
Other long-term assets: Interest rate swap agreements	$—	$6,796	$—	$6,796
Total assets at fair value	$1,894,180	$937,514	$—	$2,831,694
Liabilities				
Other long-term liabilities: Interest rate swap agreements	$—	$1,250	$—	$1,250
Total liabilities at fair value	$—	$1,250	$—	$1,250

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The following table summarizes fair value measurements by level at December 31, 2013, for assets and liabilities measured at fair value on a recurring basis:

	Level I	Level II	Level III	Total
Assets				
Cash and cash equivalents	$974,304	$—	$—	$974,304
Investments available for sale:				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$212,185	$12,238	$—	$224,423
Corporate securities	—	296,086	—	296,086
Municipal securities:				
General obligation	—	54,422	—	54,422
Pre-refunded	—	10,917	—	10,917
Revenue	—	69,054	—	69,054
Variable rate demand notes	—	28,575	—	28,575
Asset backed securities	—	139,050	—	139,050
Mortgage backed securities	—	33,891	—	33,891
Total investments	$212,185	$644,233	$—	$856,418
Restricted deposits available for sale:				
Cash and cash equivalents	$26,642	$—	$—	$26,642
Certificates of deposit	5,891	—	—	5,891
U.S. Treasury securities and obligations of U.S. government corporations and agencies	14,413	—	—	14,413
Total restricted deposits	$46,946	$—	$—	$46,946
Other long-term assets: Interest rate swap agreements	$—	$9,576	$—	$9,576
Total assets at fair value	$1,233,435	$653,809	$—	$1,887,244

The Company periodically transfers U.S. Treasury securities and obligations of U.S. government corporations and agencies between Level I and Level II fair value measurements dependent upon the level of trading activity for the specific securities at the measurement date. The Company's policy regarding the timing of transfers between Level I and Level II is to measure and record the transfers at the end of the reporting period. At September 30, 2014, there were $38,347 of transfers from Level I to Level II and $621 of transfers from Level II to Level I. The Company utilizes matrix pricing services to estimate fair value for securities which are not actively traded on the measurement date. The Company designates these securities as Level II fair value measurements. The aggregate carrying amount of the Company's life insurance contracts and other non-majority owned investments, which approximates fair value, was $73,679 and $37,608 as of September 30, 2014 and December 31, 2013, respectively.

6. Debt

Debt consists of the following:

	September 30, 2014	December 31, 2013
Senior notes, at par	$725,000	$425,000
Unamortized premium on senior notes	4,724	6,052
Fair value of interest rate swap agreements	5,546	9,576
Senior notes	735,270	440,628
Revolving credit agreement	140,000	150,000
Mortgage notes payable	70,749	72,785
Capital leases and other	8,832	5,349
Total debt	954,851	668,762
Less current portion	(5,131)	(3,065)

Long-term debt	$949,720	$665,697

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Senior Notes

In May 2011, the Company issued $250,000 non-callable 5.75% Senior Notes due June 1, 2017 ($250,000 Notes) at a discount to yield 6%. In connection with the May 2011 issuance, the Company entered into interest rate swap agreements for a notional amount of $250,000. Gains and losses due to changes in the fair value of the interest rate swap agreements completely offset changes in the fair value of the hedged portion of the underlying debt and are recorded as an adjustment to the $250,000 Notes. At September 30, 2014, the fair value of the interest rate swap agreements increased the fair value of the notes by $6,796 and the variable interest rate of the swap agreements was 3.74%.

In November 2012, the Company issued an additional $175,000 non-callable 5.75% Senior Notes due June 1, 2017 ($175,000 Add-on Notes) at a premium to yield 4.29%. The indenture governing the $250,000 Notes and the $175,000 Add-on Notes contains non-financial and financial covenants, including requirements of a minimum fixed charge coverage ratio. Interest is paid semi-annually in June and December. At September 30, 2014, the total net unamortized debt premium on the $250,000 Notes and $175,000 Add-on Notes was $4,724.

In April 2014, the Company issued $300,000 4.75% Senior Notes due May 15, 2022 ($300,000 Notes) at par. In connection with the April 2014 issuance, the Company entered into interest rate swap agreements for a notional amount of $300,000. Gains and losses due to changes in the fair value of the interest rate swap agreements completely offset changes in the fair value of the hedged portion of the underlying debt and are recorded as an adjustment to the $300,000 Notes. At September 30, 2014, the fair value of the interest rate swap agreements decreased the fair value of the notes by $1,250 and the variable interest rate of the swap agreements was 2.51%.

Revolving Credit Agreement

In May 2013, the Company entered into a new unsecured $500,000 revolving credit facility. Borrowings under the agreement bear interest based upon LIBOR rates, the Federal Funds Rate or the Prime Rate. The agreement has a maturity date of June 1, 2018, provided it will mature 90 days prior to the maturity date of the Company's 5.75% Senior Notes due 2017 if such notes are not refinanced (or extended), certain financial conditions are not met, or the Company does not carry $100,000 of unrestricted cash. As of September 30, 2014, the Company had $140,000 of borrowings outstanding under the agreement with a weighted average interest rate of 3.04%.

The agreement contains non-financial and financial covenants, including requirements of minimum fixed charge coverage ratios, maximum debt-to-EBITDA ratios and minimum tangible net worth. The Company is required to not exceed a maximum debt-to-EBITDA ratio of 3.0 to 1.0. As of September 30, 2014, there were no limitations on the availability under the revolving credit agreement as a result of the debt-to-EBITDA ratio.

Letters of Credit & Surety Bonds

The Company had outstanding letters of credit of $30,149 as of September 30, 2014, which were not part of the revolving credit facility. As discussed in Note 2, Acquisitions, the Company also had letters of credit for $60,889 (valued at the September 30, 2014 conversion rate), or €48,000, representing its proportional share of the letters of credit issued to support Ribera Salud's outstanding debt which are a part of the revolving credit facility. Collectively, the letters of credit bore interest at 1.71% as of September 30, 2014. The Company had outstanding surety bonds of $144,467 as of September 30, 2014.

7. Interest Rate Swap Agreements

In May 2011, the Company entered into $250,000 notional amount of interest rate swap agreements (2011 Swap Agreements) that are scheduled to expire June 1, 2017. Under the 2011 Swap Agreements, the Company receives a fixed rate of 5.75% and pays a variable rate of the three month LIBOR plus 3.50% adjusted quarterly, which allows the Company to adjust $250,000 of its senior notes to a floating rate. At September 30, 2014, the variable rate was 3.74%.

In April 2014, the Company entered into $300,000 notional amount of interest rate swap agreements (2014 Swap Agreements) that are scheduled to expire May 15, 2022. Under the 2014 Swap Agreements, the Company receives a fixed rate of 4.75% and pays a variable rate of the three month LIBOR plus 2.27% adjusted quarterly, which allows the Company to adjust $300,000 of its senior notes to a floating rate. At September 30, 2014, the variable rate was 2.51%.

The 2011 and 2014 Swap Agreements are formally designated and qualify as fair value hedges. The 2011 and 2014 Swap Agreements are recorded at fair value in the Consolidated Balance Sheet in other assets or other liabilities. Gains and losses due to changes in fair value of the interest rate swap agreements completely offset changes in the fair value of the hedged

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portion of the underlying debt. Therefore, no gain or loss has been recognized due to hedge ineffectiveness. Offsetting changes in fair value of both the interest rate swap agreements and the hedged portion of the underlying debt both were recognized in interest expense in the Consolidated Statement of Operations. The Company does not hold or issue any derivative instrument for trading or speculative purposes.

The fair values of the 2011 Swap Agreements as of September 30, 2014 were an asset of approximately $6,796 and are included in other long term assets in the Consolidated Balance Sheet. The fair values of the 2014 Swap Agreements as of September 30, 2014 were a liability of approximately $1,250 and are included in other long term liabilities in the Consolidated Balance Sheet.

The fair value of the 2011 and 2014 Swap Agreements excludes accrued interest and takes into consideration current interest rates and current likelihood of the swap counterparties' compliance with its contractual obligations.

8. Stockholders' Equity

In January 2014, the Company completed the acquisition of 68% of USMM and as a result, issued 2,243,217 shares of Centene common stock to the selling stockholders. Additionally, in July 2014, the Company completed a transaction whereby CHS assigned its contract with the Louisiana Department of Health and Hospitals to Centene's wholly owned subsidiary, LHC. The closing resulted in the issuance of 746,369 shares of Centene common stock.

9. Income Taxes

In September 2014, the Internal Revenue Service issued final regulations related to the compensation deduction limitation applicable to certain health insurance issuers. The new regulations provided additional information regarding the definition of a health insurance issuer. Based on the final regulations, the Company no longer believes it is subject to the compensation deduction limitation in 2013 and 2014. As a result of this change in regulation, tax benefits of $14,500 related to 2013 and $5,600 related to the first half of 2014 were recorded in the third quarter of 2014.

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10. Earnings Per Share

The following table sets forth the calculation of basic and diluted net earnings per common share:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Earnings attributable to Centene Corporation:				
Earnings from continuing operations, net of tax	$81,099	$50,325	$162,098	$113,253
Discontinued operations, net of tax	1,521	(952)	2,368	(1,394)
Net earnings	$82,620	$49,373	$164,466	$111,859
Shares used in computing per share amounts:				
Weighted average number of common shares outstanding	58,613,484	54,679,660	57,956,152	53,863,779
Common stock equivalents (as determined by applying the treasury stock method)	2,068,391	2,253,396	1,980,547	2,092,642
Weighted average number of common shares and potential dilutive common shares outstanding	60,681,875	56,933,056	59,936,699	55,956,421
Net earnings (loss) per common share attributable to Centene Corporation:				
Basic:				
Continuing operations	$1.38	$0.92	$2.80	$2.10
Discontinued operations	0.03	(0.02)	0.04	(0.02)
Basic earnings per common share	$1.41	$0.90	$2.84	$2.08
Diluted:				
Continuing operations	$1.34	$0.88	$2.70	$2.02
Discontinued operations	0.02	(0.01)	0.04	(0.02)
Diluted earnings per common share	$1.36	$0.87	$2.74	$2.00

The calculation of diluted earnings per common share for the three and nine months ended September 30, 2014 excludes the impact of 23,760 shares and 58,878 shares, respectively, related to anti-dilutive stock options, restricted stock and restricted stock units. The calculation of diluted earnings per common share for the three and nine months ended September 30, 2013 excludes the impact of 14,532 shares and 76,957 shares, respectively, related to anti-dilutive stock options, restricted stock and restricted stock units.

11. Segment Information

Centene operates in two segments: Managed Care and Specialty Services. The Managed Care segment consists of Centene's health plans including all of the functions needed to operate them. The Specialty Services segment consists of Centene's specialty companies offering auxiliary healthcare services and products.

Segment information for the three months ended September 30, 2014, follows:

	Managed Care	Specialty Services	Eliminations	Consolidated Total
Premium and service revenues from external customers	$3,730,737	$428,352	$—	$4,159,089

Premium and service revenues from internal customers	15,339	806,078	(821,417)	—
Total premium and service revenues	$3,746,076	$1,234,430	$(821,417)	$4,159,089
Earnings from operations	$79,702	$28,230	$—	$107,932

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Segment information for the three months ended September 30, 2013, follows:

	Managed Care	Specialty Services	Eliminations	Consolidated Total
Premium and service revenues from external customers	$2,502,137	$223,927	$—	$2,726,064
Premium and service revenues from internal customers	9,864	539,969	(549,833)	—
Total premium and service revenues	$2,512,001	$763,896	$(549,833)	$2,726,064
Earnings from operations	$71,336	$12,656	$—	$83,992

Segment information for the nine months ended September 30, 2014, follows:

	Managed Care	Specialty Services	Eliminations	Consolidated Total
Premium and service revenues from external customers	$9,925,307	$1,326,930	$—	$11,252,237
Premium and service revenues from internal customers	41,953	2,120,819	(2,162,772)	—
Total premium and service revenues	$9,967,260	$3,447,749	$(2,162,772)	$11,252,237
Earnings from operations	$187,653	$82,985	$—	$270,638

Segment information for the nine months ended September 30, 2013, follows:

	Managed Care	Specialty Services	Eliminations	Consolidated Total
Premium and service revenues from external customers	$7,123,336	$543,472	$—	$7,666,808
Premium and service revenues from internal customers	30,209	1,590,576	(1,620,785)	—
Total premium and service revenues	$7,153,545	$2,134,048	$(1,620,785)	$7,666,808
Earnings from operations	$126,196	$66,133	$—	$192,329

12. Contingencies

In October 2012, the Company notified the Kentucky Cabinet for Health and Family Services that it was exercising a contractual right that it believes allows the Company to terminate its Medicaid managed care contract with the Commonwealth of Kentucky effective July 5, 2013. The Company also filed a lawsuit in Franklin Circuit Court against the Commonwealth seeking a declaration of the Company's right to terminate the contract on July 5, 2013. In April 2013, the Commonwealth answered that lawsuit and filed counterclaims against the Company seeking declaratory relief and damages. In May 2013, the Franklin Circuit Court ruled that Kentucky Spirit does not have a contractual right to terminate the contract early. Kentucky Spirit appealed that ruling to the Kentucky Court of Appeals. In August 2014, the Kentucky Court of Appeals heard oral argument on the appeal. A decision from the Court of Appeals is expected in the fourth quarter of 2014.

The Company also filed a formal dispute with the Cabinet for damages incurred under the contract, which was later appealed to and denied by the Finance and Administration Cabinet. In response, the Company filed a lawsuit in April 2013, amended in September 2014, in Franklin Circuit Court seeking damages against the Commonwealth for losses sustained due to the Commonwealth's alleged breaches. Discovery is proceeding in that action.

Kentucky Spirit's efforts to resolve issues with the Commonwealth were unsuccessful and on July 5, 2013, Kentucky Spirit proceeded with its previously announced exit. The Commonwealth has alleged that Kentucky Spirit's exit constitutes a material breach of contract. The Commonwealth seeks to recover substantial damages and to enforce its rights under Kentucky Spirit's $25,000 performance bond. In March 2014, Kentucky Spirit received a demand letter from the Commonwealth seeking damages to reimburse the Commonwealth for its alleged incurred and expected losses, expenses, transition costs and other damages for the period July 6, 2013 until July 5, 2014. The letter stated that the Commonwealth is seeking damages only on behalf of the Commonwealth, not the federal Centers for Medicare and Medicaid Services (CMS). In June 2014, the Commonwealth informed the Kentucky Department of Insurance that its expenditures due to Kentucky's Spirit's departure range from $28,000 to $40,000 plus interest, and that the associated CMS expenditures range from $92,000 to $134,000. Kentucky Spirit disputes the Commonwealth's alleged damages, is pursuing its own litigation claims for damages against the Commonwealth and will vigorously defend against any allegations that it has breached the contract.

The resolution of the Kentucky litigation matters may result in a range of possible outcomes. If the Company prevails on its claims, Kentucky Spirit would be entitled to damages under its lawsuit. If the Commonwealth prevails, a liability to the

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Commonwealth could be recorded. The Company is unable to estimate the ultimate outcome resulting from the Kentucky litigation. As a result, the Company has not recorded any receivable or any liability for potential damages under the contract as of September 30, 2014. While uncertain, the ultimate resolution of the pending litigation could have a material effect on the financial position, cash flow or results of operations of the Company in the period it is resolved or becomes known.

Excluding the Kentucky matters discussed above, the Company is routinely subjected to legal proceedings in the normal course of business. While the ultimate resolution of such matters in the normal course of business is uncertain, the Company does not expect the results of any of these matters individually, or in the aggregate, to have a material effect on its financial position, results of operations or cash flows.

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ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The following discussion of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and the related notes included elsewhere in this filing. The discussion contains forward-looking statements that involve both known and unknown risks and uncertainties, including those set forth under Part II, Item 1A. "Risk Factors" of this Form 10-Q.

OVERVIEW

In 2013, we classified the operations for Kentucky Spirit Health Plan (KSHP) as discontinued operations for all periods presented in our consolidated financial statements. The following discussion and analysis, with the exception of cash flow information, is presented in the context of continuing operations unless otherwise identified.

For the third quarter of 2014, we reported net earnings per diluted share of $1.34. Details of the earnings per diluted share are highlighted below:

	Third Quarter	
	2014	2013
Net earnings per diluted share	$ 1.34	$ 0.88
Impact of Health Insurer Fee	0.15	—
Acquisition transaction costs	0.06	—
Benefit for tax adjustment related to prior periods	(0.33)	—
Total, excluding above items	$ 1.22	$ 0.88

Included in the table above are the following items:

- A $0.15 per diluted share impact for the health insurer fee related to two states where we have not yet received signed agreements.
- Transaction costs of $0.06 per diluted share associated with acquisitions in the third quarter.
- An income tax benefit of $0.33 per diluted share for periods prior to the third quarter 2014. During the third quarter of 2014, the Internal Revenue Service (IRS) issued final regulations related to compensation deduction limitations applicable to certain health insurance issuers. As a result, we no longer believe the deduction limitations apply to Centene for 2013 and 2014. Accordingly, we reversed previously recorded tax expense from prior periods for this item.

Key financial metrics for the third quarter of 2014 are summarized as follows:

- Quarter-end managed care membership of 3,705,300, including non-risk membership of 303,500, an increase of 1,092,800 members, or 42% year over year.
- Premium and service revenues of $4.2 billion, representing 53% growth year over year.
- Health Benefits Ratio of 89.7%, compared to 87.8% in 2013.
- General and Administrative expense ratio of 8.0%, compared to 9.1% in 2013.
- Operating cash flow of $441.8 million for the third quarter of 2014.

The following items contributed to our revenue and membership growth over the last year:

- AcariaHealth. In April 2013, we completed the acquisition of AcariaHealth, a specialty pharmacy company.

- California. In November 2013, our California subsidiary, California Health and Wellness (CHW), began operating under a new contract with the California Department of Health Care Services to serve Medicaid beneficiaries in 18 rural counties under the state's Medi-Cal Managed Care Rural Expansion program and Medi-Cal beneficiaries in

Imperial County. In January 2014, CHW also began serving members under the state's Medicaid expansion program.

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- Centurion. Centurion is a joint venture between Centene and MHM Services Inc. In July 2013, Centurion began operating under a new contract with the Department of Corrections in Massachusetts to provide comprehensive healthcare services to individuals incarcerated in Massachusetts state correctional facilities. In September 2013, Centurion began operating under a new contract to provide comprehensive healthcare services to individuals incarcerated in Tennessee state correctional facilities. In January 2014, Centurion began operating under a new agreement with the Minnesota Department of Corrections to provide managed healthcare services to offenders in the state's correctional facilities.

- Florida. In August 2013, our Florida subsidiary, Sunshine Health, began operating under a contract in 10 of 11 regions with the Florida Agency for Health Care Administration to serve members of the Medicaid managed care Long Term Care (LTC) program. Enrollment began in August 2013 and was implemented by region through March 2014.

In May 2014, Sunshine Health also began operating under a new contract in 9 of 11 regions of the Managed Medical Assistance (MMA) program. The MMA program includes TANF recipients as well as ABD and dual-eligible members. In addition, we began operating as the sole provider under a new statewide contract for the Child Welfare Specialty Plan (Foster Care). Enrollment for both the MMA program and Foster Care began in May 2014 and was implemented by region through August 2014.

- Health Insurance Marketplaces (HIM). In January 2014, we began serving members enrolled in Health Insurance Marketplaces in certain regions of 9 states: Arkansas, Florida, Georgia, Indiana, Massachusetts, Mississippi, Ohio, Texas and Washington.

- Illinois. In March 2014, our Illinois subsidiary, IlliniCare Health, began operating under a new contract as part of the Illinois Medicare-Medicaid Alignment Initiative serving dual-eligible members in Cook, DuPage, Lake, Kane, Kankakee and Will counties (Greater Chicago region).

In July 2014, IlliniCare Health began operating under a new contract with the Cook County Health and Hospitals System to perform third party administrative services to members enrolled in the CountyCare program, as well as care coordination, behavioral health, vision care and pharmacy benefit management services.

In September 2014, IlliniCare Health began serving additional Medicaid members under the state's Medicaid and Medicaid expansion programs.

- Louisiana. In July 2014, we completed the transaction whereby Community Health Solutions of America, Inc. (CHS) assigned its contract with the Louisiana Department of Health and Hospitals under the Bayou Health Shared Savings Program to our subsidiary, Louisiana Healthcare Connections (LHC).

- Massachusetts. In January 2014, our CeltiCare Health subsidiary began operating under a new contract with the Massachusetts Executive Office of Health and Human Services to participate in the MassHealth CarePlus program in all five regions.

- Mississippi. In July 2014, our Mississippi subsidiary, Magnolia Health, began operating as one of two contractors under a new statewide managed care contract serving members enrolled in the Mississippi Coordinated Access Network program. The program provides for membership expansion beginning in late 2014.

- New Hampshire. In December 2013, our subsidiary, New Hampshire Healthy Families, began operating under a new contract with the Department of Health and Human Services to serve Medicaid beneficiaries.

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- Ohio. In July 2013, our Ohio subsidiary, Buckeye Community Health Plan (Buckeye), began operating under a new and expanded contract with the Ohio Department of Medicaid (ODM) to serve Medicaid members statewide through Ohio's three newly aligned regions (West, Central/Southeast and Northeast). Buckeye also began serving members under the ABD Child program in July 2013. In January 2014, Buckeye began serving members under the state's Medicaid expansion program.

In May 2014, Buckeye began operating under a new contract with the ODM to serve Medicaid members in a dual-eligible demonstration program in three of seven regions: Northeast (Cleveland), Northwest (Toledo) and West Central (Dayton). This three-year program, which is part of the Integrated Care Delivery System expansion, serves those who have both Medicare and Medicaid eligibility. Enrollment began in May 2014 and implementation was completed in July 2014.

- Texas. In September 2014, we began operating under a new contract with the Texas Health and Human Services Commission to expand our operations and serve STAR+PLUS members in two Medicaid Rural Service Areas. We also began providing expanded coverage in September 2014 under our STAR+PLUS contracts to provide acute care services for intellectually and developmentally disabled members.

- U.S. Medical Management. In January 2014, we acquired a majority interest in U.S. Medical Management, LLC, a management services organization and provider of in-home health services for high acuity populations.

- Washington. In January 2014, our subsidiary, Coordinated Care, began serving additional Medicaid members under the state's Medicaid expansion program.

In addition, in July 2014, we completed an investment accounted for under the equity method for the purchase of a noncontrolling interest in Ribera Salud S.A. (Ribera Salud), a Spanish health management group. Centene is a joint shareholder with Ribera Salud's remaining investor, Banco Sabadell S.A.

We expect the following items to contribute to our future growth potential:

- We expect to realize the full year benefit in 2014 of business commenced during 2013 in California, Florida, Massachusetts, New Hampshire, Ohio and Tennessee and the acquisition of AcariaHealth as discussed above.

- In December 2013, we signed a definitive agreement to purchase a majority stake in Fidelis SecureCare of Michigan, Inc. (Fidelis), a subsidiary of Fidelis SeniorCare, Inc. The transaction is expected to close in the first half of 2015, subject to certain closing conditions including regulatory approvals, and will include cash payments contingent on the performance of the plan. Fidelis was selected by the Michigan Department of Community Health to provide integrated healthcare services to members who are dually eligible for Medicare and Medicaid in Macomb and Wayne counties. Enrollment is expected to commence in the first half of 2015.

- In November 2013, our South Carolina subsidiary, Absolute Total Care, was selected by the South Carolina Department of Health and Human Services to serve dual-eligible members as part of the state's pilot program to provide integrated and coordinated care for individuals who are eligible for both Medicare and Medicaid. Operations are expected to commence in the first quarter of 2015.

- In May 2014, our Texas subsidiary, Superior HealthPlan, was selected by the Texas Health and Human Services Commission with the Centers for Medicare & Medicaid Services to serve dual-eligible members in three counties to provide integrated and coordinated care for individuals who are eligible for both Medicare and Medicaid. Operations are expected to commence in the first quarter of 2015.

- In February 2014, the Texas Health and Human Service commission expanded our STAR+PLUS contracts to include nursing facility benefits. The additional coverage is expected to commence in the first quarter of 2015.
- In October 2014, our subsidiary, Louisiana Healthcare Connections, was recommended for a contract award by the Louisiana Department of Health and Hospitals to serve Bayou Health (Medicaid) beneficiaries. The new Bayou Health contract is expected to commence early in the first quarter of 2015.

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MEMBERSHIP

From September 30, 2013 to September 30, 2014, we increased our at-risk managed care membership by 789,300, or 30%. The following table sets forth our membership by state for our managed care organizations:

	September 30, 2014	December 31, 2013	September 30, 2013
Arizona	7,000	7,100	23,700
Arkansas	36,600	—	—
California	144,700	97,200	—
Florida	411,200	222,000	217,800
Georgia	382,600	318,700	314,100
Illinois	31,300	22,300	22,800
Indiana	199,500	195,500	198,400
Kansas	144,200	139,900	137,700
Louisiana	150,800	152,300	152,600
Massachusetts	46,600	22,600	23,200
Minnesota	9,500	—	—
Mississippi	99,300	78,300	76,900
Missouri	64,900	59,200	58,200
New Hampshire	56,600	33,600	—
Ohio	261,000	173,200	170,900
South Carolina	106,500	91,900	89,400
Tennessee	21,200	20,700	20,400
Texas	961,100	935,100	957,300
Washington	192,500	82,100	77,100
Wisconsin	74,700	71,500	72,000
Total at-risk membership	3,401,800	2,723,200	2,612,500
Non-risk membership	303,500	—	—
Total	3,705,300	2,723,200	2,612,500

At September 30, 2014, we served 193,100 Medicaid members in Medicaid expansion programs in California, Illinois, Massachusetts, New Hampshire, Ohio and Washington included in the table above. We also served 195,500 members at September 30, 2014 under our behavioral health contract in Arizona, compared to 160,700 members at September 30, 2013.

The following table sets forth our membership by line of business:

	September 30, 2014	December 31, 2013	September 30, 2013
Medicaid	2,578,300	2,054,700	1,953,300
CHIP & Foster Care	247,700	275,100	274,900
ABD, Medicare & Duals	383,400	305,300	302,000
HIM	76,000	—	—
Hybrid Programs	19,900	19,000	19,600
LTC	55,200	37,800	31,600
Correctional Services	41,300	31,300	31,100
Total at-risk membership	3,401,800	2,723,200	2,612,500
Non-risk membership	303,500	—	—
Total	3,705,300	2,723,200	2,612,500

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The following table identifies our dual eligible membership by line of business. The membership tables above include these members.

	September 30, 2014	December 31, 2013	September 30, 2013
ABD	119,300	71,700	72,000
LTC	35,500	28,800	19,600
Medicare	9,800	6,500	6,100
Total	164,600	107,000	97,700

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RESULTS OF OPERATIONS

The following discussion and analysis is based on our consolidated statements of operations, which reflect our results of operations for the three and nine months ended September 30, 2014 and 2013, prepared in accordance with generally accepted accounting principles in the United States.

Summarized comparative financial data for the three and nine months ended September 30, 2014 and 2013 is as follows ($ in millions):

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2014	2013	% Change 2013-2014	2014	2013	% Change 2013-2014
Premium	$3,780.3	$2,613.6	44.6 %	$10,182.2	$7,415.5	37.3 %
Service	378.8	112.5	236.7 %	1,070.0	251.3	325.8 %
Premium and service revenues	4,159.1	2,726.1	52.6 %	11,252.2	7,666.8	46.8 %
Premium tax and health insurer fee	192.8	69.5	177.4 %	583.2	264.8	120.3 %
Total revenues	4,351.9	2,795.6	55.7 %	11,835.4	7,931.6	49.2 %
Medical costs	3,390.1	2,293.6	47.8 %	9,092.6	6,582.5	38.1 %
Cost of services	327.2	100.5	225.7 %	935.4	218.8	327.4 %
General and administrative expenses	333.9	249.0	34.1 %	950.4	675.8	40.6 %
Premium tax expense	160.7	68.5	134.8 %	491.7	262.2	87.5 %
Health insurer fee expense	32.0	—	n.m.	94.6	—	n.m.
Earnings from operations	108.0	84.0	28.5 %	270.7	192.3	40.7 %
Investment and other income, net	(3.6)	(1.9)	(95.3)%	(7.3)	(7.2)	(1.3)%
Earnings from continuing operations, before income tax expense	104.4	82.1	27.0 %	263.4	185.1	42.2 %
Income tax expense	26.7	32.2	(17.3)%	106.1	72.9	45.5 %
Earnings from continuing operations, net of income tax	77.7	49.9	55.7 %	157.3	112.2	40.1 %
Discontinued operations, net of income tax expense (benefit) of $(0.1), $(0.6), $1.3 and $(1.0) respectively	1.5	(1.0)	259.8 %	2.4	(1.3)	269.9 %
Net earnings	79.2	48.9	61.8 %	159.7	110.9	44.0 %
Noncontrolling interest	(3.5)	(0.5)	n.m.	(4.8)	(1.0)	(373.3)%
Net earnings attributable to Centene Corporation	$82.7	$49.4	67.3 %	$164.5	$111.9	47.0 %
Amounts attributable to Centene Corporation common shareholders:						
Earnings from continuing operations, net of income tax expense	$81.2	$50.4	61.2 %	$162.1	$113.2	43.1 %
Discontinued operations, net of income tax expense	1.5	(1.0)	259.8 %	2.4	(1.3)	269.9 %
Net earnings	$82.7	$49.4	67.3 %	$164.5	$111.9	47.0 %
Diluted earnings per common share attributable to Centene Corporation:						
Continuing operations	$1.34	$0.88	52.3 %	$2.70	$2.02	33.7 %
Discontinued operations	0.02	(0.01)	300.0 %	0.04	(0.02)	300.0 %
Total diluted earnings per common share	$1.36	$0.87	56.3 %	$2.74	$2.00	37.0 %

n.m.: not meaningful.

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Three Months Ended September 30, 2014 Compared to Three Months Ended September 30, 2013

Premium and Service Revenues

Premium and service revenues increased 52.6% in the three months ended September 30, 2014 over the corresponding period in 2013 primarily as a result of the expansions in Florida, Ohio, Washington and Illinois, growth in the AcariaHealth business, the addition of California and New Hampshire operations and our participation in the Health Insurance Marketplaces.

Operating Expenses

Medical Costs

Results of operations depend on our ability to manage expenses associated with health benefits and to accurately estimate costs incurred. The Health Benefits Ratio, or HBR, represents medical costs as a percentage of premium revenues (excluding Premium Tax and Health Insurer Fee revenues) and reflects the direct relationship between the premium received and the medical services provided. The table below depicts the HBR for our membership by member category for the three months ended September 30,:

	2014		2013	
Medicaid, CHIP, Foster Care & HIM	86.5	%	84.8	%
ABD, LTC & Medicare	93.9		92.1	
Specialty Services	86.8		86.8	
Total	89.7		87.8	

The consolidated HBR for the three months ended September 30, 2014, was 89.7%, compared to 87.8% in the same period in 2013. The HBR increase compared to 2013 is attributable to an increase in higher acuity membership over the comparable prior year period.

Revenue and HBR results for new business and existing business are listed below to assist in understanding our results of operations. Existing businesses are primarily state markets or significant geographic expansion in an existing state or product that we have managed for four complete quarters. New businesses are primarily new state markets or significant geographic expansion in an existing state or product that conversely, we have not managed for four complete quarters. The following table compares the results for new business and existing business for the three months ended September 30,:

	2014		2013	
Premium and Service Revenue				
New business	27	%	14	%
Existing business	73	%	86	%
HBR				
New business	91.4	%	96.5	%
Existing business	89.0	%	86.3	%

Cost of Services

Cost of services increased by $226.8 million in the three months ended September 30, 2014, compared to the corresponding period in 2013. This was primarily due to growth in AcariaHealth as well as the acquisition of U.S. Medical Management.

General & Administrative Expenses

General and administrative expenses, or G&A, increased by $84.9 million in the three months ended September 30, 2014, compared to the corresponding period in 2013. This was primarily due to expenses for additional staff and facilities to support our membership growth and acquisition transaction costs.

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The consolidated G&A expense ratio for the three months ended September 30, 2014 and 2013 was 8.0% and 9.1%, respectively. The year over year decrease primarily reflects the leveraging of expenses over higher revenue in 2014.

Health Insurer Fee

During the three months ended September 30, 2014, we recorded $32.0 million of non-deductible expense for the Affordable Care Act (ACA) annual health insurer fee. As of September 30, 2014, we have received signed agreements from 15 of 17 applicable states which provide for the reimbursement of the ACA insurer fee including the related gross-up for the associated income tax effects. As a result, we recorded $32.1 million in Premium Tax and Health Insurer Fee revenue associated with the accrual for the reimbursement of the fee. The net effect of the health insurer fee related to states where we have not received signed agreements reduced our diluted earnings per share by $0.15 during the third quarter of 2014.

Other Income (Expense)

The following table summarizes the components of other income (expense) for the three months ended September 30, ($ in millions):

	2014	2013
Investment and other income	$5.3	$4.8
Equity method investment earnings	0.4	—
Interest expense	(9.3)	(6.6)
Other income (expense), net	$(3.6)	$(1.8)

The increase in investment income in 2014 reflects an increase in investment balances over 2013 and improved performance of certain equity investments. Interest expense increased in 2014 compared to 2013, reflecting the issuance of an additional $300 million in Senior Notes in April 2014 and a higher level of borrowings under our revolving credit agreement.

Income Tax Expense

Excluding the effects of noncontrolling interest, our effective tax rate for the three months ended September 30, 2014 and 2013, was a tax expense of 24.8% and 39.1%, respectively. During the third quarter 2014, the IRS issued final regulations related to the compensation deduction limitation applicable to certain health insurance providers. As a result, we no longer believe the deduction limitation applies for 2013 and 2014. Accordingly, we reversed $20.1 million of previously recorded tax expense for prior periods resulting in a decrease in the effective tax rate. The decrease is partially offset by the non-deductibility of the health insurer fee which increased our effective tax rate.

Segment Results

The following table summarizes our consolidated operating results by segment for the three months ended September 30, ($ in millions):

	2014	2013	% Change 2013-2014
Premium and Service Revenues			
Managed Care	$3,746.1	$2,512.0	49.1 %
Specialty Services	1,234.4	763.9	61.6 %
Eliminations	(821.4)	(549.8)	(49.4)%
Consolidated Total	$4,159.1	$2,726.1	52.6 %
Earnings from Operations			

Managed Care	$79.7	$71.3	11.7	%
Specialty Services	28.2	12.7	123.1	%
Consolidated Total	$107.9	$84.0	28.5	%

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Managed Care

Premium and service revenues increased 49.1% in the three months ended September 30, 2014, primarily as a result of expansions in Florida, Ohio, Washington and Illinois, the addition of California and New Hampshire operations and our participation in the Health Insurance Marketplaces. Earnings from operations increased 11.7% between years primarily reflecting the growth in the business.

Specialty Services

Premium and service revenues increased 61.6% in the three months ended September 30, 2014, resulting from growth in the AcariaHealth business, increased services associated with membership growth in the Managed Care segment, the addition of two Centurion contracts and the acquisition of U.S. Medical Management. Earnings from operations increased 123.1% in the three months ended September 30, 2014, primarily reflecting growth in the AcariaHealth business as well as favorable development in our legacy individual health business.

Nine Months Ended September 30, 2014 Compared to Nine Months Ended September 30, 2013

Premium and Service Revenues

Premium and service revenues increased 46.8% in the nine months ended September 30, 2014, over the corresponding period in 2013 primarily as a result of expansions in Florida, Ohio, Washington and Illinois, growth in the AcariaHealth business, the addition of the California and New Hampshire operations and our participation in the Health Insurance Marketplaces. During the nine months ended September 30, 2014, we received premium rate adjustments which yielded a net 0% composite change across all of our markets.

Operating Expenses

Medical Costs

Results of operations depend on our ability to manage expenses associated with health benefits and to accurately estimate costs incurred. The Health Benefits Ratio, or HBR, represents medical costs as a percentage of premium revenues (excluding Premium Tax and Health Insurer Fee revenues) and reflects the direct relationship between the premium received and the medical services provided. The table below depicts the HBR for our membership by member category for the nine months ended September 30,:

	2014		2013	
Medicaid, CHIP, Foster Care & HIM	86.1	%	87.9	%
ABD, LTC & Medicare	94.0		90.5	
Specialty Services	84.9		84.4	
Total	89.3		88.8	

The consolidated HBR for the nine months ended September 30, 2014 of 89.3% was an increase of 50 basis points over the comparable period in 2013. The increase compared to last year is primarily attributable to an increase in higher acuity membership over the comparable prior year period.

Cost of Services

Cost of services increased by $716.6 million in the nine months ended September 30, 2014, compared to the corresponding period in 2013. This was primarily due to the acquisition of and growth in our AcariaHealth business as well as the acquisition of U.S. Medical Management.

General & Administrative Expenses

General and administrative expenses, or G&A, increased by $274.6 million in the nine months ended