

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2018

OR

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

For the transition period from _____ to _____

Commission file 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 Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files) Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer", "accelerated filer", "small reporting company", and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Non-accelerated filer

Accelerated filer

Smaller reporting company

Emerging growth company

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

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

As of October 12, 2018, the registrant had 205,355,367 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 intend such forward-looking statements to be covered by the safe-harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995, and we are including this statement for purposes of complying with these safe-harbor provisions. We have attempted to identify these statements by terminology including “believe,” “anticipate,” “plan,” “expect,” “estimate,” “intend,” “seek,” “target,” “goal,” “may,” “will,” “would,” “could,” “should,” “can,” “continue” and other similar words or expressions (and the negative thereof) in connection with, among other things, any discussion of future operating or financial performance. In particular, these statements include without limitation statements about our market opportunity, growth strategy, competition, expected activities in completed and future acquisitions, including statements about the impact of our recent acquisition of New York State Catholic Health Plan, Inc., d/b/a Fidelis Care New York (Fidelis Care) (Fidelis Care Acquisition), investments and the adequacy of our available cash resources. These statements may be found in the various sections of this filing, such as Part I, Item 2, “*Management’s Discussion and Analysis of Financial Condition and Results of Operations*,” Part II, Item 1, “*Legal Proceedings*,” and Part II, Item 1A, “*Risk Factors*.” Readers are cautioned that matters subject to forward-looking statements involve known and unknown risks and uncertainties, including economic, regulatory, competitive and other factors that may cause our or our industry’s actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by these forward-looking statements. These statements are not guarantees of future performance and are subject to risks, uncertainties and assumptions.

All forward-looking statements included in this filing are based on information available to us on the date of this filing. Except as may be otherwise required by law, 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. You should not place undue reliance on any forward-looking statements, as actual results may differ materially from projections, estimates, or other forward-looking statements 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 declines or unexpected trends;
- changes in healthcare practices, new technologies, and advances in medicine;
- increased healthcare costs;
- changes in economic, political or market conditions;
- changes in federal or state laws or regulations, including changes with respect to income tax reform or government healthcare programs as well as changes with respect to the Patient Protection and Affordable Care Act and the Health Care and Education Affordability Reconciliation Act and any regulations enacted thereunder that may result from changing political conditions;
- rate cuts or other payment reductions or delays by governmental payors and other risks and uncertainties affecting our government businesses;
- our ability to adequately price products on federally facilitated and state-based Health Insurance Marketplaces;
- tax matters;
- disasters or major epidemics;
- the outcome of legal and regulatory proceedings;
- changes in expected contract start dates;
- provider, state, federal and other contract changes and timing of regulatory approval of contracts;
- the expiration, suspension, or termination of our contracts with federal or state governments (including but not limited to Medicaid, Medicare, TRICARE or other customers);
- the difficulty of predicting the timing or outcome of pending or future litigation or government investigations;
- challenges to our contract awards;
- cyber-attacks or other privacy or data security incidents;
- the possibility that the expected synergies and value creation from acquired businesses, including, without limitation, the acquisition (Health Net Acquisition) of Health Net, Inc. (Health Net) and the Fidelis Care Acquisition, will not be realized, or will not be realized within the expected time period;
- the exertion of management’s time and our resources, and other expenses incurred and business changes required in connection with complying with the undertakings in connection with any regulatory, governmental or third party consents or approvals for the Health Net Acquisition or the Fidelis Care Acquisition;
- disruption caused by significant completed and pending acquisitions, including the Health Net Acquisition and the Fidelis Care Acquisition, making it more difficult to maintain business and operational relationships;
- the risk that unexpected costs will be incurred in connection with the completion and/or integration of acquisition transactions, including among others, the Health Net Acquisition and the Fidelis Care Acquisition;

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- changes in expected closing dates, estimated purchase price and accretion for acquisitions;
- the risk that acquired businesses, including Health Net and Fidelis Care, will not be integrated successfully;
- the risk that, following the Fidelis Care Acquisition, we may not be able to effectively manage our expanded operations;
- restrictions and limitations in connection with our indebtedness;
- our ability to achieve improvement in the Centers for Medicare and Medicaid Services (CMS) Star ratings and maintain or achieve improvement in other quality scores in each case that can impact revenue and future growth;
- availability of debt and equity financing, on terms that are favorable to us;
- inflation; and
- foreign currency fluctuations.

This list of important factors is not intended to be exhaustive. We discuss certain of these matters more fully, as well as certain other risk factors that may affect our business operations, financial condition and results of operations, in our filings with the Securities and Exchange Commission, including our annual report on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K. Item 1A. "Risk Factors" of Part II of this filing contains a further discussion of these and other important factors that could cause actual results to differ from expectations. Due to these important factors and risks, we cannot give assurances with respect to our future performance, including without limitation our ability to maintain adequate premium levels or our ability to control our future medical and selling, general and administrative costs.

Non-GAAP Financial Presentation

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

Specifically, the Company believes the presentation of non-GAAP financial information that excludes amortization of acquired intangible assets, acquisition related expenses, as well as other items, allows investors to develop a more meaningful understanding of the Company's performance over time. The tables below provide reconciliations of non-GAAP items (\$ in millions, except per share data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
GAAP net earnings	\$ 19	\$ 205	\$ 659	\$ 598
Amortization of acquired intangible assets	65	38	149	117
Acquisition related expenses	401	7	423	13
California minimum medical loss ratio changes	—	—	30	—
Penn Treaty assessment expense	—	9	—	56
Income tax effects of adjustments ⁽¹⁾	(110)	(20)	(140)	(68)
Adjusted net earnings	\$ 375	\$ 239	\$ 1,121	\$ 716
GAAP diluted earnings per share (EPS)	\$ 0.09	\$ 1.16	\$ 3.37	\$ 3.39
Amortization of acquired intangible assets ⁽²⁾	0.24	0.14	0.59	0.42
Acquisition related expenses ⁽³⁾	1.46	0.02	1.65	0.05
California minimum medical loss ratio changes ⁽⁴⁾	—	—	0.12	—
Penn Treaty assessment expense ⁽⁵⁾	—	0.03	—	0.20
Adjusted Diluted EPS	\$ 1.79	\$ 1.35	\$ 5.73	\$ 4.06

(1) The income tax effects of adjustments are based on the effective income tax rates applicable to adjusted (non-GAAP) results.

(2) The amortization of acquired intangible assets per diluted share are net of an income tax benefit of \$0.07 and \$0.07 for the three months ended September 30, 2018 and 2017, respectively, and \$0.17 and \$0.24 for the nine months ended September 30, 2018 and 2017, respectively.

(3) Acquisition related expenses per diluted share are net of an income tax benefit of \$0.46 and \$0.02 for the three months ended September 30, 2018 and 2017, respectively, and \$0.51 and \$0.03 for the nine months ended September 30, 2018 and 2017, respectively.

(4) The impact of retroactive changes to the California minimum medical loss ratio (MLR) per diluted share is net of an income tax benefit of \$0.04 for the nine months ended September 30, 2018.

(5) The Penn Treaty assessment expense per diluted share is net of an income tax benefit of \$0.02 and \$0.12 for the three and nine months ended September 30, 2017, respectively.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
GAAP selling, general and administrative expenses	\$ 1,934	\$ 1,030	\$ 4,487	\$ 3,186
Acquisition related expenses	399	7	421	13
Penn Treaty assessment expense	—	9	—	56
Adjusted selling, general and administrative expenses	<u>\$ 1,535</u>	<u>\$ 1,014</u>	<u>\$ 4,066</u>	<u>\$ 3,117</u>

PART I
FINANCIAL INFORMATION

ITEM 1. Financial Statements.

CENTENE CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In millions, except shares in thousands and per share data in dollars)

	<u>September 30, 2018</u>	<u>December 31, 2017</u>
	<u>(Unaudited)</u>	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 6,847	\$ 4,072
Premium and trade receivables	4,647	3,413
Short-term investments	594	531
Other current assets	1,000	687
Total current assets	13,088	8,703
Long-term investments	6,272	5,312
Restricted deposits	550	135
Property, software and equipment, net	1,584	1,104
Goodwill	6,803	4,749
Intangible assets, net	2,423	1,398
Other long-term assets	437	454
Total assets	<u>\$ 31,157</u>	<u>\$ 21,855</u>
LIABILITIES, REDEEMABLE NONCONTROLLING INTERESTS AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Medical claims liability	\$ 6,983	\$ 4,286
Accounts payable and accrued expenses	4,550	4,165
Return of premium payable	918	549
Unearned revenue	286	328
Current portion of long-term debt	4	4
Total current liabilities	12,741	9,332
Long-term debt	6,379	4,695
Other long-term liabilities	1,276	952
Total liabilities	20,396	14,979
Commitments and contingencies		
Redeemable noncontrolling interests	11	12
Stockholders' equity:		
Preferred stock, \$0.001 par value; authorized 10,000 shares; no shares issued or outstanding at September 30, 2018 and December 31, 2017	—	—
Common stock, \$0.001 par value; authorized 400,000 shares; 207,550 issued and 205,354 outstanding at September 30, 2018, and 180,379 issued and 173,437 outstanding at December 31, 2017	—	—
Additional paid-in capital	7,395	4,349
Accumulated other comprehensive loss	(79)	(3)
Retained earnings	3,422	2,748
Treasury stock, at cost (2,196 and 6,942 shares, respectively)	(85)	(244)
Total Centene stockholders' equity	10,653	6,850
Noncontrolling interest	97	14
Total stockholders' equity	10,750	6,864
Total liabilities, redeemable noncontrolling interests and stockholders' equity	<u>\$ 31,157</u>	<u>\$ 21,855</u>

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

CENTENE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(In millions, except per share data in dollars)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Revenues:				
Premium	\$ 14,623	\$ 10,850	\$ 38,639	\$ 32,393
Service	732	571	2,147	1,634
Premium and service revenues	15,355	11,421	40,786	34,027
Premium tax and health insurer fee	827	477	2,771	1,549
Total revenues	16,182	11,898	43,557	35,576
Expenses:				
Medical costs	12,626	9,543	33,045	28,278
Cost of services	622	437	1,823	1,334
Selling, general and administrative expenses	1,934	1,030	4,487	3,186
Amortization of acquired intangible assets	65	38	149	117
Premium tax expense	716	510	2,451	1,643
Health insurer fee expense	178	—	532	—
Total operating expenses	16,141	11,558	42,487	34,558
Earnings from operations	41	340	1,070	1,018
Other income (expense):				
Investment and other income	80	51	186	137
Interest expense	(97)	(65)	(245)	(189)
Earnings from operations, before income tax expense	24	326	1,011	966
Income tax expense	8	125	358	381
Net earnings	16	201	653	585
Loss attributable to noncontrolling interests	3	4	6	13
Net earnings attributable to Centene Corporation	\$ 19	\$ 205	\$ 659	\$ 598
Net earnings per common share attributable to Centene Corporation:				
Basic earnings per common share	\$ 0.09	\$ 1.19	\$ 3.44	\$ 3.47
Diluted earnings per common share	\$ 0.09	\$ 1.16	\$ 3.37	\$ 3.39

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

CENTENE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE EARNINGS
(In millions)
(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Net earnings	\$ 16	\$ 201	\$ 653	\$ 585
Reclassification adjustment, net of tax	1	—	1	(1)
Change in unrealized gain (loss) on investments, net of tax	(12)	7	(75)	41
Foreign currency translation adjustments	(1)	1	(2)	5
Other comprehensive earnings (loss)	(12)	8	(76)	45
Comprehensive earnings	4	209	577	630
Comprehensive loss attributable to noncontrolling interests	3	4	6	13
Comprehensive earnings attributable to Centene Corporation	\$ 7	\$ 213	\$ 583	\$ 643

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

CENTENE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
(In millions, except shares in thousands and per share data in dollars)
(Unaudited)

Nine Months Ended September 30, 2018

	Centene Stockholders' Equity										
	Common Stock			Accumulated Other Comprehensive Loss			Retained Earnings		Treasury Stock		Non-controlling Interest
	\$.001 Par Value Shares	Amt	Additional Paid-in Capital	\$	\$	\$	\$	\$.001 Par Value Shares	Amt	\$	
Balance, December 31, 2017	180,379	\$ —	\$ 4,349	\$	\$ (3)	\$ 2,748	\$	6,942	\$ (244)	\$ 14	\$ 6,864
Comprehensive Earnings:											
Net earnings	—	—	—	—	—	659	—	—	—	(3)	656
Other comprehensive loss, net of (\$23) tax	—	—	—	—	(76)	—	—	—	—	—	(76)
Common stock issued for acquisitions	—	—	331	—	—	—	—	(4,894)	176	—	507
Common stock issued	26,604	—	2,779	—	—	—	—	—	—	—	2,779
Common stock issued for employee benefit plans	567	—	12	—	—	—	—	—	—	—	12
Common stock repurchases	—	—	—	—	—	—	—	148	(17)	—	(17)
Stock compensation expense	—	—	105	—	—	—	—	—	—	—	105
Cumulative-effect of adopting new accounting guidance	—	—	—	—	—	15	—	—	—	—	15
Contribution from noncontrolling interest	—	—	—	—	—	—	—	—	—	3	3
Purchase of noncontrolling interest	—	—	(181)	—	—	—	—	—	—	(15)	(196)
Acquisition resulting in noncontrolling interest	—	—	—	—	—	—	—	—	—	98	98
Balance, September 30, 2018	<u>207,550</u>	<u>\$ —</u>	<u>\$ 7,395</u>	<u>\$</u>	<u>\$ (79)</u>	<u>\$ 3,422</u>	<u>\$</u>	<u>2,196</u>	<u>\$ (85)</u>	<u>\$ 97</u>	<u>\$ 10,750</u>

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

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

	Nine Months Ended September 30,	
	2018	2017
Cash flows from operating activities:		
Net earnings	\$ 653	\$ 585
Adjustments to reconcile net earnings to net cash provided by operating activities		
Depreciation and amortization	354	264
Stock compensation expense	105	99
Deferred income taxes	(103)	(32)
Changes in assets and liabilities		
Premium and trade receivables	(696)	(749)
Other assets	65	(39)
Medical claims liabilities	1,380	406
Unearned revenue	(150)	255
Accounts payable and accrued expenses	35	205
Other long-term liabilities	199	45
Other operating activities, net	26	—
Net cash provided by operating activities	<u>1,868</u>	<u>1,039</u>
Cash flows from investing activities:		
Capital expenditures	(489)	(301)
Purchases of investments	(2,691)	(1,693)
Sales and maturities of investments	1,575	1,308
Acquisitions, net of cash acquired	(1,958)	—
Net cash used in investing activities	<u>(3,563)</u>	<u>(686)</u>
Cash flows from financing activities:		
Proceeds from the issuance of common stock	2,779	—
Proceeds from long-term debt	5,480	1,170
Payments of long-term debt	(3,692)	(1,124)
Common stock repurchases	(17)	(18)
Purchase of noncontrolling interest	(63)	(33)
Debt issuance costs	(25)	—
Other financing activities, net	(2)	2
Net cash provided by (used in) financing activities	<u>4,460</u>	<u>(3)</u>
Effect of exchange rate changes on cash, cash equivalents and restricted cash	—	1
Net increase in cash, cash equivalents and restricted cash	<u>2,765</u>	<u>351</u>
Cash, cash equivalents, and restricted cash and cash equivalents, beginning of period	<u>4,089</u>	<u>3,936</u>
Cash, cash equivalents, and restricted cash and cash equivalents, end of period	<u>\$ 6,854</u>	<u>\$ 4,287</u>
Supplemental disclosures of cash flow information:		
Interest paid	\$ 213	\$ 210
Income taxes paid	\$ 340	\$ 358
Equity issued in connection with acquisitions	\$ 507	\$ —

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

CENTENE CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Organization and Operations

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, 2017. 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, 2017 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 2017 amounts in the consolidated financial statements and notes to the consolidated financial statements have been reclassified to conform to the 2018 presentation. These reclassifications have no effect on net earnings or stockholders' equity as previously reported.

On July 1, 2018, the Company acquired substantially all of the assets of New York State Catholic Health Plan, Inc. d/b/a Fidelis Care New York (Fidelis Care) for approximately \$3.47 billion of cash consideration, which includes a working capital adjustment. The Fidelis Care acquisition expanded the Company's scale and presence to New York State. The acquisition was accounted for as a business combination, which requires that assets acquired and liabilities assumed be recognized at their fair values as of the acquisition date. Those estimated amounts are reflected in the accompanying financial statements.

As a result of the completion of the Fidelis Care acquisition, the Company's results of operations for the three and nine months ended September 30, 2018 include the results of operations of Fidelis Care from July 1, 2018 to September 30, 2018. The Fidelis Care operations are included in the Managed Care segment.

Recently Adopted Accounting Guidance

In August 2018, the Financial Accounting Standards Board (FASB) issued an Accounting Standards Update (ASU) which modifies the disclosure requirements on fair value measurements. The amendments in this ASU remove the requirements to disclose the amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy, the policy for timing of transfers between levels and the valuation processes for Level 3 fair value measurements. The amendments require public entities to disclose the changes in unrealized gains and losses for the period included in other comprehensive income for recurring Level 3 fair value measurements for instruments held at the end of the reporting period, and the range and weighted average used to develop significant inputs for Level 3 fair value measurements. For investments in certain entities that calculate net asset value, the standard requires the disclosure of the period of time over which the underlying assets might be liquidated if the investee has announced the timing publicly. The Company adopted the new guidance in the third quarter of 2018. The new guidance did not have any impact on the Company's consolidated financial position, results of operations or cash flows.

In June 2018, the FASB issued an ASU that simplifies the accounting for share-based payment arrangements with non-employees for goods and services. Under the ASU, the guidance on such payments to non-employees is aligned with the accounting for share-based payments granted to employees, including the measurement of equity-classified awards, which is fixed at the grant date under the new guidance. The Company adopted the new guidance in the second quarter of 2018 using the modified retrospective approach with an immaterial cumulative-effect adjustment to retained earnings.

In February 2018, the FASB issued an ASU which allows a reclassification from accumulated other comprehensive income (OCI) to retained earnings for stranded tax effects resulting from the Tax Cuts and Job Acts (TCJA). Consequently, the amendments eliminate the stranded tax effects resulting from the TCJA and will improve the usefulness of information reported to financial statement users. However, because the amendments only relate to the reclassification of the income tax effects of the TCJA, the underlying guidance that requires that the effect of a change in tax laws or rates be included in income from continuing operations is not affected. The amendments in this ASU also require certain disclosures about stranded tax effects. The Company adopted the new guidance in the first quarter of 2018 and elected to reclassify stranded tax effects as a result of the TCJA related to unrealized gains and losses on investments and defined benefit plan obligations. The Company uses the individual security approach to release income tax effects from accumulated OCI. The new guidance did not have a material impact on the Company's consolidated financial position, results of operations or cash flows.

In November 2016, the FASB issued an ASU clarifying the classification and presentation of changes in restricted cash on the statement of cash flows. The amendments in this ASU require that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and restricted cash. Therefore, amounts generally described as restricted cash should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. The Company adopted the new guidance in the first quarter of 2018. The new guidance did not have a material impact on the Company's consolidated financial position, results of operations or cash flows. Cash, cash equivalents, and restricted cash and cash equivalents reported on the Consolidated Statements of Cash Flows includes restricted cash and cash equivalents of \$6 million, \$6 million, \$17 million and \$7 million as of December 31, 2016, September 30, 2017, December 31, 2017 and September 30, 2018, respectively.

In March 2016, the FASB issued an ASU which requires entities to measure equity investments at fair value and recognize any change in fair value in net income. The standard does not apply to accounting methods that result in consolidation of the investee and those accounted for under the equity method. The standard also requires entities to record changes in instrument-specific credit risk for financial liabilities measured under the fair value option in other comprehensive income. Companies are required to record a cumulative-effect adjustment to the statement of financial position as of the beginning of the fiscal year in which the guidance is adopted, with the exception of amendments related to equity investments without readily determinable fair values, which will be applied prospectively to all investments that exist as of the date of adoption. The Company adopted the new guidance in the first quarter of 2018. The new guidance did not have a material impact on the Company's consolidated financial position, results of operations or cash flows.

In May 2014, the FASB issued an ASU which supersedes existing revenue recognition standards with a single model unless those contracts are within the scope of other standards (e.g., an insurance entity's insurance contracts). Under the new standard, recognition of revenue occurs when a customer obtains control of promised goods or services in an amount that reflects the consideration which the entity expects to receive in exchange for those goods or services. In addition, the standard requires disclosure of the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. The Company adopted the new guidance in the first quarter of 2018 using the modified retrospective approach with a cumulative-effect increase to retained earnings of \$16 million. The Company also elected the practical expedient of applying the new guidance only to contracts that are not completed as of the date of initial application. The majority of the Company's revenues are derived from insurance contracts and are excluded from the new standard.

Accounting Guidance Not Yet Adopted

In August 2018, the FASB issued an ASU which aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal use software license). The accounting for the service element of a hosting arrangement that is a service contract is not affected by the amendments in this update. The amendments in this ASU require an entity that is the customer in a hosting arrangement to follow the guidance on internal-use software to determine which implementation costs to capitalize and which costs to expense. The standard also requires an entity that is the customer to expense the capitalized implementation costs of a hosting arrangement over the term of the hosting arrangement. The new guidance requires an entity to present the expense related to the capitalized implementation costs in the same line item in the statement of income as the fees associated with the hosting element of the arrangement and classify payments for capitalized implementation costs in the statement of cash flows in the same manner as payments made for fees associated with the hosting element. The entity is also required to present the capitalized implementation costs in the statement of financial position in the same line item that a prepayment for the fees of the associated hosting arrangement would be presented. The guidance is effective for annual and interim periods beginning after December 15, 2019. Early adoption is permitted. The new guidance is not expected to have a material impact on the Company's consolidated financial position, results of operations or cash flows.

In February 2016, the FASB issued an ASU which introduces a lessee model that requires the majority of leases to be recognized on the balance sheet. The new standard also aligns many of the underlying principles of the new lessor model with those in Accounting Standards Codification 606, the FASB's new revenue recognition standard, and addresses other concerns related to the current lessee model. The standard also requires lessors to increase the transparency of their exposure to changes in value of their residual assets and how they manage that exposure. It is effective for annual and interim periods beginning after December 15, 2018. Early adoption is permitted. The initial standard required a modified retrospective transition approach, with application, including disclosures, in all comparative periods presented. In July 2018, the FASB issued an ASU which gives all entities a transition option and provides lessors with a practical expedient. The transition option allows entities to not apply the new standard in the comparative periods they present in their financial statements in the year of adoption. Under the transition option, entities can continue to apply the legacy guidance in ASC 840, including its disclosure requirements, in the comparative periods presented in the year of adoption of the lease standard. Entities that elect this option will adopt the standard using the modified retrospective transition method but recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption rather than in the earliest period presented. The practical expedient provides lessors the option to not separate the non-lease components from the associated lease components when certain criteria are met and requires them to account for the combined component in accordance with the new revenue standard if the associated non-lease components are the predominant components. The Company is currently evaluating the effect of the new lease guidance and plans to elect the transition option of using the effective date of the new standard as the date of initial application.

2. Fidelis Care Acquisition

On July 1, 2018, the Company acquired substantially all of the assets of Fidelis Care for approximately \$3.47 billion of cash consideration, which includes a working capital adjustment. The acquisition consideration was funded through the issuance of 26.6 million shares of Centene common stock as further discussed in Note 8. *Stockholders Equity* and the issuance of long-term debt as further discussed in Note 7. *Debt*. The Fidelis Care acquisition expanded the Company's scale and presence to New York State.

The acquisition of Fidelis Care was accounted for as a business combination using the acquisition method of accounting which requires assets acquired and liabilities assumed to be recognized at fair value as of the acquisition date. The valuation of assets acquired and liabilities assumed has not yet been finalized. Any necessary adjustments from preliminary estimates will be finalized within one year from the date of acquisition. Measurement period adjustments will be recorded in the period in which they are determined, as if they had been completed at the acquisition date. Due to the timing of the acquisition, the Company has performed limited valuation procedures, and the valuation of all assets and liabilities assumed is not yet complete. The Company's preliminary allocation of the fair value of assets acquired and liabilities assumed as of the acquisition date of July 1, 2018 is as follows (\$ in millions):

Assets acquired and liabilities assumed	
Cash and cash equivalents	\$ 2,001
Premium and related receivables	535
Other current assets	32
Restricted deposits	495
Property, software and equipment, net	80
Intangible assets ^(a)	1,000
Other long-term assets	18
Total assets acquired	<u>4,161</u>
Medical claims liability	1,319
Accounts payable and accrued expenses	300
Return of premium payable	124
Unearned revenue	115
Other long-term liabilities	261
Total liabilities assumed	<u>2,119</u>
Total identifiable net assets	2,042
Goodwill ^(b)	<u>1,428</u>
Total assets acquired and liabilities assumed	<u>\$ 3,470</u>

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The Company has made the following preliminary fair value adjustments based on information reviewed through September 30, 2018. Significant fair value adjustments are noted as follows:

- (a) The identifiable intangible assets acquired are to be measured at fair value as of the completion of the acquisition. The fair value of intangible assets is determined primarily using variations of the "income approach," which is based on the present value of the future after tax cash flows attributable to each identified intangible asset. Other valuation methods, including the market approach and cost approach, were also considered in estimating the fair value. As discussed above, due to the timing of the acquisition date, the Company has only performed limited valuation procedures, and the intangible asset valuation is incomplete. The Company has estimated the preliminary fair value of intangible assets to be \$1.0 billion with a weighted average life of 13 years. The Company expects the identifiable intangible assets to include customer relationships, provider contracts, trade names and developed technology.
- (b) The acquisition resulted in \$1.4 billion of goodwill related primarily to synergies expected from the acquisition and the assembled workforce of Fidelis Care. All of the goodwill has been assigned to the Managed Care segment. The goodwill is deductible for income tax purposes.

Statement of Operations

From the acquisition date through September 30, 2018, the Company's Consolidated Statements of Operations include total Fidelis Care revenues of \$2,797 million. It is impracticable to determine the effect on net income resulting from the Fidelis Care acquisition for the three and nine months ended September 30, 2018, as the Company began immediately integrating Fidelis Care into its ongoing operations.

Unaudited Pro Forma Financial Information

The unaudited pro forma total revenues for the nine months ended September 30, 2018 were \$49,170 million. It is impracticable for the Company to determine the pro forma earnings information for the nine months ended September 30, 2018 due to the nature of obtaining that information as the Company began immediately integrating Fidelis Care into its ongoing operations. The following table presents supplemental pro forma information for the three and nine months ended September 30, 2017 (\$ in millions, except per share data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017		2017	
Total revenues	\$	14,387	\$	42,954
Net earnings attributable to Centene Corporation	\$	248	\$	721
Diluted earnings per share	\$	1.22	\$	3.55

The pro forma results do not reflect any anticipated synergies, efficiencies, or other cost savings of the acquisition. Accordingly, the unaudited pro forma financial information is not indicative of the results if the acquisition had been completed on January 1, 2017 and is not a projection of future results.

The unaudited pro forma financial information reflects the historical results of Centene and Fidelis Care adjusted as if the acquisition had occurred on January 1, 2017, primarily for the following:

- Additional premium tax expense related to Fidelis Care no longer being a not-for-profit entity.
- Additional Health Insurer Fee revenue in 2018 related to Fidelis Care as some of those revenues will be subject to the Health Insurer Fee following the first year of the closing of the Fidelis Care acquisition, absent a Health Insurer Fee moratorium.
- Reduced Fidelis Care investment income to reflect lower investment balances and mix of investments associated with the acquired assets.
- Interest expense associated with debt incurred to finance the transaction.
- An adjustment to basic and diluted shares outstanding to reflect the shares issued by Centene to finance the transaction.
- An adjustment to income tax expense to reflect the tax impact of the acquisition and Fidelis Care becoming subject to income tax.
- Elimination of acquisition related costs.

Commitments

As part of the regulatory approval process, the Company entered into certain undertakings with the New York State Department of Health. The undertakings contain various commitments by the Company effective upon completion of the Fidelis Care acquisition. One of the undertakings includes a \$340 million contribution by the Company to the State of New York to be paid over a five-year period for initiatives consistent with our mission of providing high quality healthcare to vulnerable populations within New York State. As a result of the closing of the Fidelis Care acquisition, the present value of the \$340 million contribution to the State of New York, approximately \$324 million, was expensed in SG&A during the third quarter of 2018.

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

Short-term and long-term investments and restricted deposits by investment type consist of the following (\$ in millions):

	September 30, 2018				December 31, 2017			
	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	\$ 259	\$ —	\$ (3)	\$ 256	\$ 311	\$ —	\$ (2)	\$ 309
Corporate securities	2,774	4	(44)	2,734	2,208	12	(10)	2,210
Restricted certificates of deposit	430	—	—	430	4	—	—	4
Restricted cash equivalents	7	—	—	7	17	—	—	17
Municipal securities	2,231	2	(35)	2,198	2,085	12	(10)	2,087
Asset-backed securities	598	—	(4)	594	437	1	(1)	437
Residential mortgage-backed securities	382	—	(14)	368	337	1	(6)	332
Commercial mortgage-backed securities	317	—	(8)	309	272	1	(2)	271
Private equity investments	382	—	—	382	176	—	—	176
Life insurance contracts	138	—	—	138	135	—	—	135
Total	\$ 7,518	\$ 6	\$ (108)	\$ 7,416	\$ 5,982	\$ 27	\$ (31)	\$ 5,978

The Company's investments are debt securities classified as available-for-sale with the exception of life insurance contracts and certain private equity investments. The Company's investment policies are designed to provide liquidity, preserve capital and maximize total return on invested assets with the focus on high credit quality securities. The Company limits the size of investment in any single issuer other than U.S. treasury securities and obligations of U.S. government corporations and agencies. As of September 30, 2018, 96% of the Company's investments in rated securities carry an investment grade rating by nationally recognized statistical rating organizations. At September 30, 2018, the Company held certificates of deposit, life insurance contracts and private equity investments which did not carry a credit rating.

The Company's residential mortgage-backed securities are primarily issued by the Federal National Mortgage Association, Government National Mortgage Association or Federal Home Loan Mortgage Corporation, which carry implicit or explicit guarantees of the U.S. government. The Company's commercial mortgage-backed securities are primarily senior tranches with a weighted average rating of AA+ and a weighted average duration of 3.8 years at September 30, 2018.

In March 2018, the Company completed a 25% investment in RxAdvance, a full-service pharmacy benefit manager. In May 2018, the Company made an additional investment, bringing the total ownership to 28%. The investment is accounted for using the equity method of accounting. In September 2018, the Company made an additional investment in RxAdvance in the form of convertible preferred stock.

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The fair value of available-for-sale debt securities 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 (\$ in millions):

	September 30, 2018				December 31, 2017			
	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	\$ (1)	\$ 93	\$ (2)	\$ 161	\$ (1)	\$ 222	\$ (1)	\$ 79
Corporate securities	(31)	1,913	(13)	337	(6)	1,044	(4)	185
Municipal securities	(25)	1,518	(10)	286	(7)	943	(3)	175
Asset-backed securities	(3)	409	(1)	66	(1)	228	—	28
Residential mortgage-backed securities	(4)	186	(10)	178	(1)	109	(5)	171
Commercial mortgage-backed securities	(4)	174	(4)	90	(1)	112	(1)	51
Total	\$ (68)	\$ 4,293	\$ (40)	\$ 1,118	\$ (17)	\$ 2,658	\$ (14)	\$ 689

As of September 30, 2018, the gross unrealized losses were generated from 3,200 positions out of a total of 3,954 positions. The change in fair value of fixed income securities is primarily 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 (\$ in millions):

	September 30, 2018				December 31, 2017			
	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	\$ 517	\$ 515	\$ 201	\$ 201	\$ 474	\$ 474	\$ 48	\$ 47
One year through five years	2,674	2,636	350	349	2,424	2,420	88	88
Five years through ten years	2,277	2,242	—	—	1,773	1,779	—	—
Greater than ten years	202	202	—	—	129	130	—	—
Asset-backed securities	1,297	1,271	—	—	1,046	1,040	—	—
Total	\$ 6,967	\$ 6,866	\$ 551	\$ 550	\$ 5,846	\$ 5,843	\$ 136	\$ 135

Actual maturities may differ from contractual maturities due to call or prepayment options. Private equity 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.

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 private equity 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.

4. Fair Value Measurements

Assets and liabilities recorded at fair value in the Consolidated Balance Sheets are categorized based upon observable or unobservable inputs used to estimate fair value. 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, 2018, for assets and liabilities measured at fair value on a recurring basis (\$ in millions):

	Level I	Level II	Level III	Total
Assets				
Cash and cash equivalents	\$ 6,847	\$ —	\$ —	\$ 6,847
Investments available for sale:				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 143	\$ —	\$ —	\$ 143
Corporate securities	—	2,734	—	2,734
Municipal securities	—	2,198	—	2,198
Asset-backed securities	—	594	—	594
Residential mortgage-backed securities	—	368	—	368
Commercial mortgage-backed securities	—	309	—	309
Total investments	\$ 143	\$ 6,203	\$ —	\$ 6,346
Restricted deposits available for sale:				
Cash and cash equivalents	\$ 7	\$ —	\$ —	\$ 7
Certificates of deposit	430	—	—	430
U.S. Treasury securities and obligations of U.S. government corporations and agencies	113	—	—	113
Total restricted deposits	\$ 550	\$ —	\$ —	\$ 550
Total assets at fair value	\$ 7,540	\$ 6,203	\$ —	\$ 13,743
Liabilities				
Other long-term liabilities:				
Interest rate swap agreements	\$ —	\$ 147	\$ —	\$ 147
Total liabilities at fair value	\$ —	\$ 147	\$ —	\$ 147

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The following table summarizes fair value measurements by level at December 31, 2017, for assets and liabilities measured at fair value on a recurring basis (\$ in millions):

	<u>Level I</u>	<u>Level II</u>	<u>Level III</u>	<u>Total</u>
Assets				
Cash and cash equivalents	\$ 4,072	\$ —	\$ —	\$ 4,072
Investments available for sale:				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 195	\$ —	\$ —	\$ 195
Corporate securities	—	2,210	—	2,210
Municipal securities	—	2,087	—	2,087
Asset-backed securities	—	437	—	437
Residential mortgage-backed securities	—	332	—	332
Commercial mortgage-backed securities	—	271	—	271
Total investments	\$ 195	\$ 5,337	\$ —	\$ 5,532
Restricted deposits available for sale:				
Cash and cash equivalents	\$ 17	\$ —	\$ —	\$ 17
Certificates of deposit	4	—	—	4
U.S. Treasury securities and obligations of U.S. government corporations and agencies	114	—	—	114
Total restricted deposits	\$ 135	\$ —	\$ —	\$ 135
Other long-term assets:				
Interest rate swap agreements	\$ —	\$ 1	\$ —	\$ 1
Total assets at fair value	\$ 4,402	\$ 5,338	\$ —	\$ 9,740
Liabilities				
Other long-term liabilities:				
Interest rate swap agreements	\$ —	\$ 72	\$ —	\$ 72
Total liabilities at fair value	\$ —	\$ 72	\$ —	\$ 72

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. In addition, the aggregate carrying amount of the Company's life insurance contracts and other private equity investments, which approximates fair value, was \$520 million and \$311 million as of September 30, 2018 and December 31, 2017, respectively.

5. Medical Claims Liability

The following table summarizes the change in medical claims liability (\$ in millions):

	Nine Months Ended September 30,	
	2018	2017
Balance, January 1	\$ 4,286	\$ 3,929
Less: Reinsurance recoverable	18	5
Balance, January 1, net	4,268	3,924
Acquisitions	1,319	—
Incurred related to:		
Current year	33,465	28,666
Prior years	(420)	(388)
Total incurred	33,045	28,278
Paid related to:		
Current year	28,194	24,787
Prior years	3,485	3,099
Total paid	31,679	27,886
Balance at September 30, net	6,953	4,316
Plus: Reinsurance recoverable	30	17
Balance, September 30	\$ 6,983	\$ 4,333

Reinsurance recoverables related to medical claims are included in premium and related receivables. Changes in estimates of incurred claims for prior years are primarily attributable to reserving under moderately adverse conditions. Additionally, as a result of development within "Incurred related to: Prior years" due to minimum health benefits ratio (HBR) and other return of premium programs, we recorded \$23 million as a reduction to premium revenues and \$4 million as an increase to premium revenues in the nine months ended September 30, 2018 and 2017, respectively.

Incurred but not reported (IBNR) plus expected development on reported claims as of September 30, 2018 was \$5,326 million. Total IBNR plus expected development on reported claims represents estimates for claims incurred but not reported, development on reported claims, and estimates for the costs necessary to process unpaid claims at the end of each period. We estimate our liability using actuarial methods that are commonly used by health insurance actuaries and meet Actuarial Standards of Practice. These actuarial methods consider factors such as historical data for payment patterns, cost trends, product mix, seasonality, utilization of healthcare services and other relevant factors.

6. Affordable Care Act

The Affordable Care Act (ACA) established risk spreading premium stabilization programs effective January 1, 2014. These programs, commonly referred to as the "three Rs," include a permanent risk adjustment program, a transitional reinsurance program, and a temporary risk corridor program. Additionally, the ACA established a minimum annual MLR and cost sharing reductions. Each of the three R programs are taken into consideration to determine if the Company's estimated annual medical costs are less than the minimum loss ratio and require an adjustment to Premium revenue to meet the minimum MLR.

During the second quarter of 2018, the Company recognized a \$79 million net pre-tax benefit related to the reconciliation of the 2017 risk adjustment program compared to a \$48 million net pre-tax benefit related to the reconciliation of the 2016 risk adjustment program during the second quarter of 2017.

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The Company's net receivables (payables) for each of these programs are as follows (\$ in millions):

	September 30, 2018	December 31, 2017
Risk adjustment	\$ (784)	\$ (677)
Reinsurance	1	15
Risk corridor	4	6
Minimum MLR	(154)	(22)
Cost sharing reductions	(61)	(96)

7. Debt

Debt consists of the following (\$ in millions):

	September 30, 2018	December 31, 2017
\$1,400 million 5.625% Senior notes, due February 15, 2021	\$ 1,400	\$ 1,400
\$1,000 million 4.75% Senior notes, due May 15, 2022	1,005	1,006
\$1,000 million 6.125% Senior notes, due February 15, 2024	1,000	1,000
\$1,200 million 4.75% Senior notes, due January 15, 2025	1,200	1,200
\$1,800 million 5.375% Senior notes, due June 1, 2026	1,800	—
Fair value of interest rate swap agreements	(147)	(71)
Total senior notes	6,258	4,535
Revolving credit agreement	100	150
Mortgage notes payable	59	61
Construction loan payable	40	—
Capital leases and other	5	18
Debt issuance costs	(79)	(65)
Total debt	6,383	4,699
Less current portion	(4)	(4)
Long-term debt	\$ 6,379	\$ 4,695

Senior Notes

In May 2018, a wholly-owned unrestricted subsidiary of the Company (Escrow Issuer) issued \$1,800 million in aggregate principal amount of 5.375% Senior Notes at par due 2026. In connection with the closing of the Fidelis Care acquisition, the Escrow Issuer merged with and into the Company and the Company assumed the obligations of the Escrow Issuer under the 5.375% Senior Notes due 2026. The Company used the net proceeds of the offering to finance a portion of the cash consideration for the Fidelis Care acquisition, which closed in July 2018, to pay related fees and expenses, and for general corporate purposes, including the repayment of outstanding indebtedness.

The indentures governing the senior notes listed in the table above contain restrictive covenants of Centene Corporation. At September 30, 2018, the Company was in compliance with all covenants.

Interest Rate Swaps

The Company uses interest rate swap agreements to convert a portion of its interest rate exposure from fixed rates to floating rates to more closely align interest expense with interest income received on its cash equivalent and variable rate investment balances. The following is a summary of the notional amounts of the Company's interest rate swap agreements as of September 30, 2018:

Expiration Date	Notional Amount
February 15, 2021	\$ 600
May 15, 2022	500
February 15, 2024	1,000
January 15, 2025	600
Total	\$ 2,700

The fair value of the swap agreements shown above are recorded in other long-term liabilities in the Consolidated Balance Sheets. Under the swap agreements, the Company receives a fixed rate of interest and pays an average variable rate of either the one or three month LIBOR plus 3.61% adjusted monthly or quarterly, based on the terms of the individual swap agreements. At September 30, 2018, the weighted average rate was 5.89%.

The swap agreements are formally designated and qualify as fair value hedges. 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 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 swaps and the hedged portion of the underlying debt both were recognized in interest expense in the Consolidated Statements of Operations. The Company does not hold or issue any derivative instrument for trading or speculative purposes.

Revolving Credit Agreement

The Company has an unsecured \$1,500 million revolving credit facility. The agreement has a maturity date of December 14, 2022. Borrowings under the agreement bear interest based upon LIBOR rates, the Federal Funds Rate or the Prime Rate. As of September 30, 2018, the Company had \$100 million borrowings outstanding under the agreement and the Company was in compliance with all covenants.

The revolving credit facility contains non-financial and financial covenants, including requirements of minimum fixed charge coverage ratios and maximum debt-to-EBITDA ratios. The Company is required to not exceed a maximum debt-to-EBITDA ratio of 3.5 to 1.0. As of September 30, 2018, there were no limitations on the availability under the revolving credit agreement as a result of the debt-to-EBITDA ratio.

Mortgage Notes Payable

The Company has a non-recourse mortgage note of \$59 million at September 30, 2018 collateralized by its corporate headquarters building. The mortgage note is due January 1, 2021 and bears a 5.14% interest rate. The collateralized property had a net book value of \$164 million at September 30, 2018.

Construction Loan

The Company has a \$200 million non-recourse construction loan to fund the expansion of the Company's corporate headquarters. The loan bears interest based on the one month LIBOR plus 2.70% and matures in April 2021 with an optional one-year extension. The agreement contains financial and non-financial covenants aligning with the Company's revolving credit agreement. The Company has guaranteed completion of the construction project associated with the loan. As of September 30, 2018, the Company had \$40 million in borrowings outstanding under the loan.

Letters of Credit & Surety Bonds

The Company had outstanding letters of credit of \$55 million as of September 30, 2018, which were not part of the revolving credit facility. The Company also had letters of credit for \$44 million (valued at September 30, 2018 conversion rate), or €38 million, 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 1.33% as of September 30, 2018. The Company had outstanding surety bonds of \$501 million as of September 30, 2018.

8. Stockholders' Equity

In May 2018, the Company completed a registered offering of 26.6 million shares of Centene common stock with a fair value of \$2,860 million. This included the 10% over allotment option to purchase additional shares from the Company which was exercised in full by the underwriters. Net proceeds after underwriting discounts and commissions was \$2,779 million. The Company used the net proceeds of the offering to finance a portion of the cash consideration in connection with the Fidelis Care acquisition, to pay related fees and expenses, and for general corporate purposes, including the repayment of outstanding indebtedness.

In April 2018, the Company acquired MHM Services Inc. (MHM) and issued 1.7 million shares of Centene common stock to the selling shareholders, with a fair value of \$183 million.

In March 2018, the Company acquired Community Medical Holdings Corp., d/b/a Community Medical Group (CMG) and issued 1.4 million shares of Centene common stock to the selling shareholders, with a fair value of \$149 million.

In March 2018, the Company acquired an additional 61% of Interpreta Holdings, Inc. (Interpreta) and issued 1.7 million shares of Centene common stock to the selling shareholders, with a fair value of \$175 million.

9. Earnings Per Share

The following table sets forth the calculation of basic and diluted net earnings per common share (\$ in millions, except shares in thousands and per share data in dollars):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Earnings attributable to Centene Corporation	\$ 19	\$ 205	\$ 659	\$ 598
Shares used in computing per share amounts:				
Weighted average number of common shares outstanding	205,295	172,508	191,628	172,314
Common stock equivalents (as determined by applying the treasury stock method)	4,227	4,407	4,005	4,100
Weighted average number of common shares and potential dilutive common shares outstanding	209,522	176,915	195,633	176,414
Net earnings per common share attributable to Centene Corporation:				
Basic earnings per common share	\$ 0.09	\$ 1.19	\$ 3.44	\$ 3.47
Diluted earnings per common share	\$ 0.09	\$ 1.16	\$ 3.37	\$ 3.39

The calculation of diluted earnings per common share for the three and nine months ended September 30, 2018 excludes the impact of 10 thousand and 27 thousand shares, respectively, related to anti-dilutive stock options, restricted stock and restricted stock units. The calculation of diluted earnings per common share for both the three and nine months ended September 30, 2017 excludes the impact of 4 thousand and 27 thousand shares, respectively, related to anti-dilutive stock options, restricted stock and restricted stock units.

10. 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, 2018, follows (\$ in millions):

	Managed Care	Specialty Services	Eliminations	Consolidated Total
Total revenues from external customers	\$ 15,420	\$ 762	\$ —	\$ 16,182
Total revenues from internal customers	26	2,350	(2,376)	—
Total revenues	\$ 15,446	\$ 3,112	\$ (2,376)	\$ 16,182
Earnings from operations	\$ 92	\$ (51)	\$ —	\$ 41

Segment information for the three months ended September 30, 2017, follows (\$ in millions):

	Managed Care	Specialty Services	Eliminations	Consolidated Total
Total revenues from external customers	\$ 11,248	\$ 650	\$ —	\$ 11,898
Total revenues from internal customers	11	2,367	(2,378)	—
Total revenues	\$ 11,259	\$ 3,017	\$ (2,378)	\$ 11,898
Earnings from operations	\$ 238	\$ 102	\$ —	\$ 340

Segment information for the nine months ended September 30, 2018, follows (\$ in millions):

	Managed Care	Specialty Services	Eliminations	Consolidated Total
Total revenues from external customers	\$ 41,153	\$ 2,404	\$ —	\$ 43,557
Total revenues from internal customers	76	6,919	(6,995)	—
Total revenues	\$ 41,229	\$ 9,323	\$ (6,995)	\$ 43,557
Earnings from operations	\$ 983	\$ 87	\$ —	\$ 1,070

Segment information for the nine months ended September 30, 2017, follows (\$ in millions):

	Managed Care	Specialty Services	Eliminations	Consolidated Total
Total revenues from external customers	\$ 33,704	\$ 1,872	\$ —	\$ 35,576
Total revenues from internal customers	33	7,112	(7,145)	—
Total revenues	\$ 33,737	\$ 8,984	\$ (7,145)	\$ 35,576
Earnings from operations	\$ 799	\$ 219	\$ —	\$ 1,018

11. Contingencies

Overview

The Company records reserves and accrues costs for certain legal proceedings and regulatory matters to the extent that it determines an unfavorable outcome is probable and the amount of the loss can be reasonably estimated. While such reserves and accrued costs reflect the Company's best estimate of the probable loss for such matters, the recorded amounts may differ materially from the actual amount of any such losses. In some cases, no estimate of the possible loss or range of loss in excess of amounts accrued, if any, can be made because of the inherently unpredictable nature of legal and regulatory proceedings, which may be exacerbated by various factors, including but not limited to, they may involve indeterminate claims for monetary damages or may involve fines, penalties or punitive damages; present novel legal theories or legal uncertainties; involve disputed facts; represent a shift in regulatory policy; involve a large number of parties, claimants or regulatory bodies; are in the early stages of the proceedings; involve a number of separate proceedings and/or a wide range of potential outcomes; or result in a change of business practices.

As of the date of this report, amounts accrued for legal proceedings and regulatory matters were not material. However, it is possible that in a particular quarter or annual period the Company's financial condition, results of operations, cash flow and/or liquidity could be materially adversely affected by an ultimate unfavorable resolution of or development in legal and/or regulatory proceedings, including as described below. Except for the proceedings discussed below, the Company believes that the ultimate outcome of any of the regulatory and legal proceedings that are currently pending against it should not have a material adverse effect on financial condition, results of operations, cash flow or liquidity.

California

On October 20, 2015, the Company's California subsidiary, Health Net of California, Inc. (Health Net California), was named as a defendant in a California taxpayer action filed in Los Angeles County Superior Court, captioned as Michael D. Myers v. State Board of Equalization, Dave Jones, Insurance Commissioner of the State of California, Betty T. Yee, Controller of the State of California, et al., Los Angeles Superior Court Case No. BS158655. This action is brought under a California statute that permits an individual taxpayer to sue a governmental agency when the taxpayer believes the agency has failed to enforce governing law. Plaintiff contends that Health Net California, a California licensed Health Care Service Plan (HCSP), is an "insurer" for purposes of taxation despite acknowledging it is not an "insurer" under regulatory law. Under California law, "insurers" must pay a gross premiums tax (GPT), calculated as 2.35% on gross premiums. As a licensed HCSP, Health Net California has paid the California Corporate Franchise Tax (CFT), the tax generally paid by California businesses. Plaintiff contends that Health Net California must pay the GPT rather than the CFT. Plaintiff seeks a writ of mandate directing the California taxing agencies to collect the GPT, and seeks an order requiring Health Net California to pay GPT, interest and penalties for a period dating to eight years prior to the October 2015 filing of the complaint. This lawsuit is being coordinated with similar lawsuits filed against other entities (collectively, "Related Actions"). In September 2017, the Company filed a demurrer seeking to dismiss the complaint, and a motion to strike the allegations seeking retroactive relief. In March 2018, the Court overruled the Company's demurrer and denied the motion to strike. In August 2018, the trial court stayed all the Related Actions pending determination of a writ of mandate by the California Court of Appeals in two of the Related Actions. The Company intends to vigorously defend itself against these claims; however, this matter is subject to many uncertainties, and an adverse outcome in this matter could potentially have a materially adverse impact on our financial position, results of operations and cash flows.

Federal Securities Class Action

On November 14, 2016, a putative federal securities class action, Israel Sanchez v. Centene Corp., et al., was filed against the Company and certain of its executives in the U.S. District Court for the Central District of California. In March 2017, the court entered an order transferring the matter to the U.S. District Court for the Eastern District of Missouri. The plaintiffs in the lawsuit allege that the Company's accounting and related disclosures for certain liabilities acquired in the acquisition of Health Net violated federal securities laws. In July 2017, the lead plaintiff filed a Consolidated Class Action Complaint. The Company filed a motion to dismiss this complaint in September 2017. In February 2018, the Court held a hearing on the motion to dismiss but has not yet issued a ruling.

The Company denies any wrongdoing and is vigorously defending itself against these claims. Nevertheless, this matter is subject to many uncertainties and the Company cannot predict how long this litigation will last or what the ultimate outcome will be, and an adverse outcome in this matter could potentially have a materially adverse impact on our financial position and results of operations.

Additionally, on January 24, 2018, a separate derivative action was filed by plaintiff Harkesh Parekh on behalf of Centene Corporation against the Company and certain of its officers and directors in the United States District Court for the Eastern District of Missouri. Plaintiff purports to bring suit derivatively on behalf of the Company against certain officers and directors for violation of securities laws, breach of fiduciary duty, waste of corporate assets and unjust enrichment. The derivative complaint repeats many of the allegations in the federal securities class action described above and asserts that defendants made inaccurate or misleading statements, and/or failed to correct the alleged misstatements.

A second shareholder derivative action was filed on March 9, 2018, by plaintiffs Laura Wood and Peoria Police Pension Fund on behalf of Centene Corporation against the Company and certain of its officers and directors in the United States District Court for the Eastern District of Missouri. This second derivative complaint repeats many of the allegations in the securities class action and the first derivative suit. The derivative suits are expected to be consolidated and a lead plaintiff appointed for the litigation.

Medicare Parts C and D Matter

In December 2016, a Civil Investigative Demand (CID) was issued to Health Net by the United States Department of Justice regarding Health Net's submission of risk adjustment claims to CMS under Parts C and D of Medicare. The CID may be related to a federal qui tam lawsuit filed under seal in 2011 naming more than a dozen health insurers including Health Net. The lawsuit was unsealed in February 2017 when the Department of Justice intervened in the case with respect to one of the insurers (not Health Net). In subsequent pleadings, both the Department of Justice and the Relator excluded Health Net from the lawsuit. The Company is complying with the CID and will vigorously defend any lawsuits. At this point, it is not possible to determine what level of liability, if any, the Company may face as a result of this matter.

Veterans Administration Matter

In October 2017, a CID was issued to Health Net Federal Services, LLC (HNFS) by the United States Department of Justice. The CID seeks documents and interrogatory responses concerning whether HNFS submitted, or caused to be submitted, excessive, duplicative or otherwise improper claims to the U.S. Department of Veterans Affairs (VA) under a contract to provide health care coordination services for veterans. The contract began in late 2014 and ended September 30, 2018. In 2016, modifications to the contract were made to allow for possible duplicate billings with a reconciliation period at the end of the contract term. The Company is complying with the CID and believes it has been meeting its contractual obligations. At this point, it is not possible to determine what level of liability, if any, the Company may face as a result of this matter. This matter is separate from the negotiated settlements with the VA in connection with the contract expiration on September 30, 2018.

Ambetter Class Action

On January 11, 2018, a putative class action lawsuit was filed by Cynthia Harvey and Steven A. Milman against the Company and certain subsidiaries in the U.S. District Court for the Eastern District of Washington. The complaint alleges that the Company failed to meet federal and state requirements for provider networks and directories with regard to its Ambetter policies, denied coverage and/or refused to pay for covered benefits, and failed to address grievances adequately, causing some members to incur unexpected costs. In March 2018, the Company filed separate motions to dismiss each defendant. In July 2018, the plaintiff voluntarily filed a First Amended Complaint that removed Steven Milman as a plaintiff, dropped Centene Corporation and Superior Health Plan as defendants, abandoned certain claims, narrowed the putative class to Washington State only, and added Centene Management Company as a defendant. In August 2018, the Company moved to dismiss the First Amended Complaint. In response, the plaintiff voluntarily filed a Second Amended Complaint. In September 2018, the Company filed a motion to dismiss the Second Amended Complaint. The Company intends to vigorously defend itself against these claims. Nevertheless, this matter is subject to many uncertainties and the Company cannot predict how long this litigation will last or what the ultimate outcome will be, and an adverse outcome in this matter could potentially have a materially adverse impact on our financial position and results of operations.

Miscellaneous Proceedings

Excluding the matters discussed above, the Company is also routinely subjected to legal and regulatory proceedings in the normal course of business. These matters can include, without limitation:

- periodic compliance and other reviews and investigations by various federal and state regulatory agencies with respect to requirements applicable to the Company's business, including, without limitation, those related to payment of out-of-network claims, submissions to CMS for risk adjustment payments or the False Claims Act, pre-authorization penalties, timely review of grievances and appeals, timely and accurate payment of claims, and the Health Insurance Portability and Accountability Act of 1996;
- litigation arising out of general business activities, such as tax matters, disputes related to healthcare benefits coverage or reimbursement, putative securities class actions and medical malpractice, privacy, real estate, intellectual property and employment-related claims;
- disputes regarding reinsurance arrangements, claims arising out of the acquisition or divestiture of various assets, class actions and claims relating to the performance of contractual and non-contractual obligations to providers, members, employer groups and others, including, but not limited to, the alleged failure to properly pay claims and challenges to the manner in which the Company processes claims and claims alleging that the Company has engaged in unfair business practices.

Among other things, these matters may result in awards of damages, fines or penalties, which could be substantial, and/or could require changes to the Company's business. The Company intends to vigorously defend itself against the miscellaneous legal and regulatory proceedings to which it is currently a party; however, these proceedings are subject to many uncertainties. In some of the cases pending against the Company, substantial non-economic or punitive damages are being sought.

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 known and unknown risks and uncertainties, including those set forth under Part II, Item 1A. "Risk Factors" of this Form 10-Q.

EXECUTIVE OVERVIEW

General

We are a diversified, multi-national healthcare enterprise that provides services to government sponsored and commercial healthcare programs, focusing on under-insured and uninsured individuals. We provide member-focused services through locally based staff by assisting in accessing care, coordinating referrals to related health and social services and addressing member concerns and questions.

Results of operations depend on our ability to manage expenses associated with health benefits (including estimated costs incurred) and selling, general and administrative (SG&A) costs. We measure operating performance based upon two key ratios. The health benefits ratio (HBR) represents medical costs as a percentage of premium revenues, excluding premium tax and health insurer fee revenues that are separately billed, and reflects the direct relationship between the premiums received and the medical services provided. The SG&A expense ratio represents SG&A costs as a percentage of premium and service revenues, excluding premium tax and health insurer fee revenues that are separately billed.

Fidelis Care Acquisition

On July 1, 2018, we acquired substantially all of the assets of New York State Catholic Health Plan, Inc., d/b/a Fidelis Care New York (Fidelis Care) for approximately \$3.47 billion of cash consideration which includes a working capital adjustment. The cash consideration was funded through approximately \$2.8 billion of new equity, and approximately \$1.8 billion of new long-term debt. Both offerings were completed in May 2018. The Fidelis Care acquisition expanded the Company's health plan footprint to New York State. As a result of the completion of the Fidelis Care acquisition, the Company's results of operations for the three and nine months ended September 30, 2018 include the results of operations of Fidelis Care from July 1, 2018 to September 30, 2018. Due to the size of the acquisition, one of the primary drivers of the year-over-year variances discussed throughout this section is related to the acquisition of Fidelis Care.

As part of the regulatory approval process, we entered into certain undertakings with the New York State Department of Health. The undertakings contain various commitments by Centene effective upon completion of the Fidelis Care acquisition. One of the undertakings includes a \$340 million contribution by Centene to the State of New York to be paid over a five-year period for initiatives consistent with our mission of providing high quality healthcare to vulnerable populations within New York State. The present value of the \$340 million contribution to the State of New York, approximately \$324 million, was expensed in SG&A during the third quarter of 2018.

Acquisitions and Investments

We continued to execute on our growth strategy through acquisitions and investments during 2018. In the first quarter of 2018, we acquired 100% of Community Medical Holdings Corp., d/b/a Community Medical Group (CMG), an at-risk primary care provider serving Medicaid, Medicare Advantage, and Health Insurance Marketplace patients in Miami-Dade County, Florida. CMG has a multi-payor strategy and serves our Florida health plan members. The acquisition increases Centene's scale and capabilities and creates a vertical integration opportunity with providers. We also acquired an additional 61% ownership in Interpreta Holdings, Inc. (Interpreta), a clinical and genomics data analytics business, bringing our total ownership to 80%. Finally, in the first and second quarters of 2018, we completed a 28% equity method investment in RxAdvance (RxA), a full-service pharmacy benefit manager (PBM) with an innovative technology platform. In September 2018, we made an additional investment in RxA in the form of convertible preferred stock. Both the Interpreta and RxA transactions reflect our commitment to technological innovation and providing comprehensive and integrated specialty services.

In the second quarter of 2018, we acquired 100% of MHM Services Inc. (MHM), a provider of behavioral health, medical and dental services to correctional facilities, state hospitals, courts, juvenile facilities and community clinics. Under the terms of the agreement, Centene also acquired the remaining 49% ownership of Centurion, the correctional healthcare services joint venture between Centene and MHM, expanding our national footprint in the correctional healthcare sector.

Third Quarter 2018 Highlights

Our financial performance for the third quarter of 2018 is summarized as follows:

- Managed care membership of 14.4 million, an increase of 2.1 million members, or 17% year-over-year.
- Total revenues of \$16.2 billion, representing 36% growth year-over-year.
- Health benefits ratio of 86.3%, compared to 88.0% for the third quarter of 2017.
- SG&A expense ratio of 12.6%, compared to 9.0% for the third quarter of 2017.
- Adjusted SG&A expense ratio of 10.0%, compared to 8.9% for the third quarter of 2017.
- Operating cash flows of \$548 million.
- Diluted earnings per share (EPS) for the third quarter of 2018 of \$0.09, compared to \$1.16 for the third quarter of 2017.
- Adjusted Diluted EPS for the third quarter of 2018 of \$1.79, compared to \$1.35 for the third quarter of 2017.

Adjusted Diluted EPS is highlighted below and additional detail is provided above under the heading "Non-GAAP Financial Presentation":

	Three Months Ended September 30,	
	2018	2017
GAAP diluted EPS	\$ 0.09	\$ 1.16
Amortization of acquired intangible assets	0.24	0.14
Acquisition related expenses	1.46	0.02
Penn Treaty assessment expense	—	0.03
Adjusted Diluted EPS	\$ 1.79	\$ 1.35

The third quarter results include the following items, which in the aggregate had no net effect on diluted EPS:

- During the third quarter, we received 2014-2017 cost reconciliation information related to the California Medicaid in-home support services (IHSS) program, which ended December 31, 2017. As a result, our third quarter results include an estimated pre-tax benefit of \$140 million related to the IHSS program reconciliation. The 2014-2016 reconciliation is expected to be finalized by early 2019, with the final 2017 reconciliation to follow.
- September 30, 2018 represented the previously announced expiration of our contract to provide health care coordination services to the U.S. Department of Veterans Affairs under the Patient-Centered Community Care and Veterans Choice Programs. In connection with the conclusion of the contract, we recorded a pre-tax charge of \$110 million for negotiated settlements and severance costs. We will continue to provide close out and transition services through 2021.
- We recorded pre-tax expense of \$30 million associated with a contribution commitment to our charitable foundation.

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

- *Arkansas.* In February 2018, our Arkansas subsidiary, Arkansas Total Care, began managing a Medicaid special needs population comprised of people with high behavioral health needs and individuals with developmental/intellectual disabilities. Arkansas Total Care will assume full-risk on this population beginning in January 2019.
- *CMG.* In March 2018, we completed the acquisition of CMG, an at-risk primary care provider serving Medicaid, Medicare Advantage, and Health Insurance Marketplace patients in Miami-Dade County, Florida.
- *Correctional.* In April 2018, we completed the acquisition of MHM, a national provider of healthcare and staffing services to correctional systems and other government agencies. Under the terms of the agreement, Centene also acquired the remaining 49% ownership of Centurion, the correctional healthcare services joint venture between Centene and MHM. In June 2017, Centurion began operating under an expanded contract to provide correctional healthcare services for the Florida Department of Corrections in South Florida.

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- *Fidelis Care*. In July 2018, we completed the acquisition of substantially all of the assets of Fidelis Care for \$3.47 billion of cash consideration, making Fidelis Care Centene's health plan in New York State.
- *Health Insurance Marketplace*. In January 2018, we expanded our offerings in the 2018 Health Insurance Marketplace. We entered Kansas, Missouri and Nevada, and expanded our footprint in the following six existing markets: Florida, Georgia, Indiana, Ohio, Texas, and Washington.
- *Health Net Federal Services*. In January 2018, our subsidiary, Health Net Federal Services, began operating under the TRICARE West Region contract to provide administrative services to Military Health System eligible beneficiaries.
- *Illinois*. In January 2018, our Illinois subsidiary, IlliniCare Health, began operating under a state-wide contract for the Medicaid Managed Care Program. Implementation dates varied by region and the contract was fully implemented statewide in April 2018. The new contract will include children who are in need through the Department of Children and Family Services/Youth in Care by the Illinois Department of Healthcare and Family Services and Foster Care. These additional products are expected to be implemented in the second quarter of 2019.
- *Interpreta*. In March 2018, we acquired an additional 61% ownership in Interpreta, a clinical and genomics data analytics business, bringing our total ownership to 80%.
- *Maryland*. In July 2017, our specialty solutions subsidiary, Envolve, Inc., began providing health plan management services for Medicaid operations in Maryland.
- *Medicare*. In January 2018, we expanded our offerings in Medicare. We entered Arkansas, Indiana, Kansas, Louisiana, Missouri, Pennsylvania, South Carolina, and Washington and expanded our footprint in Ohio.
- *Missouri*. In May 2017, our Missouri subsidiary, Home State Health, began providing managed care services to MO HealthNet Managed Care beneficiaries under an expanded statewide contract.
- *Nevada*. In July 2017, our Nevada subsidiary, SilverSummit Healthplan, began serving Medicaid recipients enrolled in Nevada's Medicaid managed care program.
- *Pennsylvania*. In January 2018, our Pennsylvania subsidiary, Pennsylvania Health & Wellness, began serving enrollees in the Community HealthChoices program. Contract commencement dates vary by zone and will be fully implemented statewide by January 2020.
- *RxAdvance*. In March 2018, we made a 25% equity method investment in RxAdvance, a full-service PBM, and expect to use its platform to improve health outcomes and reduce avoidable drug-impacted medical and administrative costs. This partnership includes both a customer relationship and a strategic investment in RxAdvance. As part of the initial transaction, Centene has certain rights to expand its equity investment in the future. In May 2018, we made an additional investment in RxAdvance, bringing the total ownership to 28%. In September 2018, we made an additional investment in convertible preferred stock.
- *Washington*. In January 2018, our Washington State subsidiary, Coordinated Care of Washington, began providing managed care services to Apple Health's Fully Integrated Managed Care beneficiaries in the North Central Region.

The growth items listed above were partially offset by the following items:

- We were successful in reprocurring our contract in Georgia. However, the Medicaid program was expanded to include additional insurers, effective July 2017, which has reduced our market share. In addition, we are no longer serving LTSS members in Arizona or Medicaid members in Massachusetts.
- Beginning in January 2018, the State of California no longer includes costs for IHSS in its Medicaid contracts.
- Beginning in July 2018, we no longer serve correctional healthcare members in Massachusetts.

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

- We expect to realize the full year benefit in 2018 of business commenced during 2017 in Florida, Maryland, Missouri and Nevada, as discussed above.

- We expect to realize the full year benefit in 2019 of acquisitions, investments, and business commenced during 2018, as discussed above.
- In October 2018, CMS published updated Medicare Star quality ratings for the 2019 rating year. Our Star ratings returned to a 4.0 Star parent rating. The 2019 rating year will positively affect quality bonus payments for Medicare Advantage plans in 2020.
- In October 2018, Centurion was awarded a contract to provide comprehensive healthcare services to detainees of the Metropolitan Detention Center located in Albuquerque, New Mexico. The contract is expected to commence in January 2019 with a base term of four years.
- In October 2018, we announced that we are expanding our offerings in the 2019 Health Insurance Marketplace. We are entering Pennsylvania, North Carolina, South Carolina and Tennessee in 2019, and expanding our footprint in six existing markets: Florida, Georgia, Indiana, Kansas, Missouri and Texas.
- In October 2018, our Arizona subsidiary, Health Net Access, began providing physical and behavioral health care services through the Arizona Health Care Cost Containment System Complete Care program in the Central region and the Southern region.
- In October 2018, our Mississippi subsidiary, Magnolia Health, entered into a new agreement to continue providing services to Medicaid recipients enrolled in the Mississippi Coordinated Access Network.
- In August 2018, Centurion was awarded a contract to provide comprehensive healthcare services to detainees of Volusia County detention facilities located near Daytona, Florida. The contract is expected to commence on January 1, 2019.
- In July 2018, we announced a joint venture with Ascension to establish a Medicare Advantage plan. The plan is expected to be implemented in multiple geographic markets beginning in 2020.
- In July 2018, our subsidiary, Health Net Federal Services, was awarded the next generation Military & Family Life Counseling Program contract. The awarded contract is up to ten years, including multiple one-year option periods.
- In July 2018, Centurion began operating under a contract to provide healthcare services for correctional facilities in Pima County, Arizona. In addition, Centurion's contracts for correctional facilities were reprocured in Florida, New Hampshire and Tennessee.
- In June 2018, our Kansas subsidiary, Sunflower Health Plan, was selected to continue providing managed care services to KanCare beneficiaries statewide. The new contract is expected to commence January 1, 2019.
- In May 2018, our Washington State subsidiary, Coordinated Care of Washington, was selected to provide expanded managed care services to Apple Health's Fully Integrated Managed Care (FIMC) Medicaid beneficiaries. This new contract integrates physical and behavioral health.
- In May 2018, our Iowa subsidiary, Iowa Total Care, Inc., was selected to negotiate a new statewide contract for the IA Health Link Program. Pending regulatory approval, the contract is expected to commence on July 1, 2019.
- In May 2018, our Florida subsidiary, Sunshine Health, was awarded a contract to provide physical and behavioral health care services in all 11 regions through Florida's Statewide Medicaid Managed Care Program, subject to regulatory approval and successful completion of readiness review. The five year contract is expected to begin December 1, 2018 and will be implemented by region through February 2019.
- In January 2018, our New Mexico subsidiary, Western Sky Community Care, was awarded a statewide contract in New Mexico for the Centennial Care 2.0 Program. The new contract is expected to commence membership operations in January 2019.

- In January 2017, we signed a joint venture agreement with the North Carolina Medical Society, working in conjunction with the North Carolina Community Health Center Association, to collaborate on a patient-focused approach to Medicaid under the reform plan enacted in the State of North Carolina. The newly created health plan, Carolina Complete Health, was created to establish, organize and operate a physician-led health plan to provide Medicaid managed care services in North Carolina.

The future growth items listed above are partially offset by the following items:

- Effective October 2018, we no longer provide health care coordination services to veterans under the Patient-Centered Community Care and Veterans Choice Programs.
- In the first quarter of 2018, Health Net of Arizona, Inc. notified the Arizona Department of Insurance of its decision to discontinue and non-renew all of its Employer Group plans for small and large business groups in Arizona beginning January 1, 2019. The effective date of coverage termination for existing groups is dependent on remaining renewals; however, coverage will no longer be provided to any group policyholders and/or members after December 31, 2019.

MEMBERSHIP

From September 30, 2017 to September 30, 2018, we increased our managed care membership by 2,078,300, or 17%. The following table sets forth our membership by line of business:

	September 30, 2018	December 31, 2017	September 30, 2017
Medicaid:			
TANF, CHIP & Foster Care	7,260,500	5,807,300	5,809,400
ABD & LTSS	964,200	846,200	850,300
Behavioral Health	455,900	463,700	467,400
Total Medicaid	8,680,600	7,117,200	7,127,100
Commercial	2,062,500	1,558,300	1,657,800
Medicare ⁽¹⁾	417,400	333,700	331,000
Correctional	150,900	157,500	158,000
Total at-risk membership	11,311,400	9,166,700	9,273,900
TRICARE eligibles	2,858,900	2,824,100	2,823,200
Non-risk membership	219,000	216,300	213,900
Total	14,389,300	12,207,100	12,311,000

(1) Membership includes Medicare Advantage, Medicare Supplement, Special Needs Plans, and Medicare-Medicaid Plans (MMP).

The following table sets forth additional membership statistics, which are included in the membership information above:

	September 30, 2018	December 31, 2017	September 30, 2017
Dual-eligible ⁽²⁾	590,300	474,500	475,300
Health Insurance Marketplace	1,529,400	959,600	1,024,000
Medicaid Expansion	1,237,800	1,091,500	1,105,000

(2) Membership includes dual-eligible ABD & LTC and dual-eligible Medicare membership in the table above.

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, 2018 and 2017, 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, 2018 and 2017 is as follows (\$ in millions, except per share data in dollars):

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2018	2017	% Change 2017-2018	2018	2017	% Change 2017-2018
Premium	\$ 14,623	\$ 10,850	35 %	\$ 38,639	\$ 32,393	19 %
Service	732	571	28 %	2,147	1,634	31 %
Premium and service revenues	15,355	11,421	34 %	40,786	34,027	20 %
Premium tax and health insurer fee	827	477	73 %	2,771	1,549	79 %
Total revenues	16,182	11,898	36 %	43,557	35,576	22 %
Medical costs	12,626	9,543	32 %	33,045	28,278	17 %
Cost of services	622	437	42 %	1,823	1,334	37 %
Selling, general and administrative expenses	1,934	1,030	88 %	4,487	3,186	41 %
Amortization of acquired intangible assets	65	38	71 %	149	117	27 %
Premium tax expense	716	510	40 %	2,451	1,643	49 %
Health insurer fee expense	178	—	100 %	532	—	100 %
Earnings from operations	41	340	(88)%	1,070	1,018	5 %
Investment and other income (expense), net	(17)	(14)	(21)%	(59)	(52)	(13)%
Earnings from operations, before income tax expense	24	326	(93)%	1,011	966	5 %
Income tax expense	8	125	(94)%	358	381	(6)%
Net earnings	16	201	(92)%	653	585	12 %
Loss attributable to noncontrolling interests	3	4	(25)%	6	13	(54)%
Net earnings attributable to Centene Corporation	\$ 19	\$ 205	(91)%	\$ 659	\$ 598	10 %
Diluted earnings per common share attributable to Centene Corporation	\$ 0.09	\$ 1.16	(92)%	\$ 3.37	\$ 3.39	(1)%

Three Months Ended September 30, 2018 Compared to Three Months Ended September 30, 2017**Total Revenues**

The following table sets forth supplemental revenue information for the three months ended September 30, (\$ in millions):

	2018	2017	% Change 2017-2018
Medicaid	\$ 10,909	\$ 8,090	35%
Commercial	3,125	2,004	56%
Medicare ⁽¹⁾	1,363	1,138	20%
Other	785	666	18%
Total Revenues	\$ 16,182	\$ 11,898	36%

(1) Medicare includes Medicare Advantage, Medicare Supplement, Special Needs Plans, and MMP.

Total revenues increased 36% in the three months ended September 30, 2018 over the corresponding period in 2017 primarily due to the acquisition of Fidelis Care, growth in the Health Insurance Marketplace business in 2018, expansions and new programs in many of our states in 2018, other acquisitions and the reinstatement of the health insurer fee in 2018. These increases were partially offset by the impact of the removal of the IHSS program from California's Medicaid contract in January 2018.

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 that are separately billed) and reflects the direct relationship between the premium received and the medical services provided.

The HBR for the three months ended September 30, 2018 was 86.3%, compared to 88.0% in the same period in 2017. The benefit of the recognition of the previously mentioned IHSS program reconciliation reduced the HBR by approximately 100 basis points. The remaining HBR decrease compared to last year was driven by membership growth in the Health Insurance Marketplace business and the reinstatement of the health insurer fee in 2018. This was partially offset by the acquisition of Fidelis Care, which operates at a higher HBR.

Cost of Services

Cost of services increased by \$185 million in the three months ended September 30, 2018, compared to the corresponding period in 2017. This was primarily due to the acquisition of Foundation Care in October 2017, growth in our correctional services business, including the acquisition of MHM, and costs associated with the previously mentioned Veterans Affairs contract expiration.

The cost of service ratio for the three months ended September 30, 2018, was 85.0%, compared to 76.5% in the same period in 2017. The cost of service ratio was negatively impacted by approximately 400 basis points for the costs associated with the previously mentioned Veterans Affairs contract expiration. The increase in the cost of service ratio was also due to lower margins associated with our other federal services and specialty pharmacy businesses. These increases were partially offset by our correctional services business, which operates at a lower cost of service ratio.

Selling, General & Administrative Expenses

Selling, general and administrative expenses, or SG&A, increased by \$904 million in the three months ended September 30, 2018, compared to the corresponding period in 2017. This was primarily due to \$399 million of acquisition related expenses associated with the closing of the Fidelis Care acquisition, including \$324 million of charitable contribution commitments resulting from the undertaking agreements, as well as bridge loan fees, investment banking fees, and other acquisition related costs.

The remainder of the SG&A increase was primarily attributable to the acquisition of Fidelis Care, costs associated with the previously mentioned Veterans Affairs contract expiration, and expansions, new programs and growth in many of our states in 2018, including growth in the Health Insurance Marketplace business. Also, in the third quarter of 2018, we committed to contributing \$30 million to our charitable foundation.

The SG&A expense ratio was 12.6% for the third quarter of 2018, compared to 9.0% in the third quarter of 2017. The year-over-year increase was primarily due to \$399 million of acquisition related expenses associated with the closing of the Fidelis Care acquisition, which increased the ratio by approximately 260 basis points. The Adjusted SG&A expense ratio was 10.0% for the third quarter of 2018, compared to 8.9% in the third quarter of 2017. Both ratios increased by approximately 70 basis points related to costs associated with the previously mentioned Veterans Affairs contract expiration and the commitment to our charitable foundation. The remaining increases were due to growth in the Health Insurance Marketplace business, which operates at a higher SG&A expense ratio, partially offset by the acquisition of Fidelis Care, which operates at a lower SG&A expense ratio.

Health Insurer Fee Expense

Health insurance fee expense was \$178 million for the three months ended September 30, 2018. As a result of the health insurer fee moratorium, which suspended the health insurance provider fee for the 2017 calendar year, we did not record health insurer fee expense for the three months ended September 30, 2017.

Other Income (Expense)

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

	<u>2018</u>	<u>2017</u>
Investment and other income	\$ 80	\$ 51
Interest expense	(97)	(65)
Other income (expense), net	<u>\$ (17)</u>	<u>\$ (14)</u>

The increase in investment income in 2018 reflects higher interest rates and investment balances over 2017, including the impact of higher investment balances as a result of the Fidelis Care acquisition. These increases were partially offset by the prior year interest income from the State of Illinois related to capitation payment delays. Interest expense increased by \$32 million in the three months ended September 30, 2018, compared to the corresponding period in 2017, reflecting a net increase in borrowings, primarily related to the financing of the Fidelis Care acquisition and the effect of our interest rate swaps.

Income Tax Expense

For the three months ended September 30, 2018, we recorded income tax expense of \$8 million on pre-tax earnings of \$24 million, or an effective tax rate of 33.3%. The current quarter effective tax rate reflects the lower corporate tax rate as enacted in the Tax Cuts and Job Acts (TCJA), partially offset by an increased tax rate due to the non-deductibility of the health insurer fee. For the three months ended September 30, 2017, we recorded income tax expense of \$125 million on pre-tax earnings of \$326 million, or an effective tax rate of 38.3%, which reflects the higher corporate tax rate for 2017 and the impact of the health insurer fee moratorium.

The Company has completed its accounting of the effects of the TCJA on current and deferred income taxes. No material changes were made to the tax effects recorded in 2017.

Segment Results

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

	2018	2017	% Change 2017- 2018
Total Revenues			
Managed Care	\$ 15,446	\$ 11,259	37 %
Specialty Services	3,112	3,017	3 %
Eliminations	(2,376)	(2,378)	—%
Consolidated Total	<u>\$ 16,182</u>	<u>\$ 11,898</u>	<u>36 %</u>
Earnings from Operations			
Managed Care	\$ 92	\$ 238	(61)%
Specialty Services	(51)	102	(150)%
Consolidated Total	<u>\$ 41</u>	<u>\$ 340</u>	<u>(88)%</u>

Managed Care

Total revenues increased 37% in the three months ended September 30, 2018, compared to the corresponding period in 2017, primarily as a result of the acquisition of Fidelis Care and expansions, new programs, and growth in many of our states, particularly Florida, Georgia, Illinois, Missouri, Nevada, Ohio, Pennsylvania and Texas, including growth in the Health Insurance Marketplace business. Total revenues also increased as a result of the reinstatement of the health insurer fee in 2018. These increases were partially offset by the impact of the removal of the IHSS program from California's Medicaid contract in January 2018. Earnings from operations decreased \$146 million between years primarily as a result of increased acquisition related expenses, partially offset by growth due to the acquisition of Fidelis Care, growth in the Health Insurance Marketplace business and the reinstatement of the health insurer fee in 2018.

Specialty Services

Total revenues increased 3% in the three months ended September 30, 2018, compared to the corresponding period in 2017, resulting primarily from increased services associated with membership growth in the Managed Care segment, acquisitions, and growth in our specialty pharmacy business. These revenue increases are partially offset by a decline in revenue due to the previously mentioned Veterans Affairs contract expiration, decreased revenues for our other federal services business, and a decline in revenue for our behavioral health services business as a result of many states combining these services within our physical health contracts in order to integrate physical and behavioral health care to achieve a more holistic care model for our members. Earnings from operations decreased \$153 million in the three months ended September 30, 2018, compared to the corresponding period in 2017, primarily due to costs associated with the previously mentioned Veterans Affairs contract expiration and lower margins in our other federal services and behavioral health services businesses, partially offset by growth in our pharmacy benefits management business.

Nine Months Ended September 30, 2018 Compared to Nine Months Ended September 30, 2017**Total Revenues**

The following table sets forth supplemental revenue information for the nine months ended September 30, (\$ in millions):

	2018	2017	% Change 2017- 2018
Medicaid	\$ 28,033	\$ 24,125	16%
Commercial	9,331	6,126	52%
Medicare ⁽¹⁾	3,728	3,404	10%
Other	2,465	1,921	28%
Total Revenues	<u>\$ 43,557</u>	<u>\$ 35,576</u>	<u>22%</u>

(1) Medicare includes Medicare Advantage, Medicare Supplement, Special Needs Plans, and MMP.

Total revenues increased 22% in the nine months ended September 30, 2018 over the corresponding period in 2017 primarily due to the acquisition of Fidelis Care, growth in the Health Insurance Marketplace business in 2018, other acquisitions, expansions and new programs in many of our states in 2017 and 2018, and the reinstatement of the health insurer fee in 2018. Total revenues also increased by approximately \$442 million associated with pass through payments from the State of California recorded in premium tax revenue and premium tax expense. These increases were partially offset by lower revenues in California, which is a result of the removal of the IHSS program from California's Medicaid contract in January 2018. During the nine months ended September 30, 2018, we received premium rate adjustments which yielded a net 1% composite change across all of our markets.

Operating Expenses

Medical Costs

The HBR for the nine months ended September 30, 2018 was 85.5%, compared to 87.3% in the same period in 2017. The benefit of the recognition of the previously mentioned IHSS program reconciliation reduced the HBR by approximately 40 basis points. The remaining HBR decrease compared to last year was driven by membership growth in the Health Insurance Marketplace business and the reinstatement of the health insurer fee in 2018. This was partially offset by the acquisition of Fidelis Care, which operates at a higher HBR.

Cost of Services

Cost of services increased by \$489 million in the nine months ended September 30, 2018, compared to the corresponding period in 2017. This was primarily due to the acquisition of Foundation Care in October 2017, growth in our correctional services business, including the acquisition of MHM, and costs associated with the previously mentioned Veterans Affairs contract expiration.

The cost of service ratio for the nine months ended September 30, 2018, was 84.9%, compared to 81.6% in the same period in 2017. The cost of service ratio was negatively impacted by approximately 140 basis points for the costs associated with the previously mentioned Veterans Affairs contract expiration. The increase in the cost of service ratio was also due to lower margins associated with our other federal services and specialty pharmacy businesses. These increases were partially offset by our correctional services business, which operates at a lower cost of service ratio.

Selling, General & Administrative Expenses

SG&A increased by \$1,301 million in the nine months ended September 30, 2018, compared to the corresponding period in 2017. This was primarily due to \$421 million of acquisition related expenses primarily associated with the closing of the Fidelis Care acquisition, including \$324 million of charitable contribution commitments resulting from the undertaking agreements, as well as bridge loan fees, investment banking fees, and other acquisition related costs.

The remainder of the SG&A increase was primarily attributable to the acquisition of Fidelis Care, costs associated with the previously mentioned Veterans Affairs contract expiration, and expansions, new programs and growth in many of our states in 2018, including growth in the Health Insurance Marketplace business. These increases were partially offset by the \$56 million recognized during the nine months ended September 30, 2017 for our estimated share of the undiscounted guaranty association assessment resulting from the liquidation of Penn Treaty.

The SG&A expense ratio for the nine months ended September 30, 2018 was 11.0%, compared to 9.4% for the corresponding period in 2017. The year-over-year increase was primarily due to \$421 million of acquisition related expenses primarily associated with the closing of the Fidelis Care acquisition, which increased the ratio by approximately 100 basis points. The Adjusted SG&A expense ratio for the nine months ended September 30, 2018 was 10.0%, compared to 9.2% for the nine months ended September 30, 2017. Both ratios increased due to growth in the Health Insurance Marketplace business, which operates at a higher SG&A expense ratio. The remaining increases were due to approximately 25 basis points related to costs associated with the previously mentioned Veterans Affairs contract expiration and the commitment to our charitable foundation. These increases were partially offset by the acquisition of Fidelis Care, which operates at a lower SG&A expense ratio.

Health Insurer Fee Expense

Health insurance fee expense was \$532 million for the nine months ended September 30, 2018. As a result of the health insurer fee moratorium, which suspended the health insurance provider fee for the 2017 calendar year, we did not record health insurer fee expense for the nine months ended September 30, 2017.

Other Income (Expense)

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

	2018	2017
Investment and other income	\$ 186	\$ 137
Interest expense	(245)	(189)
Other income (expense), net	<u>\$ (59)</u>	<u>\$ (52)</u>

The increase in investment income in 2018 reflects higher interest rates and investment balances over 2017, including the impact of higher investment balances as a result of the Fidelis Care acquisition, and investment income on the proceeds from our equity and debt issuances in advance of the closing of the Fidelis Care acquisition. These increases were partially offset by the prior year interest income from the State of Illinois related to capitation payment delays. Interest expense increased by \$56 million in the nine months ended September 30, 2018, compared to the corresponding period in 2017, reflecting a net increase in borrowings, primarily related to the financing of the Fidelis Care acquisition and the effect of our interest rate swaps.

Income Tax Expense

For the nine months ended September 30, 2018, we recorded income tax expense of \$358 million on pre-tax earnings of \$1,011 million, or an effective tax rate of 35.4%. The current effective tax rate reflects the lower corporate tax rate as enacted in the TCJA, partially offset by an increased tax rate due to the non-deductibility of the health insurer fee. For the nine months ended September 30, 2017, we recorded income tax expense of \$381 million on pre-tax earnings of \$966 million, or an effective tax rate of 39.4%, which reflects the higher corporate tax rate for 2017 and the impact of the health insurer fee moratorium.

Segment Results

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

	2018	2017	% Change 2017-2018
Total Revenues			
Managed Care	\$ 41,229	\$ 33,737	22 %
Specialty Services	9,323	8,984	4 %
Eliminations	(6,995)	(7,145)	2 %
Consolidated Total	<u>\$ 43,557</u>	<u>\$ 35,576</u>	<u>22 %</u>
Earnings from Operations			
Managed Care	\$ 983	\$ 799	23 %
Specialty Services	87	219	(60)%
Consolidated Total	<u>\$ 1,070</u>	<u>\$ 1,018</u>	<u>5 %</u>

Managed Care

Total revenues increased 22% in the nine months ended September 30, 2018, compared to the corresponding period in 2017, primarily as a result of the acquisition of Fidelis Care and expansions, new programs, and growth in many of our states, particularly Florida, Georgia, Illinois, Indiana, Missouri, Nevada, Ohio, Pennsylvania, and Texas, including growth in the Health Insurance Marketplace business. Total revenues also increased as a result of the reinstatement of the health insurer fee in 2018, as well as due to the additional pass through payments from the State of California. These increases were partially offset by the impact of the removal of the IHSS program from California's Medicaid contract in January 2018. Earnings from operations increased \$184 million between years primarily as a result of the acquisition of Fidelis Care, growth in the Health Insurance Marketplace business, and the reinstatement of the health insurer fee in 2018, partially offset by increased acquisition related expenses. In addition, 2017 was negatively impacted by the Penn Treaty assessment expense.

Specialty Services

Total revenues increased 4% in the nine months ended September 30, 2018, compared to the corresponding period in 2017, resulting primarily from increased services associated with membership growth in the Managed Care segment, acquisitions, and growth in our specialty pharmacy, correctional, and management services businesses. These revenue increases are partially offset by a decline in revenue due to the previously mentioned Veterans Affairs contract expiration, decreased revenues for our other federal services business, and a decline in revenue for our behavioral health services business as a result of many states combining these services within our physical health contracts in order to integrate physical and behavioral health care to achieve a more holistic care model for our members. Earnings from operations decreased \$132 million in the nine months ended September 30, 2018, compared to the corresponding period in 2017, primarily due to costs associated with the previously mentioned Veterans Affairs contract expiration and lower margins in our other federal services and behavioral health services businesses, partially offset by growth in our pharmacy benefits management business.

LIQUIDITY AND CAPITAL RESOURCES

Shown below is a condensed schedule of cash flows used in the discussion of liquidity and capital resources (\$ in millions).

	Nine Months Ended September 30,	
	2018	2017
Net cash provided by operating activities	\$ 1,868	\$ 1,039
Net cash used in investing activities	(3,563)	(686)
Net cash provided by (used in) financing activities	4,460	(3)
Effect of exchange rate changes on cash and cash equivalents	—	1
Net increase in cash, cash equivalents, and restricted cash and cash equivalents	<u>\$ 2,765</u>	<u>\$ 351</u>

Cash Flows Provided by Operating Activities

Normal operations are funded primarily through operating cash flows and borrowings under our revolving credit facility. Operating activities provided cash of \$1,868 million in the nine months ended September 30, 2018 compared to \$1,039 million in the comparable period in 2017. The cash provided by operating activities in 2018 was due to net earnings and an increase in medical claims liabilities, primarily resulting from growth in the Health Insurance Marketplace business. Cash flows from operations were partially offset by an increase in premium and trade receivables of \$696 million, due to an increase in receivables from several of our federal and state customers and the repayment of approximately \$630 million of Medicaid expansion rate overpayments in California, which was previously accrued.

Cash flows provided by operations in 2017 was primarily due to net earnings, an increase in medical claims liabilities resulting from growth in the Health Insurance Marketplace business and the commencement of the Nebraska and Nevada health plans, and an increase in unearned revenue primarily due to the receipt of October capitation payments in September. Cash flows provided by operating activities were partially offset by an increase in premium and related receivables of \$749 million, primarily related to the timing of a capitation payment from one of our states and capitation payment delays from the state of Illinois.

Cash flows from operations in each year were impacted by the timing of payments we receive from our states. As we have seen historically, states may prepay the following month premium payment, which we record as unearned revenue, or they may delay our premium payment, which we record as a receivable. We typically receive capitation payments monthly; however, the states in which we operate may decide to adjust their payment schedules which could positively or negatively impact our reported cash flows from operating activities in any given period.

Cash Flows Used in Investing Activities

Investing activities used cash of \$3,563 million for the nine months ended September 30, 2018, and \$686 million in the comparable period in 2017. Cash flows used in investing activities in 2018 primarily consisted of the net additions to the investment portfolio of our regulated subsidiaries (including transfers from cash and cash equivalents to long-term investments), the Fidelis Care and other acquisitions, the investments in RxAdvance, and capital expenditures.

Cash flows used in investing activities in 2017 primarily consisted of net additions to the investment portfolio of our regulated subsidiaries (including transfers from cash and cash equivalents to long-term investments) and capital expenditures.

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We spent \$489 million and \$301 million in the nine months ended September 30, 2018 and 2017, respectively, on capital expenditures for system enhancements and market and corporate headquarters expansions.

As of September 30, 2018, our investment portfolio consisted primarily of fixed-income securities with an average duration of 3.2 years. We had unregulated cash, investments and restricted deposits of \$482 million at September 30, 2018, compared to \$310 million at December 31, 2017.

Cash Flows Provided by Financing Activities

Our financing activities provided cash of \$4,460 million in the nine months ended September 30, 2018, compared to a \$3 million use of cash in the comparable period in 2017. During 2018, our net financing activities primarily related to our offering of \$2.8 billion in shares of common stock, par value \$0.001 per share, and approximately \$1.8 billion of new long-term debt. Proceeds from both offerings were used to fund the Fidelis Care acquisition which closed on July 1, 2018, to pay related fees and expenses, and for general corporate purposes, including the repayment of outstanding indebtedness. Cash flows provided by financing activities were partially offset by the purchase of noncontrolling interest.

During 2017, our net financing activities primarily related to common stock repurchases resulting from stock relinquished to us by employees for payment of taxes upon vesting of restricted stock units.

Liquidity Metrics

The credit agreement underlying our Revolving Credit Facility contains non-financial and financial covenants, including requirements of minimum fixed charge coverage ratios and maximum debt-to-EBITDA ratios. We are required to not exceed a maximum debt-to-EBITDA ratio of 3.5 to 1.0. As of September 30, 2018, we had \$100 million borrowings outstanding under our revolving credit facility, and we were in compliance with all covenants. As of September 30, 2018, there were no limitations on the availability under the revolving credit agreement as a result of the debt-to-EBITDA ratio.

We have a \$200 million non-recourse construction loan to fund the expansion of our corporate headquarters. The loan bears interest based on the one month LIBOR plus 2.70% and matures in April 2021 with an optional one-year extension. The agreement contains financial and non-financial covenants aligning with our revolving credit agreement. We have guaranteed completion of the construction project associated with the loan. As of September 30, 2018, we had \$40 million in borrowings outstanding under the loan.

We had outstanding letters of credit of \$55 million as of September 30, 2018, which were not part of our revolving credit facility. We also had letters of credit for \$44 million (valued at the September 30, 2018 conversion rate), or €38 million, representing our 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 weighted interest of 1.33% as of September 30, 2018. In addition, we had outstanding surety bonds of \$501 million as of September 30, 2018.

The indentures governing our various maturities of senior notes contain restrictive covenants of Centene Corporation. As of September 30, 2018, we were in compliance with all covenants.

As discussed above, in May 2018, we issued approximately \$2.8 billion of new equity, and approximately \$1.8 billion of new long-term debt. Proceeds from the offerings were used to fund the Fidelis Care acquisition which closed on July 1, 2018, to pay related fees and expenses, and for general corporate purposes, including the repayment of outstanding indebtedness.

At September 30, 2018, we had working capital, defined as current assets less current liabilities, of \$347 million, compared to negative \$629 million at December 31, 2017. The increase in working capital was primarily due to the Fidelis Care acquisition. We manage our short-term and long-term investments with the goal of ensuring that a sufficient portion is held in investments that are highly liquid and can be sold to fund short-term requirements as needed.

At September 30, 2018, our debt to capital ratio, defined as total debt divided by the sum of total debt and total equity, was 37.3%, compared to 40.6% at December 31, 2017. Excluding the \$99 million non-recourse mortgage note and construction loan, our debt to capital ratio was 36.9% as of September 30, 2018, compared to 40.3% at December 31, 2017. We utilize the debt to capital ratio as a measure, among others, of our leverage and financial flexibility.

2018 Expectations

During the remainder of 2018, we expect to make net capital contributions to our insurance subsidiaries of approximately \$55 million associated with our growth and spend approximately \$185 million in additional capital expenditures primarily associated with system enhancements and market and corporate headquarters expansions. These amounts are expected to be funded by unregulated cash flow generation in 2018 and borrowings on our Revolving Credit Facility and construction loan. However, from time to time we may elect to raise additional funds for these and other purposes, either through issuance of debt or equity, the sale of investment securities or otherwise, as appropriate. In addition, we may strategically pursue refinancing opportunities to extend maturities and/or improve terms of our indebtedness if we believe such opportunities are favorable to us.

As part of the regulatory approval process, we entered into certain undertakings with the New York State Department of Health. The undertakings contain various commitments by Centene that were effective upon completion of the Fidelis Care acquisition. One of the undertakings includes a \$340 million contribution by Centene to the State of New York to be paid over a five-year period for initiatives consistent with our mission of providing high quality healthcare to vulnerable populations within New York State.

Based on our operating plan, we expect that our available cash, cash equivalents and investments, cash from our operations and cash available under our Revolving Credit Facility will be sufficient to finance our general operations and capital expenditures for at least 12 months from the date of this filing.

REGULATORY CAPITAL AND DIVIDEND RESTRICTIONS

Our operations are conducted through our subsidiaries. As managed care organizations, most of our subsidiaries are subject to state regulations and other requirements that, among other things, require the maintenance of minimum levels of statutory capital, as defined by each state, and restrict the timing, payment and amount of dividends and other distributions that may be paid to us. Generally, the amount of dividend distributions that may be paid by a regulated subsidiary without prior approval by state regulatory authorities is limited based on the entity's level of statutory net income and statutory capital and surplus.

Our regulated subsidiaries are required to maintain minimum capital requirements prescribed by various regulatory authorities in each of the states in which we operate. As of September 30, 2018, our subsidiaries had aggregate statutory capital and surplus of \$9,236 million, compared with the required minimum aggregate statutory capital and surplus requirements of \$3,374 million. During the nine months ended September 30, 2018, we made net capital contributions of \$178 million to our regulated subsidiaries. For our subsidiaries that file with the National Association of Insurance Commissioners (NAIC), we estimate our RBC percentage to be in excess of 350% of the Authorized Control Level (excluding the interim impact of the health insurer fee).

Under the California Knox-Keene Health Care Service Plan Act of 1975, as amended ("Knox-Keene"), certain of our California subsidiaries must comply with tangible net equity (TNE) requirements. Under these Knox-Keene TNE requirements, actual net worth less unsecured receivables and intangible assets must be more than the greater of (i) a fixed minimum amount, (ii) a minimum amount based on premiums or (iii) a minimum amount based on health care expenditures, excluding capitated amounts. In addition, certain of our California subsidiaries have made certain undertakings to the California Department of Managed Health Care (DMHC) to restrict dividends and loans to affiliates, to the extent that the payment of such would reduce such entities' TNE below the required amount as specified in the undertaking.

The NAIC has adopted rules which set minimum risk based capital requirements for insurance companies, managed care organizations and other entities bearing risk for healthcare coverage. As of September 30, 2018, each of our health plans was in compliance with the risk-based capital requirements enacted in those states.

As a result of the above requirements and other regulatory requirements, certain of our subsidiaries are subject to restrictions on their ability to make dividend payments, loans or other transfers of cash to their parent companies. Such restrictions, unless amended or waived or unless regulatory approval is granted, limit the use of any cash generated by these subsidiaries to pay our obligations. The maximum amount of dividends that can be paid by our insurance company subsidiaries without prior approval of the applicable state insurance departments is subject to restrictions relating to statutory surplus, statutory income and unassigned surplus. As of September 30, 2018, the amount of capital and surplus or net worth that was unavailable for the payment of dividends or return of capital to us was \$3,374 million in the aggregate.

RECENT ACCOUNTING PRONOUNCEMENTS

For this information, refer to Note 1, *Organization and Operations*, in the Notes to the Consolidated Financial Statements, included herein.

ITEM 3. Quantitative and Qualitative Disclosures About Market Risk.

INVESTMENTS AND DEBT

As of September 30, 2018, we had short-term investments of \$594 million and long-term investments of \$6,822 million, including restricted deposits of \$550 million. The short-term investments generally consist of highly liquid securities with maturities between three and 12 months. The long-term investments consist of municipal, corporate and U.S. Treasury securities, government sponsored obligations, life insurance contracts, asset backed securities and equity securities and have maturities greater than one year. Restricted deposits consist of investments required by various state statutes to be deposited or pledged to state agencies. Due to the nature of the states' requirements, these investments are classified as long-term regardless of the contractual maturity date. Substantially all of our investments are subject to interest rate risk and will decrease in value if market rates increase. Assuming a hypothetical and immediate 1% increase in market interest rates at September 30, 2018, the fair value of our fixed income investments would decrease by approximately \$218 million. Declines in interest rates over time will reduce our investment income.

We have interest rate swap agreements for a notional amount of \$2,700 million with creditworthy financial institutions to manage the impact of market interest rates on interest expense. Our swap agreements convert a portion of our interest expense from fixed to variable rates to better match the impact of changes in market rates on our variable rate cash equivalent investments. As a result, the fair value of \$2,700 million of our long-term debt varies with market interest rates. Assuming a hypothetical and immediate 1% increase in market interest rates at September 30, 2018, the fair value of our debt would decrease by approximately \$110 million. An increase in interest rates decreases the fair value of the debt and conversely, a decrease in interest rates increases the value.

For a discussion of the interest rate risk that our investments are subject to, see "Risk Factors – Our investment portfolio may suffer losses which could materially and adversely affect our results of operations or liquidity."

INFLATION

Historically, the inflation rate for medical care costs has been higher than the overall inflation rate for all items. We use various strategies to mitigate the negative effects of healthcare cost inflation. Specifically, our health plans try to control medical and hospital costs through our state savings initiatives and contracts with independent providers of healthcare services. Through these contracted care providers, our health plans emphasize preventive healthcare and appropriate use of specialty and hospital services. Additionally, our contracts with states require actuarially sound premiums that include healthcare cost trend.

While we currently believe our strategies to mitigate healthcare cost inflation will continue to be successful, competitive pressures, new healthcare and pharmaceutical product introductions, demands from healthcare providers and customers, applicable regulations, an increase in the expected rate of inflation for healthcare costs or other factors may affect our ability to control the impact of healthcare cost increases.

ITEM 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures - We maintain disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (Exchange Act) that are designed to provide reasonable assurance that information required to be disclosed by us in reports that we file or submit under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in SEC rules and forms; and (ii) accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

In connection with the filing of this Form 10-Q, management evaluated, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of the design and operation of our disclosure controls and procedures as of September 30, 2018. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level as of September 30, 2018.

Changes in Internal Control Over Financial Reporting - No change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the quarter ended September 30, 2018 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**PART II
OTHER INFORMATION**

ITEM 1. Legal Proceedings.

A description of the legal proceedings to which the Company and its subsidiaries are a party is contained in Note 11 to the consolidated financial statements included in Part I of this Quarterly Report on Form 10-Q, and is incorporated herein by reference.

ITEM 1A. Risk Factors.

**FACTORS THAT MAY AFFECT FUTURE RESULTS AND THE
TRADING PRICE OF OUR COMMON STOCK**

You should carefully consider the risks described below before making an investment decision. The trading price of our common stock could decline due to any of these risks, in which case you could lose all or part of your investment. You should also refer to the other information in this filing, including our consolidated financial statements and related notes. The risks and uncertainties described below are those that we currently believe may materially affect our Company. Additional risks and uncertainties that we are unaware of or that we currently deem immaterial also may become important factors that affect our Company.

Reductions in funding, changes to eligibility requirements for government sponsored healthcare programs in which we participate and any inability on our part to effectively adapt to changes to these programs could substantially affect our financial position, results of operations and cash flows.

The majority of our revenues come from government subsidized healthcare programs including Medicaid, Medicare, TRICARE, VA, CHIP, LTSS, ABD, Foster Care and Health Insurance Marketplace premiums. Under most programs, the base premium rate paid for each program differs, depending on a combination of factors such as defined upper payment limits, a member's health status, age, gender, county or region and benefit mix. Since Medicaid was created in 1965, the federal government and the states have shared the costs for this program, with the federal share currently averaging around 59%. We are therefore exposed to risks associated with U.S. and state government contracting or participating in programs involving a government payor, including but not limited to the general ability of the federal and/or state governments to terminate contracts with it, in whole or in part, without prior notice, for convenience or for default based on performance; potential regulatory or legislative action that may materially modify amounts owed; and our dependence upon Congressional or legislative appropriation and allotment of funds and the impact that delays in government payments could have on our operating cash flow and liquidity. For example, future levels of funding and premium rates may be affected by continuing government efforts to contain healthcare costs and may further be affected by state and federal budgetary constraints. Governments periodically consider reducing or reallocating the amount of money they spend for Medicaid, Medicare, TRICARE, VA, CHIP, LTSS, ABD and Foster Care. Furthermore, Medicare remains subject to the automatic spending reductions imposed by the Budget Control Act of 2011 and the American Taxpayer Relief Act of 2012 ("sequestration"), subject to a 2% cap. In addition, reductions in defense spending could have an adverse impact on certain government programs in which we currently participate by, among other things, terminating or materially changing such programs, or by decreasing or delaying payments made under such programs. Adverse economic conditions may continue to put pressures on state budgets as tax and other state revenues decrease while the population that is eligible to participate in these programs remains steady or increases, creating more need for funding. We anticipate this will require government agencies to find funding alternatives, which may result in reductions in funding for programs, contraction of covered benefits, and limited or no premium rate increases or premium rate decreases. A reduction (or less than expected increase), a protracted delay, or a change in allocation methodology in government funding for these programs, as well as termination of the contract for the convenience of the government, may materially and adversely affect our results of operations, financial position and cash flows. In addition, if a federal government shutdown were to occur for a prolonged period of time, federal government payment obligations, including its obligations under Medicaid, Medicare, TRICARE, VA, CHIP, LTSS, ABD, Foster Care and the Health Insurance Marketplaces, may be delayed. Similarly, if state government shutdowns were to occur, state payment obligations may be delayed. If the federal or state governments fail to make payments under these programs on a timely basis, our business could suffer, and our financial position, results of operations or cash flows may be materially affected.

Payments from government payors may be delayed in the future, which, if extended for any significant period of time, could have a material adverse effect on our results of operations, financial position, cash flows or liquidity. In addition, delays in obtaining, or failure to obtain or maintain, governmental approvals, or moratoria imposed by regulatory authorities, could adversely affect our revenues or membership, increase costs or adversely affect our ability to bring new products to market as forecasted. Other changes to our government programs could affect our willingness or ability to participate in any of these programs or otherwise have a material adverse effect on our business, financial condition or results of operations.

Finally, changes in these programs could reduce the number of persons enrolled in or eligible for these programs or increase our administrative or healthcare costs under these programs. For example, maintaining current eligibility levels could cause states to reduce reimbursement or reduce benefits in order for states to afford to maintain eligibility levels. If any state in which we operate were to decrease premiums paid to us or pay us less than the amount necessary to keep pace with our cost trends, it could have a material adverse effect on our results of operations, financial position and cash flows.

Our Medicare programs are subject to a variety of risks that could adversely impact our financial results.

If we fail to design and maintain programs that are attractive to Medicare participants; if our Medicare operations are subject to negative outcomes from program audits, sanctions or penalties; if we do not submit adequate bids in our existing markets or any expansion markets; if our existing contracts are terminated; or if we fail to maintain or improve our quality Star ratings, our current Medicare business and our ability to expand our Medicare operations could be materially and adversely affected, negatively impacting our financial performance. For example, our parent Star rating for the 2018 rating year was 3.5, which will negatively affect quality bonus payments for Medicare Advantage plans in 2019. These lowered Star ratings for the 2018 rating year for the Medicare Advantage plan (H0562) and the Company may have reduced the attractiveness of the affected plans and our other offerings to members, reduce revenue from the affected plan and impact our Medicare expansion efforts, which are a strategic focus for the Company.

There are also specific additional risks under Title XVIII, Part D of the Social Security Act associated with our provision of Medicare Part D prescription drug benefits as part of our Medicare Advantage plan offerings. These risks include potential uncollectibility of receivables, inadequacy of pricing assumptions, inability to receive and process information and increased pharmaceutical costs, as well as the underlying seasonality of this business, and extended settlement periods for claims submissions. Our failure to comply with Part D program requirements can result in financial and/or operational sanctions on our Part D products, as well as on our Medicare Advantage products that offer no prescription drug coverage.

Failure to accurately estimate and price our medical expenses or effectively manage our medical costs or related administrative costs could negatively affect our financial position, results of operations and cash flows.

Our profitability, to a significant degree, depends on our ability to estimate and effectively manage expenses related to health benefits through, among other things, our ability to contract favorably with hospitals, physicians and other healthcare providers. For example, our Medicaid revenue is often based on bids submitted before the start of the initial contract year. If our actual medical expenses exceed our estimates, our HBR, or our expenses related to medical services as a percentage of premium revenues, would increase and our profits would decline. Because of the narrow margins of our health plan business, relatively small changes in our HBR can create significant changes in our financial results. Changes in healthcare regulations and practices, the level of utilization of healthcare services, hospital and pharmaceutical costs, disasters, the potential effects of climate change, major epidemics, pandemics or newly emergent viruses, new medical technologies, new pharmaceutical compounds, increases in provider fraud and other external factors, including general economic conditions such as inflation and unemployment levels, are generally beyond our control and could reduce our ability to accurately predict and effectively control the costs of providing health benefits. In addition, the 2018 marketplace for individual products may continue to be less stable than in previous years because, among other things, other health plans have changed or stopped offering their Health Insurance Marketplace products in the states we continue to serve in 2018. Also, member behavior could continue to be influenced by the uncertainty surrounding changes to the Patient Protection and Affordable Care Act and the accompanying Health Care and Education Affordability Reconciliation Act, collectively referred to as Affordable Care Act (ACA), including the repeal of the ACA's individual mandate in the Tax Cuts and Jobs Act of 2017 (TCJA).

Our medical expenses include claims reported but not paid, estimates for claims incurred but not reported, and estimates for the costs necessary to process unpaid claims at the end of each period. Our development of the medical claims liability estimate is a continuous process which we monitor and refine on a monthly basis as claims receipts and payment information as well as inpatient acuity information becomes available. As more complete information becomes available, we adjust the amount of the estimate, and include the changes in estimates in medical expenses in the period in which the changes are identified. Given the uncertainties inherent in such estimates, there can be no assurance that our medical claims liability estimate will be adequate, and any adjustments to the estimate may unfavorably impact our results of operations and may be material.

Additionally, when we commence operations in a new state, region or product, we have limited information with which to estimate our medical claims liability. For a period of time after the inception of the new business, we base our estimates on government-provided historical actuarial data and limited actual incurred and received claims and inpatient acuity information. The addition of new categories of eligible individuals, as well as evolving Health Insurance Marketplace plans, may pose difficulty in estimating our medical claims liability.

From time to time in the past, our actual results have varied from our estimates, particularly in times of significant changes in the number of our members. If it is determined that our estimates are significantly different than actual results, our results of operations and financial position could be adversely affected. In addition, if there is a significant delay in our receipt of premiums, our business operations, cash flows, or earnings could be negatively impacted.

The implementation of the ACA, as well as potential repeal of or changes to the ACA, could materially and adversely affect our results of operations, financial position and cash flows.

In March 2010, the ACA was enacted. While the constitutionality of the ACA was generally upheld by the Supreme Court in 2012, the Court determined that states could elect to opt out of the Medicaid expansion portion of ACA without losing all federal money for their existing Medicaid programs.

Under the ACA, Medicaid coverage was expanded to all individuals under age 65 with incomes up to 138% of the federal poverty level beginning January 1, 2014, subject to each state's election. The federal government paid the entire cost for Medicaid coverage for newly eligible beneficiaries for three years (2014 through 2016). Beginning in 2017, the federal share began to decline, and will end at 90% for 2020 and subsequent years. As of September 30, 2018, 33 states and the District of Columbia have expanded Medicaid eligibility, and additional states continue to discuss expansion. The ACA also maintained CHIP eligibility standards through September 2019.

The ACA required the establishment of Health Insurance Marketplaces for individuals and small employers to purchase health insurance coverage. The ACA also required insurers participating on the Health Insurance Marketplaces to offer a minimum level of benefits and included guidelines on setting premium rates and coverage limitations. On December 22, 2017, the TCJA was signed, repealing the individual mandate requirement of the ACA beginning in 2019. On August 1, 2018, the U.S. HHS issued a final rule permitting the duration of short-term health insurance plans, defined as those plans lasting less than twelve months in duration, to be extended up to 36 months in total, taking into account renewals or extensions. The final rule, which went into effect on October 2, 2018, is currently being challenged at the state level and in pending litigation against the current administration filed in September 2018 in the U.S. District Court in Washington D.C. Additionally, the U.S. Department of Labor issued a final rule on June 19, 2018 which expanded flexibility regarding the regulation and formation of association health plans (AHPs) provided by small employer groups and associations to allow more employer groups and associations to form AHPs based upon common geography and industry sector. In July 2018, twelve states' attorneys general filed suit against the current administration in the U.S. District Court in Washington D.C. to block the final rule. Short-term health insurance plans and AHPs often provide fewer benefits than the traditional ACA insurance benefits. These changes and other potential changes involving the functioning of the Health Insurance Marketplaces as a result of new legislation, regulation or executive action, could impact our business and results of operations.

Any failure to adequately price products offered or reduction in products offered in the Health Insurance Marketplaces may have a negative impact on our results of operations, financial position and cash flow. Among other things, due to the repeal of the individual mandate in the TCJA, we may be adversely selected by individuals who have higher acuity levels than those individuals who selected us in the past and healthy individuals may decide to opt out of the pool altogether. In addition, the three Rs provisions of the ACA established to apportion risk amongst insurers may not be effective in appropriately mitigating the financial risks related to the Marketplace product. Further, the three Rs may not be adequately funded. Moreover, changes in the competitive marketplace over time may exacerbate the uncertainty in these relatively new markets. For example, competitors seeking to gain a foothold in the changing market may introduce pricing that we may not be able to match, which may adversely affect our ability to compete effectively. Competitors may also choose to exit the market altogether or otherwise suffer financial difficulty, which could adversely impact the pool of potential insured, require us to increase premium rates or result in funding issues under the three Rs. These potential exits and other continued volatility in this market may be further exacerbated by the conclusion of the risk corridor and reinsurance programs as of January 1, 2017. Our continued success in the exchanges is dependent on our ability to successfully respond to these changes in the market over time. Any significant variation from our expectations regarding acuity, enrollment levels, adverse selection, the three Rs, or other assumptions utilized in setting adequate premium rates could have a material adverse effect on our results of operations, financial position and cash flows.

The HHS has stated that it will consider a limited number of premium assistance demonstration proposals from states that want to privatize Medicaid expansion. States must provide a choice between at least two qualified health plans and offer very similar benefits as those available in the Health Insurance Marketplaces. Arkansas was the first state to obtain federal approval to use Medicaid funding to purchase private insurance for low-income residents, and we began operations under the program beginning January 1, 2014. As of September 30, 2018, seven states had approved Section 1115 waivers to implement the ACA's Medicaid expansion in ways that extend beyond the flexibility provided by the federal law.

The ACA imposed an annual insurance industry assessment of \$8.0 billion in 2014, and \$11.3 billion in each of 2015 and 2016, with increasing annual amounts thereafter. The health insurer fee payable in 2017 was suspended by the Consolidated Appropriations Act for fiscal year 2016. However, the \$14.3 billion payment resumed in 2018. Collection of the health insurer fee for 2019 has also been suspended. Such assessments are not deductible for federal and most state income tax purposes. The fee is allocated based on health insurers' premium revenues in the previous year. Each health insurer's fee is calculated by multiplying its market share by the annual fee. Market share is based on commercial, Medicare, and Medicaid premium revenues. Not-for-profit insurers may have a competitive advantage since they are exempt from paying the fee if they receive at least 80% of their premium revenues from Medicare, Medicaid, and CHIP, and other not-for-profit insurers are allowed to exclude 50% of their premium revenues from the fee calculation. There is ongoing litigation pending against the federal government alleging that the requirement to reimburse Medicaid managed care organizations for the industry assessment is unlawful. If we are not reimbursed by the states for the cost of the federal premium assessment (including the associated tax impact), or if we are unable to otherwise adjust our business model to address this new assessment, our results of operations, financial position and cash flows may be materially adversely affected.

There are numerous steps regulators required for continued implementation of the ACA, including the promulgation of a substantial number of new and potentially more onerous federal regulations. For example, in April 2016, CMS issued final regulations that revised existing Medicaid managed care rules by establishing a minimum MLR standard for Medicaid of 85% and strengthening provisions related to network adequacy and access to care, enrollment and disenrollment protections, beneficiary support information, continued service during beneficiary appeals, and delivery system and payment reform initiatives, among others. If we fail to effectively implement or appropriately adjust our operational and strategic initiatives with respect to the implementation of healthcare reform, or do not do so as effectively as our competitors, our results of operations may be materially adversely affected.

In addition, *House v. Hargan (previously v. Burwell, et al., and v. Price, et al.)*, the suit that was brought by House Republicans, was settled in December 2017. The current administration's decision to stop the cost sharing subsidies rendered further challenge to the cost sharing subsidy payments unnecessary. Therefore, 2018 premium rates for Health Insurance Marketplace were set without factoring in the cost sharing subsidy payments from the federal government. On March 23, 2018, Congress further bolstered the current administration's position by omitting cost sharing subsidy payments from the two-year Omnibus Spending Bill. This bill, coupled with the current administration's decision to end payments, could affect our earnings in 2018 and potential premium rate adjustments in 2019.

Changes to, or repeal of, portions or the entirety of the ACA, could materially and adversely affect our business and financial position, results of operations or cash flows. Even if the ACA is not amended or repealed, the current administration could propose changes impacting implementation of the ACA, which could materially and adversely affect our financial position or operations. However, the ultimate content, timing or effect of any potential future legislation enacted under the current administration cannot be predicted.

Our business activities are highly regulated and new laws or regulations or changes in existing laws or regulations or their enforcement or application could force us to change how we operate and could harm our business.

Our business is extensively regulated by the states in which we operate and by the federal government. In addition, the managed care industry has received negative publicity that has led to increased legislation, regulation, review of industry practices and private litigation in the commercial sector. Such negative publicity may adversely affect our stock price and damage our reputation in various markets.

In each of the jurisdictions in which we operate, we are regulated by the relevant insurance, health and/or human services or government departments that oversee the activities of managed care organizations providing or arranging to provide services to Medicaid, Medicare, Health Insurance Marketplace enrollees or other beneficiaries. For example, our health plan subsidiaries, as well as our applicable specialty companies, must comply with minimum statutory capital and other financial solvency requirements, such as deposit and surplus requirements.

The frequent enactment of, changes to, or interpretations of laws and regulations could, among other things: force us to restructure our relationships with providers within our network; require us to implement additional or different programs and systems; restrict revenue and enrollment growth; increase our healthcare and administrative costs; impose additional capital and surplus requirements; and increase or change our liability to members in the event of malpractice by our contracted providers. In addition, changes in political party or administrations at the state, federal or country level may change the attitude towards healthcare programs and result in changes to the existing legislative or regulatory environment.

Additionally, the taxes and fees paid to federal, state and local governments may increase due to several factors, including: enactment of, changes to, or interpretations of tax laws and regulations, audits by governmental authorities, geographic expansions into higher taxing jurisdictions and the effect of expansions into international markets.

Our contracts with states may require us to maintain a minimum HBR or may require us to share profits in excess of certain levels. In certain circumstances, our plans may be required to return premium back to the state in the event profits exceed established levels or HBR does not meet the minimum requirement. Other states may require us to meet certain performance and quality metrics in order to maintain our contract or receive additional or full contractual revenue.

The governmental healthcare programs in which we participate are subject to the satisfaction of certain regulations and performance standards. For example, under the ACA, Congress authorized CMS and the states to implement managed care demonstration programs to serve dually eligible beneficiaries to improve the coordination of their care. Participation in these demonstration programs is subject to CMS approval and the satisfaction of conditions to participation, including meeting certain performance requirements. Our inability to improve or maintain adequate quality scores and Star ratings to meet government performance requirements or to match the performance of our competitors could result in limitations to our participation in or exclusion from these or other government programs. Specifically, several of our Medicaid contracts require us to maintain a Medicare health plan. Although we strive to comply with all existing regulations and to meet performance standards applicable to our business, failure to meet these requirements could result in financial fines and penalties. Also, states or other governmental entities may not allow us to continue to participate in their government programs, or we may fail to win procurements to participate in such programs which could materially and adversely affect our results of operations, financial position and cash flows.

In addition, as a result of the expansion of our businesses and operations conducted in foreign countries, we face political, economic, legal, compliance, regulatory, operational and other risks and exposures that are unique and vary by jurisdiction. These foreign regulatory requirements with respect to, among other items, environmental, tax, licensing, intellectual property, privacy, data protection, investment, capital, management control, labor relations, and fraud and corruption regulations are different than those faced by our domestic businesses. In addition, we are subject to U.S. laws that regulate the conduct and activities of U.S.-based businesses operating abroad, such as the Foreign Corrupt Practices Act. Our failure to comply with laws and regulations governing our conduct outside the United States or to successfully navigate international regulatory regimes that apply to us could adversely affect our ability to market our products and services, which may have a material adverse effect on our business, financial condition and results of operations.

Our businesses providing pharmacy benefit management (PBM) and specialty pharmacy services face regulatory and other risks and uncertainties which could materially and adversely affect our results of operations, financial position and cash flows.

We provide PBM and specialty pharmacy services, including through our Envolve Pharmacy Solutions product. These businesses are subject to federal and state laws that govern the relationships of the business with pharmaceutical manufacturers, physicians, pharmacies, customers and consumers. We also conduct business as a mail order pharmacy and specialty pharmacy, which subjects these businesses to extensive federal, state and local laws and regulations. In addition, federal and state legislatures regularly consider new regulations for the industry that could materially and adversely affect current industry practices, including the receipt or disclosure of rebates from pharmaceutical companies, the development and use of formularies, and the use of average wholesale prices.

Our PBM and specialty pharmacy businesses would be materially and adversely affected by an inability to contract on favorable terms with pharmaceutical manufacturers and other suppliers, including with respect to the pricing of new specialty and generic drugs. In addition, our PBM and specialty pharmacy businesses could face potential claims in connection with purported errors by our mail order or specialty pharmacies, including in connection with the risks inherent in the authorization, compounding, packaging and distribution of pharmaceuticals and other healthcare products. Disruptions at any of our mail order or specialty pharmacies due to an event that is beyond our control could affect our ability to process and dispense prescriptions in a timely manner and could materially and adversely affect our results of operations, financial position and cash flows.

If any of our government contracts are terminated or are not renewed on favorable terms or at all, or if we receive an adverse finding or review resulting from an audit or investigation, our business may be adversely affected.

A substantial portion of our business relates to the provision of managed care programs and selected services to individuals receiving benefits under governmental assistance or entitlement programs. We provide these and other healthcare services under contracts with government entities in the areas in which we operate. Our government contracts are generally intended to run for a fixed number of years and may be extended for an additional specified number of years if the contracting entity or its agent elects to do so. When our contracts with the government expire, they may be opened for bidding by competing healthcare providers, and there is no guarantee that our contracts will be renewed or extended. Competitors may buy their way into the market by submitting bids with lower pricing. Even if our responsive bids are successful, the bids may be based upon assumptions or other factors which could result in the contracts being less profitable than we had anticipated. Further, our government contracts contain certain provisions regarding eligibility, enrollment and dis-enrollment processes for covered services, eligible providers, periodic financial and informational reporting, quality assurance, timeliness of claims payment and agreement to maintain a Medicare plan in the state and financial standards, among other things, and are subject to cancellation if we fail to perform in accordance with the standards set by regulatory agencies.

We are also subject to various reviews, audits and investigations to verify our compliance with the terms of our contracts with various governmental agencies, as well as compliance with applicable laws and regulations. Any adverse review, audit or investigation could result in, among other things: cancellation of our contracts; refunding of amounts we have been paid pursuant to our contracts; imposition of fines, penalties and other sanctions on us; loss of our right to participate in various programs; increased difficulty in selling our products and services; loss of one or more of our licenses; lowered quality Star ratings; or require changes to the way we do business. In addition, under government procurement regulations and practices, a negative determination resulting from a government audit of our business practices could result in a contractor being fined, debarred and/or suspended from being able to bid on, or be awarded, new government contracts for a period of time.

If any of our government contracts are terminated, not renewed, renewed on less favorable terms, or not renewed on a timely basis, or if we receive an adverse finding or review resulting from an audit or investigation, our business and reputation may be adversely impacted, our goodwill could be impaired and our financial position, results of operations or cash flows may be materially affected.

We contract with independent third-party vendors and service providers who provide services to us and our subsidiaries or to whom we delegate selected functions. Violations of, or noncompliance with, laws and regulations governing our business by such third parties, or governing our dealings with such parties, could, among other things, subject us to additional audits, reviews and investigations and other adverse effects.

Ineffectiveness of state-operated systems and subcontractors could adversely affect our business.

A number of our health plans rely on other state-operated systems or subcontractors to qualify, solicit, educate and assign eligible members into managed care plans. The effectiveness of these state operations and subcontractors can have a material effect on a health plan's enrollment in a particular month or over an extended period. When a state implements new programs to determine eligibility, new processes to assign or enroll eligible members into health plans, or chooses new subcontractors, there is an increased potential for an unanticipated impact on the overall number of members assigned to managed care plans.

Our investment portfolio may suffer losses which could materially and adversely affect our results of operations or liquidity.

We maintain a significant investment portfolio of cash equivalents and short-term and long-term investments in a variety of securities, which are subject to general credit, liquidity, market and interest rate risks and will decline in value if interest rates increase or one of the issuers' credit ratings is reduced. As a result, we may experience a reduction in value or loss of our investments, which may have a negative adverse effect on our results of operations, liquidity and financial condition.

Execution of our growth strategy may increase costs or liabilities, or create disruptions in our business.

Our growth strategy includes, without limitation, the acquisition and expansion of health plans participating in government sponsored healthcare programs and specialty services businesses, contract rights and related assets of other health plans both in our existing service areas and in new markets and start-up operations in new markets or new products in existing markets. We continue to pursue opportunistic acquisitions to expand into new geographies and complementary business lines as well as to augment existing operations and may be in discussions with respect to one or multiple targets at any given time. Although we review the records of companies or businesses we plan to acquire, it is possible that we could assume unanticipated liabilities or adverse operating conditions, or an acquisition may not perform as well as expected or may not achieve timely profitability. We also face the risk that we will not be able to effectively integrate acquisitions into our existing operations effectively without substantial expense, delay or other operational or financial problems and we may need to divert more management resources to integration than we planned.

In connection with start-up operations and system migrations, we may incur significant expenses prior to commencement of operations and the receipt of revenue. For example, in order to obtain a certificate of authority in most jurisdictions, we must first establish a provider network, have systems in place and demonstrate our ability to administer a state contract and process claims. We may experience delays in operational start dates. As a result of these factors, start-up operations may decrease our profitability. In addition, we are planning to expand our business internationally and we will be subject to additional risks, including, but not limited to, political risk, an unfamiliar regulatory regime, currency exchange risk and exchange controls, cultural and language differences, foreign tax issues, and different labor laws and practices.

If we are unable to effectively execute our growth strategy, our future growth will suffer and our results of operations could be harmed.

If competing managed care programs are unwilling to purchase specialty services from us, we may not be able to successfully implement our strategy of diversifying our business lines.

We are seeking to diversify our business lines into areas that complement our government sponsored health plan business in order to grow our revenue stream and balance our dependence on risk reimbursement. In order to diversify our business, we must succeed in selling the services of our specialty subsidiaries not only to our managed care plans, but to programs operated by third parties. Some of these third-party programs may compete with us in some markets, and they therefore may be unwilling to purchase specialty services from us. In any event, the offering of these services will require marketing activities that differ significantly from the manner in which we seek to increase revenues from our government sponsored programs. Our ineffectiveness in marketing specialty services to third parties may impair our ability to execute our business strategy.

Adverse credit market conditions may have a material adverse effect on our liquidity or our ability to obtain credit on acceptable terms.

In the past, the securities and credit markets have experienced extreme volatility and disruption. The availability of credit, from virtually all types of lenders, has at times been restricted. In the event we need access to additional capital to pay our operating expenses, fund subsidiary surplus requirements, make payments on or refinance our indebtedness, pay capital expenditures, or fund acquisitions, our ability to obtain such capital may be limited and the cost of any such capital may be significant, particularly if we are unable to access our existing credit facility.

Our access to additional financing will depend on a variety of factors such as prevailing economic and credit market conditions, the general availability of credit, the overall availability of credit to our industry, our credit ratings and credit capacity, and perceptions of our financial prospects. Similarly, our access to funds may be impaired if regulatory authorities or rating agencies take negative actions against us. If a combination of these factors were to occur, our internal sources of liquidity may prove to be insufficient, and in such case, we may not be able to successfully obtain sufficient additional financing on favorable terms, within an acceptable time, or at all.

If state regulators do not approve payments of dividends and distributions by our subsidiaries to us, we may not have sufficient funds to implement our business strategy.

We principally operate through our health plan subsidiaries. As part of normal operations, we may make requests for dividends and distributions from our subsidiaries to fund our operations. These subsidiaries are subject to regulations that limit the amount of dividends and distributions that can be paid to us without prior approval of, or notification to, state regulators. If these regulators were to deny our subsidiaries' requests to pay dividends, the funds available to us would be limited, which could harm our ability to implement our business strategy.

We derive a majority of our premium revenues from operations in a limited number of states, and our financial position, results of operations or cash flows would be materially affected by a decrease in premium revenues or profitability in any one of those states.

Operations in a limited number of states have accounted for most of our premium revenues to date. If we were unable to continue to operate in any of those states or if our current operations in any portion of one of those states were significantly curtailed, our revenues could decrease materially. Our reliance on operations in a limited number of states could cause our revenues and profitability to change suddenly and unexpectedly depending on legislative or other governmental or regulatory actions and decisions, economic conditions and similar factors in those states. For example, states we currently serve may open the bidding for their Medicaid program to other health insurers through a request for proposal process. Our inability to continue to operate in any of the states in which we operate could harm our business.

Competition may limit our ability to increase penetration of the markets that we serve.

We compete for members principally on the basis of size and quality of provider networks, benefits provided and quality of service. We compete with numerous types of competitors, including other health plans and traditional state Medicaid programs that reimburse providers as care is provided, as well as technology companies, new joint ventures, financial services firms, consulting firms and other non-traditional competitors. In addition, the administration of the ACA has the potential to shift the competitive landscape in our segment.

Some of the health plans with which we compete have greater financial and other resources and offer a broader scope of products than we do. In addition, significant merger and acquisition activity has occurred in the managed care industry, as well as complementary industries, such as the hospital, physician, pharmaceutical, medical device and health information systems businesses. To the extent that competition intensifies in any market that we serve, as a result of industry consolidation or otherwise, our ability to retain or increase members and providers, or maintain or increase our revenue growth, pricing flexibility and control over medical cost trends may be adversely affected.

If we are unable to maintain relationships with our provider networks, our profitability may be harmed.

Our profitability depends, in large part, upon our ability to contract at competitive prices with hospitals, physicians and other healthcare providers. Our provider arrangements with our primary care physicians, specialists and hospitals generally may be canceled by either party without cause upon 90 to 120 days prior written notice. We cannot provide any assurance that we will be able to continue to renew our existing contracts or enter into new contracts on a timely basis or under favorable terms enabling us to service our members profitably. Healthcare providers with whom we contract may not properly manage the costs of services, maintain financial solvency or avoid disputes with other providers. Any of these events could have a material adverse effect on the provision of services to our members and our operations.

In any particular market, physicians and other healthcare providers could refuse to contract, demand higher payments, or take other actions that could result in higher medical costs or difficulty in meeting regulatory or accreditation requirements, among other things. In some markets, certain healthcare providers, particularly hospitals, physician/hospital organizations or multi-specialty physician groups, may have significant market positions or near monopolies that could result in diminished bargaining power on our part. In addition, accountable care organizations, practice management companies, which aggregate physician practices for administrative efficiency and marketing leverage, and other organizational structures that physicians, hospitals and other healthcare providers choose may change the way in which these providers interact with us and may change the competitive landscape. Such organizations or groups of healthcare providers may compete directly with us, which could adversely affect our operations, and our results of operations, financial position and cash flows by impacting our relationships with these providers or affecting the way that we price our products and estimate our costs, which might require us to incur costs to change our operations. Provider networks may consolidate, resulting in a reduction in the competitive environment. In addition, if these providers refuse to contract with us, use their market position to negotiate contracts unfavorable to us or place us at a competitive disadvantage, our ability to market products or to be profitable in those areas could be materially and adversely affected.

From time to time, healthcare providers assert or threaten to assert claims seeking to terminate non-cancelable agreements due to alleged actions or inactions by us. If we are unable to retain our current provider contract terms or enter into new provider contracts timely or on favorable terms, our profitability may be harmed. In addition, from time to time, we may be subject to class action or other lawsuits by healthcare providers with respect to claim payment procedures or similar matters. For example, our wholly owned subsidiary, Health Net Life Insurance Company (HNL), is and may continue to be subject to such disputes with respect to HNL's payment levels in connection with the processing of out-of-network provider reimbursement claims for the provision of certain substance abuse related services. HNL expects to vigorously defend its claims payment practices. Nevertheless, in the event HNL receives an adverse finding in any related legal proceeding or from a regulator, or is otherwise required to reimburse providers for these claims at rates that are higher than expected or for claims HNL otherwise believes are unallowable, our financial condition and results of operations may be materially adversely affected. In addition, regardless of whether any such lawsuits brought against us are successful or have merit, they will still be time-consuming and costly and could distract our management's attention. As a result, under such circumstances we may incur significant expenses and may be unable to operate our business effectively.

We may be unable to attract, retain or effectively manage the succession of key personnel.

We are highly dependent on our ability to attract and retain qualified personnel to operate and expand our business. We would be adversely impacted if we are unable to adequately plan for the succession of our executives and senior management. While we have succession plans in place for members of our executive and senior management team, these plans do not guarantee that the services of our executive and senior management team will continue to be available to us. Our ability to replace any departed members of our executive and senior management team or other key employees may be difficult and may take an extended period of time because of the limited number of individuals in the managed care and specialty services industry with the breadth of skills and experience required to operate and successfully expand a business such as ours. Competition to hire from this limited pool is intense, and we may be unable to hire, train, retain or motivate these personnel. If we are unable to attract, retain and effectively manage the succession plans for key personnel, executives and senior management, our business and financial position, results of operations or cash flows could be harmed.

If we are unable to integrate and manage our information systems effectively, our operations could be disrupted.

Our operations depend significantly on effective information systems. The information gathered and processed by our information systems assists us in, among other things, monitoring utilization and other cost factors, processing provider claims, and providing data to our regulators. Our healthcare providers also depend upon our information systems for membership verifications, claims status and other information. Our information systems and applications require continual maintenance, upgrading and enhancement to meet our operational needs and regulatory requirements. We regularly upgrade and expand our information systems' capabilities. If we experience difficulties with the transition to or from information systems or do not appropriately integrate, maintain, enhance or expand our information systems, we could suffer, among other things, operational disruptions, loss of existing members and difficulty in attracting new members, regulatory problems and increases in administrative expenses. In addition, our ability to integrate and manage our information systems may be impaired as the result of events outside our control, including acts of nature, such as earthquakes or fires, or acts of terrorists.

From time to time, we may become involved in costly and time-consuming litigation and other regulatory proceedings, which require significant attention from our management.

From time to time, we are a defendant in lawsuits and regulatory actions and are subject to investigations relating to our business, including, without limitation, medical malpractice claims, claims by members alleging failure to pay for or provide healthcare, claims related to non-payment or insufficient payments for out-of-network services, claims alleging bad faith, investigations regarding our submission of risk adjuster claims, putative securities class actions, and claims related to the imposition of new taxes, including but not limited to claims that may have retroactive application. Due to the inherent uncertainties of litigation and regulatory proceedings, we cannot accurately predict the ultimate outcome of any such proceedings. An unfavorable outcome could have a material adverse impact on our business and financial position, results of operations and/or cash flows and may affect our reputation. In addition, regardless of the outcome of any litigation or regulatory proceedings, such proceedings are costly and time consuming and require significant attention from our management, and could therefore harm our business and financial position, results of operations or cash flows.

An impairment charge with respect to our recorded goodwill and intangible assets could have a material impact on our results of operations.

We periodically evaluate our goodwill and other intangible assets to determine whether all or a portion of their carrying values may be impaired, in which case a charge to earnings may be necessary. Changes in business strategy, government regulations or economic or market conditions have resulted and may result in impairments of our goodwill and other intangible assets at any time in the future. Our judgments regarding the existence of impairment indicators are based on, among other things, legal factors, market conditions, and operational performance. For example, the non-renewal of our health plan contracts with the state in which they operate may be an indicator of impairment. If an event or events occur that would cause us to revise our estimates and assumptions used in analyzing the value of our goodwill and other intangible assets, such revision could result in a non-cash impairment charge that could have a material impact on our results of operations in the period in which the impairment occurs.

If we fail to comply with applicable privacy, security, and data laws, regulations and standards, including with respect to third-party service providers that utilize sensitive personal information on our behalf, our business, reputation, results of operations, financial position and cash flows could be materially and adversely affected.

As part of our normal operations, we collect, process and retain confidential member information. We are subject to various federal and state laws and rules regarding the use and disclosure of confidential member information, including the Health Insurance Portability and Accountability Act of 1996 (HIPAA) and the Health Information Technology for Economic and Clinical Health (HITECH) Act of 2009 and the Gramm-Leach-Bliley Act, which require us to protect the privacy of medical records and safeguard personal health information we maintain and use. Certain of our businesses are also subject to the Payment Card Industry Data Security Standard, which is a multifaceted security standard that is designed to protect credit card account data as mandated by payment card industry entities. Despite our best attempts to maintain adherence to information privacy and security best practices, as well as compliance with applicable laws, rules and contractual requirements, our facilities and systems, and those of our third-party service providers, may be vulnerable to privacy or security breaches, acts of vandalism or theft, malware or other forms of cyber-attack, misplaced or lost data including paper or electronic media, programming and/or human errors or other similar events. In the past, we have had data breaches resulting in disclosure of confidential or protected health information that have not resulted in any material financial loss or penalty to date. However, future data breaches could require us to expend significant resources to remediate any damage, interrupt our operations and damage our reputation, subject us to state or federal agency review and could also result in enforcement actions, material fines and penalties, litigation or other actions which could have a material adverse effect on our business, reputation and results of operations, financial position and cash flows.

In addition, HIPAA broadened the scope of fraud and abuse laws applicable to healthcare companies. HIPAA established new enforcement mechanisms to combat fraud and abuse, including civil and, in some instances, criminal penalties for failure to comply with specific standards relating to the privacy, security and electronic transmission of protected health information. The HITECH Act expanded the scope of these provisions by mandating individual notification in instances of breaches of protected health information, providing enhanced penalties for HIPAA violations, and granting enforcement authority to states' Attorneys General in addition to the HHS Office for Civil Rights. It is possible that Congress may enact additional legislation in the future to increase penalties and to create a private right of action under HIPAA, which could entitle patients to seek monetary damages for violations of the privacy rules. HHS continued its auditing program in 2016 to assess compliance efforts by covered entities and business associates. Through a second phase of audits, which commenced for covered entities in July 2016, HHS focused on a review of policies and procedures adopted and employed by covered entities and their business associates to meet selected standards and implementation specifications of the HIPAA Privacy, Security, and Breach Notification Rules. The HHS Office for Civil Rights reported that as of February 2018, the Phase 2 desk audits of covered entities and business associates were completed, and additional comprehensive on-site audits would be conducted as a part of a permanent audit program going forward. An audit resulting in findings or allegations of noncompliance could have a material adverse effect on our results of operations, financial position and cash flows.

If we fail to comply with the extensive federal and state fraud and abuse laws, our business, reputation, results of operations, financial position and cash flows could be materially and adversely affected.

We, along with all other companies involved in public healthcare programs are the subject of fraud and abuse investigations from time to time. The regulations and contractual requirements applicable to participants in these public sector programs are complex and subject to change. Violations of fraud and abuse laws applicable to us could result in civil monetary penalties, criminal fines and imprisonment, and/or exclusion from participation in Medicaid, Medicare, TRICARE, VA and other federal healthcare programs and federally funded state health programs. Fraud and abuse prohibitions encompass a wide range of activities, including kickbacks for referral of members, incorrect and unsubstantiated billing or billing for unnecessary medical services, improper marketing and violations of patient privacy rights. These fraud and abuse laws include the federal False Claims Act, which prohibits the known filing of a false claim or the known use of false statements to obtain payment from the federal government and the federal anti-kickback statute, which prohibits the payment or receipt of remuneration to induce referrals or recommendations of healthcare items or services. Many states have false claim act and anti-kickback statutes that closely resemble the federal False Claims Act and the federal anti-kickback statute. In addition, the Deficit Reduction Act of 2005 encouraged states to enact state-versions of the federal False Claims Act that establish liability to the state for false and fraudulent Medicaid claims and that provide for, among other things, claims to be filed by *qui tam* relators. Federal and state governments have made investigating and prosecuting healthcare fraud and abuse a priority. In the event we fail to comply with the extensive federal and state fraud and abuse laws, our business, reputation, results of operations, financial position and cash flows could be materially and adversely affected.

A failure in or breach of our operational or security systems or infrastructure, or those of third parties with which we do business, including as a result of cyber-attacks, could have an adverse effect on our business.

Information security risks have significantly increased in recent years in part because of the proliferation of new technologies, the use of the internet and telecommunications technologies to conduct our operations, and the increased sophistication and activities of organized crime, hackers, terrorists and other external parties, including foreign state agents. Our operations rely on the secure processing, transmission and storage of confidential, proprietary and other information in our computer systems and networks.

Security breaches may arise from external or internal threats. External breaches include hacking personal information for financial gain, attempting to cause harm or interruption to our operations, or intending to obtain competitive information. We experience attempted external hacking or malicious attacks on a regular basis. We maintain a rigorous system of preventive and detective controls through our security programs; however, our prevention and detection controls may not prevent or identify all such attacks on a timely basis, or at all. Internal breaches may result from inappropriate security access to confidential information by rogue employees, consultants or third party service providers. Any security breach involving the misappropriation, loss or other unauthorized disclosure or use of confidential member information, financial data, competitively sensitive information, or other proprietary data, whether by us or a third party, could have a material adverse effect on our business reputation, financial condition, cash flows, or results of operations.

The market price of our common stock may decline as a result of significant acquisitions.

The market price of our common stock is generally subject to volatility, and there can be no assurances regarding the level or stability of our share price at any time. The market price of our common stock may decline as a result of acquisitions if, among other things, we are unable to achieve the expected growth in earnings, or if the operational cost savings estimates in connection with the integration of acquired businesses with ours are not realized, or if the transaction costs related to the acquisitions and integrations are greater than expected. The market price also may decline if we do not achieve the perceived benefits of the acquisitions as rapidly or to the extent anticipated by financial or industry analysts or if the effect of the acquisitions on our financial position, results of operations or cash flows is not consistent with the expectations of financial or industry analysts.

We may be unable to successfully integrate our business with Health Net and the assets acquired in the Fidelis Care Acquisition, and realize the anticipated benefits of the acquisitions.

We completed the acquisition of Health Net and certain assets of Fidelis Care on March 24, 2016 and July 1, 2018, respectively. The success of the Health Net Acquisition and the Fidelis Care Acquisition will depend, in part, on our ability to successfully combine the businesses of the Company, Health Net and Fidelis Care and realize the anticipated benefits, including synergies, cost savings, growth in earnings, innovation and operational efficiencies, from the combinations. If we are unable to achieve these objectives within the anticipated time frame, or at all, the anticipated benefits may not be realized fully or at all, or may take longer to realize than expected and the value of our common stock may be harmed.

The integration of each of Health Net's business and Fidelis Care's business with our existing business is a complex, costly and time-consuming process. The integration of the respective businesses may result in material challenges, including, without limitation:

- the diversion of management's attention from ongoing business concerns and performance shortfalls as a result of the devotion of management's attention to each integration;
- managing a larger combined company;
- maintaining employee morale and retaining key management and other employees;
- the possibility of faulty assumptions underlying expectations regarding the integration process;
- retaining existing business and operational relationships and attracting new business and operational relationships;
- consolidating corporate and administrative infrastructures and eliminating duplicative operations;
- coordinating geographically separate organizations;
- unanticipated issues in integrating information technology, communications and other systems;
- unanticipated changes in federal or state laws or regulations, including the ACA and any regulations enacted thereunder;
- unforeseen expenses or delays associated with the acquisition and/or integration; and
- decreases in premiums paid under government sponsored healthcare programs by any state in which we operate.

Many of these factors will be outside of our control, and any one of them could result in delays, increased costs, decreases in the amount of expected revenues and diversion of management's time and energy, which could materially affect our financial position, results of operations and cash flows.

We have incurred substantial expenses related to the completion of the acquisitions of Health Net and Fidelis Care and are incurring substantial expenses related to the integration of these acquisitions.

We are in the process of integrating a large number of processes, policies, procedures, operations, technologies and systems, including sales, pricing, and marketing, among other things. In addition, Centene maintains a presence in St. Louis, Missouri; whereas the businesses of Health Net and Fidelis Care continue to maintain a presence in Woodland Hills, California, and New York, New York, respectively. The substantial majority of these costs will be non-recurring expenses related to the acquisitions (including financing of the acquisitions), facilities and systems consolidation costs. We may incur additional costs to maintain employee morale and to retain key employees. We are also incurring transaction fees and costs related to formulating integration plans for the combined business, and the execution of these plans may lead to additional unanticipated costs. These incremental transaction and acquisition related costs may exceed the savings we expect to achieve from the elimination of duplicative costs and the realization of other efficiencies related to the integration of the businesses, particularly in the near term and in the event there are material unanticipated costs.

Our future results may be adversely impacted if we do not effectively manage our expanded operations as a result of the Health Net Acquisition and the Fidelis Care Acquisition.

As a result of the Health Net Acquisition and the Fidelis Care Acquisition, the size of our business is significantly larger. Our ability to successfully manage the expanded business will depend, in part, upon management's ability to design and implement strategic initiatives that address the increased scale and scope of the combined business with its associated increased costs and complexity. We will also have to manage our expanded operations in compliance with certain undertakings with regulators that were agreed to in connection with the approval of the Health Net Acquisition. These undertakings require significant investments by us, may restrict or impose additional material costs on our future operations and strategic initiatives in certain geographies, and subject us to various enforcement mechanisms. There can be no assurances that we will be successful in managing our expanded operations as a result of the Health Net Acquisition and the Fidelis Care Acquisition or that we will realize the expected growth in earnings, operating efficiencies, cost savings and other benefits.

We have substantial indebtedness outstanding and may incur additional indebtedness in the future. Such indebtedness could reduce our agility and may adversely affect our financial condition.

As of September 30, 2018, we had consolidated indebtedness of approximately \$6,383 million. We may further increase our indebtedness in the future. This increased indebtedness and higher debt-to-equity ratio will have the effect, among other things, of reducing our flexibility to respond to changing business and economic conditions and increasing borrowing costs.

Among other things, our revolving credit facility and the indentures governing our notes require us to comply with various covenants that impose restrictions on our operations, including our ability to incur additional indebtedness, create liens, pay dividends, make investments or other restricted payments, sell or otherwise dispose of substantially all of our assets and engage in other activities. Our revolving credit facility also requires us to comply with a maximum leverage ratio and a minimum fixed charge coverage ratio. These restrictive covenants could limit our ability to pursue our business strategies. In addition, any failure by us to comply with these restrictive covenants could result in an event of default under the revolving credit facility and, in some circumstances, under the indentures governing our notes, which, in any case, could have a material adverse effect on our financial condition.

The Fidelis Care Acquisition may not be accretive and may cause dilution to our earnings per share, which may negatively affect the market price of our common stock.

Although we currently anticipate that the Fidelis Care Acquisition will be accretive to earnings per share (on an adjusted earnings basis that is not pursuant to GAAP), this expectation is based on assumptions about our and Fidelis Care's business and preliminary estimates, which may change materially. As a result, amounts paid in connection with the Fidelis Care Acquisition may cause dilution to our earnings per share or decrease or delay the expected accretive effect of the Fidelis Care Acquisition and cause a decrease in the market price of our common stock. In addition, we could also encounter additional transaction-related costs or other factors such as the failure to realize all of the benefits anticipated in the Fidelis Care Acquisition, including cost and revenue synergies. All of these factors could cause dilution to our earnings per share or decrease or delay the expected accretive effect of the Fidelis Care Acquisition and cause a decrease in the market price of our common stock.

We incurred substantial expenses related to the completion of the Fidelis Care Acquisition and expect to incur substantial expenses related to the integration of our business with Fidelis Care.

We incurred substantial expenses in connection with the completion of the Fidelis Care Acquisition and expect to incur substantial expense related to the integration of our business with the acquired assets of Fidelis Care. There are a large number of processes, policies, procedures, operations, technologies and systems that must be integrated, including purchasing, accounting and finance, sales, payroll, pricing, revenue management, marketing and benefits. In addition, our businesses and Fidelis Care will continue to maintain a presence in St. Louis, Missouri and New York, New York, respectively. The substantial majority of these costs will be non-recurring expenses related to the Fidelis Care Acquisition (including the financing of the Fidelis Care Acquisition), and facilities and systems consolidation costs. We may incur additional costs to maintain employee morale and to retain key employees. We will also incur transaction fees and costs related to formulating integration plans for the combined business, and the execution of these plans may lead to additional unanticipated costs. These incremental transaction and acquisition related costs may exceed the savings we expect to achieve from the elimination of duplicative costs and the realization of other efficiencies related to the integration of the businesses, particularly in the near term and in the event there are material unanticipated costs.

Future issuances and sales of additional shares of preferred or common stock could reduce the market price of our shares of common stock.

We may, from time to time, issue additional securities to raise capital or in connection with acquisitions. We often acquire interests in other companies by using a combination of cash and our common stock or just our common stock. Further shares of preferred stock may be issued from time to time in one or more series as our Board may from time to time determine each such series to be distinctively designated. The issuance of any such preferred stock could materially adversely affect the rights of holders of our common stock. Any of these events may dilute your ownership interest in our company and have an adverse impact on the price of our common stock.

ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds.**Issuer Purchases of Equity Securities
Third Quarter 2018**

Period	Total Number of Shares Purchased ⁽¹⁾	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs⁽²⁾
July 1 - July 31, 2018	13,287	\$ 129.26	—	3,335,448
August 1 - August 31, 2018	13,545	143.61	—	3,335,448
September 1 - September 30, 2018	4,043	144.39	—	3,335,448
Total	<u>30,875</u>	<u>\$ 137.54</u>	<u>—</u>	<u>3,335,448</u>

⁽¹⁾ Shares acquired represent shares relinquished to the Company by certain employees for payment of taxes or option cost upon vesting of restricted stock units or option exercise.

⁽²⁾ Our Board of Directors adopted a stock repurchase program which allows for repurchases of up to a remaining amount of 3,335,448 shares. No duration has been placed on the repurchase program.

ITEM 6. Exhibits.

EXHIBIT NUMBER	DESCRIPTION
4.1	First Supplemental Indenture, dated as of July 1, 2018, by and between Centene and The Bank of New York Mellon Trust Company, N.A., as trustee (incorporated by reference to Exhibit 4.2 of the Company's Current Report on Form 8-K filed with the SEC on July 2, 2018).
12.1	Computation of ratio of earnings to fixed charges.
31.1	Certification of Chairman and Chief Executive Officer pursuant to Rule 13(a)-14(a) under the Securities Exchange Act of 1934, as amended.
31.2	Certification of Executive Vice President and Chief Financial Officer pursuant to Rule 13(a)-14(a) under the Securities Exchange Act of 1934, as amended.
32.1	Certification of Chairman and Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Executive Vice President and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.1	XBRL Taxonomy Instance Document.
101.2	XBRL Taxonomy Extension Schema Document.
101.3	XBRL Taxonomy Extension Calculation Linkbase Document.
101.4	XBRL Taxonomy Extension Definition Linkbase Document.
101.5	XBRL Taxonomy Extension Label Linkbase Document.
101.6	XBRL Taxonomy Extension Presentation Linkbase Document.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized as of October 23, 2018.

CENTENE CORPORATION

By: /s/ MICHAEL F. NEIDORFF
Chairman and Chief Executive Officer
(principal executive officer)

By: /s/ JEFFREY A. SCHWANEKE
Executive Vice President and Chief Financial Officer
(principal financial officer)

By: /s/ CHRISTOPHER R. ISAAK
Senior Vice President, Corporate Controller and Chief Accounting
Officer
(principal accounting officer)

Centene Corporation
Computation of ratio of earnings to fixed charges
(\$ in millions)

	Nine Months Ended		Year Ended December 31,			
	9/30/18	2017	2016	2015	2014	
Earnings:						
Pre-tax earnings from continuing operations	\$ 1,011	\$ 1,134	\$ 1,157	\$ 697	\$ 457	
Addback:						
Fixed charges	296	311	262	65	50	
Add (Subtract):						
Noncontrolling interest	6	20	1	(2)	7	
Total earnings	\$ 1,313	\$ 1,465	\$ 1,420	\$ 760	\$ 514	
Fixed Charges:						
Interest expense	\$ 245	\$ 255	\$ 217	\$ 43	\$ 35	
Interest component of rental payments ⁽¹⁾	51	56	45	22	15	
Total fixed charges	\$ 296	\$ 311	\$ 262	\$ 65	\$ 50	
Ratio of earnings to fixed charges	4.4	4.7	5.4	11.7	10.3	

⁽¹⁾ Estimated at 33% of rental expense as a reasonable approximation of the interest factor.

CERTIFICATION

I, Michael F. Neidorff, certify that:

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

Dated: October 23, 2018

/s/ MICHAEL F. NEIDORFF

Chairman and Chief Executive Officer
(principal executive officer)

CERTIFICATION

I, Jeffrey A. Schwaneke, certify that:

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

Dated: October 23, 2018

/s/ JEFFREY A. SCHWANEKE

Executive Vice President and Chief Financial Officer
(principal financial officer)

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report on Form 10-Q of Centene Corporation (the Company) for the period ended September 30, 2018, as filed with the Securities and Exchange Commission on the date hereof (the Report), the undersigned, Michael F. Neidorff, Chairman and Chief Executive Officer of the Company, hereby certifies, pursuant to 18 U.S.C. Section 1350, that:

- (1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: October 23, 2018

/s/ MICHAEL F. NEIDORFF

Chairman and Chief Executive Officer
(principal executive officer)

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report on Form 10-Q of Centene Corporation (the Company) for the period ended September 30, 2018, as filed with the Securities and Exchange Commission on the date hereof (the Report), the undersigned, Jeffrey A. Schwaneke, Executive Vice President and Chief Financial Officer of the Company, hereby certifies, pursuant to 18 U.S.C. Section 1350, that:

- (1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: October 23, 2018

/s/ JEFFREY A. SCHWANEKE

Executive Vice President and Chief Financial Officer
(principal financial officer)

