

HealthSpring, Inc.
Form 10-Q
August 11, 2006

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q
QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly Period Ended June 30, 2006
Commission File Number: 001-32739
HealthSpring, Inc.
(Exact Name of Registrant as Specified in Its Charter)**

Delaware **20-1821898**
(State or Other Jurisdiction of Incorporation or (I.R.S. Employer Identification No.)
Organization)

44 Vantage Way, Suite 300
Nashville, Tennessee **37228**
(Address of Principal Executive Offices) (Zip Code)

(615) 291-7000

(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

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

Outstanding at August 10, 2006

Common Stock, Par Value \$0.01 Per Share

57,236,133 Shares

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HEALTHSPRING, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except share data)
(unaudited)

Assets	June 30, 2006	December 31, 2005
Current assets:		
Cash and cash equivalents	\$ 320,205	\$ 110,085
Accounts receivable, net of allowance for doubtful accounts of \$3,245 and \$1,165 at June 30, 2006 and December 31, 2005, respectively	34,720	7,248
Investment securities available for sale	8,332	8,646
Current portion of investment securities held to maturity	13,228	14,313
Deferred income tax asset	12,501	5,778
Prepaid expenses and other assets	2,890	3,148
Total current assets	391,876	149,218
Investment securities held to maturity, less current portion	23,027	22,993
Property and equipment, net	4,806	4,287
Goodwill	341,619	315,057
Other intangible assets, net	84,943	87,675
Investment in and receivable from unconsolidated affiliate	1,372	1,469
Deferred financing costs	896	5,487
Restricted investments	6,715	5,652
Total assets	\$ 855,254	\$ 591,838
Liabilities and Stockholders Equity		
Current liabilities:		
Medical claims liability	\$ 103,827	\$ 82,645
Current portion of long-term debt		16,500
Accounts payable and accrued expenses	27,071	17,408
Deferred revenue	94,752	365
Funds held for the benefit of members	77,719	
Other current liabilities	831	362
Total current liabilities	304,200	117,280
Long-term debt, less current portion		172,026
Deferred income tax liability	30,010	29,782
Other long-term liabilities	297	316
Total liabilities	334,507	319,404

Minority interest		11,890
Stockholders' equity:		
Redeemable convertible preferred stock, \$0.01 par value, 1,000,000 shares authorized, 227,154 shares issued and outstanding at December 31, 2005		2
Preferred stock, \$0.01 par value, 5,000,000 shares authorized and no shares outstanding		
Common stock, \$0.01 par value, 180,000,000 shares authorized, 57,489,549 shares issued and 57,263,549 outstanding at June 30, 2006, and 74,000,000 shares authorized, 32,283,950 shares issued and 32,083,950 outstanding at December 31, 2005	575	322
Additional paid in capital	481,615	249,317
Retained earnings	38,604	10,943
Treasury stock, at cost, 226,000 shares at June 30, 2006 and 200,000 shares at December 31, 2005	(47)	(40)
Total stockholders' equity	520,747	260,544
Total liabilities and stockholders' equity	\$ 855,254	\$ 591,838

See accompanying notes to condensed consolidated financial statements.

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HEALTHSPRING, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(in thousands, except share data)
(unaudited)

	Three Months Ended June 30,	
	2006	2005
Revenue:		
Premium:		
Medicare	\$ 282,347	\$ 159,194
Commercial	31,852	31,455
Total premium revenue	314,199	190,649
Management and other fees	6,112	5,213
Investment income	2,492	760
Total revenue	322,803	196,622
Operating expenses:		
Medicare	221,451	125,778
Commercial	29,406	27,961
Total medical expense	250,857	153,739
Selling, general and administrative	35,962	23,584
Depreciation and amortization	2,444	1,715
Interest expense	96	4,167
Total operating expenses	289,359	183,205
Income before equity in earnings of unconsolidated affiliate, minority interest and income taxes	33,444	13,417
Equity in earnings of unconsolidated affiliate	63	
Income before minority interest and income taxes	33,507	13,417
Minority interest		(341)
Income before income taxes	33,507	13,076
Income tax expense	(12,398)	(5,199)
Net income	21,109	7,877
Preferred dividends		(4,514)
Net income available to common stockholders	\$ 21,109	\$ 3,363
Net income per common share available to common stockholders:		
Basic	\$ 0.37	\$ 0.10
Diluted	\$ 0.37	\$ 0.10

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Weighted average common shares outstanding:		
Basic	57,256,620	32,184,436
Diluted	57,352,474	32,184,436

See accompanying notes to condensed consolidated financial statements.

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HEALTHSPRING, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(in thousands, except unit and share data)
(unaudited)

	Six-Month Period Ended June 30, 2006	Four-Month Period Ended June 30, 2005	Predecessor Two-Month Period Ended February 28, 2005
Revenue:			
Premium:			
Medicare	\$ 549,034	\$ 208,582	\$ 94,764
Commercial	64,086	41,707	20,704
Total premium revenue	613,120	250,289	115,468
Management and other fees	11,747	6,862	3,461
Investment income	4,558	1,039	461
Total revenue	629,425	258,190	119,390
Operating expenses:			
Medicare	441,884	166,407	74,531
Commercial	56,345	35,579	16,312
Total medical expense	498,229	201,986	90,843
Selling, general and administrative	70,571	31,368	21,608
Depreciation and amortization	4,867	2,575	315
Interest expense	8,457	5,774	42
Total operating expenses	582,124	241,703	112,808
Income before equity in earnings of unconsolidated affiliate, minority interest and income taxes	47,301	16,487	6,582
Equity in earnings of unconsolidated affiliate	170		
Income before minority interest and income taxes	47,471	16,487	6,582
Minority interest	(303)	(424)	(1,248)
Income before income taxes	47,168	16,063	5,334
Income tax expense	(17,486)	(6,316)	(2,628)
Net income	29,682	9,747	2,706
Preferred dividends	(2,021)	(6,057)	
Net income available to common stockholders and members	\$ 27,661	\$ 3,690	\$ 2,706

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Net income per common share available to common stockholders:

Basic	\$	0.53	\$	0.12
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Diluted	\$	0.53	\$	0.12
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Weighted average common shares outstanding:

Basic	51,974,083	32,069,542
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Diluted	52,072,784	32,069,542
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Net income per member unit:

Basic	\$	0.55
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Diluted	\$	0.55
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Weighted average member units outstanding:

Basic	4,884,196
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Diluted	4,884,196
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See accompanying notes to condensed consolidated financial statements.

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HEALTHSPRING, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Six-Month Period Ended June 30, 2006	Four-Month Period Ended June 30, 2005	Predecessor Two-Month Period Ended February 28, 2005
Cash from operating activities:			
Net income	\$ 29,682	\$ 9,747	\$ 2,706
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation and amortization expense	4,867	2,575	315
Amortization of accrued loss on assumed lease			(97)
Stock-based compensation expense	2,160	164	
Amortization of deferred financing cost	148		
Paid-in-kind (PIK) interest on subordinated notes	116	357	
Equity in earnings of unconsolidated affiliate	(170)		
Minority interest	303	424	1,248
Deferred tax (benefit) expense	(6,495)	1,747	93
Write-off of deferred financing costs on debt repayment	5,375		
Increase (decrease) in cash equivalents due to change in:			
Accounts receivable	(27,472)	8,366	(2,470)
Prepaid expenses and other current assets	258	(934)	1,240
Medical claims liability	21,182	(4,151)	5,829
Accounts payable, accrued expenses, and other current liabilities	10,132	(21,061)	6,202
Other long-term liabilities	(19)		11
Deferred revenue	94,389	343	(113)
Net cash provided by (used in) operating activities	134,456	(2,423)	14,964
Cash flows from investing activities:			
Purchase of property and equipment	(1,633)	(1,221)	(149)
Purchase of investment securities, held-to-maturity	(5,885)	(10,252)	(5,942)
Sale/maturity of investment securities	7,251	8,632	836
Purchase of restricted investments	(1,063)	(147)	(214)
Distributions from affiliates	106		
Purchase of minority interest		(44,358)	
Acquisitions, net of cash acquired		(223,747)	
Net cash used in investing activities	(1,224)	(271,093)	(5,469)

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Cash flows from financing activities:			
Proceeds from issuance of long-term debt		200,000	
Payments on long-term debt	(188,642)	(9,483)	(117)
Deferred financing costs	(932)	(6,366)	
Proceeds from issuance of common and preferred stock	188,750	139,977	
Proceeds from sale of units in consolidated subsidiary		7,875	
Funds received for the benefit of the members, net	77,719		
Purchase of treasury stock	(7)		
Distributions to minority stockholders			(1,771)
Cash advanced in recapitalization			1,000
Net cash provided by (used in) financing activities	76,888	332,003	(888)
Net increase in cash and cash equivalents	210,120	58,487	8,607
Cash and cash equivalents at beginning of period	110,085		67,834
Cash and cash equivalents at end of period	\$ 320,205	\$ 58,487	\$ 76,441

See accompanying notes to condensed consolidated financial statements.

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HEALTHSPRING, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (cont.)
(in thousands)
(unaudited)

	Six-Month Period Ended June 30, 2006	Four-Month Period Ended June 30, 2005	Predecessor Two-Month Period Ended February 28, 2005
Supplemental disclosures:			
Cash paid for interest	\$ 2,840	\$ 5,066	\$ 42
Cash paid for taxes	7,257	5,265	279
Non-cash transaction:			
Issuance of common shares in exchange for all preferred stock and cumulative dividends	244,782		
Issuance of common shares in conjunction with recapitalization		93,877	
Unearned compensation related to issuance of stock options and restricted common stock		2,262	
Effect of acquisitions:			
Net assets acquired	\$ (27,590)	\$ (442,365)	\$
Preferred stock issued		91,082	
Common stock issued	39,783	2,442	
Purchase of minority interest	(12,193)	44,358	
Capitalized transaction costs		5,295	
Cash acquired		75,441	
Acquisitions, net of cash acquired	\$	\$ (223,747)	\$

See accompanying notes to condensed consolidated financial statements.

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HEALTHSPRING, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

(1) Organization and Basis of Presentation

HealthSpring, Inc. (HealthSpring or the Company), a Delaware corporation, was organized in October 2004 and began operations in March 2005 in connection with a recapitalization transaction accounted for as a purchase. The Company is a managed care organization that focuses primarily on Medicare, the federal government sponsored health insurance program for retired U.S. citizens aged 65 and older, qualifying disabled persons, and persons suffering from end stage renal disease. Through its health maintenance organization (HMO) subsidiaries, the Company operates Medicare Advantage health plans and stand-alone Medicare prescription drug plans in the states of Tennessee, Texas, Alabama, Illinois and Mississippi. In addition, the Company also utilizes its infrastructure and provider networks in Tennessee and Alabama to offer commercial health plans to employer groups. The Company also manages healthcare plans and physician partnerships.

Basis of Presentation

The accompanying condensed consolidated financial statements are unaudited and should be read in conjunction with the consolidated financial statements and notes thereto of HealthSpring as of December 31, 2005 and for the ten-month period from March 1, 2005 (inception) to December 31, 2005, and of NewQuest, LLC and subsidiaries (collectively, the Predecessor) as of February 28, 2005 and for the two-month period ended February 28, 2005, included in the Company s Annual Report on Form 10-K for the year ended December 31, 2005 as filed with the Securities and Exchange Commission (the SEC) on March 31, 2006 (2005 Form 10-K). The financial statements are presented in a comparative format. Although the accounting policies of HealthSpring and the Predecessor are consistent, their financial statements are not directly comparable