CENTENE CORP
Form 10-Q
July 24, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2018
OR
[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission file number: 001-31826

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

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

Registrant's telephone number, including area code: (314) 725-4477

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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	x	Accelerated filer	o
Non-accelerated filer	o (do not check if a smaller reporting company)	Smaller reporting company	o

Emerging growth company o

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. o

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

As of July 13, 2018, the registrant had 205,256,671 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,” “r “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.

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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 June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
GAAP net earnings	$300	$254	$640	$393
Amortization of acquired intangible assets	45	39	84	79
Acquisition related expenses	1	1	22	6
California minimum medical loss ratio changes	30	—	30	—
Penn Treaty assessment expense	—	—	—	47
Income tax effects of adjustments (1)	(16)	(14)	(30)	(48)
Adjusted net earnings	$360	$280	$746	$477
GAAP diluted earnings per share (EPS)	$1.50	$1.44	$3.39	$2.23
Amortization of acquired intangible assets (2)	0.17	0.14	0.35	0.28
Acquisition related expenses (3)	0.01	0.01	0.10	0.03
California minimum medical loss ratio changes (4)	0.12	—	0.12	—
Penn Treaty assessment expense (5)	—	—	—	0.17
Adjusted Diluted EPS	$1.80	$1.59	$3.96	$2.71

(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 $0.05 and $0.08 for the three months ended June 30, 2018 and 2017, respectively and $0.10 and $0.17 for the six months ended June 30, 2018 and 2017, respectively.

(3) Acquisition related expenses per diluted share are net of an income tax benefit of $0.00 for both the three months ended June 30, 2018 and 2017, and $0.02 and $0.01 for the six months ended June 30, 2018 and 2017, respectively.

(4) The impact of retroactive changes to the California minimum medical loss ratio (MLR) is net of an income tax benefit of $0.03 and $0.04 per diluted share for the three and six months ended June 30, 2018, respectively.

(5) The Penn Treaty assessment expense per diluted share is net of an income tax benefit of $0.09 for the six months ended June 30, 2017.

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	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
GAAP selling, general and administrative expenses	$1,237	$1,065	$2,553	$2,156
Acquisition related expenses	1	1	22	6
Penn Treaty assessment expense	—	—	—	47
Adjusted selling, general and administrative expenses	$1,236	$1,064	$2,531	$2,103

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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)

	June 30, 2018 (Unaudited)	December 31, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	$ 6,707	$ 4,072
Premium and trade receivables	4,067	3,413
Short-term investments	602	531
Other current assets	1,001	687
Total current assets	12,377	8,703
Long-term investments	5,746	5,312
Restricted deposits	1,943	135
Property, software and equipment, net	1,327	1,104
Goodwill	5,346	4,749
Intangible assets, net	1,501	1,398
Other long-term assets	503	454
Total assets	$ 28,743	$ 21,855
LIABILITIES, REDEEMABLE NONCONTROLLING INTERESTS AND STOCKHOLDERS’ EQUITY		
Current liabilities:		
Medical claims liability	$ 5,003	$ 4,286
Accounts payable and accrued expenses	3,803	4,165
Return of premium payable	529	549
Unearned revenue	523	328
Current portion of long-term debt	4	4
Total current liabilities	9,862	9,332
Long-term debt	6,275	4,695
Other long-term liabilities	1,898	952
Total liabilities	18,035	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 June 30, 2018 and December 31, 2017	—	—
Common stock, $0.001 par value; authorized 400,000 shares; 207,413 issued and 205,247 outstanding at June 30, 2018, and 180,379 issued and 173,437 outstanding at December 31, 2017	—	—
Additional paid-in capital	7,355	4,349
Accumulated other comprehensive loss	(67)	(3)
Retained earnings	3,403	2,748
Treasury stock, at cost (2,166 and 6,942 shares, respectively)	(81)	(244)

Total Centene stockholders’ equity	10,610	6,850
Noncontrolling interest	87	14
Total stockholders’ equity	10,697	6,864
Total liabilities, redeemable noncontrolling interests and stockholders’ equity	$ 28,743	$ 21,855

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Revenues:				
Premium	$12,113	$10,905	$24,016	$21,543
Service	762	536	1,415	1,063
Premium and service revenues	12,875	11,441	25,431	22,606
Premium tax and health insurer fee	1,306	513	1,944	1,072
Total revenues	14,181	11,954	27,375	23,678
Expenses:				
Medical costs	10,380	9,413	20,419	18,735
Cost of services	658	456	1,201	897
Selling, general and administrative expenses	1,237	1,065	2,553	2,156
Amortization of acquired intangible assets	45	39	84	79
Premium tax expense	1,189	543	1,735	1,133
Health insurer fee expense	183	—	354	—
Total operating expenses	13,692	11,516	26,346	23,000
Earnings from operations	489	438	1,029	678
Other income (expense):				
Investment and other income	65	45	106	86
Interest expense	(80)	(62)	(148)	(124)
Earnings from operations, before income tax expense	474	421	987	640
Income tax expense	175	169	350	256
Net earnings	299	252	637	384
Loss attributable to noncontrolling interests	1	2	3	9
Net earnings attributable to Centene Corporation	$300	$254	$640	$393
Net earnings per common share attributable to Centene Corporation:				
Basic earnings per common share	$1.53	$1.47	$3.46	$2.28
Diluted earnings per common share	$1.50	$1.44	$3.39	$2.23

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Net earnings	$299	$252	$637	$384
Reclassification adjustment, net of tax	—	(1)	—	(1)
Change in unrealized gain (loss) on investments, net of tax	(11)	20	(63)	34
Foreign currency translation adjustments	(2)	3	(1)	4
Other comprehensive earnings (loss)	(13)	22	(64)	37
Comprehensive earnings	286	274	573	421
Comprehensive loss attributable to noncontrolling interests	1	2	3	9
Comprehensive earnings attributable to Centene Corporation	$287	$276	$576	$430

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

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

Six Months Ended June 30, 2018

	Centene Stockholders' Equity								
	Common Stock					Treasury Stock			
	$.001 Par Value Shares	Amt	Additional Paid-in Capital	Accumulated Other Comprehensive Loss	Retained Earnings	$.001 Par Value Shares	Amt	Non-controlling Interest	Total
Balance, December 31, 2017	180,379	$ —	$ 4,349	$ (3)	$ 2,748	6,942	$ (244)	$ 14	$ 6,864
Comprehensive Earnings:									
Net earnings	—	—	—	—	640	—	—	1	641
Other comprehensive loss, net of ($19) tax	—	—	—	(64)	—	—	—	—	(64)
Common stock issued for acquisitions	—	—	331	—	—	(4,894)	176	—	507
Common stock issued	26,604	—	2,780	—	—	—	—	—	2,780
Common stock issued for employee benefit plans	430	—	8	—	—	—	—	—	8
Common stock repurchases	—	—	—	—	—	118	(13)	—	(13)
Stock compensation expense	—	—	68	—	—	—	—	—	68
Cumulative-effect of adopting new accounting guidance	—	—	—	—	15	—	—	—	15
Purchase of noncontrolling interest	—	—	(181)	—	—	—	—	—	(181)
Acquisition resulting in noncontrolling interest	—	—	—	—	—	—	—	72	72
Balance, June 30, 2018	207,413	$ —	$ 7,355	$ (67)	$ 3,403	2,166	$ (81)	$ 87	$ 10,697

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

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

	Six Months Ended June 30, 2018	Six Months Ended June 30, 2017
Cash flows from operating activities:		
Net earnings	$637	$384
Adjustments to reconcile net earnings to net cash provided by operating activities		
Depreciation and amortization	215	173
Stock compensation expense	67	62
Deferred income taxes	4	(58)
Changes in assets and liabilities		
Premium and trade receivables	(553)	(696)
Other assets	2	65
Medical claims liabilities	717	243
Unearned revenue	202	241
Accounts payable and accrued expenses	(865)	(257)
Other long-term liabilities	865	781
Other operating activities, net	29	4
Net cash provided by operating activities	1,320	942
Cash flows from investing activities:		
Capital expenditures	(362)	(181)
Purchases of investments	(1,375)	(1,317)
Sales and maturities of investments	721	1,015
Acquisitions, net of cash acquired	(237)	—
Other investing activities, net	—	(1)
Net cash used in investing activities	(1,253)	(484)
Cash flows from financing activities:		
Proceeds from the issuance of common stock	2,780	—
Proceeds from long-term debt	5,146	810
Payments of long-term debt	(3,471)	(762)
Common stock repurchases	(13)	(15)
Purchase of noncontrolling interest	(63)	—
Other financing activities, net	(1)	6
Net cash provided by financing activities	4,378	39
Net increase in cash, cash equivalents and restricted cash	4,445	497
Cash, cash equivalents, and restricted cash and cash equivalents, beginning of period	4,089	3,936
Cash, cash equivalents, and restricted cash and cash equivalents, end of period	$8,534	$4,433
Supplemental disclosures of cash flow information:		
Interest paid	$130	$99
Income taxes paid	$195	$205
Equity issued in connection with acquisitions	$507	$—

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

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CENTENE CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(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.

Recently Adopted Accounting Guidance

In June 2018, the Financial Accounting Standards Board (FASB) issued an Accounting Standards Update (ASU) that simplifies the accounting for share-based payment arrangements with nonemployees for goods and services. Under the ASU, the guidance on such payments to nonemployees 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, $8 million, $17 million and $1,827 million as of December 31, 2016, June 30, 2017, December 31, 2017 and June 30, 2018, respectively. The restricted cash and cash equivalents as of June 30, 2018 includes cash held in escrow related to the issuance of long-term debt as further discussed in Note 7. Debt.

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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 February 2018, the FASB issued an ASU which makes technical corrections and clarifications to certain aspects of the new guidance on recognizing and measuring financial instruments. The amendment clarifies, among other things, that entities will use a prospective transition approach only for equity securities they elect to measure using the new measurement alternative. The amendments are effective for annual periods beginning in 2018 and interim periods beginning in the third quarter of 2018. 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 March 2018, the FASB tentatively approved an amendment to the new guidance that allows companies the option of using the effective date of the new standard as the date of initial application. The Company is currently evaluating the effect of the new lease guidance.

2. Fidelis Care Acquisition

On July 1, 2018, the Company acquired substantially all of the assets of Fidelis Care for approximately $3.75 billion of cash consideration. 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 will be 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 anticipates a significant amount of goodwill related primarily to buyer specific synergies expected from the acquisition and the assembled workforce of Fidelis Care. The goodwill will be assigned to the Managed Care segment and will be deductible for income tax purposes.

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Unaudited Pro Forma Financial Information

The following table presents supplemental pro forma information for the three and six months ended June 30, 2018 and 2017, respectively ($ in millions, except per share data):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Total revenues	$17,013	$14,494	$32,923	$28,583
Net earnings attributable to Centene Corporation	$395	$312	$772	$489
Diluted earnings per share	$1.89	$1.54	$3.73	$2.41

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 non-for-profit entity.
- Additional Health Insurer Fee revenue and expense related to Fidelis Care as those revenues will be subject to the Health Insurer Fee following the first year of the closing of the Fidelis Care Acquisition.
- Reduced Fidelis Care investment income to reflect lower investment balances 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, will be expensed in SG&A during the third quarter of 2018.

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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):

	June 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	$267	$ —	$ (3)	$264	$311	$ —	$ (2)	$309
Corporate securities	2,441	4	(43)	2,402	2,208	12	(10)	2,210
Restricted certificates of deposit	4	—	—	4	4	—	—	4
Restricted cash equivalents	1,827	—	—	1,827	17	—	—	17
Municipal securities	2,224	3	(25)	2,202	2,085	12	(10)	2,087
Asset-backed securities	498	1	(3)	496	437	1	(1)	437
Residential mortgage-backed securities	363	—	(12)	351	337	1	(6)	332
Commercial mortgage-backed securities	296	—	(7)	289	272	1	(2)	271
Fair value and equity method investments	322	—	—	322	176	—	—	176
Life insurance contracts	134	—	—	134	135	—	—	135
Total	$8,376	$ 8	$ (93)	$8,291	$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 fair value and equity method investments. The Company’s investment policies are designed to provide liquidity, preserve capital and maximize total return on invested assets with the focus on high credit quality securities. The Company limits the size of investment in any single issuer other than U.S. treasury securities and obligations of U.S. government corporations and agencies. As of June 30, 2018, 96% of the Company’s investments in rated securities carry an investment grade rating by nationally recognized statistical rating organizations. At June 30, 2018, the Company held certificates of deposit, life insurance contracts and fair value and equity method 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 3.9 years at June 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.

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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):

	June 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	$(2)	$160	$(1)	$88	$(1)	$222	$(1)	$79
Corporate securities	(35)	1,772	(8)	180	(6)	1,044	(4)	185
Municipal securities	(19)	1,404	(6)	172	(7)	943	(3)	175
Asset-backed securities	(3)	355	—	26	(1)	228	—	28
Residential mortgage-backed securities	(4)	161	(8)	155	(1)	109	(5)	171
Commercial mortgage-backed securities	(4)	200	(3)	51	(1)	112	(1)	51
Total	$(67)	$4,052	$(26)	$672	$(17)	$2,658	$(14)	$689

As of June 30, 2018, the gross unrealized losses were generated from 2,818 positions out of a total of 3,697 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):

	June 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	$584	$578	$1,840	$1,840	$474	$474	$48	$47
One year through five years	2,286	2,253	104	103	2,424	2,420	88	88
Five years through ten years	1,758	1,740	—	—	1,773	1,779	—	—
Greater than ten years	647	641	—	—	129	130	—	—
Asset-backed securities	1,157	1,136	—	—	1,046	1,040	—	—
Total	$6,432	$6,348	$1,944	$1,943	$5,846	$5,843	$136	$135

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

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 fair value and equity method investments when evidence demonstrates that it is other-than-temporarily impaired. Evidence of a loss in value that is other-than-temporary may include the absence of an ability to recover the carrying amount of the investment or the inability of the investee to sustain a level of earnings that would justify the carrying amount of the investment.

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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 June 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	$6,707	$—	$ —	$6,707
Investments available for sale:				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$152	$—	$ —	$152
Corporate securities	—	2,402	—	2,402
Municipal securities	—	2,202	—	2,202
Asset-backed securities	—	496	—	496
Residential mortgage-backed securities	—	351	—	351
Commercial mortgage-backed securities	—	289	—	289
Total investments	$152	$5,740	$ —	$5,892
Restricted deposits available for sale:				
Cash and cash equivalents	$1,827	$—	$ —	$1,827
Certificates of deposit	4	—	—	4
U.S. Treasury securities and obligations of U.S. government corporations and agencies	112	—	—	112
Total restricted deposits	$1,943	$—	$ —	$1,943
Other long-term assets: Interest rate swap agreements	$—	$—	$ —	$—
Total assets at fair value	$8,802	$5,740	$ —	$14,542
Liabilities				
Other long-term liabilities:				
Interest rate swap agreements	$—	$136	$ —	$136
Total liabilities at fair value	$—	$136	$ —	$136

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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):

	Level I	Level II	Level III	Total
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