MAGELLAN HEALTH SERVICES INC
Form 10-Q
July 28, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(MarkOne)

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

For the Quarterly Period Ended June 30, 2006

Or

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

For the transition period from to

Commission File No. 1-6639

MAGELLAN HEALTH SERVICES, INC.

(Exact name of registrant as specified in its charter)

Delaware	**58-1076937**
(State of other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
55 Nod Road, Avon, Connecticut	**06001**
(Address of principal executive offices)	(Zip code)

(860) 507-1900

(Registrant s telephone number, including area code)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes o No x

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 twelve months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

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. (Check one):

Large accelerated filer x Accelerated filer o Non-accelerated filer 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

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY
PROCEEDINGS DURING THE PRECEDING FIVE YEARS:

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes x No o

The number of shares of the registrant s Ordinary Common Stock outstanding as of June 30, 2006 was 37,148,742.

FORM 10-Q

MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except per share amounts)

	December 31, 2005	June 30, 2006 (unaudited)
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 81,039	$ 224,573
Restricted cash	149,723	161,600
Accounts receivable, less allowance for doubtful accounts of $2,442 and $1,454 at December 31, 2005 and June 30, 2006, respectively	42,428	34,519
Short-term investments (restricted investments of $42,976 and $36,441 at December 31, 2005 and June 30, 2006, respectively)	236,153	52,925
Other current assets (restricted deposits of $16,498 and $20,542 at December 31, 2005 and June 30, 2006, respectively)	31,434	35,609
Total Current Assets	540,777	509,226
Property and equipment, net	102,898	100,669
Long-term investments (restricted investments of $2,897 and $3,512 at December 31, 2005 and June 30, 2006, respectively)	2,897	3,512
Investments in unconsolidated subsidiaries	15,339	
Deferred income taxes	76,023	80,065
Other long-term assets	10,948	7,065
Goodwill	290,192	366,822
Other intangible assets, net	30,412	39,021
Total Assets	$ 1,069,486	$ 1,106,380
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities:		
Accounts payable	$ 14,834	$ 10,320
Accrued liabilities	62,327	51,526
Medical claims payable	164,013	142,639
Other medical liabilities	45,557	64,961
Current maturities of long-term debt and capital lease obligations	25,194	25,196
Total Current Liabilities	311,925	294,642
Long-term debt and capital lease obligations	37,890	25,231
Deferred credits and other long-term liabilities	84,832	90,408
Minority interest	1,762	242
Total Liabilities	436,409	410,523
Preferred stock, par value $.01 per share		
Authorized 10,000 shares at December 31, 2005 and June 30, 2006 Issued and outstanding none at December 31, 2005 and June 30, 2006		
Ordinary common stock, par value $.01 per share		
Authorized 100,000 shares at December 31, 2005 and June 30, 2006 Issued and outstanding 36,584 shares and 37,149 shares at December 31, 2005 and June 30, 2006, respectively	366	372
Multi-Vote common stock, par value $.01 per share		
Authorized 40,000 shares at December 31, 2005 and June 30, 2006 Issued and outstanding none at December 31, 2005 and June 30, 2006, respectively		
Other Stockholders Equity:		
Additional paid-in capital	429,933	452,897
Retained earnings	194,904	237,443
Warrants outstanding	8,489	5,384
Accumulated other comprehensive loss	(615)	(239)
Total Stockholders Equity	633,077	695,857
Total Liabilities and Stockholders Equity	$ 1,069,486	$ 1,106,380

See accompanying notes to condensed consolidated financial statements.

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MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

(In thousands, except per share amounts)

	Three Months Ended June 30, 2005 (restated)	2006	Six Months Ended June 30, 2005 (restated)	2006
Net revenue	$ 464,544	$ 398,933	$ 917,298	$ 799,529
Cost and expenses:				
Cost of care	316,921	262,706	621,129	532,541
Direct service costs and other operating expenses	90,201	86,104	178,922	168,072
Equity in earnings of unconsolidated subsidiaries	(1,503)		(2,952)	(390)
Depreciation and amortization	13,573	11,333	24,791	21,990
Interest expense	8,611	1,721	17,250	3,690
Interest income	(3,899)	(4,921)	(6,932)	(9,138)
Stock compensation expense	4,419	6,594	8,169	12,094
Gain on sale of assets		(403)		(5,148)
	428,323	363,134	840,377	723,711
Income from continuing operations before income taxes and minority interest	36,221	35,799	76,921	75,818
Provision for income taxes	15,316	15,575	32,868	33,279
Income from continuing operations before minority interest	20,905	20,224	44,053	42,539
Minority interest, net	4		72	
Income from continuing operations	20,901	20,224	43,981	42,539
Income from discontinued operations (1)	816		830	
Net income	21,717	20,224	44,811	42,539
Other comprehensive (loss) income	(458)	166	(472)	376
Comprehensive income	$ 21,259	$ 20,390	$ 44,339	$ 42,915
Weighted average number of common shares outstanding basic (See Note D)	35,567	36,999	35,475	36,852
Weighted average number of common shares outstanding diluted (See Note D)	36,980	38,599	36,899	38,384
Income per common share basic:				
Income from continuing operations	$ 0.59	$ 0.55	$ 1.24	$ 1.15
Income from discontinued operations	$ 0.02	$ 0.00	$ 0.02	$ 0.00
Net income	$ 0.61	$ 0.55	$ 1.26	$ 1.15
Income per common share diluted:				
Income from continuing operations	$ 0.57	$ 0.52	$ 1.19	$ 1.11
Income from discontinued operations	$ 0.02	$ 0.00	$ 0.02	$ 0.00
Net income	$ 0.59	$ 0.52	$ 1.21	$ 1.11

(1) Net of income tax provision of $940 and $1,045 for the three months and six months ended June 30, 2005, respectively.

See accompanying notes to condensed consolidated financial statements.

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MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE SIX MONTHS ENDED JUNE 30,

(Unaudited)

(In thousands)

	2005 (restated)	2006
Cash flows from operating activities:		
Net income	$ 44,811	$ 42,539
Adjustments to reconcile net income to net cash from operating activities:		
Gain on sale of assets		(5,148)
Depreciation and amortization	24,791	21,990
Equity in earnings of unconsolidated subsidiaries	(2,952)	(390)
Non-cash interest expense	694	694
Non-cash stock compensation expense	8,169	12,094
Non-cash income tax expense	30,754	30,116
Cash flows from changes in assets and liabilities, net of effects from acquisitions of businesses:		
Restricted cash	(46,030)	(11,627)
Accounts receivable, net	12,578	6,878
Other assets	169	(3,336)
Accounts payable and accrued liabilities	(3,281)	(20,481)
Medical claims payable and other medical liabilities	19,929	(1,970)
Other liabilities	153	(53)
Minority interest, net of dividends paid	123	(1,520)
Other	344	39
Net cash provided by operating activities	90,252	69,825
Cash flows from investing activities:		
Capital expenditures	(8,628)	(8,923)
Proceeds from sale of assets		22,200
Purchase of investments	(224,683)	(23,481)
Maturity of investments	173,777	206,534
Acquisitions and investments in businesses, net of cash acquired		(120,735)
Proceeds from note receivable	7,000	3,000
Net cash (used in) provided by investing activities	(52,534)	78,595
Cash flows from financing activities:		
Payments on long-term debt and capital lease obligations	(13,560)	(12,657)
Proceeds from exercise of stock options and warrants	12,041	7,771
Net cash used in financing activities	(1,519)	(4,886)
Net increase in cash and cash equivalents	36,199	143,534
Cash and cash equivalents at beginning of period	45,390	81,039
Cash and cash equivalents at end of period	$ 81,589	$ 224,573

See accompanying notes to condensed consolidated financial statements.

MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2006

(Unaudited)

NOTE A General

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of Magellan Health Services, Inc., a Delaware corporation (Magellan), include the accounts of Magellan, its majority owned subsidiaries, and all variable interest entities (VIEs) for which Magellan is the primary beneficiary (together with Magellan, the Company). The financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the Securities and Exchange Commission s (the SEC) instructions to Form 10-Q. Accordingly, the financial statements do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments, consisting of normal recurring adjustments considered necessary for a fair presentation, have been included. The results of operations for the three months and six months ended June 30, 2006 are not necessarily indicative of the results to be expected for the full year. All intercompany accounts and transactions have been eliminated in consolidation.

These unaudited condensed consolidated financial statements should be read in conjunction with the Company s audited consolidated financial statements for the year ended December 31, 2005 and the notes thereto, which are included in the Company s Annual Report on Form 10-K filed with the SEC on March 8, 2006.

Restatements of Previously Issued Unaudited Condensed Consolidated Financial Statements

On March 7, 2006, the Company announced that it was restating previously filed financial statements to correct the Company s accounting for reversals of valuation allowances pertaining to deferred tax assets (excluding deferred tax assets related to the Company s net operating loss carryforwards) that existed prior to the Company s emergence from bankruptcy on January 5, 2004. The Company had recorded the reversals of valuation allowances for such deferred tax assets as reductions to the Company s income tax provision. In accordance with American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) 90-7, Financial Reporting by Entities in Reorganization Under the Bankruptcy Code (SOP 90-7), and the Financial Accounting Standard Board s Emerging Issues Task Force (EITF) Topic No. D-33, Timing of Recognition of Tax Benefits for Pre-Reorganization Temporary Differences and Carryforwards (EITF D-33), such reversals of valuation allowances should be recorded as reductions to goodwill. Accordingly, the Company has restated its consolidated financial statements for the fiscal year ended December 31, 2004, and for the quarters ended March 31, 2004, June 30, 2004, September 30, 2004, December 31, 2004, March 31, 2005, June 30, 2005 and September 30, 2005. All applicable financial information contained in this Form 10-Q gives effect to these restatements.

The quarterly impacts of the restatement adjustments for the three months and six months ended June 30, 2005 are reflected below (in thousands, except per share amounts):

	Three months ended June 30, 2005	Six months ended June 30, 2005
Net revenue	$	$
Cost and expenses:		
Cost of care		
Direct service costs and other operating expenses		
Equity in earnings of unconsolidated subsidiaries		
Depreciation and amortization		
Interest expense		
Interest income		
Stock compensation expense		
Gain on sale of assets		
Income from continuing operations before income taxes and minority interest		
Provision for income taxes	434	922
Income from continuing operations before minority interest	(434)	(922)
Minority interest, net		
Income from continuing operations	(434)	(922)
Discontinued operations:		
Income (loss) from discontinued operations, net of income taxes	(504)	(538)
Net income	(938)	(1,460)
Income available to common stockholders	$ (938)	$ (1,460)
Weighted average number of common shares outstanding basic	35,567	35,475
Weighted average number of common shares outstanding diluted	36,980	36,899
Income per common share available to common stockholders basic:		
Income from continuing operations	$ (0.01)	$ (0.02)
Income (loss) from discontinued operations	$ (0.02)	$ (0.02)
Net income	$ (0.03)	$ (0.04)
Income per common share available to common stockholders diluted:		
Income from continuing operations	$ (0.01)	$ (0.02)
Income (loss) from discontinued operations	$ (0.02)	$ (0.02)
Net income	$ (0.03)	$ (0.04)

The weighted average number of common shares outstanding, both basic and diluted, are not affected by the restatement.

Summary of Significant Accounting Policies

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Significant estimates of the Company include, among other things, accounts receivable realization, valuation allowances for deferred tax assets, valuation of goodwill and intangible assets, medical claims payable, other medical liabilities, stock-based compensation assumptions, tax contingencies and legal liabilities. Actual results could differ from those estimates.

Managed Care Revenue

Managed care revenue is recognized over the applicable coverage period on a per member basis for covered members. Managed care risk revenues approximated $413.3 million and $815.6 million for the three months and six months ended June 30, 2005, respectively and $349.9 million and $702.6 million for the three months and six months ended June 30, 2006, respectively.

Performance-based Revenue

The Company has the ability to earn performance-based revenue under certain risk and non-risk contracts. Performance-based revenue generally is based on either the ability of the Company to manage care for its clients below specified targets, or on other operating metrics. For each such contract, the Company estimates and records performance-based revenue after considering the relevant contractual terms and the data available for the performance-based revenue calculation. Pro-rata performance-based revenue is recognized on an interim basis pursuant to the rights and obligations of each party upon termination of the contracts. Performance-based revenues were $2.7 million and $6.9 million for the three months and six months ended June 30, 2005, respectively, and $3.0 million and $6.6 million for the three months and six months ended June 30, 2006, respectively.

Significant Customers

The Company s contracts with the State of Tennessee s TennCare program (TennCare) and with subsidiaries of WellPoint, Inc. (WellPoint), each generated revenues that exceeded, in the aggregate, ten percent of consolidated net revenues for each of the three months and six months ended June 30, 2005 and 2006. The Company also has a significant concentration of business from individual counties which are part of the Pennsylvania Medicaid program.

The Company provides managed behavioral healthcare services for TennCare, both through contracts held by the Company s wholly owned subsidiary Tennessee Behavioral Health, Inc. (TBH) and through a contract held by Premier Behavioral Health Systems of Tennessee, LLC (Premier), a joint venture in which the Company owned a fifty percent interest. In addition, the Company contracts with Premier to provide certain services to the joint venture. The Company consolidates the results of operations of Premier, including revenue and cost of care, in the Company s consolidated statements of income. On April 11, 2006, the Company purchased the other fifty percent interest in Premier for $1.5 million, so that Premier is now a wholly-owned subsidiary of the Company. TennCare has divided its program into three regions, and the Company s TennCare contracts, which extend through June 30, 2007, currently encompass all of the TennCare membership for all three regions. The Company recorded revenue of $113.6 million and $226.7 million during the three months and six months ended June 30, 2005, respectively, and $101.8 million and $210.3 million during the three months and six months ended June 30, 2006, respectively, from its TennCare contracts.

On April 7, 2006, TennCare issued a Request for Proposals (RFP) for the management of the integrated delivery of behavioral and physical medical care to TennCare enrollees in the Middle region by managed care organizations. The RFP states that the start date of any such contract awarded pursuant to the RFP is expected to be April 1, 2007. Because the Company s contracts with TennCare can be terminated by TennCare prior to June 30, 2007, the contract for the Middle region would be terminated by TennCare should an implementation occur prior to June 30, 2007 of any contract awarded pursuant to the RFP. On July 26, 2006, TennCare announced the two winning bidders to the RFP process. The Company had not partnered with either of these bidders. For the three months and six months ended June 30, 2006, revenue derived from TennCare enrollees residing in the Middle region amounted to $36.8 million and $77.2 million, respectively.

Total revenue from the Company s contracts with WellPoint approximated $54.6 million and $104.4 million during the three months and six months ended June 30, 2005, respectively, and approximated $50.4 million and $98.4 million during the three months and six months ended June 30, 2006, respectively. Included in the revenue amount for the three months and six months ended June 30, 2006 is revenue of $3.8 million and $6.2 million from contracts that National Imaging Associates, Inc. (NIA) has with WellPoint (see Note B for discussion of the Company s acquisition of NIA). The majority of the Company s managed behavioral healthcare contracts with WellPoint have terms that extend through December 31, 2007.

The Company derives a significant portion of its revenue from contracts with various counties in the State of Pennsylvania (the Pennsylvania Counties). Although these are separate contracts with individual counties, they all pertain to the Pennsylvania Medicaid program. Revenues from the Pennsylvania Counties in the aggregate totaled $54.0 million and $105.5 million in the three months and six months ended June 30, 2005, respectively and $61.9 million and $124.0 million in the three months and six months ended June 30, 2006, respectively.

The Company recorded net revenue from Aetna, Inc. (Aetna) of $60.7 million and $122.6 million for the three months and six months ended June 30, 2005, respectively, which represented in excess of ten percent of the consolidated revenues of the Company for such periods. The Company s contract with Aetna terminated on December 31, 2005. During the three months and six months ended June 30, 2006, the Company recognized $0.8 million and $5.4 million of revenue related to the performance of one-time, transitional activities associated with the contract termination.

Cash and Cash Equivalents

Cash equivalents are short-term, highly liquid interest-bearing investments with maturity dates of three months or less when purchased, consisting primarily of money market instruments. The Company records as cash and cash equivalents, excess capital and undistributed earnings for its regulated subsidiaries, which as of June 30, 2006 was $32.5 million.

Restricted Assets

The Company has certain assets which are considered restricted for: (i) the payment of claims under the terms of certain managed behavioral healthcare contracts; (ii) regulatory purposes related to the payment of claims in certain jurisdictions; and (iii) the maintenance of minimum required tangible net equity levels for certain of the Company s subsidiaries. Significant restricted assets of the Company as of December 31, 2005 and June 30, 2006 were as follows (in thousands):

	December 31, 2005	June 30, 2006
Restricted cash	$ 149,723	$ 161,600
Restricted short-term investments	42,976	36,441
Restricted deposits (included in other current assets)	16,498	20,542
Restricted long-term investments	2,897	3,512
Total	$ 212,094	$ 222,095

Investments

The Company accounts for its investments in accordance with Statement of Financial Accounting Standards (SFAS) No. 115, Accounting for Certain Investments in Debt and Equity Securities (SFAS 115).

As of June 30, 2006, there were no unrealized losses that the Company believed to be other-than-temporary, because the Company believes it is probable that: (i) all contractual terms of each investment will be satisfied, (ii) the decline in fair value is due primarily to changes in interest rates (and not because of increased credit risk), and (iii) the Company intends and has the ability to hold each investment for a period of time sufficient to allow a market recovery. Unrealized losses related to investments greater and less than one year are not material. No realized gains or losses were recorded for the three months and six months ended June 30, 2005 and 2006. The following is a summary of short-term and long-term investments at December 31, 2005 and June 30, 2006 (in thousands):

	December 31, 2005			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Government and agency securities	$ 63,783	$	$ (158)	$ 63,625
Corporate debt securities	175,580		(457)	175,123
Certificates of deposit	302			302
Total investments at December 31, 2005	$ 239,665	$	$ (615)	$ 239,050

	June 30, 2006			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Government and agency securities	$ 29,852	$	$ (82)	$ 29,770
Corporate debt securities	26,554		(157)	26,397
Certificates of deposit	270			270
Total investments at June 30, 2006	$ 56,676	$	$ (239)	$ 56,437

The maturity dates of the Company s investments as of June 30, 2006 are summarized below (in thousands):

	Amortized Cost	Estimated Fair Value
Due prior to July 1, 2007	$ 53,134	$ 52,925
Due July 1, 2007 to April 30, 2008	3,542	3,512
Total investments at June 30, 2006	$ 56,676	$ 56,437

Goodwill

Goodwill is accounted for in accordance with SFAS No. 142, Goodwill and Other Intangible Assets (SFAS 142). Pursuant to SFAS 142, the Company is required to test its goodwill for impairment on at least an annual basis. The Company has selected October 1 as the date of its annual impairment test. The balance of goodwill of $290.2 million at December 31, 2005 was allocated entirely to the Health Plan segment (as described below). At June 30, 2006, approximately $105.6 million of goodwill was allocated to the Radiology Benefits Management segment (as described below), and the remaining $261.2 million was allocated to the Health Plan segment.

The changes in the carrying amount of Company goodwill for the six months ended June 30, 2006 are reflected in the table below (in thousands):

Balance as of December 31, 2005	$ 290,192
Adjustment to goodwill as a result of the projected realization of pre-emergence deferred tax assets subsequent to fresh-start reporting(1)	(29,019)
Adjustment to goodwill as a result of the acquisition of NIA See Note B	105,649
Balance as of June 30, 2006	$ 366,822

(1) During fiscal 2006, the Company recorded tax benefits from the utilization of deferred tax assets, including net operating loss carryforwards (NOLs), that existed prior to the Company s emergence from bankruptcy on January 5, 2004. These tax benefits have been reflected as reductions of goodwill in accordance with SOP 90-7.

Intangible Assets

At December 31, 2005 and June 30, 2006, the Company had net identifiable intangible assets (primarily customer agreements and lists and provider networks) of approximately $30.4 million and $39.0 million, respectively, net of accumulated amortization of approximately $17.3 million and $22.2 million, respectively. Intangible assets are amortized over their estimated useful lives, which range from approximately four to eighteen years. Amortization expense was $3.5 million and $6.9 million for the three months and six months ended June 30, 2005, respectively and $2.6 million and $4.9 million for the three months and six months ended June 30, 2006, respectively.

Cost of Care, Medical Claims Payable and Other Medical Liabilities

Cost of care is recognized in the period in which members received managed healthcare services. In addition to actual benefits paid, cost of care includes the impact of accruals for estimates of medical claims payable.

Medical claims payable represents the liability for healthcare claims reported but not yet paid and claims incurred but not yet reported (IBNR) related to the Company s managed healthcare businesses. The IBNR portion of medical claims payable is estimated based on past claims payment experience for member groups, enrollment data, utilization statistics, authorized healthcare services and other factors. This data is incorporated into contract-specific actuarial reserve models. Although considerable variability is inherent in such estimates, management believes the liability for medical claims payable is adequate. Medical claims payable balances are continually monitored and reviewed. Changes in assumptions for cost of care caused by changes in actual experience could cause the estimates to change in the near term. The Company believes that the amount of medical claims payable is adequate to cover its ultimate liability for unpaid claims as of June 30, 2006; however, actual claims payments and other items may differ from established estimates.

Other medical liabilities consist primarily of reinvestment payables under certain managed behavioral healthcare contracts with Medicaid customers. Under this type of contract, if the cost of care is less than certain minimum amounts specified in the contract (usually as a percentage of revenue), the Company is required to reinvest such difference in behavioral healthcare programs when and as specified by the customer or to pay the difference to the customer for their use in funding such programs.

Income Taxes

The Company s effective income tax rate was 42.3 percent and 42.7 percent for the three months and six months ended June 30, 2005 (restated), respectively and 43.5 percent and 43.9 percent for the three months and six months ended June 30, 2006, respectively. The effective rates for the three months and six months ended June 30, 2005 and 2006 differ from federal statutory income tax rates primarily due to state income taxes and permanent differences between book and tax income.

Stock-Based Compensation

At December 31, 2005 and June 30, 2006, the Company had stock-based employee incentive plans, which are described below.

Stock Option Plans

On January 5, 2004, (the Effective Date), the Company established the 2003 Management Incentive Plan (2003 MIP) which allows for the issuance of up to 6,373,689 shares of common stock pursuant to stock options or stock grants. During fiscal 2004, the Company granted options for the purchase of 4.4 million shares of common stock at a weighted average grant date fair value of approximately $14.61 per share. These options vest ratably on each anniversary date over the three to four years subsequent to grant, and have a 10 year life. During fiscal 2005, the Company granted options for the purchase of 1.1 million shares of common stock at a weighted average grant date fair value of approximately $10.90 per share. These options vest ratably on each anniversary date over the four years subsequent to grant, and have a 10 year life. Other than the 2004 Options (defined below) and certain options granted under the 2006 MIP (defined below), options granted by the Company have exercise prices equal to the fair market value on the date of grant.

Summarized information relative to the Company s stock options issued under the 2003 MIP for the years ended December 31, 2004 and 2005 is as follows:

	2004		2005	
	Options	**Weighted Average Exercise Price**	**Options**	**Weighted Average Exercise Price**
Balance, beginning of period		$	4,220,222	$ 13.34
Granted	4,402,522	13.34	1,115,185	34.28
Cancelled	(182,300)	16.10	(255,947)	27.58
Exercised			(1,064,749)	12.48
Balance, end of period	4,220,222	$ 13.34	4,014,711	