UNITEDHEALTH GROUP INC
Form 10-Q
May 02, 2008
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2008

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: 1-10864

UnitedHealth Group Incorporated

(Exact name of registrant as specified in its charter)

Minnesota	**41-1321939**
(State or other jurisdiction of	**(I.R.S. Employer**

incorporation or organization)	**Identification No.)**
UnitedHealth Group Center	
9900 Bren Road East	
Minnetonka, Minnesota	**55343**
(Address of principal executive offices)	**(Zip Code)**

(952) 936-1300

(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 þ No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company ¨

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

As of April 30, 2008, there were 1,228,703,927 shares of the registrant s Common Stock, $.01 par value per share, issued and outstanding.

Table of Contents

UNITEDHEALTH GROUP

Table of Contents

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. *Financial Statements (Unaudited)*

UNITEDHEALTH GROUP

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(in millions, except per share data)	March 31, 2008	December 31, 2007
ASSETS		
Current Assets		
Cash and Cash Equivalents	$ 6,275	$ 8,865
Short-Term Investments	765	754
Accounts Receivable, net	1,934	1,574
Assets Under Management	2,086	2,210
Deferred Income Taxes	346	386
Other Current Assets	2,361	1,755
Total Current Assets	13,767	15,544
Long-Term Investments	13,345	12,667
Property, Equipment and Capitalized Software, net	2,203	2,121
Goodwill	19,307	16,854
Other Intangible Assets, net	2,456	1,737
Other Assets	2,465	1,976
TOTAL ASSETS	$ 53,543	$ 50,899
LIABILITIES AND SHAREHOLDERS EQUITY		
Current Liabilities		
Medical Costs Payable	$ 8,537	$ 8,331
Accounts Payable and Accrued Liabilities	3,731	3,654
Other Policy Liabilities	3,305	3,207
Commercial Paper and Current Maturities of Long-Term Debt	1,727	1,946
Unearned Premiums	1,483	1,354
Total Current Liabilities	18,783	18,492
Long-Term Debt, less current maturities	11,495	9,063
Future Policy Benefits for Life and Annuity Contracts	1,854	1,849
Deferred Income Taxes and Other Liabilities	1,652	1,432
Commitments and Contingencies (Note 15)		
Shareholders Equity		
Common Stock, $0.01 par value 3,000 shares authorized; 1,225 and 1,253 issued and outstanding	12	13
Additional Paid-In Capital		1,023
Retained Earnings	19,621	18,929
Accumulated Other Comprehensive Income:		
Net Unrealized Gains on Investments, net of tax effects	126	98
Total Shareholders Equity	19,759	20,063

TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$ 53,543	$ 50,899

See Notes to the Condensed Consolidated Financial Statements

3

Table of Contents

UNITEDHEALTH GROUP

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(in millions, except per share data)	Three Months Ended March 31, 2008	2007
REVENUES		
Premiums	$ 18,389	$ 17,464
Services	1,273	1,116
Products	363	197
Investment and Other Income	279	270
Total Revenues	20,304	19,047
OPERATING COSTS		
Medical Costs	15,144	14,440
Operating Costs	2,897	2,664
Cost of Products Sold	325	170
Depreciation and Amortization	225	191
Total Operating Costs	18,591	17,465
EARNINGS FROM OPERATIONS	1,713	1,582
Interest Expense	(154)	(116)
EARNINGS BEFORE INCOME TAXES	1,559	1,466
Provision for Income Taxes	(565)	(539)
NET EARNINGS	$ 994	$ 927
BASIC NET EARNINGS PER COMMON SHARE	$ 0.80	$ 0.69
DILUTED NET EARNINGS PER COMMON SHARE	$ 0.78	$ 0.66
BASIC WEIGHTED-AVERAGE NUMBER OF COMMON SHARES OUTSTANDING	1,240	1,343
DILUTIVE EFFECT OF COMMON STOCK EQUIVALENTS	38	56
DILUTED WEIGHTED-AVERAGE NUMBER OF COMMON SHARES OUTSTANDING	1,278	1,399

See Notes to the Condensed Consolidated Financial Statements

Table of Contents

UNITEDHEALTH GROUP

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(in millions)	**Three Months Ended March 31, 2008**	**2007**
OPERATING ACTIVITIES		
Net Earnings	$ 994	$ 927
Noncash Items:		
Depreciation and Amortization	225	191
Deferred Income Taxes and Other	27	(136)
Share-Based Compensation	72	260
Net Change in Other Operating Items, net of effects from acquisitions and changes in AARP balances:		
Accounts Receivable and Other Current Assets	(744)	(331)
Medical Costs Payable		411
Accounts Payable and Other Accrued Liabilities	(341)	(300)
Unearned Premiums	47	1,566
Cash Flows From Operating Activities	280	2,588
INVESTING ACTIVITIES		
Cash Paid for Acquisitions, net of cash assumed and other effects	(3,265)	(54)
Purchases of Property, Equipment and Capitalized Software	(212)	(224)
Purchases of Investments	(2,498)	(994)
Maturities and Sales of Investments	2,205	460
Cash Flows Used For Investing Activities	(3,770)	(812)
FINANCING ACTIVITIES		
(Payments of) Proceeds from Commercial Paper, net	(623)	2
Proceeds from Issuance of Long-Term Debt	2,981	
Payments for Retirement of Long-Term Debt	(500)	(400)
Common Stock Repurchases	(1,472)	(903)
Proceeds from Common Stock Issuances	75	135
Share-Based Compensation Excess Tax Benefits	16	86
Customer Funds Administered	529	1,048
Other	(106)	(5)
Cash Flows From (Used For) Financing Activities	900	(37)
(DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(2,590)	1,739
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	8,865	10,320
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 6,275	$ 12,059

See Notes to the Condensed Consolidated Financial Statements

Table of Contents

UNITEDHEALTH GROUP

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Basis of Presentation, Use of Estimates and Accounting Policies

Basis of Presentation

Unless the context otherwise requires, the use of the terms the Company, we, us, and our in the following refers to UnitedHealth Group Incorporated and its subsidiaries.

The accompanying Condensed Consolidated Financial Statements reflect all adjustments, consisting solely of normal recurring adjustments needed to present the financial results for these interim periods fairly. The year-end condensed consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. In accordance with the rules and regulations of the Securities and Exchange Commission (SEC), we have omitted certain footnote disclosures that would substantially duplicate the disclosures contained in our annual audited Consolidated Financial Statements. Read together with the disclosures below, we believe the interim financial statements are presented fairly. However, these Condensed Consolidated Financial Statements should be read together with the Consolidated Financial Statements and the notes included in our Annual Report on Form 10-K for the year ended December 31, 2007 as filed with the SEC.

Use of Estimates

These Condensed Consolidated Financial Statements include certain amounts that are based on our best estimates and judgments. These estimates require us to apply complex assumptions and judgments, often because they involve matters that are inherently uncertain and will likely change in subsequent periods. Our most significant estimates relate to medical costs, medical costs payable, revenues, intangible asset valuations, asset impairments, investment valuation and contingent liabilities. We adjust these estimates each period, as more current information becomes available. The impact of any changes in estimates is included in the determination of earnings in the period in which the estimate is adjusted.

Recent Accounting Standards

Recently Adopted Accounting Standards

In February 2007, the Financial Accounting Standards Board (FASB) issued FAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115 (FAS 159). FAS 159 expands the use of fair value accounting but does not affect existing standards that require assets or liabilities to be carried at fair value. Under FAS 159, a company may elect to use fair value to measure various assets and liabilities including accounts receivable, available-for-sale and held-to-maturity securities, equity method investments, accounts payable, guarantees and issued debt. The fair value election is irrevocable and generally made on an instrument-by-instrument basis, even if a company has similar instruments that it elects not to measure based on fair value. We adopted FAS 159 as of January 1, 2008 and elected the fair value option for the AARP Assets Under Management on the Condensed Consolidated Balance Sheet as of that date. The impact of adoption of FAS 159 was not significant to the Company. For a discussion of the instruments for which the fair value option was applied, see Note 11 of Notes to the Condensed Consolidated Financial Statements.

In September 2006, the FASB issued FAS No. 157, Fair Value Measurements (FAS 157). FAS 157 provides enhanced guidance for using fair value to measure assets and liabilities. It does not require any new fair value measurements, but does require expanded disclosures to provide information about the extent to which fair value is used to measure assets and liabilities, the methods and assumptions used to measure fair value, and the effect of fair value measures on earnings. In February 2008, the FASB issued FASB Staff Position FAS 157-2,

Table of Contents

UNITEDHEALTH GROUP

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Effective Date of FASB Statement No. 157 (FSP). The FSP delayed, for one year, the effective date of FAS 157 for all nonfinancial assets and liabilities, except those that are recognized or disclosed in the financial statements on at least an annual basis. We adopted FAS 157 as of January 1, 2008, except for those provisions deferred under the FSP. Refer to Note 10 of Notes to the Condensed Consolidated Financial Statements for additional discussion. FAS 157 is effective for financial assets and liabilities recognized or disclosed in our Condensed Consolidated Financial Statements. The deferred provisions of FAS 157 will be effective in 2009. We are currently evaluating the impact, if any, of the deferred provisions of FAS 157 on our fiscal year 2009 Consolidated Financial Statements.

Recently Issued Accounting Standards

In March 2008, the FASB issued FAS No. 161, Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133 (FAS 161). FAS 161 amends and expands the disclosure requirements of FAS 133 to require qualitative disclosure about objectives and strategies for using derivatives; quantitative disclosures about fair value amounts and gains and losses on derivative instruments; and disclosures about credit-risk-related contingent features in derivative agreements. The statement is intended to improve financial reporting about derivative instruments and hedging activities through the enhanced disclosures in order to enable investors to better understand their effects on an entity s financial position, financial performance, and cash flows. The provisions of FAS 161 are effective for our fiscal year 2009. FAS 161 is expected to expand our disclosures concerning derivative instruments upon adoption, including our interest rate swaps.

In December 2007, the FASB issued FAS No. 141 (Revised 2007), Business Combinations (FAS 141R), which replaces FAS No. 141, Business Combinations. FAS 141R establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree and the goodwill acquired. The statement also establishes disclosure requirements that will enable users to evaluate the nature and financial effects of the business combination. FAS 141R is effective for our fiscal year 2009 and must be applied prospectively to all new acquisitions closing on or after January 1, 2009. Early adoption of this standard is not permitted. We are currently evaluating the impact, if any, of FAS 141R on our Consolidated Financial Statements.

In December 2007, the FASB issued FAS No. 160, Noncontrolling Interests in Consolidated Financial Statements An Amendment of ARB No. 51 (FAS 160). FAS 160 requires that accounting and reporting for minority interests be recharacterized as noncontrolling interests and classified as a component of equity. The standard is effective for our fiscal year 2009 and must be applied prospectively. We do not expect that the adoption of FAS 160 will have a material impact on our Consolidated Financial Statements.

2. Medicare Part D Pharmacy Benefits Contract

Beginning January 1, 2006, the Company began serving as a plan sponsor offering Medicare Part D prescription drug insurance coverage under contracts with the Centers for Medicare & Medicaid Services (CMS). Under the Medicare Part D program, there are six separate elements of payment received by the Company during the plan year. These payment elements are as follows:

CMS Premium CMS pays a fixed monthly premium per member to the Company for the entire plan year.

Member Premium Additionally, certain members pay a fixed monthly premium to the Company for the entire plan year.

Low-Income Premium Subsidy For qualifying low-income members, CMS pays some or all of the member s monthly premiums to the Company on the member s behalf.

Table of Contents

UNITEDHEALTH GROUP

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Catastrophic Reinsurance Subsidy CMS pays the Company a cost reimbursement estimate monthly to fund the CMS obligation to pay approximately 80% of the costs incurred by individual members in excess of the individual annual out-of-pocket maximum of $4,050 and $3,850 as of January 1, 2008 and 2007, respectively. A settlement is made based on actual cost experience subsequent to the end of the plan year.

Low-Income Member Cost Sharing Subsidy For qualifying low-income members, CMS pays on the member s behalf some or all of a member s cost sharing amounts, such as deductibles and coinsurance. The cost sharing subsidy is funded by CMS through monthly payments to the Company. The Company administers and pays the subsidized portion of the claims on behalf of CMS, and a settlement payment is made between CMS and the Company based on actual claims experience, subsequent to the end of the plan year.

CMS Risk-Share Effective January 1, 2008, if the ultimate per member per month benefit costs of any Medicare Part D regional plan varies more than 5% above or below the level estimated in the original bid submitted by the Company and approved by CMS, there is a risk-share settlement with CMS subsequent to the end of the plan year. During the prior plan year, the risk-share provisions took effect if actual costs were more than 2.5% above or below the level originally submitted. The risk-share adjustment, if any, is recorded as an adjustment to premium revenues and other receivables or liabilities.

The CMS Premium, the Member Premium, and the Low-Income Premium Subsidy represent payments for the Company s insurance risk coverage under the Medicare Part D program and, therefore, are recorded as Premium Revenues in the Condensed Consolidated Statements of Operations. Premium revenues are recognized ratably over the period in which eligible individuals are entitled to receive prescription drug benefits. We record premium payments received in advance of the applicable service period in Unearned Premiums in the Condensed Consolidated Balance Sheets.

The Catastrophic Reinsurance Subsidy and the Low-Income Member Cost Sharing Subsidy represent cost reimbursements under the Medicare Part D program. The Company is fully reimbursed by CMS for costs incurred for these contract elements and, accordingly, there is no insurance risk to the Company. Amounts received for these subsidies are not reflected as premium revenues, but rather are accounted for as deposits, within Other Policy Liabilities in the Condensed Consolidated Balance Sheets. Related cash flows are presented as Customer Funds Administered within financing cash flows in the Condensed Consolidated Statements of Cash Flows. As of March 31, 2008, amounts on deposit for these subsidies for the 2008 and prior contract years were approximately $410 million and $300 million, respectively.

Pharmacy benefit costs and administrative costs under the contract are expensed as incurred and are recognized in Medical Costs and Operating Costs, respectively, in the Condensed Consolidated Statements of Operations.

As a result of the Medicare Part D product benefit design, the Company incurs a disproportionate amount of pharmacy benefit costs early in the contract year. While the Company is responsible for approximately 67% of a Medicare Part D beneficiary s drug costs up to $2,510, the beneficiary is responsible for 100% of their drug costs from $2,510 up to $5,726 (at the Company s discounted purchase price). Consequently, the Company incurs a disproportionate amount of pharmacy benefit costs in the first half of the contract year as compared with the last half of the contract year, when comparatively more members will be incurring claims above the $2,510 initial coverage limit. The uneven timing of Medicare Part D pharmacy benefit claims results in losses in the first half of the year that entitle the Company to risk-share adjustment payments from CMS. Accordingly, during the interim periods within the contract year we record a net risk-share receivable from CMS in Other Current Assets in the Condensed Consolidated Balance Sheets and a corresponding retrospective premium adjustment in Premium Revenues in the Condensed Consolidated Statements of Operations. This represents the estimated amount payable by CMS to the Company under the risk-share contract provisions if the program were terminated based on estimated costs incurred through that interim period. Those losses are typically expected to reverse in the second half of the year.

Table of Contents

UNITEDHEALTH GROUP

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The risk-share receivable from CMS for the 2008 contract year through March 31, 2008 was approximately $480 million. The final risk-share amount is expected to be settled approximately six months after the contract year-end. The risk-share payable due to CMS as of March 31, 2008 for the prior contract years was approximately $95 million, subject to the reconciliation process with CMS, which is expected to be settled by the end of 2008. The net risk-share receivable from CMS of approximately $385 million and $205 million was recorded in Other Current Assets in the Condensed Consolidated Balance Sheets as of March 31, 2008 and 2007, respectively. As of December 31, 2007, there was a net risk-share payable of approximately $280 million recorded in Other Policy Liabilities in the Condensed Consolidated Balance Sheets.

Total premium revenues from CMS related to the Medicare Part D program and all other Medicare-related programs were approximately 25% and 24% of our total consolidated revenues for the three months ended March 31, 2008 and 2007, respectively.

3. Acquisitions

On February 25, 2008, we acquired all of the outstanding shares of Sierra Health Services, Inc. (Sierra), a diversified health care services company based in Las Vegas, Nevada, for approximately $2.6 billion in cash, representing a price of $43.50 per share of Sierra common stock. This acquisition strengthened our position in the rapidly growing southwest region of the United States. The U.S. Department of Justice approved the acquisition conditioned upon the divestiture of our individual SecureHorizons Medicare Advantage HMO plans in Clark and Nye Counties, Nevada, which represented approximately 27,000 members. The divestiture was completed on April 30, 2008. On a preliminary basis, the total consideration paid related to this acquisition exceeded our estimated fair value of the net tangible assets acquired by approximately $2.5 billion, of which we have allocated $528 million to finite-lived intangible assets and $2.0 billion to goodwill. The allocation is pending completion of a valuation analysis. The finite-lived intangible assets primarily consist of a provider network, trademarks, and customer-related intangibles with estimated weighted-average useful lives of 15, 20, and 14 years, respectively. The acquired goodwill is not deductible for income tax purposes. The results of operations and financial condition of Sierra have been included in our consolidated results and the results of our Health Care Services and OptumHealth segments since the acquisition date. The pro forma effects of this acquisition on our Condensed Consolidated Financial Statements were not material.

On January 10, 2008, we acquired all of the outstanding shares of Fiserv Health, Inc. (Fiserv Health), a subsidiary of Fiserv, Inc., for approximately $740 million in cash. Fiserv Health is a leading administrator of medical benefits and also provides care facilitation services, specialty health solutions and pharmacy benefit management (PBM) services. This transaction allows us to expand the capacity of our existing benefits administration businesses and enables existing and new customers to leverage our full range of assets, including ancillary services, our national network and technology tools. On a preliminary basis, the total consideration paid related to this acquisition exceeded our estimated fair value of the net tangible assets acquired by approximately $754 million, of which we have allocated $253 million to finite-lived intangible assets and $501 million to goodwill. The allocation is pending completion of a valuation analysis. The finite-lived intangible assets primarily consist of trademarks and customer-related intangibles with estimated weighted-average useful lives of 3 and 12 years, respectively. The acquired goodwill is deductible for income tax purposes. The results of operations and financial condition of Fiserv Health have been included in our consolidated results and the results of our Health Care Services, OptumHealth, Ingenix and Prescription Solutions segments since the acquisition date. The pro forma effects of this acquisition on our Condensed Consolidated Financial Statements were not material.

On January 8, 2008, we announced that AmeriChoice had signed a definitive agreement to acquire Unison Health Plans (Unison). Unison provides government-sponsored health plan coverage to approximately 370,000 people in Pennsylvania, Ohio, Tennessee, Delaware and South Carolina through a network of independent health care

Table of Contents

UNITEDHEALTH GROUP

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

professionals. This all-cash transaction is expected to close by the end of the second quarter of 2008, subject to required regulatory approvals and other customary conditions. The pro forma effects of this acquisition on our Consolidated Financial Statements are not expected to be material.

For the three months ended March 31, 2008, aggregate consideration paid, net of cash assumed and other effects, for smaller acquisitions was $9 million. The acquisitions were not material to our Condensed Consolidated Financial Statements.

4. Cash, Cash Equivalents and Investments

As of March 31, 2008 and December 31, 2007, the amortized cost, gross unrealized gains and losses, and fair value of cash, cash equivalents and investments were as follows:

(in millions)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
March 31, 2008				
Cash and Cash Equivalents	$ 6,275	$	$	$ 6,275
Debt Securities Available for Sale:				
U.S. Government and Agency obligations	3,692	89	(2)	3,779
State and Municipal obligations				