

CENTENE CORP  
Form 10-Q  
October 25, 2011

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549

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FORM 10-Q

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(Mark One)

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

For the quarterly period ended September 30, 2011

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

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Commission file number: 001-31826

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

Delaware  
(State or other jurisdiction of  
incorporation or organization)

42-1406317  
(I.R.S. Employer  
Identification Number)

7700 Forsyth Boulevard  
St. Louis, Missouri  
(Address of principal executive offices)

63105  
(Zip Code)

Registrant's telephone number, including area code:

(314) 725-4477

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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: T Yes  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). T Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer”, “accelerated filer” and “small reporting company” in Rule 12b-2 of the Exchange Act. Large accelerated filer T Accelerated filer  Non-accelerated filer  (do not check if a smaller reporting company) 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 T

As of October 14, 2011, the registrant had 50,378,693 shares of common stock outstanding.

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CENTENE CORPORATION  
QUARTERLY REPORT ON FORM 10-Q

TABLE OF CONTENTS

	PAGE	
Part I		
Financial Information		
Item 1.	<u>Financial Statements</u>	
	<u>Consolidated Balance Sheets as of September 30, 2011 and December 31, 2010 (unaudited)</u>	1
	<u>Consolidated Statements of Operations for the Three and Nine Months Ended September 30, 2011 and 2010 (unaudited)</u>	2
	<u>Consolidated Statement of Stockholders' Equity for the Nine Months Ended September 30, 2011 (unaudited)</u>	3
	<u>Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2011 and 2010 (unaudited)</u>	4
	<u>Notes to the Consolidated Financial Statements (unaudited)</u>	5
Item 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	10
Item 3.	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	16
Item 4.	<u>Controls and Procedures</u>	16
Part II		
Other Information		
Item 1.	<u>Legal Proceedings</u>	17
Item 1A.	<u>Risk Factors</u>	17
Item 2.	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	23
Item 6.	<u>Exhibits</u>	24
	<u>Signatures</u>	25

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Table of Contents

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 have attempted to identify these statements by terminology including “believe,” “anticipate,” “plan,” “expect,” “estimate,” “intend,” “seek,” “target,” “goal,” “may,” “will,” “should,” “can,” “continue” and other similar words or expressions in connection with, among other things, any discussion of future operating or financial performance. In particular, these statements include statements about our market opportunity, our growth strategy, competition, expected activities and future acquisitions, investments and the adequacy of our available cash resources. These statements may be found in the various sections of this filing, including those entitled “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” 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 and 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. Actual results may differ from projections or estimates due to a variety of important factors, including:

- our ability to accurately predict and effectively manage health benefits and other operating expenses;
    - competition;
    - membership and revenue projections;
    - timing of regulatory contract approval;
    - changes in healthcare practices;
  - changes in federal or state laws or regulations, including the Patient Protection and Affordable Care Act and the Health Care and Education Affordability Reconciliation Act and any regulations enacted thereunder;
    - inflation;
    - provider contract changes;
      - new technologies;
    - reduction in provider payments by governmental payors;
      - major epidemics;
    - disasters and numerous other factors affecting the delivery and cost of healthcare;
  - the expiration, cancellation or suspension of our Medicaid managed care contracts by state governments;
    - availability of debt and equity financing, on terms that are favorable to us; and
    - general economic and market conditions.
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Table of Contents

## PART I

## FINANCIAL INFORMATION

## ITEM 1. Financial Statements.

## CENTENE CORPORATION AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

(In thousands, except share data)

(Unaudited)

	September 30, 2011	December 31, 2010
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents of continuing operations	\$451,657	\$433,914
Cash and cash equivalents of discontinued operations	—	252
Total cash and cash equivalents	451,657	434,166
Premium and related receivables, net of allowance for uncollectible accounts of \$592 and \$17, respectively	139,467	136,243
Short-term investments, at fair value (amortized cost \$104,914 and \$21,141, respectively)	106,344	21,346
Other current assets	68,908	64,154
Current assets of discontinued operations other than cash	—	912
Total current assets	766,376	656,821
Long-term investments, at fair value (amortized cost \$521,229 and \$585,862, respectively)	530,452	595,879
Restricted deposits, at fair value (amortized cost \$26,697 and \$22,755, respectively)	26,768	22,758
Property, software and equipment, net of accumulated depreciation of \$166,442 and \$138,629, respectively	345,600	326,341
Goodwill	281,981	278,051
Intangible assets, net	28,795	29,109
Other long-term assets	57,526	30,057
Long-term assets of discontinued operations	—	4,866
Total assets	\$2,037,498	\$1,943,882
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Medical claims liability	\$498,705	\$456,765
Accounts payable and accrued expenses	173,708	185,218
Unearned revenue	54,764	117,344
Current portion of long-term debt	3,203	2,817
Current liabilities of discontinued operations	—	3,102
Total current liabilities	730,380	765,246
Long-term debt	348,093	327,824
Other long-term liabilities	54,926	53,378
Long-term liabilities of discontinued operations	—	379

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Total liabilities	1,133,399	1,146,827
Commitments and contingencies		
Stockholders' equity:		
Common stock, \$.001 par value; authorized 100,000,000 shares; 52,921,255 issued and 50,377,774 outstanding at September 30, 2011, and 52,172,037 issued and 49,616,824 outstanding at December 31, 2010	53	52
Additional paid-in capital	411,924	384,206
Accumulated other comprehensive income:		
Unrealized gain on investments, net of tax	6,478	6,424
Retained earnings	534,849	453,743
Treasury stock, at cost (2,543,481 and 2,555,213 shares, respectively)	(50,594 )	(50,486 )
Total Centene stockholders' equity	902,710	793,939
Noncontrolling interest	1,389	3,116
Total stockholders' equity	904,099	797,055
Total liabilities and stockholders' equity	\$2,037,498	\$1,943,882

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

Table of Contents

CENTENE CORPORATION AND SUBSIDIARIES  
 CONSOLIDATED STATEMENTS OF OPERATIONS  
 (In thousands, except share data)  
 (Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
<b>Revenues:</b>				
Premium	\$ 1,239,464	\$ 1,060,559	\$ 3,640,829	\$ 3,085,802
Service	25,817	20,954	81,629	68,543
Premium and service revenues	1,265,281	1,081,513	3,722,458	3,154,345
Premium tax	36,754	40,348	110,948	113,009
Total revenues	1,302,035	1,121,861	3,833,406	3,267,354
<b>Expenses:</b>				
Medical costs	1,028,586	893,281	3,021,400	2,592,324
Cost of services	20,229	14,646	60,717	47,505
General and administrative expenses	167,668	132,095	496,674	401,072
Premium tax	37,005	41,591	111,668	114,885
Total operating expenses	1,253,488	1,081,613	3,690,459	3,155,786
Earnings from operations	48,547	40,248	142,947	111,568
<b>Other income (expense):</b>				
Investment and other income	2,697	713	9,379	11,912
Debt extinguishment costs	—	—	(8,488)	—
Interest expense	(4,572)	(4,858)	(15,523)	(12,540)
Earnings from continuing operations, before income tax expense	46,672	36,103	128,315	110,940
Income tax expense	18,459	13,163	49,216	42,942
Earnings from continuing operations, net of income tax expense	28,213	22,940	79,099	67,998
Discontinued operations, net of income tax expense of \$0, \$26, \$0 and \$4,376, respectively	—	260	—	3,954
Net earnings	28,213	23,200	79,099	71,952
Noncontrolling interest (loss)	(774)	538	(2,007)	2,515
Net earnings attributable to Centene Corporation	\$ 28,987	\$ 22,662	\$ 81,106	\$ 69,437
<b>Amounts attributable to Centene Corporation common stockholders:</b>				
Earnings from continuing operations, net of income tax expense	\$ 28,987	\$ 22,402	\$ 81,106	\$ 65,483
Discontinued operations, net of income tax expense	—	260	—	3,954
Net earnings	\$ 28,987	\$ 22,662	\$ 81,106	\$ 69,437
<b>Net earnings per common share attributable to Centene Corporation:</b>				
<b>Basic:</b>				
Continuing operations	\$ 0.58	\$ 0.46	\$ 1.62	\$ 1.35
Discontinued operations	—	—	—	0.08

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Earnings per common share	\$	0.58	\$	0.46	\$	1.62	\$	1.43
Diluted:								
Continuing operations	\$	0.55	\$	0.44	\$	1.55	\$	1.30
Discontinued operations		—		—		—		0.08
Earnings per common share	\$	0.55	\$	0.44	\$	1.55	\$	1.38
Weighted average number of shares outstanding:								
Basic		50,345,512		49,238,406		50,089,845		48,552,135
Diluted		52,620,350		50,938,357		52,320,906		50,192,190

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



Table of Contents

## CENTENE CORPORATION AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

(In thousands, except share data)

(Unaudited)

Nine Months Ended September 30, 2011

	Centene Stockholders' Equity								
	Common Stock					Treasury Stock			
	\$.001 Par Value Shares	Amt	Accumulated			\$.001 Par Value Shares	Amt	Non controlling Interest	Total
			Additional Paid-in Capital	Other Comprehensive Income	Retained Earnings				
Balance, December 31, 2010	52,172,037	\$ 52	\$ 384,206	\$ 6,424	\$ 453,743	2,555,213	\$ (50,486)	\$ 3,116	\$ 797,055
Comprehensive Earnings:									
Net earnings	—	—	—	—	81,106	—	—	(2,007)	79,099
Change in unrealized investment gain, net of \$50 tax	—	—	—	54	—	—	—	—	54
Total comprehensive earnings									79,153
Common stock issued for employee benefit plans	749,218	1	13,005	—	—	—	—	—	13,006
Issuance of stock warrants	—	—	—	—	—	(50,000)	1,172	—	1,172
Common stock repurchases	—	—	—	—	—	38,268	(1,280)	—	(1,280)
Stock compensation expense	—	—	13,263	—	—	—	—	—	13,263
Excess tax benefits from stock compensation	—	—	1,450	—	—	—	—	—	1,450
Contribution from Noncontrolling interest	—	—	—	—	—	—	—	569	569
Deconsolidation of Noncontrolling interest	—	—	—	—	—	—	—	(289)	(289)
	52,921,255	\$ 53	\$ 411,924	\$ 6,478	\$ 534,849	2,543,481	\$ (50,594)	\$ 1,389	\$ 904,099

Balance,  
September 30,  
2011

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

3

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Table of Contents

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

	Nine Months Ended September 30,	
	2011	2010
Cash flows from operating activities:		
Net earnings	\$79,099	\$71,952
Adjustments to reconcile net earnings to net cash provided by operating activities		
Depreciation and amortization	43,055	38,620
Stock compensation expense	13,263	10,224
Gain on sale of investments, net	(213 )	(6,331 )
Debt extinguishment costs	8,488	—
Gain on sale of UHP	—	(8,201 )
Impairment of investment	—	5,531
Deferred income taxes	(223 )	7,012
Changes in assets and liabilities		
Premium and related receivables	(13,306 )	(68,125 )
Other current assets	(6,667 )	(2,932 )
Other assets	(1,230 )	(990 )
Medical claims liabilities	40,476	(29,304 )
Unearned revenue	(65,183 )	(38,708 )
Accounts payable and accrued expenses	(11,414 )	(3,174 )
Other operating activities	3,528	(1,267 )
Net cash provided by (used in) operating activities	89,673	(25,693 )
Cash flows from investing activities:		
Capital expenditures	(52,931 )	(50,353 )
Capital expenditures of Centene Center LLC	(4,007 )	(41,607 )
Purchases of investments	(201,145 )	(382,730 )
Proceeds from asset sales	—	13,420
Sales and maturities of investments	180,124	452,128
Investments in acquisitions, net of cash acquired	(3,192 )	(26,847 )
Net cash used in investing activities	(81,151 )	(35,989 )
Cash flows from financing activities:		
Proceeds from exercise of stock options	13,582	2,394
Proceeds from borrowings	419,183	53,812
Proceeds from stock offering	—	104,534
Payment of long-term debt	(415,475 )	(97,467 )
Contributions from (distributions to) noncontrolling interest	569	(7,387 )
Excess tax benefits from stock compensation	1,632	424
Common stock repurchases	(1,280 )	(714 )
Debt issue costs	(9,242 )	—
Net cash provided by financing activities	8,969	55,596
Net increase (decrease) in cash and cash equivalents	17,491	(6,086 )

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Cash and cash equivalents, beginning of period	434,166	403,752
Cash and cash equivalents, end of period	\$451,657	\$397,666

Supplemental disclosures of cash flow information:

Interest paid	\$16,097	\$9,501
Income taxes paid	\$49,996	\$44,407

Supplemental disclosure of non-cash investing and financing activities:

Contribution from noncontrolling interest	\$—	\$306
Capital expenditures	\$(4,833 )	\$15,291

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

Table of Contents

## CENTENE CORPORATION AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except share data)

(Unaudited)

## 1. 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, 2010. 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, 2010 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 2010 amounts in the consolidated financial statements have been reclassified to conform to the 2011 presentation. These reclassifications have no effect on net earnings or stockholders' equity as previously reported.

## 2. Acquisitions

— Casenet, LLC. In December 2010, the Company acquired an additional ownership interest in Casenet, LLC for total consideration of \$6,619, bringing its ownership interest to 68%. The Company finalized the allocation of the fair value which resulted in goodwill of \$8,975, other identifiable intangible assets of \$3,561 and unearned revenue of \$7,247. All of the goodwill is deductible for income tax purposes. During the third quarter of 2011, the Company increased its ownership interest in Casenet to 77% through additional investments.

— Citrus Health Care, Inc. In December 2010, the Company acquired certain assets in non-reform counties of Citrus Health Care, Inc., a Florida Medicaid and long term care health plan for \$28,689. The Company finalized the allocation of the fair value which resulted in goodwill of \$19,069 and other identifiable intangible assets of \$9,620. All of the goodwill is deductible for income tax purposes.

## 3. Investments and Restricted Deposits

Short-term and long-term investments and restricted deposits by investment type consist of the following:

	September 30, 2011			December 31, 2010			Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 29,045	\$ 691	\$ (2 )	\$ 28,665	\$ 510	\$ (140 )	\$ 29,035
Corporate securities	189,380	3,825	(757 )	197,577	3,124	(586 )	200,115

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Restricted certificates of deposit	5,890	—	—	5,890	6,814	—	—	6,814
Restricted cash equivalents	13,488	—	—	13,488	8,814	—	—	8,814
Municipal securities:								
General obligation	117,544	3,167	(57 )	120,654	109,866	3,601	(6 )	113,461
Pre-refunded	32,682	613	—	33,295	32,442	756	—	33,198
Revenue	114,675	2,768	(16 )	117,427	100,198	2,781	(15 )	102,964
Variable rate demand notes	108,723	—	—	108,723	106,540	—	—	106,540
Asset backed securities	18,714	492	—	19,206	17,391	243	(43 )	17,591
Cost method investments and equity method securities	8,076	—	—	8,076	7,060	—	—	7,060
Life insurance contracts	14,623	—	—	14,623	14,391	—	—	14,391
Total	\$ 652,840	\$ 11,556	\$ (832 )	\$ 663,564	\$ 629,758	\$ 11,015	\$ (790 )	\$ 639,983

The Company's investments are classified as available-for-sale with the exception of life insurance contracts and certain cost method 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 September 30, 2011, 36% of the Company's investments in securities recorded at fair value that carry a rating by Moody's or S&P were rated AAA, 77% were rated AA- or higher, and 99% were rated A- or higher. At September 30, 2011, the Company held certificates of deposit, life insurance contracts and cost and equity method investments which did not carry a credit rating.

The fair value of available-for-sale investments 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:

	September 30, 2011				December 31, 2010			
	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 )	\$ 2,117	\$ —	\$ —	\$ (140 )	\$ 9,246	\$ —	\$ —
Corporate securities	(757 )	29,224	—	—	(586 )	40,341	—	—
Municipal securities:								
General obligation	(57 )	7,676	—	—	(6 )	1,131	—	—
Revenue	(16 )	7,039	—	—	(15 )	2,419	—	—
Asset backed securities	—	—	—	—	(43 )	5,276	—	—
Total	\$ (832 )	\$ 46,056	\$ —	\$ —	\$ (790 )	\$ 58,413	\$ —	\$ —

As of September 30, 2011, the gross unrealized losses were generated from 25 positions out of a total of 410 positions. The decline in fair value of fixed income securities is 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.

Table of Contents

The contractual maturities of short-term and long-term investments and restricted deposits are as follows:

	September 30, 2011				December 31, 2010			
	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	\$ 104,914	\$ 106,344	\$ 19,605	\$ 19,606	\$ 21,141	\$ 21,346	\$ 17,387	\$ 17,392
One year through five years	391,281	400,055	7,092	7,162	464,270	474,255	5,368	5,366
Five years through ten years	35,748	35,748	—	—	39,732	39,731	—	—
Greater than ten years	94,200	94,649	—	—	81,860	81,893	—	—
Total	\$ 626,143	\$ 636,796	\$ 26,697	\$ 26,768	\$ 607,003	\$ 617,225	\$ 22,755	\$ 22,758

Actual maturities may differ from contractual maturities due to call or prepayment options. Asset backed securities are included in the one year through five years category, while equity securities 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.

Realized gains and losses are determined on the basis of specific identification or a first-in, first-out methodology, if specific identification is not practicable. The Company's gross recorded realized gains and losses on investments were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Gains	\$ 107	\$ 2,310	\$ 240	\$ 6,027
Losses	(1 )	(23 )	(27 )	(268 )
Impairment of investment	—	(5,531 )	—	(5,531 )
Net realized (losses) gains	\$ 106	\$ (3,244 )	\$ 213	\$ 228

Realized gains in the nine months ended September 30, 2010 included a net realized gain of \$2,472 related to sales of fixed income investments and also included realized gains of \$3,287 representing a distribution from the Reserve Primary fund in excess of our adjusted basis.

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 cost 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.

During the quarter ended September 30, 2010, the Company determined it had an other-than-temporary impairment of a cost method investment in a start-up company that provides software to automate the clinical, administrative, and



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technical components of care management programs. As a result, the Company recorded an impairment charge of \$5,531, including \$3,531 of convertible promissory notes. The impairment charge is included in investment and other income for the quarter.

Investment amortization of \$7,545 and \$8,380 was recorded in the nine months ended September 30, 2011 and 2010, respectively.

#### 4. Fair Value Measurements

Assets and liabilities recorded at fair value in the consolidated balance sheets are categorized based upon the extent to which the fair value estimates are based upon observable or unobservable inputs. 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.

The following table summarizes fair value measurements by level at September 30, 2011, for assets measured at fair value on a recurring basis:

	Level I	Level II	Level III	Total
Assets				
Cash and cash equivalents	\$451,657	\$	\$	\$451,657
Investments available for sale:				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$17,019	\$5,325	\$	\$22,344
Corporate securities		192,448		192,448
Municipal securities:				
General obligation		120,654		120,654
Pre-refunded		33,295		33,295
Revenue		117,427		117,427
Variable rate demand notes		108,723		108,723
Asset backed securities		19,206		19,206
Total investments	\$17,019	\$597,078	\$	\$614,097
Restricted deposits available for sale:				
Cash and cash equivalents	\$13,488	\$	\$	\$13,488
Certificates of deposit	5,890			5,890