MOLINA HEALTHCARE INC
Form 10-Q
November 01, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)
ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 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: 001-31719

MOLINA HEALTHCARE, INC.
(Exact name of registrant as specified in its charter)

Delaware	13-4204626
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
200 Oceangate, Suite 100 Long Beach, California	90802
(Address of principal executive offices)	(Zip Code)

(562) 435-3666
(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 ý 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý 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 emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer ý	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨
	Emerging growth company ¨

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 ¨

Section13(a) of the Exchange Act.
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes ¨ No ý
The number of shares of the issuer's Common Stock, $0.001 par value, outstanding as of October 26, 2018, was approximately 62,389,000.

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MOLINA HEALTHCARE, INC. FORM 10-Q
FOR THE QUARTERLY PERIOD ENDED September 30, 2018

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CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(In millions, except per-share data) (Unaudited)			
Revenue:				
Premium revenue	$4,337	$4,777	$13,174	$14,165
Service revenue	130	130	391	390
Premium tax revenue	110	106	320	331
Health insurer fees reimbursed	83	—	248	—
Investment income and other revenue	37	18	93	48
Total revenue	4,697	5,031	14,226	14,934
Operating expenses:				
Medical care costs	3,790	4,220	11,362	12,822
Cost of service revenue	111	123	349	369
General and administrative expenses	311	383	998	1,227
Premium tax expenses	110	106	320	331
Health insurer fees	87	—	261	—
Depreciation and amortization	25	33	76	109
Restructuring and separation costs	5	118	38	161
Impairment losses	—	129	—	201
Total operating expenses	4,439	5,112	13,404	15,220
Gain on sale of subsidiary	37	—	37	—
Operating income (loss)	295	(81)	859	(286)
Other expenses, net:				
Interest expense	26	32	91	85
Other expenses (income), net	10	—	25	(75)
Total other expenses, net	36	32	116	10
Income (loss) before income tax expense (benefit)	259	(113)	743	(296)
Income tax expense (benefit)	62	(16)	237	(46)
Net income (loss)	$197	$(97)	$506	$(250)
Net income (loss) per share:				
Basic	$3.22	$(1.70)	$8.32	$(4.44)
Diluted	$2.90	$(1.70)	$7.60	$(4.44)

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(In millions) (Unaudited)			
Net income (loss)	$197	$(97)	$506	$(250)
Other comprehensive income (loss):				

Unrealized investment gain (loss)	1	1	(5)	2
Less: effect of income taxes	—	1	(1)	1
Other comprehensive income (loss), net of tax	1	—	(4)	1
Comprehensive income (loss)	$198	$(97)	$502	$(249)

See accompanying notes.

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CONSOLIDATED BALANCE SHEETS

	September 30, 2018		December 31, 2017	
	(In millions, except per-share data) (Unaudited)			
ASSETS				
Current assets:				
Cash and cash equivalents	$	2,814	$	3,186
Investments	1,812		2,524	
Restricted investments	—		169	
Receivables	1,346		871	
Prepaid expenses and other current assets	486		239	
Derivative asset	843		522	
Total current assets	7,301		7,511	
Property, equipment, and capitalized software, net	264		342	
Goodwill and intangible assets, net	195		255	
Restricted investments	118		119	
Deferred income taxes	143		103	
Other assets	30		141	
	$	8,051	$	8,471
LIABILITIES AND STOCKHOLDERS' EQUITY				
Current liabilities:				
Medical claims and benefits payable	$	2,042	$	2,192
Amounts due government agencies	1,030		1,542	
Accounts payable and accrued liabilities	824		366	
Deferred revenue	178		282	
Current portion of long-term debt	296		653	
Derivative liability	843		522	
Total current liabilities	5,213		5,557	
Long-term debt	1,019		1,318	
Lease financing obligations	198		198	
Other long-term liabilities	60		61	
Total liabilities	6,490		7,134	
Stockholders' equity:				
Common stock, $0.001 par value, 150 shares	—		—	

authorized; outstanding: 62 shares at September 30, 2018 and 60 shares at December 31, 2017		
Preferred stock, $0.001 par value; 20 shares authorized, no shares issued and outstanding	—	—
Additional paid-in capital	760	1,044
Accumulated other comprehensive loss	(10)	(5)
Retained earnings	811	298
Total stockholders' equity	1,561	1,337
	$ 8,051	$ 8,471

See accompanying notes.

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CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

	Common Stock Outstanding	Common Stock Amount	Additional Paid-in Capital	Accumulated Other Comprehensive Loss	Retained Earnings	Total
	(In millions) (Unaudited)					
Balance at January 1, 2018	60	$ —	$ 1,044	$ (5)	$ 298	$ 1,337
Net income	—	—	—	—	107	107
Adoption of Topic 606	—	—	—	—	6	6
Adoption of ASU 2018-02	—	—	—	(1)	1	—
Exchange of 1.625% Notes	2	—	108	—	—	108
Other comprehensive loss, net	—	—	—	(6)	—	(6)
Share-based compensation	—	—	1	—	—	1
Balance at March 31, 2018	62	—	1,153	(12)	412	1,553
Net income	—	—	—	—	202	202
Partial termination of 1.125% Warrants	—	—	(113)	—	—	(113)
Other comprehensive income, net	—	—	—	1	—	1
Share-based compensation	—	—	15	—	—	15
Balance at June 30, 2018	62	—	1,055	(11)	614	1,658
Net income	—	—	—	—	197	197
Partial termination of 1.125% Warrants	—	—	(306)	—	—	(306)
Conversion of 1.625% Notes	—	—	4	—	—	4
Other comprehensive income, net	—	—	—	1	—	1
Share-based compensation	—		7	—	—	7
Balance at September 30, 2018	62	$ —	$ 760	$ (10)	$ 811	$ 1,561

	Common Stock Outstanding	Common Stock Amount	Additional Paid-in Capital	Accumulated Other Comprehensive Loss	Retained Earnings	Total
	(In millions) (Unaudited)					
Balance at January 1, 2017	57	$ —	$ 841	$ (2)	$ 810	$ 1,649
Net income	—	—	—	—	77	77
Other comprehensive income, net	—	—	—	1	—	1
Balance at March 31, 2017	57	—	841	(1)	887	1,727
Net loss	—	—	—	—	(230)	(230)
Share-based compensation	—	—	24	—	—	24
Balance at June 30, 2017	57	—	865	(1)	657	1,521
Net loss	—	—	—	—	(97)	(97)
Share-based compensation	—	—	5	—	—	5
Balance at September 30, 2017	57	$ —	$ 870	$ (1)	$ 560	$ 1,429

See accompanying notes.

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CONSOLIDATED STATEMENTS OF CASH FLOWS

	Nine Months Ended September 30,	
	2018	2017
	(In millions) (Unaudited)	
Operating activities:		
Net income (loss)	$506	$(250)
Adjustments to reconcile net income (loss) to net cash (used in) provided by operating activities:		
Depreciation and amortization	104	139
Deferred income taxes	(32)	(68)
Share-based compensation	20	38
Non-cash restructuring costs	17	49
Amortization of convertible senior notes and lease financing obligations	18	24
Gain on sale of subsidiary	(37)	—
Loss on debt extinguishment	25	—
Impairment losses	—	201
Other, net	6	13
Changes in operating assets and liabilities:		
Receivables	(507)	(28)
Prepaid expenses and other current assets	(117)	(53)
Medical claims and benefits payable	(144)	549
Amounts due government agencies	(511)	122
Accounts payable and accrued liabilities	398	90
Deferred revenue	(55)	153
Income taxes	118	(22)
Net cash (used in) provided by operating activities	(191)	957
Investing activities:		
Purchases of investments	(1,202)	(1,894)
Proceeds from sales and maturities of investments	2,070	1,536
Purchases of property, equipment and capitalized software	(24)	(85)
Other, net	(23)	(33)
Net cash provided by (used in) investing activities	821	(476)
Financing activities:		
Repayment of credit facility	(300)	—
Repayment of principal amount of 1.125% Notes	(236)	—
Cash paid for partial settlement of 1.125% Conversion Option	(477)	—
Cash received for partial termination of 1.125% Call Option	477	—
Cash paid for partial termination of 1.125% Warrants	(419)	—
Repayment of principal amount of 1.625% Notes	(64)	—
Proceeds from senior notes offerings, net of issuance costs	—	325
Proceeds from borrowings under credit facility	—	300
Other, net	7	7
Net cash (used in) provided by financing activities	(1,012)	632
Net (decrease) increase in cash, cash equivalents, and restricted cash and cash equivalents	(382)	1,113
Cash, cash equivalents, and restricted cash and cash equivalents at beginning of period	3,290	2,912
Cash, cash equivalents, and restricted cash and cash equivalents at end of period	$2,908	$4,025

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CONSOLIDATED STATEMENTS OF CASH FLOWS
(continued)

	Nine Months Ended September 30,	
	2018	2017
	(In millions) (Unaudited)	
Supplemental cash flow information:		
Schedule of non-cash investing and financing activities:		
Common stock used for share-based compensation	$(6)	$(21)
Details of sale of subsidiary:		
Decrease in carrying amount of assets	$(243)	$—
Decrease in carrying amount of liabilities	59	—
Transaction costs	(12)	—
Receivable from buyer - recorded in prepaid expenses and other current assets	233	—
Gain on sale of subsidiary	$37	$—
Details of change in fair value of derivatives, net:		
Gain on 1.125% Call Option	$321	$158
Loss on 1.125% Conversion Option	(321)	(158)
Change in fair value of derivatives, net	$—	$—
1.625% Notes exchange transaction:		
Common stock issued in exchange for 1.625% Notes	$131	$—
Component of 1.625% Notes allocated to additional paid-in capital, net of income taxes	(23)	—
Net increase to additional paid-in capital	$108	$—

See accompanying notes.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
September 30, 2018

1. Organization and Basis of Presentation

Organization and Operations

Molina Healthcare, Inc. provides quality managed health care to people receiving government assistance. We offer cost-effective Medicaid-related solutions to meet the health care needs of low-income families and individuals, and to assist government agencies in their administration of the Medicaid program. We have three reportable segments, consisting of our Health Plans segment, which constitutes the vast majority of our operations; our Molina Medicaid Solutions segment; and our Other segment.

The Health Plans segment consists of health plans operating in 13 states and the Commonwealth of Puerto Rico. As of September 30, 2018, these health plans served approximately 4.0 million members eligible for Medicaid, Medicare, and other government-sponsored health care programs for low-income families and individuals. This membership includes Affordable Care Act Marketplace (Marketplace) members, most of whom receive government premium subsidies. The health plans are operated by our respective wholly owned subsidiaries in those states, each of which is licensed as a health maintenance organization (HMO).

Our health plans' state Medicaid contracts generally have terms of three to five years. These contracts typically contain renewal options exercisable by the state Medicaid agency, and allow either the state or the health plan to terminate the contract with or without cause. Such contracts are subject to risk of loss in states that issue requests for proposal (RFP) open to competitive bidding by other health plans. If one of our health plans is not a successful responsive bidder to a state RFP, its contract may not be renewed.

In addition to contract renewal, our state Medicaid contracts may be periodically amended to include or exclude certain health benefits (such as pharmacy services, behavioral health services, or long-term care services); populations such as the aged, blind or disabled (ABD); and regions or service areas.

The Molina Medicaid Solutions segment provides support to state government agencies' administration of their Medicaid programs, including business processing, information technology development and administrative services.

The Other segment includes primarily our behavioral health and social services provider subsidiary (Pathways), and corporate amounts not allocated to other reportable segments.

Recent Developments – Health Plans Segment

New Mexico Health Plan. In our Annual Report on Form 10-K for 2017, we reported that we were notified by the New Mexico Medicaid agency that we had not been selected for a tentative award of a 2019 Medicaid contract. A hearing was held on our judicial protest on October 17, 2018, with a decision expected in the fourth quarter of 2018. Regardless of the court's decision on our protest, we would have further rights of appeal. We are continuing to manage the business in run-off until such time as a different outcome is determined. As of September 30, 2018, we served approximately 206,000 Medicaid members in New Mexico, which represented premium revenue of $891 million for the nine months ended September 30, 2018.

Puerto Rico Health Plan. In July 2018, our Puerto Rico health plan was selected by the Puerto Rico Health Insurance Administration to be one of the organizations to administer the Commonwealth's new Medicaid Managed Care contract. We expect to serve approximately 290,000 members under the new contract. The base contract runs for a period of three years with an optional one-year extension. As of September 30, 2018, we served approximately 320,000 Medicaid members in the East and Southwest regions of Puerto Rico, which represented premium revenue of $549 million for the nine months ended September 30, 2018.

Florida Health Plan. In June 2018, our Florida health plan was awarded comprehensive Medicaid Managed Care contracts by the Florida Agency for Health Care Administration (AHCA) in Regions 8 and 11 of the Florida Statewide Medicaid Managed Care Invitation to Negotiate. As of September 30, 2018, we served approximately 96,000 Medicaid members in those regions, which represented premium revenue of approximately $346 million for the nine months ended September 30, 2018. Services under the new contract are expected to begin on January 1, 2019. We will be serving both the Medicaid and long-term care populations in the two regions.

Washington Health Plan. In May 2018, our Washington health plan was selected by the Washington State Health Care Authority (HCA) to enter into a managed care contract for the eight remaining regions of the state’s Apple Health Integrated Managed Care program, in addition to the two regions previously awarded to us. We were

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selected by HCA for the following regions: Greater Columbia, King, North Sound, Pierce, and Spokane beginning January 1, 2019; and Salish, Thurston-Mason, and Great Rivers beginning January 1, 2020. As of September 30, 2018, we served approximately 738,000 Medicaid members in Washington, which represented premium revenue of $1,558 million for the nine months ended September 30, 2018.

Recent Developments – Molina Medicaid Solutions Segment

We closed on the sale of Molina Medicaid Solutions (MMS) to DXC Technology Company on September 30, 2018. The net cash selling price for the equity interests of MMS was $233 million, which we received on October 1, 2018. As a result of this transaction, we recognized a pretax gain, net of transaction costs, of $37 million. Refer to Note 11, "Segments," for further information.

Subsequent Event – Other Segment

On October 19, 2018, we sold our Pathways subsidiary to Pyramid Health Holdings, LLC for a nominal purchase price. We expect to record a loss on sale of subsidiary amounting to approximately $40 million, net of income tax benefits.

Presentation and Reclassification

We have reclassified certain amounts in the 2017 consolidated statement of cash flows to conform to the 2018 presentation, relating to the presentation of restricted cash and cash equivalents. The reclassification is a result of our adoption of Accounting Standards Update (ASU) 2016-18, Restricted Cash effective January 1, 2018. See Note 2, "Significant Accounting Policies," for further information, including the amount reclassified.

We have combined certain line items in the accompanying consolidated balance sheets. For all periods presented, we have combined the presentation of:

- Income taxes refundable with "Prepaid expenses and other current assets;"
- Income taxes payable with "Accounts payable and accrued liabilities;"
- Goodwill, and intangible assets, net to a single line; and
- Deferred contract costs with "Other assets."

Consolidation and Interim Financial Information

The consolidated financial statements include the accounts of Molina Healthcare, Inc., its subsidiaries, and variable interest entities (VIEs) in which Molina Healthcare, Inc. is considered to be the primary beneficiary. Such VIEs are insignificant to our consolidated financial position and results of operations. In the opinion of management, all adjustments considered necessary for a fair presentation of the results as of the date and for the interim periods presented have been included; such adjustments consist of normal recurring adjustments. All significant intercompany balances and transactions have been eliminated. The consolidated results of operations for the nine months ended September 30, 2018 are not necessarily indicative of the results for the entire year ending December 31, 2018.

The unaudited consolidated interim financial statements have been prepared under the assumption that users of the interim financial data have either read or have access to our audited consolidated financial statements for the fiscal year ended December 31, 2017. Accordingly, certain disclosures that would substantially duplicate the disclosures contained in our December 31, 2017 audited consolidated financial statements have been omitted. These unaudited consolidated interim financial statements should be read in conjunction with our audited consolidated financial statements for the fiscal year ended December 31, 2017.

2. Significant Accounting Policies

Cash and Cash Equivalents

Cash and cash equivalents consist of cash and short-term, highly liquid investments that are both readily convertible into known amounts of cash and have a maturity of three months or less on the date of purchase. The following table provides a reconciliation of cash, cash equivalents, and restricted cash and cash equivalents reported within the accompanying consolidated balance sheets that sum to the total of the same such amounts presented in the accompanying consolidated statements of cash flows. The restricted cash and cash equivalents presented below are included in non-current "Restricted investments" in the accompanying consolidated balance sheets.

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	Nine Months Ended September 30,	
	2018	2017
	(In millions)	
Cash and cash equivalents	$2,814	$3,934
Restricted cash and cash equivalents	94	91
Total cash, cash equivalents, and restricted cash and cash equivalents presented in the statements of cash flows	$2,908	$4,025

Revenue Recognition

We adopted ASU 2014-09, Revenue from Contracts with Customers (Topic 606) effective January 1, 2018, using the modified retrospective approach. The insurance contracts of our Health Plans segment, which segment constitutes the vast majority of our operations, are excluded from the scope of Topic 606 because the recognition of revenue under these contracts is dictated by other accounting standards governing insurance contracts. The cumulative effect of initially applying the guidance, relating entirely to our Molina Medicaid Solutions segment contracts, resulted in an immaterial impact to beginning retained earnings, as presented in the accompanying consolidated statement of stockholders' equity. Topic 606 was only applied to service contracts that were not completed as of December 31, 2017. Refer to "Other segment" below for further information.

Health Plans segment

Premium revenue is fixed in advance of the periods covered and, except as described below, is not generally subject to significant accounting estimates. Premium revenues are recognized in the month that members are entitled to receive health care services, and premiums collected in advance are deferred. Certain components of premium revenue are subject to accounting estimates and fall into two broad categories discussed in further detail below: 1) "Contractual Provisions That May Adjust or Limit Revenue or Profit;" and 2) "Quality Incentives." Liabilities recorded for such provisions are included in "Amounts due government agencies" in the accompanying consolidated balance sheets.

1) Contractual Provisions That May Adjust or Limit Revenue or Profit:

Medicaid

- Medical Cost Floors (Minimums), and Medical Cost Corridors: Pursuant to certain contract provisions, a portion of our premium revenue may be returned if certain minimum amounts are not spent on defined medical care costs. In the aggregate, we recorded a liability under the terms of such contract provisions of $198 million and $135 million at September 30, 2018 and December 31, 2017, respectively. Approximately $144 million and $96 million of this liability accrued at September 30, 2018 and December 31, 2017, respectively, relates to our participation in Medicaid Expansion programs. Refer to Note 12, "Commitments and Contingencies," for further information regarding the California Medicaid Expansion program.
- Retroactive Premium Adjustments: State Medicaid programs periodically adjust premium rates on a retroactive basis. In these cases, we must adjust our premium revenue in the period in which we learn of the adjustment, rather than in the months of service to which the retroactive adjustment applies.

Medicare

- Minimum MLR: The Affordable Care Act (ACA) has established a minimum annual medical loss ratio (Minimum MLR) of 85% for Medicare. The medical loss ratio represents medical costs as a percentage of premium revenue. Federal regulations define what constitutes medical costs and premium revenue. If the Minimum MLR is not met, we may be required to pay rebates to the federal government. We recognize estimated rebates under the Minimum MLR as an adjustment to premium revenue in our consolidated statements of operations. The payable for the Medicare Minimum MLR was not significant at September 30, 2018 and December 31, 2017.

Marketplace

- Risk adjustment: Under this program, our health plans' composite risk scores are compared with the overall average risk score for the relevant state and market pool. Generally, our health plans will make a risk adjustment payment into the pool if their composite risk scores are below the average risk score, and will receive a risk adjustment payment from the pool if their composite risk scores are above the average risk score. We estimate our ultimate premium based on insurance policy year-to-date experience, and recognize estimated premiums relating to the risk adjustment program as an adjustment to premium

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revenue in our consolidated statements of operations. As of September 30, 2018, and December 31, 2017, the Marketplace risk adjustment payable amounted to $390 million and $912 million, respectively.

- Minimum MLR: The ACA has established a Minimum MLR of 80% for the Marketplace. If the Minimum MLR is not met, we may be required to pay rebates to our Marketplace policyholders. The Marketplace risk adjustment program is taken into consideration when computing the Minimum MLR. We recognize estimated rebates under the Minimum MLR as an adjustment to premium revenue in our consolidated statements of operations. The payable for the Marketplace Minimum MLR was not significant at September 30, 2018 and December 31, 2017.

2) Quality Incentives:

At many of our health plans, revenue ranging from approximately 1% to 3% of certain health plan premiums is earned only if certain performance measures are met.

The following table quantifies the quality incentive premium revenue recognized for the periods presented, including the amounts earned in the periods presented and prior periods. Although the reasonably possible effects of a change in estimate related to quality incentive premium revenue as of September 30, 2018 are not known, we have no reason to believe that the adjustments to prior years noted below are not indicative of the potential future changes in our estimates as of September 30, 2018.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(Dollars in millions)			
Maximum available quality incentive premium - current period	$48	$36	$135	$113
Quality incentive premium revenue recognized in current period:				
Earned current period	$39	$24	$97	$72
Earned prior periods	9	3	32	9
Total	$48	$27	$129	81
Quality incentive premium revenue recognized as a percentage of total premium revenue	1.1 %	0.6 %	1.0 %	0.6 %

Other segment

Our Pathways subsidiary's revenue is all variable, and generally invoiced after services are rendered; customer payment follows invoicing. We concluded that there is no change to revenue recognition under Topic 606 for Pathways, and therefore no impact to retained earnings effective January 1, 2018. As discussed in Note 1, "Organization and Basis of Presentation," we sold Pathways on October 19, 2018.

Medical Care Costs - Marketplace Cost Share Reduction (CSR) Update

In the nine months ended September 30, 2018, we recognized a benefit of approximately $81 million in reduced medical expense related to 2017 dates of service, including $5 million in the third quarter of 2018, as a result of the federal government's confirmation that the reconciliation of 2017 Marketplace CSR subsidies would be performed on an annual basis. In the fourth quarter of 2017, we had assumed a nine-month reconciliation of this item pending confirmation of the time period to which the 2017 reconciliation would be applied.

Concentrations of Credit Risk

Financial instruments that potentially subject us to concentrations of credit risk consist primarily of cash and cash equivalents, investments, receivables, and restricted investments. Our investments and a portion of our cash equivalents are managed by professional portfolio managers operating under documented investment guidelines. Our portfolio managers must obtain our prior approval before selling investments where the loss position of those investments exceeds certain levels. Our investments consist primarily of investment-grade debt securities with a maximum maturity of 10 years and an average duration of three years or less. Restricted investments are invested principally in certificates of deposit and U.S. treasury securities. Concentration of credit risk with respect to accounts receivable is generally limited because our payors consist principally of the governments of each state in which our health plan subsidiaries operate.

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Income Taxes

The provision for income taxes is determined using an estimated annual effective tax rate, which generally differs from the U.S. federal statutory rate primarily because of state taxes, nondeductible expenses such as the Health Insurer Fee (HIF), certain compensation, and other general and administrative expenses. The effective tax rate was not impacted by HIF in 2017 given the 2017 HIF moratorium.

The effective tax rate may be subject to fluctuations during the year as new information is obtained. Such information may affect the assumptions used to estimate the annual effective tax rate, including projected pretax earnings, the mix of pretax earnings in the various tax jurisdictions in which we operate, valuation allowances against deferred tax assets, the recognition or the reversal of the recognition of tax benefits related to uncertain tax positions, and changes in or the interpretation of tax laws in jurisdictions where we conduct business. We recognize deferred tax assets and liabilities for temporary differences between the financial reporting basis and the tax basis of our assets and liabilities, along with net operating loss and tax credit carryovers.

The Tax Cuts and Jobs Act (TCJA) was enacted on December 22, 2017. The TCJA, in part, reduced the U.S. federal statutory corporate income tax rate from 35% to 21% effective January 1, 2018. Accounting guidance allows filers a measurement period of one year from the enactment date to finalize the provisional valuation of deferred tax assets and liabilities. During the third quarter of 2018, we recognized approximately $4 million in adjustments to our provisional valuation of our deferred tax assets and liabilities recorded at December 31, 2017, and included these adjustments as a component of income tax expense from continuing operations, which decreased our effective tax rate by 150 basis points in the quarter. At September 30, 2018, we had not completed our accounting for the tax effects resulting from enactment of TCJA with respect to valuation of our deferred tax assets and liabilities. We will continue to refine our calculations as additional analysis is completed. In addition, our estimates may also be affected by expected future guidance on the tax law from the Internal Revenue Service and U.S. Treasury.

Recent Accounting Pronouncements Adopted

Revenue Recognition (Topic 606). See discussion above, in “Revenue Recognition.”

Comprehensive Income. In February 2018, the Financial Accounting Standards Board (FASB) issued ASU 2018-02, Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income, which allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the TCJA. ASU 2018-02 is effective beginning January 1, 2019; we early adopted this ASU effective January 1, 2018. The effect of applying the guidance resulted in an immaterial impact to beginning retained earnings, as presented in the accompanying consolidated statement of stockholders’ equity.

Restricted Cash. In November 2016, the FASB issued ASU 2016-18, Restricted Cash, which requires us to include in our consolidated statements of cash flows the changes in the balances of cash, cash equivalents, restricted cash and restricted cash equivalents. We adopted ASU 2016-18 on January 1, 2018. We have applied the guidance retrospectively to all periods presented. Such retrospective adoption resulted in a $91 million reclassification of restricted cash and cash equivalents from “Investing activities,” to the beginning and ending balances of cash and cash equivalents in our consolidated statements of cash flows for the nine months ended September 30, 2017. There was no impact to our consolidated statements of operations, balance sheets, or stockholders’ equity. The reconciliation of cash and cash equivalents to cash, cash equivalents, and restricted cash and cash equivalents is presented at the beginning of this note.

Recent Accounting Pronouncements Not Yet Adopted

Software Licenses. In August 2018, the FASB issued ASU 2018-15, Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract, which aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software. ASU 2018-15 is effective beginning January 1, 2020, and can be applied either retrospectively or prospectively to all implementation costs incurred after the date of adoption; early adoption is permitted. We are evaluating the effect of this guidance.

Callable Debt Securities. In March 2017, the FASB issued ASU 2017-08, Premium Amortization on Purchased Callable Debt Securities, which shortens the amortization period for certain callable debt securities held at a premium. Specifically, the amendments require the premium to be amortized to the earliest call date. ASU 2017-08 is effective beginning January 1, 2019, and must be adopted as a cumulative effect adjustment to retained earnings; early adoption is permitted. We are evaluating the effect of this guidance.

Credit Losses. In June 2016, the FASB issued ASU 2016-13, Measurement of Credit Losses on Financial Instruments. Rather than generally recognizing credit losses when it is probable that the loss has been incurred, the

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revised guidance requires companies to recognize an allowance for credit losses for the difference between the amortized cost basis of a financial instrument and the amount of amortized cost that the company expects to collect over the instrument's contractual life. ASU 2016-13 is effective beginning January 1, 2020, and must be adopted as a cumulative effect adjustment to retained earnings; early adoption is permitted. We are evaluating the effect of this guidance.

Leases. In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), as modified by:

- ASU 2017-03, Transition and Open Effective Date Information;
- ASU 2018-01, Leases (Topic 842): Land Easement Practical Expedient for Transition to Topic 842;
- ASU 2018-10, Codification Improvements to Topic 842, Leases; and
- ASU 2018-11, Leases (Topic 842): Targeted Improvements.

Under Topic 842, an entity will be required to recognize assets and liabilities for the rights and obligations created by leases on the entity's balance sheet for both financing and operating leases. Topic 842 also requires new disclosures that depict the amount, timing, and uncertainty of cash flows pertaining to an entity's leases. We will adopt Topic 842 effective January 1, 2019, using the modified retrospective method. Under this method, we will recognize the cumulative effect of initially applying the standard as an adjustment to the opening balance of retained earnings on January 1, 2019. In addition, we have elected the transition option provided under ASU 2018-11, which allows entities to continue to apply the legacy guidance in Topic 840, Leases, including its disclosure requirements, in the comparative periods presented in the year of adoption.

Under Topic 842, we will record right-of-use assets and liabilities relating primarily to our long-term office operating leases. We have substantially completed the configuration of our lease database management system for the adoption of Topic 842. We do not currently expect the adoption of this guidance to have a material effect on our consolidated results of operations, financial condition or cash flows.

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3. Net Income (Loss) per Share

The following table sets forth the calculation of basic and diluted net income (loss) per share:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(In millions, except net income per share)			
Numerator:				
Net income (loss)	$197	$(97)	$506	$(250)
Denominator:				
Shares outstanding at the beginning of the period	61.3	56.5	59.3	55.8
Weighted-average number of shares issued:				
Exchange of 1.625% Notes (1)	—	—	1.3	—
Stock-based compensation	—	—	0.2	0.4
Denominator for basic net income per share	61.3	56.5	60.8	56.2
Effect of dilutive securities:				
1.125% Warrants (1)	5.6	—	5.0	—
1.625% Notes (1)	0.6	—	0.5	—
Stock-based compensation	0.4	—	0.3	—
Denominator for diluted net income per share	67.9	56.5	66.6	56.2
Net income (loss) per share: (2)				
Basic	$3.22	$(1.70)	$8.32	$(4.44)
Diluted	$2.90	$(1.70)	$7.60	$(4.44)
Potentially dilutive common shares excluded from calculations:				
1.125% Warrants (1)	—	2.3	—	1.3
1.625% Notes (1)	—	0.6	—	0.3
Stock-based compensation	—	0.2	—	0.3

(1) For more information and definitions regarding the 1.625% Notes, refer to Note 7, “Debt.” For more information and definitions regarding the 1.125% Warrants, refer to Note 9, “Stockholders' Equity.” The dilutive effect of all potentially dilutive common shares is calculated using the treasury stock method. Certain potentially dilutive common shares issuable are not included in the computation of diluted net income (loss) per share because to do so would be anti-dilutive.

(2) Source data for calculations in thousands.

4. Fair Value Measurements

We consider the carrying amounts of cash, cash equivalents and other current assets and current liabilities (not including derivatives and the current portion of long-term debt) to approximate their fair values because of the relatively short period of time between the origination of these instruments and their expected realization or payment.

For our financial instruments measured at fair value on a recurring basis, we prioritize the inputs used in measuring fair value according to the three-tier fair value hierarchy. For a description of the methods and assumptions that we use to a) estimate the fair value; and b) determine the classification according to the fair value hierarchy for each financial instrument, see Note 4, “Fair Value Measurements,” in our 2017 Annual Report on Form 10-K.

Derivative financial instruments include the 1.125% Call Option derivative asset and the 1.125% Conversion Option derivative liability (see Note 8 “Derivatives,” for definitions and further information). These derivatives are not actively traded and are valued based on an option pricing model that uses observable and unobservable market data for inputs. Significant market data inputs used to determine fair value as of September 30, 2018, included the price of our common stock, the time to maturity of the derivative instruments, the risk-free interest rate, and the implied volatility of our common stock. The 1.125% Call Option derivative asset and the 1.125% Conversion Option

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derivative liability were designed such that changes in their fair values would offset, with minimal impact to the consolidated statements of operations. Therefore, the sensitivity of changes in the unobservable inputs to the option pricing model for such derivative instruments is mitigated.

The net changes in fair value of Level 3 financial instruments were insignificant to our results of operations for the nine months ended September 30, 2018.

Our financial instruments measured at fair value on a recurring basis at September 30, 2018, were as follows:

	Total	Quoted Market Prices (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(In millions)			
Corporate debt securities	$1,191	$ —	$ 1,191	$ —
U.S. treasury notes	221	221	—	—
Government-sponsored enterprise securities (GSEs)	170	170	—	—
Municipal securities	119	—	119	—
Asset-backed securities	92	—	92	—
Certificate of deposit	15	—	15	—
Other	4	—	4	—
Subtotal - current investments	1,812	391	1,421	—
1.125% Call Option derivative asset	843	—	—	843
Total assets	$2,655	$ 391	$ 1,421	$ 843
1.125% Conversion Option derivative liability	$843	$ —	$ —	$ 843
Total liabilities	$843	$ —	$ —	$ 843

Our financial instruments measured at fair value on a recurring basis at December 31, 2017, were as follows:

	Total	Quoted Market Prices (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(In millions)			
Corporate debt securities	$1,588	$ —	$ 1,588	$ —
U.S. treasury notes	388	388	—	—
GSEs	253	253	—	—
Municipal securities	141	—	141	—
Asset-backed securities	117	—	117	—
Certificates of deposit	37	—	37	—
Subtotal - current investments	2,524	641	1,883	—
Corporate debt securities	101	—	101	—
U.S. treasury notes	68	68	—	—
Subtotal - current restricted investments	169	68	101	—
1.125% Call Option derivative asset	522	—	—	522
Total assets	$3,215	$ 709	$ 1,984	$ 522
1.125% Conversion Option derivative liability	$522	$ —	$ —	$ 522
Total liabilities	$522	$ —	$ —	$ 522

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Fair Value Measurements – Disclosure Only

The carrying amounts and estimated fair values of our senior notes are classified as Level 2 financial instruments. Fair value for these securities is determined using a market approach based on quoted market prices for similar securities in active markets or quoted prices for identical securities in inactive markets.

	September 30, 2018		December 31, 2017	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(In millions)			
5.375% Notes	$693	$711	$692	$730
1.125% Notes (1)	295	1,142	496	1,052
4.875% Notes	326	325	325	329
1.625% Notes (2)	—	—	157	220
Credit Facility (2)	—	—	300	300
	$1,314	$2,178	$1,970	$2,631

(1) The fair value of the 1.125% Conversion Option (the embedded cash conversion option), which is included in the fair value amounts presented above, amounted to $843 million and $522 million as of September 30, 2018, and December 31, 2017, respectively. See further discussion at Note 7, “Debt,” and Note 8, “Derivatives.”

(2) For more information on debt repayments in the nine months ended September 30, 2018, refer to Note 7, “Debt.”

5. Investments

Available-for-Sale Investments

We consider all of our investments classified as current assets to be available-for-sale. The following tables summarize our investments as of the dates indicated:

	September 30, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(In millions)			
Corporate debt securities	$1,197	$ 1	$ 7	$ 1,191
U.S. treasury notes	222	—	1	221
GSEs	172	—	2	170
Municipal securities	121	—	2	119
Asset backed securities	93	—	1	92
Certificates of deposit	15	—	—	15
Other	4	—	—	4
	$1,824	$ 1	$ 13	$ 1,812

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	December 31, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(In millions)			
Corporate debt securities	$1,591	$ 1	$ 4	$ 1,588
U.S. treasury notes	389	—	1	388
GSEs	255	—	2	253
Municipal securities	142	—	1	141
Asset-backed securities	117	—	—	117
Certificates of deposit	37	—	—	37
Subtotal - current investments	2,531	1	8	2,524
Corporate debt securities	101	—	—	101
U.S. treasury notes	68	—	—	68
Subtotal - current restricted investments	169	—	—	169
	$2,700	$ 1	$ 8	$ 2,693

The contractual maturities of our available-for-sale investments as of September 30, 2018 are summarized below:

	Amortized Cost	Estimated Fair Value
	(In millions)	
Due in one year or less	$1,025	$ 1,023
Due after one year through five years	799	789
	$1,824	$ 1,812

As discussed further in Note 7, “Debt,” the 4.875% Notes’ indenture required us to hold a portion of the net proceeds from their issuance in a segregated account to be used to settle the conversion of the 1.625% Notes. Prior to September 30, 2018, this account was reported as a current asset, entitled “Restricted investments,” in the accompanying consolidated balance sheets. Because this account was used to settle the conversion of the 1.625% Notes in the third quarter of 2018, current restricted investments, as of September 30, 2018, was reduced to zero.

Gross realized gains and losses from sales of available-for-sale securities are calculated under the specific identification method and are included in investment income. Gross realized investment gains and losses for the three and nine months ended September 30, 2018 and 2017 were insignificant.

We have determined that unrealized losses at September 30, 2018 and December 31, 2017, are temporary in nature, because the change in market value for these securities has resulted from fluctuating interest rates, rather than a deterioration of the creditworthiness of the issuers. So long as we maintain the intent and ability to hold these securities to maturity, we are unlikely to experience losses. In the event that we dispose of these securities before maturity, we expect that realized losses, if any, will be insignificant.

The following table segregates those available-for-sale investments that have been in a continuous loss position for less than 12 months, and those that have been in a continuous loss position for 12 months or more as of September 30, 2018:

	In a Continuous Loss Position for Less than 12 Months			In a Continuous Loss Position for 12 Months or More		
	Estimated Fair Value	Unrealized Losses	Total Number of Positions	Estimated Fair Value	Unrealized Losses	Total Number of Positions
	(Dollars in millions)					
Corporate debt securities	$727	$ 4	460	$186	$ 3	127
U.S. Treasury notes	—	—	—	94	1	31

GSEs	—	—	—	127	2	68
Municipal securities	63	1	63	55	1	57
Asset backed securities	72	1	41	—	—	—
	$862	$ 6	564	$462	$ 7	283

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The following table segregates those available-for-sale investments that have been in a continuous loss position for less than 12 months, and those that have been in a continuous loss position for 12 months or more as of December 31, 2017:

	In a Continuous Loss Position for Less than 12 Months			In a Continuous Loss Position for 12 Months or More		
	Estimated Fair Value	Unrealized Losses	Total Number of Positions	Estimated Fair Value	Unrealized Losses	Total Number of Positions
	(Dollars in millions)					
Corporate debt securities	$1,297	$ 3	561	$94	$ 1	69
U.S. Treasury Notes	470	1	89	—	—	—
GSEs	173	1	69	95	1	47
Municipal securities	—	—	—	38	1	48
	$1,940	$ 5	719	$227	$ 3	164

Held-to-Maturity Investments

Pursuant to the regulations governing our Health Plans segment subsidiaries, we maintain statutory deposits and deposits required by government authorities primarily in certificates of deposit and U.S. treasury securities. We also maintain restricted investments as protection against the insolvency of certain capitated providers. The use of these funds is limited as required by regulations in the various states in which we operate, or as needed in the event of insolvency of capitated providers. Therefore, such investments are reported as non-current "Restricted investments" in the accompanying consolidated balance sheets. We have the ability to hold these restricted investments until maturity, and as a result, we would not expect the value of these investments to decline significantly due to a sudden change in market interest rates.

Our held-to-maturity restricted investments are carried at amortized cost, which approximates fair value.

Held-to-maturity restricted investments as of September 30, 2018, are summarized below:

	Amortized Cost	Estimated Fair Value
	(In millions)	
Due in one year or less	$111	$ 111
Due after one year through five years	7	7
	$118	$ 118

6. Medical Claims and Benefits Payable

The following table provides the details of our medical claims and benefits payable (including amounts payable for the provision of long-term services and supports, or LTSS) as of the dates indicated:

	September 30, 2018	December 31, 2017
	(In millions)	
Fee-for-service claims incurred but not paid (IBNP)	$1,609	$ 1,717
Pharmacy payable	121	112
Capitation payable	48	67
Other	264	296
	$2,042	$ 2,192

"Other" medical claims and benefits payable includes amounts payable to certain providers for which we act as an intermediary on behalf of various government agencies without assuming financial risk. Such receipts and payments do not impact our consolidated statements of operations. Non-risk provider payables amounted to $158 million and $122 million as of September 30, 2018 and December 31, 2017, respectively.

The following table presents the components of the change in our medical claims and benefits payable for the periods indicated. The amounts presented for “Components of medical care costs related to: Prior periods” represent the amounts by which our original estimate of medical claims and benefits payable at the beginning of the

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period were (more) less than the actual amount of the liability based on information (principally the payment of claims) developed since that liability was first reported.

	Nine Months Ended September 30,	
	2018	2017
	(In millions)	
Medical claims and benefits payable, beginning balance	$2,192	$1,929
Components of medical care costs related to:		
Current period	11,589	12,813
Prior periods	(227)	9
Total medical care costs	11,362	12,822
Change in non-risk provider payables	60	172
Payments for medical care costs related to:		
Current period	9,866	10,944
Prior periods	1,706	1,501
Total paid	11,572	12,445
Medical claims and benefits payable, ending balance	$2,042	$2,478

The differences between our original estimates and the amounts ultimately paid out for the most part relate to IBNP. Assuming that our initial estimate of IBNP is accurate, we believe that amounts ultimately paid would generally be between 8% and 10% less than the IBNP liability recorded at the end of the period as a result of the inclusion in that liability of the provision for adverse claims deviation and the accrued cost of settling those claims. Because we establish the provision for adverse claims deviation and the accrued cost of settling claims on a consistent basis every quarter, the lower cost recognized in a subsequent period if such a provision proved unnecessary would be offset by the establishment of a similar provision during that same period.

Because the amount of our initial liability is an estimate, we will always experience variability in that estimate as new information becomes available with the passage of time. Therefore, there can be no assurance that amounts ultimately paid out will fall within the range of 8% to 10% lower than the liability that was initially recorded.

Further, because our initial estimate of IBNP is derived from many factors, some of which are qualitative in nature rather than quantitative, we are seldom able to assign specific values to the reasons for a change in estimate—we will only be able to identify specific factors if they represent a significant departure from expectations. As a result, we do not expect to be able to fully quantify the impact of individual factors on changes in estimates.

We believe that the most significant uncertainties surrounding our IBNP estimates at September 30, 2018 are as follows:

- Across all of our health plans, the inventory of unpaid claims increased significantly during the first half of 2017, then decreased in the last half of 2017 and into 2018. Changes in claims inventories impact the timing between date of service and the date of claim payment, increasing the volatility of our liability estimates.
- In June 2018, our Puerto Rico health plan implemented state prescribed claim billing requirements to ensure more accurate claims submissions. The billing requirements were more stringent and caused a significant number of claim denials. Although we expect providers to ultimately submit updated claims with the required information, the impact of the new billing requirements creates more uncertainty in our liability estimates.
- At our Florida health plan, a new clinical service system was implemented in the first quarter of 2018. This system impacted the reporting of inpatient authorizations used in our development of claims liabilities, which makes our liability estimates subject to more than the usual amount of uncertainty.
- We recently implemented a new process for increased quality review of claims payments in 11 of our health plans. While we do not anticipate this new process will impact the percentage of claims paid within the timely turnaround requirements, we believe it will have a minor impact on the timing of some paid claims. For this reason, our liability

estimates in these 11 health plans are subject to more than the usual amount of uncertainty.

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We recognized favorable prior period claims development in the amount of $227 million for the nine months ended September 30, 2018. This amount represents our estimate as of September 30, 2018, of the extent to which our initial estimate of medical claims and benefits payable at December 31, 2017, was more than the amount that will ultimately be paid out in satisfaction of that liability. We believe these differences were due primarily to the following factors:

- The impact of the provision for adverse claims deviation and the accrued cost of settling claims as discussed above. Because we re-establish the provision for adverse claims deviation and the accrued cost of settling claims on a consistent basis every quarter, the impact of this item to medical care costs in the nine months ended September 30, 2018, results was minimal.
- Across all of our health plans, the inventory of unpaid claims increased significantly during the first half of 2017, then decreased in the last half of 2017. In hindsight, the impact of the changes in claims processing timing reduced our liabilities more than we had anticipated.
- December 2017 data from The Centers for Disease Control and Prevention indicated widespread influenza activity in several states in which we operate health plans. The additional liabilities established in consideration of increased claims related to a more severe influenza season turned out to be higher than our actual experience.
- In establishing our liability at December 31, 2017, we anticipated an increase in the utilization of medical services by Marketplace members concerned about the future of their healthcare coverage as a result of uncertainties related to high premium increases and issuer exits. This induced demand did not materialize to the degree we expected.

7. Debt

As of September 30, 2018, contractual maturities of debt were as follows. All amounts represent the principal amounts of the debt instruments outstanding.

	Total	2019	2020	2021	2022	2023	Thereafter
	(In millions)						
5.375% Notes	$700	$ —	$—	$ —	$700	$ —	$ —
4.875% Notes	330	—	—	—	—	—	330
1.125% Notes	314	—	314	—	—	—	—
	$1,344	$ —	$314	$ —	$700	$ —	$ 330

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All of our debt is held at the parent, which is reported in the Other segment. The following table summarizes our outstanding debt obligations and their classification in the accompanying consolidated balance sheets:

	September 30, 2018	December 31, 2017
	(In millions)	
Current portion of long-term debt:		
1.125% Notes, net of unamortized discount of $18 at September 30, 2018, and $51 at December 31, 2017	$296	$ 499
1.625% Notes, net of unamortized discount of $3 at December 31, 2017	—	157
Lease financing obligations	1	1
Debt issuance costs	(1)	(4)
	296	653
Non-current portion of long-term debt:		
5.375% Notes	700	700
4.875% Notes	330	330
Credit Facility	—	300
Debt issuance costs	(11)	(12)
	1,019	1,318
Lease financing obligations	198	198
	$1,513	$ 2,169

Interest cost recognized relating to our convertible senior notes for the periods presented was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(In millions)			
Contractual interest at coupon rate	$1	$ 3	$ 5	$ 9
Amortization of the discount	5	8	18	24
	$6	$ 11	$ 23	$ 33

Credit Facility

In January 2017, we entered into an amended unsecured $500 million revolving credit facility (the Credit Facility). The Credit Facility has a term of five years and all amounts outstanding will be due and payable on January 31, 2022. In May 2018, we repaid the $300 million outstanding borrowings under the Credit Facility. As of September 30, 2018, no amounts were outstanding under the Credit Facility, and outstanding letters of credit amounting to $6 million reduced our borrowing capacity under the Credit Facility to $494 million.

Borrowings under our Credit Facility bear interest based, at our election, on a base rate or an adjusted London Interbank Offered Rate (LIBOR), plus in each case the applicable margin. In addition to interest payable on the principal amount of indebtedness outstanding from time to time under the Credit Facility, we are required to pay a quarterly commitment fee. Certain of our wholly owned subsidiaries guarantee our obligations under the Credit Facility. The Credit Facility contains customary non-financial and financial covenants, including a net leverage ratio and an interest coverage ratio. As of September 30, 2018, we were in compliance with all financial and non-financial covenants under the Credit Facility and other long-term debt.

Bridge Credit Agreement

In January 2018, we entered into a bridge credit agreement with several banks, which was subsequently terminated in August 2018.

5.375% Notes due 2022

We have $700 million aggregate principal amount of senior notes (the 5.375% Notes) outstanding as of September 30, 2018, which are due November 15, 2022, unless earlier redeemed. Interest on the 5.375% Notes is payable semiannually in arrears on May 15 and November 15. Certain of our wholly owned subsidiaries guarantee our obligations under the 5.375% Notes; such guarantees mirror those of the Credit Facility. See Note 13, "Supplemental Condensed Consolidating Financial Information," for more information on the guarantors. The 5.375% Notes contain customary non-financial covenants and change in control provisions.

4.875% Notes due 2025

We have $330 million aggregate principal amount of senior notes (the 4.875% Notes) outstanding as of September 30, 2018, which are due June 15, 2025, unless earlier redeemed. Interest on the 4.875% Notes is payable semiannually in arrears on June 15 and December 15. Certain of our wholly owned subsidiaries guarantee our obligations under the 4.875% Notes; such guarantees mirror those of the Credit Facility. The 4.875% Notes contain customary non-financial covenants and change of control provisions.

1.125% Cash Convertible Senior Notes due 2020

In the second and third quarters of 2018, we entered into privately negotiated note purchase agreements with certain holders of our outstanding 1.125% cash convertible senior notes due January 15, 2020 (the 1.125% Notes).

In the third quarter of 2018, we repaid $140 million aggregate principal amount of the 1.125% Notes, plus accrued interest, for a total cash payment of $483 million. The $343 million difference between the principal amount extinguished and our cash payment primarily represents the settlement of the 1.125% Notes' embedded cash conversion option feature at fair value (which is a derivative liability we refer to as the 1.125% Conversion Option).

In the second quarter of 2018, we repaid $96 million aggregate principal amount of the 1.125% Notes, plus accrued interest, for a total cash payment of $228 million. As noted above, the $132 million difference between the principal amount extinguished and our cash payment primarily represents the settlement of the embedded cash conversion option feature at fair value.

In the nine months ended September 30, 2018, we have recorded a loss on debt extinguishment of $15 million for the 1.125% Notes purchases, including $10 million in the third quarter of 2018, primarily relating to the acceleration of the debt discount. This loss is reported in "Other expenses (income), net" in the accompanying consolidated statements of operations. No common shares were issued in connection with these transactions.

In connection with the 1.125% Notes purchases, we also entered into privately negotiated termination agreements with each of the counterparties in the second and third quarters of 2018, to partially terminate the Call Spread Overlay, defined and further discussed in Notes 8, "Derivatives," and 9, "Stockholders' Equity." The net cash proceeds from the Call Spread Overlay partial termination transactions partially offset the cash paid to settle the 1.125% Notes.

Following the transactions described above, we have $314 million aggregate principal amount of the 1.125% Notes outstanding at September 30, 2018. Interest is payable semiannually in arrears on January 15 and July 15. The 1.125% Notes are convertible only into cash, and not into shares of our common stock or any other securities. The initial conversion rate for the 1.125% Notes is 24.5277 shares of our common stock per $1,000 principal amount, or approximately $40.77 per share of our common stock. Upon conversion, in lieu of receiving shares of our common stock, a holder will receive an amount in cash, per $1,000 principal amount of 1.125% Notes, equal to the settlement amount, determined in the manner set forth in the indenture. We may not redeem the 1.125% Notes prior to the maturity date. The 1.125% Notes are convertible by the holders within one year of the current balance sheet date until they mature; therefore, they are reported in current portion of long-term debt.

Concurrent with the issuance of the 1.125% Notes, the 1.125% Conversion Option was separated from the 1.125% Notes and accounted for separately as a derivative liability, with changes in fair value reported in our consolidated statements of operations until the 1.125% Conversion Option fully settles or expires. This initial liability simultaneously reduced the carrying value of the 1.125% Notes' principal amount (effectively an original issuance discount), which is amortized to the principal amount through the recognition of non-cash interest expense over the expected life of the debt. The effective interest rate approximating what we would have incurred had nonconvertible debt with otherwise similar terms been issued is approximately 6%. As of September 30, 2018, the 1.125% Notes had a remaining amortization period of 1.3 years, and their 'if-converted' value exceeded their principal amount by approximately $626 million and $406 million as of September 30, 2018 and December 31, 2017, respectively.

1.625% Convertible Senior Notes due 2044

Conversion. On July 11, 2018, we announced notice of our election to redeem the remaining $64 million aggregate principal amount of the 1.625% convertible senior notes due 2044 (the 1.625% Notes) on August 20, 2018 (the Redemption Date), pursuant to the terms of the indenture. Also pursuant to the indenture, the 1.625% Notes were convertible until August 17, 2018, at a conversion rate of 17.2157 shares of our common stock per $1,000 principal amount equal to the settlement amount (as defined in the related indenture), or approximately $58.09 per share of our common stock.

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Through August 17, 2018, we received conversion notices from substantially all of the remaining holders of the 1.625% Notes outstanding. Under the conversions, we paid cash for the remaining $64 million aggregate principal amount and delivered 0.6 million shares of our common stock to the converting holders on the settlement dates in September 2018.
Exchange. In March 2018, we entered into separate, privately negotiated, synthetic exchange agreements with certain holders of our outstanding 1.625% Notes, under which we exchanged $97 million aggregate principal amount and accrued interest for 1.8 million shares of our common stock. We recorded a loss on debt extinguishment, including transaction fees, of $10 million, primarily relating to the inducement premium paid to the bondholders, which is recorded in “Other expenses (income), net” in the accompanying consolidated statements of operations. We did not receive any proceeds from the transaction.
Cross-Default Provisions
The indentures governing the 4.875% Notes, the 5.375% Notes and the 1.125% Notes contain cross-default provisions that are triggered upon default by us or any of our subsidiaries on any indebtedness in excess of the amount specified in the applicable indenture.

8. Derivatives
The following table summarizes the fair values and the presentation of our derivative financial instruments (defined and discussed individually below) in the accompanying consolidated balance sheets:

	Balance Sheet Location	September 30, 2018	December 31, 2017
		(In millions)	
Derivative asset:			
1.125% Call Option	Current assets: Derivative asset	$ 843	$ 522
Derivative liability:			
1.125% Conversion Option	Current liabilities: Derivative liability	$ 843	$ 522

Our derivative financial instruments do not qualify for hedge treatment; therefore, the change in fair value of these instruments is recognized immediately in our consolidated statements of operations, and reported in “Other expenses (income), net.” Gains and losses for our derivative financial instruments are presented individually in the accompanying consolidated statements of cash flows, “Supplemental cash flow information.”
1.125% Notes Call Spread Overlay. Concurrent with the issuance of the 1.125% Notes in 2013, we entered into privately negotiated hedge transactions (collectively, the 1.125% Call Option) and warrant transactions (collectively, the 1.125% Warrants), with certain of the initial purchasers of the 1.125% Notes (the Counterparties). We refer to these transactions collectively as the Call Spread Overlay. Under the Call Spread Overlay, the cost of the 1.125% Call Option we purchased to cover the cash outlay upon conversion of the 1.125% Notes was reduced by proceeds from the sale of the 1.125% Warrants. Assuming full performance by the Counterparties (and 1.125% Warrants strike prices in excess of the conversion price of the 1.125% Notes), these transactions are intended to offset cash payments in excess of the principal amount of the 1.125% Notes due upon any conversion of such notes.
In the second and third quarters of 2018, in connection with the 1.125% Notes purchases (described in Note 7, “Debt”), we entered into privately negotiated termination agreements with each of the Counterparties to partially terminate the Call Spread Overlay, in notional amounts corresponding to the aggregate principal amount of the 1.125% Notes purchased. In the third quarter of 2018, this resulted in our receipt of $343 million for the settlement of the 1.125% Call Option (which is a derivative asset), and the payment of $306 million for the partial termination of the 1.125% Warrants, for an aggregate net cash receipt of $37 million from the Counterparties.
In the second quarter of 2018, this resulted in our receipt of $134 million for the settlement of the 1.125% Call Option, and the payment of $113 million for the partial termination of the 1.125% Warrants, for an aggregate net cash receipt of $21 million from the Counterparties.
1.125% Call Option. The 1.125% Call Option, which is indexed to our common stock, is a derivative asset that requires mark-to-market accounting treatment due to cash settlement features until the 1.125% Call Option settles or expires. For further discussion of the inputs used to determine the fair value of the 1.125% Call Option, refer to Note

4, “Fair Value Measurements.”

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1.125% Conversion Option. The embedded cash conversion option within the 1.125% Notes is accounted for separately as a derivative liability, with changes in fair value reported in our consolidated statements of operations until the cash conversion option settles or expires. For further discussion of the inputs used to determine the fair value of the 1.125% Conversion Option, refer to Note 4, “Fair Value Measurements.”

As of September 30, 2018, the 1.125% Call Option and the 1.125% Conversion Option were classified as a current asset and current liability, respectively, because the 1.125% Notes may be converted within twelve months of September 30, 2018, as described in Note 7, “Debt.”

9. Stockholders' Equity

1.625% Notes

Conversion. As described in Note 7, “Debt,” we issued 0.6 million shares of our common stock in connection with the conversion of the 1.625% Notes in the third quarter of 2018.

Exchange. As described in Note 7, “Debt,” we issued 1.8 million shares of our common stock in connection with the exchange of the 1.625% Notes in March 2018.

1.125% Warrants

In connection with the Call Spread Overlay transaction described in Note 8, “Derivatives,” in 2013, we issued 13.5 million warrants with a strike price of $53.8475 per share. Under certain circumstances, beginning in April 2020, if the price of our common stock exceeds the strike price of the 1.125% Warrants, we will be obligated to issue shares of our common stock subject to a share delivery cap. The 1.125% Warrants could separately have a dilutive effect to the extent that the market value per share of our common stock exceeds the applicable strike price of the 1.125% Warrants. Refer to Note 3, “Net Income (Loss) per Share,” for dilution information for the periods presented. We will not receive any additional proceeds if the 1.125% Warrants are exercised. Following the transactions described below, 7.7 million of the 1.125% Warrants remain outstanding.

As described in Note 8, “Derivatives,” in the second and third quarters of 2018, we entered into privately negotiated termination agreements with each of the Counterparties to partially terminate the Call Spread Overlay, in notional amounts corresponding to the aggregate principal amount of the 1.125% Notes purchased. In the third quarter of 2018, we paid $306 million to the Counterparties for the termination of 3.4 million of the 1.125% Warrants outstanding, which resulted in a reduction of additional paid-in-capital for the same amount.

In the second quarter of 2018, we paid $113 million to the Counterparties for the termination of 2.4 million of the 1.125% Warrants outstanding, which resulted in a reduction of additional paid-in capital for the same amount.

Share-Based Compensation

In connection with our equity incentive plans and employee stock purchase plan, approximately 281,000 shares of common stock vested or were purchased, net of shares used to settle employees’ income tax obligations, during the nine months ended September 30, 2018.

Share-based compensation is generally recorded to “General and administrative expenses” in the accompanying consolidated statements of operations. Total share-based compensation expense for the three and nine months ended September 30, 2018, amounted to $7 million and $20 million, respectively. Total share-based compensation expense for the three months ended September 30, 2017, amounted to $3 million. Total share-based compensation expense for the nine months ended September 30, 2017, amounted to $38 million, of which $23 million was recorded to “Restructuring and separation costs” in the accompanying consolidated statements of operations.

As of September 30, 2018, there was $41 million of total unrecognized compensation expense related to unvested restricted stock awards (RSAs), performance stock awards (PSAs), and performance stock units (PSUs), which we expect to recognize over a remaining weighted-average period of 2.8 years, 0.4 years and 2.3 years, respectively. This unrecognized compensation cost assumes an estimated forfeiture rate of 12.1% for non-executive employees as of September 30, 2018.

Also as of September 30, 2018, there was $11 million of total unrecognized compensation expense related to unvested stock options, which we expect to recognize over a weighted-average period of 2.0 years. No stock options were granted or exercised in the nine months ended September 30, 2018.

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Activity for RSAs, PSAs and PSUs, for the nine months ended September 30, 2018, is summarized below:

	Restricted Stock Awards	Performance Stock Awards	Performance Stock Units	Total	Weighted Average Grant Date Fair Value
Unvested balance, December 31, 2017	401,804	84,762	91,828	578,394	$ 58.35
Granted	353,618	—	212,926	566,544	73.85
Vested	(188,954)	(32,929)	—	(221,883)	57.87
Forfeited	(152,243)	(48,701)	(104,527)	(305,471)	63.67
Unvested balance, September 30, 2018	414,225	3,132	200,227	617,584	70.11

The aggregate fair values of RSAs, PSAs and PSUs granted and vested are presented in the following table:

	Nine Months Ended September 30,	
	2018	2017
	(In millions)	
Granted:		
Restricted stock awards	$ 26	$ 19
Performance stock units	16	16
	$ 42	$ 35
Vested:		
Restricted stock awards	$ 14	$ 21
Performance stock awards	3	15
Performance stock units	—	9
	$ 17	$ 45

10. Restructuring and Separation Costs

Restructuring and separation costs are reported by the same name in the accompanying consolidated statements of operations.

IT Restructuring

Following the 2017 Restructuring Plan noted below, our new executive team has focused on a margin recovery plan that includes identification and implementation of various profit improvement initiatives. To that end, we have begun to implement a plan to restructure our information technology department (the IT Restructuring) in the third quarter of 2018.

Expected Costs

In addition to $3 million incurred in the third quarter of 2018, we expect to incur approximately $6 million for the IT Restructuring in the fourth quarter of 2018. We expect such costs to consist primarily of one-time termination benefits and other costs in the Other segment. We will update the total estimated costs for the IT Restructuring in our 2018 Annual Report on Form 10-K.

Costs Incurred

We have incurred expenses under the IT Restructuring as follows:

Three and Nine Months Ended September 30, 2018		
One-Time Termination Benefits	Other Restructuring Costs	Total

		Consulting Fees	Contract Termination Costs	
	(In millions)			
Other	$2	$ 1	$ —	$ 3

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Reconciliation of Liability

For those restructuring and separation costs that require cash settlement (one-time termination benefits and consulting fees), the following table presents a roll-forward of the accrued liability, which is reported in “Accounts payable and accrued liabilities” in the accompanying consolidated balance sheets.

	One-Time Termination Benefits	Other Restructuring Costs	Total
Accrued as of December 31, 2017	$ —	$ —	$ —
Charges	2	1	3
Cash payments	—	—	—
Accrued as of September 30, 2018	$ 2	$ 1	$ 3

2017 Restructuring Plan

Following a management-initiated, broad operational assessment in early 2017, our board of directors approved, and we committed to, a comprehensive restructuring and profitability improvement plan in June 2017 (the 2017 Restructuring Plan). Key activities under this plan to date have included:

- Streamlining of our organizational structure to eliminate redundant layers of management, consolidate regional support services, and other staff reductions to improve efficiency and the speed and quality of decision making;
- Re-design of core operating processes such as provider payment, utilization management, quality monitoring and improvement, and information technology, to achieve more effective and cost-efficient outcomes;
- Remediation of high-cost provider contracts and enhancement of high quality, cost-effective networks;
- Restructuring, including selective exits, of direct delivery operations; and
- Partnering with the lowest-cost, most effective vendors.

Costs Incurred

In our 2017 Annual Report on Form 10-K, we reported that we had incurred substantially all of the costs associated with the 2017 Restructuring Plan in 2017, amounting to $234 million. In the nine months ended September 30, 2018, we incurred an additional $35 million in such costs, primarily as a result of our further evaluation and write-off of a utilization and care management project terminated because of its inconsistency with the goals of the 2017 Restructuring Plan. We also recorded nominal amounts for one-time termination benefits, true-ups of certain lease contract termination costs, and consulting fees recorded in 2017. As of September 30, 2018, we had incurred $269 million in total costs under the 2017 Restructuring Plan. We expect to complete all activities under the 2017 Restructuring Plan in 2018, with the exception of the cash settlement of lease termination liabilities. We expect to continue to settle those liabilities through 2025, unless the leases are terminated sooner.

The following tables present the major types of such costs by segment. Current and long-lived assets include current and non-current capitalized project costs, and capitalized software determined to be unrecoverable.

	Three Months Ended September 30, 2018				
		Other Restructuring Costs			
	One-Time Termination Benefits	Write-offs of Current and Long-lived Assets	Consulting Fees	Contract Termination Costs	Total
	(In millions)				
Health Plans	$ —	$ —	$ —	$ 2	$ 2
	$ —	$ —	$ —	$ 2	$ 2

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	Nine Months Ended September 30, 2018				
		Other Restructuring Costs			
	One-Time Termination Benefits	Write-offs of Current and Long-lived Assets	Consulting Fees	Contract Termination Costs	Total
	(In millions)				
Health Plans	$ —	$ (1)	$ —	$ 10	$ 9
Other	5	20	1	—	26
	$ 5	$ 19	$ 1	$ 10	$ 35

	Three Months Ended September 30, 2017					
			Other Restructuring Costs			
	Separation Costs - Former Executives	One-Time Termination Benefits	Write-offs of Current and Long-lived Assets	Consulting Fees	Contract Termination Costs	Total
	(In millions)					
Health Plans	$ —	$ 27	$ 6	$ —	$ —	$ 33
Molina Medicaid Solutions	—	—	8	—	—	8
Other	—	23	35	16	3	77
	$ —	$ 50	$ 49	$ 16	$ 3	$ 118

	Nine Months Ended September 30, 2017					
			Other Restructuring Costs			
	Separation Costs - Former Executives	One-Time Termination Benefits	Write-offs of Current and Long-lived Assets	Consulting Fees	Contract Termination Costs	Total
	(In millions)					
Health Plans	$ —	$ 27	$ 6	$ —	$ —	$ 33
Molina Medicaid Solutions	—	—	8	—	—	8
Other	35	23	35	24	3	120
	$ 35	$ 50	$ 49	$ 24	$ 3	$ 161

As of September 30, 2018, we had incurred cumulative restructuring costs under the 2017 Restructuring Plan as follows:

Separation Costs - Former Executives	One-Time Termination Benefits	Other Restructuring Costs	Total