UNITEDHEALTH GROUP INC
Form DEF 14A
April 25, 2012

SCHEDULE 14A INFORMATION

Proxy Statement Pursuant to Section 14(a) of the Securities Exchange Act of 1934

Filed by the Registrant x

Filed by a party other than the Registrant ¨

Check the appropriate box:

¨ Preliminary Proxy Statement

¨ Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))

x Definitive Proxy Statement

¨ Definitive Additional Materials

¨ Soliciting Material Pursuant to Section 240.14a

UnitedHealth Group Incorporated

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

x No fee required

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(1) Amount Previously Paid:

(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:

9900 Bren Road East, Minnetonka, Minnesota 55343

April 25, 2012

Dear Shareholder:

We cordially invite you to attend our 2012 Annual Meeting of Shareholders. We will hold our meeting on Monday, June 4, 2012 at 10:00 a.m. Pacific Time at Anthony Marlon Auditorium, 2700 North Tenaya Way, Las Vegas, Nevada 89128. This is the operating site of our UnitedHealthcare plan servicing Nevada.

As a shareholder of UnitedHealth Group, you play an important role in our company by considering and taking action on the matters set forth in the attached proxy statement. We appreciate the time and attention you invest in making thoughtful decisions.

Attached you will find a notice of meeting and proxy statement that contain further information about the items upon which you will be asked to vote and the meeting itself, including:

- How to obtain admission to the meeting if you plan to attend; and

- Different methods you can use to vote your proxy, including by Internet, telephone and mail.

Every shareholder vote is important, and we encourage you to vote as promptly as possible. If you cannot attend the meeting in person, you may listen to the meeting via webcast. Instructions on how to access the live webcast are included in the proxy statement.

Sincerely,

Stephen J. Hemsley

President and Chief Executive Officer

Richard T. Burke

Chairman of the Board

NOTICE OF ANNUAL MEETING OF SHAREHOLDERS

TO THE SHAREHOLDERS OF UNITEDHEALTH GROUP INCORPORATED:

UnitedHealth Group Incorporated (the Company) will hold its Annual Meeting of Shareholders on Monday, June 4, 2012 at 10:00 a.m. Pacific Time at Anthony Marlon Auditorium, 2700 North Tenaya Way, Las Vegas, Nevada 89128. The purposes of the meeting are:

1. To elect the ten nominees that are set forth in the attached proxy statement to the Company s Board of Directors.

2. To cast an advisory vote to approve the Company s executive compensation.

3. To ratify the appointment of Deloitte & Touche LLP as the independent registered public accounting firm for the Company for the year ending December 31, 2012.

4. To consider the shareholder proposal set forth in this proxy statement, if properly presented at the Annual Meeting.

5. To transact other business that properly may come before the Annual Meeting or any adjournments or postponements of the meeting.

Only shareholders of record of the Company s common stock at the close of business on April 5, 2012 are entitled to receive notice of and to vote at the meeting and any adjournments or postponements of the meeting.

BY ORDER OF THE BOARD OF DIRECTORS,

Dannette L. Smith

Secretary to the Board of Directors

April 25, 2012

We cordially invite you to attend our Annual Meeting. We encourage you to vote by Internet or telephone, or complete, sign and return your proxy prior to the meeting even if you plan to attend the Annual Meeting. If you later choose to revoke your proxy, you may do so at any time before it is exercised at the Annual Meeting by following the procedures described under Question 13 of the Questions and Answers about the Annual Meeting and Voting section in the attached proxy statement.

IMPORTANT NOTICE REGARDING AVAILABILITY OF PROXY MATERIALS

FOR THE ANNUAL MEETING OF SHAREHOLDERS

TO BE HELD ON JUNE 4, 2012:

The Notice of Internet Availability of Proxy Materials, Notice of Annual Meeting,

Proxy Statement and Annual Report are available at

www.unitedhealthgroup.com/proxymaterials.

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SUMMARY

This summary highlights information contained elsewhere in this proxy statement. We encourage you to review the entire proxy statement. This proxy statement and our Annual Report for the year ended December 31, 2011 are first being mailed to the Company s shareholders and made available on the Internet at *www.unitedhealthgroup.com/proxymaterials* on or about April 25, 2012.

UnitedHealth Group

We are a diversified health and well-being company whose mission is to help people live healthier lives and enhance the performance of the health care system. We achieved strong business results in 2011, including:

- Revenues increased 8% to $101.9 billion from $94.2 billion in 2010;
- Net earnings increased 11% to $5.1 billion from $4.6 billion in 2010;
- Cash flow increased 11% to $7.0 billion as compared to $6.3 billion in 2010;
- Earnings per share increased 15% to $4.73 per share from $4.10 per share in 2010; and
- Total shareholder return was 42% compared to 2.1% for the S&P 500 generally.

Achievement of this strong financial performance was driven by our success on a broad range of initiatives that were intended to position the Company for future growth.

Corporate Governance

UnitedHealth Group is committed to meeting high standards of ethical behavior, corporate governance and business conduct in everything we do, every day. This commitment has led us to implement the following practices:

- *Board Structure and Composition* Our directors are elected annually by a majority vote of our shareholders. We have independent Board leadership, and all directors, other than our Chief Executive Officer (CEO), are independent.
- *CEO Succession Planning* Our succession plan, which is reviewed annually, addresses both an unexpected loss of our CEO and longer-term succession.
- *Stock Ownership Guidelines* Each of our executive officers satisfied our stock ownership guidelines as of December 31, 2011. Mr. Hemsley, our CEO, owned shares equal to 118 times his base salary as of March 1, 2012.
- *Stock Retention Policy* We require executive officers to hold, for at least one year, 1/3 of the net shares acquired upon vesting or exercise of any equity award granted after October 2009.
- *Clawback Policy* We may recover cash incentive compensation and equity awards from senior executives, including all of our named executive officers, in the event of fraud or misconduct resulting in a restatement of the Company s financial statements.

Independent Compensation Consultant Our Compensation and Human Resources Committee (the Compensation Committee) uses an independent compensation consultant, which performs no consulting or other services for the Company.

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Political Contributions Policy We disclose our political contributions, and the contributions of our federal and state political action committees, semi-annually and as required by law.

Environmental Policy We seek to minimize our environmental impact, and to heighten our employees awareness of the importance of the environment.

Transactions in Company Securities Our insider trading policy prohibits short sales of shares of our common stock by all directors and employees, and discourages hedging transactions.

See the Corporate Governance portion of this proxy statement for further information on our governance practices.

Enterprise-Wide Risk Oversight

Our Board of Directors, assisted by its committees, oversees management s enterprise-wide risk management activities. Risk management activities include assessing and taking actions necessary to manage risk incurred in connection with the long-term strategic direction and operation of our business.

Executive Compensation

Our executive compensation program utilizes a mix of base salary, annual and long-term cash incentives, equity awards and standard benefits to attract and retain highly qualified executives and maintain a strong relationship between executive pay and Company performance. As evidenced by the results of our say-on-pay vote at our 2011 Annual Meeting of Shareholders, we believe that shareholders have indicated strong support for our executive compensation program.

Our Overall Compensation Program Principles

§ *Pay-for-performance* Total compensation of executive officers is generally based on achievement of enterprise-wide goals that impact shareholder value.

§ *Enhance the value of the business* Incentive compensation is designed to favor the longer-term value of the Company and avoid excessive risk-taking in the short-term.

§ *Reward long-term growth and focus management on sustained success and shareholder value creation* Compensation of our executive officers is weighted toward long-term awards that encourage sustained performance and positive shareholder returns.

§ *Modest benefits and limited perquisites* We provide standard employee benefits and limited perquisites to our named executive officers.

Summary of Compensation Paid to Stephen Hemsley, our CEO, in 2011

§ *Base salary* $1.3 million, which has been at this level since 2006.

§ *Cash incentive awards* Annual cash incentive award of $3.6 million and long-term cash incentive award of $1.3 million, which reflect the Company s strong performance against pre-set targets.

- § *Equity awards* Performance shares with a targeted grant date value of $3.5 million and restricted stock units with a grant date fair value of $3.5 million.

- § *Company matching contributions* $152,025 under our 401(k) and executive savings plans.

Mr. Hemsley s total compensation is well below the CEO median in the Company s peer group. Information regarding compensation paid to each of our named executive officers in 2011 is described in the Compensation Discussion and Analysis below.

Strong Governance Standards in Oversight of Executive Compensation Policies

We endeavor to maintain strong governance standards in the oversight of our executive compensation policies and practices, including:

§ No ongoing pension obligations for any of our named executive officers.

§ No excise tax gross-ups and limited perks.

§ Performance-based compensation arrangements that use a variety of performance measures, including performance-based equity awards.

§ Double-trigger change-in-control arrangements for equity granted after 2010.

§ Our 2011 Stock Incentive Plan prohibits the repricing of stock options or stock appreciation rights without shareholder approval.

§ Annual advisory shareholder vote to approve the Company s executive compensation.

Proposal 1 Election of Directors (see pages 4-8)

The Board has nominated ten candidates for election to our Board of Directors. Each of these candidates was elected to the Board by the vast majority of the shares voted at the 2011 Annual Meeting. **The Board recommends that shareholders vote FOR the election of each nominee.**

Proposal 2 Advisory Vote to Approve the Company s Executive Compensation (see pages 53-54)

The Board is seeking an advisory vote to approve the Company s executive compensation. Before considering this proposal, please read our Compensation Discussion and Analysis, which explains the Compensation Committee s compensation decisions and how our executive compensation program aligns the interests of our executive officers with those of our shareholders. Although the vote is advisory and is not binding on the Board, the Compensation Committee will take into account the outcome of the vote when considering future executive compensation decisions. At the 2011 Annual Meeting, more than 97% of the votes cast on this proposal were in favor of our executive compensation. **The Board recommends that shareholders vote FOR the approval of the Company s executive compensation.**

Proposal 3 Ratification of Independent Registered Public Accounting Firm (see page 62)

The Audit Committee has appointed Deloitte & Touche LLP as our independent registered public accounting firm for the year ending December 31, 2012. The Board is seeking shareholder ratification of this appointment. **The Board recommends that shareholders vote FOR ratification of the selection of Deloitte & Touche LLP.**

Proposal 4 Shareholder Proposal (see pages 62-64)

We have been informed that a group of shareholders intends to introduce a resolution requesting that the Board authorize the preparation of a report addressing lobbying expenditures and oversight. The Board has concluded that the proposal is not in the best interests of the Company and its shareholders. **The Board recommends that shareholders vote AGAINST the shareholder proposal.**

PROPOSAL 1 ELECTION OF DIRECTORS

Director Nomination Process

Criteria for Nomination to the Board

The Nominating Committee Charter, which is available on our website, provides that the Nominating and Corporate Governance Committee (the Nominating Committee) analyzes, on an annual basis, Board member skills and attributes, and recommends to the Board of Directors appropriate individuals for nomination as Board members.

Based on the Company s strategic plan, the Nominating Committee developed a skills matrix to assist it in considering the appropriate balance of experience, skills and attributes required of a director and to be represented on the Board as a whole. The skills matrix is periodically reviewed and updated by the Nominating Committee. The Nominating Committee evaluates potential Board candidates against the skills matrix.

The skills matrix has two sections a list of core criteria that every member of the Board should meet and a list of skills and attributes desired to be represented collectively on the Board. The skills matrix reflects the following core director criteria that should be satisfied by each director or nominee:

Independence under the Company s Standards for Director Independence and New York Stock Exchange (NYSE) listing requirements, subject to waiver based on the Nominating Committee s business judgment;

Service on no more than three other public company boards;

High integrity and ethical standards;

Standing and reputation in the individual s field;

Risk oversight ability with respect to the particular skills of the individual director;

Understanding of and experience with complex public companies or like organizations; and

Ability to work collegially and collaboratively with other directors and management.

The skills matrix reflects the following skills and attributes desired to be represented collectively on the Board as a whole:

Corporate governance expertise;

Financial expertise;

Health care industry expertise;

Direct consumer marketing expertise;

Brand marketing/public relations expertise;

Diversity;

Legal expertise;

Capital markets expertise;

Political/health care policy expertise;

Clinical practice; and

Technology/business process expertise.

Our Nominating Committee strives to maintain a balance of tenure on the Board. Long-serving directors bring valuable experience with our company and familiarity with the challenges it has faced over the years, while newer directors bring fresh perspective and new ideas.

Diversity

UnitedHealth Group embraces and encourages a culture of diversity and inclusion. We believe that valuing diversity makes good business sense and helps to ensure our future success. Diversity is included as one of the collective attributes in our directors skills matrix. Our Board has not adopted a formal definition of diversity.

Our Board assesses its overall effectiveness through an annual evaluation process. This evaluation includes, among other things, an assessment of the overall composition of the Board, including the diversity of its members.

Nominating Advisory Committee

The Board of Directors formed the Nominating Advisory Committee in 2006 to provide its Nominating Committee with additional input from shareholders and others regarding desirable characteristics of director candidates and the composition of the Board of Directors. The Nominating Committee considers, but is not bound by, input provided by the Nominating Advisory Committee. The Nominating Advisory Committee currently includes four individuals affiliated with long-term shareholders of the Company and one individual who is a member of the medical community. Members of the Nominating Advisory Committee do not receive any compensation from the Company for serving on the Nominating Advisory Committee. The Nominating Advisory Committee held one meeting in 2011. A description of the Nominating Advisory Committee can be found on the Company s website at *www.unitedhealthgroup.com*. We have included website addresses here and throughout this proxy statement for reference only. The information contained on our website is not incorporated by reference into this proxy statement.

Process for Identifying and Evaluating Nominees

In the case of incumbent directors, in addition to the factors listed above under Criteria for Nomination to the Board, the Nominating Committee reviews the directors overall performance on the Board of Directors and other relevant factors.

In considering potential candidates to the Board who are not incumbent directors, the Nominating Committee, with input from the full Board of Directors, assesses the potential candidate s qualifications and how these qualifications fit with the desired composition of the Board of Directors as a whole. The Nominating Committee considers views expressed by members of the Nominating Advisory Committee and other shareholders regarding skill sets that would be valuable for a new director to possess.

Shareholder Recommendations for Nominees

The Nominating Committee will consider candidates recommended by shareholders upon timely written notice to the Secretary to the Board of Directors. For the 2013 Annual Meeting, this notice must be received at our principal executive offices, directed to the Secretary to the Board of Directors, on or before December 26, 2012. The notice must include the information set forth in the Bylaws about each proposed nominee, including: (i) the name, age, business address, residence address and principal occupation or employment, (ii) the number of shares of the Company s common stock which are beneficially owned, and (iii) other information concerning the nominee as would be required in soliciting proxies for the election of that nominee. The notice must also include the information set forth in the Bylaws about the shareholder making the nomination and any associated person, including information about the direct and indirect ownership of or derivative positions in the Company s common stock and arrangements and understandings related to the proposed nomination or the voting of the Company s common stock. The notice must also include a signed consent of each nominee to serve as a director of the Company, if elected. If we do not receive a notice and the required information regarding the shareholder and any associated person by the deadline described above, the proposed nominee may be excluded from consideration by the Nominating Committee. The Nominating Committee will only evaluate shareholder-recommended candidates if those recommendations meet the requirements described in this proxy statement and our Bylaws.

2012 Director Nominees

Under our Articles of Incorporation and Bylaws, each member of our Board of Directors is elected annually. The Board of Directors has nominated the ten directors set forth below for election by the shareholders at the 2012 Annual Meeting. All of the nominees were elected by our shareholders at the 2011 Annual Meeting and have informed the Board that they are willing to serve as directors if elected. If any nominee should decline or become unable to serve as a director for any reason, the persons named as proxies will elect a replacement.

The Board of Directors recommends that you vote FOR the election of each of the nominees. Proxies will be voted FOR the election of each nominee unless you specify otherwise.

Name	Age	Director Since
William C. Ballard, Jr.	71	1993
Richard T. Burke	68	1977
Robert J. Darretta	65	2007
Stephen J. Hemsley	59	2000
Michele J. Hooper	60	2007
Rodger A. Lawson	65	2011
Douglas W. Leatherdale	75	1983
Glenn M. Renwick	56	2008
Kenneth I. Shine, M.D.	77	2009
Gail R. Wilensky, Ph.D.	68	1993

The director nominees, if elected, will serve until the 2013 Annual Meeting or until their successors are elected and qualified. The following is a brief biographical description of each director nominee, which includes a discussion of the skills and attributes held by each director that are reflected in the skills matrix, as described above, and that, in part, led the Board to conclude that each respective director should continue to serve as a member of the Board.

Mr. Ballard served as Of Counsel to Greenebaum Doll & McDonald PLLC, a law firm in Louisville, Kentucky, from June 1992 until July 2008. In 1992, Mr. Ballard retired from Humana, Inc., a company operating managed health care facilities, after serving with Humana in various roles for 22 years, including as the Chief Financial Officer and a director. Mr. Ballard has satisfied all the core director criteria set forth in the skills matrix. As a result of his past experiences, Mr. Ballard also has health care industry, legal and financial/capital markets expertise and qualifies as a financial expert under applicable Securities and Exchange Commission (SEC) regulations. Mr. Ballard currently serves as a director of Health Care REIT, Inc.

Mr. Burke is Chair of the Board of UnitedHealth Group, has been a member of our Board of Directors since inception, and was Chief Executive Officer of UnitedHealthcare, Inc., our predecessor corporation, until February 1988. From 1995 until February 2001, Mr. Burke was the owner, Chief Executive Officer and Governor of the Phoenix Coyotes, a National Hockey League team. Mr. Burke has satisfied all the core director criteria set forth in the skills matrix. As a result of his past experiences, Mr. Burke also has health care industry expertise and qualifies as a financial expert under applicable SEC regulations. Mr. Burke currently serves as a director of Meritage Homes Corporation. In the past five years, he has also served as a director of First Cash Financial Services, Inc.

Mr. Darretta is the retired Vice Chair, Board of Directors, Chief Financial Officer and member of the Executive Committee of Johnson & Johnson, a health care products company. Mr. Darretta served as Chief Financial Officer and a member of the Executive Committee of Johnson & Johnson from 1997 to March 2007. Mr. Darretta joined Johnson & Johnson in 1968. Mr. Darretta has satisfied all the core director criteria set forth in the skills matrix. As a result of his past experiences, Mr. Darretta has corporate governance, health care industry, direct consumer markets, technology/business process and financial/capital markets expertise and qualifies as a financial expert under applicable SEC regulations. Mr. Darretta currently serves as a trustee for certain Putnam mutual funds. In the past five years, he also served as a director of Johnson & Johnson.

Mr. Hemsley is President and Chief Executive Officer of UnitedHealth Group and has served in that capacity since November 2006. He has been a member of the Board of Directors since February 2000. Mr. Hemsley joined the Company in 1997 as Senior Executive Vice President. He became Chief Operating Officer in 1998, was named President in 1999, and served as President and Chief Operating Officer from 1999 to November 2006. Mr. Hemsley has satisfied all the core director criteria set forth in the skills matrix except that he is not an independent director because he is our Chief Executive Officer. As a result of his past experiences, Mr. Hemsley has health care industry, financial and technology/business process expertise.

Ms. Hooper is President and Chief Executive Officer of The Directors Council, a private company which she co-founded in 2003, that works with corporate boards to increase their independence, effectiveness and diversity. She was President and Chief Executive Officer of Voyager Expanded Learning, a developer and provider of learning programs and teacher training for public schools, from 1999 until 2000. Prior to that, she was President and Chief Executive Officer of Stadtlander Drug Company, Inc., a provider of disease-specific pharmaceutical care, from 1998 until Stadtlander was acquired in 1999. Ms. Hooper has satisfied all the core director criteria set forth in the skills matrix and is a nationally recognized corporate governance expert. As a result of her past experience, she also has health care industry expertise and qualifies as a financial expert under applicable SEC regulations. She currently serves as a director of AstraZeneca plc. and PPG Industries, Inc. In the past five years, she also served as a director of Warner Music Group Corp.

Mr. Lawson is the former President of Fidelity, the world s largest mutual fund company. Mr. Lawson served in that capacity from August 2007 to March 2010. Prior to joining Fidelity, Mr. Lawson was Vice Chairman of Prudential Financial from 2002 to 2007 where he was responsible for the International Operating Division and for Global Marketing Communications. Mr. Lawson served as Executive Vice President of Prudential from 1996 to 2002. Prior to joining Prudential, Mr. Lawson was President and Chief Executive Officer of VanEck Global from June 1994 to June 1996. Mr. Lawson was Managing Director and Partner in charge of Private Global Banking and Mutual Funds at Bankers Trust from January 1992 to April 1994. Mr. Lawson was a Managing Director and Chief Executive Officer at Fidelity Investments Retail from May 1985 to May 1991, and President and Chief Executive Officer at Dreyfus Service Corporation and an officer of the company from May 1982 to May 1985. Mr. Lawson has satisfied all the core director criteria set forth in the skills matrix. As a result of his past experiences, Mr. Lawson has corporate governance, direct consumer marketing, brand marketing/public relations, financial/capital markets and technology/business process expertise and qualifies as a financial expert under applicable SEC regulations. We also believe that Mr. Lawson s past experience as an executive at a major institutional investor is of significant value to the Board. Mr. Lawson currently serves as a director of E*TRADE Financial Corporation.

Mr. Leatherdale served as the Chair and Chief Executive Officer of The St. Paul Companies, Inc. (currently known as Travelers Companies, Inc.), a property casualty insurance company, from 1990 until he retired in October 2001. Mr. Leatherdale has satisfied all the core director criteria set forth in the skills matrix. As a result of his past experiences, Mr. Leatherdale has corporate governance and financial/capital markets expertise and qualifies as a financial expert under applicable SEC regulations. In the past five years Mr. Leatherdale has also served as a director of Xcel Energy Inc.

Mr. Renwick is President and Chief Executive Officer of The Progressive Corporation, an auto insurance holding company. Before being named Chief Executive Officer in 2001, Mr. Renwick served as Chief Executive Officer-Insurance Operations and Business Technology Process Leader from 1998 through 2000. Prior to that, he led Progressive s Consumer Marketing group and served as President of various divisions within Progressive. Mr. Renwick joined Progressive in 1986 as Auto Product Manager for Florida. Mr. Renwick has satisfied all the core director criteria set forth in the skills matrix. As a result of his past experience, Mr. Renwick has corporate governance, health care industry, direct consumer markets, brand marketing/public relations, financial/capital markets and technology/business process expertise and qualifies as a financial expert under applicable SEC regulations. Mr. Renwick currently serves as a director of The Progressive Corporation and Fiserv, Inc.

Dr. Shine has served as the Executive Vice Chancellor for Health Affairs of the University of Texas System (the UT System), which consists of nine academic campuses and six health institutions, since November 2003. Dr. Shine also served as the interim Chancellor of the University of Texas System from May 2008 until February 2009. Prior to July 2002, Dr. Shine served as President of the Institute of Medicine at the National Academy of Sciences from 1992 until 2002. From 1993 until 2003, Dr. Shine served as a Clinical Professor of Medicine at the Georgetown University School of Medicine. From 1971 until 1992, Dr. Shine served in several positions at the University of California School of Medicine, with his final position being Dean and Provost, Medical Sciences, and he continues to hold the position of Professor of Medicine Emeritus. Dr. Shine has also served as Chair of the Council of Deans of the Association of American Medical Colleges from 1991 until 1992 and as President of the American Heart Association from 1985 until 1986. Dr. Shine has satisfied all the core director criteria set forth in the skills matrix. He also is a nationally recognized cardiologist and has health care policy and clinical practice expertise.

Dr. Wilensky has been a senior fellow at Project HOPE, an international health foundation, since 1993. From 2008 to 2009, Dr. Wilensky was President of the Department of Defense Health Board and chaired its sub-committee on health care delivery. From December 2006 to December 2007, Dr. Wilensky co-chaired the Department of Defense Task Force on the Future of Military Health Care. During 2007 she also served as a commissioner on the President s Commission on Care for America s Returning Wounded Warriors. From May 2001 to May 2003, she was the Co-Chair of the President s Task Force to Improve Health Care for our Nation s Veterans. From 1997 to 2001, she was also Chair of the Medicare Payment Advisory Commission. From 1992 to 1993, Dr. Wilensky served as the Deputy Assistant to President George H. W. Bush for policy development, and from 1990 to 1992, she was the Administrator of the Health Care Financing Administration (now known as the Centers for Medicare and Medicaid Services) directing the Medicaid and Medicare programs for the United States. Dr. Wilensky has satisfied all the core director criteria set forth in the skills matrix. She also is a nationally recognized health care economist and has health care policy expertise. Dr. Wilensky currently serves as a director of Quest Diagnostics Incorporated. In the past five years, she has also served as a director of Cephalon, Inc., Gentiva Health Services, Manor Care, Inc. and SRA International Inc.

CORPORATE GOVERNANCE

Overview

UnitedHealth Group is committed to high standards of corporate governance and ethical business conduct. Important documents that are reflective of this commitment include our Articles of Incorporation, Bylaws, Principles of Governance, Board of Directors Committee Charters, Standards for Director Independence, Code of Conduct: Our Principles of Ethics & Integrity, Related-Person Transactions Approval Policy, Board of Directors Communication Policy, Political Contributions Policy and Corporate Environmental Policy. You can access these documents at *www.unitedhealthgroup.com* to learn more about our corporate governance practices.

Corporate Governance Practices

Some of our key corporate governance practices include:

Board Structure and Shareholder Rights

- All members of our Board of Directors are elected annually by our shareholders.
- Our Articles of Incorporation provide that each director must be elected by a majority vote in an uncontested election.
- We have no supermajority shareholder approval provisions.
- We have a non-executive independent Chair of the Board. If the Chair of the Board is not independent, then a Lead Independent Director will be appointed by a majority vote of the independent directors.

Board and Board Committees Composition and Performance

- A Nominating Advisory Committee comprised of representatives from the shareholder and medical communities provides input into the composition of our Board of Directors.
- All members of our Audit Committee are required to be financial experts as defined by the SEC.
- A non-management director may not serve on more than four public company boards of directors (including the Company).
- Our CEO may not serve on more than two public company boards of directors (including the Company).
- Our directors are required to offer their resignations upon a change in their primary careers.
- Our Board of Directors and each Board committee regularly conduct executive sessions of non-management directors. Our Chair of the Board presides over each executive session of non-management directors. Committee Chairs preside over executive sessions of their respective committees.

Our Board of Directors and Board committees have the authority to retain independent advisors.

Our Board of Directors and Board committees conduct performance reviews annually.

All directors are required to complete a minimum level of director training.

Guidelines and Board Policies

Our Board of Directors developed our CEO succession plan with input from our CEO, and it reviews the plan annually. The CEO succession plan has two components: a succession plan that addresses emergency or unanticipated loss of our CEO and longer-term succession. Material features of this plan include identification of Board members to lead the succession process, identification and development of internal candidates and identification of external resources necessary to ensure a successful transition.

We maintain stock ownership and retention guidelines for directors and executive officers. See Compensation Discussion and Analysis Elements of Our Compensation Program Other Compensation Practices Executive Stock Ownership Guidelines, Director Compensation Equity-Based Compensation and Director Compensation Stock Ownership Guidelines for further information.

We have a related-person transactions approval policy regarding the review, approval and ratification by our Audit Committee of all related-person transactions with consideration in excess of $1. See Certain Relationships and Transactions.

We have a clawback policy that allows the Company to recover cash incentive compensation and equity awards from senior executives in the event of fraud or misconduct resulting in a restatement of the Company s financial statements or in the event of a senior executive s violation of a restrictive covenant. See Compensation Discussion and Analysis Elements of Our Compensation Program Other Compensation Practices Potential Impact on Compensation from Executive Misconduct/Compensation Clawbacks below.

We have an independent compensation consultant policy that requires the consultant engaged by the Compensation Committee to be independent of the Company or the Company will disclose the fees paid to the consultant in the Company s proxy statement.

Our Board of Directors believes that effective Board-shareholder communication strengthens the Board of Directors role as an active, informed and engaged fiduciary, so we have a communication policy that outlines how shareholders and other interested parties may communicate with the Board of Directors. See Corporate Governance Communication with the Board of Directors.

We have a political contributions policy that is overseen by our Public Policy Strategies and Responsibility Committee (the Public Policy Committee) and pursuant to which the political contributions of the Company and its federal and state political action committees are disclosed semi-annually.

We have an environmental policy that outlines our focus on minimizing our impact on the environment and creating a Company culture that heightens our employees awareness of the importance of preserving the environment and conserving energy and natural resources.

Independent Auditors

Our shareholders annually ratify the selection of our independent registered public accounting firm.

The 2011 non-audit and non-audit-related fees paid to our independent registered public accounting firm were less than 10% of total fees paid to that firm by the Company in 2011.

Principles of Governance

Our Articles of Incorporation and Bylaws, together with Minnesota law and NYSE and SEC rules, govern the Company. Our Principles of Governance set forth many of the practices, policies and procedures that provide the foundation of our commitment to strong corporate governance. The policies and practices covered in our Principles of Governance include shareholder rights and proxy voting; structure, composition and performance of the Board of Directors; use of an independent compensation consultant; stock ownership and retention requirements; Board of Directors operation; individual director responsibilities; and Board committees. Our Principles of Governance are reviewed at least annually by our Nominating Committee and are revised as necessary.

Code of Conduct: Our Principles of Ethics & Integrity

The Code of Conduct: Our Principles of Ethics & Integrity is published on the Company s website and covers our principles and policies related to business conduct, conflicts of interest, public disclosure, legal compliance, reporting and accountability, corporate opportunities, confidentiality, fair dealing and protection and proper use of Company assets. Any waiver of the Code of Conduct for the Company s executive officers, senior financial officers or directors may be made only by the Board of Directors or a committee of the Board. We will publish any amendments to the Code of Conduct and waivers of the Code of Conduct for an executive officer or director on the Company s website.

Compliance & Ethics

We strongly encourage employees to raise ethics and compliance concerns, including concerns about accounting, internal controls or auditing matters. We offer several channels for employees and third parties to report ethics and compliance concerns or incidents, including by phone or online, and individuals may choose to remain anonymous in jurisdictions where anonymous reporting is permissible. We prohibit retaliatory action against any individual who in good faith raises concerns or questions regarding ethics and compliance matters or reports suspected violations. We train all employees and periodically advise them regarding the means by which they may report possible ethics or compliance issues and their affirmative responsibility to report any possible issues. In our latest employee survey, 97% of employees said they knew what to do if unethical behavior or misconduct occurred in their work area.

Director Independence

Our Board of Directors has adopted the Company s Standards for Director Independence, which are available on the Company s website at *www.unitedhealthgroup.com*. The Standards for Director Independence requirements exceed the independence standards set by the SEC and the NYSE.

Our Board of Directors has determined that each of William C. Ballard, Jr., Richard T. Burke, Robert J. Darretta, Michele J. Hooper, Rodger A. Lawson, Douglas W. Leatherdale, Glenn M. Renwick, Kenneth I. Shine, M.D. and Gail R. Wilensky, Ph.D. is independent under the NYSE rules and the Company s Standards for Director Independence and that these directors have no material relationships with the Company that would prevent the directors from being considered independent. The Company s President and CEO, Stephen J. Hemsley, is not an independent director.

In determining independence, the Board of Directors considered, among other factors, all of the business relationships between the Company and our directors and nominees, their immediate family members (as defined by the NYSE) or their affiliated companies. The Board of Directors considered whether any director or any nominee was a director, partner, significant shareholder or executive officer of an organization that has a relationship with the Company, and charitable contributions that the Company or its affiliates made to organizations with which such directors or nominees are or have been associated. In particular, the Board of Directors evaluated the following relationships and determined that such relationships were in the normal course of business and did not impair the directors exercise of independent judgment:

Mr. Burke is an owner of Rainy Partners, LLC. Rainy Partners, LLC is a customer of the Company and paid the Company premiums for health insurance of approximately $122,000 in 2011. These premiums were determined on the same terms and conditions as premiums for our other customers.

Dr. Shine is the Executive Vice Chancellor for Health Affairs of the UT System, which includes six health institutions. The health institutions are part of the Company s broad national network of hospitals and physicians and other care providers. In 2011, we paid the UT System approximately $115 million for medical expenses on behalf of consumers who obtain health insurance from us and approximately $560,000 for funded clinical trials, marketing and meeting expenses and tuition payments for employees, which in the aggregate amounts to approximately 1.2% of the 2011 operating revenues of the UT System. Some of our self-funded customers also paid approximately $244 million to the UT System for health care services on behalf of their employees and health plan participants. Dr. Shine is neither directly nor indirectly involved in the relationship between the UT System and the Company and the customers of the Company. Dr. Shine has no direct responsibilities for any contractual or other relationships with the Company or its competitors. The UT System has established a process pursuant to which Dr. Shine will not have access to any information that is maintained by the UT System that could be used to benefit or provide an advantage to the Company.

Dr. Wilensky is a senior fellow of Project HOPE. In 2011, the Company made charitable contributions of approximately $700,000 to Project HOPE in support of its mission of providing lasting solutions to health problems. In addition, the Company paid Project HOPE approximately $1.3 million in fees, or less than 1% of Project HOPE s total revenues, related to a project to provide greater access to health care to underserved populations via a mobile telemedicine clinic. These fees were for services Project HOPE provides in the ordinary course of its business. The Company believes Project HOPE is uniquely qualified to support the mobile telemedicine clinic because of its success in providing similar health care services in underserved areas throughout the world. Dr. Wilensky is neither directly nor indirectly involved in this relationship.

Relationships between the Company and organizations on which our outside directors or their immediate family members serve only as directors.

Independent Board Leadership

Our Board of Directors believes that having independent Board leadership is an important component of our governance structure. As such, our Bylaws require the Company to have either an independent Chair of the Board or a Lead Independent Director. The Company believes the current leadership structure delineates the separate roles of managers and directors. Whereas our CEO sets the strategic direction for the Company, working with the Board, and provides day-to-day leadership, our independent Chair of the Board leads the Board in the performance of its duties and serves as the principal liaison between the independent directors and the CEO. In recognition of these distinct differences in duties, our Principles of Governance outline the specific duties of the Chair of the Board or a Lead Independent Director, including:

Chairing all meetings of the Board at which the Chair is present (Chair of the Board duty only);

Working with the CEO on the scheduling of Board meetings and the preparation of agendas and materials for Board meetings;

Coordinating the preparation of agendas and materials for executive sessions of the Board s non-management directors;

Scheduling and leading the executive sessions of the Board s non-management directors;

- Defining the scope, quality, quantity and timeliness of the flow of information between Company management and the Board that is necessary to effectively and responsibly perform their duties;

- Leading the Board process for hiring, terminating and evaluating the performance of the Company s CEO and working with the Chair of the Compensation Committee on the process for compensating and evaluating the CEO;

- Recommending outside advisors and consultants, as necessary, who report directly to the Board on Board-related issues;

- Serving as an ex-officio member of each committee and working with the Board Committee Chairs on the performance of their designated roles and responsibilities;

- Interviewing, along with the Chair of the Nominating Committee, all Board candidates and making director candidate recommendations to the Nominating Committee;

- Assisting the Board and the Company in assuring compliance with and implementation of the Company s Principles of Governance;

- Coordinating the performance evaluations of the Board and the Board committees in conjunction with the Committee Chairs and the Nominating Committee;

- Working with the Nominating Committee on the membership of Board committees; and

- Being available for communications with shareholders, as needed.

Risk Oversight

Enterprise-Wide Risk Oversight

Our Board of Directors oversees management s enterprise-wide risk management activities. Risk management activities include assessing and taking actions necessary to manage risk incurred in connection with the long-term strategic direction and operation of our business. Each director on our Board is required to have risk oversight ability for each skill and attribute the director possesses that is reflected in the collective skills section of our director skills matrix set forth in Election of Directors Director Nomination Process Criteria of Nomination to the Board above. Collectively, our Board of Directors uses its committees to assist in its risk oversight function as follows:

- Audit Committee oversees our controls and compliance activities. The Audit Committee also oversees management s processes to identify and quantify material risks facing the Company. The enterprise risk management function, which reports to the Chief Accounting Officer, assists the Company in identifying and assessing the Company s material risks. The Company s General Auditor, who reports to the Audit Committee, assists the Company in evaluating risk management controls and methodologies. The Chief Accounting Officer and General Auditor provide periodic reports to the Audit Committee. In connection with its risk oversight role, the Audit Committee regularly meets privately with representatives from the Company s independent registered public accounting firm and the Company s Chief Financial Officer, General Auditor and Chief Legal Officer;

- Compensation Committee oversees risk associated with our compensation practices and plans;

- Nominating Committee oversees Board processes and corporate governance-related risk; and

Public Policy Committee oversees risk associated with the Company s activities in the public policy arena, including health care reform and modernization activities, political contributions, government relations, community and charitable activities and corporate social responsibility.

Our Board of Directors maintains overall responsibility for oversight of the work of its various committees by receiving regular reports from the Committee Chairs regarding the work performed by the various committees. In addition, discussions about the Company s strategic plan, consolidated business results, capital structure, merger and acquisition related activities and other business discussed with the Board of Directors include a discussion of the risks associated with the particular item under consideration.

Enterprise-wide Incentive Compensation Risk Assessment

Our Compensation Committee requested that management conduct a risk-assessment of the Company s enterprise-wide compensation programs. The risk assessment reviewed both cash incentive compensation plans and individual cash incentive awards paid in 2011 for the presence of potential design elements that could incent employees to incur excessive risk, the ratio and level of incentive to fixed compensation, the amount of manager discretion, the percentage of compensation expense as compared to the business units revenues, and the presence of other design features that serve to mitigate excessive risk taking, such as the Company s clawback policy, stock ownership guidelines, multiple performance metrics, caps on individual or aggregate payments and similar features. The Compensation Committee also receives an annual report on the Company s compliance with its equity award program controls.

After considering the results of the risk assessment, management concluded that the level of risk associated with the Company s enterprise-wide compensation programs is not reasonably likely to have a material adverse effect on the Company. The results of the risk assessment were reviewed with the Compensation Committee at its February 2012 meeting. Please see Compensation Discussion and Analysis for a discussion of design elements intended to mitigate excessive risk taking by our executive officers.

Board Meetings and Annual Meeting Attendance

Directors are expected to attend Board meetings, meetings of committees on which they serve and the Annual Meeting of Shareholders. All of our incumbent directors attended the 2011 Annual Meeting. During the year ended December 31, 2011, the Board of Directors held twelve meetings. All incumbent directors who were members of the Board of Directors in 2011 attended at least 75% of the meetings of the Board and any Board committees of which they were members.

Board Committees

The Board of Directors has established four standing committees: the Audit Committee, the Compensation Committee, the Nominating Committee and the Public Policy Committee. These committees help the Board of Directors fulfill its responsibilities and assist the Board of Directors in making informed decisions. Each committee operates under a written charter, and evaluates its charter and conducts a committee performance evaluation annually.

Director	Audit	Compensation and Human Resources	Nominating and Corporate Governance	Public Policy Strategies and Responsibility
William C. Ballard, Jr.	Chair		X	
Richard T. Burke*				
Robert J. Darretta	X	X		
Stephen J. Hemsley				
Michele J. Hooper			Chair	X
Rodger A. Lawson		X		
Douglas W. Leatherdale		Chair	X	
Glenn M. Renwick	X			
Kenneth I. Shine, M.D.				X
Gail R. Wilensky, Ph.D.				Chair

* Mr. Burke is the Chair of the Board and ex-officio member of each Board committee. As an ex-officio member, Mr. Burke has a standing invitation to attend each Board committee meeting, but does not count for quorum purposes or vote on committee matters.

Audit Committee

The Audit Committee consists of Messrs. Ballard (Chair), Darretta and Renwick, each of whom is an independent director under the NYSE listing standards and the SEC rules. The Board of Directors has determined that Messrs. Ballard, Darretta and Renwick are audit committee financial experts as defined by the SEC rules. The Audit Committee has responsibility for the selection and retention of the independent registered public accounting firm, and assists the Board of Directors by overseeing financial reporting and internal controls, public disclosure and compliance activities. The Audit Committee also oversees management s processes to identify and quantify material risks facing the Company. The Audit Committee operates as a direct line of communication between the Board of Directors and our independent registered public accounting firm, as well as our internal audit, compliance and legal personnel. The Audit Committee held ten meetings in 2011.

Compensation and Human Resources Committee

The Compensation Committee consists of Messrs. Leatherdale (Chair), Darretta and Lawson, each of whom is an independent director under the NYSE listing standards, a non-employee director under the SEC rules and an outside director under the Internal Revenue Code of 1986 (the Internal Revenue Code). The Compensation Committee is responsible for overseeing our policies and practices related to total compensation for executive officers, the administration of our incentive and equity-based plans and the risk associated with our compensation practices and plans. The Compensation Committee also establishes our employment arrangements with our CEO and other executive officers, conducts an annual performance review of the CEO, and reviews and monitors director compensation programs and the Company s stock ownership guidelines. The Compensation Committee held five meetings in 2011.

Nominating and Corporate Governance Committee

The Nominating Committee consists of Ms. Hooper (Chair) and Messrs. Ballard and Leatherdale, each of whom is an independent director under the NYSE rules. The Nominating Committee s duties include identifying and nominating individuals to be proposed as nominees for election as directors at each Annual Meeting or to fill board vacancies, conducting the Board evaluation process, evaluating the categorical standards which the Board of Directors uses to determine director independence, and monitoring and evaluating corporate governance. The Nominating Committee also oversees Board processes and corporate governance-related risk. The Nominating Committee held four meetings in 2011.

Public Policy Strategies and Responsibility Committee

The Public Policy Committee consists of Dr. Wilensky (Chair), Ms. Hooper and Dr. Shine. The Public Policy Committee is responsible for assisting the Board of Directors in fulfilling its responsibilities relating to the Company s public policy, health care reform and modernization activities, political contributions, government relations, community and charitable activities and corporate social responsibility. The Public Policy Committee is also responsible for overseeing the risks associated with these activities. The Public Policy Committee held four meetings in 2011.

Communication with the Board of Directors

The Board of Directors values the input and insights of our shareholders and other interested parties and believes that effective communication strengthens the Board of Directors role as an active, informed and engaged fiduciary. The Board of Directors has adopted a Board of Directors Communication Policy to facilitate communication between shareholders and the Board. Under this policy, the Board of Directors has designated the Company s Secretary to the Board of Directors as its agent to receive and review communications.

The Company will not forward to the directors communications received which are of a personal nature or not related to the duties and responsibilities of the Board of Directors, including, without limitation, junk mail, mass mailings, business solicitations, routine customer service complaints, new product or service suggestions, and opinion survey polls. The Secretary to the Board of Directors will forward such complaints and suggestions received to the appropriate members of the Company s management.

Appropriate Board communications include matters relating to:

- Board succession planning process;
- CEO succession planning process;
- Executive compensation;
- Use of capital;
- Corporate governance; and
- General Board oversight, including accounting, internal controls, auditing and other related matters.

The policy, including information on how to contact the Board of Directors, may be found in the corporate governance section of the Company s website, *www.unitedhealthgroup.com*.

EXECUTIVE COMPENSATION

Executive Summary

UnitedHealth Group s compensation program is designed to attract and retain highly qualified executives and to maintain a strong link between pay and the achievement of enterprise-wide goals. We emphasize and reward teamwork and collaboration among executive officers, which we believe produces Company growth and performance, optimizes the use of enterprise-wide capabilities, drives efficiencies and integrates products and services for the benefit of our customers and other stakeholders.

In January 2011, UnitedHealth Group announced the next phase in the continuing alignment of the Company s UnitedHealthcare and Optum business platforms and the resulting change in roles for a number of the Company s senior executives. These changes were designed to further position the Company as it continues to grow in the evolving health care landscape. In determining 2011 executive compensation, the Compensation Committee considered the changes in executive responsibilities resulting from this realignment and the Company s strong growth, operating performance and financial results, all of which were achieved in a challenging economic environment. Some of our key business results for 2011 were:

- Revenues increased 8% to $101.9 billion from $94.2 billion in 2010;
- Net earnings increased 11% to $5.1 billion from $4.6 billion in 2010;
- Cash flow increased 11% to $7.0 billion as compared to $6.3 billion in 2010;
- Earnings per share increased 15% to $4.73 per share from $4.10 per share in 2010; and
- Total shareholder return was 42% compared to 2.1% for the S&P 500 generally.

Achievement of this strong financial performance was driven by our success on a broad range of initiatives that were intended to position the Company for future growth.

The Compensation Committee believes that total compensation for our named executive officers, which includes our Chief Executive Officer, our current and former Chief Financial Officer and each of our three other most highly compensated executive officers, should be heavily weighted toward long-term performance-based compensation, and this was the case for 2011. The elements of compensation for our named executive officers were unchanged from 2010, and in 2011, long-term compensation represented between 65% and 80% of the total mix of compensation granted to our named executive officers.

As discussed in detail below and reflected in the summary compensation table, in 2011, the Compensation Committee determined that our CEO, Mr. Hemsley, should receive the following compensation:

- Base salary of $1.3 million, which has been at this level since 2006;
- Annual cash incentive award of $3.6 million, which represents 160% of his target opportunity and reflects the Company s performance against pre-set annual incentive plan performance targets;

Long-term cash incentive award of $1.3 million for the 2009 2011 performance period, which represents maximum performance and reflects the Company s performance against pre-set 2009 2011 long term incentive plan performance targets;

A performance-based restricted stock unit opportunity (performance shares) with a targeted grant date value of $3.5 million, and restricted stock units (RSUs) with a grant date fair value of $3.5 million; and

Company matching contributions of $152,025 made under the Company s 401(k) and Executive Savings Plan.

The Compensation Committee believed this compensation was appropriate to recognize Mr. Hemsley s overall leadership in positioning the Company for long-term success during a period of significant change and modernization in the health care marketplace; in particular, the Committee recognized the CEO s leadership in enhancing the Company s reputation, ethical culture and tone at the top, and strategic leadership of the Company. Although Mr. Hemsley s total compensation is below the CEO median in the Company s peer group, the Compensation Committee and Mr. Hemsley agree that the total compensation awarded is sufficient to retain and motivate him.

We endeavor to maintain strong governance standards in the oversight of our executive compensation policies and practices, including the following policies and practices that were in effect during 2011:

The Compensation Committee s independent compensation consultant, Pay Governance LLC, is retained directly by the Compensation Committee and performs no other consulting or other services for the Company.

Stock ownership guidelines for our executive officers, each of whom satisfied the applicable ownership guidelines as of December 31, 2011.

A stock retention policy that requires executive officers to hold, for at least one year, 1/3 of the net shares acquired upon vesting or exercise (as applicable) of any equity award granted after October 2009.

No ongoing pension obligations (supplemental or otherwise) for any of our named executive officers.

No excise tax gross-ups or executive-only perks such as company cars, security systems, financial planning or vacation homes are provided to our executive officers.

A compensation clawback policy that applies to a number of senior executives, including all of our named executive officers.

Performance-based compensation arrangements that use a variety of performance measures, including performance-based equity awards.

Change-in-control benefits, including time-vested equity awards granted after 2010, are subject to double-trigger arrangements that require both a change in control and a qualifying employment termination.

Our 2011 Stock Incentive Plan prohibits the repricing of stock options or stock appreciation rights without shareholder approval.

Annual advisory shareholder vote to approve the Company s executive compensation.

Compensation Discussion and Analysis

Philosophy and Objectives of our Compensation Program

We seek to attract and retain highly qualified executives and establish a strong pay-for-performance alignment by linking senior management compensation to enterprise goals. The primary objectives of our executive compensation program are to:

- Attract, motivate and retain highly qualified executive officers.
- Align the economic interests of our executive officers with those of our shareholders.
- Reward performance that emphasizes teamwork and close collaboration among executive officers.
- Reward performance that supports the Company s values.
- Reward performance that advances our mission of helping people live healthier lives.
- Foster an entrepreneurial spirit that reflects innovative thinking and action and effective and accountable management and leverages the ingenuity of our employees.

Compensation Program Principles

Our Compensation Committee uses the following principles to implement our compensation philosophy and achieve our executive compensation program objectives:

- *Pay-for-performance.* A substantial portion of the total compensation of our executive officers is earned based on achievement of enterprise-wide goals that impact shareholder value.
- *Enhance the value of the business.* Incentive compensation design and performance measures encourage executive officers to favor the longer-term value of the Company and avoid excessive risk-taking in the short-term.
- *Reward long-term growth and focus management on sustained success and shareholder value creation.* Compensation of our executive officers is heavily weighted toward equity and long-term cash awards. These awards encourage sustained performance and positive shareholder returns.
- *Modest benefits and limited perquisites.* We provide standard employee benefits and limited perquisites to our named executive officers. We believe the absence of executive-only benefits or perquisites is appropriate in our culture and does not impact our ability to attract and retain such executives.

Determination of Total Compensation

Role of the Compensation Committee

The Compensation Committee oversees the Company s policies and philosophy related to total compensation for executive officers. The Compensation Committee approves the compensation for the named executive officers based on its own evaluation, input from our CEO (for all executive officers except for himself), internal pay equity considerations, the tenure and performance of each named executive officer, input from its independent consultant and market data.

In addition, in making 2011 compensation decisions, the Compensation Committee considered the results of the Company s first annual advisory vote to approve the Company s executive compensation, which was conducted at our 2011 Annual Meeting. At this meeting, more than 97% of the votes were cast in favor of the proposal. The Compensation Committee believes that this shareholder vote indicates strong support for our executive compensation program.

The Compensation Committee s Use of an Independent Compensation Consultant

The Compensation Committee retains a separate independent compensation consultant, Jon Weinstein at Pay Governance LLC, to advise the Compensation Committee on executive and director compensation matters, assess total compensation program levels and program elements for executive officers and evaluate competitive compensation trends. Pay Governance does not provide any other services to the Company and does not perform any work for management.

Competitive Positioning

The Compensation Committee believes that total compensation for named executive officers should be heavily weighted toward long-term performance-based compensation, but it does not target a specific mix of compensation between annual and long-term compensation or between equity and cash compensation.

In general, the Compensation Committee s goal is to achieve total compensation for the named executive officers as a group that falls within a range of the fiftieth to the seventy-fifth percentiles of the market if paid at target. Target total compensation of our named executive officers as a group in 2011, consisting of base salary, target annual cash incentive award, target long-term cash incentive award and the grant date fair value of equity awards (including performance shares at target), resulted in a target compensation opportunity for our executive officers as a group between the median and the seventy-fifth percentile of the market data for our primary peer group.

In 2011, the Compensation Committee requested that its independent compensation consultant review the peer group data used by the committee. The Compensation Committee chartered this review to ensure that competitive compensation data were:

- an accurate reflection of the external labor market for senior talent;
- sourced from companies whose scope of operations were generally consistent with the Company s size and complexity; and
- based on a sufficient number of companies to stand up over time to predictable changes in the external market.

The Compensation Committee determined to use market data developed from a broad industry group of premier companies. This group is developed by the independent compensation consultant based on the following selection criteria:

- top 100 publicly traded companies in terms of revenue or market cap;
- eliminate companies in industries that have unique structures that are not relevant to UnitedHealth Group, such as oil and gas, heavy manufacturing, aerospace and defense, auto manufacturing or similar industries, because the Company is unlikely to recruit from these companies;
- eliminate companies with a single line of business, so that only multi-segment companies are included; and
- add major companies located near UnitedHealth Group s significant executive locations, to consider local competitive dynamics.

The Company does not participate in the selection of the companies for inclusion in the general industry group and the Compensation Committee is not made aware of the companies in this group until the independent compensation consultant presents its benchmarking results to the committee.

The Compensation Committee also considered market data from the five largest publicly traded managed care companies with which we compete for business. However, the Compensation Committee does not utilize this group of managed care companies as a primary reference point for

benchmarking compensation practices because the Company is substantially larger, more complex and more diverse than the group s component companies, and because we believe that the Company competes primarily for talent and capital with other successful large companies across a broader group of industries. The companies that were included in the 2011 peer groups are listed at the end of this Compensation Discussion and Analysis.

Role of Management and CEO in Determining Executive Compensation

The Compensation Committee has the responsibility to approve and monitor all compensation for our executive officers. Management recommends appropriate enterprise-wide financial and non-financial performance goals for use in incentive compensation. Our CEO assists the Compensation Committee by providing his evaluation of the performance of the executive officers that report directly to him and recommends compensation levels for these executive officers. Our CEO does not, however, make recommendations regarding his own compensation.

Use of Tally Sheets and Wealth Accumulation Analysis

When approving compensation decisions, the Compensation Committee reviews robust tally sheet information for each of our executive officers. These tally sheets are prepared by management and quantify the elements of each executive officer s total compensation. The tally sheets include a summary of all equity awards previously granted to each executive officer, the gain realized from past vesting or exercise of equity awards and the projected value of accumulated equity awards based upon various stock price scenarios. This is done to effectively analyze the compensation each executive officer has accumulated to date and to fully understand the amount the executive officer could accumulate in the future.

Change in Named Executive Officer Responsibilities in 2011

In January 2011, UnitedHealth Group announced the next phase in the continuing alignment of its UnitedHealthcare and Optum business platforms and related changes in roles for a number of the Company s senior executives, including:

- Gail K. Boudreaux assumed overall responsibility for all UnitedHealthcare health benefits businesses;
- David S. Wichmann became Chief Financial Officer while retaining his existing corporate responsibilities for leading enterprise-wide information technology and operations;
- George L. Mikan III ceased being Chief Financial Officer and assumed responsibility for the Company s Optum business platform, including OptumHealth and OptumInsight, and working with another executive officer to oversee OptumRx; and
- Larry C. Renfro and Anthony Welters joined Mr. Hemsley in the office of the Chief Executive, focused on enterprise-wide initiatives, including emerging growth and expansion opportunities, public, regulatory and governmental affairs, reputation and market image efforts, and external relationships for the Company.

These changes were designed to further position the Company as it continues to grow in the evolving health care landscape. On July 6, 2011, we announced that Mr. Renfro was named Chief Executive Officer of Optum, and that Mr. Mikan would be leaving the Company in February 2012. Additional details about the terms of Mr. Mikan s departure can be found in Departure of George L. Mikan III below.

Elements of our Compensation Program

Overview

The compensation program for our named executive officers consists of the following elements:

Compensation Element	Objective	Type of Compensation
Base salary	To provide a base level of cash compensation for executive officers	Annual cash compensation, not variable
Annual cash incentive awards	To encourage and reward executive officers for achieving annual corporate performance goals	Annual performance compensation, variable
Long-term cash incentive awards	To encourage and reward executive officers for achieving three-year corporate performance goals	Long-term performance compensation, variable
Equity awards	To motivate and retain executive officers and align their interests with shareholders through the use of: Performance shares to motivate sustained performance and growth and potentially assist executives in building ownership in the Company; and RSUs to retain executive officers and build stock ownership positions.	Long-term performance compensation, variable
Employee benefits	The smallest part of total remuneration promotes health, well-being and financial security of employees, including executive officers	Annual indirect compensation, not variable

Annual Compensation

Base Salary

The Compensation Committee generally determines base salary levels for our named executive officers early in the fiscal year, with changes becoming effective during the first quarter of the fiscal year. For 2011, the Compensation Committee made no change to our CEO s base salary and increased the other named executive officers base salaries as set forth below due to the increased scope of their responsibilities, as discussed above:

Name	2011 Base Salary ($)	2010 Base Salary ($)	2011 to 2010

			Increase (%)
S. Hemsley	1,300,000	1,300,000	NA
D. Wichmann	850,000	700,000	21%
G. Boudreaux	850,000	700,000	21%
L. Renfro	850,000	700,000	21%
A. Welters	750,000	700,000	7%
M. Mikan	850,000	700,000	21%

Annual Cash Incentive Awards

2011 Annual Incentive Plan Performance Goals

Annual cash incentive awards may be paid if our Company meets or exceeds annual performance goals as determined by the Compensation Committee for that year. In February 2011, the Compensation Committee approved performance criteria and target performance goals for the 2011 annual cash incentive award. These performance goals are based on enterprise-wide measures because the Compensation Committee believes that the named executive officers share the responsibility to support the goals and performance of the Company as key members of the Company s leadership team. The following table sets forth these performance measures, as well as actual 2011 performance results in each of those categories:

2011 Performance Measure	Weight	Threshold Performance	Target Performance	Maximum Performance	Actual 2011 Performance
Revenue	1/3	$95.19 billion	$100.2 billion	$105.21 billion	$101.505 billion
Operating Income	1/3	$5.997 billion	$7.055 billion	$8.113 billion	$8.449 billion
Cash Flow		$4.675 billion	$5.5 billion	$6.325 billion	$6.968 billion
Stewardship:					
Customer and Physician Satisfaction					
Employee Engagement					

Finally, in February of 2012, the Company was made aware of a fraud perpetrated by an outside party involving insurance related premiums that the Company had prepaid for umbrella coverage. The assets are currently secured by a governmental agency which investigated the case, and held in a custodial account. In June of 2015, utilizing the secured funds, the court has approved restitution to all victims including the Company. It is not clear however at this point what amount will eventually be received by the Company. The value of the assets on the books amount to $213,000 at September 30, 2015 and December 31, 2014, and are included in Other Long Term Assets. It is possible that not all of those funds will be returned to the Company, or the Company may need to incur additional costs to procure collection. The Company is currently pursuing all avenues in an effort to bring closure to the event, and reclaim the assets, and has since replaced the aforementioned insurance coverage.

6. STOCK BASED PLANS

Phantom Stock Plan

Plan Description. On April 1, 2006, the Company adopted the Omega Flex, Inc. 2006 Phantom Stock Plan (the Plan). The Plan authorizes the grant of up to 1 million units of phantom stock to employees, officers or directors of the Company and of any of its subsidiaries. The phantom stock units ("Units") each represent a contractual right to payment of compensation in the future based on the market value of the Company s common stock. The Units are not shares of the Company s common stock, and a recipient of the Units does not receive any of the following:

§

ownership interest in the Company

§

shareholder voting rights

§

other incidents of ownership to the Company s common stock

The Units are granted to participants upon the recommendation of the Company s CEO, and the approval of the Compensation Committee. Each of the Units that are granted to a participant will be initially valued by the Compensation Committee, at an amount equal to the closing price of the

Company s common stock on the grant date, but are recorded at fair value using the Black-Sholes method as described below. The Units follow a vesting schedule, with a maximum vesting of 3 years after the grant date. Upon vesting, the Units represent a contractual right of payment for the value of the Unit. The Units will be paid on their maturity date, one year after all of the Units granted in a particular award have fully vested, unless an acceptable event occurs under the terms of the Plan prior to one year, which would allow for earlier payment. The amount to be paid to the participant on the maturity date is dependent on the type of Unit granted to the participant.

The Units may be *Full Value,* in which the value of each Unit at the maturity date, will equal the closing price of the Company s common stock as of the maturity date; or *Appreciation Only*, in which the value of each Unit at the maturity date will be equal to the closing price of the Company s common stock at the maturity date *minus* the closing price of the Company s common stock at the grant date.

On December 9, 2009, the Board of Directors authorized an amendment to the Plan to pay an amount equal to the value of any cash or stock dividend declared by the Company on its common stock to be accrued to the phantom stock units outstanding as of the record date of the common stock dividend. The dividend equivalent will be paid at the same time the underlying phantom stock units are paid to the participant.

In certain circumstances, the Units may be immediately vested upon the participant s death or disability. All Units granted to a participant are forfeited if the participant is terminated from his relationship with the Company or its subsidiary for cause, which is defined under the Plan. If a participant s employment or relationship with the Company is terminated for reasons other than for cause, then any vested Units will be paid to the participant upon termination. However, Units granted to certain specified employees as defined in Section 409A of the Internal Revenue Code will be paid approximately 181 days after termination.

Grants of Phantom Stock Units. As of December 31, 2014, the Company had 19,156 unvested units outstanding, all of which were granted at *Full Value*. On February 16, 2015, the Company granted an additional 10,460 *Full Value* Units with a fair value of $28.90 per unit on grant date, using historical volatility. In March 2015, the Company paid $257,000 for the 8,100 fully vested and matured units that were granted on March 3, 2011, including their respective earned dividend values. As of September 30, 2015, the Company had 20,335 unvested units outstanding.

The Company uses the Black-Scholes option pricing model as its method for determining fair value of the Units. The Company uses the straight-line method of attributing the value of the stock-based compensation expense relating to the Units. The compensation expense (including adjustment of the liability to its fair value) from the Units is recognized over the vesting period of each grant or award.

FASB ASC Topic 718, Stock Compensation, requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates in order to derive the Company s best estimate of awards ultimately to vest.

Forfeitures represent only the unvested portion of a surrendered Unit and are typically estimated based on historical experience. Based on an analysis of the Company s historical data, which has limited experience related to any stock-based plan forfeitures, the Company applied a 0% forfeiture rate to Plan Units outstanding in determining its Plan Unit compensation expense as of September 30, 2015.

The total Phantom Stock related liability as of September 30, 2015 was $800,000 of which $305,000 is included in Other Liabilities, as it is expected to be paid in February 2016, and the balance of $495,000 is included in Other Long Term Liabilities. At December 31, 2014, the total Phantom Stock liability was $952,000, with $321,000 in Other Liabilities, and $631,000 included in Other Long Term Liabilities.

In accordance with FASB ASC Topic 718, Stock Compensation, the Company recorded compensation expense of approximately $104,000 and $139,000 related to the Phantom Stock Plan for the nine months ended September 30, 2015 and 2014, respectively.

The following table summarizes information about the Company s nonvested phantom stock Units at September 30, 2015:

	Units	**Weighted Average Grant Date Fair Value**
Number of Phantom Stock Unit Awards:		
Nonvested at December 31, 2014	19,156	$15.67
Granted	10,460	$28.90
Vested	(9,281)	$15.09
Forfeited	---	---
Canceled	---	---
Nonvested at September 30, 2015	20,335	$22.74
Phantom Stock Unit Awards Expected to Vest	20,335	$22.74

The total unrecognized compensation costs calculated at September 30, 2015 are $464,000 which will be recognized through March of 2018. The Company will recognize the related expense over the weighted average period of 1.5 years.

7. NONCONTROLLING INTERESTS

The Company owns 100% of all subsidiaries, except for a small portion of one, which is owned by a Noncontrolling Interest. At December 31, 2014, total Shareholders Equity was $33,969,000, and the Noncontrolling Interest was $111,000. For the nine month period ended September 30, 2015, the Noncontrolling Interest s portion of Net Income was approximately $128,000, and their portion of Other Comprehensive Income was a loss of $6,000. At September 30, 2015, total Shareholders Equity was $45,057,000, of which the Noncontrolling Interest held a value of $233,000.

8. SHAREHOLDERS EQUITY

As of September 30, 2015 and December 31, 2014, the Company had authorized 20,000,000 common stock shares with par value of $0.01 per share. At both dates, the number of shares issued was 10,153,633, and the total number of outstanding shares was 10,091,822, with the 61,811 variance representing shares held in Treasury.

On December 10, 2014, the Board declared a special dividend of $0.49 per share to all Shareholders of record as of December 22, 2014, which was paid on January 5, 2015, in the amount of $4,945,000. Additionally, there was a dividend that was paid during 2014 by the Company s UK subsidiary, which amounted to an outlay of cash of $145,000 to the subsidiary s noncontrolling interest.

On December 9, 2013, the Board declared a special dividend of $0.425 per share to all Shareholders of record as of December 19, 2013, and payable on or before January 2, 2014. The Company paid its transfer agent $4,289,000 on December 31, 2013, and the transfer agent paid the shareholders on January 2, 2014.

On April 11, 2015, the Company s Board of Directors authorized an extension, for another 24 months, of the stock purchase program previously announced on September 12, 2007 and extended on September 15, 2009, April 5, 2011, April 4, 2012 and April 1, 2014. The original program permitted a purchase of up to $5,000,000 of the Company s common stock depending on market and business conditions. Since the program began, the Company has purchased 61,811 shares of its common stock for an aggregate purchase price of approximately $923,000, leaving a balance of approximately $4,077,000 available to purchase additional shares of its common stock within the next 24 months. Stock purchases may be made using various types of transactions, including open-market purchases or transactions off the market, and may be made under Rule 10b5-1 trading programs. The timing of stock purchases, type of transaction and number of shares purchased will depend on a number of factors, including market conditions, the price of the Company s common stock, and the Company s capital position, its financial performance and investment opportunities.

9.

SUBSEQUENT EVENTS

The Company evaluated all events or transactions that occurred through the date of this filing. During this period, the Company did not have any material subsequent events that impacted its condensed consolidated financial statements.

<u>Item 2 Management s Discussion and Analysis of Financial Condition and Results of Operations</u>

This report contains forward-looking statements, which are subject to inherent uncertainties. These uncertainties include, but are not limited to, variations in weather, changes in the regulatory environment, customer preferences, general economic conditions, increased competition, the outcome of outstanding litigation, and future developments affecting environmental matters. All of these are difficult to predict, and many are beyond the ability of the Company to control.

Certain statements in this Quarterly Report on Form 10-Q that are not historical facts, but rather reflect the Company s current expectations concerning future results and events, constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. The words believes , expects , intends , plans , anticipates , hopes , likely , will , and similar expressions identify such forward-looking statements. Such forward-looking statements involve known and unknown risks, uncertainties and other important factors that could cause the actual results, performance or achievements of the Company, or industry results, to differ materially from future results, performance or achievements expressed or implied by such forward-looking statements.

Readers are cautioned not to place undue reliance on these forward-looking *statements, which reflect management s view only as of the date of this Form 10-Q. The Company undertakes no obligation to update the result of any revisions to these forward-looking statements which may be made to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events, conditions or circumstances.*

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OVERVIEW

The Company is a leading manufacturer of flexible metal hose, and is currently engaged in a number of different markets, including construction, manufacturing, petrochemical transfer, pharmaceutical and other industries.

The Company s business is managed as a single operating segment that consists of the manufacture and sale of flexible metal hose and accessories. The Company s products are concentrated in residential and commercial construction, and general industrial markets, with a comprehensive portfolio of intellectual property and patents issued in various countries around the world. The Company s primary product, flexible gas piping, is used for gas piping within residential and commercial buildings. Through its flexibility and ease of use, the Company s TracPipe® and TracPipe® CounterStrike® flexible gas piping, along with its fittings distributed under the trademarks AutoSnap® and AutoFlare®, allows users to substantially cut the time required to install gas piping, as compared to traditional methods. The Company s products are manufactured at its Exton, Pennsylvania facilities in the United States, and in Banbury, Oxfordshire in the United Kingdom. A majority of the Company s sales across all industries are generated through independent outside sales organizations such as sales representatives, wholesalers and distributors, or a combination of both. The Company has a broad distribution network in North America and to a lesser extent in other global markets.

CHANGES IN FINANCIAL CONDITION

The Company s cash balance of $24,199,000 at September 30, 2015, increased $1,614,000 (7.1%) from the $22,585,000 balance at December 31, 2014. The increase is largely the result of cash generated from operations, partially offset by a dividend of $4,945,000 paid during the first quarter of 2015 which was accrued at December 31, 2014, and other significant cash outflows during the first quarter of the year for items such as sales promotions programs and incentive compensation, which were also accrued for at the previous year end.

The Accounts Receivable balance at September 30, 2015 was $15,233,000, compared to $13,723,000 at December 31, 2014. The increase of $1,510,000 (11%) was primarily attributable to an increase in sales during the last couple months of the current quarter, compared to the last couple of months of 2014, which increased amounts due from customers.

Dividends Payable was $4,945,000 at the end of 2014, which was paid to shareholders on January 5, 2015, thus reducing the balance to zero. This also reduced the Company s cash balance, as also described above.

RESULTS OF OPERATIONS

Three-months ended September 30, 2015 vs. September 30, 2014

The Company reported comparative results from operations for the three-months ended September 30, 2015 and 2014 as follows:

	Three-months ended September 30, (in thousands)			
	2015 ($000)	**2015**	**2014 ($000)**	**2014**
Net Sales	$ 24,556	100.0%	$ 23,837	100.0%
Gross Profit	$ 15,286	62.3%	$ 14,316	60.1%
Operating Profit	$ 6,377	26.0%	$ 6,095	25.6%

Net Sales. The Company s 2015 third quarter sales increased $719,000 (3.0%) over the same period in 2014, ending at $24,556,000 for the three months ended September 30, 2015, compared to $23,837,000 for the same three months in 2014. The change in sales is a combination of an increase in unit volume, with the bulk coming from flexible gas piping products, and the effect of a price increase implemented in late 2014, which was put forth to combat anticipated raw material price increases from the Company s vendors.

Gross Profit. The Company s gross profit margins have improved slightly between the two periods, being 62.3% and 60.1% for the three-months ended September 30, 2015 and 2014, respectively. The Company experienced some pricing relief during the third quarter on its raw material components, which along with other various factory related efficiencies, and a small price increase to customers noted above, allowed the Company to maintain a slight lead over last year.

Selling Expenses. Selling expenses consist primarily of employee salaries and associated overhead costs, commissions, and the cost of marketing programs such as advertising, trade shows and related communication costs, and freight. Selling expense was $4,009,000 and $3,706,000 for the three-months ended September 30, 2015 and 2014, respectively, representing an increase of $303,000. The largest component of the increase related to commissions largely in conjunction with the increase in sales, and there was also a rise in staffing related expenses and advertising during the quarter, as the Company puts forth efforts to increase its volume and markets. Selling expense as a percent of net sales rose slightly between periods, being 16.3% for the three-months ended September 30, 2015, compared to 15.6% for the three-months ended September 30, 2014.

General and Administrative Expenses. General and administrative expenses consist primarily of employee salaries, benefits for administrative, executive and finance personnel, legal and accounting, insurance, and corporate general and administrative services. General and administrative expenses were $4,210,000 and $3,751,000 for the three-months ended September 30, 2015 and 2014, respectively, increasing $459,000 or 12.2% between periods. The Company recognized an increase in legal and insurance related expenses of $591,000 primarily associated with product liability claims and coverage. This was softened by a decrease in staffing related expenses, and other items. As a percentage of sales, general and administrative expenses were 17.1% and 15.7% for the three months ended September 30, 2015 and 2014, respectively.

Engineering Expense. Engineering expenses consist of development expenses associated with the development of new products, and costs related to enhancements of existing products and manufacturing processes. Engineering expenses decreased $74,000 for the quarter. They were $690,000 and $764,000 for the three months ended September 30, 2015 and 2014, respectively. Engineering expenses as a percentage of sales were 2.8% and 3.2% for the three months ended September 30, 2015, and 2014, respectively.

Operating Profit. Reflecting all of the factors mentioned above, Operating Profits increased by $282,000, or 4.6% over last year. The Company had a profit of $6,377,000 in the three-month period ended September 30, 2015, versus a profit of $6,095,000 in the three-months ended September 30, 2014.

Interest Income. Interest income is recorded on cash investments, and interest expense is recorded at times when the Company has debt amounts outstanding on its line of credit. The Company recognized a modest amount of interest income for the third quarter of 2015 and 2014.

Other (Expense). This primarily consists of foreign currency exchange gains (losses) on transactions with Omega Flex Limited, our U.K. subsidiary. There was a small amount of Other Expense in both 2015 and 2014 for the third quarter.

Income Tax Expense. Income Tax Expense was $2,114,000 for the third quarter of 2015, compared to $2,002,000 for the same period in 2014. The $112,000 increase was primarily due to higher income before taxes. The Company s effective tax rate in 2015 approximates the 2014 rate and does not differ materially from expected statutory rates.

Nine-months ended September 30, 2015 vs. September 30, 2014

The Company reported comparative results from operations for the nine-months ended September 30, 2015 and 2014 as follows:

	Nine-months ended September 30, (in thousands)			
	2015 ($000)	**2015**	**2014 ($000)**	**2014**
Net Sales	$ 67,165	100.0%	$ 60,298	100.0%
Gross Profit	$ 41,014	61.1%	$ 35,049	58.1%
Operating Profit	$ 16,468	24.5%	$ 13,655	22.7%

Net Sales. The Company s sales for the first nine months of 2015 increased $6,867,000, or 11.4% over the same period in 2014, ending at $67,165,000 and $60,298,000 in 2015 and 2014, respectively.

The majority of the sales growth is the result of an increase in unit volume, with the bulk coming from the flexible gas piping business, partly attributable to the modest growth in the construction industry, particularly in residential housing. The Company has also been able to expand its markets by offering innovative products such as its AutoSnap® fitting, which complements the TracPipe® CounterStrike® flexible gas piping products, as well as DoubleTrac® and DEF-Trac® double-containment piping, used in refueling and auxiliary power generation markets. The Company has also experienced growth outside of its North American core market, particularly Europe.

Gross Profit. The Company s gross profit margins have increased between the two periods, being 61.1% and 58.1% for the nine-months ended September 30, 2015 and 2014, respectively. Although the Company experienced an increase during the first portion of the year in the cost of its strip metal, which is a significant raw material component used in the Company s piping products, there has been a softening in those costs during the third quarter. The Company has been able to diminish the overall impact through other areas, and components, including various factory related efficiencies, and a small price increase to customers that was in effect as of the beginning of the year.

Selling Expenses. Selling expenses consist primarily of employee salaries and associated overhead costs, commissions, and the cost of marketing programs such as advertising, trade shows and related communication costs, and freight. Selling expense was $11,599,000 and $10,257,000 for the nine-months ended September 30, 2015 and 2014, respectively, representing an increase of $1,342,000. Although no particular item represented a majority of the increase on its own, the largest contributors were commissions, which increased compared to last year largely in relation with the increase in sales, and there was an increase in staffing related expenses, as the Company strived to increase its unit volume and markets. Sales expense as a percent of Net Sales was largely flat, being 17.3% for the nine-months ended September 30, 2015, and 17.0% for the nine-months ended September 30, 2014.

General and Administrative Expenses. General and administrative expenses consist primarily of employee salaries, benefits for administrative, executive and finance personnel, legal and accounting, insurance, and corporate general and administrative services. General and administrative expenses were $10,906,000 and $9,011,000 for the nine-months ended September 30, 2015 and 2014, respectively, increasing $1,895,000 between periods. The majority of the change for the nine months pertained to legal and insurance related expenses primarily associated with product liability claims and coverage, which increased $1,812,000 over last year. As a percentage of sales, general and administrative expenses increased to 16.2% for the nine-months ended September 30, 2015 from 14.9% for the nine-months ended September

30, 2014.

Engineering Expense. Engineering expenses consist of development expenses associated with the development of new products, and costs related to enhancements of existing products and manufacturing processes. Engineering expenses are very similar between periods, as they were $2,041,000 and $2,126,000 for the nine months ended September 30, 2015 and 2014, respectively. Engineering expenses as a percentage of sales were 3.0% for the nine months ended September 30, 2015 and 3.5% for the nine-months ended September 30, 2014.

Operating Profit. Reflecting all of the factors mentioned above, Operating Profits increased $2,813,000 or 20.6%, ending with a profit of $16,468,000 for the first nine months of 2015, compared to $13,655,000 in 2014.

Interest Income. Interest income is recorded on cash investments, and interest expense is recorded at times when the Company has debt amounts outstanding on its line of credit. There was a nominal amount of interest income recorded during the first nine months of 2015 and 2014.

Other (Expense). This primarily consists of foreign currency exchange gains (losses) on transactions with Omega Flex Limited, our U.K. subsidiary. There was a small amount of Other Expense in both 2015 and 2014.

Income Tax Expense. Income Tax Expense was $5,338,000 for the first nine months of 2015, compared to $4,430,000 for the same period in 2014, increasing by $908,000, largely in correlation with the change in income before taxes. The Company s effective tax rate in 2015 approximates the 2014 rate and does not differ materially from expected statutory rates.

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CRITICAL ACCOUNTING POLICIES AND USE OF ESTIMATES

Financial Reporting Release No. 60, released by the Securities and Exchange Commission, requires all companies to include a discussion of critical accounting policies or methods used in the preparation of financial statements. Note 2 of the Notes to the Condensed Consolidated Financial Statements includes a summary of the significant accounting policies and methods used in the preparation of our condensed Consolidated Financial Statements. The following is a brief discussion of the Company s significant accounting policies.

The preparation of financial statements in conformity with generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. The most significant estimates and assumptions relate to revenue recognition and related sales incentives, accounts receivable allowances, inventory valuations, goodwill valuation, product liability reserve, stock-based compensation valuations and accounting for income taxes. Actual amounts could differ significantly from these estimates.

Our critical accounting policies and significant estimates and assumptions are described in more detail as follows:

Revenue Recognition

The Company s revenue recognition activities relate almost entirely to the manufacture and sale of flexible metal hose and pipe. Under GAAP, revenues are considered to have been earned when the Company has substantially accomplished what it must do to be entitled to the benefits represented by the revenues. The following criteria represent preconditions to the recognition of revenue:

.

Persuasive evidence of an arrangement for the sale of product or services must exist.

.

Delivery has occurred or services rendered.

.

The sales price to the customer is fixed or determinable.

.

Collection is reasonably assured.

The Company recognizes revenue upon shipment in accordance with the above principles.

Gross sales are reduced for all consideration paid to customers for which no identifiable benefit is received by the Company. This includes promotional incentives, which includes various programs including year-end rebates and discounts. The amounts of certain incentives are known with reasonable certainty at the time of sale, while others are projected based upon the most reliable information available at the reporting date. Commissions are accounted for as a sales expense.

Cash Equivalents

The Company considers all highly liquid investments with an original maturity of 90 days or less at the time of purchase to be cash equivalents. Cash equivalents include investments in an institutional money market fund, which invests in U.S. Treasury bills, notes and bonds, and/or repurchase agreements, backed by such obligations. Carrying value approximates fair value. Cash and cash equivalents are deposited at various area banks, which at times may exceed federally insured limits. The Company monitors the viability of the banking institutions carrying its assets on a regular basis, and has the ability to transfer cash to various institutions during times of risk. The Company has not experienced any losses related to these cash balances, and believes its credit risk to be minimal.

Accounts Receivable and Provision for Doubtful Accounts

Accounts receivable are reduced by an allowance for amounts that may become uncollectible in the future. The estimated allowance for uncollectible amounts is based primarily on specific analysis of accounts in the receivable portfolio and historical write-off experience. While management believes the allowance to be adequate, if the financial condition of the Company s customers were to deteriorate, resulting in their inability to make payments, additional allowances may be required.

The allowance for doubtful accounts reflects our best estimate of probable losses inherent in the accounts receivable balance. The Company determines the allowance based on any known collection issues, historical experience, and other currently available evidence. The reserve for future credits, discounts, and doubtful accounts was $779,000 and $710,000 as of September 30, 2015 and December 31, 2014, respectively. In regards to identifying uncollectible accounts, the Company reviews an aging report on a consistent basis to determine past due accounts, and utilizes a well established credit rating agency. The Company charges off those accounts that are deemed uncollectible once all collection efforts have been exhausted.

Inventories

Inventories are valued at the lower of cost or market. The cost of inventories is determined by the first-in, first-out (FIFO) method. The Company generally considers inventory quantities beyond two-years usage, measured on a historical usage basis, to be excess inventory and reduces the carrying value of inventory accordingly.

Property and Equipment

Property and equipment are carried at cost. Depreciation and amortization are computed using the straight-line method over the estimated useful lives of the assets or, for leasehold improvements, the life of the lease, if shorter. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts and any resulting gain or loss is reflected in other income or expense for the period. The cost of maintenance and repairs is expensed as incurred; significant improvements are capitalized.

Goodwill

In accordance with Financial Accounting Standards Board (FASB) ASC Topic 350, Intangibles Goodwill and Other, the Company performed an annual impairment test in accordance with this guidance as of December 31, 2014. This analysis did not indicate any impairment of goodwill. There were no circumstances that indicate that Goodwill might be impaired at September 30, 2015.

Stock-Based Compensation Plans

In 2006, the Company adopted a Phantom Stock Plan (the Plan), which allows the Company to grant phantom stock units (Units) to certain key employees, officers or directors. The Units each represent a contractual right to payment of compensation in the future based upon the market value of the Company s common stock. The Units follow a vesting schedule of three years from the grant date, and are then paid upon maturity. In accordance with FASB ASC Topic 718, Stock Compensation, the Company uses the Black-Scholes option pricing model as its method for determining the fair value of the Units. Further details of the Plan are provided in Note 6.

Product Liability Reserves

Product liability reserves represent the estimated unpaid amounts under the

Company s insurance policies with respect to existing claims. The Company uses the most current available data to estimate claims. As explained more fully under Note 5, Commitments and Contingencies, for various product liability claims covered under the Company s general liability insurance policies, the Company must pay certain defense costs within its deductible or self-insured retention limits, ranging primarily from $25,000 to $250,000 per claim, depending on the terms of the policy in the applicable policy year, up to an aggregate amount. The Company is vigorously defending against all known claims.

Fair Value of Financial and Nonfinancial Instruments

The Company measures financial instruments in accordance with FASB ASC Topic 820, Fair Value Measurements and Disclosures. The accounting standard defines fair value, establishes a framework for measuring fair value under GAAP, and enhances disclosures about fair value measurements. Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs. The standard creates a fair value hierarchy which prioritizes the inputs to valuation techniques used to measure fair value into three broad levels as follows: Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities; Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly; and Level 3 inputs are unobservable inputs that reflect the Company s own assumptions about the assumptions market participants would use in pricing the asset or liability. The Company relies on its actively traded share value a level 1 input in determining the fair value of the reporting unit in its annual impairment test as described in FASB ASC Topic 350, Intangibles - Goodwill and Other.

Earnings per Common Share

Basic earnings per share have been computed using the weighted-average number of common shares outstanding. For the periods presented, there are no dilutive securities. Consequently, basic and dilutive earnings per share are the same.

Currency Translation

Assets and liabilities denominated in foreign currencies, most of which relate to our United Kingdom subsidiary whose functional currency is the British pound sterling, are translated into U.S. dollars at exchange rates prevailing on the balance sheet dates. The statements of income are translated into U.S. dollars at average exchange rates for the period. Adjustments resulting from the translation of financial statements are excluded from the determination of income and are accumulated in a separate component of shareholders equity. Exchange gains and losses resulting from foreign currency transactions are included in the statements of income (other expense) in the period in which they occur.

Income Taxes

The Company accounts for tax liabilities in accordance with FASB ASC Topic 740, Income Taxes. Under this method the Company records tax expense, related deferred taxes and tax benefits, and uncertainties in tax positions.

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Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities from a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is provided for deferred tax assets if it is more likely than not that these items will either expire before the Company is able to realize the benefit, or that future deductibility is uncertain.

FASB ASC Topic 740, Income Taxes clarifies the criteria that an individual tax position must satisfy for some or all of the benefits of that position to be recognized in a company s financial statements. This guidance prescribes a recognition threshold of more-likely than-not, and a measurement attribute for all tax positions taken or expected to be taken on a tax return, in order for those tax positions to be recognized in the financial statements.

The Company follows the provisions of FASB ASC 740-10 relative to accounting for uncertainties in tax positions. These provisions provide guidance on the recognition, de-recognition and measurement of potential tax benefits associated with tax positions. The Company elected to recognize interest and penalties related to income tax matters as a component of the income tax provision in the consolidated statements of income. For additional information regarding FASB ASC 740-10, see Note 8 of the Company s December 31, 2014 Form 10-K.

Other Comprehensive Income

For the three and nine months ended September 30, 2015 and 2014, respectively, the components of other comprehensive income consisted solely of foreign currency translation adjustments.

Significant Concentration

The Company has one significant customer who represents more than 10% of the Company s Net Sales for the three and nine months ended September 30, 2015 and 2014, and more than 10% of the Company s Accounts Receivable balance at September 30, 2015 and December 31, 2014. Geographically, the Company has a significant amount of sales in the United States versus internationally. These concentrations are discussed in detail in the Company s December 31, 2014 Form 10-K, and there has been no significant change as of this quarterly report.

Subsequent Events

The Company evaluates all events or transactions through the date of the related filing that may have a material impact on its condensed consolidated financial statements. Refer to Note 9 of the condensed consolidated financial statements.

Recent Accounting Pronouncements

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*, requiring an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The updated standard will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective and permits the use of either a full retrospective or retrospective with cumulative effect transition method. The updated standard becomes effective for the Company in the first quarter of fiscal year 2018. Early adoption is permitted beginning in the first quarter of the Company s 2017 fiscal year. The Company has not yet selected a transition method and is currently evaluating the effect that the updated standard will have on the condensed consolidated financial statements.

In July 2015, the FASB issued ASU 2015-11, *Simplifying the Measurement of Inventory (Topic 330)*. Under this ASU, inventory will be measured at the lower of cost and net realizable value and options that currently exist for market value will be eliminated. The ASU defines net realizable value as the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. No other changes were made to the current guidance on inventory measurement. ASU 2015-11 is effective for interim and annual periods beginning after December 15, 2016. Early application is permitted and should be applied prospectively. The Company is evaluating the provisions of this statement, including which period to adopt, and has not determined what impact the adoption of ASU 2015-11 will have on the Company's financial position or results of operations.

LIQUIDITY AND CAPITAL RESOURCES

Historically, the Company s primary cash needs have been related to working capital items, which the Company has largely funded through cash generated from operations.

As of September 30, 2015, the Company had a cash balance of $24,199,000. Additionally, the Company has a $15,000,000 line of credit available with Santander, as discussed in detail in Note 4, which had no borrowings outstanding upon it at September 30, 2015.

Operating Activities

Cash provided by operating activities is net income adjusted for certain non-cash items and changes in certain assets and liabilities, such as those included in working capital.

For the first nine months of 2015, the Company s cash provided from operating activities was $7,050,000, compared to $8,024,000 of cash provided during the same period of 2014, thus decreasing by $974,000 between periods.

As a general trend, the Company tends to deplete cash during the first quarter of the year, as significant payments are typically made for accrued promotional incentives, incentive compensation, and taxes. Cash has then historically shown a tendency to be restored and accumulated during the latter portion of the year.

Investing Activities

Cash used in investing activities for the first nine months of 2015 and 2014 was $456,000 and $78,000, respectively, all related to capital expenditures for both periods. During 2015, the Company added machinery, furniture and fixtures and leasehold improvements to the facility in Exton which required a greater outlay of cash than in the prior year.

We believe our existing cash and cash equivalents will be sufficient to meet our anticipated cash needs for at least the next twelve months. Our future capital requirements will depend upon many factors including our rate of revenue growth, the timing and extent of any expansion efforts, and the potential for investments in, or the acquisition of any complementary products, businesses or supplementary facilities for additional capacity. There are currently no known material commitments for capital expenditures.

Financing Activities

On December 10, 2014 the Company authorized a dividend of $0.49 per share, which was paid On January 5, 2015 to the shareholders in the amount of $4,945,000 in accordance with the Company s public announcement. While a dividend was also declared during December of 2013, it was paid during that same month, in the amount of $4,289,000, and therefore did not impact cash during 2014, thus accounting for the variance between the periods.

The Company did not borrow any funds from its line of credit during the first nine months of 2015 or 2014, and had no outstanding borrowings on its line of credit as of September 30, 2015, or as of December 31, 2014.

CONTINGENT LIABILITIES AND GUARANTEES

See Note 5 to the Company s condensed consolidated financial statements.

OFF-BALANCE SHEET ARRANGEMENTS

Refer to Item 7 of the Company s 2014 year-end Form 10-K under the caption Off-Balance Sheet Obligations or Arrangements .

Item 3 Quantitative and Qualitative Information about Market Risks

The Company does not engage in the purchase or trading of market risk sensitive instruments. The Company does not presently have any positions with respect to hedge transactions such as forward contracts relating to currency fluctuations. No market risk sensitive instruments are held for speculative or trading purposes.

Item 4 Controls and Procedures

(a)

Evaluation of Disclosure Controls and Procedures.

At the end of the fiscal third quarter of 2015, the Company evaluated the effectiveness of the design and operation of its disclosure controls and procedures. The Company s disclosure controls and procedures are designed to ensure that the Company records, processes, summarizes and reports in a timely manner the information required to be disclosed in the periodic reports filed by the Company with the Securities and Exchange Commission. The Company s management, including the chief executive officer and chief financial officer, have conducted an evaluation of the effectiveness of the design and operation of the Company s Disclosure Controls and Procedures as defined in the Rule 13a-15(e) of Securities Exchange Act of 1934. Based on that evaluation, the chief executive officer and chief financial officer have concluded that, as of the date of this report, the Company s disclosure controls and procedures are effective to provide reasonable assurance of achieving the purposes described in Rule 13a-15(e), and no changes are required at this time.

(b)

Changes in Internal Controls.

There was no change in the Company s internal control over financial reporting (as defined in rule 13a-15(f) of the Securities Exchange Act of 1934) identified in connection with the evaluation required by Rule 13a-15(d) of the Securities Exchange Act of 1934 that occurred during the three-month period covered by this Report on Form 10-Q that has materially affected or is reasonably likely to materially affect the Company s internal control over financial reporting subsequent to the date the chief executive officer and chief financial officer completed their evaluation.

PART II - OTHER INFORMATION

Item 1 Legal Proceedings

In the ordinary and normal conduct of the Company s business, it is subject to periodic lawsuits, investigations and claims (collectively, the Claims). In 2010, the Company experienced a spike in Claims, but during the last three years the pace of new Claims has softened, as the Company has successfully defended itself in all court proceedings. However, expenses have increased during the current year due to the Company s vigorous defense of certain cases. The Company does not believe that the Claims have legal merit, and is therefore vigorously defending against those Claims. In 2013, the Company won two of the Claims at two separate trials, both of which were held in U.S. District Court; one in St. Louis, Missouri and the other in Bridgeport, Connecticut. In both cases, the jury unanimously found that the Company was not negligent in designing its TracPipe® product, and that the TracPipe® product was not defective or unreasonably dangerous. In 2010, the Company took its first Claim to trial in Pennsylvania, and the jury returned a verdict that the Company was not negligent in designing and selling the TracPipe product, but also returned a verdict for plaintiff on strict liability. The Company has appealed that portion of the verdict, and in December 2014, the Supreme Court of Pennsylvania ruled in favor of the Company, and returned the case to the trial court for further hearings.

The Company has in place commercial general liability insurance policies that cover the Claims, which are subject to deductibles or retentions, ranging primarily from $25,000 to $250,000 per claim, (depending on the terms of the policy and the applicable policy year) up to an aggregate amount. Litigation is subject to many uncertainties and management is unable to predict the outcome of the pending suits and claims. The potential liability for a given claim could range from zero to a maximum of $250,000, depending upon the circumstances, and insurance deductible or retention in place for the respective claim year. The aggregate maximum exposure for all current open Claims is estimated to not exceed approximately $4,900,000, which represents the potential costs that may be incurred over time for the Claims within the applicable insurance policy deductibles or retentions. It is possible that the results of operations or liquidity of the Company, as well as the Company s ability to procure reasonably priced insurance, could be adversely affected by the pending litigation, potentially materially. The Company is currently unable to estimate the ultimate liability, if any, that may result from the pending litigation, or potential litigation from future claims or claims that have not yet come to our attention, and accordingly, the liability in the consolidated financial statements primarily represents an accrual for legal costs for services previously rendered and outstanding settlements for existing claims. The liabilities recorded on the Company s books at September 30, 2015 and December 31, 2014 were $290,000 and $582,000, respectively, and are included in Other Liabilities.

Additionally, two putative class action cases have been filed against the Company; one in U.S. District Court for the Middle District of Florida titled Hall v. Omega Flex, Inc. and one in U.S. District Court for the Southern District of Ohio titled Schoelwer v. Omega Flex, Inc. In both cases, the lead plaintiffs claimed that they are exposed to an increased likelihood of harm if one of the plaintiffs houses that contain TracPipe CSST is struck by lightning, that could damage the CSST causing a release of fuel gas in the house and causing a fire. In 2014, the judges in both cases granted the Company s motion to dismiss all of the plaintiff s claims due primarily to a lack of jurisdiction because there is no actual case or controversy posed by these claims.

Finally, in February of 2012, the Company was made aware of a fraud perpetrated by an outside party involving insurance related premiums that the Company had prepaid for umbrella coverage. The assets are currently secured by a governmental agency which investigated the case, and held in a custodial account. In June of 2015, utilizing the secured funds, the court has approved restitution to all victims including the Company. It is not clear however at this point what amount will eventually be received by the Company. The value of the assets on the books amount to $213,000 at September 30, 2015 and December 31, 2014, and are included in Other Long Term Assets. It is possible that not all of those funds will be returned to the Company, or the Company may need to incur additional costs to procure collection. The Company is currently pursuing all avenues in an effort to bring closure to the event, and reclaim the assets, and has since replaced the aforementioned insurance coverage.

Item 4 Submission of Matter to a Vote of the Security Holders

No matters were submitted to the security holders of the Company for a vote during the third quarter of 2015.

Item 6 - Exhibits

Exhibit

No.

Description

31.1

Certification of Chief Executive Officer of Omega Flex, Inc. pursuant to Rule 15d-14(a) promulgated under the Securities Exchange Act of 1934, as amended.

31.2

Certification of Chief Financial Officer of Omega Flex, Inc. pursuant to 15d-14(a) promulgated under the Securities Exchange Act of 1934, as amended.

32.1

Certification of Chief Executive Officer and Chief Financial Officer of Omega Flex, Inc., pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

	OMEGA FLEX, INC. (Registrant)
Date: November 13, 2015	By: /S/ Paul J. Kane Paul J. Kane Vice President Finance and Chief Financial Officer