MAGELLAN HEALTH SERVICES INC
Form 424B3
May 09, 2005

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The information in this prospectus supplement is not complete and may be changed. The selling stockholders may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus supplement is not an offer to sell these securities and the selling stockholders are not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

Subject to completion, dated May 9, 2005

Filed Pursuant to Rule 424(b)(3)
Registration No. 333-120271

Prospectus Supplement
(to prospectus dated May 4, 2005)

4,250,000 Shares

Ordinary Common Stock

The selling stockholders named in this prospectus supplement are offering all of these shares of Ordinary Common Stock and will receive all of the proceeds of the offering.

Our Ordinary Common Stock is quoted on the Nasdaq National Market under the symbol "MGLN." On May 5, 2005, the last reported sale price for our Ordinary Common Stock on the Nasdaq National Market was $34.81.

	Per share	Total
Public offering price	$	$
Underwriting discounts and commissions	$	$
Proceeds to the selling stockholders, before expenses	$	$

One of the selling stockholders has granted the underwriters an option for a period of 30 days to purchase up to 637,500 additional shares at the public offering price less underwriting discounts and commissions to cover any over-allotments.

Investing in our Ordinary Common Stock involves a high degree of risk. See "Risk factors" beginning on page S-10 of this prospectus supplement and page 3 of the accompanying prospectus.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed upon the adequacy or accuracy of this prospectus supplement or the accompanying prospectus. Any representation to the contrary is a criminal offense.

The underwriters are offering the shares of Ordinary Common Stock as set forth in "Underwriting." Delivery of the shares of Ordinary Common Stock will be made on or about , 2005.

Sole Book-Running Manager

JPMorgan

Lead Manager

Banc of America Securities LLC

Co-Managers

Deutsche Bank Securities **Lehman Brothers**

, 2005

Table of contents

Prospectus supplement

Prospectus

You should rely only on the information contained or incorporated by reference in this prospectus supplement or the accompanying prospectus. The selling stockholders have not, and the underwriters have not, authorized anyone to provide you with different information. The selling stockholders are not, and the underwriters are not, offering to sell, or seeking offers to buy, shares of Ordinary Common Stock in any jurisdiction where offers and sales are not permitted. You should not assume that the information contained in this prospectus supplement or the accompanying prospectus is accurate as of any date other than the date on the front of the applicable document, or that any information we have incorporated by reference in the accompanying prospectus is accurate as of any date other than the date of the document incorporated by reference regardless of the time of delivery of this prospectus supplement and the accompanying prospectus or any sale of shares. Our business, financial condition, results of operations and prospects may have changed since those dates.

No action is being taken in any jurisdiction outside the United States to permit a public offering of the Ordinary Common Stock or possession or distribution of this prospectus supplement or the accompanying prospectus in that jurisdiction. Persons who come into possession of this prospectus supplement or the accompanying prospectus in jurisdictions outside the United States are required to inform themselves about and to observe any restrictions as to this offering and the distribution of this prospectus supplement or the accompanying prospectus applicable to that jurisdiction.

Summary

This summary highlights selected information contained elsewhere or incorporated by reference in this prospectus supplement and the accompanying prospectus. This summary does not contain all the information you should consider before investing in our Ordinary Common Stock. You should carefully read the entire prospectus supplement, including "Risk factors" on page S-10, the accompanying prospectus, and our consolidated financial statements and the related notes and other information contained in the annual and quarterly reports and other documents that we have filed with the Securities and Exchange Commission, or the SEC, and incorporated by reference in the accompanying prospectus, before making an investment decision. In this prospectus supplement, unless the context suggests otherwise, "Magellan" means Magellan Health Services, Inc. and the references "we," "our," and "us" mean Magellan together with its subsidiaries.

Magellan Health Services, Inc.

Our business

We believe that we are the nation's largest provider of managed behavioral healthcare services, according to enrollment data reported in an industry trade publication entitled "Open Minds Yearbook of Managed Behavioral Health & Employee Assistance Program Market Share in the United States, 2002-2003" published by Open Minds Gettysburg, Pennsylvania, referred to as Open Minds. As of March 31, 2005, we had approximately 57.7 million covered lives under managed behavioral healthcare contracts.

We manage behavioral health benefit plans for approximately 1,600 customers, including small, medium and large health plans, among them a significant number of Blue Cross/Blue Shield organizations; employers, including corporations, federal, state and local governmental agencies; and various state Medicaid programs. Based on the customers we serve, we operate in the following segments: (i) Health Plan Solutions; (ii) Employer Solutions; (iii) Public Sector Solutions; and (iv) Corporate and Other. We offer a full range of managed care services that are designed to contain behavioral healthcare costs and provide comprehensive behavioral healthcare coverage. We provide high quality, cost efficient behavioral healthcare services for our members, which include maintenance of provider networks, coordination of care, utilization review, hospital inpatient care management, outpatient care management and employee assistance programs.

We believe we have the largest and most comprehensive behavioral healthcare provider network in the United States. We coordinate and manage the delivery of behavioral healthcare treatment services through our network of approximately 63,000 behavioral healthcare professionals, which includes psychiatrists, psychologists, licensed clinical social workers, marriage and family therapists and licensed clinical professional counselors. The treatment services provided through our provider network include outpatient programs (such as counseling or therapy), intermediate care programs (such as intensive outpatient programs and partial hospitalization services), inpatient treatment and crisis intervention services. We do not own any provider of, and generally do not directly provide, treatment services.

Our industry

According to the final report, "Achieving the Promise: Transforming Mental Health Care in America," issued by the President's New Freedom Commission on Mental Health (established on

April 29, 2002 by Executive Order 13263), referred to as the Commission Report, approximately 5 to 7 percent of adults in a given year have a "serious mental illness," defined as any diagnosable mental disorder that affects work, home or other areas of social functioning; and approximately 5 to 9 percent of children have a "serious emotional disturbance" defined as any diagnosable mental disorder (in a child under 18) that severely disrupts social, academic and emotional functioning. In addition, according to the Commission Report, mental illness ranks first among all diseases in terms of causing disability in the United States, Canada and Western Europe. In 1997, the latest year for which comparable data is available, spending in the United States on the treatment of mental illness totaled almost $71 billion. In addition, the Commission Report states that the annual economic, indirect cost of mental illness is estimated to be $79 billion, of which approximately $63 billion represents the loss of productivity as a result of illnesses.

Managed behavioral healthcare companies such as ours focus on matching an appropriate level of specialist care and treatment setting with the behavioral health treatment needs of the patient to provide care in a cost-efficient manner while improving early access to care and utilizing the most modern and effective treatments. According to Open Minds, the total number of covered beneficiaries of behavioral healthcare services was approximately 227.1 million in 2002. Behavioral healthcare companies provide services primarily through: (i) risk-based products where they assume all or a portion of the responsibility for the cost of providing treatment services in exchange for a fixed per member per month fee, (ii) administrative services only products, or ASO, where they provide services such as utilization review, claims administration and/or provider network management but do not assume responsibility for the cost of the treatment services, (iii) employee assistance programs, or EAP, and (iv) products that combine features of some or all of the risk-based, administrative services only or employee assistance products.

Our competitive strengths

We believe we benefit from the following competitive strengths:

Industry leadership

We believe that we are the largest provider of managed behavioral healthcare services in the United States, based on the enrollment data reported in Open Minds. We believe our leadership position in the industry reflects our strengths as described below and enhances our ability to: (i) continue to provide a consistent level of high quality, cost-efficient behavioral healthcare services; (ii) enter into agreements with healthcare plans, large corporations and public sector customers; and (iii) develop new products and service offerings in managed behavioral healthcare and related areas.

Broad product offering and nationwide provider network

We provide a broad range of behavioral managed care services to our customers, from providing their members with information to better manage their conditions to sophisticated managed care programs. We develop highly customized solutions and systems that allow us to administer behavioral health plans with various benefit designs, features and requirements for health plan, employer and public sector customers.

Our managed behavioral healthcare network consists of approximately 63,000 behavioral healthcare providers in all 50 U.S. states and Puerto Rico. Additionally, we recently introduced several product enhancements and new products that we believe will allow us to solidify our relationships with existing customers and establish new customer relationships. We believe that the combination of our broad product offerings, our comprehensive behavioral healthcare provider network and product innovation distinguishes us from our competitors, allows us to meet our customers' needs for behavioral managed healthcare on a nationwide basis and positions us to capture additional revenue opportunities resulting from the continued growth of the behavioral managed healthcare industry.

Strong customer relationships

We believe that the breadth of our customer relationships is attributable to our broad product offerings, nationwide provider network, commitment to quality care and ability to manage behavioral healthcare costs effectively. Our customers include small, medium and large health plans, among them a significant number of Blue Cross/Blue Shield organizations; employers, including corporations, federal, state and local governmental agencies; and various state Medicaid programs. We believe our track record of successfully managing behavioral healthcare programs on behalf of our customers will allow us to win new business opportunities with existing clients as we introduce new value-added products and services, including disease management and behavioral pharmaceutical management.

Experienced management team

Our senior management team has substantial experience in the health care industry. Steven Shulman, our Chairman and Chief Executive Officer, has over 31 years of experience, and Dr. René Lerer, our President and Chief Operating Officer, has over 20 years of experience in the managed care industry. Our senior management team operates as a cohesive group with complementary skills and has a strong track record of effectively managing and growing highly successful companies in the healthcare industry. Our senior management team has established a vast network of relationships in the industry that provide unique opportunities for organic growth and future acquisition opportunities.

Strong financial condition

We actively manage our business to generate strong financial performance. We have built and maintain a highly efficient operating infrastructure which has allowed us to become a cost efficient provider of comprehensive behavioral healthcare services for our customers. As a result, since January 2004, we have demonstrated strong financial performance, generated consistent and growing cash flows, and have been able to achieve unrestricted cash and investment balances that exceed our debt. Our strong balance sheet has given us the flexibility to dedicate resources to explore new business opportunities and develop new products.

Our business strategy

We intend to pursue the following growth strategies:

Continue to manage costs effectively

We intend to continue leveraging our operating infrastructure, identifying operating efficiencies and managing our provider networks to deliver high quality, cost efficient care to our customers. We have reduced our administrative costs and improved customer service by consolidating service centers, enhancing corporate overhead efficiency, consolidating claims processing systems, improving technologies supporting our administrative functions, such as claims processing and call centers, and instituting other operational and business efficiencies, implementing best practices across the organization and by standardizing and consolidating processes as appropriate. As a result, since the management team led by Mr. Shulman took over leadership of the company, we have been able to reduce our direct service costs and administrative costs as a percentage of sales.

Leverage our market position to grow our core businesses

We believe we are positioned to grow membership, revenues and earnings over the long term as a result of our economies of scale, large customer base, proven behavioral health expertise and leading market position. We expect our organic growth to be driven by expansion of our membership base, rate increases and expanding opportunities in the public sector market. As individual state and local governments experience budgetary constraints due to escalating healthcare cost, we have observed greater interest from the state and local governments in engaging managed care providers to manage healthcare services for their Medicaid programs, including behavioral healthcare services. Given our strong experience and market leadership in behavioral healthcare industry, we believe that we are in a good position to compete for these new public sector opportunities.

Expand into new products and markets

We are exploring opportunities to expand our business including the enhancement of existing products and development of new products within as well as outside of our current business lines. We are currently developing several new products, which we expect to substantially contribute to our long term growth and further strengthen our market position. These products represent strong growth opportunities going forward, and include Behavioral Disease Management, Obesity Management, Behavioral Pharmaceutical Management and Med/Psych Integration. The development of these products is part of our longer term strategy to develop a comprehensive disease management offering. We expect to leverage our extensive customer relationships to introduce and demonstrate the value of these programs.

Recently, the disease management industry has emerged as a mechanism to provide effective care for the treatment of chronic medical conditions, improve health status of the members and reduce healthcare costs of the payers. Disease management companies utilize predictive modeling tools to identify and target members that are at risk for a health problem, develop and implement evidence-based clinical guidelines and coordinate care for the members. We believe that effective disease management programs are driven by behavior modification and that, with our expertise in behavioral healthcare management, we are well positioned to develop the next generation of disease management programs that focus on modification and management of members' behavior in order to make them better informed and more efficient healthcare consumers.

As the first step in this long term strategy, we have developed the following products:

Behavioral Disease Management We have initiated a disease management program focused on active management of behavioral health conditions, such as depression, anxiety, and substance abuse. Following the introduction of this program in January 2005 to certain of our current at-risk customers, we are already providing services to approximately 3 million members. We currently anticipate that we will have approximately 6 to 7 million members enrolled in this program by the end of 2005. While we are not collecting separate fees for this program at this time, we expect to derive financial benefit through lower cost of care to at-risk members. More importantly, we intend to use this program as a platform to build a full-scale disease management program.

Obesity Management We have developed and are actively marketing an obesity management program that helps members lose weight and helps employers and health plans manage rising costs associated with obesity and bariatric surgery. Our tiered approach to obesity management includes weight management tools and support, education assessment and referral to the network of specially trained professionals and pre and post-bariatric surgery counseling.

Behavioral Pharmaceutical Management We have developed and are actively marketing a behavioral pharmaceutical management program with the objectives of materially reducing the prescription of behavioral drugs that depart from standard clinical guidelines and improving members' compliance with the therapeutically appropriate behavioral medications within these guidelines. Our program involves identification of such departures using sophisticated internally developed analytical tools and subsequent management through mail, peer to peer and mail/phone intervention.

Med/Psych Integration We have developed and are actively marketing a Med/Psych Integration program that proactively targets and integrates the care for patients who have both a chronic medical and behavioral condition. Our studies of patients who had both medical and behavioral conditions, such as cancer and depression, have demonstrated a significant reduction in overall healthcare costs when their care was managed through our programs.

Leverage our strong financial position to grow through acquisitions

We continually evaluate opportunities to strategically leverage our financial position to acquire businesses that are complementary to our existing operations, that could accelerate our entrance into new markets, or that could leverage our existing customer relationships, leading to growth in revenues and earnings. We will continue to evaluate potential acquisitions based on internally developed criteria. In the past, members of our management team have demonstrated the ability to grow a company through strategic acquisitions. We believe we can successfully integrate acquisitions, expand breadth of services and improve operations of acquired businesses.

Corporate information

Magellan Health Services, Inc. is a Delaware corporation. Our executive offices are located at 16 Munson Road, Farmington, Connecticut 06032, our telephone number at that location is (860) 507-1900, and our website can be accessed at *www.magellanhealth.com*. Information contained in our website does not constitute part of this prospectus supplement or the accompanying prospectus.

The offering

Ordinary Common Stock offered by the selling stockholders	4,250,000 shares
Ordinary Common Stock to be outstanding after the offering	31,129,233 shares
Over-allotment option	One of the selling stockholders has granted the underwriters an option for a period of 30 days to purchase up to 637,500 additional shares at the public offering price less underwriting discounts and commissions to cover any over-allotments.
Use of proceeds	We will not receive any of the proceeds from the sale of shares by the selling stockholders. The selling stockholders will receive all of the net proceeds from the sale of shares of our Ordinary Common Stock, including the over-allotment shares, if any, offered in this prospectus supplement.
Risk factors	See "Risk factors" and other information included in this prospectus supplement and the accompanying prospectus for a discussion of factors you should carefully consider before deciding to invest in our Ordinary Common Stock.
Nasdaq symbol	MGLN

We have two classes of Common Stock consisting of Multiple and Variable Vote Restricted Convertible Common Stock, referred to as the Multi-Vote Common Stock, and Ordinary Common Stock, collectively referred to as the Common Stock. It is expected that following this offering, all special rights, powers and privileges of the Multi-Vote Common Stock will cease. After the consummation of this offering there will be 4,296,600 shares of Multi-Vote Common Stock outstanding. For a more detailed discussion, see "Description of capital stock."

The number of shares of Ordinary Common Stock that will be outstanding after the offering is based on the number of shares of our Ordinary Common Stock outstanding as of May 5, 2005 and excludes:

- 93,128 shares of Ordinary Common Stock reserved for distributions related to disputed claims for certain general unsecured creditor claims made pursuant to the Plan of Reorganization as such claims are settled;
- 3,613 shares of Multi-Vote Common Stock which Magellan Holdings L.P. currently has the right and obligation to acquire under Magellan's Plan of Reorganization in connection with the most recent quarterly resolution of disputed claims;
- 1,040,366 shares of Ordinary Common Stock issuable upon exercise of currently exercisable stock options issued under our 2003 management incentive plan;
- 4,118,968 shares of Ordinary Common Stock issuable upon exercise of stock options issued under our 2003 management incentive plan which are not currently exercisable;
- 835,375 shares of Ordinary Common Stock reserved for future grants under our 2003 management incentive plan;
- 570,417 shares of Ordinary Common Stock issuable upon exercise of currently exercisable warrants;
- 230,000 shares of Ordinary Common Stock issuable upon exercise of a warrant that will become exercisable in January 2006; and
- 30,000 shares of Ordinary Common Stock which we will reserve if our stockholders approve the 2005 director stock compensation plan which will be voted on at our annual meeting of stockholders to be held on May 18, 2005.

Unless otherwise noted, the information in this prospectus supplement assumes that the over-allotment option granted to the underwriters by one of the selling stockholders has not been exercised.

Summary consolidated financial data

In May 2003, our board of directors approved a change in our fiscal year. Instead of a fiscal year ending on September 30, we adopted a fiscal year that coincides with the calendar year, effective December 31, 2002. The following table sets forth our summary consolidated financial data as of and for each of the three fiscal years ended September 30, 2000, 2001 and 2002, for the fiscal year ended December 31, 2003 and as of and for the three month transition period ended December 31, 2002 and unaudited comparable data as of and for the three months ended December 31, 2001. The table also sets forth summary consolidated financial data (i) as of December 31, 2003 and 2004 and for the fiscal year ended December 31, 2004, and (ii) as of March 31, 2005 and for the three months ended March 31, 2004 and 2005.

On January 5, 2004, referred to as the Effective Date, we and 88 of our subsidiaries consummated the Third Joint Amended Plan of Reorganization, as modified and confirmed, referred to as the Plan of Reorganization, under chapter 11 of title 11 of the United States Bankruptcy Code, referred to as the Bankruptcy Code, which had been confirmed by order of the United States Bankruptcy Court for the Southern District of New York, referred to as the Bankruptcy Court. In connection with the consummation of the Plan of Reorganization, we implemented fresh start reporting effective December 31, 2003. Accordingly, all balance sheet data as of, and subsequent to December 31, 2003 represents balances of our company following the Effective Date, referred to as the Reorganized Company, and all balance sheet data prior to December 31, 2003 represents balances of our company prior to the Effective Date, referred to as the Predecessor Company. Statement of operations and statement of cash flows data for all periods prior to January 1, 2004 represents the results of the Predecessor Company. Accordingly, all references to us with respect to disclosures of amounts recorded (i) through or prior to December 31, 2003 in relation to statement of operations or cash flow items; and (ii) prior to December 31, 2003 in relation to balance sheet items, relate to the Predecessor Company. All references to us with respect to disclosures of amounts recorded or to be recorded (i) after December 31, 2003 in relation to statement of operations or cash flow items; and (ii) on or after December 31, 2003 in relation to balance sheet items, relate to the Reorganized Company.

As a result of the Plan of Reorganization under chapter 11 of title 11 of the Bankruptcy Code commenced in March 2003 and consummated on the Effective Date, and our implementation of fresh start reporting effective December 31, 2003, the summary consolidated financial data as of December 31, 2003 and as of and for the year ended December 31, 2004 are not comparable to the prior periods presented. Summary consolidated financial data as of and for the fiscal year ended December 31, 2003 includes certain significant unusual items. See "Selected consolidated financial data."

Summary consolidated financial data for the years ended September 30, 2002 and December 31, 2003 and 2004 and for the three months ended December 31, 2002, and as of December 31, 2003 and 2004 presented below, have been derived from our audited consolidated financial statements and the related notes incorporated in the accompanying prospectus by reference to our annual report on Form 10-K for the fiscal year ended December 31, 2004, referred to as the audited annual consolidated financial statements. Summary consolidated financial data for the fiscal years ended September 30, 2000 and 2001 and as of September 30, 2000, 2001 and 2002 have been derived from our audited consolidated financial statements not included or incorporated by reference in this prospectus supplement or the accompanying prospectus. The summary consolidated financial information as of and for the three months ended December 31, 2001 is unaudited.

The summary consolidated financial data presented below as of March 31, 2005 and for the three months ended March 31, 2004 and 2005, are derived from our unaudited condensed consolidated financial statements and the related notes incorporated in the accompanying prospectus by reference to our quarterly report on Form 10-Q for the quarterly period ended March 31, 2005, referred to as the unaudited quarterly consolidated financial statements. In the opinion of our management, these unaudited quarterly consolidated financial statements include all adjustments, consisting only of normal recurring adjustments, which we consider necessary for a fair presentation of our financial position at those dates and our results of operations for those periods. Operating results for the three month period ended March 31, 2005 are not necessarily indicative of the results that may be expected for the full fiscal year ending December 31, 2005 or portions of that fiscal year. You should read this information in conjunction with "Management's discussion and analysis of financial condition and results of operations" included elsewhere in this prospectus supplement and our consolidated financial statements and the related notes contained in our quarterly and annual reports that we have filed with the SEC and incorporated by reference in the accompanying prospectus.

	Predecessor Company						Reorganized Company		
	Fiscal Year Ended September 30,			Fiscal Year Ended December 31,	Three Months Ended December 31,		Fiscal Year Ended December 31,	Three Months Ended March 31,	
	2000	2001	2002	2003	2001[1]	2002	2004	2004[1]	2005[1]
	(in thousands, except per share data)								
Statement of Operations Data:									
Net revenue	$ 1,640,933	$ 1,755,512	$ 1,753,058	$ 1,510,746	$ 444,842	$ 445,890	$ 1,795,402	$ 440,176	$ 452,754
Salaries, cost of care and other operating expenses	1,442,082	1,557,042	1,585,314	1,324,886	395,093	391,433	1,567,465	393,928	392,929
Equity in earnings of unconsolidated subsidiaries	(9,792)	(36,566)	(13,006)	(6,202)	(3,177)	(2,138)	(5,277)	(1,844)	(1,449)
Depreciation and amortization	68,261	68,294	47,558	48,047	11,190	14,380	42,489	10,249	11,218
Interest expense (Contractual interest of $106,328 in fiscal 2003)	106,711	110,423	97,596	61,016	23,719	25,333	37,124	9,334	8,639
Interest income	(9,425)	(10,121)	(5,365)	(2,873)	(1,310)	(1,010)	(6,127)	(781)	(3,033)
Stock compensation expense							23,152	10,777	3,750
Reorganization benefit, net				(438,217)					
Goodwill impairment charges			415,880	28,780					
Special charges	25,398	3,340	15,729	9,528	4,485	3,907	5,038	1,908	
Income (loss) from continuing operations before income taxes and minority interest	17,698	63,100	(390,648)	485,781	14,842	13,985	131,538	16,605	40,700
Provision for income taxes	8,994	33,732	151,609	33,813	6,086	3,129	46,584	3,568	17,064
Income (loss) from continuing operations before minority interest	8,704	29,368	(542,257)	451,968	8,756	10,856	84,954	13,037	23,636
Minority interest	114	78	47	253	16	27	333	129	68
Income (loss) from continuing operations	8,590	29,290	(542,304)	451,715	8,740	10,829	84,621	12,908	23,568
Income (loss) from discontinued operations[2]	(56,736)	4,624	4,894	(25,028)	158	803	4,781	30	48
Income (loss) on disposal of discontinued operations[2]	(17,662)	(9,359)	(92)	4,756	820	97	(1,030)		
Reorganization benefit, net[2]				20,327					
Income (loss) before cumulative effect of change in accounting principle	(65,808)	24,555	(537,502)	451,770	9,718	11,729	88,372	12,938	23,616
Cumulative effect of change in accounting principle[2]			(191,561)		(191,561)				
Net income (loss)	(65,808)	24,555	(729,063)	451,770	(181,843)	11,729	88,372	12,938	23,616
Preferred dividends (Contractual dividends of $4,788 in fiscal 2003)	3,401	4,527	4,657	883	1,075	1,243			
Amortization of redeemable preferred stock issuance costs, and	401	522	540	172	143	136			

other									
Preferred stock reorganization items, net[2]				2,668					
Income (loss) available to common stockholders	$ (69,610)	$ 19,506	$ (734,260)	$ 448,047	$ (183,061)	$ 10,350	$ 88,372	$ 12,938	$ 23,616
Income (loss) per common share available to common stockholders basic:									
Income (loss) from continuing operations	$ 0.15	$ 0.72	$ (15.71)	$ 12.69	$ 0.22	$ 0.27	$ 2.39	$ 0.37	$ 0.67
Income (loss) from discontinued operations	(2.32)	(0.14)	0.14		0.03	0.02	0.11		
Cumulative effect of change in accounting principle			(5.50)		(5.53)				
Net income (loss)	$ (2.17)	$ 0.58	$ (21.07)	$ 12.69	$ (5.28)	$ .029	$ 2.50	$ 0.37	$ 0.67
Income (loss) per common share available to common stockholders diluted:									
Income (loss) from continuing operations	$ 0.15	$ 0.69	$ (15.71)	$ 10.86	$ 0.21	$ 0.26	$ 2.33	$ 0.35	$ 0.64
Income (loss) from discontinued operations	(2.30)	(0.13)	0.14		0.02	0.02	0.10		
Cumulative effect of change in accounting principle			(5.50)		(4.55)				
Net income (loss)	$ (2.15)	$ 0.56	$ (21.07)	$ 10.86	$ (4.32)	$ 0.28	$ 2.43	$ 0.35	$ 0.64

	Predecessor Company					Reorganized Company		
	As of September 30,			As of December 31,		As of December 31,		As of March 31,
	2000	2001	2002	2001[1]	2002	2003	2004	2005[1]
	(in thousands)							
Balance Sheet Data:								
Current assets	$ 325,532	$ 274,011	$ 283,730	$ 293,276	$ 286,131	$ 630,223	$ 540,495	$ 582,814
Current liabilities	475,758	430,285	1,494,412	425,182	1,477,999	523,531	382,308	377,069
Property and equipment, net	112,612	94,322	86,773	90,369	85,659	122,082	120,604	117,759
Total assets	1,809,666	1,666,705	1,004,080	1,667,730	998,917	1,292,017	1,188,338	1,204,234
Total debt and capital lease obligations	1,098,047	1,006,356	1,049,354	1,005,369	1,048,158	493,699	379,478	372,130
Stockholders' equity (deficit)	$ 128,464	$ 162,188	$ (570,672)	$ 170,729	$ (560,322)	$ 387,911	$ 497,053	$ 524,454

(1) Amounts are unaudited.

(2) Net of income taxes.

Risk factors

An investment in Ordinary Common Stock involves a high degree of risk. You should carefully consider the following risk factors, together with all of the other information included or incorporated by reference in this prospectus supplement and the accompanying prospectus, which we believe describe the principal risks of investing in our Ordinary Common Stock, before you decide whether to purchase any Magellan shares. Our business may also be adversely affected by risks and uncertainties not presently known to us or that we currently believe to be immaterial. If any of the following risks occur, our business, financial condition and profitability could be materially adversely affected. In such case, the trading price of Ordinary Common Stock could decline, and you may lose all or part of your investment.

Risks related to our business and industry

Fresh Start Reporting Our application of "fresh start" reporting makes it more difficult to compare our post-emergence operations and results to those in pre-emergence periods.

Due to our emergence from bankruptcy, we have implemented the "fresh start" reporting provisions of SOP 90-7, effective December 31, 2003. Fresh start reporting requires us to restate all assets and liabilities to reflect their fair values. As a result, the consolidated balance sheet as of and subsequent to December 31, 2003 and the statement of operations for periods after our emergence from bankruptcy are not comparable to the consolidated financial statements for the periods prior to our emergence from bankruptcy, which were prepared on a historical basis.

Reliance on Customer Contracts Our inability to renew, extend or replace expiring or terminated customer contracts could adversely affect our liquidity, profitability and financial condition.

Substantially all of our net revenue is derived from contracts with payors of behavioral healthcare benefits. Substantially all of these contracts may be terminated immediately with cause and many, including some of our most significant contracts, are terminable without cause by the customer upon notice and the passage of a specified period of time (typically between 60 and 180 days), or upon the occurrence of certain other specified events. Our ten largest customers accounted for 61.6 percent and 70.3 percent of our net revenue in the fiscal years ended December 31, 2003 and 2004, respectively, and for 73.8 percent of our net revenue for the three months ended March 31, 2005. Loss of all of these contracts or customers would, and loss of any one of these contracts or customers could, materially reduce our net revenue and have a material adverse effect on our liquidity, profitability and financial condition. One of these contracts was a subcontract with a health plan under which we managed the mental health and substance abuse services for certain beneficiaries of TRICARE, which subcontract expired on September 30, 2004 and was not renewed. Our contract with Aetna Inc., or Aetna, which is one of our largest customers, will terminate on December 31, 2005. We recorded net revenue from Aetna of $228.1 million for the fiscal year ended December 31, 2004 and $55.8 million and $62.0 million, respectively, during the three-month periods ended March 31, 2004 and 2005.

We are party to several contracts with entities that are now controlled by WellPoint, Inc., or WellPoint, that represent a significant concentration of business for us. Net revenue from such contracts totaled $133.1 million during the year ended December 31, 2004 and $31.4 million and $33.9 million during the three-month periods ended March 31, 2004 and 2005, respectively. One such contract, which generated net revenue of $95.0 million during the year ended December 31, 2004 and $24.4 million during the three-month period ended March 31, 2005, extends through December 31, 2005. A second contract with an entity controlled by WellPoint, which generated net revenue of $25.7 million during the year ended December 31, 2004 and $6.7 million for the three-month period ended March 31, 2005, extends through September 30, 2005 and we have recently been notified by the customer that it does not intend to renew this contract beyond such date.

In addition to Aetna and the WellPoint-related contract noted above, other managed care customers of ours have decided not to renew all or part of their contracts with us, and will instead manage behavioral healthcare services for their subscribers. We believe that the total impact of these non-renewals, including those relating to Aetna and the WellPoint affiliate, will be a reduction during 2006 from projected 2005 net revenue from these contracts of approximately $330.0 million, $250.0 million of which relates to Aetna. We cannot assure you that actual reduction in net revenue for future periods will not exceed our expectations.

Our largest customer is the State of Tennessee's TennCare program. The TennCare program provides health and other related benefits to the Medicaid recipients in the State of Tennessee as well as to certain other uninsured individuals. We, through our wholly owned subsidiary, Tennessee Behavioral Health, Inc. and Premier Behavioral Systems of Tennessee, LLC, or Premier, a joint venture in which we have a 50.0 percent interest, contract with the State of Tennessee, or the State, to manage the behavioral healthcare benefits for the TennCare program. Effective July 1, 2004, the State of Tennessee divided the TennCare program into three regions. Tennessee Behavioral Health has a contract to serve the East Region with an initial term that runs through December 31, 2005 and includes a provision for annual extensions at the State's option through December 31, 2008. Each of Tennessee Behavioral Health and Premier has a contract with respect to the West and Central regions that runs through December 31, 2005. All three contracts are subject to appropriations funding on July 1, 2005. For the fiscal year ended December 31, 2004, and the three months ended March 31, 2004 and 2005, we recorded net revenue from this customer under these contracts of approximately $431.5 million, $103.7 million and $113.2 million, respectively.

On January 10, 2005, the Governor of Tennessee stated that because of the increased costs of the TennCare program, the State will cease providing coverage to approximately 323,000 adults (which represents approximately one-fourth of total TennCare membership) who do not qualify for Medicaid and may limit benefits to be delivered under the TennCare program. Certain advocacy groups are attempting to prevent the Governor from implementing any membership and benefits reductions. Representatives of the State of Tennessee have publicly indicated that they intend to phase-in the membership reductions as early as July 1, 2005. A reduction in membership would, and benefit changes could, adversely affect our net revenue and profitability. We do not yet know which members would be eliminated from the program, and because capitation rates for TennCare members vary depending upon the level of benefits received by such members, we cannot estimate the impact of the proposed membership reductions. Further, we do not yet know the actual timing of the phased-in membership reductions, the benefit changes being proposed or the timing of those changes, and as such, we cannot estimate the impact of these potential developments at this time.

In addition, the TennCare contracts might not be extended or successfully renegotiated beyond December 31, 2005, or, if renewed or renegotiated, the terms of any new contracts might not be comparable to those of existing contracts. If this happens, our liquidity, financial condition, prospects and profitability may be adversely affected.

Changes in the Medical Managed Care Industry   Certain changes in the business practices of this industry could negatively impact our resources, profitability and results of operations.

Substantially all of our Health Plan segment net revenue are derived from customers in the medical managed care industry, including managed care companies, health insurers and other health plans. Some types of changes in this industry's business practices could negatively impact us.

For example, if our managed care customers seek to provide managed behavioral healthcare services directly to their subscribers, instead of contracting with us for such services, we could be adversely affected. In this regard, as noted above, our contract with Aetna, which is one of our largest customers, will terminate on December 31, 2005 and we have recently been notified that a contract we have with an entity controlled by WellPoint expiring in September 2005 will not be renewed. In addition to Aetna and the WellPoint-related contract, other managed care customers of ours have decided not to renew all or part of their contracts with us, and will instead manage behavioral healthcare services for their subscribers. Other of our customers that are managed care companies could also seek to provide managed behavioral healthcare services directly to their subscribers, rather than by contracting with us for such services. In addition, we have a significant number of contracts with Blue Cross and Blue Shield health plans and other regional health plans. Consolidation of the health plan industry through acquisitions and mergers could potentially result in the loss of contracts for us. Any of these changes could reduce our net revenue, and adversely affect our profitability and financial condition.

Risk-Related Products Because we provide services at a fixed fee, if we are unable to accurately predict and control behavioral healthcare costs, our profitability could decline.

We derive our net revenue primarily from arrangements under which we assume responsibility for costs of treatment services (excluding at present the cost of pharmaceuticals or other medication) in exchange for a fixed fee. We refer to such arrangements as "risk-related contracts" or "risk-related products." These arrangements provided 85.6 percent and 88.2 percent of our net revenue in the fiscal years ended December 31, 2003 and 2004, respectively. Profitability of these contracts could be reduced if we are unable to accurately estimate the rate of service utilization by members or the cost of such services when we price our services. If the cost of services provided to members under a contract together with the administrative costs exceeds the aggregate fees received by us under such contract, we will incur a loss. Our assumptions of these costs when we price our services may not ultimately reflect actual utilization rates and costs, many aspects of which are beyond our control.

Our profitability could also be reduced if we are required to make adjustments to estimates made in reporting historical financial results, particularly those regarding cost of care, reflected in our financial statements as medical claims payable. Medical claims payable includes reserves for incurred but not reported, or IBNR claims, which are claims for covered services rendered by our providers which have not yet been submitted to us for payment. We estimate and reserve for IBNR claims based on past claims payment experience, including the average interval between the date services are rendered and the date claims are paid and between the date services are rendered and the date the claims are received, enrollment data, utilization statistics, adjudication decisions, authorized healthcare services and other factors. This data is incorporated into contract specific reserve models. The estimates for submitted claims and IBNR claims are made on an accrual basis and adjusted in future periods as required.

Factors that affect our ability to price our services, control our costs or accurately make estimates of IBNR claims and other expenses for which we create reserves may include changes in our assumptions for medical costs caused by changes in actual experience including:

- changes in the delivery system;
- changes in utilization patterns;
- changes in the number of members seeking treatment;
- unforeseen fluctuations in claims backlogs;
- increases in the costs of the services;

- the occurrence of catastrophes;
- regulatory changes;
- changes in benefit plan design; and
- implementation of new products by us.

If our membership in risk-based business grows, our exposure to potential losses from risk-related products will also be increased.

Fluctuation in Operating Results   We experience fluctuations in quarterly operating results and, as a consequence, we may fail to meet or exceed market expectations, which could cause our stock price to decline.

Our quarterly operating results have varied in the past and may fluctuate significantly in the future due to seasonal and other factors, including:

- changes in utilization levels by enrolled members of our risk-based contracts, including seasonal utilization patterns (for example, members generally tend to seek services less during the third and fourth quarters of the year than in the first and second quarters of the year);
- performance based contractual adjustments to net revenue, reflecting utilization results or other performance measures;
- changes in estimates for contractual adjustments under commercial contracts;
- retrospective membership adjustments;
- the timing of implementation of new contracts and enrollment changes; and
- changes in estimates regarding medical costs and IBNR claims.

These factors may affect our quarterly and annual net revenue, expenses and profitability in the future and, accordingly, we may fail to meet or exceed market expectations, which could cause our stock price to decline.

Dependence on Government Spending for Managed Healthcare   We can be adversely affected by changes in federal, state and local healthcare policies.

All of our Public Sector Segment net revenue and a portion of our net revenue in our two other segments are derived, directly or indirectly, from governmental agencies, including state Medicaid programs. Contract rates vary from state to state, are subject to periodic negotiation and may limit our ability to maintain or increase rates. We are unable to predict the impact on our operations of future regulations or legislation affecting Medicaid programs, or the healthcare industry in general, and future regulations or legislation may have a material adverse effect on us. Moreover, any reduction in government spending for such programs could also have a material adverse effect on us. See the discussion relating to the State of Tennessee's TennCare program under " Reliance on Customer Contracts   Our inability to renew, extend or replace expiring or terminated customer contracts could adversely affect our liquidity, profitability and financial condition."

In addition, our contracts with federal, state and local governmental agencies, under both direct contract and subcontract arrangements, generally are conditioned upon financial appropriations by one or more governmental agencies, especially in the case of state Medicaid programs. These contracts generally can be terminated or modified by the customer if such appropriations are not made. Finally, some of our contracts with federal, state and local governmental agencies, under both direct contract and subcontract arrangements, require us to perform additional services if

federal, state or local laws or regulations imposed after the contract is signed so require, in exchange for additional compensation to be negotiated by the parties in good faith. Government and other third party payors are generally seeking to impose lower contract rates and to renegotiate reduced contract rates with service providers in a trend toward cost control.

Significant Stockholder Onex, our largest stockholder, may have significant influence over matters requiring stockholder approval, its interests may differ from or conflict with the interests of other stockholders, and sales of Common Stock by Onex may cause our stock price to fall.

On the Effective Date, and pursuant to our Plan of Reorganization, the members of our Board of Directors were selected, and Onex participated in that selection. Based on its holdings on April 1, 2005, the record date for the election of directors at our annual meeting of stockholders to be held on May 18, 2005 (the first stockholder meeting after the Effective Date), Onex, through its affiliate, Magellan Holdings L.P., a selling stockholder in this offering, has the ability to control the election of all three directors proposed to be elected at the stockholder meeting.

While following this offering Onex's special rights and privileges relating to its ownership of Multi-Vote Common Stock will terminate, and all directors will be elected by the collective vote of all stockholders, Onex will hold approximately 12.1 percent of our outstanding Common Stock and will continue to be our largest stockholder. As a result of Onex's substantial equity interest and voting power, Onex could have significant influence over the management and affairs of Magellan, and a significant influence on all matters submitted to the stockholders including any merger, consolidation or sale of all or substantially all of our assets. In the case of a potential acquisition of Magellan, this significant voting power could prevent our public stockholders from receiving consideration for their stock offered by the potential acquiror in a transaction not supported by Onex or result in a disposition of their Magellan shares in such a transaction supported by Onex.

The market price of our Ordinary Common Stock could also decline as a result of sales by Onex of a significant number of shares of our Common Stock, or the perception that such sales might occur. Such sales could also make it more difficult for us to sell equity securities at a time and price that we deem appropriate.

Restrictive Covenants in Our Debt Instruments Restrictions imposed by our debt agreements limit our operating and financial flexibility. These restrictions may adversely affect our ability to finance our future operations or capital needs or engage in other business activities that may be in our interest.

The indenture, referred to as the Indenture, governing our 9.375% Senior Notes due November 15, 2008, referred to as the Senior Notes, and the terms of our senior secured credit agreement with Deutsche Bank AG, referred to as the Credit Agreement, contain covenants. These covenants limit our management's discretion in operating our business by restricting or limiting our ability, among other things, to:

- incur or guarantee additional indebtedness or issue preferred or redeemable stock;
- pay dividends and make other distributions;
- repurchase equity interests;
- prepay or amend subordinated debt;
- make certain other payments called "restricted payments";
- enter into sale and leaseback transactions;
- create liens;

- sell and otherwise dispose of assets;
- acquire or merge or consolidate with another company; and
- enter into some types of transactions with affiliates.

These restrictions could adversely affect our ability to finance future operations or capital needs or engage in other business activities that may be in our interest.

The Credit Agreement also requires us to comply with specified financial ratios and tests. Failure to do so, unless waived by the lenders under the Credit Agreement pursuant to its terms, would result in an event of default under the Credit Agreement and, if indebtedness under the Credit Agreement is accelerated, would give rise to defaults under most or all of our other debt agreements. The Credit Agreement is guaranteed by most of our subsidiaries and is secured by most of our assets and our subsidiaries' assets.

Required Assurances of Financial Resources Our liquidity, financial condition, prospects and profitability can be adversely affected by present or future state regulations and contractual requirements that we provide financial assurance of our ability to meet our obligations.

Some of our contracts and certain state regulations require us or certain of our subsidiaries to maintain specified cash reserves or letters of credit and/or to maintain certain minimum tangible net equity in certain of our subsidiaries as assurance that we have financial resources to meet our contractual obligations. Many of these state regulations also restrict the investment activity of certain of our subsidiaries. Some state regulations also restrict the ability of certain of our subsidiaries to pay dividends to Magellan. Additional state regulations could be promulgated that would increase the cash or other security we would be required to maintain. In addition, our customers may require additional restricted cash or other security with respect to our obligations under our contracts, including our obligation to pay IBNR claims and other medical claims not yet processed and paid. In addition, certain of our contracts and state regulations limit the profits that we may earn on risk-related business. Our liquidity, financial condition, prospects and profitability could be adversely affected by the effects of such regulations and contractual provisions. As of March 31, 2005, our restricted cash, investments and deposits were $169.4 million.

Competition The competitive environment in our industry, and any failure in our ability to adequately respond, may limit our ability to maintain or increase our rates, which would limit or adversely affect our profitability.

Our business is highly competitive. We compete with other managed behavioral healthcare organizations as well as with insurance companies, health maintenance organizations, or HMOs, preferred provider organizations, or PPOs, third party administrators, or TPAs, independent practice associations, or IPAs, multi disciplinary medical groups and other managed care companies. Many of our competitors, particularly certain insurance companies and HMOs, are significantly larger and have greater financial, marketing and other resources than us, which can create downward pressure on prices through economies of scale. The entrance or expansion of these larger companies in the managed behavioral healthcare industry (including our customers who have insourced or who may choose to insource behavioral healthcare services) could increase the competitive pressures we face and could limit our ability to maintain or increase our rates. If this happens, our profitability could be adversely affected.

Possible Impact of Healthcare Reform Healthcare reform can significantly reduce our net revenue or profitability.

The U.S. Congress is considering legislation that, among other things, would limit healthcare plans and methods of operations, limit employers' and healthcare plans' ability to define medical necessity and permit employers and healthcare plans to be sued in state courts for coverage determinations. It is uncertain whether we could recoup, through higher net revenue or other measures, the increased costs of federally mandated benefits or other increased costs caused by such legislation or similar legislation. In addition, if any federal parity legislation is adopted and the difference in coverage limits for mental health coverage and medical health coverage is reduced or eliminated, any increase in net revenue we derive following such legislation may not be sufficient to cover the increase in costs that would result from a greater utilization of mental healthcare services. We cannot predict the effect of this legislation or other legislation that may be adopted by the U.S. Congress, and such legislation, if implemented, could have an adverse effect on us.

Government Regulation We are subject to substantial government regulation and scrutiny, which increase our costs of doing business and could adversely affect our profitability.

The managed behavioral healthcare industry and the provision of behavioral healthcare services are subject to extensive and evolving federal and state regulation. Such laws and regulations cover, but are not limited to, matters such as licensure, accreditation, government healthcare program participation requirements, information privacy and security, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Government investigations and allegations have become more frequent concerning possible violations of fraud and abuse and false claims statutes and regulations by healthcare organizations. Violators may be excluded from participating in government healthcare programs, subject to fines or penalties or required to repay amounts received from the government for previously billed services. A violation of such laws and regulations may have a material adverse effect on us.

We are subject to certain state laws and regulations and federal laws as a result of our role in management of customers' employee benefit plans.

Regulatory issues may also affect our operations including, but not limited to:

- additional state licenses that may be required to conduct our businesses, including utilization review and TPA activities;
- limits imposed by state authorities upon corporations' control or excessive influence over behavioral healthcare services through the direct employment of psychiatrists, psychologists or other professionals, and prohibiting fee splitting;
- laws that impose financial terms and requirements on us due to our assumption of risk under contracts with licensed insurance companies or HMOs;
- laws in certain states that impose an obligation to contract with any healthcare provider willing to meet the terms of our contracts with similar providers;
- maintaining confidentiality of patient information; and
- complying with the Health Insurance Portability and Accountability Act of 1996, or HIPAA, within the imposed deadlines.

The imposition of additional licensing and other regulatory requirements may, among other things, increase our equity requirements, increase the cost of doing business or force significant changes in our operations to comply with these requirements.

The costs associated with compliance with government regulation as discussed above may adversely affect our financial condition and results of operations.

Risks Related To Realization of Goodwill and Intangible Assets Our profitability could be adversely affected if the value of intangible assets is not fully realized.

Our total assets at December 31, 2004 reflect goodwill of approximately $392.3 million, representing approximately 33.0 percent of total assets. There can be no assurance that such goodwill will be realizable. The application of the fresh start reporting provisions of SOP 90-7 upon the consummation of the Plan of Reorganization as of December 31, 2003 required us to value our assets and liabilities at fair market value. In accordance with these fresh start reporting provisions implemented as of December 31, 2003, our reorganization value was allocated to our tangible and identified intangible assets. Under SOP 90-7, if any portion of our reorganization value could not be allocated to specific assets, it was reported as goodwill. We completed our annual impairment analysis of goodwill as of October 1, 2004 noting that the fair value exceeded the associated carrying value; therefore, no impairment was recorded.

At December 31, 2004, identifiable intangible assets (customer lists, contracts and provider networks) totaled approximately $44.3 million. Intangible assets are amortized over their estimated useful lives, which range from approximately two to eighteen years. The amortization periods used may differ from those used by other entities. In addition, we may be required to shorten the amortization period for intangible assets in future periods based on changes in our business. We may never realize the value of such assets.

We evaluate, on a regular basis, whether for any reason the carrying value of our intangible assets and other long-lived assets may no longer be completely recoverable, in which case a charge to earnings for impairment losses could become necessary. When events or changes in circumstances occur that indicate the carrying amount of long-lived assets may not be recoverable, we assess the recoverability of long-lived assets other than goodwill by determining whether the carrying value of such intangible assets will be recovered through the future cash flows expected from the use of the asset and its eventual disposition.

Any event or change in circumstances leading to a future determination requiring additional write-offs of a significant portion of unamortized intangible assets or goodwill would adversely affect our profitability.

Certain future changes in the composition of our stockholder population could, in certain circumstances, limit our ability to use our tax net operating losses.

We estimate that, as of December 31, 2004, we had consolidated net operating loss, referred to as NOLs, carryforwards of approximately $525 million. These NOLs expire in 2009 through 2020 and are subject to examination and adjustment by the Internal Revenue Service. In addition, our utilization of these NOLs became subject to limitation under Internal Revenue Code section 382 upon consummation of our reorganization, which affects the timing of the use of NOLs. At this time, we do not believe these limitations will materially limit the Company's ability to use any NOLs before they expire.

The limitations imposed by section 382 provide that a corporation that undergoes an "ownership change" may generally thereafter only utilize its pre-change losses (including, in some cases, certain so-called "built-in" losses that have not yet been recognized for federal income tax purposes) to offset a fixed amount of taxable income per year. A corporation generally undergoes an ownership change if the percentage of stock of the corporation owned by one or more 5% shareholders has increased by more than 50 percentage points over, at most, a three year period (with certain groups of less-than-5% shareholders treated as a single shareholder for this purpose). The Company underwent such an ownership change upon consummation of its reorganization in January 2004. Based on the stock ownership of our Common Stock reported in required filings with the SEC made to date, another ownership change would not occur as a result of the sale of the shares in this offering. However, subsequent changes in our stock ownership, including other sales of our Common Stock by 5% shareholders (including Magellan Holdings L.P.), certain purchases that result in 5% or greater ownership of our Common Stock, certain changes in the indirect beneficial ownership of our Common Stock, and issuances or redemptions of Common Stock by us, could result in another ownership change that would trigger an additional section 382 limitation.

The application of another section 382 limitation on our NOLs as a result of future ownership changes could reduce the amount of NOLs we could utilize in a year, and thereby have an adverse effect on our anticipated future cash flow, were, for example, the fair market value of our stock to decline significantly prior to such ownership change. In general, the amount of the annual limitation to which a corporation's pre-change losses are subject following an ownership change is equal to the product of (1) the fair market value of the corporation's stock immediately before the ownership change (subject to certain reductions) multiplied by (2) the "long-term tax-exempt rate" in effect for the month in which the ownership change occurs (which currently is 4.37%). In certain circumstances, the annual limitation for a particular year may be increased due to the subsequent recognition of so-called "built-in" gains that existed at the time of the ownership change. Any unused limitation may be carried forward, thereby increasing the annual limitation in the subsequent taxable year. However, if we did not continue our historic business or use a significant portion of our assets in a new business for two years after the ownership change, the resulting annual limitation would be zero.

Claims for Professional Liability   Pending or future actions or claims for professional liability (including any associated judgments, settlements, legal fees and other costs) could require us to make significant cash expenditures and consume significant management time and resources, which could have a material adverse effect on our profitability and financial position.

Management and administration of the delivery of managed behavioral healthcare services, and the direct provision of behavioral healthcare treatment services, entail significant risks of liability. In recent years, participants in the managed health care industry have become subject to an increasing number of lawsuits. From time to time, we are subject to various actions and claims of professional liability alleging negligence in performing utilization review activities, as well as for the acts or omissions of our employees, network providers or others. In the normal course of business, we receive reports relating to suicides and other serious incidents involving patients enrolled in our programs. Such incidents occasionally give rise to malpractice, professional negligence and other related actions and claims against us or our network providers. As the number of lives we cover grows and the number of providers under contract increases, actions and claims against us (and, in turn, possible legal liability) predicated on malpractice, professional negligence or other related legal theories would be expected to increase. We are also subject to actions and claims for the costs of services for which payment was denied. Many of these actions and claims seek substantial damages and require us to incur significant fees and costs related to our defense and consume significant management time and resources, which could have a material adverse effect on our profitability and financial position.

Professional Liability and Other Insurance   Claims brought against us that exceed the scope of our liability coverage or denial of coverage could materially and adversely affect our profitability and financial condition.

We maintain a program of insurance coverage against a broad range of risks in our business. As part of this program of insurance, we carry professional liability insurance, subject to certain deductibles and self-insured retentions. We also are sometimes required by customer contracts to post surety bonds with respect to our potential liability on professional responsibility claims that may be asserted in connection with services we provide. As of March 31, 2005, we had less than

$4 million of such bonds outstanding. Our insurance may not be sufficient to cover any judgments, settlements or costs relating to present or future claims, suits or complaints. Upon expiration of our insurance policies, sufficient insurance may not be available on favorable terms, if at all. To the extent our customers are entitled to indemnification under their contracts with us relating to liabilities they incur arising from the operation of our programs, such indemnification may not be covered under our insurance policies. To the extent that certain actions and claims seek punitive and compensatory damages arising from our alleged intentional misconduct, such damages, if awarded, may not be covered, in whole or in part, by our insurance policies. We also have potential liability relating to the self-insurance program we maintained previously with respect to our provider business. If we are unable to secure adequate insurance in the future, or if the insurance we carry is not sufficient to cover any judgments, settlements or costs relating to any present or future actions or claims, such judgments, settlements or costs may have a material adverse effect on our profitability and financial condition. If we are unable to obtain needed surety bonds in adequate amounts or make alternative arrangements to satisfy the requirements for such bonds, we may no longer be able to operate in those states, which would have a material adverse effect on us.

Class Action Suits and Other Legal Proceedings We could be targeted by class action and other lawsuits that could result in material liabilities to us or cause us to incur material costs, to change our operating procedures in ways that increase costs or to comply with additional regulatory requirements.

Managed healthcare companies have been targeted as defendants in national class action lawsuits regarding their business practices. We have been subject to such class actions as defendants and are also subject to other lawsuits and legal proceedings in conducting our business. These lawsuits may take years to resolve and cause us to incur substantial litigation expenses and the outcomes could have a material adverse effect on our profitability and financial condition. In addition to potential damage awards, depending upon the outcomes of such cases, these lawsuits may cause or force changes in practices of our industry and may also cause additional regulation of the industry through new federal or state laws or new applications of existing laws or regulations. Such changes could increase our operating costs.

Government Investigations We may be subjected to additional regulatory requirements and to investigations or regulatory action by governmental agencies, each of which may have a material adverse effect on our business, financial condition and results of operations.

From time to time, we receive notifications from and engage in discussions with various government agencies concerning our managed care businesses and operations. As a result of these contacts with regulators, we may, as appropriate, be required to implement changes to our operations, revise our filings with such agencies and/or seek additional licenses to conduct our business. Our inability to comply with the various regulatory requirements may have a material adverse effect on our business.

In addition, we may become subject to regulatory investigations relating to our business, which may result in litigation or regulatory action. A substantial legal liability or a significant regulatory action against us could have a material adverse effect on our business, financial condition and results of operations. Moreover, even if we ultimately prevail in the litigation, regulatory action or investigation, we could suffer significant reputational harm or a disruption to our business, which could have a material adverse effect on our business, financial condition and results of operations.

Risks related to our Ordinary Common Stock

Our Ordinary Common Stock price may be volatile.

Our Ordinary Common Stock price may fluctuate in response to many things, including but not limited to:

- our quarterly or annual earnings or those of other companies in our industry;
- unfavorable trends or the loss of significant customers;
- changes in earnings estimates or recommendations by research analysts who track our Ordinary Common Stock or the stocks of other companies in our industry or failure of analysts to cover our Ordinary Common Stock;
- new laws or regulations or new interpretations of laws or regulations applicable to our business;
- changes in accounting standards, policies, guidance, interpretations or principles;
- changes in general conditions in the U.S. and global economies or financial markets, including those resulting from war, incidents of terrorism or responses to such events; and
- sale of Ordinary Common Stock by our directors and executive officers and the selling stockholders.

Some companies that have had volatile market prices for their securities have been subject to securities class action suits filed against them. If a suit were to be filed against us, regardless of the outcome, it could result in substantial costs and a diversion of our management's attention and resources. This could have a material adverse effect on our business, results of operations and financial condition.

We may be restricted from paying cash dividends on our Common Stock in the future.

Any payment of cash dividends will depend upon our financial condition, earnings, legal requirements, restrictions in our debt agreements and other factors deemed relevant by our Board of Directors. The terms of our Credit Agreement and the Indenture restrict us from paying cash dividends on our Common Stock. See " Restrictive Covenants in Our Debt Instruments Restrictions imposed by our debt agreements limit our operating and financial flexibility." These restrictions may adversely affect our ability to finance our future operations or capital needs or engage in other business activities that may be in our interest. Furthermore, we will be permitted under the terms of our debt agreements to incur additional indebtedness that may severely restrict or prohibit the payment of dividends. We cannot assure you that the agreements governing our current and future indebtedness will permit us to pay dividends on our Common Stock. We currently do not intend to declare and pay any cash dividends on our Common Stock.

Shares eligible for future sale may adversely affect our Ordinary Common Stock price.

Sales of substantial amounts of our Ordinary Common Stock in the public market, or the perception that these sales may occur, could cause the market price of our Ordinary Common Stock to decline. This could also impair our ability to raise additional capital through the sale of our equity securities. Under our amended and restated certificate of incorporation, referred to as the Certificate of Incorporation, we are authorized to issue up to 140 million shares of Common Stock, of which approximately 35.4 million shares of Common Stock were outstanding as of May 5, 2005 and approximately 6.0 million shares of Ordinary Common Stock were reserved for issuance upon the exercise of outstanding stock options and warrants. In addition, 30,000 shares of Ordinary Common Stock will be reserved for issuance under the 2005 director stock compensation plan, pending stockholder approval. We, the selling stockholders, our executive officers and two of our directors who are affiliated with the selling stockholders have entered into lock-up agreements or the underwriting agreement described under the caption "Underwriting." These agreements provide that parties to such agreements shall not sell shares of our Common Stock until at least, 90 days after the date of this prospectus supplement in the case of Magellan and the selling stockholders, and 30 days after the date of this prospectus supplement but in no event beyond June 15, 2005, in the case of our executive officers and our two directors who are affiliated with the selling stockholders, subject to exceptions. In addition, we have granted Onex, which following this offering will own approximately 12.1 percent of our outstanding Common Stock, and a warrantholder certain demand and piggyback registration rights. We cannot predict the size of future issuances of our Common Stock or the effect, if any, that future sales and issuances of shares of our Common Stock would have on the market price of our Ordinary Common Stock. See "Shares Eligible for Future Sale."

Delaware law and our charter documents may impede or discourage a takeover, which could cause the market price of our shares to decline.

Pursuant to our Certificate of Incorporation, Magellan elected not to be governed by Section 203 of the Delaware General Corporation Law which prevents an interested stockholder from engaging in business combinations with the company for three years after becoming an interested stockholder, unless certain conditions are met. However, our Certificate of Incorporation and amended and restated bylaws, referred to as the Bylaws, contain provisions that might be characterized as anti-takeover provisions, including the election at each annual meeting of less than a majority of the board of directors, the ability of our board of directors to create and issue a new series of preferred stock and certain provisions of the Bylaws limiting or regulating the rights of the stockholders to take actions in certain circumstances. These provisions may deter or render more difficult proposals to acquire control of our company through merger, takeover or other business combination, including proposals a stockholder might consider to be in his or her best interest or impede or lengthen the time necessary to effectuate a change in membership of the board of directors and may make removal of our management more difficult, which, under certain circumstances, could reduce the market value of our Ordinary Common Stock.

Cautionary note regarding forward-looking statements

This prospectus supplement, the accompanying prospectus and the documents incorporated by reference contain "forward-looking statements" within the meaning of the U.S. Private Securities Litigation Reform Act of 1995. Forward-looking statements can be identified by words such as "anticipates," "intends," "plans," "seeks," "believes," "estimates," "expects" and similar references to future periods, or by the inclusion of forecasts or projections. Examples of forward-looking statements include, but are not limited to, statements we make regarding our belief that non-renewals of contracts will result in a reduction during 2006 from projected 2005 net revenue from these contracts of approximately $330 million, $250 million of which relates to Aetna, our belief that our medical claims payable is adequate to satisfy ultimate claim liability for unpaid claims as of March 31, 2005, our estimates of charges we will need to record in future periods for grants of Ordinary Common Stock to our non-management members of the board of directors who are not affiliated with Onex, our anticipation not to incur material charges relating to our restructuring initiatives during fiscal 2005 and our anticipation not to require to draw on amounts available under the Revolving Loan Facility for our operations, capital needs or debt service in fiscal 2005.

Forward-looking statements are based on our current expectations and assumptions regarding our business, the economy and other future conditions. Because forward-looking statements relate to the future, by their nature, they are subject to inherent uncertainties, risks and changes in circumstances that are difficult to predict. Our actual results may differ materially from those contemplated by the forward-looking statements. We caution you therefore that you should not rely on any of these forward-looking statements as statements of historical fact or as guarantees or assurances of future performance. Important factors that could cause actual results to differ materially from those in the forward-looking statements include risks, uncertainties and other important factors detailed from time to time in reports we file with the SEC, including the following:

- our ability to successfully implement our business strategy;
- our ability to renegotiate or extend expiring customer contracts or the termination of customer contracts;
- changes in business practices of the industry, including the possibility that certain of our managed care customers could seek to provide managed behavioral healthcare services directly to their subscribers, instead of contracting with us for such services;
- the impact of increased competition on our ability to maintain or obtain contracts;
- our dependence on government spending for managed healthcare, including changes in federal, state and local healthcare policies;
- the impact of present or future state regulations and contractual requirements; and
- the other factors that are described in "Risk factors."

Any forward-looking statement made by us in this prospectus supplement, the accompanying prospectus or the documents incorporated by reference, speaks only as of the date on which we make it. Factors or events that could cause our actual results to differ may emerge from time to time, and it is not possible for us to predict all of them. We undertake no obligation to publicly update any forward-looking statement, whether as a result of new information, future developments or otherwise, except as may be required by law.

Use of proceeds

We will not receive any of the proceeds from the sale of shares by the selling stockholders. The selling stockholders will receive all of the net proceeds from the sale of shares of our Ordinary Common Stock offered, including the over-allotment shares, if any, in this prospectus supplement.

Price range of common stock and dividend policy

Since January 6, 2004, shares of the Reorganized Company's Ordinary Common Stock have been quoted on the Nasdaq National Market under the symbol "MGLN." For further information regarding the Reorganized Company's Ordinary Common Stock, see Note 8 "Stockholders' Equity" to the audited annual consolidated financial statements incorporated by reference in the accompanying prospectus. Warrants to purchase shares of the Reorganized Company's Ordinary Common Stock have been quoted on the Over-the-Counter Bulletin Board, or the OTCBB, under the ticker symbol "MGLNW.OB" since February 2, 2004. The following table sets forth the high and low closing bid prices of the Reorganized Company's Ordinary Common Stock as reported by the Nasdaq National Market for the periods presented:

Calendar Year	High	Low
2004		
Period from January 6, 2004 through March 31, 2004	$ 29.01	$ 26.25
Second Quarter	33.99	27.65
Third Quarter	39.29	29.22
Fourth Quarter	38.46	31.39
2005		
First Quarter	$ 37.14	$ 33.00
Period from April 1, 2005 through May 5, 2005	33.99	31.78

At the close of business on May 5, 2005, there were approximately 352 holders of record of our Ordinary Common Stock. The stockholders of record data for the Ordinary Common Stock does not reflect stockholders whose stock was held on that date by the Depository Trust Company or other intermediaries.

Dividends

We did not declare any dividends during either the fiscal years ended December 31, 2003 or 2004 or 2005 to date. We are prohibited from paying dividends on our Common Stock under the terms of the Credit Agreement and the Indenture, except in very limited circumstances. See "Management's discussion and analysis of financial condition and results of operations Outlook Liquidity and Capital Resources Restrictive Covenants in Debt Agreements." We do not intend to pay any cash dividends for the forseeable future.

Selected consolidated financial data

In May 2003, our Board of Directors approved a change in our fiscal year. Instead of a fiscal year ending on September 30, we adopted a fiscal year that coincides with the calendar year, effective December 31, 2002. The following table sets forth our selected consolidated financial data of as of and for each of the three fiscal years ended September 30, 2000, 2001 and 2002, for the fiscal year ended December 31, 2003 and as of and for the three month transition period ended December 31, 2002 and unaudited comparable data as of and for the three months ended December 31, 2001. The table also sets forth selected consolidated financial data (i) as of December 31, 2003 and 2004 and for the fiscal year ended December 31, 2004, and (ii) as of March 31, 2005 and for the three months ended March 31, 2004 and 2005.

On the Effective Date, we and 88 of our subsidiaries consummated the Plan of Reorganization, under chapter 11 of title 11 of the Bankruptcy Code, which had been confirmed by order of the Bankruptcy Court. In connection with the consummation of the Plan of Reorganization, we implemented fresh start reporting effective December 31, 2003. Accordingly, all balance sheet data as of, and subsequent to December 31, 2003 represents balances of the Reorganized Company, and all balance sheet data prior to December 31, 2003 represents balances of the Predecessor Company. Statement of operations and statement of cash flows data for all periods prior to January 1, 2004 represents the results of the Predecessor Company. Accordingly, all references to us with respect to disclosures of amounts recorded (i) through or prior to December 31, 2003 in relation to statement of operations or cash flow items; and (ii) prior to December 31, 2003 in relation to balance sheet items, relate to the Predecessor Company. All references to us with respect to disclosures of amounts recorded or to be recorded (i) after December 31, 2003 in relation to statement of operations or cash flow items; and (ii) on or after December 31, 2003 in relation to balance sheet items, relate to the Reorganized Company.

As a result of the Plan of Reorganization under chapter 11 of title 11 of the Bankruptcy Code commenced in March 2003 and consummated on the Effective Date and our implementation of fresh start reporting effective December 31, 2003, the selected consolidated financial data as of December 31, 2003 and as of and for the year ended December 31, 2004 are not comparable to the prior periods presented. Selected consolidated financial data as of and for the fiscal year ended December 31, 2003 includes the following significant unusual items:

- Net reorganization benefit related to continuing operations of approximately $438.2 million, incurred in connection with the Plan of Reorganization. The reorganization benefit is primarily comprised of a net fresh start reorganization gain of approximately $479.7 million as a result of the application of fresh start reporting, a net benefit of approximately $7.5 million from lease rejections and court approved claim reductions, and interest income of approximately $1.1 million, which benefits were partially offset by expenses which include the write-off of deferred financing costs of approximately $18.5 million related to the 9.375% Senior Notes due 2007, outstanding prior to the Effective Date, referred to as the Old Senior Notes, and 9% Senior Subordinated Notes due 2008, outstanding prior to the Effective Date, referred to as the Old Subordinated Notes, and approximately $31.6 million of professional fees incurred in conjunction with the financial restructuring activities and chapter 11 proceedings. We also recorded a net reorganization benefit related to discontinued operations of $20.3 million, net of a $0.8 million tax benefit. See Note 3 "Summary of Significant Accounting Policies" to the audited annual consolidated financial statements incorporated by reference in the accompanying prospectus for a reconciliation of the reorganization expenses recorded in fiscal 2003.

Pursuant to FIN 46, the Reorganized Company's balance sheets as of December 31, 2003 and 2004 include the assets and liabilities of the Premier joint venture, a variable interest entity for which we are the primary beneficiary. The creditors (or other beneficial interest holders) of Premier have no recourse to our general credit, as the primary beneficiary of Premier. See Note 3 "Summary of Significant Accounting Policies Recent Accounting Pronouncements" to the audited annual consolidated financial statements incorporated by reference in the accompanying prospectus for discussion of FIN 46. The Reorganized Company early adopted FIN 46 on December 31, 2003, as early adoption of new accounting pronouncements is required by companies implementing the fresh start reporting provisions of SOP 90-7. We accounted for the joint venture under the equity method of accounting through December 31, 2003. As such, the assets and liabilities of Premier are not included in our balance sheet accounts as of the end of any of the previous periods presented.

See Note 2 "Fresh Start Reporting" to the audited annual consolidated financial statements incorporated by reference in the accompanying prospectus for discussion of fresh start adjustments recorded by us.

Net loss for fiscal 2002 included the effect of the adoption of SFAS No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142") which resulted in us recognizing an impairment loss of $207.8 million before taxes ($191.6 million after taxes), in the first quarter of fiscal 2002, recorded as a cumulative effect of a change in accounting principle, separate from operating results. Adoption of SFAS 142 also resulted in goodwill impairment charges of $415.9 million and $28.8 million in fiscal 2002 and fiscal 2003, respectively. In accordance with SFAS 142, we did not record goodwill amortization, which would have amounted to approximately $31.1 million and $31.8 million in fiscal 2002 and 2003, respectively, and $7.9 million and $7.8 million during the three months ended December 31, 2001 and 2002, respectively, had SFAS 142 not been adopted. See Note 3 "Summary of Significant Accounting Policies Predecessor Company Goodwill" to the audited annual consolidated financial statements incorporated by reference in the accompanying prospectus for further discussion of the impact to us of the adoption of SFAS 142 in fiscal 2002. In addition, our capital restructuring activities and financial condition resulted in uncertainty as of September 30, 2002 as to our ability to realize our net operating loss carryforwards and other deferred tax assets. Accordingly, as of September 30, 2002, we recorded an increase to our valuation allowance of $200.5 million, resulting in a total valuation allowance covering all of our net deferred tax assets. See Note 10 "Income Taxes" to the audited annual consolidated financial statements incorporated by reference in the accompanying prospectus.

The operating results for fiscal 2001 were positively impacted by settlements of certain contract appeals related to subcontracts with respect to TRICARE. For fiscal 2001, net revenue and equity in earnings of unconsolidated subsidiaries included $30.3 million and $22.6 million, respectively, related to such settlements. For fiscal 2001, income from continuing operations and net income each included approximately $31.7 million related to the positive impact of these settlements. Additionally, in the fourth quarter of fiscal 2002, we adopted SFAS 145, which led to the reclassification of losses due to early extinguishment of debt in fiscal 2001 from extraordinary losses to losses from operations.

Selected consolidated financial data for the years ended September 30, 2002 and December 31, 2003 and 2004 and for the three months ended December 31, 2002, and as of December 31, 2003 and 2004 presented below, have been derived from our audited annual consolidated financial statements and the related notes incorporated by reference in the accompanying prospectus. Selected consolidated financial data for the fiscal years ended September 30, 2000 and 2001 and as of September 30, 2000, 2001 and 2002 have been derived from our audited consolidated financial statements not included or incorporated by reference in this prospectus supplement or the accompanying prospectus. The selected consolidated financial information as of and for the three months ended December 31, 2001 is unaudited.

The selected consolidated financial data presented below as of March 31, 2005 and for the three months ended March 31, 2004 and 2005, are derived from our unaudited quarterly consolidated financial statements incorporated by reference in the accompanying prospectus. In the opinion of our management, these unaudited quarterly consolidated financial statements include all adjustments, consisting only of normal recurring adjustments, which we consider necessary for a fair presentation of our financial position at those dates and our results of operations for those periods. Operating results for the three month period ended March 31, 2005 are not necessarily indicative of the results that may be expected for the full fiscal year ending December 31, 2005 or portions of that fiscal year. You should read this information in conjunction with "Management's discussion and analysis of financial condition and results of operations" included elsewhere in this prospectus supplement and our consolidated financial statements and the related notes contained in our quarterly and annual reports that we have filed with the SEC and incorporated by reference in the accompanying prospectus.

	Predecessor Company						**Reorganized Company**		
	Fiscal Year Ended September 30,			**Fiscal Year Ended December 31,**	**Three Months Ended December 31,**		**Fiscal Year Ended December 31,**	**Three Months Ended March 31,**	
	2000	**2001**	**2002**	**2003**	**2001[(1)]**	**2002**	**2004**	**2004[(1)]**	**2005[(1)]**
	(in thousands, except per share data)								
Statement of Operations Data:									
Net revenue	$ 1,640,933	$ 1,755,512	$ 1,753,058	$ 1,510,746	$ 444,842	$ 445,890	$ 1,795,402	$ 440,176	$ 452,754
Salaries, cost of care and other operating expenses	1,442,082	1,557,042	1,585,314	1,324,886	395,093	391,433	1,567,465	393,928	392,929
Equity in earnings of unconsolidated subsidiaries	(9,792)	(36,566)	(13,006)	(6,202)	(3,177)	(2,138)	(5,277)	(1,844)	(1,449)
Depreciation and amortization	68,261	68,294	47,558	48,047	11,190	14,380	42,489	10,249	11,218
Interest expense (Contractual interest of $106,328 in fiscal 2003)	106,711	110,423	97,596	61,016	23,719	25,333	37,124	9,334	8,639
Interest income	(9,425)	(10,121)	(5,365)	(2,873)	(1,310)	(1,010)	(6,127)	(781)	(3,033)
Stock compensation expense							23,152	10,777	3,750
Reorganization benefit, net				(438,217)					
Goodwill impairment charges			415,880	28,780					
Special charges	25,398	3,340	15,729	9,528	4,485	3,907	5,038	1,908	
Income (loss) from continuing operations before income taxes and minority interest	17,698	63,100	(390,648)	485,781	14,842	13,985	131,538	16,605	40,700
Provision for income taxes	8,994	33,732	151,609	33,813	6,086	3,129	46,584	3,568	17,064
Income (loss) from continuing operations before minority interest	8,704	29,368	(542,257)	451,968	8,756	10,856	84,954	13,037	23,636
Minority interest	114	78	47	253	16	27	333	129	68
Income (loss) from continuing operations	8,590	29,290	(542,304)	451,715	8,740	10,829	84,621	12,908	23,568
Income (loss) from discontinued operations[(2)]	(56,736)	4,624	4,894	(25,028)	158	803	4,781	30	48
Income (loss) on disposal of discontinued operations[(2)]	(17,662)	(9,359)	(92)	4,756	820	97	(1,030)		
Reorganization benefit, net[(2)]				20,327					
Income (loss) before cumulative effect of change in accounting principle	(65,808)	24,555	(537,502)	451,770	9,718	11,729	88,372	12,938	23,616
Cumulative effect of change in accounting principle[(2)]			(191,561)		(191,561)				
Net income (loss)	(65,808)	24,555	(729,063)	451,770	(181,843)	11,729	88,372	12,938	23,616
Preferred dividends (Contractual dividends of $4,788 in fiscal 2003)	3,401	4,527	4,657	883	1,075	1,243			
Amortization of redeemable preferred stock issuance costs, and other	401	522	540	172	143	136			

Preferred stock reorganization items, net[2]				2,668					
Income (loss) available to common stockholders	$ (69,610)	$ 19,506	$ (734,260)	$ 448,047	$ (183,061)	$ 10,350	$ 88,372	$ 12,938	$ 23,616
Income (loss) per common share available to common stockholders basic:									
Income (loss) from continuing operations	$ 0.15	$ 0.72	$ (15.71)	$ 12.69	$ 0.22	$ 0.27	$ 2.39	$ 0.37	$ 0.67
Income (loss) from discontinued operations	(2.32)	(0.14)	0.14		0.03	0.02	0.11		
Cumulative effect of change in accounting principle			(5.50)		(5.53)				
Net income (loss)	$ (2.17)	$ 0.58	$ (21.07)	$ 12.69	$ (5.28)	$ .029	$ 2.50	$ 0.37	$ 0.67
Income (loss) per common share available to common stockholders diluted:									
Income (loss) from continuing operations	$ 0.15	$ 0.69	$ (15.71)	$ 10.86	$ 0.21	$ 0.26	$ 2.33	$ 0.35	$ 0.64
Income (loss) from discontinued operations	(2.30)	(0.13)	0.14		0.02	0.02	0.10		
Cumulative effect of change in accounting principle			(5.50)		(4.55)				
Net income (loss)	$ (2.15)	$ 0.56	$ (21.07)	$ 10.86	$ (4.32)	$ 0.28	$ 2.43	$ 0.35	$ 0.64

	Predecessor Company					Reorganized Company		
	As of September 30,			As of December 31,		As of December 31,		As of March 31,
	2000	2001	2002	2001[1]	2002	2003	2004	2005[1]
	(in thousands)							
Balance Sheet Data:								
Current assets	$ 325,532	$ 274,011	$ 283,730	$ 293,276	$ 286,131	$ 630,223	$ 540,495	$ 582,814
Current liabilities	475,758	430,285	1,494,412	425,182	1,477,999	523,531	382,308	377,069
Property and equipment, net	112,612	94,322	86,773	90,369	85,659	122,082	120,604	117,759
Total assets	1,809,666	1,666,705	1,004,080	1,667,730	998,917	1,292,017	1,188,338	1,204,234
Total debt and capital lease obligations	1,098,047	1,006,356	1,049,354	1,005,369	1,048,158	493,699	379,478	372,130
Stockholders' equity (deficit)	$ 128,464	$ 162,188	$ (570,672)	$ 170,729	$ (560,322)	$ 387,911	$ 497,053	$ 524,454

(1) Amounts are unaudited.

(2) Net of income taxes.

Management's discussion and analysis of financial condition and results of operations

The following discussion and analysis of the financial condition and results of operations of Magellan and its majority owned subsidiaries and all variable interest entities for which Magellan is the primary beneficiary should be read together with the audited annual consolidated financial statements and unaudited quarterly consolidated financial statements and the other information contained in annual and quarterly reports and other documents we have filed with the SEC and incorporated by reference in the accompanying prospectus.

Business Overview

We coordinate and manage the delivery of behavioral healthcare treatment services. At March 31, 2005, we managed the behavioral healthcare benefits of approximately 57.7 million individuals. Within the managed behavioral healthcare business, we operate in the following four segments, based on the services we provide and/or the customers that we serve: (i) Magellan Health Plan Solutions, or Health Plan Solutions; (ii) Magellan Employer Solutions, or Employer Solutions; (iii) Magellan Public Sector Solutions or Public Sector Solutions; and (iv) Corporate and Other.

Health Plan Solutions. Our Health Plan Solutions segment generally reflects managed behavioral healthcare services provided under contracts with Blue Cross Blue Shield health plans and other managed care companies, health insurers and other health plans. This segment's contracts encompass both risk-based and ASO contracts. Although certain health plans provide their own managed behavioral healthcare services, many health plans "carve out" behavioral healthcare from their general healthcare services and subcontract such services to managed behavioral healthcare companies such as us. In the Health Plan Solutions segment, our members are the beneficiaries of the health plan (the employees and dependents of the customer of the health plan), for which the behavioral healthcare services have been carved out to us. Our Health Plan Solutions segment managed the behavioral health benefits of approximately 42.3 million covered lives as of March 31, 2005.

We derived net revenue from our contract with Aetna of $250.3 million and $193.6 million, respectively, during the fiscal years ended September 30, 2002 and December 31, 2003, $78.8 million and $54.8 million during the three months ended December 31, 2001 and 2002, respectively, $228.1 million during the fiscal year ended December 31, 2004 and $55.8 million and $62.0 million, respectively, during the three-month periods ended March 31, 2004 and 2005. The declines in Aetna net revenue of $56.7 million in fiscal 2003 compared to fiscal 2002, and of $24.0 million for the three months ended December 31, 2002 as compared to the three months ended December 31, 2001, were mainly due to decreased membership as a result of Aetna intentionally reducing its membership levels in an effort to exit less profitable businesses. The Aetna contract will terminate on December 31, 2005.

In addition, we are party to several contracts with entities that are now controlled by WellPoint that represent a significant concentration of business for us. Total net revenue from such contracts totaled $133.1 million during the year ended December 31, 2004 and $31.4 million and $33.9 million during the three-month periods ended March 31, 2004 and 2005, respectively. One such contract, which generated net revenue of $95.0 million during the year ended December 31, 2004 and $24.4 million during the three-month period ended March 31, 2005, extends through December 31, 2005. A second contract with an entity controlled by WellPoint, which generated net revenue of $25.7 million during the year ended December 31, 2004 and $6.7 million for the three-month period ended March 31, 2005, extends through September 30, 2005 and we have recently been notified by the customer that it does not intend to renew this contract beyond such date.

Employer Solutions. Our Employer Solutions segment generally reflects the provision of EAP services, managed behavioral healthcare services and integrated products under contracts with employers, including corporations and governmental agencies, and labor unions. This segment's managed behavioral healthcare services are primarily ASO products. Our Employer Solutions Segment provided these services for approximately 13.4 million covered lives as of March 31, 2005.

Public Sector Solutions. Our Public Sector Solutions segment generally reflects managed behavioral healthcare services provided to Medicaid recipients under contracts with state and local governmental agencies. This segment's contracts encompass both risk-based and ASO contracts.

We provide managed behavioral healthcare services to the State of Tennessee's TennCare program, both through a direct contract held by our wholly owned subsidiary TBH, and through a contract held by Premier, a joint venture in which we own a 50.0 percent interest. In addition, we contract with Premier to provide certain services to the joint venture. Through fiscal 2003, we accounted for our investment in Premier using the equity method. Effective December 31, 2003, we early adopted FIN 46, under which the Reorganized Company has consolidated the balance sheet of Premier in its consolidated balance sheet as of December 31, 2003. Beginning in fiscal 2004, we have consolidated the results of operations of Premier, including net revenue and cost of care of the joint venture, in our consolidated statement of operations. The consolidation of Premier does not affect our net income, as we record minority interest for the other party's interest in Premier. The creditors (or other beneficial interest holders) of Premier have no recourse to our general credit as the primary beneficiary of Premier. See further discussion of FIN 46 in " Recent Accounting Pronouncements."

Our direct TennCare contract (exclusive of Premier's contract with TennCare) accounted for approximately $237.5 million and $157.3 million of consolidated net revenue in the fiscal years ended September 30, 2002 and December 31, 2003, respectively, and approximately $60.0 million and $63.0 million of consolidated net revenue for the three months ended December 31, 2001 and 2002, respectively. These net revenue amounts include net revenue recognized by us associated with services performed on behalf of Premier totaling $134.9 million and $39.8 million for fiscal years ended September 30, 2002 and December 31, 2003, respectively, and $33.6 million and $34.6 million for the three months ended December 31, 2001 and 2002, respectively. The decline in net revenue from fiscal 2002 to fiscal 2003 associated with the TennCare program was primarily the result of the reduction in net revenue associated with services no longer performed on behalf of Premier due to a program change, which reduction was partially offset by increases in rates. As previously noted, we started consolidating Premier in accordance with FIN 46 as of December 31, 2003. We recorded $253.0 million, $103.7 million and $113.2 million of net revenue from the TBH and Premier TennCare contracts during the fiscal year ended December 31, 2004 and the three months ended March 31, 2004 and 2005, respectively.

In September 2003, the State of Tennessee divided the TennCare program into three regions. Our contract for the East region has a term through December 31, 2005, with extensions at the State's option through December 31, 2008. Our contracts for the Middle and West regions have terms through December 31, 2005.

On January 10, 2005, the Governor of Tennessee stated that, because of the increased costs of the TennCare program, the State will cease providing coverage to approximately 323,000 adults (which represents approximately one-fourth of total TennCare membership) who do not qualify for Medicaid, and will limit benefits to be delivered under the TennCare program. Certain advocacy groups are attempting to prevent the Governor from implementing any membership and benefits reductions. Representatives of the State of Tennessee have publicly indicated that they intend to phase-in the membership reductions as early as July 1, 2005. A reduction in membership would, and benefit changes could, adversely affect our net revenue and profitability. We do not yet know which members would be eliminated from the program, and because capitation rates for TennCare members vary depending upon the level of benefits received by such members, we cannot estimate the impact of the proposed membership reductions. Further, we do not yet know the actual timing of the phased-in membership reductions, the benefit changes being proposed or the timing of those changes, and as such, we cannot estimate the impact of these potential developments at this time.

Our Public Sector Solutions segment derives a significant portion of our net revenue from contracts with various counties in the state of Pennsylvania, referred to as the Pennsylvania Counties. Although these are separate contracts with individual counties, they all pertain to the Pennsylvania Medicaid program. Net revenue from the Pennsylvania Counties in the aggregate totaled approximately $181.9 million and $189.6 million in the fiscal years ended September 30, 2002 and December 31, 2003, respectively, and approximately $36.0 million and $56.2 million for the three months ended December 31, 2001 and 2002, respectively. Our contract with one of the counties was terminated at December 31, 2003. Net revenue related to this particular county totaled approximately $22.8 million and $24.0 million in the fiscal years ended September 30, 2002 and December 31, 2003, respectively, and approximately $5.1 million and $6.4 million for the three months ended December 31, 2001 and 2002, respectively. Net revenue from the Pennsylvania Counties in the aggregate totaled approximately $187.7 million, $43.9 million and $51.5 million in the fiscal year ended December 31, 2004 and the three months ended March 31, 2004 and 2005, respectively.

Risk contracts in the Public Sector Solutions segment generally have higher per member premiums, cost and (to some degree) more volatility than risk contracts in either the Health Plan Solutions and Employer Solutions segments due to the nature of populations, benefits provided and other matters. See "Risk factors Risks related to our business and industry Dependence on Government Spending for Managed Healthcare We can be adversely affected by changes in federal, state and local healthcare policies," " Possible Impact of Healthcare Reform Healthcare reform can significantly reduce our net revenue or profitability" and " Government Regulation We are subject to substantial government regulation and scrutiny, which increase our costs of doing business and could adversely affect our profitability." Our Public Sector Solutions segment managed the behavioral health benefits of approximately 2.0 million covered lives as of March 31, 2005.

Corporate and Other. This segment is comprised primarily of operational support functions such as sales and marketing and information technology, as well as corporate support functions such as executive, finance, human resources and legal. Discontinued operations activity is not included in the Corporate and Other segment operating results. In the quarter ended September 30, 2004, we reclassified certain expenses from our Corporate and Other segment to our other segments, as discussed in Note 16 "Business Segment Information" to the audited annual consolidated financial statements and Note I "Business Segment Information" to the unaudited quarterly consolidated financial statements incorporated by reference in the accompanying prospectus.

Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of net revenue and expenses during the reporting period. Actual results could differ from those estimates. We consider the following to be our critical accounting policies and estimates:

Fresh Start Reporting. In connection with the consummation of the Plan of Reorganization, we adopted the "fresh start reporting" provisions of SOP 90-7, with respect to our financial reports, which required us to restate our assets and liabilities to their fair values based upon the provisions of the Plan of Reorganization and certain valuations which we made in connection with the implementation of the Plan of Reorganization. We were required to apply the fresh start provisions of SOP 90-7 to our financial statements, because we had concluded that (a) the reorganization value of the assets of the emerging entity immediately before the date of confirmation was less than the total of all post-petition liabilities and allowed claims, and (b) the holders our existing voting shares immediately before confirmation (i.e., the holders of shares of Magellan's pre-petition common stock that were issued and outstanding prior to the commencement of the chapter 11 proceedings) received less than 50.0 percent of the voting shares of the emerging entity. SOP 90-7 sets forth the principles regarding the date at which a company that has emerged from a chapter 11 proceeding should apply fresh start reporting to account for the effects of the Plan of Reorganization. Under SOP 90-7, application of fresh start reporting is permitted as early as the date on which the Plan of Reorganization is confirmed by the bankruptcy court, but SOP 90-7 further provides that fresh start reporting is not applied until all material conditions are satisfied. All material conditions to the Plan of Reorganization were satisfied as of December 29, 2003, referred to as the Material Conditions Date. Due to the proximity of the Material Conditions Date to year end and the immateriality of the results of operations for the intervening two day period through December 31, 2003, we applied fresh start reporting as if the material conditions were satisfied as of December 31, 2003. All adjustments and reorganization expenses as a result of the application of fresh start reporting are reflected in the audited annual consolidated financial statements as of and for the year ended December 31, 2003 incorporated by reference in the accompanying prospectus. See Note 2 "Fresh Start Reporting" to the audited annual consolidated financial statements incorporated by reference in the accompanying prospectus for adjustments we recorded pursuant to the application of SOP 90-7.

Upon adoption of fresh start reporting as of December 31, 2003, we created, in substance, per SOP 90-7, a new reporting entity. The Reorganized Company has adopted the same accounting policies as the Predecessor Company with the exception of the date on which the Reorganized Company performs its annual goodwill impairment test under SFAS No. 142. The Reorganized Company performed its annual impairment test on October 1, as opposed to September 1.

As a result of the application of the fresh start reporting provision of SOP 90-7, our consolidated balance sheets prior to December 31, 2003 are not comparable with the consolidated balance sheet as of, and subsequent to, December 31, 2003. All balance sheet data as of, and subsequent to December 31, 2003 represents balances of the Reorganized Company, and all balance sheet data prior to December 31, 2003 represents balances of the Predecessor Company. Statement of operations and statement of cash flows data for all periods prior to January 1, 2004 represents the results of the Predecessor Company. Accordingly, all references to us with respect to disclosures of amounts recorded (i) through or prior to December 31, 2003 in relation to statement of operations or cash flow items; and (ii) prior to December 31, 2003 in relation to balance sheet items, relate to the Predecessor Company. All references to us with respect to disclosures of amounts recorded or to be recorded (i) after December 31, 2003 in relation to statement of operations or cash flow items; and (ii) on or after December 31, 2003 in relation to balance sheet items, relate to the Reorganized Company.

Managed Care Revenue. Managed care revenue is recognized over the applicable coverage period on a per member basis for covered members. Managed care risk revenues earned for the fiscal years ended September 30, 2002 and December 31, 2003 approximated $1,537.9 million and $1,292.5 million, respectively and managed care risk revenues for the three months ended December 31, 2001 and 2002 were approximately $390.3 million and $388.7 million, respectively. Managed care risk revenues earned for the fiscal year ended December 31, 2004 and the three months ended March 31, 2004 and 2005 approximated $1,583.9 million, $386.3 million and $402.3 million, respectively.

Performance-Based Revenue. We have the ability to earn performance-based revenue under certain risk and non-risk contracts. Performance-based revenue generally is based on either our ability to manage care for our clients below specified targets, or on other operating metrics. For each such contract, we estimate and record performance-based revenue after considering the relevant contractual terms and the data available for the performance-based revenue calculation. Pro-rata performance based revenue is recognized on an interim basis pursuant to the rights and obligations of each party upon termination of the contracts. We recognized performance revenue of approximately $13.0 million and $7.7 million in the fiscal years ended September 30, 2002 and December 31, 2003, respectively and $3.4 million and $1.0 million for the three months ended December 31, 2001 and 2002, respectively. We recognized performance revenue of approximately $9.7 million, $0.9 million and $2.7 million in the fiscal year ended December 31, 2004 and the three months ended March 31, 2004 and 2005, respectively.

Cost of Care and Medical Claims Payable. Cost of care is recognized in the period in which members received behavioral health services. In addition to actual benefits paid, cost of care includes the impact of accruals for estimates of medical claims payable. Medical claims payable represents the liability for healthcare claims reported but not yet paid and claims incurred but not yet reported, or IBNR, related to our managed healthcare business. The IBNR portion of medical claims payable is estimated based on past claims payment experience for member groups, enrollment data, utilization statistics, authorized healthcare services and other factors. This data is incorporated into contract specific actuarial reserve models. Although considerable variability is inherent in such estimates, management believes the liability for medical claims payable is adequate. Medical claims payable balances are continually monitored and reviewed. Changes in assumptions for cost of care caused by changes in actual experience could cause these estimates to change in the near term. We believe that the amount of medical claims payable is adequate to cover our ultimate liability for unpaid claims as of December 31, 2004 and March 31, 2005. However, actual claims payments and other items may differ from established estimates.

The following table presents the components of the change in medical claims payable for the years ended December 31, 2003 and 2004 (in thousands):

	2003	2004
Medical claims payable, beginning of period	$ 205,331	$ 177,141
Cost of care:		
Current year	918,358	1,197,658
Prior years	(11,874)	(7,064)
Total reported cost of care	906,484	1,190,594
Claim payments:		
Payments for current year	765,872	1,021,209
Payments for prior years	168,802	151,888
Total claim payments	934,674	1,173,097
Medical claims payable, end of period	$ 177,141	$ 194,638

Long-lived Assets. Long-lived assets, including property and equipment and intangible assets to be held and used, are currently reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount should be addressed pursuant to SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS 144") which superseded SFAS No. 121, "Accounting for Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of" ("SFAS 121"). Pursuant to this guidance, impairment is determined by comparing the carrying value of these long-lived assets to management's best estimate of the future undiscounted cash flows expected to result from the use of the assets and their eventual disposition. The cash flow projections used to make this assessment are consistent with the cash flow projections that management uses internally in making key decisions. In the event an impairment exists, a loss is recognized based on the amount by which the carrying value exceeds the fair value of the asset, which is generally determined by using quoted market prices or the discounted present value of expected future cash flows.

Goodwill. Goodwill is accounted for in accordance with SFAS No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142"). Under SFAS 142, goodwill is no longer amortized over its estimated useful life, but rather is tested for impairment based upon fair values at least on an annual basis. In accordance with SFAS 142, the book value of goodwill is assigned our reporting units. See Note 3 "Summary of Significant Accounting Policies" to the audited annual consolidated financial statements and Note A "General Summary of Significant Accounting Policies" to the unaudited quarterly consolidated financial statements incorporated by reference in the accompanying prospectus.

Deferred Taxes. We file a consolidated federal income tax return for Magellan and our eighty percent or more owned consolidated subsidiaries. We account for income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes." We estimate income taxes for each of the jurisdictions in which we operate. This process involves estimating current tax exposures together with assessing temporary differences resulting from differing treatment of items for tax and book purposes. Deferred tax assets and/or liabilities are determined by multiplying the differences between the financial reporting and tax reporting bases for assets and liabilities by the enacted tax rates expected to be in effect when such differences are recovered or settled. We then assess the likelihood that the deferred tax assets will be recovered from the reversal of temporary timing differences and future taxable income, and to the extent we cannot conclude that recovery is more likely than not, we establish a valuation allowance. The effect of a change in tax rates on deferred taxes is recognized in income in the period that includes the enactment date.

For federal income tax purposes, the emergence from bankruptcy, including the cancellation of indebtedness event occurred on January 5, 2004 and the actual attribute reduction calculation as set forth under Internal Revenue Code Section 108 occurred at or immediately after December 31, 2004 (the taxable year of discharge), and generally after determining the income tax liability for 2004. We changed our income tax reporting year to a calendar year basis in conformity with our financial reporting year effective December 31, 2003.

After consideration of the effect of bankruptcy emergence, including the effect of cancellation of indebtedness income and the related attribute reduction effects as provided under Internal Revenue Code Section 108, we estimate that we have reportable net operating loss carryforwards, or NOLs, as of December 31, 2004 of approximately $525 million available to reduce future federal taxable income. These estimated NOLs expire in 2009 through 2020 and are subject to examination and adjustment by the Internal Revenue Service. In accordance with SOP 90-7, subsequent (post-bankruptcy) utilization by us of NOLs which existed at January 5, 2004 will be accounted for as reductions to goodwill and therefore, will only benefit cash flows due to reduced tax payments and will not benefit our tax provision for income taxes.

Valuation allowances on deferred tax assets (including NOLs) are estimated based on our assessment of the realizability of these amounts. Our history of recent operating losses (prior to reorganization benefits) and financial restructuring activities and the lack of substantial history of profitable operations subsequent to our emergence from bankruptcy have created uncertainty as to our ability to realize our NOLs and other deferred tax assets. Accordingly, we had a valuation allowance covering all of our net deferred tax assets as of December 31, 2003 and substantially all of our net deferred tax assets at December 31, 2004 and March 31, 2005. As of December 31, 2004 and March 31, 2005, net deferred tax assets, after reduction for valuation allowance, represent our estimate of those net deferred tax assets which are more likely than not to be realizable.

In addition, our utilization of NOLs became subject to limitation under Internal Revenue Code Section 382 upon emergence from bankruptcy, which affects the timing of the use of NOLs. At this time, we do not believe these limitations will cause us to be unable to use any NOLs before they expire. Furthermore, as of December 31, 2003, we had tax contingencies which created an uncertainty as to our ability to realize our NOLs. In addition to recording a full valuation allowance against all NOLs, we recorded this contingent liability of $23.2 million for taxes payable. During fiscal 2004, we received favorable guidance from the Internal Revenue Service which resolved this contingency, resulting in the reversal of the related liability and a reduction to goodwill (in accordance with SOP 90-7). See "Risk factors Risks related to our business and industry Certain future changes in the composition of our stockholder population could, in certain circumstances, limit our ability to use our tax net operating losses."

We recognized tax expense attributable to estimated, current taxable income for the three months ended December 31, 2002 and for the years ended December 31, 2003 and 2004 and the three months ended March 31, 2004 and 2005 due to the uncertainty as to our ability to realize deferred tax assets based on our history of recent operating losses (prior to reorganization benefits) and financial restructuring activities and the lack of sufficient history of profitable operations subsequent to our emergence from bankruptcy.

Emergence from Chapter 11

On the Effective Date, Magellan and 88 of its subsidiaries consummated the Plan of Reorganization under chapter 11 of title 11 of the Bankruptcy Code.

All distributions required by the Plan of Reorganization were made as of the Effective Date except for distributions related to disputed claims for certain general unsecured creditor claims, referred to as Other GUCs, for which distributions were made subsequent to the Effective Date periodically as such disputed claims were settled. As of May 1, 2005, the total amount of outstanding, disputed claims for Other GUCs was $4.0 million, referred to as the Disputed Claims. We do not believe that it is probable that any liability for the Disputed Claims will be incurred, and thus no liability has been recorded for the Disputed Claims as of March 31, 2005. Nonetheless, we have withheld from distribution 93,128 shares of Ordinary Common Stock which will be distributed in accordance with the terms of the Plan of Reorganization upon the final resolution of the Disputed Claims. If the Disputed Claims were to be settled for the full amount of $4.0 million, then the amount of additional consideration that we would be required to issue to the individual claimants that filed the Disputed Claims is cash of $0.2 million and Series B Notes of $1.0 million.

Results of Operations

We evaluate performance of our segments based on profit or loss from continuing operations before depreciation and amortization, interest expense, interest income, stock compensation expense, reorganization benefit, net, goodwill impairment charges, special charges, income taxes and minority interest, which we refer to as Segment Profit. Management uses Segment Profit information for internal reporting and control purposes and considers it important in making decisions regarding the allocation of capital and other resources, risk assessment and employee compensation among other matters. See Note 16 "Business Segment Information" to the audited annual consolidated financial statements and Note I "Business Segment Information" to the unaudited quarterly consolidated financial statements incorporated by reference in the accompanying prospectus. Our behavioral customer segments are defined below. In certain limited cases, customer contracts that would otherwise meet the definition of one segment are managed and reported internally in another segment, in which cases the membership and financial results of such contracts are reflected in the segment in which it is managed and reported internally. During the quarter ended September 30, 2004, our internal reporting of certain operational and corporate support costs, such as claims administration and network services, changed to allocate such costs from the Corporate and Other segment to the Health Plan Solutions, Employer Solutions and Public Sector Solutions segments. Accordingly, we have reclassified the financial results for all prior periods to allocate such costs into the corresponding segments consistent with our internal reporting. All periods presented were adjusted to conform with the fiscal 2004 reclassification. This reclassification does not affect consolidated financial results for any of the periods presented. For comparative purposes, we have presented results of operations below for the twelve month period ended December 31, 2002, which information is unaudited.

The table below summarizes, for the periods indicated, operating results and other financial information, by business segment (in thousands). Given our change in year end during fiscal year 2003, we believe the period comparisons below present the most useful comparison for readers:

	Predecessor Company				
	Health Plan Solutions	Employer Solutions	Public Sector Solutions	Corporate and Other	Consolidated
Fiscal Year Ended September 30, 2002					
Net revenue	$ 1,013,033	$ 188,703	$ 551,322	$	$ 1,753,058
Cost of care	596,811	72,446	456,497		1,125,754
Direct service costs	226,141	85,799	53,256		365,196
Other operating expenses				94,364	94,364
Equity in (earnings) loss of unconsolidated subsidiaries	(15,537)		2,531		(13,006)
Segment profit (loss)	$ 205,618	$ 30,458	$ 39,038	$ (94,364)	$ 180,750
Twelve Months Ended December 31, 2002(1)(2)					
Net revenue	$ 988,465	$ 189,533	$ 576,108	$	$ 1,754,106
Cost of care	581,882	72,352	477,559		1,131,793
Direct service costs	212,070	84,409	54,664		351,143
Other operating expenses				98,718	98,718
Equity in (earnings) loss of unconsolidated subsidiaries	(13,699)		1,732		(11,967)
Segment profit (loss)	$ 208,212	$ 32,772	$ 42,153	$ (98,718)	$ 184,419
Fiscal Year Ended December 31, 2003					
Net revenue	$ 870,540	$ 159,034	$ 481,172	$	$ 1,510,746
Cost of care	464,128	44,858	397,498		906,484
Direct service costs	180,336	79,071	40,466		299,873
Other operating expenses				118,529	118,529
Equity in (earnings) loss of unconsolidated subsidiaries	(6,560)		358		(6,202)
Segment profit (loss)	$ 232,636	$ 35,105	$ 42,850	$ (118,529)	$ 192,062

	Reorganized Company				
	Health Plan Solutions	Employer Solutions	Public Sector Solutions	Corporate and Other	Consolidated
Fiscal Year Ended December 31, 2004					
Net revenue	$ 904,872	$ 135,676	$ 754,854	$	$ 1,795,402
Cost of care	484,047	37,168	669,379		1,190,594
Direct service costs	170,131	66,294	40,528		276,953
Other operating expenses				99,918	99,918
Equity in earnings of unconsolidated subsidiaries	(5,277)				(5,277)
Segment profit (loss)	$ 255,971	$ 32,214	$ 44,947	$ (99,918)	233,214
Three Months Ended March 31, 2004(2)(3)					

Net revenue	$ 223,139	$ 35,269	$ 181,768	$	$ 440,176
Cost of care	123,010	10,227	160,967		294,204
Direct service costs	44,372	18,192	10,273		72,837
Other operating expenses				26,887	26,887
Equity in earnings of unconsolidated subsidiaries	(1,844)				(1,844)
Segment profit (loss)	$ 57,601	$ 6,850	$ 10,528	$ (26,887)	$ 48,092
Three Months Ended March 31, 2005[(2)]					
Net revenue	$ 224,902	$ 31,660	$ 196,192	$	$ 452,754
Cost of care	121,728	7,860	174,620		304,208
Direct service costs	39,582	15,705	7,587		62,874
Other operating expenses				25,847	25,847
Equity in earnings of unconsolidated subsidiaries	(1,449)				(1,449)
Segment profit (loss)	$ 65,041	$ 8,095	$ 13,985	$ (25,847)	$ 61,274

(1) The results of operations for the twelve months ended December 31, 2002 represent the amalgamation of the results of operations for the nine-month period ended September 30, 2002 (unaudited) and the three month period ended December 31, 2002 (audited) previously reported in our Form 10-Q for the quarterly period ended September 30, 2003 filed with the SEC on November 19, 2003 and the Transition Report on Form 10-K for the transition period from October 1, 2002 to December 31, 2002 filed with the SEC on August 12, 2003, respectively.

(2) Amounts are unaudited.

(3) The segment financial information disclosed for the three months ended March 31, 2004 in the tables above is different than that which was previously reported in the Quarterly Report on Form 10-Q for the quarter ended March 31, 2004, due to certain reclassifications between segments. See Note I "Business Segment Information" to the unaudited quarterly consolidated financial statements incorporated by reference in the accompanying prospectus for further discussion of the segment reclassifications.

The following table reconciles Segment Profit as calculated in the table above to consolidated net income (loss) (in thousands):

	Predecessor Company			Reorganized Company		
					Three Months Ended March 31,	
	Fiscal Year Ended September 30, 2002	Twelve Months Ended December 31, 2002(2)(3)	Fiscal Year Ended December 31, 2003	Fiscal Year Ended December 31, 2004	2004(2)	2005(2)
Segment profit	$ 180,750	$ 184,419	$ 192,062	$ 233,214	$ 48,092	$ 61,274
Depreciation and amortization	47,558	50,748	48,047	42,489	10,249	11,218
Interest expense	97,596	99,210	61,016	37,124	9,334	8,639
Interest income	(5,365)	(5,065)	(2,873)	(6,127)	(781)	(3,033)
Reorganization benefit, (net)			(438,217)			
Stock compensation expense				23,152	10,777	3,750
Special charges	15,729	15,151	9,528	5,038	1,908	
Goodwill impairment charges	415,880	415,880	28,780			
Income (loss) from continuing operations before provision for income taxes and minority interest	(390,648)	(391,505)	485,781	131,538	16,605	40,700
Provision for income taxes	151,609	148,652	33,813	46,584	3,568	17,064
Income (loss) from continuing operations before minority interest	(542,257)	(540,157)	451,968	84,954	13,037	23,636
Minority interest	47	58	253	333	129	68
Income (loss) from continuing operations	(542,304)	(540,215)	451,715	84,621	12,908	23,568
Discontinued operations:						
Income (loss) from discontinued operations(1)	4,894	5,539	(25,028)	4,781	30	48
Income (loss) on disposal of discontinued operations(1)	(92)	(815)	4,756	(1,030)		