HealthMarkets, Inc.
Form 10-Q
August 12, 2010

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2010

OR

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

For the transition period from __________ to __________.

Commission file number: 001-14953

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

Delaware	**75-2044750**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification Number)**

9151 Boulevard 26, North Richland Hills, Texas 76180
(Address of principal executive offices, zip code)
(817) 255-5200
(Registrant s phone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 1 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

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

Large accelerated filer o	Accelerated filer o	Non-accelerated filer þ (Do not check if a smaller reporting company)	Smaller reporting company o

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

On July 30, 2010, the registrant had 28,116,195 outstanding shares of Class A-1 Common Stock, $.01 Par Value, and 2,717,126 outstanding shares of Class A-2 Common Stock, $.01 Par Value.

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HEALTHMARKETS, INC.
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CONSOLIDATED CONDENSED BALANCE SHEETS
(In thousands, except per share data)

	June 30, 2010 (Unaudited)	December 31, 2009
ASSETS		
Investments:		
Securities available for sale		
Fixed maturities, at fair value (cost: 2010 $719,678; 2009 $742,630)	$ 758,825	$ 756,180
Equity securities, at fair value (cost: 2009 $234)		234
Trading securities, at fair value		9,893
Short-term and other investments, at fair value (cost: 2010 $314,185; 2009 $370,676)	315,674	371,534
Total investments	1,074,499	1,137,841
Cash and cash equivalents	14,469	17,406
Student loan receivables	64,784	69,911
Restricted cash	12,011	8,647
Investment income due and accrued	9,956	10,464
Reinsurance recoverable ceded policy liabilities	360,983	361,305
Agent and other receivables	30,821	26,390
Deferred acquisition costs	46,866	64,339
Property and equipment, net of accumulated depreciation of $141,439 and $134,155 at June 30, 2010 and December 31, 2009, respectively)	47,047	48,690
Goodwill and other intangible assets	84,350	85,973
Recoverable federal income taxes		17,879
Other assets	26,923	22,653
	$ 1,772,709	$ 1,871,498
LIABILITIES AND STOCKHOLDERS EQUITY		
Policy liabilities:		
Future policy and contract benefits	$ 456,900	$ 462,217
Claims	296,036	339,755
Unearned premiums	39,851	46,309
Other policy liabilities	7,700	8,247
Accounts payable and accrued expenses	47,586	65,692
Other liabilities	56,368	74,929
Current and deferred federal income taxes	58,755	51,978
Debt	553,420	481,070
Student loan credit facility	72,450	77,350
Net liabilities of discontinued operations	1,638	1,752
	1,590,704	1,609,299

Commitments and Contingencies (Note 10)

Stockholders equity:		
Preferred stock, par value $0.01 per share authorized 10,000,000 shares, none issued		
Common Stock, Class A-1, par value $0.01 per share authorized 90,000,000 shares, 28,116,254 issued and 28,116,195 outstanding at June 30, 2010; 27,608,371 issued and 27,608,371 outstanding at December 31, 2009. Class A-2, par value $0.01 per share authorized 20,000,000 shares, 4,026,104 issued and 2,719,704 outstanding at June 30, 2010; 4,026,104 issued and 2,565,874 outstanding at December 31, 2009	321	316
Additional paid-in capital	43,238	42,342
Accumulated other comprehensive income	23,065	3,739
Retained earnings	138,178	246,427
Treasury stock, at cost (59 Class A-1 common shares and 1,306,400 Class A-2 common shares at June 30, 2010; -0- Class A-1 common shares and 1,460,230 Class A-2 common shares at December 31, 2009)	(22,797)	(30,625)
	182,005	262,199
	$ 1,772,709	$ 1,871,498

See Notes to Consolidated Condensed Financial Statements.

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HEALTHMARKETS, INC.
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CONSOLIDATED CONDENSED STATEMENTS OF INCOME
(In thousands, except per share data)
(Unaudited)

	Three Months Ended June 30, 2010	Three Months Ended June 30, 2009	Six Months Ended June 30, 2010	Six Months Ended June 30, 2009
REVENUE				
Health premiums	$ 188,914	$ 250,503	$ 394,687	$ 513,643
Life premiums and other considerations	498	624	1,149	1,342
	189,412	251,127	395,836	514,985
Investment income	10,840	11,035	22,111	21,351
Commissions and other income	16,890	15,536	30,539	32,777
Total other-than-temporary impairment losses		(2,683)		(4,078)
Portion of loss recognized in other comprehensive income (before taxes)				
Net impairment losses recognized in earnings		(2,683)		(4,078)
Realized gains, net	2,422	1,533	2,641	1,555
	219,564	276,548	451,127	566,590
BENEFITS AND EXPENSES				
Benefits, claims, and settlement expenses	99,952	142,080	221,748	309,679
Underwriting, acquisition, and insurance expenses	44,311	98,376	98,667	179,276
Other expenses	49,240	21,908	94,743	41,914
Interest expense	7,268	8,184	15,460	17,693
	200,771	270,548	430,618	548,562
Income from continuing operations before income taxes	18,793	6,000	20,509	18,028
Federal income tax expense	8,389	2,807	9,337	6,812
Income from continuing operations	10,404	3,193	11,172	11,216
Income from discontinued operations, (net of income tax expense of $7,000 and $15,000 for the three and six months ended June 30, 2010, respectively, and $9,000 and $27,000 for the three and six months ended June 30, 2009, respectively)	13	16	27	51
Net income	$ 10,417	$ 3,209	$ 11,199	$ 11,267

Basic earnings per share:

Income from continuing operations	$	0.35	$	0.11	$	0.38	$	0.38
Income from discontinued operations		0.00		0.00		0.00		0.00
Net income per share, basic	$	0.35	$	0.11	$	0.38	$	0.38
Diluted earnings per share:								
Income from continuing operations	$	0.34	$	0.11	$	0.37	$	0.37
Income from discontinued operations		0.00		0.00		0.00		0.00
Net income per share, diluted	$	0.34	$	0.11	$	0.37	$	0.37

See Notes to Consolidated Condensed Financial Statements.

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HEALTHMARKETS, INC.
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CONSOLIDATED CONDENSED STATEMENTS OF COMPREHENSIVE INCOME
(In thousands)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Net income	$ 10,417	$ 3,209	$ 11,199	$ 11,267
Implementation effect upon adoption of ASC 320-10		1,017		1,017
Other comprehensive income:				
Unrealized gains on securities available for sale arising during the period	17,543	21,670	28,874	26,771
Reclassification for investment (gains) losses included in net income	(2,427)	3,035	(2,646)	3,030
Other-than-temporary impairment losses recognized in OCI		(1,565)		(1,565)
Effect on other comprehensive income from investment securities	15,116	23,140	26,228	28,236
Unrealized gains (losses) on derivatives used in cash flow hedging during the period	21	(409)	(466)	(899)
Reclassification adjustments included in net income	1,468	2,248	3,972	4,880
Effect on other comprehensive income from hedging activities	1,489	1,839	3,506	3,981
Other comprehensive income before tax	16,605	24,979	29,734	32,217
Income tax expense related to items of other comprehensive income	5,812	8,743	10,408	11,277
Other comprehensive income net of tax	10,793	16,236	19,326	20,940
Comprehensive income	$ 21,210	$ 20,462	$ 30,525	$ 33,224

See Notes to Consolidated Condensed Financial Statements.

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HEALTHMARKETS, INC.
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CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Six Months Ended June 30, 2010	Six Months Ended June 30, 2009
Operating Activities:		
Net income	$ 11,199	$ 11,267
Adjustments to reconcile net income to cash (used in) provided by operating activities:		
Income from discontinued operations	(27)	(51)
Realized gains, net	(2,641)	3,013
Change in deferred income taxes	(5,808)	3,479
Depreciation and amortization	11,450	14,614
Amortization of prepaid monitoring fees	7,500	6,250
Equity based compensation expense	(1,766)	2,285
Other items, net	7,166	6,867
Changes in assets and liabilities:		
Investment income due and accrued	(283)	1,298
Due premiums	1,111	2,086
Reinsurance recoverable ceded policy liabilities	322	12,162
Agent and other receivables	(7,818)	6,129
Deferred acquisition costs	17,473	17
Prepaid monitoring fees	(15,000)	(12,500)
Current income tax recoverable	20,057	(1,812)
Policy liabilities	(52,266)	(59,814)
Other liabilities and accrued expenses	(22,886)	(13,129)
Cash used in continuing operations	(32,217)	(17,839)
Cash used in discontinued operations	(87)	(81)
Net cash used in operating activities	(32,304)	(17,920)
Investing Activities:		
Student loan receivables	4,280	3,205
Securities available for sale	107,554	32,775
Short-term and other investments, net	55,838	(99,573)
Purchases of property and equipment	(5,689)	(1,367)
Proceeds from subsidiaries sold, net of cash disposed of $437 in 2009		(440)
Intangible assets acquired	(297)	
Acquisitions net of cash acquired	252	
Change in restricted cash	(178)	546
Decrease (increase) in agent receivables	(997)	(1,811)
Cash (used in) provided by continuing operations	160,763	(66,665)

Cash (used in) provided by discontinued operations		
Net cash (used in) provided by investing activities	160,763	(66,665)
Financing Activities:		
Repayment of student loan credit facility	(4,900)	(5,050)
Decrease in investment products	(3,775)	(4,004)
Change in cash overdraft	2,607	4,383
Proceeds from shares issued to agent plans and other	4,265	4,415
Purchases of treasury stock	(7,855)	(14,390)
Dividends paid	(120,652)	
Excess tax reduction from equity based compensation	(1,086)	(1,108)
Cash used in continuing operations	(131,396)	(15,754)
Cash (used in) provided by discontinued operations		
Net cash used in financing activities	(131,396)	(15,754)
Net change in cash and cash equivalents	(2,937)	(100,339)
Cash and cash equivalents at beginning of period	17,406	100,339
Cash and cash equivalents at end of period in continuing operations	$ 14,469	$
Supplemental disclosures:		
Income taxes paid	$ 808	$ 6,279
Interest paid	$ 14,279	$ 19,878

See Notes to Consolidated Condensed Financial Statements.

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HEALTHMARKETS, INC.
and Subsidiaries
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Unaudited)

1. BASIS OF PRESENTATION

The accompanying consolidated condensed financial statements for HealthMarkets, Inc. (the Company or HealthMarkets) and its subsidiaries have been prepared in accordance with United States generally accepted accounting principles (GAAP) for interim financial information and the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, such financial statements do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, these financial statements include all adjustments, consisting of normal recurring adjustments and accruals, necessary for the fair presentation of the consolidated condensed balance sheets, statements of income, statements of comprehensive income and statements of cash flows for the periods presented. The accompanying December 31, 2009 consolidated condensed balance sheet was derived from audited consolidated financial statements, but does not include all disclosures required by GAAP for annual financial statement purposes. Preparing financial statements requires management to make estimates and assumptions that affect the amounts that are reported in the financial statements and the accompanying disclosures. Although these estimates are based on management s knowledge of current events and actions that HealthMarkets may undertake in the future, actual results may differ materially from the estimates. Operating results for the three and six months ended June 30, 2010 are not necessarily indicative of the results that may be expected for the full year ending December 31, 2010. We have evaluated subsequent events for recognition or disclosure through the date we filed this Form 10-Q with the Securities and Exchange Commission (the SEC). For further information, refer to the consolidated financial statements and notes thereto, included in the Company s Annual Report on Form 10-K for the year ended December 31, 2009.

Concentrations

Through its Commercial Health Division (formerly the Self-Employed Agency Division), the Company s insurance subsidiaries provide health insurance products in 41 states and the District of Columbia. As is the case with many of HealthMarkets competitors in this market, a substantial portion of the Company s insurance subsidiaries products are issued to members of various independent membership associations that act as the master policyholder for such products. In 2010, the two principal membership associations in the self-employed market through which the Company s health insurance products were made available were the Alliance for Affordable Services (AAS) and Americans for Financial Security (AFS). While the Company believes that its insurance subsidiaries are providing association group coverage in full compliance with applicable law, changes in the relationship with the membership associations and/or changes in the laws and regulations governing association group insurance could have a material adverse impact on the Company s financial condition and results of operations. During the six months ended June 30, 2010, the Company issued approximately 44% and 13%, of its new policies through AAS and AFS, respectively. Additionally, during the six months ended June 30, 2010, the Company generated approximately 55% of its health premium revenue from new and existing business from the following 10 states:

	Percentage
California	14%
Texas	7%
Florida	6%
Massachusetts	6%
Illinois	5%
Washington	4%
North Carolina	4%
Maine	3%
Pennsylvania	3%
Wisconsin	3%

55%

2010 Change in Estimate Amortization of Intangible Assets

On January 1, 2010, the Company re-evaluated the amortization period related to an intangible asset recorded in the Commercial Health Division. See Note 6 of Notes to Consolidated Condensed Financial Statements.

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Reclassification

Certain amounts in the 2009 financial statements have been reclassified to conform to the 2010 financial statement presentation.

Recent Accounting Pronouncements

In July 2010, the Financial Account Standards Board (FASB) issued Accounting Standards Update (ASU) 2010-20, *Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses* (ASU 2010-20). ASU 2010-20 provides enhanced disclosures related to the credit quality of financing receivables and the allowance for credit losses, and provides that new and existing disclosures should be disaggregated based on how an entity develops its allowance for credit losses and how it manages credit exposures. Under the provisions of ASU 2010-20, additional disclosures required for financing receivables include information regarding the aging of past due receivables, credit quality indicators, and modifications of financing receivables. The provisions of ASU 2010-20 are effective for periods ending after December 15, 2010, with the exception of the amendments to the rollforward of the allowance for credit losses and the disclosures about modifications which are effective for periods beginning after December 15, 2010. Comparative disclosures are required only for periods ending subsequent to initial adoption. The Company is currently assessing the effects of adopting the provisions of ASU 2010-20.

In April 2010, the FASB issued ASU No. 2010-15, *How Investments Held through Separate Accounts Affect an Insurer s Consolidation Analysis of Those Investments,* (ASU 2010-15). ASU 2010-15 clarifies that insurance companies should not consider separate account interests held for the benefit of policy holders in an investment to be the insurer s interests and that the Company should not combine those interests with its general account interest in the same investment when assessing the investment for consolidation, unless the separate account interests are held for the benefit of a related party policy holder. Additionally, ASU provides guidance on how an insurer should consolidate an investment fund in situations in which the insurer concludes that consolidation is required. ASU 2010-15 is effective for interim and annual periods beginning after December 15, 2010. The Company does not anticipate that the adoption of ASU 2010-15 will have a material impact on the Company s financial position or results of operations.

In March 2010, the FASB issued ASU No. 2010-11, *Derivatives and Hedging (Topic 815) Scope Exception Related to Embedded Credit Derivatives,* (ASU 2010-11). ASU 2010-11 clarifies the scope exception for embedded credit derivative features related to the transfer of credit risk in the form of subordination of one financial instrument to another. This standard also addresses how to determine which embedded credit derivative features, including those in collateralized debt obligations and synthetic collateralized debt obligations, are considered to be embedded derivatives that should not be analyzed for potential bifurcation and separate accounting. ASU 2010-11 is effective for the third quarter of 2010. The Company has not yet determined the impact that the adoption of this guidance will have on its financial position and results of operations.

On January 1, 2010, the Company adopted ASU No. 2009-17, *Consolidations: Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities* (ASU 2009-17), which provides amendments to FASB Accounting Standards Codification (ASC) Topic 810, *Consolidation*. ASU 2009-17 modifies financial reporting for variable interest entities (VIEs). Under this guidance, companies are required to perform a periodic analysis to determine whether their variable interest must be consolidated by the Company. Additionally, Companies must disclose significant judgments and assumptions made when determining whether it must consolidate a VIE. Upon adoption, the Company determined that Grapevine Finance, LLC (Grapevine) is a VIE and, as such, the Company began consolidating the activities of Grapevine on January 1, 2010. See Note 5 of Notes to Consolidated Condensed Financial Statements.

On January 1, 2010, the Company adopted ASU No. 2009-16, *Accounting for Transfers of Financial Assets and Servicing Assets and Liabilities* (ASU 2009-16), which provides amendments to FASB ASC Topic 860, *Transfers and Servicing* (ASC 860). ASU 2009-16 incorporates the amendments to SFAS No. 140 made by SFAS No. 166, *Accounting for Transfers of Financial Assets an amendment of SFAS No. 140,* into the FASB ASC. ASU 2009-16 provides greater transparency about transfers of financial assets and requires that all servicing assets and servicing liabilities be initially measured at fair value. Additionally, ASU 2009-16 eliminates the concept of a non-consolidated qualifying special-purpose entity (QSPE) and removes the exception from applying FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities,* to QSPEs. Upon adoption, the Company was no longer permitted to account for Grapevine as a QSPE, and instead was required to evaluate its activities under ASU 2009-17. See Note 5 of Notes to Consolidated Condensed Financial Statements.

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During the first quarter of 2010, the Company adopted ASC Update 2009-12, *Fair Value Measurements and Disclosures Investments in Certain Entities that Calculate Net Asset Value per Share (or Its Equivalent)* (ASC 2009-12), which provides amendments to Subtopic 820, *Fair Value Measurements and Disclosures* (ASC 820), for the fair value measurement of investments in certain entities that calculate net asset value per share (or its equivalent). See Note 2 of Notes to Consolidated Condensed Financial Statements for additional disclosures required under ASC 2009-12.

During the first quarter of 2010, the Company adopted ASC Update 2010-06, *Fair Value Measurements and Disclosures: Improving Disclosures about Fair Value Measurements* (ASU 2010-06). ASU 2010-06 amends ASC Subtopic 820-10 to require new disclosures around the transfers in and out of Level 1 and Level 2 and around activity in Level 3 fair value measurements. Such guidance also provides amendments to ASC 820 which clarifies existing disclosures on the level of disaggregation, inputs and valuation techniques. See Note 2 of Notes to Consolidated Condensed Financial Statements for additional fair value measurement disclosures.

In January 2010, the FASB issued ASC Update 2010-09, *Subsequent Events: Amendments to Certain Recognition and Disclosure Requirements* (ASU 2010-09), which amends ASC Topic 855, Subsequent Events. Such guidance requires an entity to evaluate subsequent events through the date that the financial statements are issued. ASU 2010-09 is effective for interim and annual periods ending after June 1