HealthMarkets, Inc.
Form 10-Q
May 14, 2008

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 March 31, 2008

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 is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

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 April 29, 2008 the registrant had 26,922,331 outstanding shares of Class A-1 Common Stock, $.01 Par Value, and 3,583,442 outstanding shares of Class A-2 Common Stock, $.01 Par Value.

HEALTHMARKETS, INC.
and Subsidiaries
First Quarter 2008 Form 10-Q
TABLE OF CONTENTS

PART 1. FINANCIAL INFORMATION
ITEM 1. Financial Statements

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

	March 31, 2008 (Unaudited)	December 31, 2007
ASSETS		
Investments:		
Securities available for sale		
Fixed maturities, at fair value (cost: 2008 $1,227,524; 2007 $1,314,069)	$ 1,214,582	$ 1,304,424
Equity securities, at fair value (cost: 2008 $271; 2007 $300)	315	346
Policy loans	14,199	14,279
Short-term and other investments, at fair value (cost: 2008 $256,181; 2007 $163,727)	254,349	162,552
Total investments	1,483,445	1,481,601
Cash and cash equivalents	6,544	14,309
Student loans	90,186	96,254
Restricted cash	9,381	8,496
Investment income due and accrued	19,141	20,114
Due premiums	3,683	4,055
Reinsurance receivables	62,798	73,032
Agents and other receivables	46,446	63,965
Deferred acquisition costs	196,314	197,979
Property and equipment, net	70,420	69,939
Goodwill and other intangible assets	88,786	89,194
Recoverable federal income taxes	12,977	4,962
Other assets	47,674	31,682
Total assets	$ 2,137,795	$ 2,155,582
LIABILITIES AND STOCKHOLDERS EQUITY		
Policy liabilities:		
Future policy and contract benefits	$ 467,988	$ 463,277
Claims	436,667	435,099
Unearned premiums	90,934	92,266
Other policy liabilities	10,621	10,764
Accounts payable and accrued expenses	58,532	69,633
Other liabilities	103,145	112,210
Deferred federal income tax	86,255	84,968
Debt	481,070	481,070
Student loan credit facility	94,600	97,400
Net liabilities of discontinued operations	2,568	2,635

Total liabilities	1,832,380	1,849,322
Commitments and contingencies		
Stockholders Equity:		
Preferred stock, par value $0.01 per share		
Common stock, par value $0.01 per share	310	310
Additional paid-in capital	56,009	55,754
Accumulated other comprehensive loss	(20,110)	(13,132)
Retained earnings	274,849	281,141
Treasury stock, at cost	(5,643)	(17,813)
Total stockholders equity	305,415	306,260
Total liabilities and stockholders equity	$ 2,137,795	$ 2,155,582

See Notes to Consolidated Condensed Financial Statements.

1

Table of Contents

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

	Three Months Ended March 31, 2008	Three Months Ended March 31, 2007
REVENUE		
Health premiums	$ 317,265	$ 333,762
Life premiums and other considerations	18,755	16,381
	336,020	350,143
Investment income	21,832	26,460
Other income	22,192	25,615
Gains on sales of investments	1,377	2,403
	381,421	404,621
BENEFITS AND EXPENSES		
Benefits, claims, and settlement expenses	224,257	215,331
Underwriting, acquisition, and insurance expenses	128,306	120,447
Other expenses	26,951	21,782
Interest expense	11,172	12,996
	390,686	370,556
Income (loss) from continuing operations before income taxes	(9,265)	34,065
Federal income taxes (benefit)	(2,941)	11,441
Income (loss) from continuing operations	(6,324)	22,624
Income from discontinued operations, net of income tax	31	67
Net income (loss)	$ (6,293)	$ 22,691
Basic earnings per share:		
Income (loss) from continuing operations	$ (0.20)	$ 0.75
Income from discontinued operations		
Net income (loss) per share, basic	$ (0.20)	$ 0.75
Diluted earnings per share:		
Income (loss) from continuing operations	$ (0.20)	$ 0.73
Income from discontinued operations		
Net income (loss) per share, diluted	$ (0.20)	$ 0.73

See Notes to Consolidated Condensed Financial Statements.

Table of Contents

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

	Three Months Ended March 31, 2008	Three Months Ended March 31, 2007
Net income (loss)	$ (6,293)	$ 22,691
Other comprehensive income (loss):		
Unrealized gains (losses) on securities available for sale	(4,461)	2,935
Reclassification for investment gains (losses) included in net income	505	(877)
Effect on other comprehensive income from investment securities	(3,956)	2,058
Unrealized losses on derivatives used in cash flow hedging during the period	(6,635)	(909)
Reclassification adjustment for losses included in net income	(162)	(60)
Effect on other comprehensive income from hedging activities	(6,797)	(969)
Other comprehensive income (losses) before tax	(10,753)	1,089
Income tax expense (benefit) related to items of other comprehensive income (loss)	(3,775)	381
Other comprehensive income (loss) net of tax	(6,978)	708
Comprehensive income (loss)	$ (13,271)	$ 23,399

See Notes to Consolidated Condensed Financial Statements.

3

Table of Contents

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

	Three Months Ended March 31	
	2008	**2007**
Operating Activities:		
Net income (loss)	$ (6,293)	$ 22,691
Income from discontinued operations	(31)	(67)
Adjustments to reconcile net income (loss) to cash provided by operating activities:		
Gains on sales of investments	(1,377)	(2,403)
Change in deferred income taxes	5,063	7,073
Depreciation and amortization	6,774	6,090
Equity based compensation expense	2,899	3,730
Provision for doubtful accounts	4,068	113
Changes in assets and liabilities:		
Investment income due and accrued	155	(69)
Due premiums	372	(218)
Reinsurance receivables	10,234	(8,115)
Other receivables	21,326	716
Deferred acquisition costs	1,665	(2,650)
Prepaid monitoring fees	(9,375)	(9,375)
Current income tax recoverable	(8,015)	4,410
Policy liabilities	6,856	13,288
Other liabilities and accrued expenses	(14,172)	(13,170)
Other items, net	(5,026)	1,319
Cash provided by continuing operations	15,123	23,363
Cash used in discontinued operations	(36)	(188)
Net cash provided by operating activities	15,087	23,175
Investing Activities:		
Increase in investment assets	(10,797)	(46,800)
Decrease in student loans	3,375	3,340
Increase in restricted cash	(885)	(1,024)
Purchase of property and equipment	(5,744)	(3,878)
Distribution from investment in Grapevine Finance LLC	81	468
Decrease (increase) in agents receivables	(107)	53
Net cash used in investing activities	(14,077)	(47,841)
Financing Activities:		
Decrease in investment products	(2,051)	(1,001)

Repayment of student loan credit facility	(2,800)	(2,250)
Exercise of stock options	261	25
Purchase of treasury stock	(4,185)	(38)
Other		400
Net cash used in financing activities	(8,775)	(2,864)
Net change in cash and cash equivalents	(7,765)	(27,530)
Cash and cash equivalents at beginning of period	14,309	32,756
Cash and cash equivalents at end of period in continuing operations	$ 6,544	$ 5,226
Supplemental disclosures:		
Income taxes paid (refunded)	28	(4)
Interest paid	9,828	10,843

See Notes to Consolidated Condensed Financial Statements.

4

Table of Contents

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

1. BASIS OF PRESENTATION

The accompanying unaudited 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 a fair presentation of the consolidated condensed balance sheets, statements of income (loss), statements of comprehensive income (loss) and statements of cash flows for the periods presented. Operating results for the three month period ending March 31, 2008 are not necessarily indicative of the results that may be expected for the full year ending December 31, 2008. 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, 2007.

Certain amounts in the prior period financial statements have been reclassified to conform to the 2008 financial statement presentation.

Recent Accounting Pronouncements

On March 19, 2008, the FASB issued FAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities,* which amends FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities.* The Statement requires companies with derivative instruments to disclose information that should enable financial statement users to understand how and why a company uses derivative instruments, how derivative instruments and related hedged items are accounted for under FAS No. 133, and how derivative instruments and related hedged items affect a company s financial position, financial performance, and cash flows. The required disclosures include the fair value of derivative instruments and their gains or losses in tabular format, information about credit risk related contingent features in derivative agreements, counterparty credit risk, and a company s strategies and objectives for using derivative instruments. The Statement expands the current disclosure framework in FAS No. 133. FAS No. 161 is effective prospectively for periods beginning on or after November 15, 2008.

In December 2007, FAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51*, was issued. The objective of FAS No. 160 is to improve the relevance, comparability, and transparency of the financial information related to minority interest that a reporting entity provides in its consolidated financial statements. This Statement is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. The Company believes this statement will not have a material impact on its financial position or results of operations.

In February 2007, FAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (FAS 159) was issued. FAS 159 permits an entity to elect fair value as the initial and subsequent measurement attribute for many financial assets and liabilities. Entities electing the fair value option would be required to recognize changes in fair value in earnings. Entities electing the fair value option are required to distinguish on the face of the statement of financial position, the fair value of assets and liabilities for which the fair value option has been elected and similar assets and liabilities measured using another measurement attribute. FAS 159 is effective for fiscal year 2008. The adjustment to reflect the difference between the fair value and the carrying amount would be accounted for as a cumulative-effect adjustment to retained earnings as of the date of initial adoption. The Company did not elect the provisions of FAS 159.

In December 2007, the FASB issued FAS No. 141(R), *Business Combinations* (FAS 141(R)), which replaces FAS No. 141, *Business Combinations.* FAS 141(R) retains the underlying concepts of FAS No. 141 in that all business combinations are still required to be accounted for at fair value under the acquisition method of accounting, but FAS 141(R) changed the method of applying the acquisition method in a number of significant aspects. Acquisition costs will generally be expensed as incurred; non-controlling interests will be valued at fair value at the acquisition date;

in-process research and development will be recorded at fair value as an indefinite-lived intangible asset at the acquisition date; restructuring costs associated with a business combination will generally be expensed subsequent to the acquisition date; and changes in deferred tax asset valuation allowances and income tax uncertainties after the acquisition date

Table of Contents

generally will affect income tax expense. FAS 141(R) is effective on a prospective basis for all business combinations for which the acquisition date is on or after the beginning of the first annual period subsequent to December 15, 2008, with the exception of the accounting for changes in valuation allowances on deferred taxes and acquired tax contingencies related to acquisitions prior to the date of adoption of FAS 141 (R). Early adoption is not permitted. The provisions of FAS 141(R) are effective for the fiscal year beginning on or after December 15, 2008, which for the Company is fiscal year 2009. We are currently evaluating the impact of the provisions of FAS 141(R).

2. DEBT

In connection with the Merger completed on April 5, 2006, HealthMarkets, LLC, a direct wholly-owned subsidiary of the Company, entered into a credit agreement, providing for a $500.0 million term loan facility and a $75.0 million revolving credit facility, which includes a $35.0 million letter of credit sub-facility. The full amount of the term loan was drawn at closing, and the proceeds were used to fund a portion of the consideration paid in the Merger. At March 31, 2008, the Company had an aggregate of $362.5 million of indebtedness outstanding under the term loan facility, which indebtedness bore interest at the London inter-bank offered rate (LIBOR) plus a borrowing margin of 1.00%. The Company has not drawn on the $75.0 million revolving credit facility.

Also in connection with the merger, on April 5, 2006, HealthMarkets Capital Trust I and HealthMarkets Capital Trust II (two newly formed Delaware statutory business trusts, collectively the Trusts) issued $100.0 million of floating rate trust preferred securities (the Trust Securities) and $3.1 million of floating rate common securities. The Trusts invested the proceeds from the sale of the Trust Securities, together with the proceeds from the issuance to HealthMarkets, LLC by the Trusts of the common securities, in $100.0 million principal amount of HealthMarkets, LLC s Floating Rate Junior Subordinated Notes due June 15, 2036 (the Notes), of which $50.0 million principal amount accrue interest at a floating rate equal to three-month LIBOR plus 3.05% and $50.0 million principal amount accrue interest at a fixed rate of 8.367%.

On April 29, 2004, UICI Capital Trust I (a Delaware statutory business trust, the 2004 Trust) completed the private placement of $15.0 million aggregate issuance amount of floating rate trust preferred securities with an aggregate liquidation value of $15.0 million (the 2004 Trust Preferred Securities). The 2004 Trust invested the $15.0 million proceeds from the sale of the 2004 Trust Preferred Securities, together with the proceeds from the issuance to the Company by the 2004 Trust of its floating rate common securities in the amount of $470,000 (the Common Securities and, collectively with the 2004 Trust Preferred Securities, the 2004 Trust Securities), in an equivalent face amount of the Company s Floating Rate Junior Subordinated Notes due 2034 (the 2004 Notes). The 2004 Notes will mature on April 29, 2034. The 2004 Notes accrue interest at a floating rate equal to three-month LIBOR plus 3.50%, payable quarterly.

The following table sets forth detail of the Company s debt and interest expense (dollars in thousands):

	Principal Amount at March 31, 2008	Interest Expense Three Months Ended March 31, 2008
2006 credit agreement:		
Term loan	$ 362,500	$ 5,424
$75 Million revolver (non-use fee)		37
Trust preferred securities:		
UICI Capital Trust I	15,470	292
HealthMarkets Capital Trust I	51,550	1,004
HealthMarkets Capital Trust II	51,550	1,090
Other:		

Interest on Deferred Tax		1,042
Student loan credit facility	94,600	1,180
Amortization of financing fees		1,103
Total	$ 575,670	$ 11,172

Management uses derivative instruments to protect against the risk of changes in prevailing interest rates adversely affecting future cash flows associated with changes in the LIBOR rate applicable to its term loan credit facility discussed above. The derivative instrument used by the Company to protect against such risk is the interest rate swap. The Company accounts for its interest rate swaps in accordance with FAS 133, *Accounting for Derivative Instruments and Hedging Activities*.

Table of Contents

The Company owns three interest rate swap agreements with an aggregate notional amount of $300.0 million. The terms of the swaps are 3, 4 and 5 years beginning on April 11, 2006. The Company presents the fair value of the interest rate swap agreements at the end of the period in either Other assets or Other liabilities, as applicable, on its consolidated condensed balance sheet. At March 31, 2008, the interest rate swaps had an aggregate fair value of approximately $15.0 million, which is reflected under the caption Other Liabilities. During the three months ended March 31, 2008, the Company incurred a loss of $17,000, related to the ineffectiveness of the interest rate swap. The Company does not expect the ineffectiveness related to its hedging activity to be material to the Company s financial results in the future. There were no components of the derivative instruments that were excluded from the assessment of hedge effectiveness.

During the quarter ended March 31, 2008, pretax income of $348,000 ($226,000 net of tax) was reclassified into interest expense from accumulated other comprehensive income as adjustments to interest payments on variable rate debt. In addition, expense of $169,000 ($110,000 net of tax) was reclassified into earnings associated with the previous termination of the hedging relationship in the fourth quarter of 2006.

At March 31, 2008, accumulated other comprehensive income included a deferred after-tax net loss of $10.6 million related to the interest rate swaps of which $1.7 million ($1.1 million net of tax) is the remaining amount of loss associated with the previous terminated hedging relationship. This amount is expected to be reclassified into earnings in conjunction with the interest payments on the variable rate debt through April 2011.

The Company uses regression analysis to assess the hedge effectiveness in achieving the offsetting cash flows attributable to the risk being hedged. In addition, the Company utilizes the hypothetical derivative methodology for the measurement of ineffectiveness. Derivative gains and losses not effective in hedging the expected cash flows will be recognized immediately in earnings.

3. NET INCOME PER SHARE

The following table sets forth the computation of basic and diluted earnings per share:

	Three Months Ended March 31	
	2008	2007
	(In thousands, except per share amounts)	
Income (loss) from continuing operations	$ (6,324)	$ 22,624
Income from discontinued operations	31	67
Net income (loss) available to common shareholders	$ (6,293)	$ 22,691
Weighted average shares outstanding, basic	30,796	30,242
Dilutive effect of stock options and other shares		763
Weighted average shares outstanding, dilutive	30,796	31,005
Basic earnings (losses) per share:		
From continuing operations	$ (0.20)	$ 0.75
From discontinued operations		
Net income per share, basic	$ (0.20)	$ 0.75
Diluted earnings (losses) per share:		
From continuing operations	$ (0.20)	$ 0.73

From discontinued operations				
Net income (loss) per share, diluted	$	(0.20)	$	0.73

As of March 31, 2008, 27,000,062 shares of Class A-1 common stock were issued, of which 26,922,331 were outstanding and 77,731 shares were held in treasury and 4,012,139 shares of Class A-2 common stock were issued, of which 3,945,042 shares were outstanding and 67,097 shares were held in treasury.

4. COMMITMENTS AND CONTINGENCIES

The Company is a party to the following material legal proceedings:

Commonwealth of Massachusetts Litigation

As previously disclosed, on October 23, 2006, MEGA was named as a defendant in an action filed by the Commonwealth of Massachusetts (*Commonwealth of Massachusetts v. The MEGA Life and Health Insurance Company*), pending in the Superior Court of Suffolk County, Massachusetts, Case Number 06-4411. The Complaint was served on MEGA on or around January 19, 2007. Plaintiff has alleged that MEGA engaged in unfair and deceptive practices by

Table of Contents

issuing policies that contained exclusions of, or otherwise failed to cover, certain benefits mandated under Massachusetts law. In addition, plaintiff has alleged that MEGA violated Massachusetts laws that (i) require health insurance policies to provide coverage for outpatient contraceptive services to the extent the policies provide coverage for other outpatient services and (ii) limit exclusions of coverage for pre-existing conditions. On August 22, 2007, the Attorney General filed an amended complaint which added HealthMarkets and Mid-West as defendants in this action and broadened plaintiff s original allegations. The amended complaint includes allegations that the defendants engaged in unfair and deceptive trade practices and illegal association membership practices, imposed illegal waiting periods and restrictions on coverage of pre-existing conditions and failed to comply with Massachusetts law regarding mandatory benefits. This proceeding is in an early stage and its outcome is uncertain. Civil discovery has commenced and motions on various points of law and procedure have been filed by the parties, including a motion to dismiss filed by defendants which was denied in March 2008. At present, the Company is unable to determine what, if any, impact this matter may have on the Company s consolidated financial condition or results of operation.

State of Maine Rate Inquiry Litigation

As previously disclosed, MEGA was named as a defendant in an action filed on November 15, 2007 by the Department of Professional and Financial Regulation, Maine Bureau of Insurance (*In Re: MEGA Life and Health Insurance Company Rates For Individual Plans*) pending before the Superintendent of the Maine Bureau of Insurance, Docket No. Ins-07-1010. The Maine Attorney General moved to intervene and was granted status as a party to the action. The action was initiated to determine whether MEGA is in compliance with Maine s requirement that rates for health insurance not be excessive, inadequate, or unfairly discriminatory as set forth in 24-A M.R.S.A. § 2736-C(5) and Maine Rule Ch. 940, § 8(A). The parties executed a settlement agreement resolving this matter on April 3, 2008 on terms that did not have a material adverse effect upon the Company s consolidated financial condition or results of operations and did not require MEGA to admit wrongdoing, liability or violation of law.

Association Group Litigation

As previously disclosed, HealthMarkets and MEGA were named as defendants in an action filed on July 25, 2006 (Christopher Closson, individually, and as Successor in interest to Kathy Closson, deceased v. HealthMarkets, MEGA, National Association for the Self-Employed, et al.) pending in the Superior Court for the County of Riverside, California, Case No. RIC453741. Plaintiff has alleged several causes of action, including breach of fiduciary duty, negligent failure to obtain insurance, fraud by concealment, promissory fraud, civil conspiracy, professional negligence, negligence, intentional infliction of emotional distress and violation of the California Consumer Legal Remedies Act. Plaintiff seeks injunctive relief, and general and punitive monetary damages in an unspecified amount. On May 2, 2007, the California court dismissed the causes of action alleging civil conspiracy and intentional infliction of emotional distress (with leave to amend) and the cause of action alleging violation of the California Consumer Legal Remedies Act (without leave to amend). On June 11, 2007, plaintiff filed an amended complaint, which MEGA responded to on July 16, 2007. On May 5, 2008, the Court denied MEGA s motion for summary judgment in this matter.

Other Litigation Matters

The Company and its subsidiaries are parties to various other pending and threatened legal proceedings, claims, demands, disputes and other matters arising in the ordinary course of business, including some asserting significant liabilities arising from claims, demands, disputes and other matters with respect to insurance policies, relationships with agents, relationships with former or current employees, and other matters. From time to time, some such matters, where appropriate, may be the subject of internal investigation by management, the Board of Directors, or a committee of the Board of Directors. The Company believes that the liability, if any, resulting from the disposition of such proceedings, claims, demands, disputes or matters would not be material to the Company s financial condition or results of operations.

Regulatory Matters

The Rhode Island Office of the Health Insurance Commissioner conducted a targeted market conduct examination regarding MEGA s small employer market practices during 2005. As a result of that examination, MEGA is in the process of negotiating a settlement with the Office of the Health Insurance Commissioner. The Company anticipates that Mid-West will also agree to a settlement with the Office of the Health Insurance Commissioner since it sells similar plans in Rhode Island. The Company believes that this settlement will be on terms that will not have a material adverse effect upon the Company s consolidated financial condition or results of operations. Negotiations are on-going and the settlement is not final.

Table of Contents

The Company s insurance subsidiaries are subject to various pending market conduct or other regulatory examinations, inquiries or proceedings arising in the ordinary course of business. As previously disclosed, these matters include the multi-state market conduct examination of HealthMarkets principal insurance subsidiaries for the examination period January 1, 2000 through December 31, 2005. Reference is made to the discussion of the multi-state market conduct examination contained in the Company s Annual Report on Form 10-K for the year ended December 31, 2007 under the caption Item 3 Legal Proceedings and in Note 17 of Notes to the Company s Consolidated Financial Statements included in such report. State insurance regulatory agencies have authority to levy significant fines and penalties and require remedial action resulting from findings made during the course of such matters. Historically, our insurance subsidiaries have from time to time been subject to such fines and penalties, none of which individually or in the aggregate have had a material adverse effect on our results of operations or financial condition. However, the multi-state market conduct examination and other regulatory examinations, inquiries or proceedings could result in, among other things, changes in business practices that require the Company to incur substantial costs. Such results, singly or in combination, could injure our reputation, cause negative publicity, adversely affect our debt and financial strength ratings, place us at a competitive disadvantage in marketing or administering our products or impair our ability to sell or retain insurance policies, thereby adversely affecting our business, and potentially materially adversely affecting the results of operations in a period, depending on the results of operations for the particular period. Determination by regulatory authorities that we have engaged in improper conduct could also adversely affect our defense of various lawsuits.

2006 Sale of Student Insurance Division

On December 1, 2006, the Company sold substantially all of the assets formerly comprising MEGA s Student Insurance Division.

The purchase price is subject to downward or upward adjustment based on the amount of premium to be generated with respect to the 2007-2008 school year and actual claims experience with respect to the in-force block of student insurance business at the time of the sale. The Company has recorded $1.2 million and $6.5 million of realized gains as an adjustment to the purchase price related to positive claim experience in 2007 and 2006, respectively. The Company has made no adjustment to the purchase price due to the premium provision. The Company will continue to examine whether any additional adjustments should be made in the future.

5. SEGMENT INFORMATION

The Company operates three business segments, the Insurance segment, Other Key Factors and Disposed Operations. The Insurance segment includes the Company s Self-Employed Agency Division (SEA), the Life Insurance Division, the Medicare Division and Other Insurance Division. Other Key Factors includes investment income not allocated to the Insurance segment, realized gains or losses on sale of investments, interest expense on corporate debt, general expenses relating to corporate operations, variable non-cash stock-based compensation and operations that do not constitute reportable operating segments. Disposed Operations includes the Company s former Star HRG Division and former Student Insurance Division.

Allocations of investment income and certain general expenses are based on a number of assumptions and estimates, and the business segments reported operating results would change if different methods were applied. Certain assets are not individually identifiable by segment and, accordingly, have been allocated by formulas. Segment revenue includes premiums and other policy charges and considerations, net investment income, fees and other income. Management does not allocate income taxes to segments. Transactions between reportable operating segments are accounted for under respective agreements, which provide for such transactions generally at cost.

Table of Contents

Revenue from continuing operations, income (loss) from continuing operations before income taxes, and assets by operating segment are set forth in the tables below:

	Three Months Ended March 31