HEALTHWAYS, INC
Form 10-Q
May 07, 2009
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the Quarterly Period Ended March 31, 2009

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 000-19364

HEALTHWAYS, INC.

(Exact Name of Registrant as Specified in its Charter)

Delaware	62-1117144
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

701 Cool Springs Boulevard, Franklin, TN 37067
(Address of Principal Executive Offices) (Zip Code)

615-614-4929
(Registrant's Telephone Number, Including Area Code)

(Former name, former address and former fiscal year, if changed since last report)

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 x 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 12 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, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x Accelerated filer o Non-accelerated filer 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 x

As of May 4, 2009 there were outstanding 33,689,869 shares of the Registrant's Common Stock, par value $.001 per share.

Healthways, Inc.

Form 10-Q

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Part I

Item 1. Financial Statements

HEALTHWAYS, INC.

CONSOLIDATED BALANCE SHEETS

(In thousands)

(Unaudited)

ASSETS

	March 31, 2009	December 31, 2008
Current assets:		
Cash and cash equivalents	$ 40,739	$ 5,157
Accounts receivable, net	123,703	115,108
Prepaid expenses	11,762	13,479
Other current assets	7,093	3,810
Income taxes receivable	8,000	—
Deferred tax asset	27,748	30,488
Total current assets	219,045	168,042
Property and equipment:		
Leasehold improvements	37,367	34,635
Computer equipment and related software	142,441	138,369
Furniture and office equipment	29,392	29,610
Capital projects in process	21,862	17,462
	231,062	220,076
Less accumulated depreciation	(117,639)	(108,635)
	113,423	111,441
Other assets	8,083	18,089
Customer contracts, net	31,360	32,715
Other intangible assets, net	67,326	68,207
Goodwill, net	484,584	484,596
Total assets	$ 923,821	$ 883,090

See accompanying notes to the consolidated financial statements.

HEALTHWAYS, INC.

CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share data)

(Unaudited)

LIABILITIES AND STOCKHOLDERS' EQUITY

	March 31, 2009	December 31, 2008
Current liabilities:		
Accounts payable	$ 18,322	$ 21,633
Accrued salaries and benefits	45,472	33,161
Accrued liabilities	74,851	26,294
Deferred revenue	8,425	6,904
Contract billings in excess of earned revenue	73,298	71,406
Income taxes payable	—	8,034
Current portion of long-term debt	3,825	2,035
Current portion of long-term liabilities	5,066	4,609
Total current liabilities	229,259	174,076
Long-term debt	310,867	304,372
Long-term deferred tax liability	7,260	8,073
Other long-term liabilities	33,631	39,533
Stockholders' equity:		
Preferred stock		
$.001 par value, 5,000,000 shares		
authorized, none outstanding	—	—
Common stock		
$.001 par value, 120,000,000 shares authorized,		
33,682,571 and 33,648,976 shares outstanding	34	34
Additional paid-in capital	215,481	213,461
Retained earnings	133,693	148,506
Accumulated other comprehensive loss	(6,404)	(4,965)
Total stockholders' equity	342,804	357,036
Total liabilities and stockholders' equity	$ 923,821	$ 883,090

See accompanying notes to the consolidated financial statements.

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HEALTHWAYS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except earnings per share data)

(Unaudited)

	Three Months Ended March 31, 2009	2008
Revenues	$ 182,736	$ 180,940
Cost of services (exclusive of depreciation and amortization of $8,786 and $8,429, respectively, included below)	132,838	128,187
Selling, general & administrative expenses	18,785	18,691
Depreciation and amortization	12,250	11,809
Operating income	18,863	22,253
Gain on sale of investment	(2,581)	—
Interest expense	4,060	4,887
Legal settlement and related costs	39,956	—
Income (loss) before income taxes	(22,572)	17,366
Income tax expense (benefit)	(7,759)	7,163
Net income (loss)	$ (14,813)	$ 10,203
Earnings (loss) per share:		
Basic	$ (0.44)	$ 0.28
Diluted	$ (0.43)	$ 0.27
Weighted average common shares and equivalents:		
Basic	33,669	36,035
Diluted	34,067	37,730

See accompanying notes to the consolidated financial statements.

HEALTHWAYS, INC.

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

For the Three Months Ended March 31, 2009

(In thousands)

(Unaudited)

	Preferred Stock	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total
Balance, December 31, 2008	$—	$34	$213,461	$148,506	$(4,965)	$357,036
Comprehensive loss:						
Net loss	—	—	—	(14,813)	—	(14,813)
Net change in fair value of interest rate swaps, net of income taxes of $432	—	—	—	—	519	519
Change in fair value of investment, net of income tax benefit of $49	—	—	—	—	(71)	(71)
Sale of investment, net of income taxes of $1,045	—	—	—	—	(1,536)	(1,536)
Foreign currency translation adjustment	—	—	—	—	(351)	(351)
Total comprehensive loss						(16,252)
Exercise of stock options	—	—	65	—	—	65
Tax effect of option exercises	—	—	(156)	—	—	(156)
Repurchase of stock options	—	—	(736)	—	—	(736)
Share-based employee compensation expense	—	—	2,847	—	—	2,847
Balance, March 31, 2009	$—	$34	$215,481	$133,693	$(6,404)	$342,804

See accompanying notes to the consolidated financial statements.

HEALTHWAYS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Three Months Ended March 31, 2009	2008
Cash flows from operating activities:		
Net income (loss)	$ (14,813)	$ 10,203
Adjustments to reconcile net income (loss) to net cash provided by operating activities, net of business acquisitions:		
Depreciation and amortization	12,250	11,809
Amortization of deferred loan costs	348	291
Gain on sale of investment	(2,581)	—
Share-based employee compensation expense	2,847	4,484
Excess tax benefits from share-based payment arrangements	(32)	(3,057)
Increase in accounts receivable, net	(8,593)	(20,110)
Increase in other current assets	(8,150)	(902)
Increase (decrease) in accounts payable	3,238	(2,568)
Increase in accrued salaries and benefits	12,309	8,789
Increase in other current liabilities	39,717	6,734
Deferred income taxes	2,303	(27)
Other	1,907	8,849
Increase in other assets	(868)	(1,856)
Payments on other long-term liabilities	(1,392)	(1,789)
Net cash flows provided by operating activities	38,490	20,850
Cash flows from investing activities:		
Acquisition of property and equipment	(11,504)	(29,007)
Acquisitions, net of cash acquired	—	(279)
Sale of investment	11,626	—
Change in restricted cash	(538)	—
Other	(940)	(1,250)
Net cash flows used in investing activities	(1,356)	(30,536)
Cash flows from financing activities:		
Proceeds from issuance of long-term debt	91,200	62,287
Payments of long-term debt	(84,940)	(551)
Deferred loan costs	(769)	—
Exercise of stock options	65	2,734
Excess tax benefits from share-based payment arrangements	32	3,057
Repurchases of common stock	—	(22,208)
Repurchase of stock options	(736)	—
Change in outstanding checks and other	(6,149)	—
Net cash flows (used in) provided by financing activities	(1,297)	45,319

Effect of exchange rate changes on cash	(255)	283

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Net increase in cash and cash equivalents	35,582	35,916
Cash and cash equivalents, beginning of period	5,157	40,515
Cash and cash equivalents, end of period	$ 40,739	$ 76,431

See accompanying notes to the consolidated financial statements.

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HEALTHWAYS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(1) Interim Financial Reporting

The accompanying consolidated financial statements of Healthways, Inc. and its wholly-owned subsidiaries for the three months ended March 31, 2009 and 2008 are unaudited. However, in our opinion, the consolidated financial statements reflect all adjustments consisting of normal, recurring accruals necessary for a fair presentation. We have reclassified certain items in prior periods to conform to current classifications.

We have omitted certain financial information that is normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States but that is not required for interim reporting purposes. You should read the accompanying consolidated financial statements in conjunction with the financial statements and notes thereto included in our Annual Report on Form 10-K for the fiscal year ended August 31, 2008. In August 2008, our Board of Directors approved a change in our fiscal year-end from August 31 to December 31. Accordingly, our full fiscal year began on January 1, 2009 following a four-month transition period ending December 31, 2008.

(2) Recently Issued Accounting Standards

In April 2009, the FASB issued FASB Staff Position (“FSP”) No. FAS 107-1 and APB 28-1, “Interim Disclosures about Fair Value of Financial Instruments,” to require disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. FSP FAS 107-1 and APB 28-1 apply to all financial instruments within the scope of FAS 107 and are effective for interim reporting periods ending after June 15, 2009. The adoption of FSP FAS 107-1 and APB 28-1 will result in increased disclosures in our interim periods but will not have an impact on our financial position or results of operations.

(3) Share-Based Compensation

We have several shareholder-approved stock incentive plans for employees and directors. We currently have three types of share-based awards outstanding under these plans: stock options, restricted stock, and restricted stock units. We believe that such awards align the interests of our employees and directors with those of our stockholders. We account for share-based compensation in accordance with Statement of Financial Accounting Standards (“SFAS”) No. 123(R), “Share-Based Payment.”

For the three months ended March 31, 2009 and 2008, we recognized share-based compensation costs of $2.8 million and $4.5 million, respectively.

A summary of our stock options as of March 31, 2009 and changes during the three months then ended is presented below:

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Options	Shares (000s)	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (years)	Aggregate Intrinsic Value ($000s)
Outstanding at January 1, 2009	4,124	$ 20.20		
Granted	1,129	11.65		
Exercised	(12)	5.02		
Forfeited or expired	(66)	27.49		
Outstanding at March 31, 2009	5,175	18.28	5.44	$ 2,337
Exercisable at March 31, 2009	3,240	16.72	4.04	2,312

The weighted-average grant-date fair value of options granted during the three months ended March 31, 2009 was $6.70.

The following table shows a summary of our restricted stock and restricted stock units (“nonvested shares”) as of March 31, 2009 as well as activity during the three months then ended:

Nonvested Shares	Shares (000s)	Weighted-Average Grant Date Fair Value
Nonvested at January 1, 2009	501	$ 41.01
Granted	655	11.07
Vested	(21)	45.97
Forfeited	(12)	41.02
Nonvested at March 31, 2009	1,123	23.45

(4) Income Taxes

Our effective tax rate was a benefit of 34.4% for the three months ended March 31, 2009 compared to an expense of 41.2% for the three months ended March 31, 2008. The decrease in the effective rate for the three months ended March 31, 2009 was primarily due to the change from a pretax profit for the three months ended March 31, 2008 to a pretax loss for the three months ended March 31, 2009, as well as certain unrecognized tax benefits and tax interest accruals.

We file income tax returns in the U.S. Federal jurisdiction and in various state and foreign jurisdictions. During the three months ended March 31, 2009, the Internal Revenue Service completed an audit of our 2005 and 2006 tax years, the resolution of which did not result in a material adjustment to our financial statements.

(5) Derivative Investments and Hedging Activities

SFAS No. 133, “Accounting for Derivative Investments and Hedging Activities,” as amended, establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. It requires companies to record all derivatives at estimated fair value as either assets or liabilities on the balance sheet and to recognize the unrealized gains and losses, the treatment of which depends on whether the derivative is designated as a hedging instrument. On January 1, 2009, we adopted SFAS No. 161, “Disclosures about Derivative Instruments and Hedging Activities - An Amendment of FASB Statement No. 133,” which expands the disclosure requirements of SFAS No. 133.

We are subject to certain risks related to our ongoing business operations. The primary risks managed by using derivative instruments are interest rate risk and foreign currency exchange rate risk.

We currently maintain six interest rate swap agreements to reduce our exposure to interest rate fluctuations on our floating rate debt commitments (see Note 7 for further information). These interest rate swap agreements effectively modify our exposure to interest rate risk by converting a portion of our floating rate debt to fixed obligations with interest rates ranging from 3.433% to 4.995%, thus reducing the impact of interest rate changes on future interest expense. Under these agreements, we receive a variable rate of interest based on the three-month LIBOR, and we pay a fixed rate of interest plus a spread of 0.875% to 1.750% on revolving advances and a spread of 1.50% on term loan borrowings. We have designated these interest rate swap agreements as qualifying cash flow hedges.

We enter into foreign currency options and/or forward contracts in order to minimize our earnings exposure to fluctuations in foreign currency exchange rates. These foreign currency exchange contracts do not qualify for hedge accounting treatment under SFAS No. 133. We routinely monitor our foreign currency exposures to maximize the overall effectiveness of our foreign currency hedge positions. We do not execute transactions or hold derivative financial instruments for trading or other purposes.

The location and amounts of the estimated fair values of derivative instruments in the consolidated balance sheet at March 31, 2009 were as follows:

(In $000s)	**Foreign currency exchange contracts**	**Interest rate swap agreements**	**Total**
Assets:			
Derivatives not designated as hedging instruments:			
Other current assets	$2,000	—	$2,000
Total assets	$2,000	—	$2,000
Liabilities:			
Derivatives not designated as hedging instruments:			
Accrued liabilities	$2,073	—	$2,073
Derivatives designated as hedging instruments:			
Accrued liabilities	—	$2,775	$2,775
Other long-term liabilities	—	$7,565	$7,565
Total liabilities	$2,073	$10,340	$12,413

Cash Flow Hedges

Derivative instruments that are designated and qualify as cash flow hedges are recorded at estimated fair value in the balance sheet, with the effective portion of the gains and losses being reported in other comprehensive income (“OCI”) or loss. These gains and losses are reclassified into earnings in the same period during which the hedged transaction affects earnings, which, in the case of the interest rate swap agreements, is the termination of the agreement, whether scheduled or unscheduled, or the period in which all or a portion of the hedge becomes ineffective. As of March 31, 2009, we expect to reclassify $5.7 million of net losses on interest rate swap agreements from accumulated OCI to interest expense within the next 12 months due to the payment of interest associated with floating rate debt.

As of March 31, 2009, we are currently a party to the following interest rate swap agreements for which we receive a variable rate of interest based on the three-month LIBOR and for which we pay the following fixed rates of interest plus a spread of 0.875% to 1.750% on revolving advances and a spread of 1.50% on term loan borrowings:

Swap #	Original Notional Amount (in $000s)	Fixed Interest Rate	Termination Date	
1	$230,000	4.995 %	March 31, 2010	(1)
2	40,000	3.987 %	December 31, 2009	
3	40,000	3.433 %	December 30, 2011	
4	50,000	3.688 %	December 30, 2011	(2)
5	40,000	3.855 %	December 30, 2011	(3)
6	30,000	3.760 %	March 30, 2011	(4)

(1) The principal value of this swap agreement amortizes over a 39-month period. During the three months ended March 31, 2009, the notional amount of this swap was $120 million.

(2) This swap agreement becomes effective April 1, 2009.

(3) This swap agreement becomes effective October 1, 2009.

(4) This swap agreement becomes effective January 2, 2010.

We currently believe that we meet the hedge accounting criteria under SFAS No. 133 in accounting for these interest rate swap agreements.

Gains and losses representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in current earnings. The following table shows the effect of our cash flow hedges on the consolidated statement of operations (or when applicable, the consolidated balance sheet) during the three months ended March 31, 2009:

(In $000s) Derivatives in SFAS No. 133 Cash Flow Hedging Relationships	Amount of Gain (Loss) Recognized in OCI on Derivatives (Effective Portion)	Location of Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)
Interest rate swap agreements, gross of tax effect	$(560)	Interest expense	$(1,511)

During the three months ended March 31, 2009, there were no gains or losses on cash flow hedges recognized in income resulting from hedge ineffectiveness.

Derivative Instruments Not Designated as Hedging Instruments

Our foreign currency exchange contracts require current period mark-to-market accounting, with any change in fair value being recorded each period in the statement of operations in selling, general and administrative expenses. As of March 31, 2009, we had the following outstanding foreign currency forward contracts that were entered into to hedge forecasted foreign net income (loss) and intercompany debt.

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Foreign Currency	Notional Amount (000s)
Euro	€381
British Pound Sterling	£300
Australian Dollar	AUD 1,618

These forward contracts did not have a material effect on our consolidated statement of operations during the three months ended March 31, 2009.

(6) Fair Value Measurements

On January 1, 2009, we adopted SFAS No. 157, "Fair Value Measurement". SFAS No. 157 provides guidance for using fair value to measure assets and liabilities, including a fair value hierarchy that prioritizes the information used to develop fair value assumptions. It also requires expanded disclosure about the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. The standard applies whenever other standards require (or permit) assets or liabilities to be measured at fair value and does not expand the use of fair value in any new circumstances.

Fair Value Hierarchy

SFAS No. 157 defines fair value as the price that would be received upon sale of an asset or paid upon transfer of a liability in an orderly transaction between market participants at the measurement date, assuming the transaction occurs in the principal or most advantageous market for that asset or liability. SFAS No. 157 classifies the inputs used to measure fair value into the following hierarchy:

Level 1: Quoted prices in active markets for identical assets or liabilities;

Level 2: Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-based valuation techniques in which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities; and

Level 3: Unobservable inputs that are supported by little or no market activity and typically reflect management's estimates of assumptions that market participants would use in pricing the asset or liability.

Assets and Liabilities Measured at Fair Value on a Recurring Basis

The following table presents our assets and liabilities measured at fair value on a recurring basis at March 31, 2009, all of which are classified as Level 2 in the fair value hierarchy:

(In 000s)		March 31, 2009
Assets:		
Foreign currency exchange contracts	$	2,000
Liabilities:		
Foreign currency exchange contracts	$	2,073
Interest rate swap agreements	$	10,340

The fair values of forward foreign currency exchange contracts are valued using broker quotations of similar assets or liabilities in active markets. The fair values of interest rate swap agreements are primarily determined based on the present value of future cash flows using internal models and third-party pricing services with observable inputs, including interest rates, yield curves and applicable credit spreads. Counterparty credit risk, which is mitigated by the existence of master netting agreements, did not have a material impact on derivative fair value estimates.

(7) Long-Term Debt

On December 1, 2006, we entered into a Third Amended and Restated Revolving Credit and Term Loan Agreement (the "Third Amended Credit Agreement"). The Third Amended Credit Agreement provides us with a $400.0 million revolving credit facility, including a swingline sub facility of $10.0 million and a $75.0 million sub facility for letters of credit, a $200.0 million term loan facility, and an uncommitted incremental accordion facility of $200.0 million. As of March 31, 2009, availability under our revolving credit facility and swingline sub facility totaled $280.6 million.

Revolving advances under the Third Amended Credit Agreement generally bear interest, at our option, at 1) LIBOR plus a spread of 0.875% to 1.750% or 2) the greater of the federal funds rate plus 0.5%, or the prime rate, plus a spread of 0.000% to 0.250%. Term loan borrowings bear interest, at our option, at 1) LIBOR plus 1.50% or 2) the greater of the federal funds rate plus 0.5%, or the prime rate. See Note 5 for a description of our interest rate swap agreements. The Third Amended Credit Agreement also provides for a fee ranging between 0.150% and 0.300% of unused commitments. The Third Amended Credit Agreement is secured by guarantees from most of the Company's domestic subsidiaries and by security interests in substantially all of the Company's and such subsidiaries' assets.

We are required to repay outstanding revolving loans on the revolving commitment termination date, which is December 1, 2011. We are required to repay term loans in quarterly principal installments aggregating $0.5 million each, which commenced on March 31, 2007, and the entire unpaid principal balance of the term loans is due and payable at maturity on December 1, 2013.

The Third Amended Credit Agreement contains various financial covenants, which require us to maintain, as defined, ratios or levels of 1) total funded debt to EBITDA, 2) fixed charge coverage, and 3) net worth. In connection with a legal settlement (see Note 9), in March 2009 we entered into a sixth amendment to the Third Amended Credit Agreement to expressly exclude up to $40 million of expenses attributable to this settlement from the calculation of earnings before interest, taxes, depreciation and amortization, or EBITDA, for purposes of covenant calculations. The Third Amended Credit Agreement also restricts the payment of dividends and limits the amount of repurchases of the Company's common stock. As of March 31, 2009, we were in compliance with all of the covenant requirements of the Third Amended Credit Agreement.

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As described in Note 5 above, as of March 31, 2009, we are currently a party to six interest rate swap agreements for which we receive a variable rate of interest based on the three-month LIBOR and for which we pay a fixed rate of interest plus a spread of 0.875% to 1.750% on revolving advances and a spread of 1.50% on term loan borrowings.

(8) Restructuring and Related Charges

As of March 31, 2009, we have incurred cumulative net charges of approximately $9.9 million related to a restructuring of the Company, which was largely completed by the end of calendar 2008. This restructuring was primarily focused on streamlining management and better positioning the Company to deliver fully integrated solutions. The restructuring charges primarily consisted of severance costs, net of equity forfeitures, and costs associated with capacity consolidation. For the four months ended December 31, 2008, these charges were presented in a separate line on the consolidated statement of operations.

During the three months ended March 31, 2009, we incurred net restructuring charges of ($0.4) million, which are included in cost of services and selling, general, and administrative expenses. We do not expect to incur significant additional costs related to this restructuring.

The change in accrued restructuring and related charges during the three months ended March 31, 2009 was as follows:

(In 000s)			
Accrued restructuring and related charges at January 1, 2009	$	10,460	
Additions		191	
Payments		(4,509	)
Adjustments [1]		(507	)
Accrued restructuring and related charges at March 31, 2009	$	5,635	

[1] Adjustments for the three months ended March 31, 2009 primarily resulted from actual severance amounts which differed from initial estimates due to employees who transitioned to new roles.

(9) Commitments and Contingencies

Former Employee Action

In June 1994, a former employee whom we dismissed in February 1994 filed a “whistle blower” action on behalf of the United States government. Subsequent to its review of this case, the federal government determined not to intervene in the litigation. The employee sued Healthways, Inc. and our wholly-owned subsidiary, American Healthways Services, Inc. (“AHSI”), as well as certain named and unnamed medical directors and one named client hospital, West Paces Medical Center (“WPMC”), and other unnamed client hospitals.

Healthways, Inc. was subsequently dismissed as a defendant. In addition, WPMC has settled claims filed against it as part of a larger settlement agreement that WPMC’s parent organization, HCA Inc., reached within the United States government. The plaintiff has also dismissed its claims against the medical directors with prejudice, and on February 7, 2007 the court granted the plaintiff's motion and dismissed all claims against all named medical directors.

In March 2009, our Board of Directors approved a proposed settlement agreement with the United States of America, acting through the United States Department of Justice and on behalf of the Department of Health and Human Services (collectively, the “United States”), and the former employee in connection with the settlement of the lawsuit. Pursuant to the settlement agreement, which was effective April 1, 2009, we agreed to pay $28 million to the United States in settlement of the litigation. Additionally, we incurred a charge in the first quarter of 2009 of an additional $12 million for other costs and fees related to the settlement, including the estimated legal costs and expenses of the plaintiff’s attorneys.

In a related matter, we have settled the arbitration claim filed against us by WPMC and the arbitration counter-claim we filed against WPMC in February 2006, both of which sought indemnification for certain costs and expenses incurred in connection with the qui tam case.

Securities Class Actions

Beginning on June 5, 2008, Healthways and certain of its present and former officers and/or directors were named as defendants in two putative securities class actions filed in the U.S. District Court for the Middle District of Tennessee, Nashville Division. On August 8, 2008, the court ordered the consolidation of the two related cases, appointed lead plaintiff and lead plaintiff’s counsel, and granted lead plaintiff leave to file a consolidated amended complaint.

The amended complaint, filed on September 22, 2008, alleges that the Company and the individual defendants violated Sections 10(b) of the Securities Exchange Act of 1934 (the “Act”) and that the individual defendants violated Section 20(a) of the Act as “control persons” of Healthways. The amended complaint further alleges that certain of the individual defendants also violated Section 20A of the Act based on their stock sales. Plaintiff purports to bring these claims for unspecified monetary damages on behalf of a class of investors who purchased Healthways stock between July 5, 2007 and August 25, 2008.

In support of these claims, Lead Plaintiff alleges generally that, during the proposed class period, the Company made misleading statements and omitted material information regarding (1) the purported loss or restructuring of certain contracts with customers, (2) the Company’s participation in the Medicare Health Support (“MHS”) pilot program for the Centers for Medicare & Medicaid Services, and (3) the Company’s guidance for fiscal year 2008. Defendants filed a motion to dismiss the amended complaint on November 13, 2008. On March 9, 2009, the Court denied Defendants’ motion to dismiss. Plaintiff has served discovery requests on Defendants, and the discovery phase of the lawsuit is presently underway.

Shareholder Derivative Lawsuits

Also, on June 27, 2008 and July 24, 2008, respectively, two shareholders filed putative derivative actions purportedly on behalf of Healthways in the Chancery Court for the State of Tennessee, Twentieth Judicial District, Davidson County, against certain directors and officers of the Company. These actions are based upon substantially the same facts alleged in the securities class action litigation described above. The plaintiffs are seeking to recover damages in an unspecified amount and equitable and/or injunctive relief.

On August 13, 2008, the Court consolidated these two lawsuits and appointed lead counsel. On October 3, 2008, the Court ordered that the consolidated action be stayed until the motion to dismiss in the securities class action had been resolved by the District Court. By stipulation of the parties, the

plaintiffs' consolidated complaint must be filed by May 8, 2009. Discovery has not yet commenced in the consolidated case, and no trial date has been set.

ERISA Lawsuits

Additionally, on July 31, 2008, a purported class action alleging violations of the Employee Retirement Income Security Act ("ERISA") was filed in the U.S. District Court for the Middle District of Tennessee, Nashville Division against Healthways, Inc. and certain of its directors and officers alleging breaches of fiduciary duties to participants in the Company's 401(k) plan. The central allegation is that Company stock was an imprudent investment option for the 401(k) plan.

The complaint was amended on September 29, 2008. The named defendants are: the Company, the Board of Directors, certain officers, and members of the Investment Committee charged with administering the 401(k) plan. The amended complaint alleges that the defendants violated ERISA by failing to remove the Company stock fund from the 401(k) plan when it allegedly became an imprudent investment, by failing to disclose adequately the risks and results of the MHS pilot program to 401(k) plan participants, and by failing to seek independent advice as to whether to continue to permit the plan to hold Company stock. It further alleges that the Company and its directors should have been more closely monitoring the Investment Committee and other plan fiduciaries. The amended complaint seeks damages in an undisclosed amount and other equitable relief. Defendants filed a motion to dismiss on October 29, 2008.   On January 28, 2009, the Court granted Defendants' motion to dismiss Plaintiff's claims for breach of the duty to disclose with regard to any non-public information and information beyond the specific disclosure requirements of ERISA and denied Defendants' motion to dismiss as to the remainder of Plaintiff's claims. Plaintiff has served discovery requests on Defendants, and the discovery phase of the lawsuit is presently underway.

Outlook

We are also subject to other claims and suits that arise from time to time in the ordinary course of our business. We do not believe that any of the legal proceedings pending against us as of the date of this report will have a material adverse effect on our liquidity or financial condition. We may settle claims, sustain judgments or incur expenses relating to legal proceedings in a particular fiscal quarter which may adversely affect our results of operations. As these matters are subject to inherent uncertainties, our view of these matters may change in the future.

**(10)	Sale of Investment**

In January 2009, a private company in which we held preferred stock was acquired by a third party. As part of this sale, we received two payments totaling $11.6 million in January and February 2009 and recorded a gain of $2.6 million.

**(11)	Comprehensive Income (Loss)**

Comprehensive income (loss), net of income taxes, was ($16.3) million and $8.4 million for the three months ended March 31, 2009 and 2008, respectively.

(12) Earnings (Loss) Per Share

The following is a reconciliation of the numerator and denominator of basic and diluted earnings (loss) per share for the three months ended March 31, 2009 and 2008:

(In 000s, except per share data)	Three Months Ended March 31,	
	2009	2008
Numerator:		
Net income (loss) - numerator for earnings (loss) per share	$ (14,813)	$