

CENTENE CORP  
Form 10-Q  
July 27, 2010

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549

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FORM 10-Q

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(Mark One)

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

For the quarterly period ended June 30, 2010

OR

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: 001-31826

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CENTENE CORPORATION  
(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of  
incorporation or organization)

42-1406317  
(I.R.S. Employer  
Identification Number)

7711 Carondelet Avenue  
St. Louis, Missouri

63105

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(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code:

(314) 725-4477

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: T Yes  No

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). T Yes  No

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 "small reporting company" in Rule 12b-2 of the Exchange Act. Large accelerated filer  Accelerated filer  Non-accelerated filer  (do not check if a smaller reporting company) Smaller reporting company

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

As of July 16, 2010, the registrant had 51,669,507 shares of common stock outstanding.

CENTENE CORPORATION  
QUARTERLY REPORT ON FORM 10-Q

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CAUTIONARY STATEMENT ON FORWARD-LOOKING STATEMENTS

All statements, other than statements of current or historical fact, contained in this filing are forward-looking statements. We have attempted to identify these statements by terminology including “believe,” “anticipate,” “plan,” “expect,” “estimate,” “intend,” “seek,” “target,” “goal,” “may,” “will,” “should,” “can,” “continue” and other similar words or expressions in connection with, among other things, any discussion of future operating or financial performance. In particular, these statements include statements about our market opportunity, our growth strategy, competition, expected activities and future acquisitions, investments and the adequacy of our available cash resources. These statements may be found in the various sections of this filing, including those entitled “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” and Part II, Item 1A. “Risk Factors.” Readers are cautioned that matters subject to forward-looking statements involve known and unknown risks and uncertainties, including economic, regulatory, competitive and other factors that may cause our or our industry’s actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by these forward-looking statements. These statements are not guarantees of future performance and are subject to risks, uncertainties and assumptions.

All forward-looking statements included in this filing are based on information available to us on the date of this filing and we undertake no obligation to update or revise the forward-looking statements included in this filing, whether as a result of new information, future events or otherwise, after the date of this filing. Actual results may differ from projections or estimates due to a variety of important factors, including:

- our ability to accurately predict and effectively manage health benefits and other operating expenses;
    - competition;
    - changes in healthcare practices;
  - changes in federal or state laws or regulations, including the Patient Protection and Affordable Care Act and the Health Care and Education Affordability Reconciliation Act and any regulations enacted thereunder;
    - inflation;
    - provider contract changes;
      - new technologies;
    - reduction in provider payments by governmental payors;
      - major epidemics;
    - disasters and numerous other factors affecting the delivery and cost of healthcare;
  - the expiration, cancellation or suspension of our Medicaid managed care contracts by state governments;
    - availability of debt and equity financing, on terms that are favorable to us; and
      - general economic and market conditions.
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## PART I

## FINANCIAL INFORMATION

## ITEM 1. Financial Statements.

## CENTENE CORPORATION AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

(In thousands, except share data)

(Unaudited)

	June 30, 2010	December 31, 2009
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents of continuing operations, including \$5,154 and \$8,667, respectively, from consolidated variable interest entities	\$264,723	\$400,951
Cash and cash equivalents of discontinued operations	877	2,801
Total cash and cash equivalents	265,600	403,752
Premium and related receivables, net of allowance for uncollectible accounts of \$1,336 and \$1,338, respectively, including \$7,266 and \$11,313, respectively, from consolidated variable interest entities	164,420	103,456
Short-term investments, at fair value (amortized cost \$29,542 and \$39,230, respectively)	29,660	39,554
Other current assets, including \$3,918 and \$4,507, respectively, from consolidated variable interest entities	83,843	64,866
Current assets of discontinued operations other than cash	2,314	4,506
Total current assets	545,837	616,134
Long-term investments, at fair value (amortized cost \$522,589 and \$514,256, respectively)	537,399	525,497
Restricted deposits, at fair value (amortized cost \$20,485 and \$20,048, respectively)	20,570	20,132
Property, software and equipment, net of accumulated depreciation of \$118,995 and \$103,883, respectively, including \$138,998 and \$89,219, respectively, from consolidated variable interest entities	313,839	230,421
Goodwill	244,304	224,587
Intangible assets, net	24,589	22,479
Other long-term assets	35,557	36,829
Long-term assets of discontinued operations	11,442	26,285
Total assets	\$1,733,537	\$1,702,364
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Medical claims liability	\$455,375	\$470,932
Accounts payable and accrued expenses, including \$30,366 and \$14,020, respectively, from consolidated variable interest entities	167,613	132,001
Unearned revenue	5,695	91,644
Current portion of long-term debt	771	646
Current liabilities of discontinued operations	7,365	20,685
Total current liabilities	636,819	715,908
Long-term debt	252,028	307,085

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Other long-term liabilities	64,870	59,561
Long-term liabilities of discontinued operations	652	383
<b>Total liabilities</b>	<b>954,369</b>	<b>1,082,937</b>
<b>Commitments and contingencies</b>		
<b>Stockholders' equity:</b>		
Common stock, \$.001 par value; authorized 100,000,000 shares; 51,654,541 issued and 49,210,505 outstanding at June 30, 2010, and 45,593,383 shares issued and 43,179,373 shares outstanding at December 31, 2009	52	46
Additional paid-in capital	395,926	281,806
Accumulated other comprehensive income:		
Unrealized gain on investments, net of tax	9,400	7,348
Retained earnings	405,682	358,907
Treasury stock, at cost (2,444,036 and 2,414,010 shares, respectively)	(47,830 )	(47,262 )
Total Centene Corporation stockholders' equity	763,230	600,845
Noncontrolling interest	15,938	18,582
Total stockholders' equity	779,168	619,427
<b>Total liabilities and stockholders' equity</b>	<b>\$1,733,537</b>	<b>\$1,702,364</b>

The accompanying notes to the consolidated financial statements are an integral part of these statements.

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## CENTENE CORPORATION AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except share data)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
<b>Revenues:</b>				
Premium	\$ 1,025,928	\$ 909,698	\$ 2,025,243	\$ 1,794,704
Service	24,682	21,591	47,589	45,440
Premium and service revenues	1,050,610	931,289	2,072,832	1,840,144
Premium tax	26,162	108,180	72,661	131,760
Total revenues	1,076,772	1,039,469	2,145,493	1,971,904
<b>Expenses:</b>				
Medical costs	859,335	755,706	1,699,043	1,495,046
Cost of services	15,707	14,559	32,859	30,521
General and administrative expenses	133,470	129,221	268,977	251,500
Premium tax	26,551	108,548	73,294	132,490
Total operating expenses	1,035,063	1,008,034	2,074,173	1,909,557
Earnings from operations	41,709	31,435	71,320	62,347
<b>Other income (expense):</b>				
Investment and other income	4,142	4,418	11,199	8,031
Interest expense	(3,869)	(4,160)	(7,682)	(8,146)
Earnings from continuing operations, before income tax expense	41,982	31,693	74,837	62,232
Income tax expense	17,254	11,789	29,779	22,634
Earnings from continuing operations, net of income tax expense	24,728	19,904	45,058	39,598
Discontinued operations, net of income tax (benefit) expense of \$(90), \$(196), \$4,350 and \$(356), respectively	(226)	(485)	3,694	(934)
Net earnings	24,502	19,419	48,752	38,664
Noncontrolling interest (loss)	1,729	(811)	1,977	(24)
Net earnings attributable to Centene Corporation	\$ 22,773	\$ 20,230	\$ 46,775	\$ 38,688
<b>Amounts attributable to Centene Corporation common stockholders:</b>				
Earnings from continuing operations, net of income tax expense	\$ 22,999	\$ 20,715	\$ 43,081	\$ 39,622
Discontinued operations, net of income tax (benefit) expense	(226)	(485)	3,694	(934)
Net earnings	\$ 22,773	\$ 20,230	\$ 46,775	\$ 38,688
<b>Net earnings (loss) per common share attributable to Centene Corporation:</b>				
<b>Basic:</b>				
Continuing operations	\$ 0.46	\$ 0.48	\$ 0.89	\$ 0.92
Discontinued operations	—	(0.01)	0.08	(0.02)

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Earnings per common share	\$	0.46	\$	0.47	\$	0.97	\$	0.90
Diluted:								
Continuing operations	\$	0.45	\$	0.47	\$	0.86	\$	0.90
Discontinued operations		—		(0.01)		0.08		(0.02)
Earnings per common share	\$	0.45	\$	0.46	\$	0.94	\$	0.88
Weighted average number of shares outstanding:								
Basic		49,135,552		43,001,157		48,203,312		43,034,390
Diluted		50,866,318		44,242,339		49,807,084		44,240,071

The accompanying notes to the consolidated financial statements are an integral part of these statements.



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## CENTENE CORPORATION AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

(In thousands, except share data)

(Unaudited)

Six Months Ended June 30, 2010

	Centene Stockholders' Equity								
	Common Stock			Accumulated			Treasury Stock		
	\$ .001 Par Value Shares	Amt	Additional Paid-in Capital	Other Comprehensive Income	Retained Earnings	\$ .001 Par Value Shares	Amt	Non controlling Interest	Total
Balance, December 31, 2009	45,593,383	\$ 46	\$ 281,806	\$ 7,348	\$ 358,907	2,414,010	\$ (47,262)	\$ 18,582	\$ 619,427
Consolidation of Syncare LLC	—	—	—	—	—	—	—	219	219
Comprehensive Earnings:									
Net earnings	—	—	—	—	46,775	—	—	1,977	48,752
Change in unrealized investment gain, net of \$1,261 tax	—	—	—	2,052	—	—	—	—	2,052
Total comprehensive earnings									50,804
Common stock issued for stock offering	5,750,000	6	104,528	—	—	—	—	—	104,534
Common stock issued for employee benefit plans	311,158	—	2,198	—	—	—	—	—	2,198
Common stock repurchases	—	—	—	—	—	30,026	(568)	—	(568)
Issuance of stock warrants	—	—	296	—	—	—	—	—	296
Stock compensation expense	—	—	6,888	—	—	—	—	—	6,888
Excess tax benefits from stock compensation	—	—	210	—	—	—	—	—	210
Distributions to noncontrolling interest	—	—	—	—	—	—	—	(4,840)	(4,840)
	51,654,541	\$ 52	\$ 395,926	\$ 9,400	\$ 405,682	2,444,036	\$ (47,830)	\$ 15,938	\$ 779,168

Balance, June  
30, 2010

The accompanying notes to the consolidated financial statements are an integral part of this statement.

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## CENTENE CORPORATION AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Six Months Ended June	
	30,	
	2010	2009
Cash flows from operating activities:		
Net earnings	\$48,752	\$38,664
Adjustments to reconcile net earnings to net cash (used in) provided by operating activities:		
Depreciation and amortization	24,918	20,892
Stock compensation expense	6,888	7,611
(Gain) loss on sale of investments, net	(3,987 )	450
(Gain) on sale of UHP	(8,201 )	
Deferred income taxes	4,928	1,512
Changes in assets and liabilities:		
Premium and related receivables	(57,718 )	(23,327 )
Other current assets	948	1,357
Other assets	1,719	(608 )
Medical claims liabilities	(28,868 )	17,093
Unearned revenue	(85,950 )	44,129
Accounts payable and accrued expenses	(3,536 )	(49,377 )
Other operating activities	1,851	3,723
Net cash (used in) provided by operating activities	(98,256 )	62,119
Cash flows from investing activities:		
Capital expenditures	(63,602 )	(29,833 )
Purchases of investments	(306,124 )	(415,052 )
Proceeds from asset sales	13,420	
Sales and maturities of investments	291,735	377,320
Investments in acquisitions, net of cash acquired	(21,473 )	(7,621 )
Net cash used in investing activities	(86,044 )	(75,186 )
Cash flows from financing activities:		
Proceeds from exercise of stock options	1,759	1,109
Proceeds from borrowings	42,161	288,000
Proceeds from stock offering	104,534	
Payment of long-term debt	(97,193 )	(264,135 )
Distributions to noncontrolling interest	(4,840 )	(707 )
Excess tax benefits from stock compensation	295	15
Common stock repurchases	(568 )	(5,447 )
Debt issue costs		(368 )
Net cash provided by financing activities	46,148	18,467
Net (decrease) increase in cash and cash equivalents	(138,152 )	5,400
Cash and cash equivalents, beginning of period	403,752	379,099
Cash and cash equivalents, end of period	\$265,600	\$384,499

Supplemental disclosures of cash flow information:

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Interest paid	\$7,320	\$7,658
Income taxes paid	\$27,940	\$31,512
Supplemental disclosure of non-cash investing and financing activities:		
Contribution from noncontrolling interest	\$306	\$5,107

The accompanying notes to the consolidated financial statements are an integral part of these statements.

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CENTENE CORPORATION AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except share data)

(Unaudited)

1. Basis of Presentation

The accompanying interim financial statements have been prepared under the presumption that users of the interim financial information have either read or have access to the audited financial statements for the fiscal year ended December 31, 2009 filed on Form 10-K on February 22, 2010. The unaudited interim financial statements herein have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, footnote disclosures, which would substantially duplicate the disclosures contained in the December 31, 2009, audited financial statements, have been omitted from these interim financial statements where appropriate. In the opinion of management, these financial statements reflect all adjustments, consisting only of normal recurring adjustments, which are necessary for a fair presentation of the results of the interim periods presented.

Certain 2009 amounts in the consolidated financial statements have been reclassified to conform to the 2010 presentation. These reclassifications have no effect on net earnings or stockholders' equity as previously reported.

2. Recent Accounting Pronouncements

In June 2009, new guidance was issued related to the consolidation of variable interest entities to require an analysis to determine whether a variable interest gives the Company a controlling financial interest in a variable interest entity. This guidance requires an ongoing reassessment and eliminates the quantitative approach previously required for determining whether an entity is the primary beneficiary. This guidance was effective for fiscal years beginning after November 15, 2009, and early adoption was prohibited. The adoption of this guidance did not have an impact on the consolidated financial statements and related disclosures.

The Company has determined that all other recently issued accounting guidance will not have a material impact on its consolidated financial position, results of operations and cash flows, or do not apply to its operations.

3. Discontinued Operations: University Health Plans, Inc.

In March 2010, the Company completed the sale of certain assets of the New Jersey health plan, University Health Plans, Inc., or UHP, and recorded a pre-tax gain of \$8,201. Goodwill and intangible assets associated with the New Jersey operations disposed of as a part of the sale were \$3,720. The assets, liabilities and results of operations of UHP were classified as discontinued operations for all periods presented beginning in December 2008 and were previously reported in the Medicaid Managed Care segment. The total revenue associated with UHP included in results from discontinued operations was zero and \$35,119 for the three months ended June 30, 2010 and 2009, respectively. The total revenue associated with UHP included in results from discontinued operations was \$21,993 and \$72,086 for the six months ended June 30, 2010 and 2009, respectively. UHP had statutory capital of approximately \$10,000 at June 30, 2010, which will be transferred to unregulated cash upon receiving regulatory approval.

During the three and six months ending June 30, 2010, the Company incurred additional exit costs related to lease termination costs and employee retention programs and made related payments. In total, the Company has incurred exit costs totaling \$5,459. The change in the exit cost liability for UHP is summarized as follows:

Three Months Ended June 30,			Six Months Ended June 30, 2010		
	2010				
Employee	Lease		Employee	Lease	
Benefits	Termination	Total	Benefits	Termination	Total

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Beginning						
Balance	\$ 1,951	\$ 1,136	\$ 3,087	\$ 2,726	\$ 267	\$ 2,993
Incurred	—	—	—	73	1,136	1,209
Paid	(559 )	(67 )	(626 )	(1,407 )	(334 )	(1,741 )
Ending						
Balance	\$ 1,392	\$ 1,069	\$ 2,461	\$ 1,392	\$ 1,069	\$ 2,461

#### 4. Acquisitions

In June 2010, the Company acquired certain assets of Carolina Crescent Health Plan, South Carolina's largest non-profit Medicaid managed care organization. The Company paid \$16,949 in cash and recorded \$1,044 of contingent consideration, subject to adjustment. Goodwill of \$14,394 and other identifiable intangible assets of \$3,599 were recorded in the Medicaid Managed Care segment.

#### 5. Variable Interest Entities

##### Centene Center, LLC

In June 2009, the Company executed an agreement as a 50% joint venture partner in a real estate development entity, Centene Center LLC, or Centene Center, associated with the construction of a real estate development to include the Company's corporate headquarters. Centene Center is a variable interest entity, or VIE, and the Company concluded it was the primary beneficiary. Accordingly, the Company's consolidated financial statements include the accounts of Centene Center.

As part of financing the real estate development, Centene Center executed a \$95,000 construction loan due June 1, 2011, which may be extended for two additional one year terms. The Company and its development partner have guaranteed up to \$65,000 each associated with this construction loan until substantial completion of the real estate development when the guarantee is reduced to 50% of the outstanding loan balance. As of June 30, 2010, \$61,719 was outstanding under this loan and Centene Center has capitalized \$1,089 of interest in 2010.

##### Access Health Solutions, LLC

The Company maintains a 49% ownership interest in Access Health Solutions, LLC, or Access, a Medicaid managed care entity in Florida. The Company also has rights to acquire the remaining assets and ownership interests in Access. As a result of these rights, the Company determined that Access is a VIE and the Company is the primary beneficiary. The Company records its investment in Access as a consolidated subsidiary in its financial statements.

##### Syncare, LLC

During the first quarter of 2010, one of the Company's employees became the owner of Syncare, LLC, or Syncare, a disease management company providing services to private and public insurers. Additionally, the Company is a guarantor on a \$300 loan that was utilized to purchase the business and is a guarantor of Syncare's \$100 business loan. As a result, the Company determined that Syncare, LLC is a VIE and the Company is the primary beneficiary. The Company has presented Syncare as a consolidated entity effective February 1, 2010.

#### Summary

The carrying amounts of the consolidated assets and liabilities related to the Company's interests in Centene Center, Access and Syncare, are as follows:

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	June 30, 2010	December 31, 2009
Cash and cash equivalents	\$ 5,154	\$ 8,667
Premium and related receivables	7,266	11,313
Other current assets	3,918	4,507
Property, software and equipment	138,998	89,219
Accounts payable and accrued expenses	\$ 30,366	\$ 14,020
Long-term debt	61,819	32,559

The assets of each VIE can only be used to settle obligations of each respective VIE. With respect to the long-term debt balances, creditors have recourse to the Company through the guarantees discussed above.

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## 6. Investments and Restricted Deposits

Short-term and long-term investments and restricted deposits by investment type consist of the following:

	June 30, 2010				December 31, 2009			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury securities	\$ 29,211	\$ 564	\$ —	\$ 29,775	\$ 27,080	\$ 213	\$ (5 )	\$ 27,288
Corporate securities	187,763	3,137	(28 )	190,872	165,720	581	(940 )	165,361
State and municipal securities	320,699	11,095	(22 )	331,772	333,955	11,628	(31 )	345,552
Cost method investments and equity securities	7,862	—	—	7,862	9,751	312	(170 )	9,893
Reserve Primary fund	—	—	—	—	2,444	—	—	2,444
Life insurance contracts	14,241	—	—	14,241	14,650	—	—	14,650
Asset backed securities	12,840	267	—	13,107	19,934	61	—	19,995
<b>Total</b>	<b>\$ 572,616</b>	<b>\$ 15,063</b>	<b>\$ (50 )</b>	<b>\$ 587,629</b>	<b>\$ 573,534</b>	<b>\$ 12,795</b>	<b>\$ (1,146)</b>	<b>\$ 585,183</b>

The Company's investments are classified as available for sale with the exception of life insurance contracts and certain cost method investments. The Company's investment policies are designed to provide liquidity, preserve capital and maximize total return on invested assets with the focus on high credit quality securities rated A or higher. Additionally, the Company limits the size of investment in any single issuer.

The Company monitors investments for other than temporary impairment. Certain investments have experienced a decline in fair value due to changes in credit quality, market interest rates and/or general economic conditions. Based on management's intent and ability to hold these investments until their anticipated recovery, no other than temporary impairment has been recorded. Investments in a gross unrealized loss position are as follows:

	June 30, 2010				December 31, 2009			
	Less Than 12 Months Unrealized Losses	12 Months or More Fair Value	12 Months or More Unrealized Losses	12 Months or More Fair Value	Less Than 12 Months Unrealized Losses	12 Months or More Fair Value	12 Months or More Unrealized Losses	12 Months or More Fair Value
U.S. Treasury securities	\$ —	\$ —	\$ —	\$ —	\$ (5 )	\$ 785	\$ —	\$ —
Corporate securities	(28 )	8,289						