HEALTHWAYS, INC
Form 10-K
March 15, 2013

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

FORM 10-K

[X] Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the Fiscal Year Ended December 31, 2012

or

[ ] Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission file number 000-19364

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

Delaware (State or other jurisdiction of incorporation or organization)	62-1117144 (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)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock - $.001 par value, and related Preferred Stock Purchase Rights	The NASDAQ Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act:
None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes ¨ No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act.

Yes ¨ No x

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 ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, 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 x No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

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.

Large accelerated filer ¨ Accelerated filer x Non-accelerated filer ¨ Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes ¨ No x

As of June 30, 2012, the last business day of the registrant's most recently completed second fiscal quarter, the aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant was approximately $257.2 million based on the price at which the shares were last sold for such date on The NASDAQ Stock Market.

As of March 8, 2013, 34,113,451 shares of Common Stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Proxy Statement for the Annual Meeting of Stockholders to be held May 30, 2013 are incorporated by reference into Part III of this Form 10-K.

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PART I.

Item 1. Business

Overview

Founded in 1981, Healthways, Inc. ("Healthways") provides specialized, comprehensive solutions to help people improve their physical, emotional and social well-being, thereby improving their health and productivity and reducing their health-related costs.

We provide highly specific and personalized interventions for each individual in a population, irrespective of health status, age or payor. We utilize predictive modeling capabilities to allow us to identify and stratify those participants who are most at risk for an adverse health event. Our evidence-based well-being improvement services are made available to consumers using a range of methods desired by an individual including venue-based face-to-face interactions; print; phone; mobile and remote devices; on-line; emerging modalities; and any combination thereof to motivate and sustain healthy behaviors.

In North America, our customers include health plans, employers, integrated healthcare systems, hospitals, physician groups, and government entities in all 50 states and the District of Columbia. We also provide services to commercial healthcare businesses and/or government entities in Brazil, Australia and France. We operate domestic and international well-being improvement call centers staffed with licensed health professionals. Our fitness center network encompasses approximately 15,000 U.S. locations. We also maintain an extensive network of over 88,000 complementary, alternative and physical medicine practitioners, which offers convenient access to the significant number of individuals who seek health services outside of the traditional healthcare system.

Our guiding philosophy and approach to market is predicated on the fundamental belief that healthier people cost less and are more productive. As described more fully below, our programs are designed to improve well-being by helping people adopt or maintain healthy behaviors, reduce health-related risk factors, and optimize their care for identified health conditions.

First, our programs are designed to help people adopt or maintain healthy behaviors by:

- fostering wellness and disease prevention through total population screening, well-being assessments and supportive interventions; and
- engaging people in our health improvement programs and networks, such as fitness, weight management, chiropractic, and complementary and alternative medicine.

Our prevention programs focus on education, physical fitness, health coaching, and behavior change techniques and support. We believe this approach improves the well-being status of member populations and reduces the short- and long-term health-related costs for participants, including associated costs from the loss of employee productivity.

Second, our programs are designed to help people reduce health-related risk factors by:

- promoting personal change and improvement in the lifestyle behaviors that lead to poor health or chronic conditions; and
- providing educational materials and personal interactions with highly trained nurses and other healthcare professionals to create and sustain healthier behaviors for those individuals at-risk or in the early stages of chronic conditions.

We enable our customers to engage their covered populations through specific interactions that are sensitive to each individual's health risks and needs. Our programs are designed to motivate people to make positive lifestyle changes and accomplish individual goals, such as increasing physical activity for seniors through the Healthways SilverSneakers® fitness solution, overcoming nicotine addiction through the QuitNet® on-line smoking cessation community, or generating sustainable weight-loss through our Innergy® solution.

Finally, our programs are designed to help people optimize care for identified health conditions by:

- incorporating the latest, evidence-based clinical guidelines into interventions to optimize patient health outcomes;
- developing care support plans and motivating members to set attainable goals for themselves;
- providing local market resources to address acute episodic interventions;
- coordinating members' care with their healthcare providers;
- providing software licensing and management consulting in support of well-being improvement services; and
- providing high-risk care management for members at risk for hospitalization due to complex conditions.

Our approach is to use proprietary, analytic models to identify individuals who are likely to incur future high costs, including those who have specific gaps in care, and through evidence-based interventions drive adherence to proven standards of care, medication regimens and physicians' plans of care to reduce disease progression and related medical spending.

We recognize that each individual plays a variety of roles in his or her pursuit of improved well-being, often simultaneously. By providing the full spectrum of services to meet each individual's needs, we believe our interventions can be delivered at scale and in a manner that reflects those unique needs over time. We believe that real and sustainable behavior change generates measurable, long-term cost savings and improved individual and business performance.

Customer Contracts

Our fees are generally billed on a per member per month ("PMPM") basis or upon member participation. For PMPM fees, we generally determine our contract fees by multiplying the contractually negotiated PMPM rate by the number of members covered by our services during the month. We typically set PMPM rates during contract negotiations with customers based on the value we expect our programs to create and a sharing of that value between the customer and the Company. In addition, some of our services, such as the Healthways SilverSneakers fitness solution, include fees that are based upon member participation.

Our contracts with health plans and integrated healthcare systems generally range from three to five years with a number of comprehensive strategic agreements extending up to ten years in length. Contracts with self-insured employers typically have two to four-year terms. Some of our contracts allow the customer to terminate early.

Some of our contracts place a portion of our fees at risk based on achieving certain performance metrics, cost savings, and/or clinical outcomes improvements ("performance-based"). Approximately 7% of revenues recorded during the year ended December 31, 2012 were performance-based and were subject to final reconciliation as of December 31, 2012.

Technology

Our solutions require sophisticated analytical, data management, Internet and computer-telephony solutions based on state-of-the-art technology. These solutions help us deliver our services to large populations within our customer base. Our predictive modeling capabilities allow us to identify and stratify those participants who are most at risk for an adverse health event. We incorporate behavior-change science with consumer-friendly interactions to facilitate consumer preferences for engagement and convenience. We use sophisticated data analytical and reporting solutions to validate the impact of our programs on clinical and financial outcomes. We continue to invest heavily in technology, as evidenced by our long-term applications and technology services outsourcing agreement with HP Enterprise Services, LLC, and are continually expanding and improving our proprietary clinical, data management, and reporting systems to continue to meet the information management requirements of our services. The behavior change techniques and predictive modeling incorporated in our technology identify an individual's readiness to change and provide personalized support through appropriate interactions using a range of methods desired by an individual, including venue-based face-to-face; print; phone; mobile and remote devices; on-line; emerging modalities; and any combination thereof to motivate and sustain healthy behaviors.

Backlog

Backlog represents the estimated average annualized revenue at target performance over the term of the contract for business awarded but not yet started at December 31, 2012. Annualized revenue in backlog as of December 31, 2012 and 2011 was as follows:

(In thousands)	December 31, 2012	December 31, 2011
Annualized revenue in backlog	$ 39,000	$ 29,400

Business Strategy

The World Health Organization defines health as "…not only the absence of infirmity and disease, but also a state of physical, mental, and social well-being."

Our business strategy reflects our passion to enhance well-being and, as a result, reduce overall healthcare costs and improve workforce engagement, yielding better business performance for our customers. Our solutions are designed to improve well-being by helping people to:

- adopt or maintain healthy behaviors;
- reduce health-related risk factors; and
- optimize care for identified health conditions.

Through our solutions, we work to optimize the well-being of entire populations, one person at a time, domestically and internationally, thereby creating value by reducing overall healthcare costs and improving productivity and performance for individuals, families, health plans, governments, employers, integrated healthcare systems and communities.

We believe it is critical to impact an entire population's well-being and underlying health status in a long-term, cost effective way. Believing that what gets measured gets acted upon, in 2008, we entered into an exclusive, 25-year relationship with Gallup to create a definitive measure and empiric database of changes in the well-being of the U.S. population, known as the Gallup-Healthways Well-Being Index® ("WBI"), as well as processes to establish benchmarking for purposes of comparing the well-being of any subset of the national population. The responses to the over 1.8 million completed WBI surveys to date have provided Gallup and us with an unmatched database to support our mutual goal of understanding the causes and effects of well-being for a population. In October 2012, we created a global joint venture with Gallup that will develop the next generation of Gallup-Healthways individual well-being assessment tools to provide employers, health providers, insurers and other interested parties with validated tools to assess, measure and report on changes in the well-being of their employees, patients, members and customers. In addition, Gallup will incorporate well-being into the construct of its World Poll to aid in satisfying a growing global interest in gaining clear insights for government and business leaders charged with shaping the policy responses necessary to improve health, increase individual and organizational performance, lower healthcare costs and achieve sustained economic growth.

To enhance well-being within their respective populations, our current and prospective customers require solutions that focus on the underlying drivers of healthcare demand, address worsening health status, reverse or slow unsustainable cost trends, foster healthy behaviors, mitigate health risk factors, and manage chronic conditions. Our strategy is to deliver programs that engage individuals and help them enhance their well-being and underlying health status regardless of their starting point. We believe we can achieve well-being improvements in a population that generate significant cost savings and increases in productivity by providing effective programs that support the individual throughout his or her well-being journey.

Our strategy includes, as a priority, the ongoing expansion of our value proposition through our total population management capabilities. We continue to enhance our well-being improvement solutions to extend our reach and effectiveness and to meet increasing demand for integrated solutions. The flexibility of our programs allows customers to provide a range of services they deem appropriate for their organizations. Customers may select from certain single program options up to a total-population approach, in which all members of a customer's population are eligible to receive our services. Contracts signed in 2011 and 2012 have expanded both the level of integration and breadth of services provided to major health plans as they develop and implement a number of patient-centered medical home models. Our services extend beyond chronic care and wellness programs to include care management and pharmacy benefit management, as well as health promotion, prevention and quality improvement solutions.

Significant changes in government regulation of healthcare continue to afford us expanding opportunities to provide services to integrated healthcare systems, hospitals, and physicians in addition to health plans and employers. In 2011, we acquired Navvis & Company ("Navvis"), a well-established provider of strategic counsel and change management services enabling its healthcare system clients to become future-ready clinical enterprises within healthcare's rapidly emerging value-based reimbursement system. Our strategy includes providing integrated healthcare systems, hospitals, and physician enterprises with both consultative strategic planning services and a range of capabilities that enable and support the delivery of Physician-Directed Population Health solutions. During 2012, we signed and began implementing the first set of contracts with integrated healthcare systems to provide these services.

Self-insured employers continue to demand services that focus across the entire population of employees and their dependent family members. Our well-being improvement solution, in addition to improving individuals' health and reducing direct healthcare costs, targets a much larger improvement in employer profitability by reducing the impact of productivity lost for health-related reasons. With the success of our work aimed at total population management, we expect to gain an even greater competitive advantage in responding to employers' needs for a healthier, higher-performing and less costly workforce.

Our strategy also includes the further enhancement and deployment of our proprietary technology platform known as Embrace®. This platform, which is essential to our total population management solution, enables us to integrate data from the healthcare organizations and other entities interacting with an individual. Embrace provides for the delivery of our integrated solutions and ongoing communications between the individual and his or her medical and health experts, using a range of methods, including venue-based face-to-face; print; phone; mobile and remote devices; on-line; emerging modalities; and any combination thereof.

We plan to increase our competitive advantage in delivering our services by leveraging the scope of our capabilities, including our medical information content, behavior change processes and techniques, strategic relationships, health provider networks, and fitness center relationships. We also plan to continue to scale the delivery of our solutions employing a blend of our scalable, state-of-the-art well-being improvement call centers and proprietary technologies, modalities, and techniques. We may add new capabilities and technologies through internal development, strategic alliances with other entities, and/or selective acquisitions or investments. Examples include our collaboration with Blue Zones, LLC in delivering a scaled well-being improvement solution to support the "Healthiest State" initiative in Iowa; our investment in our wholly-owned subsidiary MeYou Health, LLC in bringing to market well-being improvement tools in the social media space through Internet and personal device delivery methods; and our expanded strategic relationship with Johns Hopkins Medicine to commercialize the sustained weight loss program Innergy resulting from a three-year clinical trial conducted by the National Heart, Lung and Blood Institute.

We will continue to enhance, expand and integrate additional capabilities with health plans, integrated healthcare systems, employers, domestic government entities, and communities, as well as the public and private sectors of healthcare in international markets.

Segment and Major Customer Information

We have aggregated our operating segments into one reportable segment, well-being improvement services. During 2012, Humana, Inc. ("Humana") comprised approximately 11.5% of our revenues. No other customer accounted for 10% or more of our revenues in 2012.

Competition

The healthcare industry is highly competitive and subject to continual change in the manner in which services are provided. Other entities, whose financial, research, staff, and marketing resources may exceed our resources, are marketing a variety of population health improvement services and other services to health plans, integrated healthcare systems, self-insured employers, and government entities, or have announced an intention to offer such services. These entities include disease management companies, health and wellness companies, retail drug stores, major pharmaceutical companies, health plans, healthcare organizations, providers, pharmacy benefit management companies, medical device and diagnostic companies, healthcare information technology companies, Internet-based medical content companies, revenue cycle management companies, and other entities that provide services to health plans, self-insured employers, integrated health systems, and government entities.

We believe we have advantages over our competitors because of the breadth and depth of our well-being improvement capabilities, including our scope of strategic relationships, state-of-the-art well-being improvement call center technology linked to our proprietary information technology, predictive modeling capabilities, behavior-change techniques, the comprehensive recruitment and training of our clinical colleagues, our experienced management team, the comprehensive clinical nature of our product offerings, our established reputation for providing well-being improvement services to members with health risk factors or chronic diseases, and the proven financial and clinical outcomes of our programs. However, we cannot assure you that we can compete effectively with other companies such as those noted above.

Industry Integration and Consolidation

Consolidation has been an important factor in all aspects of the healthcare industry, including the well-being and health management sector. While we believe the size of our membership base provides us with the economies of scale to compete even in a consolidating market, we cannot assure you that we can effectively compete with companies formed as a result of industry consolidation or that we can retain existing health plan, integrated healthcare system, or employer customers if they are acquired by other entities which already have programs similar to ours or are not interested in our programs.

In March 2010, President Obama signed the Patient Protection and Affordable Care Act, as amended by the Health Care and Education Reconciliation Act of 2010 (collectively, “PPACA”), into law. PPACA required the U.S. Department of Health & Human Services (“HHS”) to establish a Medicare Shared Savings Program that promotes accountability and coordination of care among providers through the creation of Accountable Care Organizations (“ACOs”). The program allows providers, including hospitals, physicians, and other designated professionals, to form ACOs and voluntarily work together to invest in infrastructure and redesign delivery processes to achieve high quality and efficient delivery of services. We have begun to provide support and services for multiple ACOs that serve Medicare Fee-for-Service beneficiaries through our partnerships with integrated health systems. Further, PPACA required HHS to establish voluntary national bundled payment programs under which participating groups of providers receive a single payment for certain medical conditions or episodes of care. While ACOs and bundled payments are Medicare programs under PPACA, commercial insurers and private managed care health plans may increasingly shift to ACO and bundled payment models as well. We expect these and other changes resulting from PPACA to further encourage integration and increase consolidation in the healthcare industry.

Governmental Regulation

Governmental regulation impacts us in a number of ways in addition to those regulatory risks presented under Item 1A. “Risk Factors” below.

Patient Protection and Affordable Care Act

PPACA changes how healthcare services are covered, delivered, and reimbursed through, among other things, significant reductions in the growth of Medicare program payments. In addition, PPACA reforms certain aspects of health insurance, expands existing efforts to tie Medicare and Medicaid payments to performance and quality, and contains provisions intended to strengthen fraud and abuse enforcement. PPACA contains provisions that have, and will continue to have, an impact on our customers, including commercial health plans and Medicare Advantage programs. On June 28, 2012, the U.S. Supreme Court upheld the constitutionality of the individual mandate provisions of the Health Reform Law but struck down the provisions that would have allowed HHS to penalize states that do not implement the Medicaid expansion provisions with the loss of existing federal Medicaid funding.

Among other things, PPACA seeks to decrease the number of uninsured individuals and expand coverage through the expansion of public programs and private sector health insurance as well as a number of health insurance market reforms. In addition, PPACA contains several provisions that encourage utilization of preventive services and wellness programs, such as those we provide. However, PPACA also contains various provisions that directly affect the customers or prospective customers that contract for our services and may increase their costs and/or reduce their revenues. For example, PPACA prohibits commercial health plans from using gender, health status, family history, or occupation to set premium rates, eliminates pre-existing condition exclusions, and bans annual benefit limits. In addition, PPACA mandates minimum medical loss ratios ("MLRs") for health plans such that the percentage of health coverage premium revenue spent on healthcare medical costs and quality improvement expenses be at least 80% for individual and small group health plans and 85% for large group coverage and Medicare Advantage plans, with policyholders receiving rebates, and the Centers for Medicare and Medicaid Services ("CMS") receiving refunds in the case of Medicare Advantage plans, if the actual loss ratios fall below these minimums. The MLR requirements were implemented beginning in January 2011 for commercial plans and will begin in 2014 for Medicare Advantage plans.

Changes in laws governing reimbursement to health plans providing services under governmental programs such as Medicare and Medicaid may affect us. PPACA will impact Medicare Advantage programs in a variety of ways. PPACA reduces premium payments to Medicare Advantage plans such that the managed care per capita payments paid by CMS to Medicare Advantage plans are, on average, equal to those for traditional Medicare. While PPACA will award bonuses to Medicare Advantage plans that achieve service benchmarks and quality ratings, overall payments to Medicare Advantage plans are expected to be significantly reduced under PPACA. The impact of these reductions on the Company's business is not yet clear.

It is difficult to predict with any reasonable certainty the full impact of PPACA on the Company due to the law's complexity, lack of implementing regulations or interpretive guidance, gradual and potentially delayed implementation, remaining or new court challenges, and possible amendment or repeal.

Other Laws

While many of the governmental and regulatory requirements affecting healthcare delivery generally do not directly apply to us, our customers must comply with a variety of regulations including Medicare Advantage marketing and other restrictions, the licensing and reimbursement requirements of federal, state and local agencies and the requirements of municipal building codes and health codes. Certain of our services, including health service utilization management and certain claims payment functions, require licensure by government agencies. We are subject to a variety of legal requirements in order to obtain and maintain such licenses.

Certain of our professional healthcare employees, such as nurses, must comply with individual licensing requirements. All of our healthcare professionals who are subject to licensing requirements are licensed in the state in which they are physically present, such as the professionals located at a well-being improvement call center. Multiple state licensing requirements for healthcare professionals who provide services telephonically over state lines may require some of our healthcare professionals to be licensed in more than one state. We continually monitor legislative, regulatory and judicial developments in telemedicine in order to stay in compliance with state and federal laws; however, new agency interpretations, federal or state legislation or regulations, or judicial decisions could increase the requirement for multi-state licensing of all well-being improvement call center health professionals, which would increase our costs of services.

Federal privacy regulations issued pursuant to the Health Insurance Portability and Accountability Act of 1996 ("HIPAA") extensively restrict the use and disclosure of individually-identifiable health information by health plans, most healthcare providers, and certain other entities (collectively, "covered entities"). Federal security regulations issued pursuant to HIPAA require covered entities to implement and maintain administrative, physical and technical safeguards to protect the confidentiality, integrity and availability of electronic individually-identifiable health information. We are required to comply with certain aspects of the HIPAA privacy and security regulations as a result of the American Recovery and Reinvestment Act of 2009 ("ARRA"), the services we provide, and our customer contracts. ARRA extends the application of certain provisions of the security and privacy regulations to business associates (entities that handle individually-identifiable health information on behalf of covered entities) and subjects business associates to civil and criminal penalties for violation of the regulations. On January 17, 2013, HHS released a final rule that implements many of these ARRA provisions and becomes effective March 26, 2013. The final rule subjects business associates and their subcontractors to direct liability under the HIPAA privacy and security regulations and will likely require amendments to existing agreements with business associates and with subcontractors of business associates. Covered entities and business associates must comply with the final rule by September 23, 2013, except that existing agreements may qualify for an extended compliance date of September 22, 2014.

We may be subject to civil and criminal penalties for violations of HIPAA and its implementing regulations. ARRA significantly increased the civil penalties for violations, with penalties of up to $50,000 per violation for a maximum civil penalty of $1.5 million in a calendar year for violations of the same requirement. In addition, we may be contractually or directly obligated to comply with any applicable state laws or regulations related to the confidentiality and security of confidential personal information. In the event of a data breach involving individually-identifiable health information, we are subject to contractual obligations and state and federal requirements that may require us to notify our customers or individuals affected by the breach. These requirements may also require us or our customers to notify regulatory agencies and the media of the data breach. In addition, the recently issued ARRA regulations create a presumption that non-permitted uses and disclosures of unsecured individually identifiable health information constitute breaches for which notice is required, unless it can be demonstrated that there is a low probability the information has been compromised.

Federal law contains various prohibitions related to false statements and false claims, some of which apply to private payors as well as federal programs. Actions may be brought under the federal False Claims Act by the government as well as by private individuals, known as "whistleblowers," who are permitted to share in any settlement or judgment.

There are many potential bases for liability under the False Claims Act. Liability under the False Claims Act arises when an entity knowingly submits a false claim for reimbursement to the federal government, and the False Claims Act defines the term "knowingly" broadly. In some cases, whistleblowers, the federal government, and some courts have taken the position that entities that allegedly have violated other statutes, such as the "fraud and abuse" provisions of the Social Security Act, have thereby submitted false claims under the False Claims Act. From time to time, participants in the healthcare industry, including our company and our customers, may be subject to actions under the False Claims Act, and it is not possible to predict the impact of such actions.

Employees

As of March 1, 2013, we had approximately 2,400 employees. Our employees are not subject to any collective bargaining agreements. We believe we have good relationships with our employees.

Available Information

Our Internet address is www.healthways.com. We make available free of charge, on or through our Internet website, our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission (the "SEC"). The public may read and copy any materials that we file with the SEC at the SEC's Public Reference Room at 100 F Street NE, Room 1580, NW, Washington DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC at www.sec.gov.

Item 1A. Risk Factors

In the execution of our business strategy, our operations and financial condition are subject to certain risks. A summary of certain material risks is provided below, and you should take such risks into account in evaluating any investment decision involving the Company. This section does not describe all risks applicable to us and is intended only as a summary of certain material factors that could impact our operations in the industry in which we operate. Other sections of this Annual Report on Form 10-K (this "Report") contain additional information concerning these and other risks.

We depend on payments from customers, and cost reduction pressure on our customers may adversely affect our business and results of operations.

The healthcare industry in which we operate currently faces significant cost reduction pressures as a result of increased competition, constrained revenues from governmental and private revenue sources, increasing underlying medical care costs, and general economic conditions. We believe that these pressures will continue and possibly intensify.

We believe that our solutions, which are geared to foster well-being improvement by engaging people in health improvement programs, specifically assist our customers in controlling the high costs of healthcare; however, the pressures to reduce costs in the short term may negatively affect our ability to sign and/or retain contracts under existing terms or to restructure these contracts on terms that would not have a material negative impact on our results of operations. These financial pressures could have a negative impact on our results of operations.

A significant percentage of our revenues is derived from health plan customers.

A significant percentage of our revenues is derived from health plan customers. The health plan industry continues to undergo a period of consolidation, and we cannot assure you that we will be able to retain health plan customers if they are acquired by other health plans that already participate in competing programs or are not interested in our programs. In addition, a reduction in the number of covered lives enrolled with our health plan customers or a decision by our health plan customers to take programs in-house could adversely affect our results of operations. Our health plan customers are subject to increased obligations under PPACA, including new benefit mandates, limitations on exclusions and factors used for rate setting, requirements for MLRs and increased taxes. In determining how to meet these requirements, health plan customers or prospective customers may seek reduced fees or choose to reduce or delay the purchase of our services.

In addition, PPACA mandates the establishment of American Health Benefit Exchanges ("Exchanges"), which must be fully operational by January 1, 2014. PPACA requires that each state establish or participate in an Exchange where individuals may compare and purchase health insurance. Health plans participating in an Exchange must offer a set of minimum benefits and may elect to offer additional benefits. Chronic disease management is classified as a minimum essential health benefit, but the parameters of the chronic disease management benefit are not yet defined by regulation. It is possible that our services will not qualify under this definition. We cannot predict whether individuals who are currently receiving our services will switch to health plans offered through the Exchanges that do not include our services. If we are unable to provide services to health plans participating in Exchanges, if health plans in the Exchanges that engage our services are not successful or if the Exchanges otherwise reduce the number of members receiving our services or the payments we receive, our results of operations could be negatively impacted.

We currently derive a significant percentage of our revenues from one customer.

Because of the size of its membership, Humana comprised approximately 11.5% of our revenues in 2012. Our primary contract with Humana continues through 2016. The loss of, or the restructuring of a contract with, this or other large customers could have a material adverse effect on our business and results of operations. No other customer accounted for 10% or more of our revenues in 2012.

Our business strategy is dependent in part on developing new and additional products to complement our existing services, as well as establishing additional distribution channels through which we may offer our products and services.

Our strategy focuses on helping people adopt or maintain healthy behaviors, reducing health-related risk factors, and optimizing care for identified health conditions. While we have considerable experience in solutions for a broad range of health conditions, any new or modified programs will involve inherent risks of execution, such as our ability to implement our programs within expected timelines or cost estimates; our ability to obtain adequate financing to provide the capital that may be necessary to support our operations and to support or guarantee our performance under new contracts; and our ability to deliver outcomes on any new products or services. In addition, as part of our business strategy, we may enter into relationships to establish additional distribution channels through which we may offer our products and services. As we offer products through new or alternative distribution channels, we may face difficulties, such as potential customer overlap that may lead to pricing conflicts, which may adversely affect our business.

Failure to successfully execute on the terms of our contracts could result in significant harm to our business.

Our ability to grow and expand our business is contingent upon our ability to achieve desired performance metrics, cost savings, and/or clinical outcomes improvements under our existing contracts and to favorably resolve contract billing and interpretation issues with our customers. Some of our contracts place a portion of our fees at risk based on achieving such metrics, savings, and/or improvements. We cannot guarantee that we will achieve and reach mutual agreement with customers with respect to contractually required performance metrics, cost savings and/or clinical outcomes improvements under our contracts within the expected time frames. Unusual and unforeseen patterns of healthcare utilization by individuals with diseases or conditions for which we provide services could adversely affect our ability to achieve desired performance metrics, cost savings, and clinical outcomes. Our inability to meet or exceed the targets under our customer contracts could have a material adverse effect on our business and results of operations. Also, our ability to provide financial guidance with respect to performance-based contracts is contingent upon our ability to accurately forecast variables that affect performance and the timing of revenue recognition under the terms of our contracts ahead of data collection and reconciliation.

In addition, certain of our contracts are increasing in complexity, requiring integration of data, systems, people, programs and services, the execution of sophisticated business activities, and the delivery of a broad array of services to large numbers of people who may be geographically dispersed. The failure to successfully manage and execute the terms of these agreements could result in the loss of fees and/or contracts and could adversely affect our business and results of operations.

We depend on the timely receipt of accurate data from our customers and our accurate analysis of such data.

Identifying which members may benefit from receiving our services and measuring our performance under our contracts are highly dependent upon the timely receipt of accurate data from our customers and our accurate analysis of such data. Data acquisition, data quality control and data analysis are complex processes that carry a risk of untimely, incomplete or inaccurate data from our customers or flawed analysis of such data, which could have a material adverse effect on our ability to recognize revenues.

Our ability to achieve estimated annualized revenue in backlog is based on certain estimates.

Our ability to achieve estimated annualized revenue in backlog in the manner and within the timeframe we expect is based on certain estimates regarding the implementation of our services. We cannot assure you that the amounts in backlog will ultimately result in revenues in the manner and within the timeframe we expect.

Changes in macroeconomic conditions may adversely affect our business.

Economic difficulties and other macroeconomic conditions could reduce the demand and/or the timing of purchases for certain of our services from customers and potential customers. A loss of a significant customer or a reduction in a customer's enrolled lives could have a material adverse effect on our business and results of operations. In addition, changes in economic conditions could create liquidity and credit constraints. We cannot assure you that we would be able to secure additional financing if needed and, if such funds were available, whether the terms or conditions would be acceptable to us.

The expansion of our services into international markets subjects us to additional business, regulatory and financial risks.

We provide health improvement programs and services in Brazil, Australia and France, and we intend to continue expanding our international operations as part of our business strategy. We have incurred and expect to continue to incur costs in connection with pursuing business opportunities in international markets. Our success in the international markets will depend in part on our ability to anticipate the rate of market acceptance of our solutions and the individual market dynamics and regulatory requirements in potential international markets. Because the international market for our services is relatively immature and also involves many new solutions, there is no guarantee that we will be able to achieve the necessary cost savings and clinical outcomes improvements under our contracts with international customers within the expected time frames and reach mutual agreement with customers with respect to those outcomes. The failure to accurately forecast the costs necessary to implement our strategy of establishing a presence in these markets could have a material adverse effect on our business.

In addition, as a result of doing business in foreign markets, we are subject to a variety of risks which are different from or additional to the risks we face within the United States. Our future operating results in these countries or in other countries or regions throughout the world could be negatively affected by a variety of factors which are beyond our control. These factors include political conditions, economic conditions, legal and regulatory constraints, currency regulations, and other matters in any of the countries or regions in which we operate, now or in the future. In addition, foreign currency exchange rates and fluctuations may have an impact on our future costs or on future cash flows from our international operations, and could adversely affect our financial performance. Other factors which may impact our international operations include foreign trade, monetary and fiscal policies both of the United States and of other countries, laws, regulations and other activities of foreign governments, agencies and similar organizations. Additional risks inherent in our international operations generally include, among others, the costs and difficulties of managing international operations, adverse tax consequences and greater difficulty in enforcing intellectual property rights in countries other than the United States.

We may experience difficulties associated with the implementation and/or integration of new businesses, services (including outsourced services), or technologies.

We may face substantial difficulties, costs and delays in effectively implementing and/or integrating acquired businesses, services (including outsourced services), or technologies into our platform. Implementing internally-developed solutions and/or integrating newly acquired businesses, services (including outsourced services), and technologies could be costly and time-consuming and may strain our resources. Consequently, we may not be successful in implementing and/or integrating these new businesses, services, or technologies and may not achieve anticipated revenue and cost benefits.

The performance of our business and the level of our indebtedness could prevent us from meeting the obligations under our debt agreement or have an adverse effect on our future financial condition, our ability to raise additional capital, or our ability to react to changes in the economy or our industry.

On June 8, 2012, we entered into the Fifth Amended and Restated Revolving Credit and Term Loan Agreement (the "Fifth Amended Credit Agreement"), which was amended on February 5, 2013. As of December 31, 2012, our long-term debt, including the current portion, was $287.6 million.

Our ability to service our indebtedness will depend on our ability to generate cash in the future. We cannot assure you that our business will generate sufficient cash flow from operations or that future borrowings will be available in an amount sufficient to enable us to service our indebtedness or to fund other liquidity needs.

The Fifth Amended Credit Agreement contains various financial covenants, restricts the payment of dividends, and limits the amount of repurchases of our common stock. A breach of any of these covenants could result in a default under the Fifth Amended Credit Agreement, in which all amounts outstanding under the Fifth Amended Credit Agreement may become immediately due and payable, and all commitments under the Fifth Amended Credit Agreement to extend further credit may be terminated.

Our indebtedness could have a material adverse effect on our future financial condition or our ability to react to changes in the economy or industry by, among other things:

- increasing our vulnerability to a downturn in general economic conditions, loss of revenue and/or profit margins in our business, or to increases in interest rates, particularly with respect to the portion of our outstanding debt that is subject to variable interest rates;
- potentially limiting our ability to obtain additional financing or to obtain such financing on favorable terms;
- causing us to dedicate a portion of future cash flow from operations to service or pay down our debt, which reduces the cash available for other purposes, such as operations, capital expenditures, and future business opportunities; and
- possibly limiting our ability to adjust to changing market conditions and placing us at a competitive disadvantage compared to our competitors who may be less leveraged.

We have a significant amount of goodwill and intangible assets, the value of which could become impaired.

We have recorded significant portions of the purchase price of certain acquisitions as goodwill and/or intangible assets. At December 31, 2012, we had approximately $338.7 million and $90.2 million of goodwill and intangible assets, respectively. We review goodwill and intangible assets not subject to amortization for impairment on an annual basis (during the fourth quarter) or more frequently whenever events or circumstances indicate that the carrying value may not be recoverable. If we determine that the carrying values of our goodwill and/or intangible assets are impaired, we may incur a non-cash charge to earnings, which could have a material adverse effect on our results of operations for the period in which the impairment occurs.

A failure of our information systems could adversely affect our business.

Our ability to deliver our services depends on effectively using information technology. We expect to continually invest in updating and expanding our information technology capabilities. In some cases, we may have to make systems investments before we generate revenues from contracts with new customers. In addition, these system requirements expose us to technology obsolescence risks.

The nature of our business involves the receipt and storage of a significant amount of health information about the participants of our programs. If we experience a data security breach, we could be exposed to government enforcement actions and private litigation. In addition, our customers could lose confidence in our ability to protect the health information of their members, which could cause them to discontinue usage of our services.

We rely upon our information systems for operating and monitoring all major aspects of our business. These systems and our operations could be damaged or interrupted by natural disasters, power loss, network failure, improper operation by our employees, data privacy or security breaches, computer viruses, computer hacking, network penetration or other illegal intrusions or other unexpected events. Any disruption in the operation of our information systems, regardless of the cause, could adversely impact our operations, which may affect our financial condition, results of operations and cash flows.

We face competition for staffing, which may increase our labor costs and reduce profitability.

We compete with other healthcare and services providers in recruiting qualified management, including executives with the required skills and experience to operate and grow our business, and staff personnel for the day-to-day operations of our business and well-being improvement call centers, including nurses, health coaches, and other healthcare professionals. In some markets, the scarcity of nurses, experienced health coaches, and other medical support personnel has become a significant operating issue to healthcare businesses. All of these challenges may require us to enhance wages and benefits to recruit and retain qualified management and other professionals. A failure to attract and retain qualified management, nurses, health coaches, and other healthcare professionals, or to control labor costs, could have a material adverse effect on our profitability.

Our industry is a rapidly evolving and highly competitive segment of the healthcare industry.

The rapidly growing industry in which we operate is a continually evolving segment of the overall healthcare industry with many entities, whose financial, research, staff, and marketing resources may exceed our resources, marketing a variety of population health improvement services and other services to health plans, integrated healthcare systems, self-insured employers, and government entities, or announcing an intention to offer such services.

We believe we have advantages over our competitors because of the breadth and depth of our well-being improvement capabilities, including our scope of strategic relationships, state-of-the-art well-being improvement call center technology linked to our proprietary information technology, predictive modeling capabilities, behavior-change techniques, the comprehensive recruitment and training of our clinical colleagues, our experienced management team, the comprehensive clinical nature of our product offerings, our established reputation for providing well-being improvement services to members with health risk factors or chronic diseases, and the proven financial and clinical outcomes of our programs. However, we cannot assure you that we can compete effectively with other companies such as those noted above.

If we lose the services of our Chief Executive Officer or other members of our senior management team, we may not be able to execute our business strategy.

Our success depends in large part upon the continued service of our senior management team. In particular, we believe that our Chief Executive Officer, Ben R. Leedle, Jr., is critical to our strategic direction and is uniquely positioned to lead the Company through the current transformational period in the healthcare industry that is largely due to the changes resulting from healthcare reform. The loss of our Chief Executive Officer, even temporarily, or any other member of our senior management team could have a material adverse effect on our business.

We are party to litigation that could force us to pay significant damages and/or harm our reputation.

We are subject to certain legal proceedings, which potentially involve large claims and significant defense costs (see Item 3. "Legal Proceedings"). These legal proceedings and any other claims that we may face, whether with or without merit, could result in costly litigation, and divert the time, attention, and resources of our management. Although we currently maintain liability insurance, there can be no assurance that the coverage limits of such insurance policies will be adequate or that all such claims will be covered by insurance. Although we believe that we have conducted our operations in full compliance with applicable statutory and contractual requirements and that we have meritorious defenses to outstanding claims, it is possible that resolution of these legal matters could have a material adverse effect on our results of operations. In addition, legal expenses associated with the defense of these matters may be material to our results of operations in a particular financial reporting period.

Compliance with new federal and state legislative and regulatory initiatives could adversely affect our results of operations or may require us to spend substantial amounts acquiring and implementing new information systems or modifying existing systems.

Our customers are subject to considerable state and federal government regulation. Many of these regulations are vaguely written and subject to differing interpretations that may, in certain cases, result in unintended consequences that could impact our ability to effectively deliver services.

We believe that federal requirements governing the confidentiality of individually-identifiable health information permit us to obtain individually-identifiable health information for well-being improvement purposes from a covered entity; however, state legislation or regulations could require additional and more restrictive security regulations. We are required by contract, the services we provide, ARRA and implementing regulations to comply with most requirements of the HIPAA privacy and security regulations. We may be subject to criminal or civil penalties for violations of these regulations. The 2013 regulations implementing many of these ARRA requirements will likely require amendments to existing agreements with our customers and subcontractors. In addition, the regulations create a presumption that non-permitted uses and disclosures of unsecured individually identifiable health information constitute breaches for which notice must be made by us or our customers to affected individuals and, in some cases, the media, unless it can be demonstrated that there is a low probability that the information has been compromised. This presumption and revised standard for determining whether a non-permitted use or disclosure constitutes a breach may result in a greater number of incidents being classified as breaches and, thus, a greater number of required notifications.

Although we continually monitor the extent to which federal and state legislation or regulations may govern our operations, new federal or state legislation or regulations in this area that restrict our ability to obtain and handle individually-identifiable health information or that otherwise restrict our operations could have a material adverse effect on our results of operations.

Government regulators may interpret current regulations or adopt new legislation governing our operations in a manner that subjects us to penalties or negatively impacts our ability to provide services.

Broadly written Medicare fraud and abuse laws and regulations that are subject to varying interpretations may expose us to potential civil and criminal litigation regarding the structure of current and past contracts entered into with our customers.

Expanding the well-being and health management industry to Medicare beneficiaries enrolled in Medicare Advantage plans could lead to increased direct regulation of well-being and health management services. Further, providing services to Medicare Advantage beneficiaries may result in our being subject directly to various federal laws and regulations, including provisions related to fraud and abuse, false claims and billing and reimbursement for services, and the federal False Claims Act.

In addition, certain of our services, including health utilization management and certain claims payment functions, require licensure by government agencies. We are subject to a variety of legal requirements in order to obtain and maintain such licenses, but little guidance is available to determine the scope of some of these requirements. Failure to obtain and maintain any required licenses or failure to comply with other laws and regulations applicable to our business could have a material negative impact on our operations.

Certain of our professional healthcare employees, such as nurses, must comply with individual licensing requirements.

All of our healthcare professionals who are subject to licensing requirements, such as the professionals located at a well-being improvement call center, are licensed in the state in which they are physically present. Multiple state licensing requirements for healthcare professionals who provide services telephonically over state lines may require us to license some of our healthcare professionals in more than one state. We continually monitor legislative, regulatory and judicial developments in telemedicine; however, new agency interpretations, federal or state legislation or regulations, or judicial decisions could increase the requirement for multi-state licensing of all well-being improvement call center health professionals, which would increase our costs of services and could have a material adverse effect on our results of operations.

Healthcare reform legislation may result in a reduction to our revenues from government health plans and private insurance companies.

Among other things, PPACA seeks to decrease the number of uninsured individuals and expand coverage through the expansion of public programs and private sector health insurance and a number of health insurance market reforms. PPACA also contains several provisions that encourage the utilization of preventive services and wellness programs, such as those provided by the Company. However, PPACA also contains various provisions that directly affect the customers or prospective customers that contract for our services and may increase their costs and/or reduce their revenues. For example, PPACA prohibits commercial health plans from using gender, health status, family history, or occupation to set premium rates, eliminates pre-existing condition exclusions, and bans annual benefit limits. In addition, PPACA mandates minimum MLRs for health plans such that the percentage of health coverage premium revenue spent on healthcare medical costs and quality improvement expenses must be at least 80% for individual and small group health plans and 85% for large group coverage and Medicare Advantage plans, with policyholders receiving rebates, and CMS receiving refunds in the case of Medicare Advantage plans, if the actual loss ratios fall below these minimums. The MLR requirements were implemented beginning in January 2011 for commercial plans and will begin in 2014 for Medicare Advantage plans. PPACA also reduces funding to Medicare Advantage programs, which may cause some Medicare Advantage plans to raise premiums or limit benefits. On February 15, 2013, CMS released preliminary benchmark payment rates for Medicare Advantage plans for calendar year 2014. The preliminary rates were expected to be lower than rates in 2013, but the magnitude of the proposed reduction was greater than generally anticipated by industry experts. These proposed payment rates are preliminary and could change when the final rates are announced on April 1, 2013.

While we believe that our programs and services specifically assist our customers in controlling their costs and improving their competitiveness, it is possible that the reforms imposed by PPACA will adversely affect the profitability of our customers and cause our customers or prospective customers to reduce or delay the purchase of our services or to demand reduced fees. Further, demand for our programs could be reduced if Medicare Advantage plans respond to PPACA funding reductions or other changes by eliminating our programs or by limiting or changing benefits in a manner that causes some Medicare Advantage beneficiaries to terminate their Medicare Advantage coverage. As a result, if the final benchmark payment rates for Medicare Advantage plans for 2014 are materially lower than current rates, our results of operations and cash flows could be adversely affected.

Because of PPACA's complexity, lack of implementing regulations or interpretive guidance, gradual and potentially delayed implementation, remaining or new court challenges, and possible amendment or repeal, we are unable to predict all of the ways in which PPACA could impact the Company. We could also be impacted by future healthcare reform legislative initiatives and/or government regulation.

Item 1B. Unresolved Staff Comments

Not applicable.

Item 2. Properties

We lease approximately 264,000 square feet of office space in Franklin, Tennessee, which contains our corporate headquarters and one of our well-being improvement call centers, pursuant to an agreement that expires in February 2023. We also lease approximately 92,000 square feet of office space in Chandler, Arizona which contains additional corporate employees and one of our well-being improvement call centers.

In addition, we lease office space for our eight other well-being improvement call center locations for an aggregate of approximately 224,000 square feet of space with lease terms expiring on various dates from 2013 to 2016. Our operations support and training offices contain approximately 40,000 square feet in aggregate and have lease terms expiring from 2014 to 2020.

Item 3. Legal Proceedings

Contract Dispute

We currently are involved in a contractual dispute with Blue Cross Blue Shield of Minnesota regarding fees paid to us as part of a former contractual relationship. On January 25, 2010, Blue Cross Blue Shield of Minnesota issued notice of arbitration with the American Arbitration Association in Minneapolis alleging a violation of certain contract provisions. We believe we performed our services in compliance with the terms of our agreement and that the assertions made in the arbitration notice are without merit. On August 3, 2011, we asserted numerous counterclaims against Blue Cross Blue Shield of Minnesota. We are not able to reasonably estimate a range of potential losses, if any, related to this dispute.

Anti-Trust Lawsuit

On May 1, 2012, American Specialty Health Group ("ASH") amended a claim (the "Amended Claim") that it had previously filed against the Company in the U.S. District Court in the Southern District of California ("Court") on December 2, 2011 (the "Original Claim"). The Original Claim alleged that the Company's exclusivity provisions in some of its contracts with participating locations in its SilverSneakers fitness network violate California's Unfair Competition Law ("UCL") and that the Company interfered with ASH's contractual relations and prospective economic advantages. The Amended Claim added allegations that the Company is in violation of the Sherman Antitrust Act (the "Act") because such exclusivity provisions create illegal restraints on trade and constitute monopolization or attempted monopolization in violation of the Act. Under the Amended Claim, ASH is seeking damages in excess of $15,000,000, treble damages under the Act, and injunctive relief. The Company has asserted counterclaims against ASH for interference and violation of the UCL, and on October 12, 2012, the Court granted the Company's motion to add an additional counterclaim that ASH has falsely advertised the composition of its fitness facility network in violation of the Lanham Act.

We believe ASH's claims are without merit and intend to vigorously defend ourselves against the Amended Claim.

Performance Award Lawsuit

On September 4, 2012, Milton Pfeiffer ("Plaintiff"), claiming to be a stockholder of the Company, filed a putative derivative action against the Company and the Board of Directors (the "Board") in Delaware Chancery Court alleging that the Compensation Committee of the Board and the Board breached their fiduciary duties and violated the Company's 2007 Stock Incentive Plan (the "Plan") by granting Ben R. Leedle, Jr., Chief Executive Officer and President of the Company, discretionary performance awards under the Plan in the form of options to purchase an aggregate of 500,000 shares of the Company's common stock, which consisted of a performance award in November 2011 granting Mr. Leedle the right to purchase 365,000 shares and a performance award in February 2012 granting Mr. Leedle the right to purchase 135,000 shares (the "Performance Awards"). Plaintiff alleges that the Performance Awards exceeded what is authorized by the Plan and that the Company's 2012 proxy statement, in which the Performance Awards are disclosed, is false and misleading. Plaintiff also alleges that Mr. Leedle breached his fiduciary duties and was unjustly enriched by receiving the Performance Awards. Plaintiff is seeking, among other things, the rescission or disgorgement of all alleged "excess" awards granted to Mr. Leedle under the Performance Awards, to recover any incidental damages to the Company, and an award of attorneys' fees and expenses. On November 2, 2012, the Company and the Board filed a Motion to Dismiss because Plaintiff failed to make a demand upon the Board as required by Delaware law.

Outlook

We are also subject to other contractual disputes, claims and legal proceedings that arise from time to time in the ordinary course of our business. While we are unable to estimate a range of potential losses, 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. As these matters are subject to inherent uncertainties, our view of these matters may change in the future.

Item 4. Mine Safety Disclosures

Not applicable.

Executive Officers of the Registrant

The following table sets forth certain information regarding our executive officers as of March 15, 2013. Executive officers of the Company serve at the pleasure of the Board.

Officer	Age	Position
Ben R. Leedle, Jr.	52	Chief Executive Officer and director of the Company since September 2003. President of the Company from May 2002 through October 2008 and April 2011 to present. Executive Vice President and Chief Operating Officer of the Health Plan Group from 2000 until May 2002. Senior Vice President of the Company from 1996 until 2000.
Michael Farris	53	Chief Commercial Officer of the Company since October 2012. Navvis & Company Chief Executive Officer from 2004 to September 2012.
Alfred Lumsdaine	47	Chief Financial Officer of the Company since January 2011. Chief Accounting Officer of the Company from February 2002 until January 2011.
Peter Choueiri	47	President, Healthways International, since January 2012 and Chief Operating Officer, Healthways International, from June 2011 through January 2012. Head of Global Markets for North America, Middle East/Africa, and Southern Europe/Latin America for Munich Reinsurance Company in Germany from May 2009 to May 2011 and Head of Divisional Unit Healthcare from October 2005 to May 2009.
Glenn Hargreaves	46	Chief Accounting Officer of the Company since July 2012 and Controller since January 2011. Director of

		Tax of the Company from April 2005 until January 2011.
Mary Flipse	46	General Counsel of the Company since July 2012. Director, Corporate Counsel of the Company from February 2012 to July 2012. Operations Counsel of the Company from August 2011 until February 2012. Assistant General Counsel of King Pharmaceuticals from May 2005 to July 2011.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Market Information

Our common stock is traded on The NASDAQ Stock Market ("NASDAQ") under the symbol "HWAY".

The following table sets forth the high and low sales prices per share of our common stock as reported by NASDAQ for the relevant periods.

	High	Low
Year ended December 31, 2012		
First quarter	$ 8.49	$ 6.66
Second quarter	8.00	6.21
Third quarter	11.96	7.73
Fourth quarter	11.94	8.58
Year ended December 31, 2011		
First quarter	$ 15.88	$ 10.38
Second quarter	17.26	13.55
Third quarter	17.62	9.83
Fourth quarter	11.20	5.59

Unregistered Sales of Equity Securities

In April 2012, we acquired Ascentia Health Care Solutions ("Ascentia"), a firm that supports and promotes population health management, patient centered programs, payer strategies and physician practice enhancement programs. In partial consideration for this acquisition, we issued 14,409 unregistered shares of our common stock, $.001 par value, which were valued in the aggregate at $0.1 million, to the Chief Executive Officer of Ascentia. The issuance of the shares was exempt from registration under Section 4(a)(2) of the Securities Act of 1933, as amended ("Securities Act"), because it was a transaction not involving a public offering.

On August 31, 2011, we acquired Navvis & Company ("Navvis"), a firm that provides strategic counsel and change management services to healthcare systems. In partial consideration for this acquisition, we issued 432,902 unregistered shares of our common stock, $.001 par value, which were valued in the aggregate at $3.3 million, to J&P Consulting, Inc. and MJLE, Inc. The issuance of the shares was exempt from registration under Section 4(a)(2) of the Securities Act because it was a transaction not involving a public offering.

Holders

At March 1, 2013, there were approximately 9,400 holders of our common stock, including 204 stockholders of record.

Dividends

We have never declared or paid a cash dividend on our common stock. We intend to retain any earnings to finance the growth and development of our business and do not expect to declare or pay any cash dividends in the foreseeable future. Our Board will review our dividend policy from time to time and may declare dividends at its discretion;

however, our Fifth Amended Credit Agreement places restrictions on the payment of dividends. For further discussion of the Fifth Amended Credit Agreement, see Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operation - Liquidity and Capital Resources."

Repurchases of Common Stock

Our Board authorized a share repurchase program which was publicly announced on October 21, 2010. The share repurchase program allowed for the repurchase of up to $60 million of our common stock from time to time in the open market or in privately negotiated transactions through October 19, 2012. No shares were repurchased between October 1 and October 19, 2012 pursuant to the program.

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs
October 1 through 19, 2012	—	—	2,254,953	—
Total	—			

Securities Authorized for Issuance Under Equity Compensation Plans

See Part III, Item 12, "Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters", for information regarding securities authorized for issuance under our equity compensation plans, which is incorporated by reference herein.

Item 6. Selected Financial Data

The following table represents selected financial data. The table should be read in conjunction with Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and Item 8, "Financial Statements and Supplementary Data" of this Report.

(In thousands, except per share data)	Year Ended December 31, 2012	Year Ended December 31, 2011	Year Ended December 31, 2010	Year Ended December 31, 2009	Four Months Ended December 31, 2008	Year Ended August 31, 2008
Operating Results:						
Revenues	$ 677,170	$ 688,765	$ 720,333	$ 717,426	$244,737	$736,243
Cost of services (exclusive of depreciation and amortization included below)	533,880	510,724	493,713	522,999	177,651	503,940
Selling, general and administrative expenses	60,888	64,843	72,830	71,535	27,790	71,342
Depreciation and amortization	51,734	49,988	52,756	49,289	16,188	47,479
Impairment loss	—	183,288	—	—	4,344	—
Restructuring and related charges	1,773	9,036	10,258	—	10,264	—
Operating income (loss)	$ 28,895	$ (129,114)	$ 90,776	$ 73,603	$ 8,500	$113,482
Gain on sale of investment	—	—	(1,163)	(2,581)	—	—
Interest expense	14,149	13,193	14,164	15,717	6,757	20,927
Legal settlement and related costs	—	—	—	39,956	—	—
Income (loss) before income taxes	$ 14,746	$ (142,307)	$ 77,775	$ 20,511	$ 1,743	$ 92,555
Income tax expense	6,722	15,386	30,445	10,137	1,009	37,740
Net income (loss)	$ 8,024	$ (157,693)	$ 47,330	$ 10,374	$ 734	$ 54,815

Basic income (loss) per share:	$ 0.24	$ (4.68)	$ 1.39	$ 0.31	$ 0.02	$ 1.57
Diluted income (loss) per share: (1)	$ 0.24	$ (4.68)	$ 1.36	$ 0.30	$ 0.02	$ 1.50
Weighted average common shares and equivalents:						
Basic	33,597	33,677	34,129	33,730	33,616	34,977
Diluted (1)	33,836	33,677	34,902	34,359	34,038	36,597
Balance Sheet Data:						
Cash and cash equivalents	$ 1,759	$ 864	$ 1,064	$ 2,356	$ 5,157	$ 35,242
Working capital (deficit)	13,551	8,774	547	(44,296)	(6,034)	21,276
Total assets	748,268	708,905	861,689	882,366	883,090	906,813
Long-term debt	278,534	266,117	243,425	254,345	304,372	345,395
Other long-term liabilities	26,602	31,351	39,140	42,615	39,533	31,227
Stockholders' equity	278,821	265,716	430,841	377,277	357,036	354,334
Other Operating Data:						
Annualized revenue in backlog	$ 39,000	$ 29,400	$ 37,100	$ 32,400	$ 35,900	$ 13,600

(1) The assumed exercise of stock-based compensation awards for the year ended December 31, 2011 was not considered because the impact would be anti-dilutive.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

Founded in 1981, Healthways, Inc. ("Healthways") provides specialized, comprehensive solutions to help people improve their physical, emotional and social well-being, thereby improving their health and productivity and reducing their health-related costs.

We provide highly specific and personalized interventions for each individual in a population, irrespective of health status, age or payor. We utilize predictive modeling capabilities to allow us to identify and stratify those participants who are most at risk for an adverse health event. Our evidence-based well-being improvement services are made available to consumers using a range of methods desired by an individual including venue-based face-to-face interactions; print; phone; mobile and remote devices; on-line; emerging modalities; and any combination thereof to motivate and sustain healthy behaviors.

In North America, our customers include health plans, employers, integrated healthcare systems, hospitals, physician groups, and government entities in all 50 states and the District of Columbia. We also provide services to commercial healthcare businesses and/or government entities in Brazil, Australia and France. We operate domestic and international well-being improvement call centers staffed with licensed health professionals. Our fitness center network encompasses approximately 15,000 U.S. locations. We also maintain an extensive network of over 88,000 complementary, alternative and physical medicine practitioners, which offers convenient access to the significant number of individuals who seek health services outside of the traditional healthcare system.

Our guiding philosophy and approach to market is predicated on the fundamental belief that healthier people cost less and are more productive. As described more fully below, our programs are designed to improve well-being by helping people adopt or maintain healthy behaviors, reduce health-related risk factors, and optimize their care for identified health conditions.

First, our programs are designed to help people adopt or maintain healthy behaviors by:

- fostering wellness and disease prevention through total population screening, well-being assessments and supportive interventions; and
- engaging people in health improvement programs, such as fitness, weight management, chiropractic, and complementary and alternative medicine.

Our prevention programs focus on education, physical fitness, health coaching, and behavior change techniques and support. We believe this approach improves the well-being status of member populations and reduces the short- and long-term health-related costs for participants, including associated costs from the loss of employee productivity.

Second, our programs are designed to help people reduce health-related risk factors by:

- promoting personal change and improvement in the lifestyle behaviors that lead to poor health or chronic conditions; and
- providing educational materials and personal interactions with highly trained nurses and other healthcare professionals to create and sustain healthier behaviors for those individuals at-risk or in the early stages of chronic conditions.

We enable our customers to engage everyone in their covered populations through specific interactions that are sensitive to each individual's health risks and needs. Our programs are designed to motivate people to make positive lifestyle changes and accomplish individual goals, such as increasing physical activity for seniors through the Healthways SilverSneakers fitness solution, overcoming nicotine addiction through the QuitNet on-line smoking cessation community, or generating sustainable weight-loss through our Innergy solution.

Finally, our programs are designed to help people optimize care for identified health conditions by:

- incorporating the latest, evidence-based clinical guidelines into interventions to optimize patient health outcomes;

- developing care support plans and motivating members to set attainable goals for themselves;
- providing local market resources to address acute episodic interventions;
- coordinating members' care with their healthcare providers;
- providing software licensing and management consulting in support of well-being improvement services; and
- providing high-risk care management for members at risk for hospitalization due to complex conditions.

Our approach is to use proprietary, analytic models to identify individuals who are likely to incur future high costs, including those who have specific gaps in care, and through evidence-based interventions drive adherence to proven standards of care, medication regimens and physicians' plans of care to reduce disease progression and related medical spending.

We recognize that each individual plays a variety of roles in his or her pursuit of improved well-being, often simultaneously. By providing the full spectrum of services to meet each individual's needs, we believe our interventions can be delivered at scale and in a manner that reflects those unique needs over time. We believe that real and sustainable behavior change generates measurable, long-term cost savings and improved individual and business performance.

Forward-Looking Statements

Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements, which are based upon current expectations, involve a number of risks and uncertainties, and are subject to the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements include all statements that are not historical statements of fact and those regarding the intent, belief, or expectations of the Company, including, without limitation, all statements regarding the Company's future earnings and results of operations, and can be identified by the use of words like "may," "believe," "will," "expect," "project," "estimate," "anticipate, or "continue" and similar expressions. Readers are cautioned that any such forward-looking statements are not guarantees of future performance and involve significant risks and uncertainties, and that actual results may vary from those in the forward-looking statements as a result of various factors, including, but not limited to:

- the effectiveness of management's strategies and decisions;
- our ability to sign and implement new contracts for our solutions;
- our ability to accurately forecast the costs required to successfully implement new contracts;
- our ability to renew and/or maintain contracts with our customers under existing terms or restructure these contracts on terms that would not have a material negative impact on our results of operations;
- our ability to effectively compete against other entities, whose financial, research, staff, and marketing resources may exceed our resources;
- our ability to accurately forecast the Company's revenues, margins, earnings and net income, as well as any potential charges that we may incur as a result of changes in our business;
- our ability to accurately forecast performance and the timing of revenue recognition under the terms of our customer contracts ahead of data collection and reconciliation;
- the impact of the Patient Protection and Affordable Care Act, as amended by the Health Care and Education Reconciliation Act of 2010 ("PPACA"), on our operations and/or the demand for our services;
- our ability to anticipate the rate of market acceptance of our solutions in potential international markets;
- our ability to accurately forecast the costs necessary to establish a presence in international markets;
- the risks associated with foreign currency exchange rate fluctuations and our ability to hedge against such fluctuations;
- the risks associated with deriving a significant concentration of our revenues from a limited number of customers;
- our ability to achieve and reach mutual agreement with customers with respect to contractually required performance metrics, cost savings and clinical outcomes improvements, or to achieve such metrics, savings and improvements within the time frames contemplated by us;

- our ability to achieve estimated annualized revenue in backlog in the manner and within the timeframe we expect, which is based on certain estimates regarding the implementation of our services;

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- our ability and/or the ability of our customers to enroll participants and to accurately forecast their level of enrollment and participation in our programs in a manner and within the timeframe anticipated by us;
- the ability of our customers to provide timely and accurate data that is essential to the operation and measurement of our performance under the terms of our contracts;
- our ability to favorably resolve contract billing and interpretation issues with our customers;
- our ability to service our debt, make principal and interest payments as those payments become due, and remain in compliance with our debt covenants;
- the risks associated with changes in macroeconomic conditions, which may reduce the demand and/or the timing of purchases for our services from customers or potential customers, reduce the number of covered lives of our existing customers, or restrict our ability to obtain additional financing;
- counterparty risk associated with our interest rate swap agreements and foreign currency exchange contracts;
- our ability to integrate new or acquired businesses, services (including outsourced services), or technologies into our business and to accurately forecast the related costs;
- our ability to anticipate and respond to strategic changes, opportunities, and emerging trends in our industry and/or business and to accurately forecast the related impact on our earnings;
- the impact of any impairment of our goodwill or other intangible assets;
- our ability to develop new products and deliver outcomes on those products;
- our ability to implement our integrated data and technology solutions platform within the required timeframe and expected cost estimates and to develop and enhance this platform and/or other technologies to meet evolving customer and market needs;
- our ability to obtain adequate financing to provide the capital that may be necessary to support our operations and to support or guarantee our performance under new contracts;
- unusual and unforeseen patterns of healthcare utilization by individuals with diseases or conditions for which we provide services;
- the ability of our customers to maintain the number of covered lives enrolled in the plans during the terms of our agreements;
- the risks associated with data privacy or security breaches, computer hacking, network penetration and other illegal intrusions;
- the impact of PPACA on our operations and/or the demand for our services;
- the impact of any new or proposed legislation, regulations and interpretations relating to the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 and any legislative or regulatory changes with respect to Medicare Advantage;
- the impact of future state, federal, and international legislation and regulations applicable to our business, including PPACA, on our ability to deliver our services and on the financial health of our customers and their willingness to purchase our services;
- current geopolitical turmoil, the continuing threat of domestic or international terrorism, and the potential emergence of a health pandemic;
- the impact of legal proceedings involving us and/or our subsidiaries;and
- other risks detailed in this Report, including those set forth in Item 1A. “Risk Factors.”

We undertake no obligation to update or revise any such forward-looking statements.

Critical Accounting Policies

We describe our accounting policies in Note 1 of the Notes to the Consolidated Financial Statements. We prepare the consolidated financial statements in conformity with generally accepted accounting principles in the United States (“U.S. GAAP”), which requires us to make estimates and judgments that affect the reported amounts of assets and liabilities and related disclosures at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates.

We believe the following accounting policies are the most critical in understanding the estimates and judgments that are involved in preparing our financial statements and the uncertainties that could impact our results of operations, financial condition and cash flows.

Revenue Recognition

Our fees are generally billed on a per member per month ("PMPM") basis or upon member participation. For PMPM fees, we generally determine our contract fees by multiplying the contractually negotiated PMPM rate by the number of members covered by our services during the month. We typically set PMPM rates during contract negotiations with customers based on the value we expect our programs to create and a sharing of that value between the customer and the Company. In addition, some of our services, such as the Healthways SilverSneakers fitness solution, include fees that are based upon member participation.

Our contracts with health plans and integrated healthcare systems generally range from three to five years with a number of comprehensive strategic agreements extending up to ten years in length. Contracts with self-insured employers typically have two to four-year terms. Some of our contracts allow the customer to terminate early.

Some of our contracts place a portion of our fees at risk based on achieving certain performance metrics, cost savings, and/or clinical outcomes improvements ("performance-based"). Approximately 7% of revenues recorded during the year ended December 31, 2012 were performance-based and were subject to final reconciliation as of December 31, 2012.

We recognize revenue as follows: (1) we recognize the fixed portion of PMPM fees and fees for service as revenue during the period in which we perform our services; and (2) we recognize performance-based revenue based on the most recent assessment of our performance, which represents the amount that the customer would legally be obligated to pay if the contract were terminated as of the latest balance sheet date.

We generally bill our customers each month for the entire amount of the fees contractually due for the prior month's enrollment, which typically includes the amount, if any, that is performance-based and may be subject to refund should we not meet performance targets. Fees for service are typically billed in the month after the services are provided. Deferred revenues arise from contracts that permit upfront billing and collection of fees covering the entire contractual service period, generally 12 months. A limited number of our contracts provide for certain performance-based fees that we cannot bill until we reconcile them with the customer.

We generally assess our level of performance for our contracts based on medical claims and other data that the customer is contractually required to supply. A minimum of four to nine months' data is typically required for us to measure performance. In assessing our performance, we may include estimates such as medical claims incurred but not reported and a medical cost trend compared to a baseline year. In addition, we may also provide contractual allowances for billing adjustments (such as data reconciliation differences) as appropriate.

If data is insufficient or incomplete to measure performance, or interim performance measures indicate that we are not meeting performance targets, we do not recognize performance-based fees subject to refund as revenues but instead record them in a current liability account entitled "contract billings in excess of earned revenue." Only in the event we do not meet performance levels by the end of the measurement period, typically one year, are we contractually obligated to refund some or all of the performance-based fees. We would only reverse revenues that we had already recognized if performance to date in the measurement period, previously above targeted levels, subsequently dropped below targeted levels. Historically, any such adjustments have been immaterial to our financial condition and results of operations.

During the settlement process under a contract, which generally occurs six to eight months after the end of a contract year, we settle any performance-based fees and reconcile healthcare claims and clinical data. As of December 31, 2012, cumulative performance-based revenues that have not yet been settled with our customers but that have been recognized in the current and prior years totaled approximately $41.3 million, all of which were based on actual data received from our customers. Of this amount, $34.5 million was settled with customers after December 31, 2012, and

$6.8 million remains subject to final reconciliation. Data reconciliation differences, for which we provide contractual allowances until we reach agreement with respect to identified issues, can arise between the customer and us due to customer data deficiencies, omissions, and/or data discrepancies.

Performance-related adjustments (including any amounts recorded as revenue that were ultimately refunded), changes in estimates, or data reconciliation differences may cause us to recognize or reverse revenue in a current fiscal year that pertains to services provided during a prior fiscal year. During 2012, 2011 and 2010, we recognized a net increase in revenue of $9.2 million, $2.9 million, and $25.8 million that related to services provided prior to each respective year.

Impairment of Intangible Assets and Goodwill

We review goodwill for impairment at the reporting unit level (operating segment or one level below an operating segment) on an annual basis or more frequently whenever events or circumstances indicate that the carrying value may not be recoverable. We may elect to perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying value. If we conclude during the qualitative assessment that this is the case, we perform a quantitative review as described below. Otherwise, we do not perform a quantitative review. If we elect not to perform a qualitative assessment, then we proceed to the quantitative review described below.

During a quantitative review of goodwill, we estimate the fair value of each reporting unit using a combination of a discounted cash flow model and a market-based approach, and we reconcile the aggregate fair value of our reporting units to our consolidated market capitalization. Estimating fair value requires significant judgments, including management's estimate of future cash flows, which is dependent on internal forecasts, estimation of the long-term growth rate for our business, the useful life over which cash flows will occur, and determination of our weighted average cost of capital, as well as relevant comparable company earnings multiples for the market-based approach. Changes in these estimates and assumptions could materially affect the estimate of fair value and potential goodwill impairment for each reporting unit.

If we determine that the carrying value of goodwill is impaired based upon an impairment review, we calculate any impairment using a fair-value-based goodwill impairment test as required by U.S. GAAP. The fair value of a reporting unit is the price that would be received upon a sale of the unit as a whole in an orderly transaction between market participants at the measurement date.

Except for a trade name that has an indefinite life and is not subject to amortization, we amortize identifiable intangible assets, such as acquired technologies and customer contracts, over their estimated useful lives using the straight-line method. We assess the potential impairment of intangible assets subject to amortization whenever events or changes in circumstances indicate that the carrying values may not be recoverable. If we determine that the carrying value of other identifiable intangible assets may not be recoverable, we calculate any impairment using an estimate of the asset's fair value based on the estimated price that would be received to sell the asset in an orderly transaction between market participants.

We review intangible assets not subject to amortization, which consist of a trade name, on an annual basis or more frequently whenever events or circumstances indicate that the assets might be impaired. We estimate the fair value of the trade name using a present value technique, which requires management's estimate of future revenues attributable to this trade name, estimation of the long-term growth rate for these revenues, and determination of our weighted average cost of capital. Changes in these estimates and assumptions could materially affect the estimate of fair value for the trade name.

Future events could cause us to conclude that impairment indicators exist and that goodwill and/or other intangible assets are impaired. Any resulting impairment loss could have a material adverse impact on our financial condition and results of operations.

Income Taxes

The objectives of accounting for income taxes are to recognize the amount of taxes payable or refundable for the current year and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in an entity's financial statements or tax returns. Accounting for income taxes requires significant judgment in determining income tax provisions, including determination of deferred tax assets, deferred tax liabilities, and any valuation allowances that might be required against deferred tax assets, and in evaluating tax positions.

We recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position should be measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. U.S. GAAP also provides guidance on derecognition of income tax assets and liabilities, classification of current and deferred income tax assets and liabilities, accounting for interest and penalties associated with tax positions, and income tax disclosures. Judgment is required in assessing the future tax consequences of events that have been recognized in our financial statements or tax returns. Variations in the actual outcome of these future tax consequences could materially impact our consolidated financial position, results of operations, and cash flows.

Share-Based Compensation

We measure and recognize compensation expense for all share-based payment awards based on estimated fair values at the date of grant. Determining the fair value of stock options at the grant date requires judgment in developing assumptions, which involve a number of variables. These variables include, but are not limited to, the expected stock price volatility over the term of the awards and expected stock option exercise behavior. In addition, we also use judgment in estimating the number of share-based awards that are expected to be forfeited.

Results of Operations

The following table sets forth the components of the statements of operations for the fiscal years ended December 31, 2012, 2011 and 2010 expressed as a percentage of revenues.

	Year Ended December 31,		
	2012	2011	2010
Revenues	100.0%	100.0%	100.0%
Cost of services (exclusive of depreciation and amortization included below)	78.8%	74.2%	68.5%
Selling, general and administrative expenses	9.0%	9.4%	10.1%
Depreciation and amortization	7.6%	7.3%	7.3%
Impairment loss	—	26.6%	—
Restructuring and related charges	0.3%	1.3%	1.4%
Operating income (loss) (1)	4.3%	(18.7)%	12.6%
Gain on sale of investment	—%	—%	(0.2)%
Interest expense	2.1%	1.9%	2.0%
Income (loss) before income taxes (1)	2.2%	(20.7)%	10.8%
Income tax expense	1.0%	2.2%	4.2%
Net income (loss)	1.2%	(22.9)%	6.6%

(1) Figures may not add due to rounding.

Revenues

Revenues for fiscal 2012 decreased $11.6 million, or 1.7%, over fiscal 2011, primarily due to decreases in revenue from the wind-down of our contract with CIGNA Healthcare, Inc. (“CIGNA”) in advance of the contract’s expiration in February 2013, as well as certain other contract or program terminations with three smaller health plan customers. These decreases were somewhat offset by the following:

- the commencement of contracts with new customers;
- an increase in participation in our fitness solutions, as well as in the number of members eligible to participate in such solutions; and
- an increase in performance-based revenues due to our ability to measure and achieve performance targets on certain contracts during the year ended December 31, 2012.

Revenues for fiscal 2011 decreased $31.6 million, or 4.4%, over fiscal 2010, primarily due to the following:

- the recognition of revenues in 2010 in connection with a final settlement with CMS associated with our participation in two MHS programs; and

- contract and program terminations and restructurings with certain customers.

These decreases were somewhat offset by revenue from new and expanded contracts and an increase in participation in our fitness solutions, as well as in the number of members eligible to participate in such solutions.

Cost of Services

Cost of services (excluding depreciation and amortization) as a percentage of revenues for fiscal 2012 increased to 78.8% compared to 74.2% for fiscal 2011, primarily due to the following:

- the wind-down of our contract with CIGNA and certain other contract or program terminations with three smaller health plan customers to whom we provided traditional disease management services, all of which carried a lower than average cost of services as a percentage of revenues;
- increased costs related to the implementation of a significant number of new contracts and the launch of new business in the evolving health systems market; and
- an expanded and extended contract during the year ended December 31, 2012 which moved from a cost-plus model to a volume-based model in which revenues are expected to ramp over time, while the underlying cost structure remained consistent with the year ended December 31, 2011.

These increases were partially offset by decreases in cost of services (excluding depreciation and amortization) as a percentage of revenues due to the following:

- an increase in performance-based revenues wherein a significant portion of the related costs were incurred and recognized in a prior period;
- costs associated with implementing a new and innovative contract in 2011 for which we weren't able to recognize revenue until 2012; and
- efficiencies gained in our fitness solutions through certain cost management initiatives.

Cost of services (excluding depreciation and amortization) as a percentage of revenues for fiscal 2011 increased to 74.2% compared to 68.5% for fiscal 2010, primarily due to the following:

- costs associated with implementing certain significant new and innovative contracts;
- an increase in implementation expenses primarily related to our Embrace platform;
- an increased portion of our revenue generated by fitness solutions, which typically have a higher cost of services as a percentage of revenue than our other programs;
- changes in the contract structure of certain incentive-based wellness programs from a utilization model to a PMPM model, as well as an increase in the number of members eligible for these programs and their utilization of such programs; and
- costs associated with an initiative to promote member participation in our fitness solutions.

These increases were somewhat offset by the following decreases in cost of services (excluding depreciation and amortization) as a percentage of revenues:

· a decrease in the level of short and long-term performance-based incentive compensation based on the Company's financial performance against established internal targets for these periods;
- a decrease in salaries and benefits expense, primarily due to a restructuring of the Company, which was completed during the fourth quarter of 2010; and
- cost savings related to certain operational efficiencies.

Selling, General and Administrative Expenses

Selling, general and administrative expenses as a percentage of revenues decreased to 9.0% for fiscal 2012 compared to 9.4% for fiscal 2011, primarily due to certain cost reductions from a restructuring of the Company in 2011 that was largely completed during the fourth quarter of 2011.

Selling, general and administrative expenses as a percentage of revenues decreased to 9.4% for fiscal 2011 compared to 10.1% for fiscal 2010, primarily due to the following:

- a decrease in the level of long-term performance-based incentive compensation during the year ended December 31, 2011, compared to the year ended December 31, 2010, based on the Company's financial performance against established internal targets for these periods; and
- cost savings realized during 2011 from a restructuring of the Company that was largely completed during the fourth quarter of 2010.

These decreases were somewhat offset by increased costs involved in pursuing business in evolving markets.

Depreciation and Amortization

Depreciation and amortization expense increased 3.5% for fiscal 2012 compared to fiscal 2011, primarily due to increased depreciation expense related to our Embrace platform, partially offset by decreased amortization expense due to certain intangible assets becoming fully amortized during 2011.

Depreciation and amortization expense decreased 5.2% for fiscal 2011 compared to fiscal 2010, primarily related to certain computer software that became fully depreciated during 2011, slightly offset by increased depreciation expense resulting from the implementation of our Embrace platform

Restructuring and Related Charges and Impairment Loss

During fiscal 2012, we incurred net charges of $1.8 million related to a restructuring of the Company in the fourth quarter of 2012, which primarily consisted of termination benefits related to capacity realignment.

During fiscal 2011, we incurred net charges of $9.0 million related to a restructuring of the Company in the fourth quarter of 2011, which primarily consisted of termination benefits and costs associated with capacity reductions following CIGNA's decision to wind down its contract beginning in 2012. Also during fiscal 2011, we incurred charges of $183.3 million primarily related to an impairment of goodwill during the fourth quarter of 2011.

Gain on Sale of Investment

In January 2009, a private company in which we held preferred stock was acquired by a third party. During the second quarter of 2010, we recognized a gain of $1.2 million related to the receipt of a final escrow payment as a result of this sale.

Interest Expense

Interest expense for fiscal 2012 increased $1.0 million compared to fiscal 2011, primarily due to the write-off of previously deferred loan costs as a result of entering into the Fifth Amended Credit Agreement in June 2012.

Interest expense for fiscal 2011 decreased $1.0 million compared to fiscal 2010, primarily as a result of a decrease in floating interest rates on outstanding borrowings during fiscal 2011 compared to fiscal 2010.

Income Tax Expense

Our effective tax rate increased to 45.6% for the year ended December 31, 2012, primarily due to routine reconciliations of estimated amounts and the relatively small base of pretax income for 2012 in relation to certain unrecognized tax benefits and non-deductible expenses.

In 2011 we had positive income tax expense of $15.4 million despite a pre-tax loss of $142.3 million primarily due to an impairment loss of $183.3 million, the majority of which was not deductible for tax purposes. In 2010 our effective tax rate was 39.1%.

Outlook

Despite the loss of our contract with CIGNA and one other terminated health plan contract, we anticipate that revenues for 2013 will increase over 2012 primarily due to increased revenues from new and expanded contracts and from our fitness solutions.

We expect cost of services as a percentage of revenues for 2013 to increase slightly compared to 2012 primarily due to the wind down of our contract with CIGNA and one other terminated health plan contract, both of which carried a lower than average cost of services as a percentage of revenues. In addition, we anticipate that, due to the nature of recent significant new and expanded contracts, costs on these contracts may be incurred before revenues are fully expressed. We expect selling, general and administrative expenses as a percentage of revenues for 2013 to decrease compared to 2012 primarily due to our ability to more effectively leverage our selling, general and administrative expenses as a result of expected growth in our operations. We anticipate depreciation and amortization expense for 2013 will increase compared to 2012 primarily due to continued investment in our Embrace platform.

We anticipate that quarterly revenues and net income (loss) will improve sequentially throughout 2013 as staged services and new contracts are implemented, as lives being served expand, and as performance based-revenue is measured and recognized.

As discussed in “Liquidity and Capital Resources” below, a significant portion of our long-term debt is subject to fixed interest rate swap agreements; however, we cannot predict the potential for changes in interest rates, which would impact our variable rate debt.

Liquidity and Capital Resources

Operating activities for fiscal 2012 provided cash of $40.7 million compared to $76.3 million for fiscal 2011. The decrease in operating cash flow resulted primarily from the following:

- a decrease in gross margins;
- an increase in days sales outstanding from 51 days at December 31, 2011 to 57 days at December 31, 2012;
- an increase in certain long-term incentive and other benefit payments during 2012; and
- an increase in severance payments in 2012 made as a result of a restructuring of the Company that was largely completed during the fourth quarter of 2011.

These decreases in operating cash flow were slightly offset by an increase in operating cash flow due to reduced tax payments in 2012 as compared to 2011.

Investing activities during fiscal 2012 used $60.5 million in cash, which primarily consisted of capital expenditures associated with our Embrace platform.

Financing activities during fiscal 2012 provided $20.6 million in cash primarily due to net borrowings under the Fifth Amended Credit Agreement.

On June 8, 2012, we entered into the Fifth Amended Credit Agreement. The Fifth Amended Credit Agreement provides us with a $200.0 million revolving credit facility that expires on June 8, 2017 and includes a swingline sub facility of $20.0 million and a $75.0 million sub facility for letters of credit. The Fifth Amended Credit Agreement also provides a $200.0 million term loan facility that matures on June 8, 2017, $195.0 million of which remained outstanding on December 31, 2012, and an uncommitted incremental accordion facility of $200.0 million. As of December 31, 2012, availability under the revolving credit facility totaled $55.0 million as calculated under the most restrictive covenant.

Borrowings under the Fifth Amended Credit Agreement generally bear interest at variable rates based on a margin or spread in excess of either (1) the one-month, two-month, three-month or six-month rate (or with the approval of affected lenders, nine-month or twelve-month rate) for Eurodollar deposits (“LIBOR”) or (2) the greatest of (a) the SunTrust Bank prime lending rate, (b) the federal funds rate plus 0.50%, and (c) one-month LIBOR plus 1.00% (the “Base Rate”), as selected by the Company. The LIBOR margin varies between 1.75% and 3.00%, and the Base Rate margin varies between 0.75% and 2.00%, depending on our leverage ratio. The Fifth Amended Credit Agreement also provides for an annual fee ranging between 0.30% and 0.50% of the unused commitments under the revolving credit facility. Extensions of credit under the Fifth Amended Credit Agreement are secured by guarantees from all of the Company's active 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 under the revolving credit facility on June 8, 2017. We are required to repay term loans in quarterly principal installments aggregating (1) 1.250% of the original aggregate principal amount of the term loans during each of the eight quarters beginning with the quarter ended September 30, 2012, (2) 1.875% of the original aggregate principal amount of the term loans during each of the next four quarters beginning with the quarter ending September 30, 2014, (3) 2.500% of the original aggregate principal amount of the term loans during each of the remaining quarters prior to maturity on June 8, 2017, at which time the entire unpaid principal balance of the term loans is due and payable.

The Fifth Amended Credit Agreement contains financial covenants that require us to maintain specified ratios or levels of (1) total funded debt to EBITDA and (2) fixed charge coverage. The Fifth Amended Credit Agreement also limits repurchases of the Company's common stock and the amount of dividends that the Company can pay to holders of its common stock. As of December 31, 2012, we were in compliance with all of the financial covenant requirements of the Fifth Amended Credit Agreement.

The Fifth Amended Credit Agreement contains various other affirmative and negative covenants that are customary for financings of this type.

On February 5, 2013, we entered into a First Amendment to the Fifth Amended Credit Agreement, which provided for, among other things, a temporary increase in the LIBOR margin and Base Rate margin of 0.25% through December 31, 2013, only in the event that our total funded debt to EBITDA ratio is greater than or equal to 3.50.

In order to reduce our exposure to interest rate fluctuations on our floating rate debt commitments, we maintain interest rate swap agreements that effectively modify our exposure to interest rate risk by converting a portion of our floating rate debt to fixed obligations, thus reducing the impact of interest rate changes on future interest expense. Under these agreements, we receive a variable rate of interest based on LIBOR, and we pay a fixed rate of interest with interest rates ranging from 0.370% to 3.385% plus a spread. We maintain interest rate swap agreements with current notional amounts of $430.0 million and termination dates ranging from June 30, 2013 to December 31, 2016. Of this amount, $180.0 million was effective at December 31, 2012, $30.0 million became effective in January 2013, $110.0 million will become effective in June 2013, $60.0 million will become effective in November 2013, and $50.0 million will become effective in 2015, as older interest rate swap agreements expire. We have designated these interest rate swap agreements as qualifying cash flow hedges. We currently meet the hedge accounting criteria under U.S. GAAP in accounting for these interest rate swap agreements.

In October 2010, our Board authorized a share repurchase program, which allowed for the repurchase of up to $60 million of our common stock from time to time in the open market or in privately negotiated transactions through October 19, 2012. No shares were repurchased during 2012 pursuant to the program.

We believe that cash flows from operating activities, our available cash, and our anticipated available credit under the Fifth Amended Credit Agreement will continue to enable us to meet our contractual obligations and to fund our current operations for the foreseeable future. However, if our operations require significant additional financing resources, such as capital expenditures for technology improvements, additional well-being improvement call centers and/or letters of credit or other forms of financial assurance to guarantee our performance under the terms of new contracts, or if we are required to refund performance-based fees pursuant to contract terms, we may need to raise additional capital by expanding our existing credit facility and/or issuing debt or equity securities. If we face a limited ability to arrange such financing, it may restrict our ability to effectively operate our business. We cannot assure you that we would always be able to secure additional financing if needed and, if such funds were available, whether the terms or conditions would be acceptable to us.

If contract development accelerates or acquisition opportunities arise, we may need to issue additional debt or equity securities to provide the funding for these increased growth opportunities. We may also issue equity securities in connection with future acquisitions or strategic alliances. We cannot assure you that we would be able to issue additional debt or equity securities on terms that would be acceptable to us.

Any material commitments for capital expenditures are included in the "Contractual Obligations" table below.

Contractual Obligations

The following schedule summarizes our contractual cash obligations as of December 31, 2012:

(In thousands)	Payments Due By Year Ended December 31,				
	2013	2014 - 2015	2016 - 2017	2018 and After	Total
Deferred compensation plan payments (1)	$ 6,816	$ 1,042	$ 441	$ 5,106	$ 13,405
Long-term debt and related interest (2)	23,131	48,812	259,854	—	331,797
Operating lease obligations (3)	14,783	22,491	18,691	41,635	97,600
Capital lease obligations (4)	1,330	992	—	—	2,322
Purchase obligations	7,070	—	—	—	7,070
Outsourcing obligations (5)	26,228	42,208	35,683	58,618	162,737
Other contractual cash obligations (6)	15,431	22,828	16,850	15,000	70,109
Total contractual cash obligations (7)	$ 94,789	$ 138,373	$331,519	$120,359	$ 685,040

(1) Consists of payments under a non-qualified deferred compensation plan and performance cash awards.

(2) Consists of scheduled principal payments, repayment of outstanding revolving loans, and estimated interest payments on outstanding borrowings under the Fifth Amended Credit Agreement. Estimated interest payments are $13.1 million for 2013, $18.8 million for 2014 and 2015 combined, and $12.3 million for 2016 and 2017 combined.

(3) Excludes total sublease income of $0.7 million.

(4) Consists of scheduled principal payments and estimated interest payments on capital lease obligations. Estimated interest payments are immaterial.

(5) Outsourcing obligations primarily include a ten-year applications and technology services outsourcing agreement with HP Enterprise Services, LLC entered into in May 2011 that contains minimum fee requirements. Total payments over the remaining term, including an estimate for future contractual cost of living adjustments, must equal or exceed a minimum level of approximately $161.2 million; however, based on initial required service and equipment level assumptions, we estimate that the remaining payments will be approximately $331.3 million. The agreement allows us to terminate all or a portion of the services after the first two years provided we pay certain termination fees, which could be material to the Company.

(6) Other contractual cash obligations primarily include $2.8 million of severance payments, which are payable in 2013, as well as a 25-year strategic relationship agreement with Gallup that we entered into in January 2008 and a 5-year global joint venture agreement with Gallup that we entered into in October 2012. We have minimum remaining contractual cash obligations of $49.5 million related to these agreements, $7.5 million of which will occur during 2013, 2014, and 2015, $6.0 million which will occur in 2016 and 2017 and the remaining $15.0 million of which will occur ratably over the following 15 years.

(7) We have excluded long-term liabilities of $1.3 million related to uncertain tax positions as we are unable to reasonably estimate the timing of these payments in individual years due to uncertainties in the timing of effective settlement of tax positions.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements as of December 31, 2012.

Recently Issued Accounting Standards

In July 2012, the Financial Accounting Standards Board issued Accounting Standards Update ("ASU") No. 2012-02, "Intangibles—Goodwill and Other (Topic 350)—Testing Indefinite-Lived Intangible Assets for Impairment." ASU No. 2012-02 permits an entity to perform a qualitative assessment to determine whether it is more likely than not that the fair value of an indefinite-lived intangible asset is less than its carrying value. If the entity concludes that this is the case, it must perform the currently prescribed quantitative impairment test by comparing the fair value of the indefinite-lived intangible asset with its carrying value. Otherwise, the quantitative impairment test is not required. ASU No. 2012-02 is effective for fiscal years beginning after September 15, 2012, with earlier adoption permitted. We do not expect the adoption of this standard to have a material impact on our consolidated results of operations, financial position, cash flows, or notes to the consolidated financial statements.

In February 2013, the FASB issued ASU No. 2013-02 which requires companies to provide information about the amounts reclassified out of accumulated other comprehensive income ("AOCI") by component. In addition, entities are required to present, either on the face of the statement where net income is presented or in the accompanying notes, significant amounts reclassified out of AOCI by the respective line items of net income, but only if the amount reclassified is required to be reclassified to net income in its entirety in the same reporting period. For amounts that are not required to be reclassified in their entirety to net income, Entities are required to cross-reference to other disclosures that provide additional detail on those amounts. ASU No. 2013-02 is effective prospectively for reporting periods beginning after December 15, 2012. We do not expect the adoption of this standard to have a material impact on our consolidated results of operations, financial position, cash flows, or notes to the consolidated financial statements.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

We are subject to market risk related to interest rate changes, primarily as a result of the Fifth Amended Credit Agreement. Borrowings under the Fifth Amended Credit Agreement generally bear interest at variable rates based on a margin or spread in excess of either (1) one-month, two-month, three-month or six-month LIBOR (or with the approval of affected lenders, nine-month or twelve-month) LIBOR or (2) the greatest of (a) the SunTrust Bank prime lending rate, (b) the federal funds rate plus 0.50%, and (c) the Base Rate (as previously defined), as selected by the Company. The LIBOR margin varies between 1.75% and 3.00%, and the Base Rate margin varies between 0.75% and 2.00%, depending on our leverage ratio.

In order to reduce our interest rate exposure under the Fifth Amended Credit Agreement, we have entered into interest rate swap agreements effectively converting a portion of our floating rate debt to fixed obligations with interest rates ranging from 0.370% to 3.385% plus a spread.

We estimate that a one-point interest rate change would have resulted in a change in interest expense of approximately $1.0 million for the year ended December 31, 2012.

As a result of our investment in international initiatives, we are also exposed to foreign currency exchange rate risks. Because a significant portion of these risks is economically hedged with currency options and forwards contracts and because our international initiatives are not yet material to our consolidated results of operations, a 10% change in foreign currency exchange rates would not have had a material impact on our consolidated results of operations, financial position, or cash flows for the year ended December 31, 2012. We do not execute transactions or hold derivative financial instruments for trading purposes.

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders of Healthways, Inc.

We have audited the accompanying consolidated balance sheets of Healthways, Inc. as of December 31, 2012 and 2011, and the related consolidated statements of operations, comprehensive income (loss), changes in stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2012. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Healthways, Inc. at December 31, 2012 and 2011, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2012, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Healthways, Inc.'s internal control over financial reporting as of December 31, 2012, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 15, 2013 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Nashville, Tennessee
March 15, 2013

Item 8. Financial Statements and Supplementary Data

HEALTHWAYS, INC.
CONSOLIDATED BALANCE SHEETS
(In thousands)

ASSETS

	December 31, 2012	December 31, 2011
Current assets:		
Cash and cash equivalents	$ 1,759	$ 864
Accounts receivable, net	108,337	97,459
Prepaid expenses	9,727	11,417
Other current assets	7,227	1,412
Income taxes receivable	5,920	6,065
Deferred tax asset	8,839	10,314
Total current assets	141,809	127,531
Property and equipment:		
Leasehold improvements	40,679	41,622
Computer equipment and related software	267,902	239,732
Furniture and office equipment	23,552	26,324
Capital projects in process	11,799	17,811
	343,932	325,489
Less accumulated depreciation	(187,438)	(183,301)
	156,494	142,188
Other assets	21,042	10,797
Intangible assets, net	90,228	92,997
Goodwill, net	338,695	335,392
Total assets	$ 748,268	$ 708,905

See accompanying notes to the consolidated financial statements.

HEALTHWAYS, INC.
CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share data)

LIABILITIES AND STOCKHOLDERS' EQUITY

	December 31, 2012	December 31, 2011
Current liabilities:		
Accounts payable	$ 26,343	$ 22,578
Accrued salaries and benefits	24,909	35,617
Accrued liabilities	39,234	28,639
Deferred revenue	5,643	9,273
Contract billings in excess of earned revenue	14,793	13,154
Current portion of long-term debt	11,801	3,725
Current portion of long-term liabilities	5,535	5,771
Total current liabilities	128,258	118,757
Long-term debt	278,534	266,117
Long-term deferred tax liability	36,053	26,964
Other long-term liabilities	26,602	31,351
Stockholders' equity:		
Preferred stock		
$.001 par value, 5,000,000 shares		
authorized, none outstanding	—	—
Common stock		
$.001 par value, 120,000,000 shares authorized,		
33,924,464 and 33,304,681 shares outstanding	34	33
Additional paid-in capital	251,357	247,137
Retained earnings	56,541	48,517
Treasury stock, at cost, 2,254,953 shares in treasury	(28,182)	(28,182)
Accumulated other comprehensive loss	(929)	(1,789)
Total stockholders' equity	278,821	265,716
Total liabilities and stockholders' equity	$ 748,268	$ 708,905

See accompanying notes to the consolidated financial statements.

HEALTHWAYS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except earnings per share data)

	Year Ended December 31, 2012	2011	2010
Revenues	$ 677,170	$ 688,765	$ 720,333
Cost of services (exclusive of depreciation and amortization of $36,094, $36,248, and $39,203, respectively, included below)	533,880	510,724	493,713
Selling, general and administrative expenses	60,888	64,843	72,830
Depreciation and amortization	51,734	49,988	52,756
Impairment loss	—	183,288	—
Restructuring and related charges	1,773	9,036	10,258
Operating income (loss)	28,895	(129,114)	90,776
Gain on sale of investment	—	—	(1,163)
Interest expense	14,149	13,193	14,164
Income (loss) before income taxes	14,746	(142,307)	77,775
Income tax expense	6,722	15,386	30,445
Net income (loss)	$ 8,024	$ (157,693)	$ 47,330
Earnings (loss) per share:			
Basic	$ 0.24	$ (4.68)	$ 1.39
Diluted(1)	$ 0.24	$ (4.68)	$ 1.36
Weighted average common shares and equivalents			
Basic	33,597	33,677	34,129
Diluted (1)	33,836	33,677	34,902

See accompanying notes to the consolidated financial statements.

(1) The assumed exercise of stock-based compensation awards for the year ended December 31, 2011 was not considered because the impact would be anti-dilutive.

HEALTHWAYS, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(In thousands)

	Year Ended December 31, 2012	2011	2010
Net income (loss)	$ 8,024	$ (157,693)	$ 47,330
Other comprehensive income (loss), net of tax	23,619	—	23,619

Accrued liabilities	317	102,376	72,190	—	174,883
Total current liabilities	743	135,297	172,106	—	308,146
Long-term debt, less current portion	—	2,645,367	—	—	2,645,367
Due to affiliates	1,529	25,693	830,246	(857,468)	—
Other liabilities	4,396	304,574	39,706	—	348,676
Deferred income taxes - net	—	538,035	148,169	(495,524)	190,680
Shareholders' equity	5,126,792	4,042,364	6,915,354	(10,957,718)	5,126,792
	$ 5,133,460	$ 7,691,330	$ 8,105,581	$ (12,310,710)	$ 8,619,661

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ROWAN COMPANIES PLC AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

Rowan Companies plc and Subsidiaries
Condensed Consolidating Balance Sheets
December 31, 2015
(in thousands)

	Rowan plc (Parent)	RCI (Issuer)	Non-guarantor subsidiaries	Consolidating adjustments	Consolidated
CURRENT ASSETS:					
Cash and cash equivalents	$17,297	$9,506	$ 457,425	$—	$ 484,228
Receivables - trade and other	110	1,369	409,040	—	410,519
Other current assets	394	19,230	6,904	—	26,528
Total current assets	17,801	30,105	873,369	—	921,275
Property and equipment - gross	—	592,809	8,475,284	—	9,068,093
Less accumulated depreciation and amortization	—	242,665	1,419,596	—	1,662,261
Property and equipment - net	—	350,144	7,055,688	—	7,405,832
Investments in subsidiaries	4,763,306	6,028,242	—	(10,791,548)	—
Due from affiliates	629	1,218,233	55,751	(1,274,613)	—
Other assets	—	4,999	15,161	—	20,160
	$4,781,736	$7,631,723	$ 7,999,969	$(12,066,161)	$ 8,347,267
CURRENT LIABILITIES:					
Accounts payable - trade	$960	$19,111	$ 89,503	$—	$ 109,574
Deferred revenues	—	6	33,056	—	33,062
Accrued liabilities	778	119,388	65,869	—	186,035
Total current liabilities	1,738	138,505	188,428	—	328,671
Long-term debt	—	2,692,419	—	—	2,692,419
Due to affiliates	2,880	55,750	1,215,983	(1,274,613)	—
Other liabilities	4,659	304,709	48,555	—	357,923
Deferred income taxes - net	—	522,927	150,822	(477,954)	195,795
Shareholders' equity	4,772,459	3,917,413	6,396,181	(10,313,594)	4,772,459
	$4,781,736	$7,631,723	$ 7,999,969	$(12,066,161)	$ 8,347,267

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ROWAN COMPANIES PLC AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

Rowan Companies plc and Subsidiaries
Condensed Consolidating Income Statements
Three months ended June 30, 2016
(in thousands)
(unaudited)

	Rowan plc (Parent)	RCI (Issuer)	Non-guarantor subsidiaries	Consolidating adjustments	Consolidated
REVENUES	$—	$15,070	$ 610,108	$ (13,317)	$ 611,861
COSTS AND EXPENSES:					
Direct operating costs (excluding items below)	—	6,244	213,305	(12,064)	207,485
Depreciation and amortization	—	4,487	95,455	199	100,141
Selling, general and administrative	6,811	—	20,752	(1,452)	26,111
Loss on disposals of property and equipment	—	60	1,878	—	1,938
Total costs and expenses	6,811	10,791	331,390	(13,317)	335,675
INCOME (LOSS) FROM OPERATIONS	(6,811)	4,279	278,718	—	276,186
OTHER INCOME (EXPENSE):					
Interest expense, net of interest capitalized	—	(38,249)	(1,130)	1,130	(38,249)
Interest income	9	1,226	344	(1,130)	449
Gain on extinguishment of debt	—	1,787	—	—	1,787
Other - net	5,111	(5,091)	(664)	—	(644)
Total other income (expense) - net	5,120	(40,327)	(1,450)	—	(36,657)
INCOME (LOSS) BEFORE INCOME TAXES	(1,691)	(36,048)	277,268	—	239,529
Provision (benefit) for income taxes	—	10,706	20,030	(7,936)	22,800
Equity in earnings of subsidiaries, net of tax	218,420	162,264	—	(380,684)	—
NET INCOME (LOSS)	$216,729	$115,510	$ 257,238	$ (372,748)	$ 216,729

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ROWAN COMPANIES PLC AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

Rowan Companies plc and Subsidiaries
Condensed Consolidating Income Statements
Three months ended June 30, 2015
(in thousands)
(unaudited)

	Rowan plc (Parent)	RCI (Issuer)	Non-guarantor subsidiaries	Consolidating adjustments	Consolidated
REVENUES	$—	$18,290	$ 509,095	$ (18,649)	$ 508,736
COSTS AND EXPENSES:					
Direct operating costs (excluding items below)	—	3,173	268,259	(17,488)	253,944
Depreciation and amortization	—	3,388	91,538	464	95,390
Selling, general and administrative	7,006	1,423	24,354	(1,625)	31,158
Gain on disposals of property and equipment	—	346	(8)	—	338
Material charges and other operating expenses	—	—	5,000	—	5,000
Total costs and expenses	7,006	8,330	389,143	(18,649)	385,830
INCOME (LOSS) FROM OPERATIONS	(7,006)	9,960	119,952	—	122,906
OTHER INCOME (EXPENSE):					
Interest expense, net of interest capitalized	—	(30,840)	(4,092)	4,092	(30,840)
Interest income	124	4,100	303	(4,092)	435
Other - net	5,601	(5,595)	(86)	—	(80)
Total other income (expense) - net	5,725	(32,335)	(3,875)	—	(30,485)
INCOME (LOSS) BEFORE INCOME TAXES	(1,281)	(22,375)	116,077	—	92,421
Provision (benefit) for income taxes	—	2,017	13,467	(7,798)	7,686
Equity in earnings of subsidiaries, net of tax	86,016	1,429	—	(87,445)	—
NET INCOME (LOSS)	$84,735	$(22,963)	$ 102,610	$ (79,647)	$ 84,735

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ROWAN COMPANIES PLC AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

Rowan Companies plc and Subsidiaries
Condensed Consolidating Income Statements
Six months ended June 30, 2016
(in thousands)
(unaudited)

	Rowan plc (Parent)	RCI (Issuer)	Non-guarantor subsidiaries	Consolidating adjustments	Consolidated
REVENUES	$ —	$ 35,858	$ 1,109,519	$ (33,336)	$ 1,112,041
COSTS AND EXPENSES:					
Direct operating costs (excluding items below)	—	7,220	435,663	(30,566)	412,317
Depreciation and amortization	—	8,682	189,794	517	198,993
Selling, general and administrative	13,838	—	42,490	(3,287)	53,041
Loss on disposals of property and equipment	—	70	4,045	—	4,115
Total costs and expenses	13,838	15,972	671,992	(33,336)	668,466
INCOME (LOSS) FROM OPERATIONS	(13,838)	19,886	437,527	—	443,575
OTHER INCOME (EXPENSE):					
Interest expense, net of interest capitalized	—	(77,173)	(3,072)	3,072	(77,173)
Interest income	24	3,201	740	(3,072)	893
Gain on extinguishment of debt	—	2,364	—	—	2,364
Other - net	10,468	(10,424)	(3,265)	—	(3,221)
Total other income (expense) - net	10,492	(82,032)	(5,597)	—	(77,137)
INCOME (LOSS) BEFORE INCOME TAXES	(3,346)	(62,146)	431,930	—	366,438
(Benefit) Provision for income taxes	—	22,183	22,502	(17,775)	26,910
Equity in earnings of subsidiaries, net of tax	342,874	188,858	—	(531,732)	—
NET INCOME (LOSS)	339,528	104,529	409,428	(513,957)	339,528

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ROWAN COMPANIES PLC AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

Rowan Companies plc and Subsidiaries
Condensed Consolidating Income Statements
Six months ended June 30, 2015
(in thousands)
(unaudited)

	Rowan plc (Parent)	RCI (Issuer)	Non-guarantor subsidiaries	Consolidating adjustments	Consolidated
REVENUES	$ —	$ 33,336	$ 1,056,446	$ (34,007)	$ 1,055,775
COSTS AND EXPENSES:					
Direct operating costs (excluding items below)	—	4,870	536,550	(31,742)	509,678
Depreciation and amortization	—	7,968	176,399	713	185,080
Selling, general and administrative	11,218	2,065	48,439	(2,978)	58,744
Loss (gain) on disposals of property and equipment	—	4	(179)	—	(175)
Material charges and other operating expenses	—	—	5,000	—	5,000
Total costs and expenses	11,218	14,907	766,209	(34,007)	758,327
INCOME (LOSS) FROM OPERATIONS	(11,218)	18,429	290,237	—	297,448
OTHER INCOME (EXPENSE):					
Interest expense, net of interest capitalized	—	(63,586)	(6,541)	6,541	(63,586)
Interest income	258	6,567	306	(6,541)	590
Other - net	11,205	(11,118)	(1,208)	—	(1,121)
Total other income (expense) - net	11,463	(68,137)	(7,443)	—	(64,117)
INCOME (LOSS) BEFORE INCOME TAXES	245	(49,708)	282,794	—	233,331
Provision for income taxes	—	2,407	42,216	(19,696)	24,927
Equity in earnings of subsidiaries, net of tax	208,159	23,507	—	(231,666)	—
NET INCOME (LOSS)	208,404	(28,608)	240,578	(211,970)	208,404

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ROWAN COMPANIES PLC AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

Rowan Companies plc and Subsidiaries
Statements of Comprehensive Income
Three months ended June 30, 2016
(in thousands)
(unaudited)

	Rowan plc (Parent)	RCI (Issuer)	Non-guarantor subsidiaries	Consolidating adjustments	Consolidated
NET INCOME (LOSS)	$216,729	$115,510	$ 257,238	$ (372,748)	$ 216,729
OTHER COMPREHENSIVE INCOME:					
Net reclassification adjustments for amount recognized in net income as a component of net periodic benefit cost, net of income taxes	2,515	2,515	—	(2,515)	2,515
COMPREHENSIVE INCOME (LOSS)	$219,244	$118,025	$ 257,238	$ (375,263)	$ 219,244

Rowan Companies plc and Subsidiaries
Statements of Comprehensive Income
Three months ended June 30, 2015
(in thousands)
(unaudited)

	Rowan plc (Parent)	RCI (Issuer)	Non-guarantor subsidiaries	Consolidating adjustments	Consolidated
NET INCOME (LOSS)	$84,735	$(22,963)	$ 102,610	$ (79,647)	$ 84,735
OTHER COMPREHENSIVE INCOME:					
Net reclassification adjustments for amount recognized in net income as a component of net periodic benefit cost, net of income taxes	3,413	3,413	—	(3,413)	3,413
COMPREHENSIVE INCOME (LOSS)	$88,148	$(19,550)	$ 102,610	$ (83,060)	$ 88,148

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ROWAN COMPANIES PLC AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

Rowan Companies plc and Subsidiaries
Statements of Comprehensive Income
Six months ended June 30, 2016
(in thousands)
(unaudited)

	Rowan plc (Parent)	RCI (Issuer)	Non-guarantor subsidiaries	Consolidating adjustments	Consolidated
NET INCOME (LOSS)	$339,528	$104,529	$ 409,428	$ (513,957)	$ 339,528
OTHER COMPREHENSIVE INCOME:					
Net reclassification adjustments for amount recognized in net income as a component of net periodic benefit cost, net of income taxes	5,030	5,030	—	(5,030)	5,030
COMPREHENSIVE INCOME (LOSS)	$344,558	$109,559	$ 409,428	$ (518,987)	$ 344,558

Rowan Companies plc and Subsidiaries
Statements of Comprehensive Income
Six months ended June 30, 2015
(in thousands)
(unaudited)

	Rowan plc (Parent)	RCI (Issuer)	Non-guarantor subsidiaries	Consolidating adjustments	Consolidated
NET INCOME (LOSS)	$208,404	$(28,608)	$ 240,578	$ (211,970)	$ 208,404
OTHER COMPREHENSIVE INCOME:					
Net reclassification adjustments for amount recognized in net income as a component of net periodic benefit cost, net of income taxes	6,799	6,799	—	(6,799)	6,799
COMPREHENSIVE INCOME (LOSS)	$215,203	$(21,809)	$ 240,578	$ (218,769)	$ 215,203

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ROWAN COMPANIES PLC AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

Rowan Companies plc and Subsidiaries
Consolidating Statements of Cash Flows
Six months ended June 30, 2016
(in thousands)
(unaudited)

	Rowan plc (Parent)	RCI (Issuer)	Non-guarantor subsidiaries	Consolidating adjustments	Consolidated
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	$(8,274)	$(49,243)	$445,165	$ 722	$388,370
INVESTING ACTIVITIES:					
Capital expenditures	—	(23,399)	(40,996)	—	(64,395)
Proceeds from disposals of property and equipment	—	410	672	—	1,082
Collections on subsidiary notes receivables	—	357,795	—	(357,795)	—
Investments in consolidated subsidiaries	(200)	(109,126)	—	109,326	—
Net cash provided by (used in) investing activities	(200)	225,680	(40,324)	(248,469)	(63,313)
FINANCING ACTIVITIES:					
Advances (to) from affiliates	(974)	10,080	(8,384)	(722)	—
Contributions from parent	—	—	109,326	(109,326)	—
Reductions of long-term debt	—	(47,862)	(357,795)	357,795	(47,862)
Net cash provided by (used in) financing activities	(974)	(37,782)	(256,853)	247,747	(47,862)
(DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(9,448)	138,655	147,988	—	277,195
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	17,297	9,506	457,425	—	484,228
CASH AND CASH EQUIVALENTS, END OF PERIOD	$7,849	$148,161	$605,413	$ —	$761,423

ROWAN COMPANIES PLC AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

Rowan Companies plc and Subsidiaries
Consolidating Statements of Cash Flows
Six months ended June 30, 2015
(in thousands)
(unaudited)

	Rowan plc (Parent)	RCI (Issuer)	Non-guarantor subsidiaries	Consolidating adjustments	Consolidated
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	$(3,758)	$6,654	$ 474,316	$ (28,492)	$ 448,720
INVESTING ACTIVITIES:					
Capital expenditures	—	(7,113)	(609,285)	—	(616,398)
Proceeds from disposals of property, plant and equipment	—	1,704	594	—	2,298
Net cash used in investing activities	—	(5,409)	(608,691)	—	(614,100)
FINANCING ACTIVITIES:					
Advances (to) from affiliates	(16,323)	(74,952)	92,783	(1,508)	—
Proceeds from borrowings	—	220,000	—	—	220,000
Reductions of long-term debt	—	(170,000)	—	—	(170,000)
Dividends paid	(25,220)	—	(30,000)	30,000	(25,220)
Net cash provided by (used in) financing activities	(41,543)	(24,952)	62,783	28,492	24,780
DECREASE IN CASH AND CASH EQUIVALENTS	(45,301)	(23,707)	(71,592)	—	(140,600)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	45,909	48,580	244,665	—	339,154
CASH AND CASH EQUIVALENTS, END OF PERIOD	$608	$24,873	$ 173,073	$ —	$ 198,554

ROWAN COMPANIES PLC AND SUBSIDIARIES

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the accompanying unaudited condensed consolidated financial statements as of and for the three and six months ended June 30, 2016, included in this Form 10-Q and with our annual report on Form 10-K for the year ended December 31, 2015. The following discussion and analysis contains forward-looking statements that involve risks and uncertainties. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of certain factors, including those set forth under “Risk Factors” in Item 1A of our annual report, as may be updated in our subsequent quarterly reports. See “Forward-Looking Statements.”

OVERVIEW

Rowan plc is a global provider of offshore contract drilling services to the international oil and gas industry, with a focus on high-specification and premium jack-up rigs and ultra-deepwater drillships. Our fleet currently consists of 31 mobile offshore drilling units, including 27 self-elevating jack-up rigs and four ultra-deepwater drillships. Our fleet operates worldwide, including the United States Gulf of Mexico ("US GOM"), the United Kingdom ("U.K.") and Norwegian sectors of the North Sea, the Middle East, Trinidad and Suriname.

As of July 1, 2016, the date of our most recent Fleet Status Report, three of our four drillships were under contract in the US GOM. Additionally, we had four jack-up rigs under contract in the North Sea, ten under contract in the Middle East, two in Trinidad and one in Suriname, and one under contract in the US GOM. We had an additional six marketed jack-up rigs, three cold-stacked jack-up rigs and one drillship without a contract.

We contract our drilling rigs, related equipment and work crews primarily on a "day rate" basis. Under day rate contracts, we generally receive a fixed amount per day for each day we are performing drilling or related services. In addition, our customers may pay all or a portion of the cost of moving our equipment and personnel to and from the well site. Contracts can range in duration from one month to multiple years.

Customer Contract Termination and Settlement

On May 23, 2016, we reached an agreement with Freeport-McMoRan Oil and Gas LLC ("FMOG") and its parent company, Freeport-McMoRan Inc. ("FCX") in connection with the drilling contract for the drillship Rowan Relentless ("FMOG Agreement"), which was scheduled to terminate in June 2017. The FMOG Agreement provided that the drilling contract be terminated immediately, and that FCX will pay us $215 million in cash over a period of 90 days to settle outstanding receivables and early termination of the contract, of which $85 million has been received through June 30, 2016 and the remaining $130 million, which is included in Receivables - trade and other on the Condensed Consolidated Balance Sheet as of June 30, 2016, is due to be paid on or before August 21, 2016. In addition, we may also receive two additional contingent payments from FCX, payable on September 30, 2017, of $10 million and $20 million depending on the average price of West Texas Intermediate ("WTI") crude oil over a 12-month period beginning June 30, 2016. The $10 million payment will be due if the average price over the period is greater than $50 per barrel and the additional $20 million payment will be due if the average price over the period is greater than $65 per barrel ("FMOG Provision"). We warm-stacked the Rowan Relentless in order to reduce costs. During the quarter ended June 30, 2016, we recognized $173.2 million in revenue for the Rowan Relentless, including $130.9 million for the cancelled contract value, $6.2 million for the fair value of the derivative associated with the FMOG Provision, $5.6 million for previously deferred revenue related to the contract, and $ 30.5 million for operations through May 22, 2016.

Day Rate Concessions

On June 1, 2016, we executed a contract extension for the Rowan Viking of 270 days for $275,000 per day following the primary term of the original contract in exchange for day rate concessions reducing the day rate for the primary term from $345,528 per day to $275,000 per day. This reduced day rate was applied to January 1, 2016 through November 6, 2017, and as a result, we recorded a reduction to revenue for amounts earned under this contract during the period from January 1, 2016 through March 31, 2016 of $6.3 million in the second quarter of 2016.

CURRENT BUSINESS ENVIRONMENT

The business environment for offshore drillers continues to be challenging as demand for drilling services remains low being overwhelmed by the substantial supply of offshore drilling units. As a result capital expenditures by operators worldwide has

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declined dramatically during 2015 and 2016. The resulting cancellation and/or postponement of drilling programs has resulted in reduced demand for offshore drilling services globally, downward pressure on day rates and rig utilization, and the cold-stacking and retirement of rigs in the worldwide fleet.

In response to market conditions, we have reduced day rates on certain drilling contracts (some in exchange for extended contract duration), warm-stacked six of our modern jack-ups, sold three of our oldest jack-ups, and cold-stacked three other jack-ups. Further, as a result of one of our customers choosing to exit the offshore market, a drillship contract was terminated, though we reached a settlement to receive a substantial portion of the remaining backlog. Given the current outlook, we expect day rates and utilization to remain depressed over the short and medium term. Additionally, customers may continue to seek to renegotiate or terminate existing contracts. As market and credit conditions continue to deteriorate in the oil and gas industry, there is an increased risk of customer defaults, customer restructurings or insolvency and further termination of contracts.

A significant contributing factor to the softness in the offshore drilling market has been the influx of 220 newbuild jack-ups and 156 newbuild floaters delivered since the beginning of the current newbuild cycle in early 2006. The addition of newbuild units, combined with numerous rigs that have rolled off contracts in past quarters without securing follow-on work, has continued to increase competitive supply, putting additional downward pressure on day rates and utilization. Further, as of July 11, 2016, there were approximately 119 additional jack-up rigs on order or under construction worldwide for delivery through 2020 (38% of the currently contracted jack-up fleet of approximately 314 rigs), and approximately 67 floaters on order or under construction worldwide for delivery through 2020 (40% of the currently contracted floater fleet of approximately 166 rigs). Only thirteen jack-ups and thirty-two floaters currently on order or under construction have contracts.

We expect the business environment for the remainder of 2016 to remain challenging and, in the absence of a more substantial and sustained recovery in commodity prices, it may deteriorate further. However, we believe that we are well-positioned strategically given our status as a strong and stable financial counter-party to our customers, current backlog of $2.7 billion as of July 1, 2016, solid operational reputation, and a modern fleet of high-specification jack-ups and state-of-the-art ultra-deepwater drillships. While challenging market conditions persist, we continue to focus on operating and cost efficiencies, which could include cold-stacking or retiring additional drilling rigs.

In addition, as a U.K. domiciled company with operations in the U.K., and particularly in the North Sea and Aberdeen, our business, tax structure and results of operations may be negatively affected by economic and political uncertainties resulting from the U.K.'s decision to depart from the European Union and any subsequent referendum in Scotland to seek independence from the U.K.

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RESULTS OF OPERATIONS

The following table presents certain key performance indicators by rig classification:

	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
Revenues (in thousands):				
Deepwater	$339,993	$155,494	$561,311	$298,169
Jack-ups	264,657	339,939	537,590	733,795
Subtotal - Day rate revenues	604,650	495,433	1,098,901	1,031,964
Other revenues[1]	7,211	13,303	13,140	23,811
Total revenues	611,861	$508,736	$1,112,041	$1,055,775
Revenue-producing days:				
Deepwater	325	251	686	477
Jack-ups	1,605	1,987	3,101	4,172
Total revenue-producing days	1,930	2,238	3,788	4,649
Available days: [2]				
Deepwater	364	288	728	527
Jack-ups	2,184	2,457	4,368	4,897
Total available days	2,548	2,745	5,096	5,424
Average day rate: [3]				
Deepwater [4]	$607,014	$620,156	$609,846	$625,743
Jack-ups	$164,941	$171,075	$173,341	$175,871
Total fleet [4]	$239,388	$221,391	$252,436	$221,983
Utilization: [5]				
Deepwater	89 %	87 %	94 %	90 %
Jack-ups	73 %	81 %	71 %	85 %
Total fleet	76 %	82 %	74 %	86 %

(1) Other revenues, which are primarily revenues received for contract reimbursable costs, are excluded from the computation of average day rate.
(2) Available days are defined as the aggregate number of calendar days (excluding days for which a rig is cold-stacked) in the period, or, with respect to new rigs entering service, the number of calendar days in the period from the date the rig was placed in service.
(3) Average day rate is computed by dividing day rate revenues by the number of revenue-producing days, including fractional days. Day rate revenues include the contractual rates and amounts received in lump sum, such as for rig mobilization or capital improvements, which are amortized over the initial term of the contract. Revenues attributable to reimbursable expenses are excluded from average day rates.
(4) Average day rate for the three and six months ended June 30, 2016 includes operating days for the Rowan Relentless up to the contract termination which was 52 days and 143 days for the three and six months ended June 30, 2016, respectively.

(5) Utilization is the number of revenue-producing days, including fractional days, divided by the number of available days.

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Three months ended June 30, 2016 compared to three months ended June 30, 2015

A summary of our consolidated results of operations follows (in thousands):

	Three months ended June 30, 2016	2015	Change	% Change
Deepwater:				
Revenues from external customers	$341,389	$161,889	$179,500	111 %
Operating expenses:				
Direct operating costs (excluding items below)	56,029	70,430	(14,401)	(20)%
Depreciation and amortization	29,891	21,150	8,741	41 %
Selling, general and administrative	—	—	—	n/m
Other operating items	1	—	1	n/m
Income (loss) from operations	$255,468	$70,309	$185,159	263 %
Jack-ups:				
Revenues from external customers	$270,472	$346,847	$(76,375)	(22)%
Operating expenses:				
Direct operating costs (excluding items below)	151,456	183,514	(32,058)	(17)%
Depreciation and amortization	71,131	70,925	206	— %
Selling, general and administrative	—	—	—	n/m
Other operating items	1,840	5,000	(3,160)	(63)%
Income (loss) from operations	$46,045	$87,408	$(41,363)	(47)%
Unallocated costs and other:				
Revenues from external customers	$—	$—	$—	n/m
Operating expenses:				
Direct operating costs (excluding items below)	—	—	—	n/m
Depreciation and amortization	(881)	3,315	(4,196)	n/m
Selling, general and administrative	26,111	31,158	(5,047)	(16)%
Other operating items	97	338	(241)	(71)%
Income (loss) from operations	$(25,327)	$(34,811)	$9,484	(27)%
Total company:				
Revenues	$611,861	$508,736	$103,125	20 %
Direct operating costs (excluding items below)	207,485	253,944	(46,459)	(18)%
Depreciation and amortization	100,141	95,390	4,751	5 %
Selling, general and administrative	26,111	31,158	(5,047)	(16)%
Other operating items	1,938	5,338	(3,400)	(64)%
Income from operations	276,186	122,906	153,280	125 %
Other income (expense), net	(36,657)	(30,485)	(6,172)	20 %
Income before income taxes	239,529	92,421	147,108	159 %
Provision for income taxes	22,800	7,686	15,114	197 %
Net income	$216,729	$84,735	$131,994	156 %

"n/m" means not meaningful.

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Revenues

Consolidated. The increase in consolidated revenue is described below.

Deepwater. An analysis of the net changes in revenues for the three months ended June 30, 2016, compared to three months ended June 30, 2015, are set forth below (in millions):

	Increase (decrease)
Contract Termination for Rowan Relentless and related items	$ 142.7
Addition of the Rowan Relentless in June 2015	21.6
Higher drillship utilization	22.9
Lower drillship day rates	(2.7)
Lower reimbursable revenues	(5.0)
Net increase	$ 179.5

Jack-ups. An analysis of the net changes in revenues for the three months ended June 30, 2016, compared to three months ended June 30, 2015, are set forth below (in millions):

	Increase (decrease)
Lower jack-up utilization	$ (65.4)
Lower jack-up day rates	(9.8)
Lower reimbursable revenues	(1.7)
Higher other revenue	0.5
Net decrease	$ (76.4)

Direct operating costs

Consolidated. The decrease in consolidated direct operating costs is described below.

Deepwater. An analysis of the net changes in direct operating costs for the three months ended June 30, 2016, compared to three months ended June 30, 2015, are set forth below (in millions):

	Increase (decrease)
Addition of the Rowan Relentless	$ 6.9
Reduction in drillship operating expense	(10.5)
Reduction in shore base costs and other	(5.8)
Lower reimbursable costs	(5.0)
Net decrease	$ (14.4)

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Jack-ups. An analysis of the net changes in direct operating costs for the three months ended June 30, 2016, compared to three months ended June 30, 2015, are set forth below (in millions):

	Increase (decrease)
Decrease due to idle or cold-stacked rigs	$ (20.7)
Reduction in shore base costs and other	(3.5)
Lower reimbursable costs	(1.7)
Reduction in jack-up operating expense	(6.2)
Net decrease	$ (32.1)

Depreciation and amortization

Depreciation and amortization for the second quarter of 2016 increased largely due to the addition of the Rowan Relentless.

Selling, general and administrative

Selling, general and administrative expenses for the second quarter of 2016 decreased primarily as a result of lower labor costs, largely due to reductions in headcount and lower share-based compensation.

Other operating items

Material charges for the three months ended June 30, 2015 included a $5.0 million adjustment to an estimated liability for the termination of a contract in connection with refurbishment work on the Rowan Gorilla III. This matter was settled during the third quarter of 2015. Losses on disposals of property and equipment increased $1.6 million in the second quarter of 2016 as compared to the same period in 2015.

Other expense, net

Other non-operating expense, net, increased primarily due to $8.7 million of interest capitalization in the second quarter of 2015. There was no interest capitalization in the second quarter of 2016 as the drillship construction program was completed in 2015. Additionally, we recognized a gain of $1.8 million on the early extinguishment of debt in the second quarter of 2016.

Provision for income taxes

The effective tax rate increased to 9.5% in the second quarter of 2016 compared to an effective tax rate of 8.3% in the second quarter of 2015. The higher effective tax rate for the three months ended June 30, 2016 is primarily due to the recognition of unfavorable discrete items in the current quarter, partially offset by the change in the geographic mix of earnings.

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Six months ended June 30, 2016 compared to six months ended June 30, 2015

A summary of our consolidated results of operations follows (in thousands):

	Six months ended June 30,		Change	% Change
	2016	2015		
Deepwater:				
Revenues from external customers	$563,923	$308,760	$255,163	83 %
Operating expenses:				
Direct operating costs (excluding items below)	123,011	129,457	(6,446)	(5)%
Depreciation and amortization	57,239	38,813	18,426	47 %
Selling, general and administrative	—	—	—	n/m
Other operating items	298	—	298	n/m
Income (loss) from operations	$383,375	$140,490	$242,885	173 %
Jack-ups:				
Revenues from external customers	$548,118	$747,015	$(198,897)	(27)%
Operating expenses:				
Direct operating costs (excluding items below)	289,306	380,221	(90,915)	(24)%
Depreciation and amortization	139,485	139,958	(473)	— %
Selling, general and administrative	—	—	—	n/m
Other operating items	3,736	5,000	(1,264)	(25)%
Income (loss) from operations	$115,591	$221,836	$(106,245)	(48)%
Unallocated costs and other:				
Revenues from external customers	$—	$—	$—	n/m
Operating expenses:				
Direct operating costs (excluding items below)	—	—	—	n/m
Depreciation and amortization	2,269	6,309	(4,040)	(64)%
Selling, general and administrative	53,041	58,744	(5,703)	(10)%
Other operating items	81	(175)	256	n/m
Income (loss) from operations	$(55,391)	$(64,878)	$9,487	(15)%
Total company:				
Revenues	$1,112,041	$1,055,775	$56,266	5 %
Direct operating costs (excluding items below)	412,317	509,678	(97,361)	(19)%
Depreciation and amortization	198,993	185,080	13,913	8 %
Selling, general and administrative	53,041	58,744	(5,703)	(10)%
Other operating items	4,115	4,825	(710)	(15)%
Income from Operations	443,575	297,448	146,127	49 %
Other income (expense), net	(77,137)	(64,117)	(13,020)	20 %
Income before income taxes	366,438	233,331	133,107	57 %
Provision for income taxes	26,910	24,927	1,983	8 %
Net income	$339,528	$208,404	$131,124	63 %

"n/m" means not meaningful.

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Revenues

Consolidated. The increase in consolidated revenue is described below.

Deepwater. An analysis of the net changes in revenues for the six months ended June 30, 2016, compared to the six months ended June 30, 2015, are set forth below (in millions):

	Increase (decrease)
Contract Termination for Rowan Relentless and related items	$ 142.7
Addition of the Rowan Reliance and Rowan Relentless in February and June of 2015, respectively	119.0
Higher drillship utilization	2.3
Lower reimbursable revenues	(8.0)
Lower drillship average day rates	(0.8)
Net increase	$ 255.2

Jack-ups. An analysis of the net changes in revenues for the six months ended June 30, 2016, compared to the six months ended June 30, 2015, are set forth below (in millions):

	Increase (Decrease)
Lower jack-up utilization	(186.9)
Lower jack-up average day rates	(8.6)
Lower reimbursable revenues	(4.4)
Impact of jack-up sold in 2015	(0.7)
Higher other revenue	1.7
Net decrease	$ (198.9)

Direct operating costs

Consolidated. The decrease in consolidated direct operating costs is described below.

Deepwater. An analysis of the net changes in direct operating costs for the six months ended June 30, 2016, compared to the six months ended June 30, 2015, are set forth below (in millions):

	Increase (decrease)
Addition of the Rowan Reliance and Rowan Relentless	$ 19.7
Reduction in drillship operating expense	(17.0)
Lower Reimbursable costs	(8.0)
Reduction in shore base costs and other	(1.1)
Net decrease	$ (6.4)

Jack-ups. An analysis of the net changes in direct operating costs for the six months ended June 30, 2016, compared to the six months ended June 30, 2015, are set forth below (in millions):

	Increase (decrease)
Decrease due to idle or cold-stacked rigs	$ (50.1)
Reduction in jack-up direct operating expense	(21.7)
Reduction in shore base costs and other	(14.7)
Lower reimbursable costs	(4.4)
Net decrease	$ (90.9)

Depreciation and amortization

Depreciation and amortization for the six months ended June 30, 2016, increased largely due to the addition of the Rowan Reliance and Rowan Relentless in 2015.

Selling, general and administrative

Selling, general and administrative expenses for the six months ended June 30, 2016 declined primarily as a result of lower labor costs, largely due to reductions in headcount.

Other operating items

Material charges for the six months ended June 30, 2015, included a $5.0 million adjustment to an estimated liability for the termination of a contract in connection with refurbishment work on the Rowan Gorilla III. This matter was settled during the third quarter of 2015. Losses, net on disposals of property and equipment increased $4.3 million in the six months ended June 30, 2016 as compared to the same period in 2015.

Other expense, net

Other non-operating expense, net, increased primarily due to $16.2 million of interest capitalization in the six months ended June 30, 2015. There was no interest capitalization in the six months ended June 30, 2016 as the drillship construction program was completed in 2015. Additionally, we recognized a gain of $2.4 million on the early extinguishment of debt in the six months ended June 30, 2016.

Provision for income taxes

The effective tax rate decreased to 7.3% in the six months ended June 30, 2016 compared to an effective tax rate of 10.7% in the six months ended June 30, 2015. The lower rate in 2016 was attributable to the change in the geographic mix of earnings.

Rig Utilization

The following table sets forth an analysis of time that our rigs were idle or out-of-service as a percentage of available days (which excludes cold-stacked rigs) and time that our rigs experience operational downtime and are off-rate as a percentage of revenue-producing days:

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	Three months ended June 30, 2016	2015	Six months ended June 30, 2016	2015
Deepwater:				
Idle	10.7%	—	5.4 %	—
Out-of-service	—	—	0.3 %	—
Operational downtime	—	12.8%	0.1 %	9.5 %
Jack-up:				
Idle	21.7%	15.2%	23.1%	10.5%
Out-of-service	3.4 %	2.8 %	5.0 %	3.1 %
Operational downtime	1.9 %	1.4 %	1.3 %	1.5 %

Idle Days – We define idle days as the time a rig is not under contract and available to work. Idle days exclude cold-stacked rigs, which are not marketed.

Out-of-Service Days – We define out-of-service days as those days when a rig is (or is planned to be) out of service and is not able to earn revenue. The Company may be compensated for certain out-of-service days, such as for shipyard stays or for rig transit periods preceding a contract; however, recognition of any such compensation is deferred and recognized over the primary term of the drilling contract.

Operational Downtime – We define operational downtime as the unbillable time when a rig is under contract and unable to conduct planned operations due to equipment breakdowns or procedural failures.

LIQUIDITY AND CAPITAL RESOURCES

A comparison of key balance sheet amounts and ratios follows (dollars in millions):

	June 30, 2016	December 31, 2015
Cash and cash equivalents	$761.4	$ 484.2
Current assets	$1,342.1	$ 921.3
Current liabilities	$308.1	$ 328.7
Current ratio	4.36	2.80
Long-term debt, less current portion	$2,645.4	$ 2,692.4
Shareholders' equity	$5,126.8	$ 4,772.5
Debt-to-capitalization ratio	34 %	36 %

Sources and uses of cash and cash equivalents were as follows (in millions):

	Six months ended June 30, 2016	2015
Net cash provided by operating activities	$388.4	$448.7
Capital expenditures	(64.4)	(616.4)
Net borrowings (reductions) of debt	(47.9)	50.0
Payment of cash dividends	—	(25.2)
Proceeds from disposals of property and equipment	1.1	2.3
Total net source (use)	$277.2	$(140.6)

Operating Cash Flows

Cash flows from operations declined to approximately $388 million in 2016 from $449 million in the comparable prior-year period, primarily as a result of the timing of collections on trade receivables.

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The Company has not provided deferred income taxes on undistributed earnings of its non-U.K. subsidiaries, including RCI's non-U.S. subsidiaries. It is the Company's policy and intention to permanently reinvest earnings of non-U.S. subsidiaries of RCI outside the U.S. Generally, earnings of non-U.K. subsidiaries in which RCI does not have a direct or indirect ownership interest can be distributed to the Company without imposition of either U.K. or local country tax.

As of December 31, 2015, RCI's portion of the unremitted earnings of its non-U.S. subsidiaries that could be includable in taxable income of RCI, if distributed, was approximately $336.8 million. Should the non-U.S. subsidiaries of RCI make a distribution from these earnings, we may be subject to additional U.S. income taxes. It is not practicable to estimate the amount of deferred tax liability related to the undistributed earnings, and RCI's non-U.S. subsidiaries have no plan to distribute earnings in a manner that would cause them to be subject to U.S., U.K. or other local country taxation.

At June 30, 2016 RCI's non-U.S. subsidiaries held approximately $189 million of the $761 million of consolidated cash and cash equivalents. Management believes the Company has significant net assets, liquidity, contract backlog and/or other financial resources available to meet its operational and capital investment requirements and otherwise allow the Company to continue to maintain its policy of reinvesting such undistributed earnings outside the U.K. and U.S. indefinitely.

Backlog

Our backlog by geographic area as of the date of our most recent Fleet Status Report is presented below (in thousands):

	July 1, 2016		
	Jack-ups	Deepwater	Total
US GOM	$13,267	$886,500	$899,767
Middle East	1,211,610	—	1,211,610
North Sea	394,052	—	394,052
Central and South America	148,813	—	148,813
Total backlog	$1,767,742	$886,500	$2,654,242

We estimate our backlog will be realized as follows (in thousands):

	July 1, 2016		
	Jack-ups	Deepwater	Total
2016	$430,747	$257,729	$688,476
2017	681,207	496,451	1,177,658
2018	306,730	132,320	439,050
2019	64,970	—	64,970
2020 and later years	284,088	—	284,088
Total backlog	$1,767,742	$886,500	$2,654,242

Our contract backlog represents remaining contractual terms and may not reflect actual revenue due to a number renegotiations or factors such as rig downtime, estimated contract durations, customer concessions or contract cancellations.

About 65% of our remaining available rig days in 2016 and 46% of available rig days in 2017 were under contract or commitment as of July 1, 2016, excluding cold-stacked rigs. As of that date, we had three jack-ups that were cold-stacked and six that were available.

In 2014 and 2015, we recognized asset impairment charges on several of our jack-up drilling units as a result of the decline in market conditions and the expectation of future demand and day rates. If market conditions deteriorate further, we could be required to recognize additional impairment charges in future periods.

Investing Activities

Capital expenditures for the six months ended June 30, 2016, totaled $64.4 million and included the following:

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•$40.6 million for improvements to the existing fleet, including contractually required modifications; and
•$23.8 million for rig equipment and other.

We currently estimate our 2016 capital expenditures to range from approximately $145-$155 million, primarily for fleet maintenance, rig equipment, spares and other. This amount excludes any contractual modifications that may arise due to our securing additional work.

We expect to fund our 2016 capital expenditures using available cash and cash flows from operations.

The capital budget reflects an appropriation of money that we may or may not spend, and the timing of such expenditures may change. We will periodically review and adjust the capital budget as necessary based upon current and forecast cash flows and liquidity, anticipated market conditions in our business, the availability of financial resources, and alternative uses of capital to enhance shareholder value.

Financing Activities

During the six months ended June 30, 2016, we paid $45.8 million in cash to retire $47.9 million aggregate principal amount of the 5% Notes due 2017 and 7.875% Notes due 2019, plus accrued interest, and recognized a $2.4 million gain on early extinguishment of debt.

As of June 30, 2016, we had $2.7 billion principal amount of outstanding long-term debt consisting of $357.7 million principal amount of 5% Senior Notes due September 2017; $396.5 million principal amount of 7.875% Senior Notes due 2019; $700 million principal amount of 4.875% Senior Notes due 2022; $400 million aggregate principal amount of 4.75% Senior Notes due 2024; $400 million principal amount of 5.4% Senior Notes due 2042; and $400 million aggregate principal amount of 5.85% Senior Notes due 2044 (together, the “Senior Notes”). The Senior Notes are fully and unconditionally guaranteed on a senior and unsecured basis by Rowan plc.

Interest payments on the Senior Notes currently approximate $150 million annually, after giving effect to the repurchases made to date. No principal payments are required until each series’ final maturity date, although we may make additional repurchases depending on market prices and the availability of cash. Management believes that cash flows from operating activities, existing cash balances, and amounts available under the revolving credit facility will be sufficient to satisfy the Company’s cash requirements for the following twelve months.

Restrictive provisions in the Company’s bank credit facility agreement limit consolidated debt to 60% of book capitalization. Our consolidated debt to total capitalization ratio at June 30, 2016 was 34%.

Other provisions of our debt agreements limit the ability of the Company to create liens that secure debt, engage in sale and leaseback transactions, merge or consolidate with another company and, in the event of noncompliance, restrict investment activities and asset purchases and sales, among other things. The Company was in compliance with its debt covenants at June 30, 2016, and expects to remain in compliance over the following twelve months.

Letters of credit

We periodically employ letters of credit in the normal course of our business, and had outstanding letters of credit of approximately $10.7 million at June 30, 2016.

CRITICAL ACCOUNTING POLICIES AND MANAGEMENT ESTIMATES

The Company’s significant accounting policies are presented in Note 2 of “Notes to Consolidated Financial Statements” in Item 8 of our 2015 Form 10-K. These policies, and management judgments, assumptions and estimates made in their application underlie reported amounts of assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. We believe that our most critical accounting policies and management estimates involve carrying values of long-lived assets, pension and other postretirement benefit liabilities and costs (specifically, assumptions used in actuarial calculations), and income taxes (particularly our estimated reserves for uncertain tax positions). Changes in such policies and/or estimates would produce significantly different amounts from those reported herein.

During the quarter ended June 30, 2016, there were no material changes to the judgments, assumptions or policies upon which our critical accounting estimates were based.

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Recent Accounting Pronouncements

See Note 1 of the “Notes to Unaudited Condensed Consolidated Financial Statements” in Item 1 of PART I of this report.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Interest rate risk – Our outstanding debt at June 30, 2016, consisted entirely of fixed-rate debt with a carrying value of $2.645 billion and a weighted-average annual interest rate of 5.6%. Due to the fixed-rate nature of our debt, management believes the risk of loss due to changes in market interest rates is not material.

Currency exchange rate risk – A substantial majority of our revenues are received in U.S. dollars, which is our functional currency. However, in certain countries in which we operate, local laws or contracts may require us to receive some payment in the local currency. We are exposed to foreign currency exchange risk to the extent the amount of our monetary assets denominated in the foreign currency differs from our obligations in that foreign currency. In order to mitigate the effect of exchange rate risk, we attempt to limit foreign currency holdings to the extent they are needed to pay liabilities in the local currency. In the past, we have entered into spot purchases or short-term derivative transactions, such as forward exchange contracts, with one-month durations. We did not enter into such transactions for the purpose of speculation, trading or investing in the market and we believe that our use of forward exchange contracts has not exposed us to material credit risk or other material market risk. Although our risk policy allows us to enter into such forward exchange contracts, we do not currently anticipate entering into such transactions in the future and had no such contracts outstanding as of June 30, 2016.

Commodity price risk – Fluctuating commodity prices affect our future earnings materially to the extent that they influence demand for our products and services.

Fair Value Derivative Asset – At June 30, 2016, the fair value of the Contingent Payment Derivative was $6.4 million. We estimate the fair value of this instrument using Monte Carlo simulation which takes into account a variety of factors including the Price Targets, the WTI Spot price, the expected volatility, the risk-free interest rate, the slope of the WTI forward curve, and the remaining contractual term of the FMOG Provision. We are required to revalue this asset each quarter. We believe that the assumptions that have the greatest impact on the determination of fair value is the WTI Spot Price on the valuation date and the expected volatility. The following table illustrates the potential effect on the fair value of the derivative asset at June 30, 2016 from changes in the assumptions made which would lower the fair value (in thousands):

	Decrease in Asset Value
10% decrease in WTI spot price	$ 3,017
10% decrease in expected volatility	$ 290

Item 4. Controls and Procedures

Under the supervision and with the participation of our principal executive officer and principal financial officer, management has evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934) as of the end of the period covered by this report. Based on that evaluation, our principal executive officer and our principal financial officer have concluded that our disclosure controls and procedures were effective as of June 30, 2016.

There have been no changes to our internal controls over financial reporting during the quarter ended June 30, 2016, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

There were no new material legal proceedings filed during the quarter, nor any material developments to proceedings reported in prior periods.

Item 1A. Risk Factors

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There are numerous factors that affect our business and results of operations, many of which are beyond our control. Security holders and potential investors in our securities should carefully consider the risk factors set forth in our Annual Report on Form 10-K for the year ended December 31, 2015, in addition to other information in such annual report and in our Quarterly Reports on Form 10-Q. These risk factors are important factors that could cause our actual results to differ materially from those currently anticipated or expected.

The United Kingdom's referendum to exit from the European Union will have uncertain effects and could adversely impact our business, results of operations and financial condition.

On June 23, 2016, the U.K. voted to exit from the E.U. (commonly referred to as "Brexit"). The terms of Brexit and the resulting U.K./E.U. relationship are uncertain for companies doing business both in the U.K. and the overall global economy. In addition, our business and operations may be impacted by any subsequent vote in Scotland to seek independence from the U.K. The U.K. vote has impacted global markets, including currencies, and resulted in a sharp decline in the value of the British pound, as compared to the U.S. dollar and other currencies. Volatility in the securities markets and in currency exchange rates may continue as the U.K. negotiates its exit from the E.U. In the longer term, any impact from Brexit on our business and operations will depend, in part, on the outcome of tariff, tax treaties, trade, regulatory, and other negotiations. Approximately 7.6% and 5.7% of our total revenues were generated in the U.K. for the year ended December 31, 2015 and the six months ended June 30, 2016, respectively. Risks related to Brexit that we may encounter include:

- adverse impact on macroeconomic growth and oil and gas demand resulting from the strength of the U.S. dollar;
- continued volatility in currencies including the British pound and U.S. dollar that may impact our financial results;
- reduced demand for our services in the U.K. and globally;
- increased costs of doing business in the U.K. and in the North Sea;
- increased regulatory costs and challenges for operating our business in the North Sea;
- volatile capital and debt markets, and access to other sources of capital;
- risks related to our global tax structure and the tax treaties upon which we rely;
- business uncertainty resulting from prolonged political negotiations; and
- uncertain stability of the E.U. and global economy if other countries exit the E.U.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Issuer Purchases of Equity Securities

The following table presents information with respect to acquisitions of our shares for the second quarter of 2016:

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Month ended	Total number of shares acquired [1]	Average price paid per share [1]	Total number of shares purchased as part of publicly announced plans or programs [2]	Approximate dollar value of shares that may yet be purchased under the plans or programs [2]
Balance forward				$ —
April 30, 2016	45,690	$16.54	—	—
May 31, 2016	61,483	19.17	—	—
June 30, 2016	—	—	—	—
Total	107,173	$18.05	—	

[1] The total number of shares acquired reflects shares acquired from employees by an affiliated employee benefit trust (EBT) upon forfeiture of nonvested awards or in satisfaction of tax withholding requirements. The price paid for shares acquired as a result of forfeitures is the par value of $0.125 per share. The price paid for shares acquired in satisfaction of withholding taxes is the share price on the date of the transaction. In February 2015, we issued 1.1 million shares to the EBT, which shares were acquired at a price equal to the par value of $0.125 per share. There were no shares repurchased under any share repurchase program during the second quarter of 2016.

[2] The ability to make share repurchases is subject to the discretion of the Board of Directors and the limitations set forth in the Companies Act, which generally provide that share repurchases may only be made out of distributable reserves. In addition, U.K. law also generally prohibits a company from repurchasing its own shares through “off market purchases” without the prior approval of shareholders, which approval is valid for a maximum period of five years. Prior to and in connection with the redomestication, we obtained approval to purchase our own shares. To effect such repurchases, we entered into a purchase agreement with a specified dealer in July 2012, pursuant to which we may purchase up to a maximum of 50,000,000 shares over a five-year period, subject to an annual cap of 10% of the shares outstanding at the beginning of each applicable year. Subject to Board approval, share repurchases may be commenced or suspended from time to time without prior notice and, in accordance with the shareholder approval and U.K. law, any shares repurchased by us will be cancelled. This authority to repurchase shares terminates in April 2017 unless otherwise reapproved by our shareholders prior to that time. U.K. law prohibits us from

conducting “on market purchases” because our shares are not traded on a recognized investment exchange in the U.K.

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Item 6. Exhibits

The following is a list of exhibits filed with this Form 10-Q:

31.1*	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1*	Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2*	Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS*	XBRL Instance Document.
101.SCH*	XBRL Taxonomy Extension Schema Document.
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document.
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document.

* Filed or furnished herewith.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

	ROWAN COMPANIES PLC (Registrant)
Date: August 2, 2016	/s/ STEPHEN M. BUTZ Stephen M. Butz Executive Vice President, Chief Financial Officer
Date: August 2, 2016	/s/ DENNIS S. BALDWIN Dennis S. Baldwin Chief Accounting Officer