FORM 10-Q

Quarterly report pursuant to sections 13 or 15(d)

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COVENTRY HEALTH CARE INC

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549
FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2000

OR

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

For the transition period from _____________ to ________________

Commission File Number 0-19147

COVENTRY HEALTH CARE, INC.
(Exact name of registrant as specified in its charter)

Delaware	**52-2073000**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

6705 Rockledge Drive, Suite 900, Bethesda, Maryland 20817
(Address of principal executive offices) (Zip Code)

(301) 581-0600
(Registrant' s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES [X] NO [ ]

Indicate the number of shares outstanding of each of the issuer' s classes of common stock, as of the latest practicable date.

Class	Outstanding at October 31, 2000
Common Stock $.01 Par Value	59,413,477

COVENTRY HEALTH CARE, INC.

FORM 10-Q

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PART I. Financial Information
ITEM 1: Financial Statements

COVENTRY HEALTH CARE, INC. AND SUBSIDIARIES
Consolidated Balance Sheets
(in thousands, except share data)

	September 30, 2000	December 31, 1999
	(unaudited)	
ASSETS		

Cash and cash equivalents	$ 173,322	$ 240,076
Short-term investments	80,064	88,365
Accounts receivable, net	59,089	53,173
Other receivables, net	60,550	42,304
Deferred income taxes	56,157	56,157
Other current assets	6,315	3,330
Total current assets	435,497	483,405
Long-term investments	369,343	286,162
Property and equipment, net	39,020	37,863
Goodwill and intangible assets, net	265,801	268,289
Other long-term assets	6,926	5,864
Total assets	$ 1,116,587	$ 1,081,583
LIABILITIES AND STOCKHOLDERS' EQUITY		
Medical claim liabilities	$ 321,717	$ 308,095
Other medical liabilities	48,672	54,691
Accounts payable and other accrued liabilities	136,011	110,186
Deferred revenue	19,666	49,914
Total current liabilities	526,066	522,886
Long-term liabilities	22,305	31,217
Total liabilities	548,371	554,103
Redeemable convertible preferred stock, $.01 par value; Series A, 6,000,000 shares authorized; 4,709,545 shares issued and 4,235,840 outstanding in 2000; and 4,709,545 issued and outstanding in 1999	42,358	47,095
Stockholders' equity:		
Common stock, $.01 par value; 200,000,000 shares authorized; 60,552,791 shares issued and 59,340,088 outstanding in 2000; and 59,643,753 shares issued and 59,148,797 outstanding in 1999	606	596
Treasury stock, at cost, 1,212,703 and 494,956 shares in 2000 and 1999, respectively	(10,989)	(5,380)
Additional paid-in capital	489,875	480,792
Accumulated other comprehensive loss	(1,193)	(2,780)
Retained earnings	47,559	7,157
Total stockholders' equity	525,858	480,385
Total liabilities and stockholders' equity	$ 1,116,587	$ 1,081,583

SEE NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.

COVENTRY HEALTH CARE, INC. AND SUBSIDIARIES
Consolidated Statements of Operations
(in thousands, except per share data)
(unaudited)

	Quarters Ended September 30, 2000	Quarters Ended September 30, 1999	Nine Months Ended September 30, 2000	Nine Months Ended September 30, 1999
Operating revenues:				
Managed care premiums	$635,361	$509,815	$1,851,800	$1,529,088
Management services	12,256	20,074	34,421	60,479
Total operating revenues	647,617	529,889	1,886,221	1,589,567
Operating expenses:				
Health benefits	544,019	437,674	1,584,245	1,310,804
Selling, general and administrative	81,819	73,790	242,850	227,962
Depreciation and amortization	6,852	7,034	20,276	21,079
Total operating expenses	632,690	518,498	1,847,371	1,559,845
Operating earnings	14,927	11,391	38,850	29,722
Other income, net	10,742	7,805	29,078	20,578
Earnings before income taxes	25,669	19,196	67,928	50,300
Provision for income taxes	10,263	8,226	27,525	21,880
Net earnings	$ 15,406	$ 10,970	$ 40,403	$ 28,420
Net earnings per share:				
Basic	$ 0.26	$ 0.19	$ 0.69	$ 0.48
Diluted	$ 0.23	$ 0.17	$ 0.62	$ 0.46

SEE NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.

COVENTRY HEALTH CARE, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Cash Flows
(in thousands)
(unaudited)

Nine Months Ended
September 30,

	2000	1999
Net cash from operating activities	$ 19,401	$ (66,759)
Cash flows from investing activities:		
Capital expenditures, net	(13,766)	(8,999)
Net proceeds from sale of intangibles	--	12,841
Sales of investments	318,379	171,863
Purchases of investments	(388,586)	(331,397)
Payments for acquisitions, net of cash acquired	440	--
Net cash from investing activities	(83,533)	(155,692)
Cash flows from financing activities:		
Payments on long-term debt and notes payable	--	(829)
Net payments for repurchase and issuance of stock	(2,622)	3,366
Net cash from financing activities	(2,622)	2,537
Net decrease in cash and cash equivalents	(66,754)	(219,914)
Cash and cash equivalents at beginning of period	240,076	405,323
Cash and cash equivalents at end of period	$ 173,322	$ 185,409
Supplemental disclosure of cash flow information:		
Cash paid for interest	$ --	$ 25
Income taxes paid, net	$ 8,500	$ 23,920

SEE NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.

Coventry Health Care, Inc. and Subsidiaries
Notes to the Condensed Consolidated Financial Statements
(unaudited)

1. BASIS OF PRESENTATION

The condensed consolidated financial statements of Coventry Health Care, Inc. and Subsidiaries (“Coventry” or “the Company”) contained in this report are unaudited but reflect all adjustments, consisting of normal recurring adjustments which, in the opinion of management, are necessary for the fair presentation of the results of the interim periods reflected. Certain information and footnote disclosures normally included in the consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States have been omitted pursuant to applicable rules and regulations of the Securities and Exchange Commission (“the SEC”). The results of operations for the interim periods reported herein are not necessarily indicative of results to be expected for the full year. It is suggested that these condensed consolidated financial statements be read in conjunction with the consolidated financial statements and notes thereto included in the Company’ s most recent Annual Report on Form 10-K for the year ended December 31, 1999, filed with the SEC on March 29, 2000.

2. SIGNIFICANT ACCOUNTING POLICIES

In June 1998, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 133 requires companies to record derivatives on the balance sheet as assets or liabilities, measured at fair value. Gains or losses resulting from changes in the values of the derivatives would be accounted for depending on the use of the derivatives and whether they qualify for hedge accounting. In June 1999, the FASB also issued SFAS No. 137, which defers the effective date of SFAS No. 133 until fiscal years beginning after June 15, 2000. The Company does not believe that adoption of SFAS No. 133 (as amended by SFAS No. 137) will have a material affect on its future results of operations.

In December 1999, the SEC issued Staff Accounting Bulletin No. 101 ("SAB No. 101"), "Revenue Recognition in Financial Statements." SAB No. 101 provides guidance on applying generally accepted accounting principals to revenue recognition, presentation and disclosure in financial statements. Subsequently, the SEC has amended the implementation dates so that the Company is required to adopt the provisions of SAB No. 101 in the fourth quarter of 2000. The Company does not believe the impact of SAB No. 101 will materially affect its future results of operations or financial position.

3. ACQUISITIONS AND DISPOSITIONS

Effective October 1, 1999, the Company acquired Carelink Health Plans ("Carelink"), the managed care subsidiary of Camcare, Inc., for a total purchase price of approximately $8.4 million including transaction costs of approximately $0.4 million. The acquisition was accounted for using the purchase method of accounting, and, accordingly, the operating results of Carelink have been included in the Company' s consolidated financial statements since the date of the acquisition. The purchase price for Carelink was allocated to the assets, including the identifiable intangible assets, and liabilities based on estimated fair values. The $4.7 million excess of purchase price over the net identifiable assets acquired was allocated to goodwill, which is amortized over a useful life of 25 years.

On November 1, 1999, the Company' s subsidiary, Coventry Health Care of the Carolinas, Inc., acquired Kaiser Foundation Health Plan of North Carolina' s commercial membership, of approximately 31,000, in Charlotte, North Carolina. The total purchase price was approximately $2.1 million including transaction costs.

In the fourth quarter of 1999, the Company notified the Indiana Department of Insurance of its intention to close its subsidiary, Coventry Health Care of Indiana, Inc. As of September 30, 2000, the health plan had approximately 500 members throughout the state. As a result of the costs associated with exiting the Indiana market, the Company recorded a reserve of $2.0 million in the fourth quarter of 1999. The Company plans to close the health plan by the end of the fourth quarter 2000 and has expended approximately $1.0 million of the reserve as of September 30, 2000.

Effective February 1, 2000, the Company completed its acquisition of The Anthem Company' s West Virginia managed care subsidiary, PrimeONE, Inc., ("PrimeONE"), for a purchase price of $1.25 million plus statutory net worth and transaction costs for a total approximate purchase price of $4.3 million. The acquisition was accounted for using the purchase method of accounting, and, accordingly, the operating results of PrimeONE have been included in the Company' s consolidated financial statements since the date of the acquisition. The purchase price for PrimeONE was allocated to the assets, including the identifiable intangible assets, and liabilities based on estimated fair values. The $1.9 million excess of purchase price over the net identifiable assets acquired was allocated to goodwill, which is amortized over a useful life of 25 years.

On February 3, 2000, Coventry completed the acquisition of Prudential Health Care Plan, Inc.' s Medicaid business in St. Louis, Missouri for approximately $100 per member that ultimately transferred to the Company. The transition period has ended and final payment for the purchase of the Medicaid business of approximately 9,400 members was made during the third quarter of 2000.

On August 1, 2000, Coventry completed the acquisition of Maxicare Louisiana, Inc. ("Maxicare") for a purchase price of $550,000 plus statutory net worth and transaction costs for a total approximate purchase price of $3.5 million. As of the purchase date, Maxicare had approximately 14,000 members. The acquisition was accounted for using the purchase method of accounting, and, accordingly, the operating results of Maxicare have been included in the Company' s consolidated financial statements since the date of the acquisition. The purchase price for Maxicare was allocated to the assets, including identifiable intangible assets, and liabilities based on the estimated fair values. The $1.7 million excess of purchase price over the net identifiable assets acquired was allocated to goodwill, which is amortized over a useful life of 25 years.

4. CONVERTIBLE EXCHANGEABLE SUBORDINATED NOTES AND REDEEMABLE CONVERTIBLE PREFERRED STOCK

During the second and third quarters of 1999, the Company converted all the Convertible Exchangeable Senior Subordinated Notes held by Warburg, Pincus Ventures, L.P. and Franklin Capital Associates III, L.P. ("Franklin") totaling $47.1 million, including accumulated interest, into 4,709,545 shares of Series A redeemable convertible preferred stock ("preferred stock") at a price of $10 per share. The preferred stock is subject to mandatory redemption at a price of $10 per share (subject to adjustment for any stock dividend, stock split, stock distribution or combination thereof), plus accrued dividends, on May 15, 2002, 2003 and 2004 in an amount equal to one-third of the shares outstanding on the first redemption date, or such lesser number of shares as shall then be outstanding. The preferred stock is carried at its fair value, which equals both its redemption value and liquidation value as of September 30, 2000. The holders of the preferred stock are entitled to receive, when and as declared, dividends payable in additional shares of preferred stock, before any dividends shall be set apart for or paid to holders of common stock. The preferred stock is convertible to common stock on a share-for-share basis, subject to adjustment for anti-dilution, and is callable by the Company if the market price of the Company' s common stock exceeds certain agreed upon targets. On July 20, 2000, Franklin converted all of its 473,705 shares of preferred stock into common stock of the Company on a one-for-one basis, thus reducing the outstanding balance of preferred stock to 4,235,840 shares.

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5. COMPREHENSIVE INCOME

Comprehensive income for the quarters and nine months ended September 30, 2000 and 1999 is as follows (in thousands):

	September 30, 2000	September 30, 1999	September 30, 2000	September 30, 1999
Net earnings	$15,406	$ 10,970	$40,403	$ 28,420
Other comprehensive gain (loss), net of tax:				
Net unrealized gains (losses) on securities, net of reclassification adjustment	853	(722)	1,587	(4,802)
Comprehensive income	$16,259	$ 10,248	$41,990	$ 23,618

6. EARNINGS PER SHARE

Basic earnings per share ("EPS") are based on the weighted average number of common shares outstanding during the year. Diluted EPS, when applicable, assumes the conversion of convertible notes and the exercise of all options, warrants and redeemable convertible preferred stock using the treasury stock method. Net earnings are increased for the assumed elimination of interest expense on the convertible notes.

The following table summarizes the earnings and the average number of common shares used in the calculation of basic and diluted EPS (in thousands, except for per share amounts):

	Quarter Ended September 30, 2000		
	Earnings (Numerator)	Shares (Denominator)	Per Share Amount

	Earnings (Numerator)	Shares (Denominator)	Per Share Amount
Basic EPS	$ 15,406	59,223	$ 0.26
Effect of dilutive securities:			
Options and warrants		3,257	
Redeemable convertible preferred stock		4,236	
Diluted EPS	$ 15,406	66,716	$ 0.23

Quarter Ended September 30, 1999

	Earnings (Numerator)	Shares (Denominator)	Per Share Amount
Basic EPS	$ 10,970	59,102	$ 0.19
Effect of dilutive securities:			
Options and warrants		517	
Redeemable convertible preferred stock		1,717	
Convertible notes		2,993	
Diluted EPS	$ 10,970	64,329	$ 0.17

Nine Months Ended September 30, 2000

	Earnings (Numerator)	Shares (Denominator)	Per Share Amount
Basic EPS	$ 40,403	58,889	$ 0.69
Effect of dilutive securities:			
Options and warrants		1,470	
Redeemable convertible preferred stock		4,550	
Diluted EPS	$ 40,403	64,909	$ 0.62

Nine Months Ended September 30, 1999

	Earnings (Numerator)	Shares (Denominator)	Per Share Amount
Basic EPS	$ 28,420	58,972	$ 0.48
Effect of dilutive securities:			
Options and warrants		663	
Redeemable convertible preferred stock		605	
Convertible notes		4,035	
Interest on convertible notes	848		

Diluted EPS	$ 29,268	64,275	$ 0.46

7. SEGMENT INFORMATION

SFAS No. 131, “Disclosures about Segments of an Enterprise and Related Information”, requires that a public business enterprise report financial and descriptive information about its reportable operating segments. Operating segments are components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision-maker in deciding how to allocate resources and in assessing performance. SFAS No. 131 also requires that all public business enterprises report information about the revenues derived from the enterprise’ s products or services (or groups of similar products and services), about the countries in which the enterprise earns revenues and holds assets and about major customers regardless of whether that information is used in making operating decisions.

The Company has two reportable segments: commercial products and government products. The products are provided to a cross section of employer groups and individuals through the Company’ s health plans in the Midwest, Mid-Atlantic, and Southeastern United States. Commercial products include health maintenance organization (“HMO”), preferred provider organization (“PPO”), and point-of-service (“POS”) products. HMO products provide comprehensive health care benefits to members through a primary care physician. PPO and POS products permit members to participate in managed care but allow them the flexibility to utilize out-of-network providers in exchange for increased out-of-pocket costs.

Government products include Medicare Risk and Medicaid. The Company provides comprehensive health benefits to members participating in government programs and receives premium payments from federal and state governments. The Company evaluates the performance of its operating segments and allocates resources based on gross margin. Assets are not allocated to specific products and, accordingly, cannot be reported by segment.

Quarter Ended September 30, 2000
(in thousands)

	Commercial	Government Programs	Total
Revenues	$ 459,724	$ 175,637	$ 635,361
Gross Margin	64,198	27,144	91,342

Quarter Ended September 30, 1999
(in thousands)

	Commercial	Government Programs	Total
Revenues	$ 371,115	$ 138,700	$ 509,815
Gross Margin	53,142	18,999	72,141

Nine Months Ended September 30, 2000
(in thousands)

	Commercial	Government Programs	Total
Revenues	$ 1,340,237	$ 511,563	$ 1,851,800
Gross Margin	200,579	66,976	267,555

	Nine Months Ended September 30, 1999 (in thousands)		
	Commercial	Government Programs	Total
Revenues	$ 1,137,208	$ 391,880	$ 1,529,088
Gross Margin	172,740	45,544	218,284

Following are reconciliations of total reportable segment information to financial statement amounts:

	Quarters Ended September 30,		Nine Months Ended September 30,	
	2000	1999	2000	1999
Revenues:				
Reportable segments	$ 635,361	$ 509,815	$ 1,851,800	$ 1,529,088
Management services	12,256	20,074	34,421	60,479
Total revenues	$ 647,617	$ 529,889	$ 1,886,221	$ 1,589,567
Earnings before income taxes:				
Gross margin from reportable segments	$ 91,342	$ 72,141	$ 267,555	$ 218,284
Management Services	12,256	20,074	34,421	60,479
Selling, general and administrative	(81,819)	(73,790)	(242,850)	(227,962)
Depreciation and amortization	(6,852)	(7,034)	(20,276)	(21,079)
Other income, net	10,742	7,805	29,078	20,578
Earnings before income taxes	$ 25,669	$ 19,196	$ 67,928	$ 50,300

8. LEGAL PROCEEDINGS

In the normal course of business, the Company has been named as a defendant in various legal actions such as actions seeking payments for claims denied by the Company, medical malpractice actions, and other various claims seeking monetary damages. The claims are in various stages of proceedings and some may ultimately be brought to trial. Incidents occurring through September 30, 2000 may result in the assertion of additional claims. With respect to medical malpractice, the Company carries professional malpractice and general liability insurance for each of its operations on a claims-made basis with varying deductibles for which the Company maintains reserves. In the opinion of management, the outcome of these actions should not have a material, adverse effect on the financial position or results of operations of the Company.

Other managed care companies have been sued recently in class action lawsuits claiming violations of the federal racketeering act ("RICO") and federal employee benefits law ("ERISA"), and generally claiming that managed care companies overcharge consumers and misrepresent that they deliver quality health care. Although it is possible that the Company may be the target of a similar suit, the Company has not been named in such a suit and believes there is no valid basis for such a suit.

The Company' s industry is heavily regulated and the laws and rules governing the industry and interpretations of those laws and rules are subject to frequent change. Existing or future laws could have a significant impact on the Company' s operations.

As reported in the Company' s Annual Report on Form 10-K for the year ended December 31, 1999, and updated in its Form 10-Q for the quarters ended March 31 and June 30, 2000, the Company has been in dispute with Unity Health Network ("Unity") and with BJC Health System ("BJC"). In the second quarter of 2000, the Company initiated arbitration proceedings against Unity for deficits in the risk fund pools for 1999. On October 10, 2000, the parties entered into a settlement agreement pursuant to which Unity will pay the Company' s subsidiary, Group Health Plan ("GHP"), approximately $7.4 million to fund the risk pool deficits.

With respect to the dispute with BJC, on October 12, 2000 the parties settled the arbitration and all related matters by mutual agreement. As part of the settlement, BJC will receive approximately $4.0 million from the Company' s subsidiaries GHP and HealthCare USA ("HCUSA"), an amount for which the Company had previously reserved. Effective January 1, 2001, the current global capitation contract between GHP and BJC covering approximately 63,000 members will terminate and be replaced by a new 2-year fee-for-service provider contracts with BJC and Washington University Physician Network ("WUPN"). Also, effective January 1, 2001, the current global capitation contract between HCUSA and BJC covering approximately 27,000 members will terminate and be replaced by a new 2-year fee-for-service provider contract with BJC, and a 1-year provider agreement with WUPN. As the Company has for some time anticipated a restructuring of these provider contracts, and priced its products based upon underlying costs, the new contracts are expected to have an immaterial impact on the Company' s 2001 financial results.

9. SUBSEQUENT EVENTS

On October 2, 2000, Coventry completed the acquisition of WellPath Community Health Plans ("WellPath"), the managed care subsidiary of Duke University Health System, located in Chapel Hill, North Carolina. The purchase price was $20.7 million and WellPath had approximately 151,000 members as of September 30, 2000.

On October 26, 2000, Coventry signed a definitive agreement to acquire Health Partners of the Midwest' s ("Health Partners") commercial membership and certain provider agreements for approximately $4.5 million. Health Partners is a St. Louis based, not-for-profit health plan affiliated with BJC and Washington University School of Medicine ("WUSM"). Coventry expects to retain approximately 42,000 fully insured commercial members and 25,000 self-insured members. As part of the acquisition, GHP will enter into provider contracts with BJC and WUPN for health care services for the Health Partners membership and a three-year contract to administer BJC' s self-funded managed care health benefit program for employees. The acquisition will be accounted for as an asset purchase and is expected to close in the first quarter of 2001, subject to receipt of regulatory and other customary approvals.

ITEM 2: Management' s Discussion and Analysis of Financial Condition and Results of Operations

Quarters and Nine Months Ended September 30, 2000 and 1999

The statements contained in this Form 10-Q that are not historical are forward-looking statements, made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, which are subject to risks and uncertainties. These forward-looking statements may be affected by a number of factors, including the "Risk Factors" contained in Management' s Discussion and Analysis of Financial Condition and Results of Operations contained in Item 7 of the Company' s Annual Report on Form 10-K for the year ended December 31, 1999, and actual operations and results may differ materially from those expressed in this Form 10-Q. Among the factors that may materially affect the Company' s business are potential increases in medical costs, difficulties in increasing premiums due to competitive pressures, price restrictions under Medicaid and Medicare, imposition of regulatory restrictions, issues relating to marketing of products or accreditation or certification of the products by private or governmental bodies, difficulties in obtaining or maintaining favorable contracts with health care providers, credit risks on global capitation arrangements, financing costs and contingencies and litigation risk.

GENERAL

Overview

Coventry Health Care, Inc. (together with its subsidiaries, “the Company”, “Coventry”, “we”, “our”, or “us”) is a managed health care company operating health plans under the names Coventry Health Care, Coventry Health and Life, HealthAmerica, HealthAssurance, HealthCare USA, Group Health Plan, Southern Health, Carelink Health Plans, and WellPath. The Company provides a full range of managed care products and services including health maintenance organization (“HMO”), point-of-service (“POS”), preferred provider organization (“PPO”) products, and Medicare Risk and Medicaid products. The Company also administers self-insured plans for large employer groups. Coventry was incorporated under the laws of the State of Delaware on December 17, 1997 and is the successor to Coventry Corporation, which was incorporated on November 21, 1986.

As of September 30, 2000, in continuing operations, Coventry had 1,314,277 members for whom it assumes underwriting risk (“risk members”) and 236,307 members of self-insured employers for whom it provides management services, but does not assume underwriting risk (“non-risk members”). The following tables show the total number of members as of September 30, 2000 and 1999 and the percentage change in membership between those dates:

	September 30, 2000	September 30, 1999	Percent Change
Risk membership in continuing operations:			
Carolinas	37,170	19,139	94.2%
Delaware	80,644	57,048	41.4%
Georgia	32,263	26,314	22.6%
Iowa	71,376	76,703	(6.9%)
Kansas City	83,019	64,148	29.4%
Louisiana	56,943	36,267	57.0%
Nebraska	31,732	26,686	18.9%
Pennsylvania	382,243	369,815	3.4%
Richmond	54,409	52,302	4.0%
St. Louis	348,030	311,893	11.6%
West Virginia	93,865	21,824	330.1%
Wichita	42,583	39,976	6.5%
Total risk membership	1,314,277	1,102,115	19.3%
Total non-risk membership	236,307	237,903	(0.7%)
Total membership in continuing operations	1,550,584	1,340,018	15.7%
Total membership in non-continuing operations:			
Indiana	511	23,985	(97.9%)
Total membership	1,551,095	1,364,003	13.7%

	September 30, 2000	September 30, 1999	Percent Change
Risk membership in continuing operations:			
Commercial	1,059,795	910,466	16.4%
Governmental Programs	254,482	191,649	32.8%
Total risk membership in continuing operations	1,314,277	1,102,115	19.3%
Total non-risk membership	236,307	237,903	(0.7%)
Total membership in continuing operations	1,550,584	1,340,018	15.7%
Total membership in non-continuing operations:			

Indiana	511	23,985	(97.9%)
Total membership	1,551,095	1,364,003	13.7%

The Company' s operating expenses are primarily medical costs, including medical claims under contractual relationships with a wide variety of providers, and capitation payments. Medical claims expense also includes an estimate of claims incurred but not reported ("IBNR"). The Company currently believes that the estimates for IBNR liabilities relating to its businesses are adequate in order to satisfy its ultimate claims liability with respect thereto. In determining the Company' s medical claims liabilities, the Company employs standard actuarial reserve methods (specific to the plans' membership, product characteristics, geographic territories and provider networks) that consider utilization frequency and unit costs of inpatient, outpatient, pharmacy and other medical costs, as well as claim payment backlogs and the changing timing of provider reimbursement practices. Underwriting, finance, accounting, and other appropriate plan and corporate personnel review calculated reserves, and judgments are then made as to the necessity for reserves in addition to the calculated amounts. Changes in assumptions for medical costs caused by changes in actual experience, changes in the delivery system, changes in pricing due to ancillary capitation and fluctuations in the claims backlog could cause these estimates to change in the near term. The Company periodically monitors and reviews its IBNR reserves, and as actual settlements are made or accruals adjusted, differences are reflected in current operations.

Acquisitions and Dispositions

After the merger on April 1, 1998, between Coventry and Principal Health Care, Inc. ("PHC"), the PHC plans continued to use the Principal brand name under the terms of the License Agreement, as amended, between the parties even though the Plans were no longer subsidiaries of Principal Life. In the fourth quarter of 1999, the Company' s PHC subsidiaries changed the word Principal in their names to Coventry. All aspects of the health plans' operations, such as member coverage and access, remained unchanged.

Effective October 1, 1999, the Company acquired Carelink Health Plans ("Carelink"), the managed care subsidiary of Camcare, Inc., for a total purchase price of approximately $8.4 million including transaction costs of approximately $0.4 million. The acquisition was accounted for using the purchase method of accounting, and, accordingly, the operating results of Carelink have been included in the Company' s consolidated financial statements since the date of the acquisition. The purchase price for Carelink was allocated to the assets, including the identifiable intangible assets, and liabilities based on estimated fair values. The $4.7 million excess of purchase price over the net identifiable assets acquired was allocated to goodwill, which is being amortized over a useful life of 25 years. Carelink is the market leader and has a broad provider network in West Virginia with a service area covering the majority of the state' s population.

On November 1, 1999, the Company' s subsidiary, Coventry Health Care of the Carolinas, Inc., acquired Kaiser Foundation Health Plan of North Carolina, Inc. 's ("KFHPNC") commercial membership, of approximately 31,000, in Charlotte, North Carolina. The total purchase price was approximately $2.1 million including transaction costs. The transaction more than doubles Coventry' s membership in the Charlotte market.

In the fourth quarter of 1999, the Company notified the Indiana Department of Insurance of its intention to close its subsidiary, Coventry Health Care of Indiana, Inc. As of September 30, 2000, the health plan had approximately 500 members throughout the state. As a result of the costs associated with exiting the Indiana market, Coventry recorded a reserve of $2.0 million in the fourth quarter of 1999. Coventry has expended approximately $1.0 million of the reserve as of September 30, 2000 and expects to close the plan by the end of the fourth quarter 2000.

Effective February 1, 2000, the Company completed its acquisition of The Anthem Company' s West Virginia managed care subsidiary, PrimeONE, Inc., ("PrimeONE"), for a purchase price of $1.25 million plus statutory net worth and transaction costs for a total approximate purchase price of $4.3 million. The acquisition was accounted for using the purchase method of accounting, and, accordingly, the operating results of PrimeONE have been included in the Company' s consolidated financial statements since the date of the acquisition. The purchase price for PrimeONE was allocated to the assets, including the identifiable intangible assets, and liabilities based on estimated fair values. The $1.9 million excess of purchase price over the net identifiable assets acquired was allocated to goodwill, which is amortized over a useful life of 25 years. This transaction, combined with the Carelink acquisition, solidifies Coventry' s market leadership position in West Virginia.

On February 3, 2000, Coventry completed the acquisition of Prudential Health Care Plan, Inc. 's ("Prudential") Medicaid business in St. Louis, Missouri for approximately $100 per member that ultimately transferred to the Company. The transition period has ended and final payment for the purchase of the Medicaid business of approximately 9,400 members was made during the third quarter of 2000.

On August 1, 2000, Coventry completed the acquisition of Maxicare Louisiana, Inc., ("Maxicare"), for a purchase price of $550,000 plus statutory net worth and transaction costs for a total approximate purchase price of $3.5 million. As of the purchase date, Maxicare had approximately 14,000 members. The acquisition was accounted for using the purchase method of accounting, and, accordingly, the operating results of Maxicare have been included in the Company' s consolidated financial statements since the date of the acquisition. The purchase price for Maxicare was allocated to the assets, including identifiable intangible assets, and liabilities based on the estimated fair values. The $1.7 million excess of purchase price over the net identifiable assets acquired was allocated to goodwill, which is amortized over a useful life of 25 years.

Joint Venture

The Company announced in the first quarter of 2000 that it entered into an agreement with E.M. Warburg, Pincus & Co., L.L.C. ("Warburg Pincus") and Frederick C. Dunlap to fund a company that will seek to invest in emerging companies that are developing technology applications for the health care industry. After an initial working capital investment provided by Warburg Pincus, the joint venture investments will be funded 80.1% by Warburg Pincus and Frederick C. Dunlap and 19.9% by Coventry. Coventry has the ability to decrease the 19.9% contribution at its discretion and, through September 30, 2000, less than $1,000 has been contributed by Coventry.

Legal Proceedings

In the normal course of business, the Company has been named as a defendant in various legal actions such as actions seeking payments for claims denied by the Company, medical malpractice actions, and other various claims seeking monetary damages. The claims are in various stages of proceedings and some may ultimately be brought to trial. Incidents occurring through September 30, 2000 may result in the assertion of additional claims. With respect to medical malpractice, the Company carries professional malpractice and general liability insurance for each of its operations on a claims-made basis with varying deductibles for which the Company maintains reserves. In the opinion of management, the outcome of these actions should not have a material, adverse effect on the financial position or results of operations of the Company.

Other managed care companies have been sued recently in class action lawsuits claiming violations of the federal racketeering act ("RICO") and federal employee benefits law ("ERISA"), and generally claiming that managed care companies overcharge consumers and misrepresent that they deliver quality health care. Although it is possible that the Company may be the target of a similar suit, the Company has not been named in such a suit and believes there is no valid basis for such a suit.

The Company' s industry is heavily regulated and the laws and rules governing the industry and interpretations of those laws and rules are subject to frequent change. Existing or future laws could have a significant impact on the Company' s operations.

As reported in the Company' s Annual Report on Form 10-K for the year ended December 31, 1999, and updated in its Form 10-Q for the quarters ended March 31 and June 30, 2000, the Company has been in dispute with Unity Health Network ("Unity") and with BJC Health System ("BJC"). In the second quarter of 2000, the Company initiated arbitration proceedings against Unity for deficits in the risk fund pools for 1999. On October 10, 2000, the parties entered into a settlement agreement pursuant to which Unity will pay the Company' s subsidiary, Group Health Plan ("GHP"), approximately $7.4 million to fund the risk pool deficits. The settlement will have an immaterial impact on the Company' s 2001 financial results.

With respect to the dispute with BJC, on October 12, 2000 the parties settled the arbitration and all related matters by mutual agreement. As part of the settlement, BJC will receive approximately $4.0 million from the Company' s subsidiaries GHP and HealthCare USA ("HCUSA"), an amount for which the Company had previously reserved. Effective January 1, 2001, the current global capitation contract between GHP and BJC covering approximately 63,000 members will terminate and be replaced by a new 2-year fee-for-service provider contracts with BJC and Washington University Physician Network ("WUPN"). Also, effective January 1, 2001, the current global capitation contract between HCUSA and BJC covering approximately 27,000 members will terminate and be replaced by a new 2-year fee-for-service provider contract with BJC, and a 1-year provider agreement with WUPN. As the Company has for some time anticipated a restructuring of these provider contracts, and priced its products based upon underlying costs, the new contracts are expected to have an immaterial impact on the Company' s 2001 financial results.

RESULTS OF OPERATIONS

Quarters Ended September 30, 2000 and 1999

Total membership, as of September 30, 2000, increased approximately 211,000, or 15.7%, in continuing operations compared to September 30, 1999. Of the 15.7% increase, 9.9% is due to the acquisitions of Carelink, PrimeONE, and Maxicare and the membership purchases of KFHPNC in North Carolina and Prudential in St. Louis, Missouri. The remaining increase is the result of continued strong enrollment across all product areas. Commercial membership increased approximately 149,000, or 16.4%, and government program membership increased approximately 63,000, or 32.8%, from the third quarter of 1999. Membership decreased in a small number of markets due to Coventry' s efforts to adhere to a strict pricing discipline.

Managed care premiums increased $125.5 million, or 24.6%, from the prior year' s third quarter. The increase is attributable to rate increases, same store membership growth, and acquisitions. The increase in rates is primarily due to commercial rate increases that included an increase in excess of 12.5% on third quarter renewals. Total premium yields for the third quarter of 2000 increased by an average of $11.18, or 7.3%, from the prior year' s third quarter on a per member per month ("PMPM") basis, to $163.86 PMPM. The increase in premium revenue from acquisitions was a result of the purchases of Carelink and the KFHPNC membership in the fourth quarter of 1999, the purchase of PrimeONE and the Prudential membership in the first quarter of 2000, and the purchase of Maxicare in the third quarter of 2000.

Management services revenue decreased $7.8 million, or 38.9%, from the prior year' s third quarter primarily as a result of the expiration of the PPO Access, Marketing Services and Management Services Agreements with Principal Life. The expiration of these agreements was anticipated and was offset by reduced SG&A expenses as a percentage of revenue, premium rate increases, and solid acquisitions.

Health benefits expense increased $106.3 million, or 24.3%, from the prior year' s third quarter, but the medical loss ratio ("MLR") is 0.2% lower than the prior year' s third quarter. The lower MLR was driven by a lower Medicare MLR, as a result of a seasonably lower third quarter and emerging favorable experience. Excluding acquisitions, the MLR would be more favorable this quarter than reported.

Coventry continues to focus on ways to control its medical costs, including implementation of best practices to reduce inpatient days and improvement of the overall quality and level of care. Coventry is also continuously monitoring and renegotiating with its provider networks to improve reimbursement rates and improve member access to providers.

Medical claim liability accruals are monitored and reviewed monthly. Differences for actual settlements from reserves are reflected in current operations. In addition to the procedures for determining reserves as discussed above, the Company reviews the actual payout of claims relating to prior period accruals, which may take six months or more to fully develop. Medical costs are affected by a variety of factors, including the severity and frequency of claims, which can be difficult to predict and may not be entirely within the Company' s control. The Company continually refines its actuarial practices to incorporate new cost events and trends.

Selling, General, and Administrative ("SG&A") expense increased $8.0 million, or 10.9%, from the prior year' s third quarter. SG&A expense as a percent of revenue decreased to 12.6% for the quarter ended September 30, 2000, from 13.9% in the prior year' s third quarter. The decrease in SG&A expense as a percent of revenue was due to increased revenue, primarily attributable to the rate increases mentioned above and to acquisitions, which required minimal incremental SG&A expense. Total employee headcount per thousand members has decreased by 10.5% from the prior year' s third quarter.

Other income, net of interest expense, increased $2.9 million, or 37.6%, from the prior year' s third quarter. The increase in other income was primarily due to the increase in investment income, as a result of an increase in the Company' s short-term and long-term investments compared to the third quarter of 1999.

Earnings from operations increased $3.5 million, or 31.0%, from the prior year' s third quarter. The increase in earnings from operations was attributable to various factors mentioned above: premium increases, SG&A reductions, and acquisitions.

Nine Months Ended September 30, 2000 and 1999

Managed care premiums increased $322.7 million, or 21.1%, from the nine months ended September 30, 1999. The increase was attributable to rate increases, same store membership growth, and acquisitions. The increase in rates was primarily due to commercial rate increases that include those in excess of 10.5% on first quarter renewals, 13.0% on second quarter renewals, and 12.5% on third quarter renewals. Total premium yields for the nine months ended September 30, 2000 increased by an average of $12.12, or 8.1%, from the corresponding period of 1999 on a PMPM basis, to $162.02 PMPM. The increase in premium revenue from acquisitions was a result of the purchases of Carelink and the KFHPNC membership in the fourth quarter of 1999, the purchase of PrimeONE and the Prudential membership in the first quarter of 2000, and the purchase of Maxicare in the third quarter of 2000.

Management services revenue decreased $26.1 million, or 43.1%, from the nine months ended September 30, 1999 primarily as a result of the expiration of the PPO Access, Marketing Services and Management Services Agreements with Principal Life. The expiration of these agreements was anticipated and was offset by reduced SG&A expenses as a percentage of revenue, premium rate increases and solid acquisitions.

Health benefits expense increased $273.4 million, or 20.9%, from the nine months ended September 30, 1999, due to acquisitions and medical trend. Despite the increase in expense, the medical loss ratio is 0.1% lower than the corresponding period in 1999. The lower MLR was driven by premiums increasing at a greater pace than that of health benefits. Excluding acquisitions, the MLR would be more favorable this year than reported.

SG&A expense increased $14.9 million, or 6.5%, for the nine months ended September 30, 2000 from the corresponding period in 1999. SG&A expense as a percent of revenue decreased to 12.9%, from 14.3% in the corresponding period in 1999. The decrease in SG&A expense as a percent of revenue was primarily attributable to the premium rate increases, improved operational efficiencies driven by consolidation of eighteen service centers into three regional service centers and continued management scrutiny of monthly expenses.

Other income, net of interest expense, increased $8.5 million, or 41.3%, from the nine months ended September 30, 1999. The increase in other income was primarily due to the increase in investment income, as a result of an increase in the Company' s short-term and long-term investments compared to the third quarter of 1999.

Earnings from operations increased $9.1 million, or 30.7% from the nine months ended September 30, 1999. The increase in earnings from operations was attributable to various factors mentioned above: premium increases, SG&A reductions, and acquisitions.

LIQUIDITY AND CAPITAL RESOURCES

The Company's total cash and investments, excluding deposits of $17.0 million restricted under state regulations, increased $15.9 million to $605.7 million at September 30, 2000 from $589.8 million at December 31, 1999. This increase was attributable to the cash inflow from operating activities reduced primarily by capital expenditures of $13.8 million, and the change in deposits restricted under state regulations. The change in deposits included a $5.9 million decrease when funds were released by the State of Florida in relation to the Company' s sale of Principal Health Care of Florida, Inc.

The Company' s investment guidelines emphasize investment grade fixed income instruments in order to provide short-term liquidity and minimize the risk to principal. The Company believes that since its long-term investments are available-for-sale, the amount of such investments should be added to current assets when assessing the Company' s working capital and liquidity; on such basis, current assets plus long-term investments less short-term liabilities increased to $278.8 million at September 30, 2000 from $246.7 million at December 31, 1999.

The Company' s HMOs and its insurance company subsidiary, Coventry Health and Life Insurance Company ("CH&L"), are required by state regulatory agencies to maintain minimum surplus balances, thereby limiting the dividends the Company may receive from its HMOs and its insurance company subsidiary. After considering these statutory reserve requirements, the Company' s HMO subsidiaries had surplus in excess of statutory requirements of approximately $104.7 million and $102.6 million at September 30, 2000 and December 31, 1999, respectively. CH&L had surplus in excess of statutory requirements of approximately $3.1 million and $15.0 million at September 30, 2000 and December 31, 1999, respectively. The decrease in the CH&L surplus was due to a tax settlement with the Internal Revenue Service, for prior tax periods, made in the third quarter of 2000, and due to a dividend that was declared and paid in the second quarter of 2000 by CH&L to the parent company.

Excluding funds held by entities subject to regulation, the Company had cash and investments of approximately $79.3 million and $61.1 million at September 30, 2000 and December 31, 1999, respectively, which are available to pay inter-company balances to regulated subsidiaries and for general corporate purposes. Of the $18.2 million increase from the year ended December 31, 1999, approximately $11.0 million is a result of dividends declared and paid from regulated subsidiaries to the parent company. The Company also has entered into agreements with certain of its regulated subsidiaries to provide additional capital if necessary to prevent the impairment of the subsidiary' s net worth.

During the second and third quarters of 1999, the Company converted all the Convertible Exchangeable Senior Subordinated Notes held by Warburg, Pincus Ventures, L.P. ("Warburg Pincus") and Franklin Capital Associates III, L.P. ("Franklin") totaling $47.1 million, including accumulated interest, into 4,709,545 shares of Series A redeemable convertible preferred stock ("preferred stock") at a price of $10 per share. The preferred stock is subject to mandatory redemption at a price of $10 per share (subject to adjustment for any stock dividend, stock split, stock distribution or combination thereof), plus accrued dividends, on May 15, 2002, 2003 and 2004 in an amount equal to one-third of the shares outstanding on the first redemption date, or such lesser number of shares as shall then be outstanding. The preferred stock is carried at its fair value, which equals both its redemption value and liquidation value as of September 30, 2000. The holders of the preferred stock shall be entitled to receive, when and as declared, dividends payable in additional shares of preferred stock, before any dividends shall be set apart for

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or paid to holders of common stock. The preferred stock is convertible to common stock on a share-for-share basis, subject to adjustment for anti-dilution, and is callable by the Company if the market price of the Company' s common stock exceeds certain agreed upon targets. On July 20, 2000, Franklin converted all of its 473,705 shares of preferred stock into common stock of the Company on a one-for-one basis, thus reducing the outstanding balance of preferred stock to 4,235,840 shares.

Projected capital investments of approximately $15.0 million in year 2000 consist primarily of computer hardware, software and related equipment costs associated with the development and implementation of improved operational and communications systems. As of September 30, 2000 approximately $13.8 million has been spent.

The Company believes that cash flows generated from operations, cash on hand and investments, and excess funds in certain of its regulated subsidiaries will be sufficient to fund continuing operations through December 31, 2001.

SHARE REPURCHASES

As part of a program previously authorized by the Board of Directors the Company repurchased, as of September 30, 2000, approximately 840,190 and 55,396 shares of its common stock in 2000 and 1999, respectively, and reissued approximately 122,443 shares of its common stock in 2000, at an aggregate cost of $5.6 million and $0.4 million in 2000 and 1999, respectively. The repurchased stock may be reissued. Stock repurchases may be made from time to time at prevailing prices in the open market, by block purchase or in private transactions. Coventry had approximately 64.9 million year-to-date weighted average diluted shares of common stock outstanding as of September 30, 2000.

OTHER SHARE TRANSACTIONS

On May 5, 2000, the Company announced that its two largest shareholders, The Principal Financial Group ("Principal Life") and Warburg Pincus, have entered into a private transaction whereby Warburg Pincus will purchase 10 million shares of Coventry common stock from Principal Life for $10 per share. Principal Life includes Principal Life Insurance Company and Principal Health Care, Inc. All required regulatory approvals were obtained and the transaction was completed on September 8, 2000, and, as a result, Warburg Pincus and Principal Life own approximately 31% and 23%, respectively, of Coventry' s fully diluted common shares.

E-COMMERCE INITIATIVES

The Company has launched several e-commerce initiatives. Each initiative is intended to reach a segment of our core business customers: providers, brokers, employers and members, and will have a distinct e-commerce solution.

Provider Channel. In February 2000, the Company entered into a three-year agreement with WebMD, Inc., ("WebMD"), the first end-to-end Internet health care company connecting physicians and consumers to the entire health care industry. The Company is using WebMD' s Internet services to manage the electronic submission and processing of eligibility determination, referrals and authorizations, claims submission, claim status, and reporting. The Company is continuing to roll out this service in its St Louis, Missouri, Central & Southern Illinois markets and has begun rolling out the WebMD services in its Central and Western Pennsylvania markets, to be followed by its other markets. It is expected that this relationship will significantly improve service to our members.

Broker/Employer Channel. In February 2000, the Company entered into a two-year agreement with Workscape, Inc., ("Workscape"), which specializes in the development of Internet solutions for the insurance industry. Workscape is focusing on automating the full broker/small employer relationship, including enrolling customers, providing benefits information, generating customized proposals, registering agents, processing applications, underwriting risk, and calculating rates. The Company is currently rolling out this initiative in its Pittsburgh and Harrisburg, Pennsylvania markets, to be followed by its other markets.

Member/Employer Channel. In July 2000, the Company entered into a three-year agreement with US Internetworking ("USi") for web site design through implementation and hosting services. The USi project will replace all of the Company' s current corporate and health plan web sites with professionally designed "customer centric" web sites, easily navigated by members, employers, physicians and brokers for rich health plan and health care information and on-line customer service transaction functionality. Members and employers will have the ability to access their own health care information, including: benefit inquiry; claim or authorization inquiry; ID cards/other materials request; eligibility inquiry; and change primary care physician request, through the use of a secure ID and password. The site will link to Coventry' s Provider Channel: WebMD, and Coventry' s Broker Channel: Workscape. Additionally, the Company has expanded their relationship with WebMD to provide health care and medical information through a co-branding arrangement with the WebMD Consumer Portal. The new sites begin rolling out in November of 2000 and will continue rolling out into early 2001. In March 2000, the Company announced a one-year agreement with GeoAccess to implement GeoAccess' online health care directory technology. This technology makes information about health plan providers available to members. The online directories are currently live on the majority of the Company' s health plan web sites.

LEGISLATION AND REGULATION

Numerous proposals have been introduced in the United States Congress and various state legislatures relating to health care reform. Some proposals, if enacted, could among other things, restrict the Company' s ability to raise prices and to contract independently with employers and providers. Certain reform proposals favor the growth of managed health care, while others would adversely affect managed care. Although the provisions of any legislation adopted at the state or federal level cannot be accurately predicted at this time, management of the Company believes that the ultimate outcome of currently proposed legislation would not have a material adverse effect on the Company and its results of operations in the short-term.

ITEM 3: Quantitative and Qualitative Disclosures of Market Risk

The Company' s material risk in investments in financial instruments is in its debt securities portfolio. The Company invests primarily in marketable state and municipal, U.S. Government and agencies, corporate, and mortgage-backed debt securities.

The Company has established policies and procedures to manage its exposure to changes in the fair value of its investments. These policies include an emphasis on credit quality, management of portfolio duration, maintaining or increasing investment income through high coupon rates and actively managing profile and security mix depending upon market conditions. The Company has classified all of its investments as available-for-sale. At September 30, 2000, the fair value of the Company' s investments was $449.4 million. Securities at September 30, 2000 mature according to their contractual terms, as follows (actual maturities may differ because of call or prepayment rights):

	Amortized Cost (in thousands)	Fair Value
Maturities:		
Within 1 year	$ 155,954	$ 155,915
1 to 5 years	232,851	233,004
6 to 10 years	54,661	53,771
Over 10 years	6,618	6,717

Other securities without stated maturity	-	-
Total short-term and long-term securities	$ 450,084	$ 449,407

The Company believes its investment portfolio is diversified and expects no material loss to result from the failure to perform by the issuer of the debt securities it holds. GNMA and FNMA insure the mortgage-backed securities.

The Company' s projections of hypothetical net losses in fair value of the Company' s market rate sensitive instruments, should potential changes in market rates occur, are presented below. While the Company believes that the potential market rate change is reasonably possible, actual results may differ.

Based on the Company' s debt securities portfolio and interest rates at September 30, 2000, a 100 basis point increase in interest rates would result in a decrease of $14.8 million, or 3.3%, in the fair value of the portfolio. Changes in interest rates may affect the fair value of the debt securities portfolio and may result in unrealized gains or losses. Gains or losses would be realized upon the sale of the investments.

PART II. OTHER INFORMATION

ITEM 1: Legal Proceedings

In the normal course of business, the Company has been named as a defendant in various legal actions such as actions seeking payments for claims denied by the Company, medical malpractice actions, and other various claims seeking monetary damages. The claims are in various stages of proceedings and some may ultimately be brought to trial. Incidents occurring through September 30, 2000 may result in the assertion of additional claims. With respect to medical malpractice, the Company carries professional malpractice and general liability insurance for each of its operations on a claims-made basis with varying deductibles for which the Company maintains reserves. In the opinion of management, the outcome of these actions should not have a material, adverse effect on the financial position or results of operations of the Company.

Other managed care companies have been sued recently in class action lawsuits claiming violations of the federal racketeering act ("RICO") and federal employee benefits law ("ERISA"), and generally claiming that managed care companies overcharge consumers and misrepresent that they deliver quality health care. Although it is possible that the Company may be the target of a similar suit, the Company has not been named in such a suit and believes there is no valid basis for such a suit.

The Company' s industry is heavily regulated and the laws and rules governing the industry and interpretations of those laws and rules are subject to frequent change. Existing or future laws could have a significant impact on the Company' s operations.

As reported in the Company' s Annual Report on Form 10-K for the year ended December 31, 1999, and updated in its Form 10-Q for the quarters ended March 31 and June 30, 2000, the Company has been in dispute with Unity Health Network ("Unity") and with BJC Health System ("BJC"). In the second quarter of 2000, the Company instituted arbitration proceedings against Unity for deficits in the risk fund pools for 1999. On October 10, 2000, the parties entered into a settlement agreement pursuant to which Unity will pay the Company' s subsidiary, Group Health Plan ("GHP"), approximately $7.4 million to fund the risk pool deficits. The settlement will have an immaterial impact on the Company' s 2001 financial results.

With respect to the dispute with BJC, on October 12, 2000 the parties settled the arbitration and all related matters by mutual agreement. As part of the settlement, BJC will receive approximately $4.0 million from the Company' s subsidiaries GHP and HealthCare USA ("HCUSA"), an amount for which the Company had previously reserved. Effective January 1, 2001, the current global capitation contract between GHP and BJC covering approximately 63,000 members will terminate and be replaced by a new 2-year fee-for-service provider contracts with BJC and Washington University Physician Network ("WUPN"). Also, effective January 1, 2001, the current global capitation contract between HCUSA and BJC covering approximately 27,000 members will terminate and be replaced by a new 2-year fee-for-service provider contract with BJC, and a 1-year provider agreement with WUPN. As the

Company has for some time anticipated a restructuring of these provider contracts, and priced its products based upon underlying costs, the new contracts are expected to have an immaterial impact on the Company' s 2001 financial results.

ITEMS 2, 3, 4 and 5: Not Applicable

ITEM 6: Exhibits and Reports on Form 8-K

(a) Exhibit

Exhibit No.	Description of Exhibit
4.1	Shareholders' Agreement dated as of May 5, 2000, by and among Coventry Heath Care, Inc., a Delaware corporation, Warburg, Pincus Ventures, L.P., a Delaware limited partnership, Warburg, Pincus Netherlands Equity Partners II, C.V., a Netherlands limited partnership, and Warburg, Pincus Netherlands Equity Partners III, C.V., a Netherlands limited partnership.
27	Financial data schedule (for SEC use only)

(b) Reports on Form 8-K

No reports on Form 8-K were filed during the quarter ended September 30, 2000.

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.

COVENTRY HEALTH CARE, INC
(Registrant)

Date: November 10, 2000

By: /s/ Allen F. Wise
Allen F. Wise
President, Chief Executive Officer and Director

Date: November 10, 2000

By: /s/ Dale B. Wolf
Dale B. Wolf
Executive Vice President, Chief Financial Officer, and Treasurer

Exhibit Listing

(a)

Exhibit No.	Description of Exhibit
4.1	Shareholders' Agreement dated as of May 5, 2000, by and among Coventry Heath Care, Inc., a Delaware corporation, Warburg, Pincus Ventures, L.P., a Delaware limited partnership, Warburg, Pincus Netherlands Equity Partners II, C.V., a Netherlands limited partnership, and Warburg, Pincus Netherlands Equity Partners III, C.V., a Netherlands limited partnership.
27	Financial data schedule (for SEC use only)

EXHIBIT 4.1

SHAREHOLDERS' AGREEMENT

THIS SHAREHOLDERS' AGREEMENT (this "Agreement"), dated as of May 5, 2000, is by and among Coventry Health Care, Inc., a Delaware corporation (the "Company"), Warburg, Pincus Ventures, L.P., a Delaware limited partnership ("WPV"), Warburg, Pincus Equity Partners, L.P., a Delaware limited partnership ("WPEP"), Warburg, Pincus Netherlands Equity Partners I, C.V., a Netherlands limited partnership ("WPNI"), Warburg, Pincus Netherlands Equity Partners II, C.V., a Netherlands limited partnership ("WPNII"), and Warburg, Pincus Netherlands Equity Partners III, C.V., a Netherlands limited partnership ("WPNIII" and, together with WPV, WPEP, WPNI and WPNII, the "Warburg Entities").

R E C I T A L S:

WHEREAS, pursuant to the terms of a Purchase Agreement, dated as of the date hereof (the "Purchase Agreement"), by and among WPEP, WPNI, WPNII, WPNIII and Principal Health Care, Inc. ("Principal"), WPEP, WPNI, WPNII and WPNIII have agreed to purchase an aggregate of 10,000,000 shares of Common Stock, par value $.01 per share, of the Company ("Common Stock"); and

WHEREAS, pursuant to the terms of the Amended and Restated Securities Purchase Agreement, dated as of April 2, 1997, as amended, by and among WPV, Franklin Capital Associates III, L.P. and the Company (the "Warburg Agreement"), and the Shareholders' Agreement, dated as of April 1, 1998, by and among the Company, Principal and Principal Mutual Life Insurance Company (the "Principal Agreement"), the consent of the Company is required for the purchase and sale of the Common Stock as contemplated by the Purchase Agreement; and.

WHEREAS, the Company has agreed to consent to the purchase and sale of the Common Stock in accordance with the terms of the Purchase Agreement, subject to the terms and conditions set forth herein.

NOW THEREFORE, in consideration of the foregoing premises and the mutual covenants and agreements set forth herein, and intending to be legally bound hereby, the parties hereto agree as follows:

SECTION 1. RESTRICTION ON RESALE; LEGEND.

1. RESALE OF SECURITIES. The Warburg Entities hereby covenant that:

    1. they will not, directly or indirectly, sell or otherwise Transfer any shares of Common Stock Owned by them, except pursuant to an effective registration under the Securities Act or in a transaction which, in the opinion of counsel reasonably satisfactory to the Company, qualifies as an exempt transaction under the Securities Act and the rules and regulations promulgated thereunder; and

    2. on or before the fifth anniversary of the Closing Date, they will not, directly or indirectly, sell or otherwise Transfer, or permit any of their Affiliates, directly or indirectly, to sell or to Transfer any shares of Common Stock Owned by them to any person if such person (together with the Affiliates of such person) would Own, after giving effect to such sale or Transfer, more than 9.9% of the outstanding shares of Common Stock, provided, however, that the Warburg Entities may sell or Transfer shares of Common Stock to one of their Affiliates if such Affiliate agrees to be bound by the terms of this Agreement. The foregoing restrictions shall not apply to any sale or Transfer made (A) pursuant to an effective registration under the Securities Act, (B) pursuant to and in compliance with

Rule 144 under the Securities Act, (C) pursuant to a pro rata distribution by any of the Warburg Entities to its partners or (D) with the written consent of the Company' s Board of Directors.

2. STOCK LEGEND. The stock certificates evidencing ownership of the shares of Common Stock acquired by WPEP, WPNI, WPNII and WPNIII under the Purchase Agreement will bear substantially the following legends:

> THE SECURITIES EVIDENCED HEREBY HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE "ACT"), OR ANY STATE SECURITIES LAW, AND MAY NOT BE SOLD, TRANSFERRED OR OTHERWISE DISPOSED OF EXCEPT PURSUANT TO AN EFFECTIVE REGISTRATION UNDER THE ACT OR IN A TRANSACTION WHICH, IN THE OPINION OF COUNSEL REASONABLY ACCEPTABLE TO THE COMPANY, IS EXEMPT FROM SUCH REGISTRATION.
>
> THE SECURITIES EVIDENCED HEREBY ARE SUBJECT TO RESTRICTIONS ON TRANSFER CONTAINED IN THAT CERTAIN SHAREHOLDERS' AGREEMENT, DATED MAY 5, 2000, BETWEEN THE COMPANY AND WARBURG, PINCUS EQUITY PARTNERS, L.P. AND CERTAIN OF ITS AFFILIATES, A COPY OF WHICH AGREEMENT IS ON FILE AT THE OFFICE OF THE SECRETARY OF THE COMPANY. ANY ATTEMPTED TRANSFER OF THE SECURITIES IN VIOLATION OF THE PROVISIONS OF THE SHAREHOLDERS' AGREEMENT SHALL BE VOID AB INITIO AND SHALL NOT BE RECOGNIZED BY THE COMPANY.

The legend in the first paragraph above shall be removed by the Company from and after the expiration of the holding period for restricted securities under the Securities Act, if the Company shall receive an opinion of counsel, from counsel reasonably acceptable to the Company, that such legend is not required under the Securities Act or any state securities laws. In addition, whenever any shares cease to be subject to this Agreement and are not otherwise restricted securities, the shareholder thereof shall be entitled to receive from the Company, without expense, upon surrender to the Company of the certificate representing such shares, a new certificate representing such shares, of like tenor but without a legend of the character set forth above.

SECTION 2. STANDSTILL. The Warburg Entities hereby covenant and agree that, on or before the fifth anniversary of the Closing Date, they will not, and will cause their respective Affiliates to not, without the prior written consent of a majority of the members of the Company' s Board of Directors, do any of the following:

1. acquire, offer or agree to acquire any shares of Common Stock (or options or warrants to acquire, or securities convertible into or exchangeable for, shares of Common Stock) if, as a result of such acquisition, the Warburg Entities (together with any of their respective Affiliates) would Own more than a number of shares of Common Stock in excess of a number equal to 34.9% of the outstanding shares of Common Stock on a fully diluted basis;
2. directly or indirectly commence or participate in a solicitation of proxies either to oppose the election of any person to the Board of Directors or to seek the removal of any Person from the Board of Directors, which person has been nominated by the Nominating Committee of the Board of Directors;
3. directly or indirectly make or solicit or assist any third party to make a tender or exchange offer to purchase any shares of Common Stock or make any public announcement concerning, or submit any written proposal to the Board of Directors of the Company for a merger, share exchange, acquisition of substantially all of the assets or similar transaction involving the Company.

SECTION 3. SUSPENSION OF COVENANTS. The provisions of Section 1(a)(ii) and 2 hereof shall thereafter cease to apply in the event of any of the following:

1. the Company issues voting securities in an acquisition by the Company of another corporation or entity by merger, consolidation, exchange offer, purchase of substantially all of the assets or stock, or other form of business combination ("Company Acquisition") to any person as a result of which such person, together with its affiliates, shall own a number of shares of voting securities that shall equal or exceed the number of such shares owned by the Warburg Entities and their respective Affiliates in the aggregate;
2. the number of shares of Common Stock then owned by the Warburg Entities and its Affiliates, in the aggregate, shall be less than 10% of the then issued and outstanding shares of Common Stock; or
3. the number of shares of Common Stock then owned by any person (other than Mutual, or a person who acquired a number of shares of Common Stock in a Company Acquisition which did not equal or exceed the number of shares owned by Mutual and its Affiliates in the aggregate, so long as the Company does not permit such person to acquire additional shares of Common Stock) and the Affiliates of such person, in the aggregate, shall be greater than 15% of the issued and outstanding shares of Common Stock

SECTION 4. MISCELLANEOUS.

- **4.1. DEFINITIONS.** Capitalized terms used but not defined herein shall have the meaning assigned to such terms in the Purchase Agreement. As used in this Agreement, the following terms have the respective meaning set forth below:

  1. Affiliate: as to the Warburg Entities, any person a majority of the voting securities of which are Owned by the Warburg Entities, and as to any other person, as defined in Rule 12b-2 under the Exchange Act.

  2. Exchange Act: the Securities Exchange Act of 1934, as amended.

  3. person: an individual, partnership, joint-stock company, limited liability company, corporation, trust or unincorporated organization, and a government or agency or political subdivision thereof.

  4. Securities Act: the Securities Act of 1933, as amended.

  5. Owns, Own or Owned: shall mean beneficial ownership, within the meaning of Rule 13d-3 under the Exchange Act.

  6. Transfer: shall mean any sale, assignment, pledge, hypothecation, or other disposition or encumbrance.

- **4.2. NOTICES.** Any notice required to be given hereunder shall be sufficient if in writing, and sent by facsimile and by courier service (with proof of service), hand delivery or certified or registered mail (return receipt requested and first-class postage prepaid), addressed: (x) if to the Company, at the Company' s principal business address at 6705 Rockledge Drive, Suite 100, Bethesda, Maryland 20817, Attention: Dale Wolf (Facsimile: (301) 493-0760) or (y) if to any of the Warburg Entities, at 466 Lexington Avenue, New York, NY 10019, Attention: Joel Ackerman (Facsimile: 212-878-9351), or (z) to such other address as any party shall specify by written notice so given, and such notice shall be deemed to have been delivered as of the date so telecommunicated, personally delivered or if mailed, the date of receipt.
- **4.3. ASSIGNMENT, BINDING EFFECT; BENEFIT.** Unless expressly provided in this Agreement, neither this Agreement nor any of the rights, interests or obligations hereunder shall be assigned by any of the parties hereto (whether by operation of law or otherwise) without the prior written consent of the other parties. Subject to the preceding sentence, this Agreement shall be binding upon and shall inure to the benefit of the parties hereto and their respective successors and assigns.
- **4.4. ENTIRE AGREEMENT.** This Agreement and the Warburg Agreement (except for Section 6.6 of the Warburg Agreement, which is superceded in its entirety by this Agreement) constitute the entire agreement among the parties with respect to the subject matter hereof and supersedes all prior agreements and

understandings among the parties with respect thereto. No addition to or modification of any provision of this Agreement shall be binding upon any party hereto unless made in writing and signed by all parties hereto.

- **4.5. AMENDMENT.** This Agreement may not be amended except by an instrument in writing signed on behalf of each of the parties hereto.
- **4.6. GOVERNING LAW.** This Agreement shall be governed by and construed in accordance with the laws of the State of Delaware, without regard to its rules of conflict of laws.
- **4.7. HEADINGS.** Headings of the sections of this Agreement are for the convenience of the parties only, and shall be given no substantive or interpretive effect whatsoever.
- **4.8.INTERPRETATION.** In this Agreement, unless the context otherwise requires, words describing the singular number shall include the plural and vice versa, and words denoting any gender shall include all genders and words denoting natural persons shall include corporations and partnerships and vice versa.
- **4.9. WAIVERS.** Except as provided in this Agreement, no action taken pursuant to this Agreement, including, without limitation, any investigation by or on behalf of any party, shall be deemed to constitute a waiver by the party taking such action of compliance with any representations, warranties, covenants or agreements contained in this Agreement. The waiver by any party hereto of a breach of any provision hereunder shall not operate or be construed as a waiver of any prior or subsequent breach of the same or any other provision hereunder.
- **4.10. SEVERABILITY.** Any term or provision of this Agreement which is invalid or unenforceable in any jurisdiction shall, as to that jurisdiction, be ineffective to the extent of such invalidity or unenforceability without rendering invalid or unenforceable the remaining terms and provisions of this Agreement or affecting the validity or enforceability of any of the terms or provisions of this Agreement in any other jurisdiction. If any provision of this Agreement is so broad as to be unenforceable, the provision shall be interpreted to be only so broad as is enforceable.
- **4.11. ENFORCEMENT OF AGREEMENT.** The parties hereto agree that irreparable damage would occur in the event that any of the provisions of this Agreement was not performed in accordance with its specific terms or was otherwise breached. It is accordingly agreed that the parties shall be entitled to an injunction or injunctions to prevent breaches of this Agreement and to enforce specifically the terms and provisions hereof, this being in addition to any other remedy to which they are entitled at law or in equity.
- **4.12. COUNTERPARTS.** This Agreement may be executed in one or more counterparts, each of which shall be deemed an original and all of which together shall be considered one and the same agreement.

IN WITNESS WHEREOF, theparties have executed this Agreement and caused the same to be duly delivered on their behalf on the day and year first written above.

COVENTRY HEALTH CARE, INC.

By: /s/ Allen F. Wise
Name: Allen F. Wise
Title: President and Chief Executive Officer

WARBURG, PINCUS VENTURES, L.P.
By: Warburg, Pincus & Co.,
General Partner
By: /s/ Stephen Distler
Name: Stephen Distler

WARBURG, PINCUS EQUITY PARTNERS, L.P.
By: Warburg, Pincus & Co.,
General Partner
By: /s/ Stephen Distler

Name: Stephen Distler

WARBURG, PINCUS NETHERLANDS EQUITY PARTNERS I, C.V.
By: Warburg, Pincus & Co.,
General Partner
By: /s/ Stephen Distler
Name: Stephen Distler

WARBURG, PINCUS NETHERLANDS EQUITY PARTNERS II, C.V.
By: Warburg, Pincus & Co.,
General Partner
By: /s/ Stephen Distler
Name: Stephen Distler

WARBURG, PINCUS NETHERLANDS EQUITY PARTNERS III, C.V.
By: Warburg, Pincus & Co.,
General Partner
By: /s/ Stephen Distler
Name: Stephen Distler

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THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM THE FINANCIAL STATEMENTS OF COVENTRY HEALTH CARE, INC. FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2000 AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH FINANCIAL STATEMENTS.
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