Conference Call Transcript

WLP - Q4 2004 WellPoint, Inc. Earnings Conference Call

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PLEASE NOTE: THIS TRANSCRIPT HAS BEEN EDITED FOR ACCURACY

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PRESENTATION

Operator

Welcome to the WellPoint fourth-quarter results conference call. At this time all participants are in a listen-only mode. Later there will be a question-and-answer session; instructions will be given at that time. (OPERATOR INSTRUCTIONS). As a reminder, this conference call is being recorded. I will now turn the conference call over to the management team of WellPoint. Please go ahead.

Tami Durle - ***WellPoint - VP, IR***

Welcome to WellPoint's fourth-quarter earnings conference call. I'm Tami Durle, Vice President of Investor Relations, and with me are Larry Glasscock, our President and Chief Executive Officer, and Dave Colby, Chief Financial Officer. Larry will begin this morning's call with an overview of our fourth-quarter performance followed by Dave who will review our financials in more detail. And as a reminder, our financial results for the fourth quarter of 2004 include 1 month of the former WellPoint Health Network operations and 3 months of the former Anthem Inc. operations.

We will be making some forward-looking statements on this call. Listeners are cautioned that these statements are subject to certain risks and uncertainties, many of which are difficult to predict and generally beyond the control of WellPoint. These risks and uncertainties can cause actual results to differ materially from our current expectations. We advise listeners to review the risk factors discussed in our press release this morning and other periodic filings we make with the SEC. I will now turn the call over to Larry Glasscock.

Larry Glasscock - ***WellPoint - Chairman, President, CEO***

Good morning and thank you, Tami. We are very pleased to report a strong fourth quarter and another outstanding year. The highlight of the year was our successful closing of the merger with WellPoint Health Networks on November 30, 2004. We have also continued to successfully execute our strategies to deliver on our long-term goal of achieving at least 15 percent underlying earnings per share growth which was exceeded in 2004. We have accomplished this by focusing on profitable enrollment growth with innovative product offerings, pricing with discipline, continuing to reduce our administrative cost, further penetrating our specialty business, and then finally, utilizing our cash flow effectively.

Our enrollment now exceeds 27.7 million medical members and we have the number one market position in 12 of the 13 states where our companies operate as a Blue Cross or Blue Cross/Blue Shield licensee. These market positions offer advantages in

attracting physicians and hospitals to our networks and in helping to keep our products affordable. What is even more exciting is that while we hold the leading position in these markets, all have additional room for expansion.

In the fourth quarter WellPoint reported GAAP net income of 92 cents per diluted share, higher than the 90 cents per share guidance provided during our January 7th call. This is the 13th consecutive quarter, which constitutes every quarter since our IPO, that we have met or exceeded Wall Street analysts' expectations. These results included a loss of 47 cents per diluted share due to the repurchase of surplus notes in December of 2004, expenses of 31 cents per diluted share for merger-related undertakings in California and Georgia and net realized investment gains of 1 cent per diluted share.

Operating revenue reached an all-time high of $6.7 billion in the quarter, a 59 percent increase year-over-year. Revenue increases were driven by the merger and supplemented by strong organic revenue growth, particularly in the Individual and Small Group businesses, known as ISG, large group and national account businesses. We are continuing to drive revenue growth with an organizational structure that keeps our regional leadership close to our customers but promotes best practices through throughout the Company.

Our regions have been organized into strategic business units. The central region includes the Blue Plans in Indiana, Kentucky, Missouri and Ohio and also our non-Blue branded businesses of Health Link and UniCare. The West region consists of our Blue plans in California, Colorado as well as Nevada. The Northeast region includes Connecticut, Maine and New Hampshire. The Southeast region groups Georgia and Virginia together. As we focus on the continued integration of our Blue plan in Wisconsin, I kept it as a single state region. In addition to our new geographic regions we have strategic business units for our National Accounts and specialty businesses.

We've also introduced centers of business excellence into our corporate structure which enable us to leverage across the entire enterprise the very deep knowledge we have about our business within each of our regions. These will provide additional focus on the individual, small group, key accounts, major accounts and special accounts as well as senior and state sponsored market segments. Each center will be led by a president of our strategic business units who will have a team of experts from every single region to help identify best practices.

I was very fortunate to be able to choose from the best of the best in selecting the leadership of our newly organized businesses. Each of our leaders is extremely talented and very experienced and I'm very pleased with how well our new team has come together. Overall our combined membership grew by almost 1.7 million medical members in 2004 or by 6.4 percent on a comparable basis to 2003. This is among the best growth rates in our industry. We had strong membership growth in each of our major new regions ranging from 5.8 percent to 9.3 percent on a comparable basis in 2004.

In our central region we added 559,000 members in 2004 with National Accounts and ISG leading the way. We saw particularly strong growth in the central region states of Ohio and Missouri. In the West region National Accounts was the primary driver of our membership gains and California, our largest state, added almost 400,000 members. Our Southeast region had the most growth on a percentage basis of any of our geographic regions in 2004 adding over 500,000 members or more than 9 percent, again due to strong National Accounts growth.

The Northeast region grew by 6.8 percent with Connecticut contributing most of the membership gain. In Wisconsin we had some membership attrition in 2004 following the acquisition of Cobalt Corp. in September of 2003. This occurred as we right sized and positioned our product offerings and priced for future sustainability. We expect to resume growth in Wisconsin during 2005. And importantly, preliminary January sales in Wisconsin are showing great improvement over 2004.

From a business mix perspective, approximately 47 percent of our membership is self-funded at year end 2004 and 53 percent is fully insured. The trend toward more self-funded business due to our successful national account strategy is continuing, as 45 percent of our business was self-funded at the end of 2003 on a comparable basis.

From a line of business perspective National Accounts led the way in 2004 with growth of 1.1 million members or 19.2 percent. ISG added over 330,000 members in 2004 with a growth rate of 6.8 percent on a comparable basis. And very importantly, we are off to a great start in 2005. We have about 20 new National Accounts effective in the first quarter of 2005. In addition we have accounts like Bank of America where we expanded our service to them from 5 states to all 50 states. We have been very successful in winning national account business. These customers are particularly attracted to our broad provider networks, very competitive discounts and distinctive customer service. In addition to new accounts we are continuing to see moderate in-group growth, a sign of positive economic growth.

While our membership growth has been strong, we also see a tremendous business opportunity among those currently uninsured. About a third of the 45 million uninsured individuals in the United States earn more than $50,000 annually. These families have the means to purchase insurance but have not; partly because they do not see the value of buying into the insurance pool.

To combat rising healthcare costs and meet the needs of the uninsured we have rolled out a number of very innovative new products. For instance, in Indiana, Kentucky and Ohio we introduced our Blue Access economy plan during December. This

plan is designed to provide a solid foundation of basic health coverage including a range of deductible options, a prescription drug card and office visit co-payments. We listened to the needs of our customers and designed this plan specifically for individuals who need the security of the health plan at a price they can afford. Although it's still early in the product's launch, we are excited that the majority of the applicants for this product were previously uninsured.

Another innovative plan design is our new Tonik suite of products. Introduced by Blue Cross of California, Tonik targets young invincibles with affordable monthly premiums, coverage for preventative needs such as routine doctor visits as well as the more serious medical necessities. Unlike other individual policies, seeing a dentist, getting eye exams, glasses and contacts are all-inclusive within the new benefit design without the need to purchase separate dental or vision policies. Following its introduction in the fourth quarter enrollment has exceeded our forecast. Approximately 70 percent of Tonik members are in the targeted 19- to 29-year-old age range and 70 percent were previously uninsured.

Another way we are attracting members is through our innovative consumer directed health plans which are integrated into tax advantaged financing vehicles such as Health Savings Accounts. We have seen growing interest in this product. Although we believe the adoption rate of HSA type products will initially be slow, they will increase over the coming years as market awareness and experience with these plans increase. Our HSA products are supported by extensive internet based tools that help our members make wise decisions in their health care utilization. Sophisticated tools, like our Subimo coverage advisor that became available December, help our members estimate and compare the likely total cost for alternative treatment plans. Estimates are based on each family's profile and are tailored to their healthcare needs, benefit plan selected and use of medical services.

Another product we announced last month is SmartValue, an affordable new health plan and California's first Medicare Advantage private fee for service plan. With low monthly premiums, smart value offers comprehensive coverage for medical care and discounts on prescription drugs. SmartValue is unique among Medicare Advantage plans because enrollees may see any doctor or specialist of their choice as long as the physician accepts Medicare payment and agrees to the terms and conditions of the plan. In addition, enrollees are able to see a specialist without a referral.

We view the Medicare market as an attractive opportunity. With the aging of the baby boomer generation, this market segment is going to continue to grow. We've approached this market with cautious optimism. In fact, we recently re-entered or expanded our Medicare Advantage offerings in several service areas. We are also offering Medicare discount drug cards throughout each of our states and have issued over 338,000 cards, making us one of the largest issuer of these cards in the country.

The Medicare modernization act includes a Medicare Part D benefit for prescription drug coverage and expansion of the Medicare Advantage program. Extensive regulations were issued last month relating to these programs and we are very encouraged by the opportunities presented. Our initial impression is that CMS was responsive to many of the industry's concerns and recommendations, and wants to make sure this is a viable program for seniors. We believe we are particularly well positioned to capitalize on the Part D drug benefit with our powerful Blue Cross/Blue Shield brand that is valued by seniors and our experience with Medicare drug benefits through our existing Medicare Advantage and Medicare supplement plans.

Enhancing our opportunity, we operate the fourth-largest pharmacy benefit manager in the country, offering a full-spectrum of PBM services with an excellent cost structure. While we look forward to expanding our participation in the Medicare program, we will continue to do so cautiously, cognizant that we do not want to become too dependent on a single customer.

In addition to increased revenue opportunities, part of our strategy for earnings growth is to continue to reduce selling and administrative expenses as a percentage of revenue. The size and scale of our new company presents us with significant advantages to spread administrative costs over a much larger membership base. We made great strides in 2004 with an improvement of 180 basis points in our SG&A ratio over the last 12 months.

We are continuing to make investments in sophisticated tools that reduce administrative expenses while improving customer service. Many of our customers can now enroll in their healthcare benefits through secure online tools. The new capabilities not only make enrolling fast and easy for employees and individuals, but also allow employers to streamline their work, lower administrative costs and save time. This is part of our continuing effort to become even easier to do business with.

Our physician technology program has also been very successful. Over 19,000 physicians are participating in the program with more than 16,000 choosing the paperwork reduction package and almost 3,000 choosing the e-prescribing application. Thousands of prescriptions have already been written utilizing the e-prescribing capability. These new technologies are designed to reduce administrative cost while enhancing the quality of patient care, through reduced medication errors and improving physician communications.

We also have opportunities to reduce our administrative costs by executing on our merger integration plans. The integration plan is well underway, is proceeding according to plan and is right on schedule. We remain committed to capture synergies through a very efficient and timely integration process. We continue to

expect savings of at least $250 million in realized annual synergies when we are fully integrated in 2006.

Several analysts have made assumptions that our synergy expectations will be exceeded. While we are confident that we will meet our expectations, some of the synergies require upfront costs to achieve and others, such as lease commitments, have longer lead-times for realization. Therefore our synergy expectations are more likely to be exceeded beyond 2006. Let me now turn this call over to Dave Colby to talk more about our financial results. Dave?

Dave Colby - ***WellPoint - EVP, CFO***

Thank you, Larry, and good morning to everyone on this call. I'd just like to cover a couple of housekeeping items to begin with. As Tami said, unless otherwise indicated our reported results include 3 months of legacy Anthem operations, and 1 month of legacy WellPoint Health Networks operations following the merger which closed on November 30, 2004. Thus the most significant driver of fourth-quarter year-over-year changes relates to including legacy WellPoint operations following the merger.

Because the merger closed toward the end of the quarter, comparable combined financial statement information for the fourth quarter 2003 is not as meaningful. Future quarters will include financial commentary that compares current results to 3 months of legacy Anthem and 3 months of legacy WellPoint on a combined basis. However, since membership is reported at a point in time, we are providing you with comparable combined end of year membership information that assumes the merger was completed December 31, 2003. This was calculated by adding legacy WellPoint and legacy Anthem together, then making the appropriate conforming adjustments and eliminations, and is presented in this morning's press release.

As a reminder, we have modified our membership accounting to ensure a consistent approach for estimating BlueCard host membership and to eliminate overlapping host membership where we are also the home plan. These items resulted in a net reduction of approximately 900,000 members from the mathematical addition of legacy Anthem and legacy WellPoint. The membership reclassification by customer type was impacted by a new definition of National Accounts. National Accounts are now defined as accounts having more than 5,000 eligible employees with at least 5 percent of membership outside the headquarters state. We have also provided historical membership on a combined comparable basis for the last four quarters on our Investor Relations Website.

Let me turn now to the fourth-quarter 2004 results. As Larry said, we are very pleased with the fourth-quarter earnings per diluted share of 92 cents. This is 2 cents per share higher than our previous guidance due to slightly lower than expected benefit expenses from the legacy Anthem operations and favorable investment income, partially offset by increased administrative expenses due to about $22 million of severance costs expensed in the fourth quarter.

Also in that quarter we repurchased high coupon surplus notes which resulted in a pre-tax loss of approximately 146 million or 47 cents per share in the fourth quarter. The fourth quarter also includes 61.5 million of merger-related undertakings expensed for California and Georgia, resulting in an after-tax cost of 31 cents per share. Realized investment gains added another penny per share in the fourth quarter.

Our premium revenues were 6.2 billion in the fourth quarter, an increase of 2.3 billion or 60 percent over the fourth quarter of 2003, again primarily due to the merger but also organic membership growth and disciplined pricing. On a comparable basis, fully insured membership increased by 389,000 members or 2.7 percent led by our Individual and Small Group businesses at increased 6.8 percent.

As it discussed on our January 7th earnings guidance call, there has been significant interest about our pricing strategy as a combined company. Legacy Anthem and legacy WellPoint pricing policies were actually much more similar than many have an appreciation for. In the future we plan to continue to price our business with discipline to achieve a targeted level of profitability. Premium increases will at least equal cost trend percentages in 2005, where cost trend includes both medical benefits and administrative cost.

We want to be clear that we are not interested in under pricing our business to increase market share. Competitively we are continuing to see generally rational pricing in the marketplace. While there will always be circumstances here or there that are unusual, overall we do not see irrational behavior in the market. We remain very disciplined in our approach and we do not chase business that we believe is priced unprofitably.

In terms of administrative services fees, they totaled $440 million in the fourth quarter of 2004, an increase of $144 million or 49 percent over the fourth quarter of last year, again due primarily to the acquisition and also organic membership growth primarily in our national account area. On a combined basis our self-funded membership increased by 1.3 million members or 11 percent year-over-year.

Our benefit expense ratio was 81.5 percent in the fourth quarter, slightly favorable to our prior guidance, due to lower-than-expected medical expenses in the quarter. Rolling 12-month commercial premium yields and medical costs each increased by just less than 10 percent on a combined basis -- that is combining legacy Anthem and legacy WellPoint for all periods. Outpatient trends continue to be the biggest single driver of medical inflation, although it has declined slightly.

Legacy Anthem has implemented and is expanding a highly effective radiology management program and is focusing on fixed-rate recontracting for outpatient services. Legacy WellPoint is also addressing unit cost trends through trend management initiatives including recontracting. As we continue our integration, successful medical management and contracting initiatives will be expanded throughout our enterprise based on best practices. We are also changing plan designs to encourage appropriate utilization of outpatient services.

In-patient trends were driven primarily by unit cost increases, utilization has remained consistently low. Recent contracting efforts have included increasing outlier thresholds where we have case rate agreements, and expanding pay for performance programs. Most of the increase in pharmacy trends resulted from higher unit costs. Price increases on high utilization drugs such as Lipitor, Nexium and Zocor have driven unit cost growth. We have seen, however, a significant reduction in utilization and cost in the COXII inhibitor class of drugs as a result of the removal of Vioxx from the market, and questions about the safety of other COXII drugs.

Our generic drug use continues to increase and is around 50 percent of scrip volume. This offset some of the impact of price increases and is due to innovative benefit designs, generic sampling pilot programs, coupons and other member incentives. Therapeutic generic substitution is being enhanced with programs like our GenericSelect program. GenericSelect offers up to 4 months of free GenericSelect drugs, and in Missouri we're actually piloting it for 6 months free. Despite the potential supply issues for flu vaccines, flu costs have been relatively low so far this flu season. We are not seeing any increase in cold related drugs or antibiotics that can be a predictor of flu activities.

We are now reporting the selling, general and administrative expense ratio excluding the cost of drugs sold through our mail-order pharmacy. The SG&A ratio in the fourth quarter was 17.0 percent, slightly higher than we previously expected due in part to the higher severance expenses. The fourth-quarter SG&A ratio improved 270 basis points from the fourth quarter of 2003; this improvement was due to leveraging our administrative expenses over the larger membership base, controlling our spending and increasing the use of technology.

Interest expense was $45 million in the fourth quarter, up $12 million or 38 percent from the fourth quarter of last year as we borrowed about $2 billion to fund the WellPoint acquisition. Amortization of intangibles was $28 million in the fourth quarter of 2004, up $16 million or 131 percent from last year due primarily to $2.1 billion of identifiable intangible assets associated with the WellPoint merger.

Our new SEC reporting segments are the Health Care Segment, the Specialty Segment and the Other Segment. Variances in each segment's operating revenue and operating gain or loss were primarily due to the merger. The Health Care Segment consists of our five health insurance geographic regions plus National Accounts as well as senior and state-sponsored program businesses. In the fourth quarter operating revenue in our Health Care Segment was $6.5 billion, an increase of $2.4 billion or 58 percent when compared to the fourth quarter of last year. Operating gain was $506 million, an increase of $188 million or 59 percent over the fourth quarter of last year. The operating margin remained relatively constant as the benefit expense ratio increase was offset by a reduction in the SG&A ratio.

The Specialty Segment includes pharmacy, dental, vision, life, disability, behavior health and our workers compensation businesses. In the fourth quarter operating revenues in our Specialty Segment were $426 million, an increase of $227 million when compared to the fourth quarter of last year, while the operating gain was $46 million, an increase of $25 million over the fourth quarter. In the fourth quarter we filled 51.4 million prescriptions through our PBM. In the fourth quarter our Specialty Segment comprised about 6 percent of revenues. However, since the operating margins are higher than those in our Health Care Segment, about 9 percent of our operating gain was from these specialty businesses.

As we integrate the specialty product businesses of our legacy companies, we expect to expand product offerings, improve service levels and reduce costs. These improvements should help us better penetrate our medical membership base and provide opportunities for more third-party sales.

Now let me move to our balance sheet. Cash and investments were $15 billion at December 31, 2004, an increase of $7.7 billion from the year-end 2003. Total assets were almost $39.7 billion at the end of 2004, again up about $26.3 billion from 2003. The unpaid life, accident and health liability was $4.2 billion at the end of the fourth quarter, an increase of $2.4 billion from year-end 2003. The merger, occurring on November 30, 2004, skewed the calculation of days in claims payable in the quarter. Year-end reserves included both legacy WellPoint and legacy Anthem totals while only December benefit expenses were included in the income statement for legacy WellPoint.

On a comparable consolidated basis, which actually adjusts reported days claims payable for the full quarter of legacy WellPoint benefit expenses and the reclassification of certain reserves out of claims payable for legacy WellPoint, days in claims payable were 48.2 days in the fourth quarter or down 1.4 days sequentially. This decrease was primarily attributable to four things.

First, the timing of our PBM payments, which we pay every 2 weeks, which caused days in claims payable to come down by 0.4 days. We actually improved the claims payment cycle times -- the average time between service date and pay date -- by one-half a day. There were also some purchase accounting reserve

adjustments where we actually reduced some of the reserves at legacy WellPoint by 0.2 days, those went through purchase accounting, and did not go through the income statement at all. And then there were some other miscellaneous items that accounted for about 0.3 days.

Long-term debt of $4.3 billion at the end of 2004 was up $2.6 billion from a year ago following the financing of our legacy WellPoint acquisition and the repurchase of surplus notes. Our debt to capital ratio was 19 percent at year-end 2004, down from 22 percent reported a year ago. We have included in our press release a reconciliation of our reserves. This disclosure is comparable to the reconciliation provided in our fourth-quarter 2003 press release.

It is not a pro forma schedule. As you can see, the legacy WellPoint opening balance sheet reserves of $2.4 billion following purchase accounting were added on the line for business combinations. As additional evidence of the similarities between the reserving methodologies of legacy Anthem and legacy WellPoint, opening the reserves through purchase accounting were adjusted by just $6 million or only 1/4 of 1 percent on a $2.4 billion reserve liability.

We calculate the percentage of prior year redundancies to total incurred claims recorded in the prior year in order to demonstrate the adequacy of our prior year reserves. For the years ended 2004 and 2003 this metric was 1.4 percent and 2.3 percent, respectively. The 1.4 percent reported in 2004 is identical to that reported at September 30, 2004 for legacy Anthem. Note that 2003 was heavily influenced by our acquisition of Trigon. Having only 5 months of incurred claims for our Southeast segment during 2002 impacted the ratio for 2003. Had the Southeast segment been included for the full year 2002, the 2003 ratio would have been 2.0 percent.

We continue to establish reserves in a consistent and conservative manner. The schedule also demonstrates that we are paying claims at a faster rate. The amount of claims paid in the current year resulting from claims incurred in the current year has increased from 85.6 percent in 2003 to 87.3 percent in 2004, excluding the impact of our merger with WellPoint. The increase is primarily attributable to our systems auto adjudication capabilities and improved electronic connectivity with our provider networks. The result is our ability to pay claims quicker.

Operating cash flow exceeded $1.3 billion for the full year 2004, 1.4 times net income and indicating the strong quality of our earnings.

In terms of 2005 guidance, we remain unchanged from our January 7, 2005 earnings guidance call. We continue to expect 2005 earnings per share to be around $7.75 or 27 percent above 2004 on a GAAP basis. The quarterly earnings per share breakdown is $1.82 in the first quarter, $1.90 in the second, $1.97 in the third quarter, rising to $2.05 in the fourth quarter. We have not included the impact of expensing stock options in our guidance. Statement of financial accounting standards 123(R) is an extensive document that was recently issued, and we intend to fully comply. Additional earnings guidance will be provided once estimates of its impact can be established.

Finally, the merger of Anthem and WellPoint Health Networks into WellPoint Inc. presented the opportunity to evaluate best practices in our industry. Our membership and financial statement reclassifications were the result of these evaluations. We intend to provide the same level of visibility and transparency to our financial results as we have previously, and believe we are among the leaders in our industry in this regard. I will now turn the call back over to Larry for some closing remarks.

Larry Glasscock - ***WellPoint - Chairman, President, CEO***

Dave, thank you very much. I want to make just one final comment before I turn the call over for questions. It's really about the pride we take in being a good corporate citizen. WellPoint has consistently participated in many, many worthwhile endeavors in our communities and beyond over these past years. In response to the unprecedented Asian Tsunami disaster we made a contribution of $750,000 split among four relief agencies, three of which specialize in the delivery of healthcare.

This is just one of the many philanthropic projects funded from our charitable foundations in 2004. Our associates participated in this fund-raising effort very dramatically and we're very appreciative to each and every one of them. Now I'd like to open the call up for questions.

QUESTION AND ANSWER

Operator

(OPERATOR INSTRUCTIONS) Bill McKeever, UBS.

Bill McKeever - ***UBS Warburg - Analyst***

Congratulations on the quarter. My question is on Medicare. It seems that for the pharmacy product there's going to be an opportunity as well as for the HMO. On the PPO side there seems to be a bit more controversy whether or not that product might actually be stillborn. I am wondering what your thoughts are on a viable Medicare PPO product going into '06, given the limitations of being able to control medical costs?

Larry Glasscock - ***WellPoint - Chairman, President, CEO***

Bill, as you know, the PPO regions are divided into I think 26 of them, and we are working very hard on those regions. Some of our plans can participate without partnering with any other plan. That's something that allows us, we think, to get to market quicker. We think there are going to be some opportunities in the PPO end of this. We will work very hard to service some by 1/01/06. We're still working on that, but I think given the compression of timing there may be some companies that come in a little bit later than 1/01/06. But we believe there's some real opportunity.

If you think about this Medicare opportunity overall, we had about 1 million senior members enrolled at 12/31/04, and of those about 140,000 were Medicare Advantage members. We're excited about this opportunity. We think that, as I said earlier, the Blues name positions us very well. The senior market, obviously among others, respects our brand very much. We think we have a lot of experience, we think that's going to play very well for us.

Bill McKeever - ***UBS Warburg - Analyst***

My follow-on is just on the cost trends. I didn't hear a cost trend where you exited '04, and where you think you might be in '05?

Dave Colby - ***WellPoint - EVP, CFO***

I think it's very consistent with what we said in the guidance. We finished the year with premium and cost trends just less than 10 percent, and we are expecting for 2005 for that to be down about another 100 basis points.

Bill McKeever - ***UBS Warburg - Analyst***

Okay, great. Thanks very much.

Operator

Patrick Hojlo, CSFB.

Patrick Hojlo - ***CSFB - Analyst***

I was hoping you could give a little more color on membership additions as of 1/01/05. It sounds like you've had some good progress still in the national account front with 20 National Accounts. Can you tell us how that 20 new National Accounts compares to last year on a combined basis, and tell us whether we should think about membership through '05 looking similar growth wise to '04 in terms of mix -- that is ISG versus National Accounts?

Larry Glasscock - ***WellPoint - Chairman, President, CEO***

Let me first talk National Accounts. One thing very important to note here is that we have a new definition for National Accounts. Based on our integration work we thought it made sense to redefine National Accounts as companies that have more than 5,000 eligible employees and at the same time have at least 5 percent of that total outside of their headquarters state. So that's a different definition than what we've used in the past. Even with that higher cut off we've had, as I said earlier, 20 new National Accounts so far in the first quarter, and that gives us additional membership of about 250,000 members in that category.

We are very pleased with the start we're off to here in National Accounts. We believe we've got great leadership here with John Watts. I'm very pleased with the way this is coming together and we are particularly pleased with the confidence that many of our existing accounts continue to place in us, led by companies like Banc of America where, as I had mentioned in my remarks, we've gone from serving five states now to all 50 states. So very, very good progress here. I'll let Dave address for you membership going forward, because we provided that in the guidance that we did on January 7th.

Dave Colby - ***WellPoint - EVP, CFO***

I think in terms of guidance, we did see growth overall if you put it on a combined basis of 6.4 percent. I think our guidance for 2005 brought it down a little bit to about 4 percent, which is still very strong growth, but I do think the market is competitive. I think it's prudent to be a little bit more conservative, but I think you will still see as Larry said the same drivers of growth.

Certainly, we have a product that is very attractive to large National Accounts. It is an area that historically, we have been under penetrated in.

The other big opportunity that we see is the Individual and Small Group market, primarily in the individual market, where we really are trying to go after the large segment of Americans that don't have health insurance, yet they have income levels that could buy it with our economy plan, our Tonik plan. We really think we are selling into that segment which significantly increases the pie that we are trying to attract. It is a lot easier to sell somebody who does not have somebody else's coverage, than trying to steal it away.

Patrick Hojlo - ***CSFB - Analyst***

Could you give us a total number of membership adds for 1/1/05?

Dave Colby - ***WellPoint - EVP, CFO***

The ones that we have stated are the National Accounts that are about 250,000 lives. The others, you can figure out what 4 percent membership growth is. That is a little bit over a million in new lives, and you can look at historically at how we have added them. But we will report that at the end of the first quarter.

Larry Glasscock - ***WellPoint - Chairman, President, CEO***

One of the things too that we are also very pleased about if you look at these 20 new National Accounts is where we are winning that business from. And it's really from a very wide variety of our competitors. So we think this goes back and addresses the issue of the strength of our networks, the depth of our discounts, and then finally just the fact that we are providing service levels that our customers truly value. So we are very pleased with the start that we are off to here.

Patrick Hojlo - ***CSFB - Analyst***

Sounds great, fantastic. Thanks, guys.

Operator

Charles Boorady, Smith Barney.

Charles Boorady - ***Smith Barney - Analyst***

My first question is on the reserve table, just recognizing that acquisitions could throw that off a bit. The total paid to total incurred rose slightly above 100 percent; it looks specifically like the amounts paid related to prior years was higher than normal. And I'm wondering if the amount paid related to prior years included any unusual items such as old hospital claim settlements or other related items?

Dave Colby - ***WellPoint - EVP, CFO***

I don't think so. I think there is some issue with the merger being in there because you have some of the paid numbers with legacy WellPoint after December 1st. But the number that we tend to focus more on is, are we actually paying claims faster. If we look at what we paid in the current year versus what was incurred in the current year, are we seeing a higher percentage of current claims paid; and that we are.

Charles Boorady - ***Smith Barney - Analyst***

Do you have a rough number of days from date of service to the date of claim payment?

Dave Colby - ***WellPoint - EVP, CFO***

Well, we try to say, because it is very hard to compute, that our days in claims payable if you try to put in a full quarter of legacy WellPoint benefit expense was about 48.2 days. In-house claims, we generally in both companies did about the same. Once we'd get a clean claim, we process it in 4 to 6 days.

Charles Boorady - ***Smith Barney - Analyst***

My follow-on is on enrollment. You mentioned 20 National Accounts signed on in '05. Does that include BlueCard, because I see in your membership breakout you give a total national, that would include national and BlueCard? Or were you talking about just the National Accounts?

Dave Colby - ***WellPoint - EVP, CFO***

Those would be home plan BlueCard, ones that we're servicing, not the host members.

Charles Boorady - ***Smith Barney - Analyst***

Do you have a sense at this point already for other Blue Plans that signed up, BlueCard employers in other markets, what kind of enrollment growth you might see from them?

Larry Glasscock - ***WellPoint - Chairman, President, CEO***

We don't really estimate that. We wait to get, we shared with you before how we go about calculating that, so we need some experience to really hone in on that number. But I can tell you just

anecdotally that in talking with some of my colleagues, it looked like a very good January again for Blue Plans.

Dave Colby - ***WellPoint - EVP, CFO***

Particularly those that deal with National Accounts, which is a handful of plans really.

Operator

Josh Raskin, Lehman Brothers.

Josh Raskin - ***Lehman Brothers - Analyst***

I need a quick question for Dave first. The payables balance, I look on the roll-forward table, the acquired payables, it looked like it was about $2.4 billion, but the September balance sheet for WellPoint was closer to 2.65, 2.66 billion. I think you had mentioned some reclassifications. Is it simply just a different definition for the payable balance?

Dave Colby - ***WellPoint - EVP, CFO***

You have got it exactly right, Josh. If you remember, what we had always said was the difference between just the balance sheet geography where the legacy Anthem claims payable was more of a pure IBNR in inventory, ours also included any litigation reserves that were related to claims, or any specific disputed amounts were all lumped in that. What we have done is we have moved that to a separate line item. So the roll forward now is really a purer roll forward of IBNR and in-house inventory.

Josh Raskin - ***Lehman Brothers - Analyst***

And where did the 250-300 million of reclass go to -- what line item does that go to?

Dave Colby - ***WellPoint - EVP, CFO***

I think it still winds up in claims payable.

Josh Raskin - ***Lehman Brothers - Analyst***

Okay but it's not the IBNR portion

Dave Colby - ***WellPoint - EVP, CFO***

No, reserve for other policy holder liabilities.

Josh Raskin - ***Lehman Brothers - Analyst***

Larry, I think you had mentioned cautiously optimistic on the Medicare program overall, and suggested that you didn't want customer dependency issues to grow. Just wondering -- I don't need an exact percentage -- but any sort of thoughts around where Medicare would become too big for you guys to pilot?

Larry Glasscock - ***WellPoint - Chairman, President, CEO***

No, to help you think about it, our largest single customer now accounts for less than 2 percent of our revenue and our largest seven customers account for less than 5 percent of our revenue. So I must say we haven't landed on a specific number. These new regs which were issued January -- I forget the date, maybe the 23rd or something like that -- there are 2,000 pages of regulations. And we've wandered through all those. We think there are some real opportunities based on how those regulations came out and we're going to move forward with the opportunities that we think make sense. But always being aware of how the rules can change.

Dave Colby - ***WellPoint - EVP, CFO***

And even within there, Josh, trying to be diversified in terms of products. So if we're in the drug benefit, in the PPO, in the HMO, in disease management. We think there are great opportunities there as you manage geriatric care. We obviously are a big Medicare contractor for Part A and Part B payments. So even if it got up to a large number, it has to be diversified both product wise and geographically.

Josh Raskin - ***Lehman Brothers - Analyst***

But obviously you don't think you're anywhere near that percentage?

Dave Colby - ***WellPoint - EVP, CFO***

No we are not, and I think there are some big opportunities there.

Larry Glasscock - ***WellPoint - Chairman, President, CEO***

We've expanded our service area for Medicare Advantage. So for example, I think we've got six or seven states -- let's see California, Georgia, Indiana, Kentucky, we also expanded in Missouri, Ohio and Virginia. So with Medicare Advantage, we've stepped out and added some additional counties. I mentioned earlier the SmartValue program that we introduced in California, I'm very excited about that. Part D I think we'll be able to play a role because, again, we've had so much experience with our Medicare sup products where we have a drug benefit associated with those.

As Bill McKeever said earlier, I think the PPO, that's going to -- that'll take a little bit of time to work through all of that. But we think longer-term there will be opportunities there as well.

Josh Raskin - *Lehman Brothers - Analyst*

Okay, thanks.

Operator

Matthew Borsch, Goldman Sachs.

Matthew Borsch - *Goldman Sachs - Analyst*

A question on the -- your current Medicare enrollment. Can you give us a breakout on the senior enrollment and how much of that is Medicare supplement and how much is Medicare Advantage and maybe just address the question of how you see the Medicare supplement business impacted in 2006?

Larry Glasscock - *WellPoint - Chairman, President, CEO*

Our Medicare Advantage product is roughly putting the legacy company numbers together. I think there are about 140,000 Medicare Advantage members. We have, as I said earlier, something slightly over a million senior members, so the balance of those are supplement. It's still difficult to say how all of the supplement products will shake out as a result of part D. We're continuing to work on modeling that, but I don't have anything at the moment that I can really share in terms of details.

Matthew Borsch - *Goldman Sachs - Analyst*

And just in terms of a follow-up, you mentioned growth of 400,000 members in California for full year 2004. Can you just give us a breakdown of what the sequential increase in California enrollment was during the quarter?

Dave Colby - *WellPoint - EVP, CFO*

We're trying not to break out now individual states. You have the West region that we are providing that you could get on a sequential basis. And on a comparable basis the west region, which is Colorado, Nevada and California went from 8,494,000 to 8,655,000. It's probably safe to assume where most of that growth is, given the size of California.

Operator

Ellen Wilson, Stanford Bernstein.

Ellen Wilson - *Sanford Bernstein - Analyst*

I was wondering if you could drill down a little bit on your medical cost run guidance for '05. It sounds like you're talking about something in the range of 9 percent. Could you highlight the specific components to get you there and specifically give some color on the underlying drivers of the 100 basis points of year-over-year deceleration in '05 versus '04 assumed?

Dave Colby - *WellPoint - EVP, CFO*

No problem. I think the number one driver of the reduction of 100 basis is some of the things that we're trying to do on the outpatient utilization and cost. We're doing programs to try to reduce the volume of outpatient services where we have unnecessary imaging or radiology exams, and also trying to put more things on almost a DRG or a case rate basis to try to bring the unit cost down there. That, as you know, over the last couple of years has been the single biggest driver of cost increases. It has been probably the most problematic area. And that is where we're hoping to really see some significant reduction. I think we'll see a little bit of improvement in the inpatient hospital side but not dramatic. That's been running in the high single-digit range. Pharmacy, I think we're going to see that stay relatively constant, in around the 10 percent range. And then physician services, professional services have been relatively constant in the mid single digit range. Our focus right now is outpatient utilization.

Operator

Christine Arnold, Morgan Stanley.

Christine Arnold - *Morgan Stanley - Analyst*

First of all, could you talk about how much of your med sup membership is in H I&J?

Larry Glasscock - *WellPoint - Chairman, President, CEO*

I don't have that number offhand.

Dave Colby - *WellPoint - EVP, CFO*

It is less than half. It's a relatively small population. It has a drug benefit.

Christine Arnold - *Morgan Stanley - Analyst*

So significantly probably less than half from that million that are in Med Supp, right?

Dave Colby - ***WellPoint - EVP, CFO***

Yes.

Christine Arnold - ***Morgan Stanley - Analyst***

So is it possible to get rates in medical trends for legacy WellPoint versus legacy Anthem in 2004 and maybe some components due on a combined basis or separately?

Dave Colby - ***WellPoint - EVP, CFO***

We have, as of December 1st, combined these companies. Every region is combined. I guess the only region that technically doesn't have any change is the Northeast region. But it is very hard with the way we've scrambled these eggs to try to get a very quick and thorough integration of these companies, to start trying to break out things. Obviously we could start looking at things by state. But if you look at us historically, Christine, there really wasn't much difference in terms of the trends of the two companies.

Operator

Tom Carroll, Legg Mason.

Thomas Carroll - ***Legg Mason - Analyst***

Following up on Medicare, as you've spent, I'm sure, some quality time with the 2,000+ pages of MMA regs, are there any components of the new Medicare options that are available through managed care that you absolutely won't consider? To put the question slightly differently.

Larry Glasscock - ***WellPoint - Chairman, President, CEO***

Let me put it this way, the people who are responsible for this have not told me yet that there's anything that we ought to absolutely take off the table. I've had several meetings with them already and many, many more to come. But I can't say, Tom, that I've been told that there's anything that we would react to adversely.

Operator

Scott Fidel, JP Morgan.

Scott Fidel - ***JP Morgan - Analyst***

My question had to do with just now that you've combined the new regions and some of the growth initiatives that you think can most benefit from the combined companies -- for example, now that you have the new west region, are there any new opportunities you're seeing in Nevada or in the new Southeast region with Georgia and Virginia? Just some of the maybe new opportunities there.

Larry Glasscock - ***WellPoint - Chairman, President, CEO***

Let me talk about the West region first because I think there are enormous opportunities there. When you look at California's ISG product set and look at how we can spread that across the region, that's an incredible opportunity. The other big opportunity in the west has to do with our cost structure in Colorado and Nevada. I believe by making those two states part of the West region that we can dramatically improve our cost structure there. So I'm very excited about the West region.

Equally excited about the Southeast region, putting Virginia and Georgia together. One of the exciting opportunities there will be the new Medicaid managed care contract that's going to be, actually the RFP is already out, and the bids are due, as I remember, April 1st. There are going to be number of regions established across the state. In most of those regions at least two options will be offered and in the Atlanta region a number of options will be offered. And as you know, legacy WellPoint was very experienced in Medicaid managed care. I'm very excited about the opportunities there. I could go on forever but I won't. I think for each and every region there's incredible opportunity.

Operator

Doug Simpson, Merrill Lynch.

Doug Simpson - ***Merrill Lynch - Analyst***

Good morning. A lot of my questions have been asked and answered already. But just wondering, on the risk management side, how do you guys think about your book and protecting it from any bump in utilization that we might see down the road if we see jobs growth come back a little bit more meaningfully? This is a broad question obviously.

Dave Colby - ***WellPoint - EVP, CFO***

What's interesting, Doug, is if job growth comes back you usually don't actually see a bump. We're usually more concerned about a bump in utilization when the economy softens and people are afraid that they're going to lose their job and they want to use their

health coverage before it expires. Actually the remarkable thing is when people first get hired they tend to want to focus on doing a good job and making a good first impression, the last thing they do is take days off to seek medical care, that's just behavioral.

I'm not sure that we are terribly concerned about economic growth stimulating utilization. That being said, both companies are somewhat anal retentive in terms of monitoring claims trends. We will look at it not just on a quarterly or monthly basis, but a weekly and daily basis. We have a substantial amount of our business that prices throughout the year and we're constantly looking at what we need to do to adjust our rates to hit the profitability targets that I talked about. We are not in this game to get more market share. We have plenty of market share in our areas, we have the size and scope.

Operator

Eric Veiel, Wachovia.

Eric Veiel - ***Wachovia - Analyst***

This is a follow-up a little bit. I think Larry alluded to the strategy, but could you just clarify for us Larry, legacy Anthem's approach to Medicaid managed care have been relatively passive whereas WellPoint legacy had been much more active. On the go forward basis which approach is more likely to be the Company strategy?

Larry Glasscock - ***WellPoint - Chairman, President, CEO***

The legacy Anthem was in the business where we thought it made sense for us. So I wouldn't say we were passive about it. I would say that based on what I have seen in the legacy WellPoint, we are very focused on it. We have a gentleman who runs it that I've met with a number of times, John Moynahan who's very impressive. I feel very fortunate to have him on our team. So I would say the legacy WellPoint approach will be one that we're going to continue to pursue, and that is where there's a good opportunity, we'll go after it.

Operator

Joseph France, Banc of America Securities.

Joseph France - ***Banc of America Securities - Analyst***

David, in your comments you were talking about the WellPoint being number one in 12 of the 13 markets. Could we talk about the market that you're not number one in?

Dave Colby - ***WellPoint - EVP, CFO***

Yes. That would be Nevada.

Larry Glasscock - ***WellPoint - Chairman, President, CEO***

Let me just say, when that became part of Anthem back in November of '99 our market share in Nevada was right around 5 percent. We have more than doubled that in a very short period of time. So we like the progress that we've made there and we're going to continue to push forward. We think we can make even more progress with some new products sets that are going to be part of this from the legacy WellPoint. We also have some, as I remember, we had some UniCare lives in Nevada. So I'm very optimistic about our future opportunities there.

Operator

Ed Kroll, SG Cowen.

Ed Kroll - ***SG Cowen - Analyst***

My question -- I just wanted to clarify and then ask a question on the percentage of operating profit that you got from your specialty businesses, did you say it was 9 percent in the quarter?

Dave Colby - ***WellPoint - EVP, CFO***

Yes, 9 percent.

Ed Kroll - ***SG Cowen - Analyst***

Where do you think that will go over the next 3 or 4 years as a percent of the total?

Dave Colby - ***WellPoint - EVP, CFO***

Ed, if you look that the legacy WellPoint, we were up closer to 14 to 15 percent where those products were a little bit more mature. It's hard to say that we'll get exactly to that number because legacy WellPoint focused a little bit more on the smaller side of the market where they value the one-stop shop. legacy Anthem being big in large National Accounts will tend to have that business fragmented a little bit more. I'm not sure we'll get quite up to that range, but certainly getting into the low teens is something that I think is achievable within the next few years.

Larry Glasscock - ***WellPoint - Chairman, President, CEO***

If you think about it, we've got in the specialty products virtually two of everything. And so I think there's incredible opportunity in

putting these together. And it's why in our synergy estimates that we said 75 million of that $250 million would come out of the specialty businesses. I said earlier that we've got the fourth-largest PBM in the country. One very exciting thing about all of that national account growth is 60 percent of those account sales also included the pharmacy benefit. I think we've got enormous opportunity here and we just need to make one out of everything that was two and move forward.

Operator

Carl McDonald, CIBC.

Carl McDonald - ***CIBC - Analyst***

As we think about the roll forward table for 2005, what would have been the comparable prior year development in '04 had the deal closed at the beginning of the year and should we expect a similar amount in '05?

Dave Colby - ***WellPoint - EVP, CFO***

I think the best way to look at that, Carl, is the percentage of prior year development when we had a 1.4 percent number. This year I do think that you'll see that number increase a little bit because both companies I think would say that they had a little bit more negative developments beginning the year due to the flu season. Where they turned out to be not quite as conservative, as I know the legacy WellPoint was off by some $30+ million. So I think you'll see that 1.4 increase slightly and, of course, that gets to be a bigger number on a combined basis now that you'll have two companies together.

Larry Glasscock - ***WellPoint - Chairman, President, CEO***

Let me just wrap up here. I'd like to say first of all that we are very optimistic about the future. I firmly believe our new structure and our new senior management team provide the base from which our new company can achieve an even greater sustainable competitive advantage. We can do that by being intently focused on our customers and their needs. And for those of you who've been following us, you know we do that relentlessly. And with that focus and through the collective talents of our associates we can outperform others in improving the quality of healthcare, lowering cost, introducing innovative products and delivering world-class distinctive service, while providing profitable growth for our shareholders. So again, I'm incredibly optimistic about what's in front of us. I want to thank you for your interest this morning and I hope you have a great day.

Operator

Ladies and gentlemen, this conference is available for replay beginning today at 1:15 p.m. Eastern Time through February 21st at midnight. To access the AT&T executive replay service dial 1-800-475-6701, the access code 762-257. International participants may call area code 320-365-3844 and again the access code 762-257. That concludes your conference for today. Thank you for your participation and for using AT&T Executive Teleconference. You may now disconnect.