

WellChoice, Inc. and Subsidiaries
Consolidated Financial Statements

Years ended December 31, 2004, 2003 and 2002

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Report of Independent Registered Public Accounting Firm

To the Board of Directors of
WellChoice, Inc.

We have audited the accompanying consolidated balance sheets of WellChoice, Inc. and subsidiaries as of December 31, 2004 and 2003, and the related consolidated statements of income, changes in stockholders' equity and cash flows for each of the three years in the period ended December 31, 2004. Our audits also included the financial statement schedules listed in the Index at Item 15(a). These financial statements and schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedules based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of WellChoice, Inc. and subsidiaries at December 31, 2004 and 2003, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2004, in conformity with accounting principles generally accepted in the United States. Also, in our opinion, the related financial statement schedules, when considered in relation to the basic financial statements taken as a whole, present fairly in all material respects the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of WellChoice, Inc. and subsidiaries' internal control over financial reporting as of December 31, 2004, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 14, 2005 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

New York, New York
February 14, 2005

Report of Independent Registered Public Accounting Firm on Internal Control over Financial Reporting

The Board of Directors of WellChoice, Inc.

We have audited management's assessment, included in the accompanying Management's Report on Internal Control over Financial Reporting, that WellChoice, Inc. maintained effective internal control over financial reporting as of December 31, 2004, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). WellChoice, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that WellChoice, Inc. maintained effective internal control over financial reporting as of December 31, 2004, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, WellChoice, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2004, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of WellChoice, Inc. and subsidiaries as of December 31, 2004 and 2003, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2004 of WellChoice, Inc. and subsidiaries and our report dated February 14, 2005 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

New York, New York
February 14, 2005

WellChoice, Inc. and Subsidiaries
Consolidated Balance Sheets

	December 31	
	2004	2003
	<i>(In thousands, except share and per share data)</i>	
Assets		
Investments:		
Fixed maturities, at fair value (amortized cost: \$1,374,592 and \$1,036,747)	\$1,361,832	\$1,037,255
Marketable equity securities, at fair value (cost: \$43,774 and \$52,890)	53,430	60,414
Short-term investments	170,577	232,474
Other long-term equity investments	18,624	31,686
Total investments	1,604,463	1,361,829
Cash and cash equivalents	758,518	697,518
Total investments and cash and cash equivalents	2,362,981	2,059,347
Receivables:		
Billed premiums, net	107,575	92,399
Accrued premiums	340,838	285,773
Other amounts due from customers, net	117,180	107,062
Notes receivable, net	12,665	12,410
Advances to hospitals, net	1,882	10,788
Accrued investment income	10,763	9,613
Miscellaneous, net	71,313	51,333
Total receivables	662,216	569,378
Property, equipment and information systems, net of accumulated depreciation	107,120	113,526
Prepaid pension expense	60,682	53,515
Deferred taxes, net	157,723	216,534
Other	39,377	30,693
Total assets	\$3,390,099	<u>\$3,042,993</u>

See notes to consolidated financial statements.

WellChoice, Inc. and Subsidiaries
Consolidated Balance Sheets (continued)

	December 31	
	2004	2003
	<i>(In thousands, except share and per share data)</i>	
Liabilities and stockholders' equity		
Liabilities:		
Unpaid claims and claims adjustment expense	\$ 678,814	\$ 609,491
Unearned premium income	138,722	134,174
Managed cash overdrafts	215,357	197,995
Accounts payable and accrued expenses	67,405	104,526
Advance deposits	160,553	113,843
Group and other contract liabilities	99,349	112,204
Postretirement benefits other than pensions	144,577	142,743
Obligations under capital lease	44,004	48,345
Other	158,993	147,315
Total liabilities	1,707,774	1,610,636
Stockholders' equity:		
Common stock, \$0.01 per share value, 225,000,000 shares authorized; shares issued and outstanding: 2004—84,047,152; 2003—83,676,446	840	837
Class B common stock, \$0.01 per share value, one share authorized, issued and outstanding	—	—
Preferred stock, \$0.01 per share value, 25,000,000 shares authorized; none issued and outstanding	—	—
Additional paid-in capital	1,275,160	1,262,222
Retained earnings	408,759	162,584
Unearned restricted stock compensation	(9,904)	(6,027)
Accumulated other comprehensive income	7,470	12,741
Total stockholders' equity	1,682,325	1,432,357
Total liabilities and stockholders' equity	\$3,390,099	\$3,042,993

See notes to consolidated financial statements.

WellChoice, Inc. and Subsidiaries
Consolidated Statements of Income

	Year ended December 31		
	2004	2003	2002
	<i>(In thousands, except share and per share data)</i>		
Revenue:			
Premiums earned	\$ 5,254,617	\$ 4,875,380	\$ 4,628,035
Administrative service fees	502,236	445,865	396,203
Investment income, net	57,717	51,235	64,806
Net realized investment gains	11,743	11,799	2,604
Other income (loss), net	670	(1,724)	14,012
Total revenue	<u>5,826,983</u>	<u>5,382,555</u>	<u>5,105,660</u>
Expenses:			
Cost of benefits provided	4,536,521	4,162,246	3,947,382
Administrative expenses	903,088	876,687	833,160
Conversion and IPO expenses	—	—	15,350
Total expenses	<u>5,439,609</u>	<u>5,038,933</u>	<u>4,795,892</u>
Income from continuing operations before income taxes	387,374	343,622	309,768
Income tax (expense) benefit	(141,199)	(142,496)	67,847
Income from continuing operations	<u>246,175</u>	<u>201,126</u>	<u>377,615</u>
Loss from discontinued operations, net of taxes of \$0	—	—	(1,056)
Net income	<u>\$ 246,175</u>	<u>\$ 201,126</u>	<u>\$ 376,559</u>
Basic net income per common share	\$ 2.95	\$ 2.41	
Diluted net income per common share	\$ 2.94	\$ 2.41	
Shares used to compute basic earnings per share based on weighted average shares outstanding	83,539,772	83,490,478	
Shares used to compute diluted earnings per share based on weighted average shares outstanding	83,848,159	83,518,167	
Net loss for the period from November 7, 2002 (date of conversion and initial public offering) to December 31, 2002			\$ (38,542)
Basic and diluted net loss per common share for the period from November 7, 2002 (date of conversion and initial public offering) to December 31, 2002			\$ (0.46)
Shares used to compute earnings per share, based on weighted average shares outstanding November 7, 2002 (date of conversion and initial public offering) to December 31, 2002			83,333,244

See notes to consolidated financial statements.

WellChoice, Inc. and Subsidiaries

Consolidated Statements of Changes in Stockholders' Equity

(In thousands, except share and per share data)

	Common Stock Number of Shares	Par Value	Additional Paid In Capital	Unassigned Reserves	Retained (Deficit) Earnings	Unearned Restricted Stock Compensation	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity (1)
Balance at January 1, 2002				\$ 813,310			\$15,935	\$ 829,245
Initial public offering of common stock	83,490,478	\$835	\$1,255,566	(1,228,411)				27,990
Net income (loss)				415,101	\$ (38,542)			376,559
Other comprehensive income							2,468	2,468
Comprehensive income								379,027
Balance at December 31, 2002	83,490,478	835	1,255,566	—	(38,542)		18,403	1,236,262
Net income (loss)					201,126			201,126
Other comprehensive loss							(5,662)	(5,662)
Comprehensive income								195,464
Issuance of common stock for stock incentive plan	185,969	2	6,656			\$ (6,027)		631
Balance at December 31, 2003	83,676,447	837	1,262,222	—	162,584	(6,027)	12,741	1,432,357
Net income					246,175			246,175
Other comprehensive loss							(5,271)	(5,271)
Comprehensive income								240,904
Secondary public offering costs			(752)					(752)
Issuance of common stock for stock incentive plan, net of forfeitures, and stock purchase plan	369,436	3	13,525			(10,154)		3,374
Exercise of stock options	23,901	—	741					741
Tax benefit realized on exercise of stock options and vesting of restricted stock awards			447					447
Amortization of unearned stock compensation						6,277		6,277
Repurchase of common stock	(22,632)	—	(1,023)					(1,023)
Balance at December 31, 2004	84,047,152	\$840	\$1,275,160	\$ —	\$408,759	\$ (9,904)	\$ 7,470	\$1,682,325

(1) Reserve for Policyholders' Protection prior to for profit conversion

See notes to consolidated financial statements.

WellChoice, Inc. and Subsidiaries
Consolidated Statements of Cash Flows

	Year ended December 31		
	2004	2003	2002
	<i>(In thousands)</i>		
Cash flows from operating activities			
Net income	\$ 246,175	\$ 201,126	\$ 376,559
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	37,580	39,453	34,502
Net realized gain on sales of investments	(11,743)	(11,799)	(2,604)
(Credit) provision for doubtful accounts	(3,573)	937	1,284
Accretion of discount (premium), net	2,393	5,537	(2,733)
Equity in (earnings) loss of other long-term equity investments	(719)	(1,364)	229
Deferred income tax expense (benefit)	61,306	55,806	(151,372)
Other	(7,167)	(8,306)	(5,763)
Changes in assets and liabilities:			
Billed and accrued premiums receivable	(69,056)	(17,854)	43,372
Other customer receivable	(10,844)	(14,431)	(24,956)
Notes receivable	(255)	(352)	(1,610)
Advances to hospitals	9,179	(10,666)	1,757
Accrued investment income	(1,150)	217	(383)
Insurance proceeds receivable	—	—	13,716
Miscellaneous receivables	(16,638)	3,087	(8,212)
Other assets	(8,684)	2,894	(6,207)
Unpaid claims and claims adjustment expenses	69,323	49,567	(74,205)
Unearned premium income	4,548	6,670	7,321
Managed cash overdrafts	17,362	27,725	(4,332)
Accounts payable and accrued expenses	(29,286)	(8,854)	(9,608)
Advance deposits	46,710	(23,919)	(73,494)
Group and other contract liabilities	(12,855)	(666)	16,315
Postretirement benefits other than pensions	1,834	(993)	5,530
Other liabilities	14,893	1,261	47,584
Net cash provided by operating activities	<u>339,333</u>	<u>295,076</u>	<u>182,690</u>
Cash flows from investing activities			
Purchases of property, equipment and information systems	(33,324)	(43,519)	(33,691)
Proceeds from sale of property, equipment and information systems	16	1,803	1,349
Purchases of available for sale investments	(1,618,196)	(1,568,589)	(1,757,657)
Proceeds from sales and maturities of available for sale investments	1,374,149	1,524,670	1,660,541
Net cash used in investing activities	<u>(277,355)</u>	<u>(85,635)</u>	<u>(129,458)</u>
Cash flows from financing activities			
(Decrease) increase in capital lease obligations	(4,341)	646	(2,379)
Net (costs) proceeds from common stock issued in public offering	(752)	—	27,990
Proceeds from the exercise of stock options and employee stock purchase plan, net of treasury stock repurchases	4,115	—	—
Net cash (used in) provided by financing activities	<u>(978)</u>	<u>646</u>	<u>25,611</u>
Net change in cash and cash equivalents	61,000	210,087	78,843
Cash and cash equivalents at beginning of period	697,518	487,431	408,588
Cash and cash equivalents at end of period	<u>\$ 758,518</u>	<u>\$ 697,518</u>	<u>\$ 487,431</u>
Supplemental disclosure:			
Income taxes paid	<u>\$ 88,392</u>	<u>\$ 79,901</u>	<u>\$ 90,473</u>

See notes to consolidated financial statements.

WellChoice, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Dollars in thousands except share and per share data)

December 31, 2004

1. Organization and For-Profit Conversion

WellChoice, Inc. ("WellChoice") was formed in August 2002 as a Delaware Corporation to be the parent holding company of Empire HealthChoice, Inc. ("EHC"), following its conversion to a for-profit company. WellChoice owns a Health Maintenance Organization ("HMO") and two health insurance companies through its investment in WellChoice Holdings of New York, Inc. ("WellChoice Holdings").

On November 7, 2002, EHC converted from a not-for-profit health service corporation to a for-profit accident and health insurer under the New York State insurance laws and the converted EHC issued all its authorized capital stock to the New York Public Asset Fund (the "Fund") and The New York Charitable Asset Foundation (the "Foundation"). The Fund and the Foundation then received their respective shares of WellChoice common stock in exchange for the transfer of all the outstanding shares of EHC to WellChoice Holdings. Pursuant to the plan of conversion, WellChoice issued 82,300,000 shares to the Fund and the Foundation and completed an initial public offering of 19,199,000 shares of common stock, consisting of 18,008,523 shares that were sold by the Fund and Foundation and 1,190,477 newly issued shares of common stock sold by WellChoice. After deducting the underwriting discount, net proceeds to WellChoice were approximately \$27,990.

On June 21, 2004, the Fund sold an additional 9,075,000 shares of common stock in a secondary public offering. The Company did not receive any proceeds from the offering. As of December 31, 2004, additional paid in capital was reduced by \$752 to record costs incurred as a result of this offering. At December 31, 2004, the Fund owned 52,001,903, or 61.9%, of the shares of common stock issued and outstanding.

WellChoice Holdings is a non-insurance holding company which wholly-owns Empire HealthChoice Assurance Inc. ("EHCA"), d/b/a Empire Blue Cross Blue Shield. In connection with EHC's conversion to a for-profit entity, EHC merged with EHCA. EHCA wholly-owns Empire HealthChoice HMO, Inc. ("EHC HMO") and WellChoice Insurance of New Jersey, Inc. ("WCINJ"). EHC HMO is an HMO licensed under Article 44 of the New York Public Health Law and is also licensed to operate an HMO in the State of New Jersey. WCINJ is a credit, life, accident and health insurance company licensed in eleven states, which currently writes business only in New Jersey.

EHCA and its subsidiaries offer a comprehensive array of insurance products to employer groups and individuals. Products include traditional comprehensive indemnity health coverage and managed care products and services offered through an HMO, preferred provider organization ("PPO") and exclusive provider organization ("EPO"). EHCA and its subsidiaries also process claims for self-insured employers and government programs. EHCA and EHC HMO are members of the Blue Cross Blue Shield Association ("BCBSA") which provides EHCA and EHC HMO the ability to participate with other Blue Cross Blue Shield plans in BCBSA sponsored programs and entitles it to use the Blue Cross and Blue Shield names and marks in the New York City metropolitan area and one or both of these names and marks in select upstate New York counties.

WellChoice through December 31, 2004 had, through a subsidiary investment, a 24.97% interest in National Accounts Service Company, LLC ("NASCO"), a limited liability company, which processes national account claims for the Company and other Blue Cross Blue Shield plans. See footnote 9. On December 31, 2004, WellChoice withdrew from and ceased to be a member of NASCO and received \$13,444 in exchange for its equity interest in NASCO.

WellChoice, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (continued)
(Dollars in thousands except share and per share data)

2. Summary of Significant Accounting Policies

Basis of Presentation

The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States ("GAAP"). The consolidated financial statements include the accounts of WellChoice and its wholly-owned subsidiaries (collectively, the "Company"). All significant intercompany transactions have been eliminated.

The preparation of financial statements requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Such estimates and assumptions could change in the future as more information becomes known, which could impact the amounts reported and disclosed herein.

Certain 2003 and 2002 amounts have been reclassified to conform with the 2004 presentation.

Conversion

The conversion was accounted for as a reorganization using the historical carrying values of EHC and its subsidiaries assets and liabilities. Immediately following the conversion, EHC's unassigned reserves were reclassified to par value of common stock and additional paid-in capital. The costs of the conversion were recognized as an expense.

Investments-Fixed Maturities and Marketable Equity Securities

The Company has classified all of its fixed maturity and marketable equity security investments as available for sale and, accordingly, they are carried at fair value. The fair value of investments in fixed maturities and marketable equity securities are based on quoted market prices. Unrealized gains and losses are reported as a separate component of other comprehensive income, net of deferred income taxes. The amortized cost of fixed maturities, including certain trust preferred securities, is adjusted for amortization of premiums and accretion of discounts to maturity, which is included in investment income. Investment income is shown net of investment expenses. The cost of securities sold is based on the specific identification method. When the fair value of an investment is lower than its cost and such a decline is determined to be other than temporary, the cost of the investment is written down to fair value and the amount of the write down is charged to net income as a realized loss.

Short-Term Investments

The Company considers securities with maturities greater than three months and less than one year at the date of purchase as short-term investments. Short-term investments are carried at fair value, and consist principally of U.S. treasury bills, commercial paper and money market investments. The fair value of short-term investments is based on quoted market prices.

Other Long-Term Equity Investments

Other long-term equity investments include joint ventures and warrants. Joint ventures are accounted for under the equity method. The Company's warrants are considered derivatives and are carried at fair value. The warrants are not classified as hedging instruments. Fair values of warrants are determined using the Black-Scholes options valuation model. Changes in the fair values of warrants are recorded as realized gains or losses. At December 31, 2004 and 2003, the fair value of these warrants were \$2,557 and \$3,506, respectively.

WellChoice, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (continued)
(Dollars in thousands except share and per share data)

Cash and Cash Equivalents

The Company considers all bank deposits, highly liquid securities and certificates of deposit with maturities of three months or less at the date of purchase to be cash equivalents. These cash equivalents are carried at cost which approximates fair value.

Pharmaceutical Rebate Sharing Program

The Company participates in pharmaceutical rebate sharing programs with drug manufacturers through a third party pharmacy benefit manager. Rebates for fully insured groups are recorded as a reduction to the cost of benefits provided. Rebates for self-funded groups are, pursuant to the terms of the self-funded agreement, either recorded as administrative service fee revenue or refunded to the self-funded group. The Company records an estimate for pharmacy rebates earned but not yet received. These estimates are adjusted as new information becomes known and such adjustments are included in current period results of operations. Pharmacy rebates included in miscellaneous receivables were \$16,407 and \$15,813 at December 31, 2004 and 2003, respectively.

Market Stabilization and Stop Loss Pools

The Company is required to participate in Market Stabilization and Stop Loss Pools ("Pools") as established by the State of New York. Contributions and recoveries under the Pools are estimated based on interpretations of applicable regulations and are recorded as an addition or a reduction to cost of benefits provided. These estimates are adjusted as new information becomes known and such adjustments are included in current period results of operations. In 2004 and 2003, cost of benefits provided was reduced by \$33,896 and \$57,549, respectively, for activity related to the Pools. Pool recoverables included in miscellaneous receivables were \$39,959 and \$23,877 at December 31, 2004 and 2003, respectively.

Receivables

Receivables are reported net of allowance for doubtful accounts of \$10,131 and \$14,661 at December 31, 2004 and 2003, respectively. The allowance for doubtful accounts calculation is based upon historical experience, which takes into consideration the length of time the receivable has been outstanding.

Property, Equipment and Information Systems

Property, equipment and information systems are reported at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, which are not greater than twenty-one years for property and improvements and three to ten years for equipment and furniture. Purchased software is capitalized and depreciated for a period not to exceed three years. The Company capitalizes certain costs incurred during the application development stage related to developing internal use software. These capitalized costs are amortized over a three-year period beginning when the software is placed into production. Computer software costs that are incurred in the preliminary project stages and post-implementation/operation stages, are expensed as incurred.

Unpaid Claims and Claims Adjustment Expenses

The cost of unpaid claims, both for reported claims and claims incurred but not yet reported to the Company, is calculated based upon claim history, claim inventory, number of claims received, changes in product mix, number of contracts in force, recent trend experience, unit costs and the regulatory environment. The estimated expense of processing these claims is also included in the consolidated financial statements as a component of administrative expense. These estimates are subject to the effects of medical claim trends and other uncertainties. Although considerable variability is inherent in such estimates, management believes that the reserves for claims and claims

WellChoice, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (continued)
(Dollars in thousands except share and per share data)

adjustment expenses are adequate. The estimates are continually reviewed and adjusted as experience develops or new information becomes known. Such adjustments are included in current period results of operations.

Advance Deposits

Under certain funding arrangements, customers are contractually obligated to remit funds on a paid claims basis. Funds received prior to payment of claims are classified as advance deposits.

Retirement Benefits

Retirement benefits represent outstanding obligations for certain retiree health care and life insurance benefits and any unfunded liabilities related to defined benefit pension plans. Liabilities for pension benefits are accrued in accordance with SFAS No. 87, "Employers' Accounting for Pensions". Medical and life insurance benefits for retirees are accrued in accordance with SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions".

Revenue

Membership contracts are generally for a period of one year and are subject to cancellation by the employer group upon 60 days written notice. Premiums are normally due monthly and are recognized as revenue during the period in which the Company is obligated to provide services to members. Premiums received prior to such periods are recorded as unearned premiums. Premiums on retrospectively rated group contracts are accrued by making estimates based on past claims experience on such contracts. Premiums collected on retrospectively rated group contracts in excess of premiums earned are classified as group and other contract liabilities. Premiums earned for products subject to minimum loss ratio regulations are reduced for estimated refunds. Refund estimates are adjusted as new information becomes known and such adjustments are included in current period results of operations. Premiums earned for the years ended December 31, 2004 and 2003 were reduced by \$3,785 and \$28,834, respectively, related to these estimates.

Administrative service fees are recognized in the period the related services are performed. All benefit payments under these programs are excluded from revenue and cost of benefits provided.

Cost of Benefits Provided

Cost of benefits provided includes claims paid, claims in process and pending, and an estimate of unreported claims for healthcare service provided to insured members during the period. Costs of benefits are reported net of pharmacy rebates, coordination of benefits and pool recoveries.

Acquisition Costs

Marketing and other costs associated with the acquisition of membership contracts are expensed as incurred.

Income Taxes

The Company accounts for income taxes using the liability method. Accordingly, deferred tax assets and liabilities are recognized for the future tax consequences attributable to the difference between the financial reporting and tax basis of assets and liabilities. Deferred tax assets are reduced by a valuation allowance if it is more than likely than not that all or some portion of the deferred tax assets will not be realized.

Premium Deficiency

A premium deficiency reserve is established when expected claim payments or incurred costs, claim adjustment expenses and administrative costs exceed the premiums to be collected for the remainder of a contract period. For

WellChoice, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (continued)
(Dollars in thousands except share and per share data)

purposes of determining if a premium deficiency reserve exists, contracts are grouped in a manner consistent with how policies are marketed, serviced and measured. Anticipated investment income is not utilized in the premium deficiency reserve calculation. At December 31, 2004 and 2003, a premium deficiency reserve of \$0 and \$402, respectively, is included in group and other contract liabilities.

Stock-Based Compensation

The Company has an incentive stock plan that provides for stock-based compensation, including stock options, restricted stock awards, restricted stock units and an employee stock purchase plan. Stock options are granted for a fixed number of shares with an exercise price equal to the fair value of the shares at the date of the grant. Restricted stock awards and restricted stock units are valued at the fair value of the stock on the grant date, with no cost to the grantee. The employee stock purchase plan, in accordance with the Section 423 of the Internal Revenue Code, allows for a purchase price per share to be 85% of the lower of the fair value of a share of common stock on (i) the first trading day of the offering period, or (ii) the last trading day of the offering period. The Company accounts for stock-based compensation using the intrinsic method under Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees", and, accordingly, if the exercise price is equal to the fair market value of the shares at the date of the grant, the Company recognizes no compensation expense related to stock options. For grants of restricted stock and restricted stock units, unearned compensation, equivalent to the fair value of the shares at the date of grant, is recorded as a separate component of shareholders' equity and subsequently amortized to compensation expense over the vesting period. The Company has adopted the disclosure-only provisions of SFAS No. 123, "Accounting for Stock-Based Compensation", as amended.

Earnings Per Share

For 2004 and 2003, earnings per share amounts, on a basic and diluted basis, have been calculated based upon the weighted-average common shares outstanding for the year. For 2002, earnings per share amounts, on a basic and diluted basis, have been calculated based upon the weighted-average common shares outstanding for the period from November 7, 2002, the date of the for-profit conversion and initial public offering, to December 31, 2002.

Basic earnings per share excludes dilution and is computed by dividing income available to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted earnings per share include the dilutive effect of all stock options, restricted stock awards and restricted stock units using the treasury stock method. Under the treasury stock method, the exercise of stock options is assumed, with the proceeds used to purchase common stock at the average market price for the period. The difference between the number of shares assumed issued and number of shares assumed purchased represents the dilutive shares.

Pro Forma Disclosure

The pro forma information regarding net income and earnings per share has been determined as if the Company accounted for its stock-based compensation using the fair value method. The fair value for the stock options was estimated at the date of grant using a Black-Scholes option valuation model with the following weighted-average assumptions:

	<u>2004</u>	<u>2003</u>
Risk-free interest rate	3.48%	3.47%
Volatility factor	38%	42%
Dividend Yield	—	—
Expected life	5 years	5 years

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The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's stock option grants have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its stock option grants.

For purposes of pro forma disclosures, compensation expense is increased for the estimated fair value of the options amortized over the options' vesting periods and for the difference between the market price of the stock and discounted purchase price of the shares on the purchase date for the employee stock purchases. The Company's pro forma information is as follows:

	Year ended December 31		
	2004	2003	2002
Reported net income	\$246,175	\$201,126	\$376,559
Add: Stock-based compensation cost, net of tax, included in reported net income	3,898	342	—
Less: Total stock-based compensation determined under the fair value based method for all awards, net of tax	(10,864)	(597)	—
Pro forma net income	<u>\$239,209</u>	<u>\$200,871</u>	<u>\$376,559</u>

	Year ended December 31,			
	2004		2003	
	As Reported	Pro Forma	As Reported	Pro Forma
Earnings per share:				
Basic net income per common share	\$ 2.95	\$ 2.86	\$ 2.41	\$ 2.41
Diluted net income per common share	2.94	2.86	2.41	2.41
Weighted-average fair value of options granted during the year	—	14.12	—	12.92
Weighted-average fair value of restricted stock awards granted during the year	36.90	36.90	31.03	31.03
Weighted-average fair value of restricted stock unit awards granted during the year	39.38	39.38	31.03	31.03

Recent Accounting Pronouncements

In March 2003, the Emerging Issues Task Force ("EITF") reached a final consensus on Issue No. 03-1, "The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments ("EITF 03-1")." EITF 03-1 provides accounting guidance regarding the determination of when an impairment of debt and marketable equity securities and investments accounted for under the cost method should be considered other than temporary and recognized. An EITF 03-1 consensus reached in November 2003 also requires certain quantitative and qualitative disclosures for debt and Marketable equity securities classified as available-for-sale or held-to-maturity under SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities," that are impaired at the balance sheet date but for which an other than temporary impairment has not been recognized. The Company has complied with the disclosure requirements of EITF 03-1 which were effective December 31, 2003. In September 2004, the Financial Accounting Standards Board ("FASB") issued FASB Staff Position ("FSP") FSP EITF 03-1-1, "Effective Date of Paragraphs 10-20 of EITF Issue No. 03-1," which defers the

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effective date for the measurement and recognition guidance contained in paragraphs 10-20 of EITF 03-1 pending the development of further guidance. The Company will continue to monitor the developments concerning this Issue and is currently unable to determine the impact of EITF 03-1 on its financial position or results of operations.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), "Share-Based Payment" ("SFAS 123R"), which replaces SFAS No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123") and supercedes APB Opinion No. 25, "Accounting for Stock Issued to Employees." SFAS 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values, beginning with the first interim or annual period after June 15, 2005, with early adoption encouraged. The pro forma disclosures previously permitted under SFAS 123, no longer will be an alternative to financial statement recognition. The Company is required to adopt SFAS 123R in the third quarter of fiscal 2005, beginning July 1, 2005. Under SFAS 123R, the Company must determine the transition method to be used at date of adoption, the appropriate fair value model to be used for valuing share-based payments and the amortization method for compensation cost. The transition methods include prospective and retroactive adoption options. Under the retroactive options, prior periods may be restated either as of the beginning of the year of adoption or for all periods presented. The prospective method requires that compensation expense be recorded for all unvested stock options and restricted stock at the beginning of the first quarter of adoption of SFAS 123R, while the retroactive methods would record compensation expense for all unvested stock options and restricted stock beginning with the first period restated. The Company anticipates adopting the prospective method and expects that the adoption of SFAS 123R will have an impact similar to the current proforma disclosure for existing options under SFAS 123. In addition, the Company does not expect that the expense associated with future grants derived from the fair value model selected, will have a material adverse effect on the Company's financial position, results of operations or cash flows.

3. Investments

Available-for-sale investments are as follows:

	<u>Cost or Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
At December 31, 2004				
Fixed maturities:				
U.S. Treasury Notes	\$ 251,381	\$ 45	\$ (899)	\$ 250,527
U.S. Government Agency obligations	461,098	389	(2,989)	458,498
U.S. Government Agency mortgage-backed securities	156,890	119	(1,982)	155,027
Public utility bonds	16,156	—	(394)	15,762
Corporate securities	489,067	173	(7,222)	482,018
Total fixed maturities	<u>1,374,592</u>	<u>726</u>	<u>(13,486)</u>	<u>1,361,832</u>
Marketable equity securities:				
Common stock	43,774	9,954	(298)	53,430
Total marketable equity securities	<u>43,774</u>	<u>9,954</u>	<u>(298)</u>	<u>53,430</u>
Total fixed maturities and marketable equity securities investments	<u>\$1,418,366</u>	<u>\$10,680</u>	<u>\$(13,784)</u>	<u>\$1,415,262</u>

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	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
At December 31, 2003				
Fixed maturities:				
U.S. Treasury Notes	\$ 94,032	\$ 518	\$ (54)	\$ 94,496
U.S. Government Agency obligations	457,514	987	(6,197)	452,304
U.S. Government Agency mortgage-backed securities	84,812	242	(797)	84,257
Public utility bonds	5,361	—	(26)	5,335
Corporate securities	395,028	7,299	(1,464)	400,863
Total fixed maturities	1,036,747	9,046	(8,538)	1,037,255
Marketable equity securities:				
Common stock	42,834	7,354	(172)	50,016
Non-redeemable preferred stock	10,056	342	—	10,398
Total marketable equity securities	52,890	7,696	(172)	60,414
Total fixed maturities and marketable equity securities investments	<u>\$1,089,637</u>	<u>\$16,742</u>	<u>\$(8,710)</u>	<u>\$1,097,669</u>

The following table shows our investments' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2004:

Description of Securities	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury Notes	\$ 189,359	\$ (898)	\$ 107	\$ (1)	\$ 189,466	\$ (899)
U.S. Government Agency obligations	299,658	(2,671)	14,659	(318)	314,317	(2,989)
U.S. Government Agency mortgage- backed securities	128,293	(1,596)	11,558	(386)	139,851	(1,982)
Public utility bonds	15,762	(394)	—	—	15,762	(394)
Corporate securities	407,400	(6,401)	15,452	(821)	422,852	(7,222)
Total fixed maturities	1,040,472	(11,960)	41,776	(1,526)	1,082,248	(13,486)
Common stock	2,551	(289)	90	(9)	2,641	(298)
Total temporarily impaired securities	<u>\$1,043,023</u>	<u>\$(12,249)</u>	<u>\$41,866</u>	<u>\$(1,535)</u>	<u>\$1,084,889</u>	<u>\$(13,784)</u>

The unrealized losses in the Company's investments in U.S. Treasury Notes, U.S. Government Agency obligations, U.S. Government Agency Mortgage-Backed Securities were caused by interest rate increases. The contractual cash flows of these investments are either guaranteed by the U.S. Government or an agency of the U.S. Government. Accordingly, it is expected that the securities would not be settled at a price less than the amortized cost of the Company's investment. Based on the immaterial severity of the impairments and the ability and intent of the Company to hold these investments until recovery of fair value, which may be maturity, the bonds were not considered to be other than temporarily impaired at December 31, 2004.

The unrealized losses in the Company's investments in Public Utility and Corporate bonds were caused by interest rate increases. The Company evaluated the credit rating of these securities and noted no deterioration. The

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contractual terms of the securities does not permit the issuers to settle the bond at less than amortized cost. Because the decline in market value is attributable to changes in interest rates and not credit quality and because the Company has the ability and intent to hold these investments until a recovery of fair value, which may be maturity, the Company did not consider these investments to be other than temporarily impaired at December 31, 2004.

The Company's unrealized loss in marketable equity securities consists of securities held for the Company's non-qualified employee benefit plans. Approximately 97% of the unrealized loss relates to securities that have been in an unrealized loss position for less than 12 months. Based on the duration of the impairment, overall market volatility and the Company's ability and intent to hold these securities for a reasonable period of time sufficient for a recovery of fair value, the Company did not consider these investments to be other than temporarily impaired at December 31, 2004.

The amortized cost and fair value of fixed maturities, by contractual maturity, are shown below:

	December 31, 2004	
	Amortized Cost	Fair Value
Due in 1 year or less	\$ 108,094	\$ 107,767
Due after 1 year through 5 years	564,521	561,532
Due after 5 years through 10 years	174,689	174,284
Due after 10 years	527,288	518,249
Total	\$1,374,592	\$1,361,832

Mortgage-backed securities do not have a single maturity date and have been included in the above table based on the year of final maturity. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. The Company accounts for amortization of premiums and discounts related to changes in expected maturities using the retrospective method. Therefore prepayment assumptions (based primarily on interest rates) have a significant effect on amounts reported. A one percentage point increase in interest rates would increase the expected maturity by 2.6 years resulting in a decrease in value of \$7,295. A one percentage point decrease in interest rates would decrease the expected maturity by 2.5 years resulting in an increase in value of \$4,179.

Proceeds from sales of available for sale securities for the years ended December 31, 2004, 2003 and 2002 were \$609,990, \$268,062 and \$231,840, respectively. The Company's investment portfolio is not significantly concentrated in any particular industry or geographic region.

Investment income, net is summarized as follows:

	Year ended December 31		
	2004	2003	2002
Fixed maturities	\$48,344	\$41,759	\$57,507
Marketable equity securities	224	1,100	1,081
Short-term investments and cash equivalents	9,741	8,237	7,775
Other long-term equity investments	118	23	117
Interest and dividend income	58,427	51,119	66,480
Equity in earnings (losses) of joint ventures	719	1,364	(229)
Less investment expenses including interest on advance deposits	(1,429)	(1,248)	(1,445)
Investment income, net	\$57,717	\$51,235	\$64,806

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Realized and unrealized gains and losses on investments were as follows:

	Year ended December 31		
	2004	2003	2002
Realized gains:			
Fixed maturities	\$ 8,486	\$ 9,480	\$ 4,447
Equity securities	3,371	558	375
Short-term investments and cash equivalents	—	4	6
Other long-term equity investments	2,682	2,044	—
Total realized gains	<u>14,539</u>	12,086	4,828
Realized losses:			
Fixed maturities	(2,426)	—	(1,747)
Equity securities	—	(13)	—
Short-term investments and cash equivalents	(16)	—	(1)
Other long-term equity investments	(354)	(274)	(476)
Total realized losses	<u>(2,796)</u>	(287)	(2,224)
Net realized gains	11,743	11,799	2,604
Changes in unrealized (losses) gains:			
Fixed maturities	(13,196)	(16,236)	6,305
Equity securities	5,528	7,300	(2,531)
Short-term investments	(97)	(119)	23
Net unrealized (losses) gains	<u>(7,765)</u>	(9,055)	3,797
Total net realized and unrealized gains	<u>\$ 3,978</u>	<u>\$ 2,744</u>	<u>\$ 6,401</u>

The components of other comprehensive (loss) income are as follows:

	Year ended December 31		
	2004	2003	2002
Unrealized gains from investments, net of taxes of \$(801), \$(118), and \$(2,186)	\$ 849	\$ 857	\$ 4,059
Reclassification adjustment for gains included in net income, net of taxes of \$3,295, \$3,511 and \$857	(6,120)	(6,519)	(1,591)
Other comprehensive (loss) income	<u>\$ (5,271)</u>	<u>\$ (5,662)</u>	<u>\$ 2,468</u>

In 2004, the Company participated in a security lending program, whereby certain securities from its portfolio are loaned to qualified brokers in exchange for cash collateral, equal to at least 102% of the market value of the securities loaned. The securities lending agent indemnified the Company against loss in the event of default by the borrower. Income generated by the securities lending program is reported as a component of net investment income. As of December 31, 2004, fixed maturity securities of \$293,871 were loaned under the program.

The Company is required by BCBSA to maintain a deposit for the benefit and security of out-of-state policyholders. At December 31, 2004, the fair value and amortized cost of the investment on deposit were \$9,556 and \$9,590 respectively. The Company also maintains a deposit to satisfy the requirements of its workers' compensation insurance carrier. At December 31, 2004, the fair value and amortized cost of the investment on deposit were \$1,008 and \$1,008, respectively.

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4. Property and Equipment

Property and equipment, including capitalized lease arrangements, are as follows:

	December 31	
	2004	2003
Buildings and improvements	\$132,958	\$126,466
Equipment and furniture	70,039	68,719
Software systems	81,064	66,777
Total property and equipment	284,061	261,962
Less accumulated depreciation and amortization	176,941	148,436
Net property and equipment	\$107,120	\$113,526

All property and equipment is used by the Company for its operations and includes two facilities and certain equipment leased under agreements, which are accounted for as capital leases. Depreciation expense, including depreciation on assets held under capital leases totaled \$32,631, \$38,870 and \$34,168 for the years ended December 31, 2004, 2003 and 2002, respectively.

For the year ended December 31, 2004, the cost and accumulated depreciation of assets retired were \$4,829 and \$4,695, respectively. Of these retirements, cost and accumulated depreciation of \$3,886 and \$3,752, respectively, was for information system equipment and personal computers.

For the year ended December 31, 2003, the cost and accumulated depreciation of assets retired were \$5,639 and \$3,480, respectively. Of these retirements, cost and accumulated depreciation of \$1,681 and \$638, respectively, was for information system equipment and personal computers.

For the year ended December 31, 2002, the cost and accumulated depreciation of assets retired were \$2,278 and \$1,077, respectively. Of these retirements, cost and accumulated depreciation of \$2,213 and \$1,036, respectively, was for information system equipment and personal computers.

5. Claim Reserves

Activity in unpaid claims and certain claim adjustment expenses is summarized as follows:

	Year ended December 31		
	2004	2003	2002
Balance as of January 1	\$ 609,893	\$ 563,224	\$ 634,130
Incurred related to:			
Current period	4,567,630	4,244,356	3,993,607
Prior periods	(31,109)	(82,110)	(46,225)
Total incurred	4,536,521	4,162,246	3,947,382
Paid related to:			
Current period	3,940,184	3,693,619	3,493,244
Prior periods	527,416	421,958	525,044
Total paid	4,467,600	4,115,577	4,018,288
Balance at end of periods	\$ 678,814	\$ 609,893*	\$ 563,224*

* Includes \$402 and 3,300 of premium deficiency reserve in WCINJ included in group and other contract liabilities as of December 31, 2003 and 2002, respectively.

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The provision for claims and claim adjustment expenses attributable to prior year incurrals had a favorable development of \$31,109, \$82,110, and \$46,225 in 2004, 2003 and 2002 respectively, due to health care trends being lower than anticipated when the reserves were established. Moreover, actual claim payment lags were shorter than assumed in determining the reserves, due to continued improvement in the claim adjudication process. The favorable development in 2003 included \$34,882 of recoveries from the New York Market Stabilization Pools for Medicare Supplemental policies for Pool Years 2000, 2001 and 2002, and \$2,898 of amortization of the premium deficiency reserve in WCINJ. Additionally, the development of the prior years' claim liability impacts premiums for retrospectively rated contracts. Accordingly, the Company's favorable (unfavorable) development of \$11,923, \$25,118, and \$(1,532) in 2004, 2003, and 2002, respectively, on such contracts, was largely offset by decreases (increases) in premiums.

6. Income Taxes

WellChoice and its subsidiaries file a consolidated federal income tax return. WellChoice currently has a tax sharing agreement in place with all of its subsidiaries. In accordance with the Company's tax sharing agreement, the Company's subsidiaries pay federal income taxes to WellChoice based on a separate company calculation.

The significant components of the provision for income tax (expense) benefit are as follows:

	Year ended December 31		
	2004	2003	2002
Current tax expense	\$ (79,893)	\$ (86,690)	\$ (83,526)
Deferred tax (expense) benefit	(61,306)	(55,806)	151,373
Income tax (expense) benefit	<u>\$ (141,199)</u>	<u>\$ (142,496)</u>	<u>\$ 67,847</u>

A reconciliation of income tax computed at the federal statutory tax rate of 35% to total income tax is as follows:

	Year ended December 31		
	2004	2003	2002
Income tax at prevailing corporate tax rate applied to pre-tax income	\$(135,581)	\$(120,268)	\$(108,049)
Increase (decrease):			
Change in valuation allowance	—	—	195,698
State and local income taxes, net of federal income tax benefit	(11,218)	(8,933)	(5,077)
Other	5,600	(13,295)	(14,725)
Income tax (expense) benefit	<u>\$ (141,199)</u>	<u>\$ (142,496)</u>	<u>\$ 67,847</u>

Prior to 2002, EHC maintained a valuation allowance on its regular tax net operating loss carryforwards and certain other temporary differences due to uncertainty in its ability to utilize these assets within an appropriate period. The use of these assets was largely dependent on the conversion and future positive taxable income. Because the approval of EHC's plan of conversion by the New York State Insurance Department (the "Department"), removed the uncertainty of the conversion, the Company concluded in the third quarter of 2002 that the valuation allowance related to these assets was no longer necessary. Accordingly, the income tax benefit for 2002 includes the reversal of the valuation allowance of \$174,977 related to the Company's regular tax operating loss carryforwards.

As a result of the conversion to a for-profit accident and health insurance company in 2002, the Company adjusted its deferred tax assets for temporary differences related to EHCA's liability for state and local taxes which resulted in the recognition of a \$5,374 deferred tax asset. In May 2003, the New York State Legislature enacted budget

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legislation that eliminates the net income portion of the New York State franchise tax applicable to every insurance company other than life insurance companies effective January 1, 2003. As a result, the Company's tax provision for 2003 was increased by \$5,374, reflecting the reversal of the previously recorded deferred tax asset.

During 2004, the Company reached a settlement with the Internal Revenue Service ("IRS") related to the valuation of the Company's former headquarters sold in 1997. The Company had obtained an independent appraisal of the property as of January 1, 1987 (the date the Company became subject to federal income taxes) to support its value for the property. The Company recorded a contingent tax expense of approximately \$9,200 in prior years to reflect its best estimate of the ultimate settlement with the IRS. The final settlement amount was \$3,500 and as a result, the Company's tax provision for the 2004 was decreased by \$5,700.

Prior to January 1, 1987, EHC was exempt from federal income taxes. With the enactment of the Tax Reform Act of 1986, EHC, and all other Blue Cross and Blue Shield plans, became subject to federal income tax. Among other provisions of the Internal Revenue Code, these plans were granted a special deduction (the "833(b) deduction") for regular tax calculation purposes. The 833(b) deduction is calculated as the excess of 25% of the incurred claim and claim adjustment expenses for the tax year over adjusted surplus, as defined, limited to taxable income. The amount of 833(b) utilized in each tax year is accumulated in an adjusted surplus balance. Once the cumulative adjusted surplus balance exceeds the 833(b) deduction for the current taxable year, the deduction is eliminated. As a result of the 833(b) deduction, EHC has incurred no regular tax liability but in profitable years, paid taxes at the alternative minimum tax rate of 20%. The Company's ability to utilize the 833(b) deduction was exhausted in 2003.

During the fourth quarter of 2002, the Company reevaluated its tax position for financial statement purposes related to EHC's ability to utilize the 833(b) deduction and determined that when EHC converted to a for-profit entity, its ability to utilize the 833(b) deduction was uncertain. No authority directly addresses whether a conversion transaction will render the 833(b) deduction unavailable. The Company is aware, however, that the IRS has taken the position related to other Blue Cross Blue Shield plans that a conversion could result in the inability of a Blue Cross Blue Shield plan to utilize the 833(b) deduction. In light of the absence of governing authority, while the Company continued to take the deduction on its tax returns after the conversion, the Company has assumed, for financial statement reporting purposes, that the deduction will be disallowed. As a result, the Company, for financial statement purposes, has utilized \$123,797 of the alternative minimum tax credits in excess of those utilized for income tax purposes.

The Company's gross deferred tax assets and liabilities are as follows:

	<u>December 31</u>	
	<u>2004</u>	<u>2003</u>
Deferred tax assets:		
Alternative minimum tax credit carryforward	\$ 94,851	\$149,801
Fixed assets	1,750	7,387
Loss reserve discounting	4,293	3,982
Post-retirement benefits other than pensions	50,602	49,960
Post-employment benefits	4,268	3,834
Bad debts	3,546	5,523
Deferred compensation	8,385	6,003
Unpaid expense accruals	10,569	14,339
Other temporary differences	9,105	5,739
Total deferred tax assets	<u>187,369</u>	<u>246,568</u>

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	December 31	
	2004	2003
Deferred tax liabilities:		
Unrealized gains on investments	5,409	8,705
Pension income adjustment	23,260	20,352
Bonds and bond discount	977	977
Total deferred tax liabilities	29,646	30,034
Net deferred tax assets	\$157,723	\$216,534

The Company's alternative minimum tax credit carryforward for income tax purposes of \$218,648 has no expiration date.

The Company completed a study of the intangible assets, which existed at January 1, 1987 and has filed amended returns for 1989 and 1990 and 1996 claiming a refund for taxes paid. The Company is aware that the IRS and other Blue Cross Blue Shield plans are currently in litigation to determine whether intangible assets that existed at January 1, 1987 are entitled to tax basis and therefore are deductible in future years' tax returns. If the Company prevails, these potential future tax benefits of up to \$107,000 will be available to the Company. As of December 31, 2004 the Company has not recognized this potential benefit in its financial statements.

The Company paid federal income taxes of \$74,000, \$58,000 and \$84,000 in 2004, 2003 and 2002, respectively.

7. Information Technology Outsourcing

In June 2002, the Company entered into a ten-year outsourcing agreement with International Business Machines Corporation ("IBM"). Under the terms of the contract, IBM is responsible for operating the Company's data center, technical help desk and a portion of the core applications development. IBM has entered into a separate agreement to sublease the Company's data center. IBM's charges under the contract include personnel, calculated as a function of IBM's cost for personnel dedicated to the outsourcing; computer equipment, based on equipment usage rates; space, based on actual usage rates; and certain other costs.

IBM is expected to invoice the Company approximately \$447,200 over the remaining term of the agreement for operating the Company's data center and technical help desk as follows:

2005	\$ 80,800
2006	67,600
2007	60,000
2008	58,000
2009	55,700
2010	53,200
2011	51,400
2012	20,500
	\$447,200

The agreement provides for IBM to assist the Company in developing new IT systems. The original agreement required the Company to purchase \$65,000 of enhancement and modernization services and equipment from IBM over a five-year term. On October 27, 2004, the agreement was amended and the contractual commitment

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associated with this portion of the contract was eliminated. In addition, IBM and the Company have terminated the agreement related to the development of a new claims payment system in coordination with deNovis, Inc.

In addition, in 2003 the Company accelerated the repayment of price concessions of \$7,339 granted under the original contract. The refunding of the price concessions had no impact on the Company's results of Operations. At December 31, 2004 and 2003 other liabilities include \$10,000 of cash flow concessions the Company has taken on monthly invoices from IBM. In accordance with the terms of the IBM contract the Company is required to repay these amounts in the future.

The Company will own all software developed by IBM under the agreement. All such software in which the Company will have all rights, title and interest will be accounted for in accordance with SOP 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use".

During 2002, in connection with the agreement, the Company sold computer equipment with a net book value of \$1,736 to IBM. No gain or loss on the sale of the computer equipment was recognized. Also in connection with the agreement, the Company licensed to IBM certain Internet portal technology for an upfront initial license fee of \$2,000. In accordance with SOP 98-1, the Company applied the proceeds from the license of the Internet portal technology to the book value of the assets and no gain or loss was recorded. Under the agreement, IBM has the right to sublicense the Internet portal technology to third parties and the Company will receive 4% of IBM's gross revenues from its licensing for fifteen years. The Company received no licensing revenue for the years ended December 31, 2004, 2003 and 2002.

The outsourcing agreement can be terminated by either the Company or IBM in certain circumstances for cause without penalty. The Company can terminate the contract without cause after two years or if it experiences a change in control and, in such instances, would be obligated to pay certain termination costs, which vary based on the duration of the contract but are significant in the early years, to IBM. During the term of the agreement, the Company may not perform or engage a third party to perform any of the data center or technical help desk services, or more than 20% of the in-scope core applications software services outsourced to IBM without the written consent of IBM.

During the second quarter of 2002, in connection with the IBM outsourcing, the Company began the implementation of a restructuring plan relating to its information technology personnel. Certain employees were involuntarily terminated in accordance with a plan of termination, certain employees were retained by the Company and certain employees were transitioned to IBM. Severance and other costs accrued at June 30, 2002 relating to the plan of termination were \$5,351. During the year ended December 31, 2004, the Company expensed additional \$209 related to an adjustment to estimated severance and other compensation costs previously accrued. As of December 31, 2004, the Company made all the payments related to severance and other compensation costs. To help retain its employees and to help IBM retain its newly transitioned employees, the Company offered stay bonuses for these individuals. The Company recognizes the cost of these stay bonuses as these employees provide service. Administrative expenses for the years ended December 31, 2004, 2003 and 2002 included \$604, \$4,571 and \$3,889, respectively, related to these bonuses.

8. Restructuring

In November 2002, as part of the Company's continuing focus on increasing overall productivity, and in part as a result of the implementation of the technology outsourcing strategy, the Company continued streamlining certain operations and adopted a plan to terminate approximately 500 employees across all segments of its business.

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Severance and other costs of \$13,472 were accrued relating to the plan for the year ended December 31, 2002. In March 2004, the Company expensed an additional \$649 related to an adjustment to the estimated severance and other compensation costs previously recorded. As of December 31, 2004, the Company made all the payments related to severance and other compensation costs. In an effort to facilitate the restructuring plan certain employees were offered stay bonuses. The Company recognizes the cost of these stay bonuses as these employees provide service. Administrative expenses for the years ended December 31, 2004, 2003 and 2002, included \$236, \$788 and \$243, respectively, related to these bonuses.

9. Statutory Information

Insurance companies, including HMOs are subject to certain Risk-Based Capital ("RBC") requirements as specified by the National Association of Insurance Commissioners (the "NAIC"). Under those requirements, the amount of capital and statutory-basis surplus maintained by an insurance company is to be determined based on the various risk factors related to it. At December 31, 2004, EHCA and each of its wholly-owned insurance subsidiaries met the RBC requirements.

EHCA and its subsidiaries are subject to minimum capital requirements under the state insurance laws. Combined statutory-basis surplus of EHCA and its subsidiaries at December 31, 2004 and 2003 of \$1,018,351 and \$935,995, respectively, exceeded their respective requirements. Combined statutory-basis net income of EHCA and its subsidiaries was \$287,472, \$259,340 and \$316,936, for the years ended December 31, 2004, 2003 and 2002, respectively.

In accordance with the rules of the New York State Insurance Department ("Department"), the maximum amount of dividends which can be paid by the Company's subsidiaries without approval of the Department is subject to restrictions relating to statutory surplus and adjusted net income or adjusted net investment income.

In September 2004, March 2004, and June 2003, WellChoice received dividend payments from its subsidiary, EHCA, in the amount of \$75,000, \$120,000, and \$140,000 respectively. The dividend payments were approved by the Department. On December 24, 2004, the Superintendent approved the payment of a dividend to WellChoice from EHCA in the amount of \$125,000. This dividend was approved by EHCA's Board of Directors on January 6, 2005 and paid on February 4, 2005.

EHCA made cash contributions to its HMO and insurance subsidiaries of approximately, \$65,000 during 2002. The capital contributions were made to ensure that its sufficient surplus under applicable BCBSA and state licensing requirements. There were no cash contributions made during 2004 and 2003.

In 2003, WellChoice began the process of dissolving ENASCO. In connection with the dissolution, WellChoice transferred the investment interest in NASCO to EHCA in the form of a capital contribution. EHCA immediately transferred the NASCO investment interest to WCINJ in the form of a capital contribution.

10. Contingencies

Consumers Union of the U.S., Inc. et. al. On August 20, 2002, Consumers Union of U.S., Inc., the New York Statewide Senior Action Council and several other groups and individuals filed a lawsuit in New York Supreme Court challenging Chapter One of the New York Laws of 2002, (the "Conversion Legislation"), on several constitutional grounds, including that it impairs the plaintiffs' contractual rights, impairs the plaintiffs' property rights without due process of law, and constitutes an unreasonable taking of property. In addition, the lawsuit

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alleges that EHC has violated Section 510 of the New York Not-For-Profit Corporation Law and that the directors of EHC breached their fiduciary duties, among other things, in approving the plan of conversion. On September 20, 2002, the Company responded to this complaint by moving to dismiss the plaintiffs' complaint in its entirety on several grounds. On November 6, 2002, pursuant to a motion filed by plaintiffs, the New York Supreme Court issued a temporary restraining order temporarily enjoining and restraining the transfer of the proceeds of the sale of common stock issued in the name of, or on behalf of, the Fund or the Foundation to the State or any of its agencies or instrumentalities. The court also ordered that such proceeds be deposited in escrow with The Comptroller of the State of New York pending the hearing of the application for a preliminary injunction. The court did not enjoin WellChoice, EHC or the other defendants from completing the conversion or its initial public offering. On March 6, 2003, the court delivered its decision dated February 28, 2003, in which it dismissed all of the plaintiffs' claims in the complaint.

However, the February 28, 2003 decision granted two of the plaintiffs, Consumers Union and one other group, leave to replead the complaint to allege that the Conversion Legislation violates the State Constitution on the ground that it is a local law granting an exclusive privilege, immunity and/or franchise to EHC. On April 1, 2003, the remaining plaintiffs filed an amended complaint, asserting the State constitutional claim as suggested in the court's decision. The amended complaint seeks to invalidate the Conversion Legislation and, for the first time, to rescind its initial public offering. On May 28, 2003, the defendants filed motions to dismiss the amended complaint in its entirety, for failure to state a claim. On October 1, 2003, the court dismissed all claims against the individual members of the board of directors of EHC, but denied defendants' motions to dismiss the amended complaint. In its decision, the court stated that the plaintiffs' decision to limit their request for preliminary relief in their original complaint to restraining the disposition of the selling stockholders' proceeds of the initial public offering, but not to block the offering, may affect such ultimate relief as may be granted in the action, but was not a reason to dismiss the amended complaint.

The parties appealed the February 28, 2003 and the October 1, 2003 decisions and on May 20, 2004, the New York State Appellate Division, First Department, unanimously upheld the lower court's decisions on (a) February 28, 2003 to dismiss all of the plaintiffs' claims in the initial complaint and (b) October 1, 2003 to deny defendants' motion to dismiss the amended complaint. In addressing the plaintiffs' allegation that the Conversion Legislation is prohibited by the State Constitution and therefore invalid, the court rejected the defendants' position that the Conversion Legislation does not fall within the constitutional prohibition. The court stated that the language of the constitutional prohibition, at least facially, provides no support for an exception for the Conversion Legislation. On June 24, 2004, all parties filed motions before the Appellate Division requesting that the cases be certified for immediate review by the New York State Court of Appeals to determine whether the Appellate Division's May 20, 2004 decision was proper. On October 12, 2004, the Appellate Division granted these motions. Per a briefing schedule set by the Court of Appeals, opening briefs and the record on appeal were filed on January 4, 2005, opposition briefs for all parties are due on March 9, 2005 and reply briefs for all parties are due on March 21, 2005. No date has been set for oral argument, but the Company expects that it will occur during the spring of 2005.

The parties have agreed to stay the lower court proceedings, pending resolution of all appeals of both motions. Pursuant to a stipulation, pending the final disposition of the appeals, the proceeds of any sale of any of its stock issued in the name of, or on behalf of, the Fund or the Foundation, shall be transferred to The Comptroller of the State of New York, to be held in escrow in a separate interest bearing account.

Thomas, et al. v. Empire, et al. In May 2003, this putative class action was commenced in the United States District Court for the Southern District of Florida, Miami Division against the Blue Cross Blue Shield

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Association, Empire and substantially all of the other Blue plans in the country. The named plaintiffs have brought this case on their own behalf and also purport to bring it on behalf of similarly situated physicians and seek damages and injunctive relief to redress their claim of economic losses which they allege is the result of defendants, on their own and as part of a common scheme, systemically denying, delaying and diminishing claim payments. More specifically, plaintiffs allege that the defendants deny payment based upon cost or actuarial criteria rather than medical necessity or coverage, improperly downcode and bundle claims, refuse to recognize modifiers, intentionally delay payment by pending otherwise payable claims and through calculated understaffing, use explanation of benefits, that fraudulently conceal the true nature of what was processed and paid and, finally, by use of capitation agreements which they allege are structured to frustrate a provider's ability to maximize reimbursement under the capitated agreement. The plaintiffs allege that the co-conspirators include not only the named defendants but also other insurance companies, trade associations and related entities such as Milliman and Robertson (actuarial firm), McKesson (claims processing software company), National Committee for Quality Assurance, Health Insurance Association of America, the American Association of Health Plans and the Coalition for Quality Healthcare. In addition to asserting a claim for declaratory and injunctive relief to prevent future damages, plaintiffs assert several causes of action based upon civil RICO and mail fraud.

The plaintiffs have subsequently amended their complaint, adding several medical societies as additional plaintiffs a cause of action based upon an assignment of benefits, adding several additional defendants including WellChoice and two of its other subsidiaries, WCINJ and EHC HMO and dropping their direct RICO claim, but instead base their RICO claim solely on a conspiracy theory.

In October 2003, the action was transferred to District Court Judge Federico Moreno, who also presides over *Shane v. Humana, et al.*, a class-action lawsuit brought against other insurers and HMOs on behalf of health care providers nationwide. The *Thomas* case involves allegations similar to those made in the *Shane* action. In the *Shane* case, the 11th Circuit Court of Appeals, on September 1, 2004, upheld class certification as to RICO related claims but decertified a class as to state law claims. On October 15, 2004, the *Shane* defendants filed a petition for a writ of certiorari, seeking U.S. Supreme Court review of the 11th Circuit decision.

On June 14, 2004, the court ordered the commencement of discovery. The defendants filed motions to dismiss on October 4, 2004, which are pending before the court. Meanwhile, class certification discovery is ongoing. Plaintiffs' motion for class certification was served on December 31, 2004 and its response is due by February 28, 2005.

Solomon, et al. v. Empire, et al. In November 2003, this putative class action was commenced in the United States District Court for the Southern District of Florida, Miami Division against the Blue Cross Blue Shield Association, EHC and substantially all other Blue plans in the country. This case is similar to *Thomas, et al. v. Empire, et al.* except that this case is brought on behalf of certain ancillary providers, such as podiatrists, psychologists, chiropractors and physical therapists. Like the *Thomas* plaintiffs, the Solomon plaintiffs allege that the defendants, on their own and as part of a common scheme, systematically deny, delay and diminish payments to these providers. The plaintiffs' allegations are similar to those set forth in *Thomas* but also include an allegation that defendants have subjected plaintiffs claims for reimbursement to stricter scrutiny than claims submitted by medical doctors and doctors of osteopathy. Plaintiffs are seeking compensatory and monetary damages and injunctive relief. The complaint was subsequently amended to add several new parties, including WellChoice and two of its other subsidiaries, WCINJ and EHC HMO.

By an Order dated January 7, 2004, the case was transferred to Judge Moreno, but not consolidated with the other pending actions. The Court, on its own initiative, deemed this action a "tag along" action to the *Shane* litigation.

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On June 14, 2004, the court ordered the commencement of discovery. The defendants filed motions to dismiss on August 27, 2004 which are pending before the court. Meanwhile, class certification discovery is ongoing. The Company expect plaintiffs' motion for class certification to be served shortly and its response will be due on or about February 28, 2005.

The Company intends to vigorously defend all these proceedings, however, their ultimate outcomes cannot presently be determined.

Other. The Company is also involved in numerous claims, contractual disputes and uncertainties, including disputes with healthcare providers involving payment arrangements and contract terms, in the ordinary course of business. The Company believes it has meritorious defenses in all of these matters and intends to vigorously defend its respective position. In the opinion of management, after consultation with legal counsel, the ultimate disposition of these matters will not have a material adverse effect on the Company's consolidated financial condition or results of operations.

In June 2002, the Company settled a class action lawsuit for an estimated \$23,000 in claims and legal fees. During the period from June 2002 to September 2002, the members of the class were informed of their right to receive payment, were required to respond, and the payments due to respondents were determined. Based on the number of respondents to the class action mailing through August 24, 2002 and the Company's estimate of the number of late respondents to the mailing, the Company revised its best estimate of the ultimate liability for this action to \$14,600. This change in estimate has been recorded in the consolidated financial statements for year ended December 31, 2002. At December 31, 2004 and 2003 unpaid claims and claims adjustments expense included \$75 and \$150, respectively, related to this estimate.

In October 2004, the Company renewed its existing credit and guaranty agreement with The Bank of New York, as Issuing Bank and Administrative Agent, and several other financial institutions as agents and lenders, which provides the Company with a credit facility. The Company is able to borrow under the credit facility for general working capital purposes. The total outstanding amounts under the credit facility cannot exceed \$100,000. The facility has a term of 364 days with a current maturity date of October 15, 2005, subject to extension for additional periods of 364 days with the consent of the lenders. Borrowings under the facility will bear interest, at the Company's option, at The Bank of New York's prime commercial rate (or, if greater, the federal funds rate plus 0.50%) as in effect from time to time plus a margin of between zero and 0.75%, or LIBOR plus a margin of between 0.875% and 2.0%, with the applicable margin to be determined based on our financial strength rating. As of December 31, 2004, there were no funds drawn against this line of credit.

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11. Commitments

The Company leases office facilities and equipment under capital and operating lease arrangements. Future minimum payments for capital leases and noncancelable operating leases, including escalation clauses, as of December 31, 2004 are as follows:

	<u>Capital Leases</u>	<u>Operating Leases</u>
2005	\$12,686	\$ 34,713
2006	12,882	34,584
2007	13,126	33,910
2008	13,418	34,109
2009	13,122	32,610
Future years	<u>10,628</u>	<u>240,714</u>
Net minimum lease payment	75,862	<u>\$410,640</u>
Less:		
Interest	20,929	
Maintenance, taxes, etc.	<u>10,929</u>	
Present value of minimum lease payments	<u>\$44,004</u>	

The average imputed interest rate on the capital leases was 14% in 2004. Rent expense under operating leases was \$50,188, \$46,762 and \$54,082 for the years ended December 31, 2004, 2003 and 2002, respectively.

The schedule above includes rent commitments for the Company's Staten Island facility. However, as part of the information technology outsourcing agreement with IBM (see footnote 7), the Company entered into a sublease agreement with IBM for this property. The Company expects to receive net sublease income of approximately \$1,644 per year until 2012.

During the third quarter of 2003, management determined that based on current and projected occupancy requirements, the Company would not receive economic benefit from certain unoccupied leased office space. As a result, The Company recognized an administrative expense of \$1,110 and \$13,367 for the years ended December 31, 2004 and 2003, respectively, representing the net present value difference between the fair value of estimated sublease rentals and the remaining lease obligation for this space. At December 31, 2004, and 2003 \$13,874 and \$12,764, respectively, of these costs are included in other liabilities.

12. Related Party Transactions

Administrative expenses incurred related to NASCO services totaled \$4,829, \$17,818 and \$14,673 for the years ended December 31, 2004, 2003 and 2002, respectively. Accounts payable as of December 31, 2004 and 2003, includes amounts due to NASCO of \$411 and \$1,919, respectively.

Active Health Management, Inc., ("AHM") an entity in which the Company has a 0.8% ownership interest, provides certain medical management services to the Company. Administrative expenses incurred related to AHM services totaled \$3,863, \$3,521 and \$5,882 for the years ended December 31, 2004, 2003 and 2002, respectively. Accounts payable as of December 31, 2004 include \$707 due to AHM. There were no accounts payable as of December 31, 2003 due to AHM.

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An Executive Vice President of a labor union account was a member of the Company's board of Directors until June 2003. For the years ended December 31, 2003 and 2002, the Company earned premium revenue \$17,793 and \$18,019, respectively from the union. Billed premiums receivable at December 31, 2003 included amounts due from the union of \$2,058. In addition, the Company recorded administrative service fees revenue of \$2,384 and \$2,957 for the years ended December 31, 2003, and 2002. Other amounts due from customers at December 31, 2003 included \$829 for service fees due from the union.

A member of the Company's board of directors is an Executive Vice President and Chief Operating Officer of a hospital in the Company's provider network. For the years ended December 31, 2004, 2003 and 2002, the Company made payments to the hospital in the amount of \$157,798, \$130,605 and \$101,998 respectively for the reimbursement of claims to this provider.

A physician in a group practice, which participates in the Company's provider network, was a member of the Company's board of Directors until June 2003. For the years ended December 31, 2003 and 2002, the Company made payments in the amount of \$309 and \$313, respectively to this group practice for the reimbursement of claims.

13. Insurance Proceeds

In December 2002, the Company and its insurance carrier settled the Company's business property protection and blanket earnings and extra expense claim related to loss of the Company's offices located at the World Trade Center for \$74,000. During 2002, the Company recorded gains related to the business property portion of the claim of \$7,959, respectively, which were included in other income. Administrative expense for the year ended December 31, 2002 includes a gain of \$19,300 representing extra expense settlement proceeds for items expensed in 2001 and extra expenses that had not yet been incurred.

14. Pension Benefits

The Company had several noncontributory, defined benefit pension plans covering substantially all of its employees. In May 1998, the Company's Board of Directors approved a consolidation of the Company's defined benefit pension plans into one "cash balance" defined benefit plan (the "Cash Balance Plan"). The redesigned plan, effective January 1, 1999, provides employees with an opening balance based on the previous benefits attributed to the employee under prior plans with increases through contributions by the Company based on the employee's age and length of service. The benefit provided at retirement is the sum of all contributions and interest earned.

Prior to the redesign, the Company's pension benefits were provided through three plans. Although the manner in which these plans were funded differed, the benefits relating to each were similar.

As part of the consolidation of the plans, the Cash Balance Plan assumed the assets and benefit obligations of the previous plans, some of which were previously retained by an insurer under an annuity purchase contract. As a result of the consolidation of the plans, the Company is amortizing the amount of the plan assets in excess of the benefit obligation assumed from the insurer, \$116,865 over the average remaining service life of plan participants (10.5 years).

The effect of the change in pension benefits reduced the benefit obligation by \$20,606 which will be amortized over the remaining service life of the Cash Balance Plan members (13 years).

The Company also has an unfunded, nonqualified supplemental plan to provide benefits in excess of ERISA limitations on recognized salary or benefits payable from the qualified pension. This supplemental plan is accounted for using the projected unit credit actuarial cost method.

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The following table sets forth the plans' change in the actuarially determined benefit obligation, plan assets and information on the plan's funded status.

	December 31	
	2004	2003
Change in benefit obligation		
Benefit obligation at beginning of period	\$393,071	\$400,268
Service cost	16,497	16,307
Interest cost	22,784	23,760
Actuarial loss (gain)	7,850	(7,806)
Benefits paid	(26,943)	(39,458)
Benefit obligation at end of period*	<u>413,259</u>	<u>393,071</u>
Change in plan assets		
Fair value of plan assets at beginning of period	445,511	450,977
Actual return on plan assets	20,597	33,916
Administrative expenses	(1,167)	(870)
Employer contributions	312	945
Benefits paid	(26,943)	(39,457)
Fair value of plan assets at end of period*	<u>438,310</u>	<u>445,511</u>
Information on funded status and amounts recognized		
Funded status	25,051	52,440
Unrecognized net transition asset	(336)	(525)
Unrecognized prior service credits	(45,574)	(58,263)
Unrecognized net loss from past experience different from that assumed	81,541	59,863
Prepaid benefit cost	<u>\$ 60,682</u>	<u>\$ 53,515</u>

* The nonqualified supplemental plan has a projected benefit obligation of \$6,221 and \$5,540 at December 31, 2004 and 2003, respectively. This plan has no plan assets at December 31, 2004 and 2003. The accrued benefit cost associated with this plan was \$5,774 and \$4,636 at December 31, 2004 and 2003, respectively.

Based on the funded status of the pension plan, the Company does not anticipate any contributions to be made during 2005 for the Cash Balance Plan. The Company expects to contribute approximately \$415 to the non-qualified plan in 2005.

The expected benefits to be paid are as follows:

2005	\$ 34,055
2006	34,575
2007	35,916
2008	33,538
2009	36,298
2010-2014	<u>193,849</u>
Total	<u>\$368,231</u>

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Actuarial assumptions used were as follows:

	December 31	
	2004	2003
Discount rate	6.0%	6.5%
Rate of increase in future compensation levels	4.0	4.0
Expected long-term rate of return	7.5	7.5

As of the December 31, 2004 measurement date the expected long-term rate of return on assets assumption is 7.50%. As defined in SFAS No. 87, "Employers' Accounting for Pensions", this assumption represents the rate of return on plan assets reflecting the average rate of earnings expected on the funds invested or to be invested to provide for the benefits included in the benefit obligation. The assumption has been determined by reflecting expectations regarding future rates of return for the investment portfolio, with consideration given to the distribution of investments by asset class and historical rates of return for each individual asset class.

The following table sets forth the percentage of total plan assets for each major category of assets:

	December 31	
	2004	2003
Asset allocation by asset class		
Equity securities	28.1%	25.4%
Debt securities	71.9	74.6
Total	<u>100.0%</u>	<u>100.0%</u>

The plan is diversified across three broad asset classes - large cap equity, international equity and domestic fixed income with the target allocation of 20% to large cap, 5% to international equities and the remaining 75% to fixed income. The Company has retained the services of investment managers to implement the Plan's strategies.

Net pension income for the actuarially developed plans included the following components:

	Year ended December 31		
	2004	2003	2002
Service cost	\$ 16,497	\$ 16,307	\$ 15,977
Interest cost on projected benefit obligation	22,784	23,760	26,144
Expected return on plan assets	(33,359)	(34,590)	(36,054)
Net amortization and deferral	<u>(12,779)</u>	<u>(12,836)</u>	<u>(12,070)</u>
Net pension income	<u>\$ (6,857)</u>	<u>\$ (7,359)</u>	<u>\$ (6,003)</u>

The Company administers two noncontributory defined contribution plans offering employees the opportunity to accumulate funds for their retirement. The Deferred Compensation Plan, which is closed to new contributions, and the Executive Savings Plan are nonqualified plans designed to provide executives with an opportunity to defer a portion of their base salary and/or incentive compensation. At December 31, 2004 and 2003, the plan assets of \$18,137 and \$16,515, respectively are included as components of cash and investments and an offsetting liability to plan participants is included in other liabilities.

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The Company also administers a contributory 401(k) Deferred Savings Plan which is offered to all eligible employees. The Company matches contributions of participating employees; 50% of the first 6% of employee contributions or \$5,301, \$5,247 and \$5,921 for the years ended December 31, 2004, 2003 and 2002, respectively.

15. Other Postretirement Employee Benefits

In addition to pension benefits, the Company provides certain health care and life insurance benefits for retired employees. Substantially all employees may become eligible for those benefits if they reach retirement age while working for the Company.

The change in benefit obligation, plan assets and information on the plans' funded status and the components of the net periodic benefit cost are as follows:

	December 31	
	2004	2003
Change in benefit obligation		
Benefit obligation at beginning of period	\$ 117,811	\$ 120,726
Service cost	1,453	1,597
Interest cost	6,259	6,975
Actuarial gain	(9,890)	(2,457)
Benefits paid	(4,989)	(9,030)
Benefit obligation at end of period	110,644	117,811
Change in plan assets		
Fair value of plan assets at beginning of period	—	—
Employer contributions	4,989	9,030
Benefits paid	(4,989)	(9,030)
Fair value of plan assets at end of period	—	—
Information on funded status and amounts recognized		
Funded status	(110,644)	(117,811)
Unrecognized net actuarial gain	(68,346)	(63,647)
Unrecognized transition obligation	34,413	38,715
Accrued postretirement benefit cost	\$(144,577)	\$(142,743)

The expected benefits to be paid are as follows:

2005	\$ 8,370
2006	8,482
2007	8,649
2008	8,621
2009	8,766
2010-2014	44,075
Total	\$86,963

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	December 31		
	2004	2003	2002
Components of net periodic benefit cost			
Service cost	\$ 1,453	\$ 1,597	\$ 1,500
Interest cost	6,259	6,975	7,686
Amortization of transition obligation	4,302	4,302	4,301
Amortization of actuarial gain	(5,191)	(4,837)	(4,699)
Net periodic postretirement benefit cost	<u>\$ 6,823</u>	<u>\$ 8,037</u>	<u>\$ 8,788</u>

Actuarial gains or losses for postretirement life and health benefits are recorded separately when they exceed 10% of their respective accumulated postretirement benefit obligations and, at that time, the entire amount of the gain is amortized over the period in which eligibility requirements are fulfilled (20 years).

On December 8, 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 ("Modernization Act") was signed into law. The Modernization Act introduced a voluntary Medicare Part D prescription drug benefit and created a new 28% federal subsidy for the sponsors of the postretirement prescription drug benefits that are at least actuarially equivalent to the new Medicare Part D benefit. The current measurements of accumulated postretirement benefit obligation and net periodic postretirement benefit cost do not reflect any amount associated with the subsidy as The Company is unable, at this time, to conclude whether the benefits provided by the plan are actuarially equivalent to Medicare Part D under the Modernization Act.

The actuarial assumptions used for determining the accumulated postretirement benefit obligation as measured on December 31, 2004 and 2003 are as follows:

	December 31	
	2004	2003
Weighted-average discount rate	6.0%	6.5%
Health care trend rates:		
Participants under age 65 in EPO and PPO Plans	9.75%-4.5%	10.0%-4.5%
Participants under age 65 in other plans	10.5%-4.5%	10.0%-4.5%
Participants age 65 and over in Medicare HMOs	3.61%-5.0%	30.7%-4.5%
Participants age 65 and over in Indemnity Plans	9.75%-4.5%	9.0%-4.5%
Caps on Company paid portion of health care premiums for participants who retire on or after May 1, 1996 (in whole dollars):		
Participants age 65 and older with Medicare Carve-out Plans	\$2,358	\$2,358
Participants under age 65 with POS—Point of Service Plans	\$4,926	\$4,926

The trend rate ranges shown indicate the trend rates will decrease 1.0% annually, other than the Medicare HMO and the Indemnity Plan, until ultimately leveling out at 4.5%. The annual trend rate for the Medicare HMO is 3.61%, (37.61)%, and 9.5% for the next three years and then 0.75% decreases annually until 5.0% and then ultimately leveling out at 4.5%. The annual trend rate ranges shown for the Indemnity Plan indicate the trend rate will decrease 0.75% annually until ultimately leveling out at 4.5%.

The health care cost trend rate assumptions have a significant effect on the amounts reported. Increasing and decreasing the assumed health care cost trend rates by one percentage point in each year would increase and

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decrease the postretirement benefit obligation as of December 31, 2004 by \$7,067 and \$6,328, respectively, and increase and decrease the service and interest cost components of net periodic postretirement benefit cost for December 31, 2004 by \$466 and \$422, respectively.

16. Concentration of Business

The Company's business is concentrated in New York and New Jersey, with 99% of its premium revenue received from New York business. As a result, future acts of terrorism, changes in regulatory, market or healthcare provider conditions in either of these states, particularly New York, could have a material adverse effect on the Company's business, financial condition or results of operations.

The Company earns revenue from its contracts with the Center for Medicare and Medicaid Services (CMS), the federal agency that administers the Medicare program. Specifically, the Company has a contract with CMS to provide HMO Medicare+Choice coverage to Medicare beneficiaries in certain New York counties and the Company has a contract to serve as fiscal intermediary for the Medicare Part A program and a carrier for the Medicare Part B program (collectively, referred to as "Medicare Services"). The Company's Medicare+Choice product and Medicare Services represented 10% and 25% of total premium earned and administrative service fee revenue, respectively, during 2004.

The Company earns revenue from its contracts to provide healthcare services to New York State and New York City employees. The New York State and New York City PPO business accounts for approximately 19% and 15% of total premium earned, respectively, during 2004.

The Company is a party to license agreements with the Blue Cross Blue Shield Association, an association of independent Blue Cross Blue Shield plans, which entitles the Company to use the Blue Cross and Blue Shield names and marks in 28 New York counties. The Company uses these names and marks to identify the Company's products and services in these licensed counties. Approximately 99% of the Company's business is distributed under these names and marks.

17. Segment Information

WellChoice has two reportable segments: commercial managed care and other insurance products and services. The commercial managed care segment includes group PPO, HMO (including Medicare+Choice), EPO and other products as well as the Company's New York City and New York State PPO business. The other insurance products and services segment consists of the Company's traditional indemnity products, Medicare supplemental, individual hospital only, state sponsored individual plans, government mandated individual plans and government contracts with CMS to act as a fiscal intermediary for Medicare Part A program beneficiaries and as a carrier for Medicare Part B program beneficiaries.

Income from continuing operations before income tax expense for the period ended December 31, 2004 include administrative expenses of \$883 and \$227, for the managed care and other insurance products and services segments respectively, related to unoccupied leased office space, see footnote 11. Income from continuing operations before income tax expense for the period ended December 31, 2003 included administrative expenses of \$10,717 and \$2,650, for the managed care and other insurance products and services segments respectively, related to unoccupied leased office space, see footnote 11.

The reportable segments follow the Company's method of internal reporting by products and services. The financial results of the Company's segment are presented consistent with the accounting policies described in

WellChoice, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (continued)
(Dollars in thousands except share and per share data)

footnote 2. Administrative expenses, investment income, and other income, but not assets, are allocated to the segments. There are no intersegment sales or expenses.

The following table presents information by reportable segment:

	Commercial Managed Care	Other Insurance Products and Services	Total
Year ended December 31, 2004			
Revenues from external customers	\$4,871,734	\$ 885,119	\$5,756,853
Investment income and net realized gains	57,972	11,488	69,460
Other revenue	580	90	670
Income from continuing operations before income tax expense	339,591	47,783	387,374
Year ended December 31, 2003			
Revenues from external customers	4,373,643	947,602	5,321,245
Investment income and net realized gains	52,885	10,149	63,034
Other loss	(1,450)	(274)	(1,724)
Income from continuing operations before income tax expense	292,667	50,955	343,622
Year ended December 31, 2002			
Revenues from external customers	3,935,234	1,089,004	5,024,238
Investment income and net realized gains	54,047	13,363	67,410
Other revenue	11,272	2,740	14,012
Income from continuing operations before income tax expense	253,424	56,344	309,768

The following table presents our revenue from external customers by products and services:

	Year ended December 31		
	2004	2003	2002
Revenues from external customers:			
Commercial managed care:			
Premiums earned:			
PPO	\$2,706,121	\$2,561,614	\$2,349,911
HMO	1,493,724	1,231,239	1,133,637
EPO	299,518	297,891	234,112
Other	49,248	8,764	5,343
Administrative service fees	323,123	274,135	212,231
Total commercial managed care	<u>4,871,734</u>	<u>4,373,643</u>	<u>3,935,234</u>
Other insurance products and services			
Premiums earned:			
Indemnity	223,937	312,519	397,175
Individual	482,069	463,353	507,857
Administrative service fees	179,113	171,730	183,972
Total other insurance products and services	<u>885,119</u>	<u>947,602</u>	<u>1,089,004</u>
Total revenues from external customers	<u>\$5,756,853</u>	<u>\$5,321,245</u>	<u>\$5,024,238</u>

WellChoice, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (continued)
(Dollars in thousands except share and per share data)

18. Stock-Based Compensation

The Company's incentive plan provides for the grant of stock options, stock appreciation rights, restricted stock awards and restricted stock units. On March 26, 2003, the Company's Board of Directors adopted the 2003 Omnibus Incentive Plan (the "2003 Incentive Plan"). In accordance with the 2003 Incentive Plan a maximum of 6,250,000 shares of common stock may be issued, of which no more than 1,875,000 shares may be issued under grants of restricted stock awards and restricted stock units. A maximum of 500,000 shares may be issued to non-employee directors. Awards are granted by the Compensation Committee of the Board of Directors. Options vest and expire over terms set by the Committee at the time of grant.

Stock Option Grants

In accordance with the 2003 Incentive Plan, the Company's Compensation Committee granted options to purchase shares of common stock to the Company's officers, employees and non-management directors at the fair market value at the date of grant. These options generally vest over a three-year vesting period and expire ten years after the grant date. A summary of the stock option activity for the years ended December 31, 2004 and 2003 is as follows:

	Number of Options	Weighted Average Exercise price per share
Balance at January 1, 2003	—	\$ —
Granted	790,981	31.05
Balance at December 31, 2003	790,981	31.05
Granted	2,145,022	37.01
Exercised	23,901	31.03
Forfeited	74,667	32.38
Balance at December 31, 2004	<u>2,837,435</u>	<u>\$35.52</u>
Options exercisable at December 31, 2004	240,560	31.05

There were no options exercised, forfeited or expired for the year ended December 31, 2003. There were no options exercisable as of December 31, 2003. No stock options were granted or outstanding prior to 2003.

Information about stock options outstanding at December 31, 2004 is summarized as follows:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
\$30.01 – \$35.00	732,646	8.84	31.17	240,560	31.05
35.01 – 40.00	2,082,348	9.69	36.97	—	—
40.01 and over	22,441	9.71	42.13	—	—

Restricted Stock Awards

During 2004 and 2003, the Company granted 271,212 and 185,969 shares, respectively, of the Company's stock as restricted stock awards to certain eligible executives valued at the fair value of the stock on the grant date with

WellChoice, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (continued)
(Dollars in thousands except share and per share data)

no cost to the employee. Restricted stock awards generally vest over a three-year period. The fair value of these awards is being amortized to compensation expense over the vesting period. Administrative expense for the years ended December 31, 2004 and 2003 includes \$5,312 and \$497, respectively, of compensation expense related to these awards. Unearned restricted stock compensation as of December 31, 2004 and 2003 includes \$9,661 and \$5,274, respectively related to the restricted stock awards.

Restricted Stock Unit Awards

During 2004 and 2003, the Company granted 11,557 and 27,076 shares of common stock as restricted unit awards, respectively, to non-employee members of the Board of Directors. Restricted stock unit awards are settled in shares of WellChoice, Inc. common stock and dividend equivalents. The restricted stock unit awards granted in 2004 and 2003 will 100% vest on May 18, 2005 and February 1, 2005, respectively, provided the grantee serves as a Director and has not terminated other than due to retirement prior to the vesting date. The fair value of the restricted unit awards is being amortized to compensation expense over the vesting period. Administrative expense for the years ended December 31, 2004 and 2003 includes \$965 and \$87, respectively, of compensation expense related to these awards. Unearned restricted stock compensation as of December 31, 2004 and 2003 includes \$243 and \$753, respectively, related to restricted stock unit awards.

Employee Stock Purchase Plan

The Company has authorized 3,000,000 shares of common stock for issuance under the Employee Stock Purchase Plan ("Stock Purchase Plan"), which is intended to provide employees of the Company and certain related companies or corporations with an opportunity to share in the ownership of WellChoice and to provide a stronger incentive to work for the continued success of the Company. Any employee that meets the eligibility requirements defined in the Stock Purchase Plan may participate. No employee will be permitted to purchase more than \$25 worth of stock in any calendar year, based on the fair market value of the stock at the beginning of each offering period. The purchase price per share is 85% of the lower of the fair market value of a share of common stock on the first day or the last day of the offering period. Employees become participants by electing payroll deductions from 1% to 10% of their base compensation and all or part of any incentive compensation, after-tax. The Company has two offering periods beginning on January 1 and July 1 of each calendar year. The first offering period of the Stock Purchase Plan commenced on January 1, 2004. Payroll deductions of \$3,373 had been accumulated and applied towards the purchase of 106,218 shares of common stock for the period ended December 31, 2004. Purchased stock is accumulated in the employee's investment account.

19. Earnings Per Share

The denominator for basic and diluted earnings per share for 2004 and 2003, and for the period from November 7, 2002 (date of for-profit conversion and initial public offering) through December 31, 2002 is as follows:

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Denominator for basic earnings per common share—weighted-average shares	83,539,772	83,490,478	83,490,478
Effect of dilutive securities—employee and director stock options and non vested restricted stock awards	<u>308,387</u>	<u>27,689</u>	<u>—</u>
Denominator for diluted earnings per common share	<u>83,848,159</u>	<u>83,518,167</u>	<u>83,490,478</u>

WellChoice, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (continued)
(Dollars in thousands except share and per share data)

Weighted-average shares used for basic earnings per share assumes that shares issued in the initial public offering were issued on the effective date of the initial public offering. Weighted-average shares used for basic earnings per share also assumes that adjustments, if any, to the common stock issued in the initial public offering occurred at the beginning of the quarter in which changes were identified.

There were no shares or dilutive securities outstanding prior to the for-profit conversion and initial public offering. For comparative pro forma earnings per share presentation, the weighted-average shares outstanding and the effect of dilutive securities for the period from November 7, 2002 to December 31, 2002, are shown above.

Stock options, restricted stock awards, and restricted stock units are not considered outstanding in computing the weighted-average number of shares outstanding for basic earnings per share. Stock options, restricted stock awards and restricted stock unit awards are included, from the grant date, in determining diluted earnings per share using the treasury stock method. The stock options are dilutive in periods when the average market price exceeds the grant price. For the year ended December 31, 2004, 22,441 stock options were excluded from the dilution computation because they would have been antidilutive. The restricted stock unit awards are dilutive when the aggregate fair value exceeds the amount of unearned compensation remaining to be amortized.

The following unaudited quarterly financial data are presented on a consolidated basis for each of the years ended December 31, 2004 and 2003.

	Quarter ended			
	March 31	June 30	September 30	December 31
2004 Data				
Total revenues	\$ 1,384,542	\$ 1,504,071	\$ 1,450,999	\$ 1,487,371
Income from continuing operations before income tax expense	97,178	94,176	99,816	96,204
Net income	59,236	65,381	61,895	59,663
Basic net income per common share	\$ 0.71	\$ 0.78	\$ 0.74	\$ 0.71
Diluted net income per common share	\$ 0.71	\$ 0.78	\$ 0.74	\$ 0.71
Shares used to compute basic earnings per share, based on weighted average shares outstanding for the quarter	83,491,767	83,493,145	83,559,141	83,593,095
Shares used to compute dilutive earnings per share, based on weighted average shares outstanding for the quarter	83,753,744	83,798,907	83,908,346	84,358,456
2003 Data				
Total revenues	1,292,078	1,374,511	1,339,339	1,376,627
Income from continuing operations before income tax expense	82,983	85,436	87,461	87,742
Net income	47,741	48,775	52,058	52,552
Basic and diluted net income per common share	\$ 0.57	\$ 0.59	\$ 0.62	\$ 0.63
Shares used to compute basic earnings per share, based on weighted average shares outstanding for the quarter	83,490,478	83,490,478	83,490,478	83,490,478
Shares used to compute dilutive earnings per share, based on weighted average shares outstanding for the quarter	83,490,478	83,490,478	83,490,478	83,892,582

Supplemental Schedules

WellChoice, Inc. and Subsidiaries
Schedule I—Summary of Investments Other than
Investments In Related Parties

<u>Type of Investment</u>	<u>Cost</u>	<u>Value</u>	<u>Amount at which Shown in the Balance Sheet</u>
	<i>(Dollars in thousands)</i>		
Investments at December 31, 2004			
Fixed maturities:			
Bonds:			
United States Government and government authorities	\$ 869,369	\$ 864,052	\$ 864,052
All other corporate bonds	<u>505,223</u>	<u>497,780</u>	<u>497,780</u>
Total fixed maturities	1,374,592	1,361,832	1,361,832
Equity securities:			
Industrial, miscellaneous and all other	<u>43,774</u>	<u>53,430</u>	<u>53,430</u>
Total equity securities	43,774	<u>\$ 53,430</u>	53,430
Other long-term investments	18,624	xxx	18,624
Short-term investments	<u>170,577</u>	xxx	<u>170,577</u>
Total investments	<u>\$1,607,567</u>	xxx	<u>\$1,604,463</u>

WellChoice, Inc. and Subsidiaries
Schedule II—Condensed Financial Information of Registrant
Condensed Balance Sheets

	December 31,	
	2004	2003
	<i>(In thousands)</i>	
Assets		
Investments:		
Fixed maturities, at fair value (amortized cost: \$222,567 and \$155,021)	\$ 221,643	\$ 154,078
Marketable equity securities, at fair value cost: \$43,774 and \$52,890)	53,430	60,414
Short-term investments	29,070	611
Other long-term equity investments	18,624	18,685
Total investments	322,767	233,788
Cash and cash equivalents	243,068	129,447
Total investments and cash and cash equivalents	565,835	363,235
Receivables	3,906	3,962
Investment in subsidiaries	1,092,188	1,057,855
Property, equipment and information systems, net of accumulated depreciation	107,120	113,526
Prepaid pension expense	60,682	53,515
Deferred taxes, net	56,860	69,164
Other	21,539	17,079
Total assets	\$1,908,130	\$1,678,336

WellChoice, Inc. and Subsidiaries
Schedule II-Condensed Financial Information of Registrant
Condensed Balance Sheets (continued)

	December 31,	
	2004	2003
	<i>(In thousands, except share and per share data)</i>	
Liabilities and stockholders' equity		
Liabilities:		
Accounts payable and accrued expenses	\$ 67,320	\$ 103,796
Capital lease obligations	44,004	48,345
Other	114,481	93,838
Total liabilities	225,805	245,979
Stockholders' equity:		
Common stock, \$0.01 per share value, 225,000,000 shares authorized; shares issued and outstanding: 200—84,047,152; 2003—83,676,446	840	837
Class B common stock, \$0.01 per share value, one share authorized, issued and outstanding	—	—
Preferred stock, \$0.01 per share value, 25,000,000 shares authorized; none issued and outstanding	—	—
Additional paid-in capital	1,275,160	1,262,222
Retained earnings	408,759	162,584
Unearned restricted stock compensation	(9,904)	(6,027)
Accumulated other comprehensive income	7,470	12,741
Total stockholders' equity	1,682,325	1,432,357
Total liabilities and stockholders' equity	\$1,908,130	\$1,678,336

WellChoice, Inc. and Subsidiaries
Schedule II—Condensed Financial Information of Registrant
Condensed Statements of Operations

	For the year ended December 31,		Period from November 7, 2002 (date of for profit conversion and initial public offering) to December 31,
	2004	2003	2002
	<i>(In thousands)</i>		
Equity in net income (loss) of subsidiaries, net of tax expense	\$237,655	\$196,708	\$(40,331)
Other income	15,681	8,103	1,268
Income (loss) from continuing operations before income taxes	253,336	204,811	(39,063)
Income tax (expense) benefit	(7,161)	(3,685)	521
Net income (loss)	<u>\$246,175</u>	<u>\$201,126</u>	<u>\$(38,542)</u>

WellChoice, Inc. and Subsidiaries
Schedule II—Condensed Financial Information of Registrant
Condensed Statements of Cash Flows

	For the year ended December 31,		Period from November 7, 2002 (date of for profit conversion and initial public offering) to December 31,
	2004	2003	2002
	<i>(In thousands)</i>		
Cash flows from operating activities			
Net income (loss)	\$ 246,175	\$ 201,126	\$ (38,542)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization	37,580	39,453	6,084
Equity in earnings of wholly-owned unconsolidated subsidiaries	(237,655)	(196,708)	40,214
Deferred income tax benefit	9,751	26,779	(521)
Dividends received from Empire HealthChoice Assurance, Inc.	195,000	140,000	91,038
Other	(15,446)	(10,139)	(1,167)
Changes in assets and liabilities:			
Other receivables	40	2,185	1,013
Other assets	(4,460)	(5,363)	(2,471)
Accounts payable and accrued expenses	(28,641)	(16,730)	25,203
Other liabilities	23,902	(64,701)	(91,821)
Net cash provided by operating activities	<u>226,246</u>	<u>115,902</u>	<u>29,030</u>
Cash flows from investing activities			
Purchases of property, equipment and information systems	(33,308)	(43,519)	(4,124)
			50,519
Proceeds from sale of property, equipment and information systems	—	1,803	—
Purchases of available for sale investments	(479,519)	(152,392)	3,825
Proceeds from sales and maturities of available for sale investments	401,180	98,145	1,977
Net cash provided by (used in) investing activities	<u>(111,647)</u>	<u>(95,963)</u>	<u>52,197</u>
Cash flows from financing activities			
(Decrease) increase in capital lease obligations	(4,341)	646	—
Net (expenses) proceeds from common stock issued in public offering	(752)	—	(355)
Net proceed from employee compensation programs	4,115	—	27,990
Net cash (used in) provided by financing activities	<u>(978)</u>	<u>646</u>	<u>27,635</u>
Change in cash and cash equivalents	113,621	20,585	108,862
Cash and cash equivalents at beginning of period	129,447	108,862	—
Cash and cash equivalents at end of period	<u>\$ 243,068</u>	<u>\$ 129,447</u>	<u>\$108,862</u>

WellChoice, Inc. and Subsidiaries
Schedule III—Supplementary Insurance Information
(Dollars in thousands)

	<u>Unpaid Claims And Claims Expenses</u>	<u>Unearned Premiums</u>
Segment		
December 31, 2004		
Commercial managed care	\$588,886	\$ 83,277
Other insurance products and services	<u>89,928</u>	<u>55,445</u>
Total	<u>\$678,814</u>	<u>\$138,722</u>
December 31, 2003		
Commercial managed care	\$505,057	\$ 74,802
Other insurance products and services	<u>104,434</u>	<u>59,372</u>
Total	<u>\$609,491</u>	<u>\$134,174</u>

	<u>Premiums and Fees</u>	<u>Net Investment Income</u>	<u>Cost of Benefits Provided</u>	<u>Other Operating Expenses</u>	<u>Premium Written</u>
Segment					
Year ended December 31, 2004					
Commercial managed care	\$4,871,734	\$57,972	\$3,940,618	\$650,077	\$4,557,086
Other insurance products and services	<u>885,119</u>	<u>11,488</u>	<u>595,903</u>	<u>253,011</u>	<u>702,079</u>
Total	<u>\$5,756,853</u>	<u>\$69,460</u>	<u>\$4,536,521</u>	<u>\$903,088</u>	<u>\$5,259,165</u>
Year ended December 31, 2003					
Commercial managed care	\$4,373,643	\$52,885	\$3,520,701	\$611,710	\$4,106,600
Other insurance products and services	<u>947,602</u>	<u>10,149</u>	<u>641,545</u>	<u>264,977</u>	<u>775,451</u>
Total	<u>\$5,321,245</u>	<u>\$63,034</u>	<u>\$4,162,246</u>	<u>\$876,687</u>	<u>\$4,882,051</u>
Year ended December 31, 2002					
Commercial managed care	\$3,935,234	\$54,047	\$3,201,752	\$545,377	\$3,726,666
Other insurance products and services	<u>1,089,004</u>	<u>13,363</u>	<u>745,630</u>	<u>303,133</u>	<u>908,690</u>
Total	<u>\$5,024,238</u>	<u>\$67,410</u>	<u>\$3,947,382</u>	<u>\$848,510</u>	<u>\$4,635,356</u>

WellChoice, Inc. and Subsidiaries
Schedule V—Valuation and Qualifying Accounts

	<u>Balance at Beginning of Period</u>	<u>Charged (Credited) to Costs and Expenses</u>	<u>Charged (Credited) to Other Accounts</u>	<u>Other (Deductions) Recoveries</u>	<u>Balance End of Period</u>
	<i>(Dollars in thousands)</i>				
Year ended December 31, 2004					
Allowance for doubtful accounts	\$ 14,661	\$ (412)	\$ —	\$(4,118)	\$10,131
Deferred tax assets valuation allowance	—	—	—	—	—
Year ended December 31, 2003					
Allowance for doubtful accounts	13,724	834	—	103	14,661
Deferred tax assets valuation allowance	—	—	—	—	—
Year ended December 31, 2002					
Allowance for doubtful accounts	12,440	773	—	511	13,724
Deferred tax assets valuation allowance	195,698	(195,698)	—	—	—