

ANTHEM, INC.

**3Q02 EARNINGS CONFERENCE CALL
NOVEMBER 4, 2002, 8:30 AM EST**

FINAL TRANSCRIPT

CORPORATE PARTICIPANTS

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Anthem, Inc. - CEO

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CONFERENCE CALL PARTICIPANTS

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by and welcome. This is the Anthem third quarter results conference call.

At this time all participants are in a listen-only mode. Later we will conduct a question and answer session. Instructions will be given at that time. If you should require assistance during the call, please press zero then star. And as a reminder, this conference is being recorded.

I would now like to turn the conference over to our host, Tami Durlle. Please go ahead.

Tami Durlle - Anthem, Inc. - Vice President of Investor Relations

Good morning and thanks for joining us.

This is Tami Durlle, Vice President of Investor Relations and we are pleased to share with you Anthem's third quarter 2002 results.

This morning Larry Glasscock, Anthem's Chief Executive Officer will begin the call with an overview of the third quarter results. Mike Smith, Anthem's Chief Financial Officer, will then discuss our third quarter financial performance in detail. Before taking your questions, Larry will provide our earnings outlook for the rest of 2002 and 2003.

We will be making some forward-looking statements on this morning's call and listeners are cautioned there are factors that could cause actual results to differ materially from our current expectations. These risk factors are discussed in our press release this morning, Anthem's second quarter 2002 Form 10-Q, filed in August and other periodic filings which we have made with the SEC.

Larry?

Larry Glasscock - Anthem, Inc. - Chief Executive Officer

Thank you, Tami and good morning to everyone.

Anthem had a great third quarter. Our earnings momentum continued, operating margins reached a record 5.5% on a consolidated basis, and we are growing membership.

In addition we completed the Trigon transaction on July 31st, only 93 days after our merger announcement on April 29th. Giving you

the visibility we promised, we now have a new Southeast segment where we will report the operating results of Trigon.

With the completion of the Trigon acquisition on July 31st the third quarter income statement includes two months of Trigon's operations and, of course, our balance sheet and membership data as of September 30th includes Trigon as well. Later Mike will explain in more detail the effect of adding Trigon to our reported third quarter results.

Anthem's third quarter 2002 earnings were \$1.05 per diluted share an increase of 33% year-over-year on a FAS 142 comparable basis, excluding net realized investment gains and the impact of nonrecurring items. Operating revenue was \$3.5 billion for the quarter, an increase of 38% on a reported basis compared to the third quarter of 2001.

If you exclude the impact of the Southeast segment to the current quarter's results, operating revenue increased 16% year-over-year. Consolidated operating gain was \$193.5 million in the quarter, resulting in a 5.5% operating margin, the best in our history.

We remain disciplined in our pricing with premium yields of approximately 15% in the third quarter, covering medical cost trends in the high 12% range on a same-store basis. Our enrollment increased by 3.1 million members compared to the third quarter of 2001.

The acquisition of Trigon or now Anthem Southeast added 2.5 million members while same store enrollment increased by 585,000 members or 7% year-over-year. All lines of business contributed to the same store year-over-year growth in enrollment. However, three customer segments, national accounts, local large group and our individual business accounted for about 91% of the growth.

In Anthem's Midwest region, membership reached almost 5.2 million at September 30, an increase of 7% year-over-year. In the East, enrollment now stands at 2.4 million members, an 8% increase from September 30th of last year and the membership in our West region was 823,000 or an 8% increase year-over-year. In Anthem's new Southeast region enrollment was 2.5 million members.

As we mentioned on our last quarter's call, Anthem Southeast will now include Blue Card host members, which is consistent with our other regions. Compared to the third quarter of 2001 our Southeast membership increased by 8%, this includes Blue Card membership in both the third quarter of 2001 and 2002 enrollment numbers.

We are seeing membership gains in every geographic region, principally due to four factors. First, a strong brand name. Blue Cross and Blue Shield, the Blue system's national membership has reached almost 85 million members, the highest enrollment level in the Blues in 20 years.

Second, Anthem's product portfolio and network breadth which offer our customers significant choice and value.

Third, we are a financially strong and secure company, which is important to employers and individuals seeking a long-term health benefits partner.

And fourth, a very focused effort to provide our customers with distinctive service.

I think the metric that best reflects our ability to meet customers' needs is membership retention. On an enterprise-wide basis, Anthem enjoys a retention rate greater than 90%.

As we have discussed before, since late 1999 we have been migrating membership to systems of choice in our Midwest and East regions while maintaining very high levels of customer service. At this time more than 80% of our membership in the Midwest and the East is on their respective systems of choice and the systems migration in these two regions should be essentially complete by the end of 2003.

As we look ahead to 2003, we are optimistic that we will capture continued growth in enrollment. About 37% of our membership renews in the first quarter of the year with the third quarter representing the second largest renewal period with about 30% of our membership.

As I previously mentioned, retention of the third quarter of 2002 was above 90% and we do not anticipate this trend to change materially as we project 2003 membership. As you would expect, the majority of national accounts have January 1 renewals.

To date Anthem has won 21 new national accounts for January 2003 and we expect to add approximately 100,000 net new national members in the first quarter of 2003. Overall, our total enrollment should increase by about 250 to 300,000 members in the first quarter of 2003.

Before I conclude my introductory comments I want to quickly reflect on the past 12 months.

Anthem as you know just celebrated its first anniversary as a public company. Since our initial public offering on October 30th of last year, we have continued to execute the same strategy and our performance is getting better every day. We are pleased to be among the largest publicly traded companies in the industry and our stock performance since the IPO reflects the focus and dedication of our 19,000 associates who are working extremely hard to meet our customers' needs.

With that said, we are proud of our achievements over the past year, yet we are not satisfied. Our company-wide efforts to integrate operations, consolidate systems, penetrate under served

markets and grow membership while reducing administrative costs will remain our focus.

Now here is Mike Smith who will discuss our third quarter financial results in more detail. Mike.

Michael Smith - Anthem, Inc. - Chief Financial Officer

Thank you, Larry and good morning.

As Larry mentioned, we closed the Trigon acquisition on July 31st. Therefore our financial results for the third quarter include the operating results of the former Trigon for the months of August and September only. In a minute I will walk you through the details of the acquisition, but let's first look at the financial results for the quarter.

Anthem's third quarter 2002 net income was \$171.2 million, or \$1.29 per diluted share. If you exclude the impact of net realized investment gains and nonrecurring items, net income was \$139 million or \$1.05 per diluted share. This results in a 33% year-over-year growth rate in earnings per share on a FAS 142 comparable basis. The reconciliation of reported earnings of \$1.29 per diluted share to adjusted earnings of \$1.05 per diluted share takes the following items into account.

First, consistent with our past practice, the impact of net realized gains and losses is excluded from the adjusted earnings per share number. In the third quarter net realized gains represented about 4 cents per share.

Second, the third quarter included 20 cents of nonrecurring tax benefits related to the reduction in our tax valuation allowance. As a result, Anthem's effective tax rate in the third quarter was at 24.8%.

Continued momentum in our results over the last several quarters contributes to the recoverability of certain deferred tax assets, thus triggering a reduction in our allowance. Therefore, if you take the \$1.29 per share reported, less the 4 cents impact from net realized gains and less 20 cents of nonrecurring tax benefits, the adjusted earnings per share in the quarter was \$1.05 per share.

On last quarter's conference call, we established \$1.00 per share as the high end of our expectations for the third quarter and we are therefore quite pleased our performance was stronger than we had expected.

Now looking at the Trigon acquisition. We closed the acquisition on July 31st by issuing 39 million shares of Anthem common stock, \$950 million of public debt and we used approximately \$250 million of cash on hand. Trigon shareholders received 1.062 shares of Anthem common stock and \$30 of cash for each share of Trigon stock.

Following the transaction, the weighted average shares outstanding increased by almost 27 million shares from the second quarter to the third quarter of 2002. Interest expense was \$30.3 million in the third quarter of 2002, of which \$11 million was due to two months of interest on the \$950 million of new public debt. Also, amortization of intangibles increased by about \$5 million sequentially as a result of the acquisition.

Obviously, all income statement line items such as premiums and administrative expenses were impacted in the third quarter by virtue of our Trigon transaction. Although the acquisition creates a more complex quarter to analyze, the operating performance of our Southeast region or the former Trigon is reasonably transparent as Anthem Southeast is a separate reportable segment.

Now let's focus on Anthem's operating results on a segment by segment basis. Consolidated operating gain was \$193.5 million in the quarter, a \$114.4 million increase year-over-year.

Anthem's new Southeast segment accounted for \$46.3 million of the increase with the remaining \$68.1 million coming from same store improvements. Each of our operating segments contributed to this 86% same store increase in operating gain.

In the Midwest, operating margin improved to 4.4% in the third quarter, and this represented the fourth consecutive quarter of margin improvement for this segment. Operating gain was \$67.3 million in the quarter, a 96% increase over last year's third quarter results. The year-over-year improvement in the Midwest was due to several items.

First, local large group, small group and individual businesses reported improved underwriting results.

Second, in this year's third quarter, a \$16 million favorable adjustment for prior year reserve developments was recognized.

Third, offsetting the favorable underwriting results and positive reserve developments we recorded a \$23 million adjustment for the accrual of premium taxes in the State of Ohio. And finally, as you may recall, we had strengthened reserves in the Midwest by approximately \$11 million in the third quarter of 2001.

The third quarter 2002 operating gain in the East was \$61.7 million, an improvement of \$31.4 million on a year-over-year basis. Our operating margin in this segment increased 250 basis points to a record 5.7% in the third quarter. The growth in operating gain was driven primarily by improved underwriting results along with the fact that the third quarter of 2001 included a \$9.4 million reserve strengthening adjustment.

In the West, we reported a \$31.7 million operating gain in the third quarter of 2002. During the quarter, we recorded a \$10.9 million adjustment for favorable reserve developments. Therefore, the

better than expected operating gain in this segment for the quarter is not representative of a sustainable run rate.

We are projecting an operating gain of \$15 million to \$17 million in the fourth quarter for the West segment with further momentum and improvement expected in 2003. Improvement in our 2003 results in the West is expected even as we begin our systems migration project in that region and as we fund an increase in our marketing efforts.

The Southeast region's operating gain for the two months ended September 30th was \$46.3 million or about \$15 million above our expectations. In the fourth quarter, the Southeast segment is expected to report an operating gain in the \$68 million to \$73 million range. Therefore the very solid results in the Southeast in the third quarter are expected to continue.

Claims trends remain favorable in Virginia and we are taking a very disciplined approach in our spending as we integrate these operations.

Our integration team, which includes more than 200 associates from across Anthem, continues to meet regularly to ensure a successful transition. Effective with the closing, we began the execution phase of the team's recommendations. The implementation of our shared service model has resulted in a the alignment of those functional areas under common leadership.

We will continue to follow a disciplined integration process to allow for both a smooth transition and the timely capture of our expected synergies.

The specialty segment's third quarter 2002 operating gain was \$13.4 million, resulting in a 9.9% operating margin.

Anthem prescription management, our PBM, continues to drive improved results for this segment. Anthem prescription management processed approximately 620,000 mail order scripts this quarter, a 32% increase compared to the third quarter of 2001. The build-out of our vision and behavioral health businesses also remains very much on plan.

As we discussed on last quarter's call, Anthem behavioral health will begin administration of behavioral health benefits for our customers in Colorado in early 2003. Our vision products, are projected to launch in 2003 as well.

The other segments operating loss was \$26.9 million this quarter, as compared to a loss of \$1.8 million in the third quarter of 2001. The two main drivers contributing to the year-over-year increase in the loss include higher incentive compensation expense as a result of above-target performance and a \$5.7 million reduction in the remaining carrying value of our investment in MedUnite.

As we look forward to the next quarter, we would expect a comparable level of operating loss for this segment.

Larry will give you more specifics about our fourth quarter 2002 and full year 2003 guidance later but I want to make certain that we capture for you an understanding of the quality of our third quarter operating results.

As I have just discussed, favorable adjustments for prior year reserve developments recorded in the quarter were essentially offset by additional administrative expenses relating to our MedUnite write down and the Ohio premium tax renewal. All in, these items essentially net to zero.

We are pleased with our underlying performance this quarter and expect continued improvement in our operating results.

Anthem's consolidated benefit expense ratio was 81.5% in the third quarter, an improvement of 360 basis points year-over-year. This improvement was primarily due to the lower than expected medical cost trends, coupled with \$27 million in adjustments for favorable prior year reserve developments and the non-recurrence of a \$21 million strengthening recorded in 2001.

If you exclude the adjustments in both periods, the benefit expense ratio improved 180 basis points to 82.4%. Medical cost trends for our fully insured group business remains stable in the high 12% range.

The trends for each of the medical cost components are relatively consistent whether you include or exclude the impact of the Southeast region and the drivers of each component were also consistent with prior quarters.

In-patient trends were in the 9% to 10% range, outpatient running about 13% to 14%. Professional fees in the 11% to 12% range and pharmacy at 17%. Medical cost trends are expected to be about 12% to 13% for full year 2002, and we project a comparable range for next year as well. The consolidated administrative expense ratio was 19.5% in the third quarter of 2002, compared with 18.7% in the third quarter of 2001 an increase of 80 basis points.

Excluding the Ohio premium tax accrual and the MedUnite write-down, this ratio was flat with the prior year's third quarter and improved 50 basis points sequentially.

Turning to the balance sheet, cash and investments reached \$6.6 billion at the end of the third quarter and total assets now exceed \$12 billion. Anthem continues to enjoy very good asset quality.

Our investment portfolio is allocated approximately 97% to fixed maturity securities and 3% to equities with 100% of the fixed maturities in investment grade securities.

We see strength in our balance sheet reserves as well. Total policy liabilities were \$2.3 billion at September 30, an increase of \$600 million from year-end 2001. The Trigon acquisition accounted for \$491 million of the increase with the remaining \$109 million representing increases in same-store reserves.

Days claims payable in the third quarter were 61 days, down 1.6 days compared to the prior quarter.

Excluding Trigon, this metric declined by one day sequentially, primarily due to improved claims paying efficiencies in the East. The efficiencies resulted from process improvements implemented during the past year resulting in the average claims backlog declining by about 20%. Excluding the impact of the Trigon acquisition, Anthem's stand-alone IB&R reserve increased from the second quarter.

We have not changed our reserving methodology and continue to take a conservative stance in estimating our medical costs. Anthem's total debt increased from last quarter due to borrowings to fund the majority of the cash portion of the Trigon acquisition.

Our balance sheet, which was made part of this release this morning shows long-term debt of approximately \$1.7 billion.

Note that an additional \$100 million of debt is included in other current liabilities as this debt has a maturity in July 2003. Our total debt to total capital remains at approximately 25% at September 30th.

Operating cash flow was \$381 million in the third quarter of 2002, up \$130 million compared to last year's third quarter. On a year to date basis, operating cash flow increased 22% to \$624 million.

Also note that included in our \$624 million of cash flow, we have absorbed a \$137 million payment to fund our pension plan and cash flow still exceeded net income by 1.7 times. For the full year 2002, we expect over \$900 million in operating cash flow, and in 2003, operating cash flow should exceed \$1 billion.

During the third quarter, we repurchased approximately 1.2 million shares of our common stock with \$72 million of cash. Thus far we have repurchased \$109 million of our common stock and \$291 million of authorization remains under our share repurchase program. We will continue to evaluate the alternative options available to invest excess cash flow and improve shareholder returns.

Right now investment in our current businesses, opportunistic acquisitions and the share repurchase program are our top priorities. We have excellent liquidity with a strong balance sheet to support future growth opportunities.

Now Larry will walk you through our earnings outlook for the fourth quarter of 2002 and the full year 2003.

Larry Glasscock - Anthem, Inc. - Chief Executive Officer

Thank you, Mike.

As you know, our guidance does not include the pending Blue Cross & Blue Shield of Kansas acquisition. We expect the Supreme Court of Kansas to hear oral arguments later this year concerning this case and render a court decision later in 2003.

Also we have not projected any additional share repurchases in determining our earnings guidance. We now expect full year 2002 earnings per share in the \$4.05 to \$4.10 range, which is an increase from the \$3.85 to \$3.95 per share we previously expected. Fourth quarter 2002 earnings per share are expected to be in the \$1.05 to \$1.10 range.

For 2003, we expect earnings per share of \$4.65 to \$4.75 which represents an increase in the guidance of \$4.50 to \$4.60 per share we reported on last quarter's conference call.

We continue to be pleased with the progress on the integration of the Southeast region. We are now projecting the realization of more savings in 2003.

You will recall that we previously targeted \$40 million by 2003 and now we expect to capture \$40 to \$50 million. We also remain convinced we can capture at least \$75 million by 2004.

Now let me walk you through the details surrounding our 2002 guidance.

Remember that Anthem Southeast will report a full quarter of results in the fourth quarter. Likewise, financing costs of the merger will be recognized for a full quarter as well.

We estimate the fourth quarter 2002 diluted shares outstanding to be in the 145 million to 147 million range with the full year 2002 diluted share count in the 121 to 123 million range. Consolidated operating gain is projected to be in the \$200 million to \$215 million range in the fourth quarter resulting in a full year 2002 operating gain of \$620 million to \$635 million. This is approximately \$65 million to \$75 million higher than we expected on last quarter's conference call for the full year 2002.

We are projecting fourth quarter 2002 operating gain for each of our reportable segments as follows: Midwest in the \$70 or \$75 million range, East in the \$65 to \$70 million range, Southeast approximately \$68 to \$73 million, West \$15 to \$17 million, Specialty in the \$11 to \$13 million range. And the other segment operating loss should be comparable to the loss in the third quarter.

This updated guidance reflects an improved outlook for each of our four health segments for 2002. Excluding Anthem Southeast, 2002

medical membership is now projected to increase 7% to 8% in the higher end of the 6% to 8% range projected on last quarter's call. We are estimating mid to high single digit membership growth in the Midwest and East and high single to low double digit growth in the West. The Southeast region should also add about 20,000 members in the fourth quarter.

Anthem's consolidated benefit expense ratio is projected to be in the 82% to 84% range for the fourth quarter. The administrative expense ratio is projected to be approximately 18.5% to 19.5% next quarter. And the fourth quarter 2002 effective tax rate is expected to be in the 36% to 37% range.

Let me now turn to 2003. We are projecting earnings of \$4.65 to \$4.75 per share, which is an increase of at least 15% over 2002 projected earnings.

We expect sequential improvement in earnings per share in the second, third and fourth quarters with the first quarter of 2003 down slightly from the fourth quarter of this year due to normal seasonality associated with Medicare deductibles being paid in the first quarter and holiday postponement of medical services.

Membership gains are projected in the 4% to 6% range for 2003. We expect premium yields to cover projected medical cost trends of 12% to 13% for our fully insured group business with buy-downs in the 250 to 350 basis-point range for 2003. Consolidated operating gains should increase approximately 45% to 50% in 2003, based on our expectations for the reported full year 2002.

We expect operating margins to be in the mid 5% range in 2003.

A little over one year ago we set a goal of reaching 4.5% to 5% margins over the next couple of years and we have accomplished this goal. However, the bar has been raised and we think we are well-positioned as we continue closing the gap in margin performance between Anthem and our top performing peers.

We also project a relatively stable benefit expense ratio in 2003 and the administrative expense ratio should be in the 17.5% to 18% range next year. The effective tax rate is forecasted to be about 36% to 37% for 2003.

I would like to close by reiterating how pleased we are with the strength and quality of our financial results in the third quarter. Furthermore, the momentum and early success in integrating Anthem Southeast has given us the confidence to increase our expectations for the fourth quarter of 2002 and for 2003. Our commitment to offering product choices, broad network access and distinctive service continues to provide the kind of value that our customers desire while also benefiting our shareholders.

With that we would now be happy to answer any of your questions.

QUESTION AND ANSWER

Operator

Thank you, sir.

Ladies and gentlemen if you wish to ask a question, please press the one on your phone. You will hear a tone indicating that you have been placed in queue. You may remove yourself from queue at any time by pressing the pound key on your phone. If you are using a speaker phone, please pick up your hand set before pressing the numbers.

One moment please for the first question.

Our first question comes from the line of Charles Boorady with Salomon Smith Barney.

Charles Boorady - Salomon Smith Barney

Good morning and happy anniversary and congratulations on the quarter.

The question regarding the causative variation in the Midwest segment in terms of the prior period adjustments and sort of color on how they can go negative \$11 million last year and then plus \$15.7 million this year. In terms of was there a change in assumptions or an improvement in the systems to help measure medical trends or was there an actual variance in the underlying results of that magnitude?

Michael Smith - Anthem, Inc. - Chief Financial Officer

Charles, it's Mike. I'll take your question.

First let me reiterate what Larry and I both said.

No change in underwriting strategy or philosophy. Recall that the adjustment last year was made in the wake of our nation's tragedy, and we believed it appropriate to conservatively account for any delay that might be experienced in the reporting of claims incurred by our members. We had no specific book of business, we had no single item motivating last year's recording of the reserve strengthening.

This year we are blessed to enjoy improved efficiencies as Larry also mentioned, we have now migrated a good bit of our data to the new Anthem Midwest model, and we are also experiencing favorable trend.

Charles Boorady - Salomon Smith Barney

Was there -- in terms of why in the Midwest and not, say, in the East or other segments, is there a reason why we would have seen the greater variance in the Midwest or is it just the sheer size of that segment?

Michael Smith - Anthem, Inc. - Chief Financial Officer

In fact it is the size as, again, Larry reported. The Midwest has substantial portions of our enrollment, we are further along in the systems migration. We also announced this quarter, as you heard, similar favorable reserve developments in the West. The East, on the other hand, did not require any similar look back at the reserves and there is nothing particularly unique Midwest versus East or any other region.

Charles Boorady - Salomon Smith Barney

One follow-up and then I'll get back in the queue. In terms of Kansas, would there be any reason for an update post-election, will these elections have any impact around outlook for when that might close and what's the earliest possible close date you can envision?

Larry Glasscock - Anthem, Inc. - Chief Executive Officer

No, Charles. This is being driven by the Supreme Court of Kansas.

As we said, we expect them to hear the case over the next few months and we expect a court decision at least some time in '03. So no, I don't think it's driven by the election at all.

Charles Boorady - Salomon Smith Barney

New Insurance Commissioner, would they be able to have any effect on the process or has that train already left the station, so to speak?

Larry Glasscock - Anthem, Inc. - Chief Executive Officer

I don't want to anticipate what a new commissioner would do. Right now we are focused on the Kansas Supreme Court decision.

Charles Boorady - Salomon Smith Barney

Okay. Terrific, thanks.

Operator

Our next question comes from the line of Roberta Goodman with Merrill Lynch. Please go ahead.

Roberta Goodman - Merrill Lynch

Thanks.

I was wondering if you could talk a little bit more about the enrollment expectations for next year and if there are particular geographies or segments that are driving what looks to be a higher rate of enrollment growth than one might have expected. At this point between this year and the next.

Larry Glasscock - Anthem, Inc. - Chief Executive Officer

Roberta, this is Larry.

We are expecting enrollment growth across all of our regions. You heard me say that we are expecting in the first quarter or in January about 100,000 new contracts simply from the enrollment of our new national accounts business where we serve as the control plan. So we think in the first quarter overall we will be up another 250 to 300,000 net new members.

The national business and the individual business will be driving the significant portion of that growth. We are seeing very good growth as you saw from our release in our individual business.

We are very proud of the fact that we have a number of new control plan accounts, about 21 in number, and that's up from last year when we had 12 new accounts. So at the same time we have retained 100% of our national account control business.

So we are very pleased with our national results, but having said that, we are seeing wins in all of our regions so we are optimistic on that earnings guidance or rather membership guidance that we have given you of a 4% to 6% increase.

Roberta Goodman - Merrill Lynch

I was wondering also if you could talk a little bit about the 250 to 350 basis points of benefit buy-down, what kinds of buy-downs you're seeing and if there are any nuances either regionally or by segment?

Larry Glasscock - Anthem, Inc. - Chief Executive Officer

We aren't seeing really that much in the way of nuances, but what we are seeing most as we look at the 250 to 350 basis point range is the addition of increasing co-pays on particularly certain outpatient procedures such as MRIs. We are also seeing increased co-pays in ER visits and specialist visits. Putting in some co-pays on outpatient surgeries.

I wouldn't say we are seeing anything unique in any of the individual markets. But what we are seeing is a lot more talk about defined contribution, but we are still seeing employers for 2003, at least, addressing lower costs through these buy-downs.

Roberta Goodman - Merrill Lynch

So would it be appropriate to categorize that as the employers seeking to get at some of the problem areas in the trend through the benefit buy-down.

Larry Glasscock - Anthem, Inc. - Chief Executive Officer

I think that's a fair statement, yes.

Roberta Goodman - Merrill Lynch

Thank you.

Larry Glasscock - Anthem, Inc. - Chief Executive Officer

Thank you, Roberta

Operator

Our next question comes from the line of Josh Raskin with Lehman Brothers. Please go ahead.

Josh Raskin - Lehman Brothers

Thanks. Just two quick questions. One a little bit more about the med trend expectations, I think both Mike and Larry mentioned, flat expectations over '02 for '03. Any shift in the components there? Are you seeing anything that would indicate one way or the other?

Larry Glasscock - Anthem, Inc. - Chief Executive Officer

We are not seeing very much shift in the components, and what we are seeing, Josh, is very much what we saw in '01. You may recall the trends there were up 12 to 13%. They'll be up another 12 to 13% in '02. So we see the trends still being relatively stable with not much -- not much of a difference among the categories.

I can talk a little bit more about inpatient. We think for '03 that inpatient trend will be 80% driven by unit cost. As you know the hospitals continue to negotiate higher rates, but our length of stay and inpatient days per thousand are very well maintained. Our guidance for '03 is really in the low double digit area.

For outpatient, we are seeing the trend there driven 2/3 by utilization and they are the areas you would expect, radiology, labs, outpatient surgery. So our guidance for '03 here is in the low to mid teens. As far as professional fees are concerned, that's largely utilization driven and we see guidance for next year in the low double digits, and in the whole pharmacy arena, utilization continues to remain very strong in what we are guiding for in '03 here, are increases in the mid to high teens.

Josh Raskin - Lehman Brothers

Okay. Great. It's a lot of detail. Very helpful.

Just one quick question also on the Ohio premium taxes. Just wondering what triggers that and if there's any expectation going forward of similar accruals?

Michael Smith - Anthem, Inc. - Chief Financial Officer

Josh, it's Mike. Let me take that.

Let me kind of ground a broader understanding.

This is a tax that was enacted in 1997. It's a tax that is actually imposed in January following a year of business by a licensed carrier in the state. We therefore recorded 1997's activity, the tax it prompted was an expense in '98 and so on.

Recent discussion among the accounting industry and the regulator in Ohio suggests that the convention is migrating to recording the tax in the year of the business, not necessarily at the date of the assessment. And we simply took the lead and recorded the '02 expense in '02 as opposed to waiting until January '03 to record retroactively the expense. No change in the law, but an evolution among carriers who are reporting this expense for both STAT and GAAP purposes in the state of Ohio.

Josh Raskin - Lehman Brothers

Okay. That's helpful.

So we saw one then in the first quarter of this year and the third quarter and we'll sort of see them once in the following years?

Michael Smith - Anthem, Inc. - Chief Financial Officer

Yeah.

Arguably what happens is we return to 12 months expense in a 12-month period beginning in '03. '02's earnings, as we have highlighted in this release, actually have both last year's expense and the current expense in it. That's why we isolated the \$23 million as the nonrecurring issue this year.

Josh Raskin - Lehman Brothers

Okay. That's helpful. I'll get back in line with other questions.

Operator

Our next question comes from the line of Matthew Borsch with Goldman Sachs. Please go ahead.

Matthew Borsch - Goldman Sachs

Just two quick follow-up questions on the premium and medical cost trends.

Just to confirm on the premium yield expectation. You're pricing for a stable medical loss ratio for 2003, and in line with the trend of 12% to 13%. That actually represents a deceleration in pricing from 2002, am I correct?

Michael Smith - Anthem, Inc. - Chief Financial Officer

Matt, your analysis is correct. Our stated guidance is that we are pricing to meet trend in '03. Arithmetically you have made the observation that as trends stabilizes, the required premium increase will be slightly lower than what we have described throughout '02.

Matthew Borsch - Goldman Sachs

Great. On the pharmacy trend, your pharmacy trend has remained somewhat high relative to some of your competitors. I'm just wondering what you think is driving that, is it regional differences or some other factors?

Michael Smith - Anthem, Inc. - Chief Financial Officer

Matt, I think it's -- I think it's several items. One has to do with customer mix. Anthem's Midwest book is significantly influenced by pharmacy contracts with customers who do not bake into their benefit design the management of pharmacy benefits, speaking specifically of the autos. In the East, similarly we have a substantial portion of our membership in municipally based contracts again without pharmacy management baked into the design. I would also add that we believe there may be some inconsistency across the industry in the development and calculation of these trends. At Anthem we include the high end, high cost injectables in our trend. We are not certain that is the case as an industry-wide practice.

Matthew Borsch - Goldman Sachs

Great. Thanks. I'll get back in the queue.

Operator

Our next question comes from the line of Carl McDonald with CSFB. Please go ahead.

Carl McDonald - Credit Suisse First Boston

Thank you. Could you talk a little bit more about your market share in Colorado and Nevada and what segments that growth is coming from? I think the market share at the time of the IPO was 18% and 12%. Thank you.

Michael Smith - Anthem, Inc. - Chief Financial Officer

Yeah. I'm happy to take the call.

No substantial shift in the customer mix in the Colorado market. Our share, we believe is still in the 17% to 18% range. Some had contemplated that as one of our major competitors withdrew from the small group, HMO product offering that we would see an acceleration of our small group membership growth in Colorado. Rather our growth has been fairly steady across all customer segments.

Larry Glasscock - Anthem, Inc. - Chief Executive Officer

If I could add, we are delighted with the way the Colorado and Nevada business continues to progress for us. We are being very disciplined in our pricing and therefore we had some customers that decided to pursue other options, just given the fact that we weren't willing to price it at a rate that we thought was not going to contribute to our margin.

Again we continue to be very pleased, we would have had, excluding the change in Medicare Plus Choice out there which we got out of January 1 of this year, our enrollment would have been up 9%.

We are very pleased with this, and as you may recall, we were just named company of the year in the finance and insurance segment by the Colorado business magazine out there and the woman who runs that business for us was named Businesswoman of the Year. So we are very pleased with our progress in Colorado and Nevada.

Carl McDonald - Credit Suisse First Boston

Thanks. Could you just tell us what your free cash of the parent company was at the end of September?

Michael Smith - Anthem, Inc. - Chief Financial Officer

Cash available at the parent company enjoyed the benefit of two items. Actually we still had cash on hand from dividends paid by the regulated subs to the parent in the spring. We had cash on hand at Trigon at closing that allowed us to fund approximately \$250 million of the purchase price out of combined cash accounts and we expect to take a dividend from the regulated subs early in '03 of another \$300 million. Considering we have only used \$109 million for share repurchases, we expect a fairly strong position of liquidity at year end.

Carl McDonald - Credit Suisse First Boston

I'm sorry. What was the free cash to parent?

Michael Smith - Anthem, Inc. - Chief Financial Officer

Cash available in the parent's accounts right now are approximately \$400 million.

Operator

Our next question comes from the line of Christine Arnold of Morgan Stanley? Please go ahead.

Christine Arnold - Morgan Stanley

Good morning. You said you increased your IBNR on a same-store basis at Anthem, could you quantify that for us?

Michael Smith - Anthem, Inc. - Chief Financial Officer

Christine we -- my apologies if that was not made clear in the text of our report. We talked about the overall increase being accounted for in part by Trigon's part of the consolidated balance and then referred to the net which was a little over \$109 million being a same-store increase in the reserve.

Christine Arnold - Morgan Stanley

Okay. So that excludes the timing differences?

Michael Smith - Anthem, Inc. - Chief Financial Officer

That's net of those differences in fact.

Christine Arnold - Morgan Stanley

Okay. So gross of those differences the number will be even higher?

Michael Smith - Anthem, Inc. - Chief Financial Officer

That is correct.

Christine Arnold - Morgan Stanley

By -- okay, by some amount.

Michael Smith - Anthem, Inc. - Chief Financial Officer

Well, the aggregate of the releases is in the \$26 million range and we're \$109 million or so net of that.

Christine Arnold - Morgan Stanley

Okay., but wasn't there also factors timing and claims payments in addition to the reserves?

Michael Smith - Anthem, Inc. - Chief Financial

Let's talk through -- more specifically then the days claim reduction, maybe I'll get you a more precise number. Days claim payable were down roughly 6/10 of a day attributable to Trigon, 8/10 of a day related to the efficiencies gained in the East systems migration. 2/10 of a day from the favorable development adjustments made and net of all of that, the policy liability reserve itself on a same store basis is up over \$109 million from year-end.

Christine Arnold - Morgan Stanley

So it's .8 in efficiency?

Michael Smith - Anthem, Inc. - Chief Financial Officer

Yes.

Christine Arnold - Morgan Stanley

Great, thank you.

Operator

This next question comes from the line of Eric Veiel of Deutsche Banc. Please go ahead.

Eric Veiel - Deutsche Banc

Couple of quick questions. Mike, I was just wondering if you could walk through if there was about a six or so million dollars write-down of MedUnite in the other segment, why wouldn't we see the other segment loss tick down sequentially in the fourth quarter.

Larry Glasscock - Anthem, Inc. - Chief Executive Officer

Let me take that.

First of all, let me refresh your memory on MedUnite. We now have that carrying value down to zero. You are correct.

What we are looking at is essentially our LTI or incentive accrual is going to continue to do well, at least well from an expense point of view because our performance is very significantly above our forecast. And our incentive accrual, just to give you a brief update because we have talked about aligning our interest with the shareholders before, but our incentive plan, long term incentive plan, is built around three components. And that is cumulative growth in net income, achieving operating margin and then comparing our performance relative to our peers. So as we continue achieve against each of those we expect the incentive compensation accrual to hopefully increase because that would be a good thing for you as well.

Eric Veiel - Deutsche Banc

Okay. So it's essentially going to offset the write-down that you took in MedUnite this quarter?

Larry Glasscock - Anthem, Inc. - Chief Executive Officer

That's correct.

Eric Veiel - Deutsche Banc

Second question, you gave us some nice detail on the mail volume at APM. I was wondering if you could you tell us what was the total prescription volume processed through PBM?

Michael Smith - Anthem, Inc. - Chief Financial Officer

Eric, I do not have the total count for scripts.

I can tell you that mail order penetration -- I beg your pardon, total retail script volume was 10.6 million scripts in third quarter '02, that's an increase of 8% compared to the third quarter of '01. Mail scripts, as I mentioned, in our discussion of the earnings, was 620,000. Mail scripts being up 32%. Mail order penetration is now

at 5.4%, slightly better than our run rate at last year end when we were at 4.8% penetration.

Eric Veiel - Deutsche Banc

That's great. Thank you very much for that detail.

Operator

This next question comes from the line of John Rex with Bear Stearns. Please go ahead.

John Rex - Bear Stearns

Just regarding the IT spending in the Midwest and East. You said you were coming close to completing that project.

I was wondering if you could expect a meaningful impact from a slowdown in spending? I'm sure that was incorporated in your outlook but I was wondering if you could quantify how meaningful that is and how much offset there is from developments in the West in terms of what you'll be spending there?

Larry Glasscock - Anthem, Inc. - Chief Executive Officer

Well, we still have some work to do, as you know. We have moved over 2 million members now to the system of choice and we are going to continue to migrate members you know, that balance of this year into next. That goes, John, with also with the migration beginning in the West region where we're going to migrate to facets and that's going to be about \$10 - \$15 million in 2003.

So in terms -- back to your question of administrative expense, over the next few years we believe we continue can continue to get on the neighborhood of 30 to 50 basis points in improvement by virtue of the systems consolidation effort. But as you know, we have taken a very conservative approach here. We have migrated our business as opposed converting it and we believe that's been the right model for us. Our service levels have been very good. We will see some reduction in administrative cost over the next few years, as I said, 30 to 50 basis points.

John Rex - Bear Stearns

Is there, say, a dollar level we can think about going away in '04 as you will have completed Midwest and East or can we think about it that way?

Larry Glasscock - Anthem, Inc. - Chief Executive Officer

John, we are not giving guidance, as you know, out into '04 yet. We will get more specific about that in the future, but it's a great question.

John Rex - Bear Stearns

In terms of Trigon and the increased your expectations for synergies, was that all on cost savings or a combination of revenue and cost savings in terms of the increased outlook?

Michael Smith - Anthem, Inc. - Chief Financial Officer

John, it's Mike. Let me share a report that I'll make on behalf of Tom Snead and myself. Tom and I continue to co-Chair the transition teams.

The increase in our synergy capture as described today is strictly focused around additional cost savings. The component of the targeted savings have shifted slightly and the upside is in the administrative and corporate savings which previously had been identified as \$10 to \$15 million. We now believe that's \$20 to \$25 million.

John Rex - Bear Stearns

Great, thank you.

Operator

This next question comes from the line of Michael Baker with Raymond James. Please go ahead.

Michael Baker - Raymond James

First I was wondering if you could update us with respect to your PBM strategy both with respect to the current relationship with Merck Medco as well as injectable drugs?

Larry Glasscock - Anthem, Inc. - Chief Executive Officer

Sure. With regard to Merck Medco, as you know, their contract with Trigon, now Anthem Southeast, runs through the full year 2003.

So we are in the process right now of analyzing what we want to do there for the future, but we continue to believe there are significant benefits that we derive from having this in-house PBM. It goes back to the ability to really integrate our data with our health data, and we are incentivized to manage the drug trend of our health plans and we are not worried about someone else's agenda.

As you know, unlike others -- unlike some others we run our own mail service so all that's spread between cost and price is retained, and therefore given back to our health plans. So we have a very good record of service in our PBM. We are very pleased with it and we intend to continue to run it for the benefit of our customers.

Michael Baker - Raymond James

Then I was wondering with respect to any developments with respect to the injectable drugs?

Larry Glasscock - Anthem, Inc. - Chief Executive Officer

Yeah. Injectables, as you know, we have put that into a fourth tier out in our Colorado operation, that was put in effective 1-1-02, and on essentially a pilot basis and we'll be evaluating that and whether we want to roll that out further.

Michael Baker - Raymond James

Thank you very much.

Larry Glasscock - Anthem, Inc. - Chief Executive Officer

Surely.

Operator

This next question comes from the line of James Morris, Utendahl Capital. Please go ahead.

James Morris - Utendahl Capital

Good morning.

Larry Glasscock - Anthem, Inc. - Chief Executive Officer

Good morning.

James Morris - Utendahl Capital

I have a question.

I was wondering if you could help me understand the national accounts a little bit. I see that in the third quarter of this year the number of national accounts excluding Blue Card dropped off significantly. Is there a reason for that?

Larry Glasscock - Anthem, Inc. - Chief Executive Officer

Yes, there is a reason and thank you for bringing it up. I suppose we could have mentioned it.

In the first quarter of '02, we actually reclassified some members from national accounts to Blue Card, and that really came out of doing a very detailed review of our membership and we frankly found there's some inconsistencies to the way it had been classified historically. We move 133,000 members to Blue Card from national.

And if you go back and essentially now true that all up, based on the number I just gave you, we actually increased our national non Blue card membership by about 52,000 members from the end of last year. And as I mentioned for the first quarter of this year, this coming year, 2003, we are seeing very good growth in this national control plan business. So we are very pleased with the way things are going in national. And thank you for bringing this to everyone's attention.

James Morris - Utendahl Capital

Thank you.

Operator

The next question comes from the line of Darren Feldman of Aladdin Capital. Please go ahead. Mr. Feldman, Do you have your mute button on?

We will move on to the line of Charles Boorady with Salomon Smith Barney. Please go ahead.

Charles Boorady - Salomon Smith Barney

Thanks for the follow-up.

I'm just curious for the enrollment guidance in 2003, can you give us a sense of what would be in the Blue Card in national and total versus other segments? Should we expect roughly the same mix of growth in '03 as we saw in '02 or would you expect that mix to change somewhat?

Larry Glasscock - Anthem, Inc. - Chief Executive Officer

It's still too early to tell, Charles. I can't give you guidance.

What I can say is, as I said earlier, we see the 4% to 6% membership growth. We think we have estimated the Blue Card growth conservatively, but we just don't know from the other Blue

Cross Blue Shield plans yet what their enrollment gains have been in their Blue Card business.

So until we know that, it's hard to give you better guidance. What I do know is that the Blue plans appear to be doing very well in terms of national account enrollment. So we are very optimistic that we will see some good membership growth there.

Charles Boorady - Salomon Smith Barney

At 250,000 to 300,000 in the first quarter, would it be fair to assume a preponderance of that would come in the larger accounts?

Larry Glasscock - Anthem, Inc. - Chief Executive Officer

I think that would be a good assumption. We are continuing to see, however, good membership growth in individual, but national accounts will be very important.

Charles Boorady - Salomon Smith Barney

If you have a macro question, do you have a sense for what the total national Blue Card enrollment is among all Blues plans at this point, Larry?

Larry Glasscock - Anthem, Inc. - Chief Executive Officer

I do not have that.

Charles Boorady - Salomon Smith Barney

Thanks.

Larry Glasscock - Anthem, Inc. - Chief Executive Officer

Thank you, Charles. Probably time for one more question, if there is one.

Operator

Our final question comes from the line of Matthew Borsch with Goldman Sachs. Please go ahead.

Matthew Borsch - Goldman Sachs

Yeah, hi. I just a follow-up question on the national accounts. I know you're not going to name the accounts, but can you on the 21 new national accounts, can you just give us a little bit of information maybe about the size of the accounts and maybe some

sense of where you might have won them from, if not specific competitors, then types of competitors?

Larry Glasscock - Anthem, Inc. - Chief Executive Officer

Yes. I can do that.

First of all, we have won them across each of the regions. This has been a very successful year for us. We have had good results in Ohio, in the Midwest generally, in the East.

In terms of the names. Obviously you're right, I can't name those, but what we are seeing is a very good growth -- there's some accounts in the East where the membership gain by virtue of these accounts will be in excess of 10,000 contracts each. And there are others in the 5 to 10 range and some below 5. It's a very, very nice mix of business.

Matthew Borsch - Goldman Sachs

Great. Is it generally the case that when you win these accounts that you become the primary -- the primary self-insured carrier for these employers?

Larry Glasscock - Anthem, Inc. - Chief Executive Officer

I think generally speaking that's true, yes.

Matthew Borsch - Goldman Sachs

Thank you.

Operator

We'll turn the session back to Ms. Durlle for any closing remarks.

Tami Durlle - Anthem, Inc. - Vice President of Investor Relations

Thank you. Before we close out the call, I wanted to announce that on our web site, Anthem.com, we have provided a historical summary of Trigon's membership and income statement results by quarter for 2001 and the first two quarters of this year in a reporting format consistent with Anthem's presentation style. We hope you find this information useful in your analysis. As always if you have questions, do not hesitate to contact our investor relations team. Thanks for your interest in Anthem and have a great day.

Operator

Ladies and gentlemen, this conference will be available for replay after 1:45 p.m. Eastern time today through Friday, November 22 at midnight.

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That does conclude our conference for today. Thank you for your participation and for using AT&T executive teleconference, you may now disconnect.

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