ANTHEM, INC.

4Q02 EARNINGS CONFERENCE CALL
FEBRUARY 3, 2003, 8:00 AM EST

FINAL TRANSCIPT

CORPORATE PARTICIPANTS

Tami Durle
Anthem - Vice President of Investor Relations

Larry Glasscock
Anthem - President and CEO

Michael Smith
Anthem - CFO

CONFERENCE CALL PARTICIPANTS

Charles Boorady
Salomon Smith Barney

Scott Fidel
JP Morgan

Matthew Borsch
Goldman Sachs

Roberta Goodman
Merrill Lynch

John Rex
Bear Stearns

Michael Baker
Raymond James

Christine Arnold
Morgan Stanley

Josh Raskin
Lehman Brothers

Eric Veiel
Deutsche Bank

Safe Harbor Statement Under the Private Securities Litigation Reform Act of 1995

This transcript contains certain forward-looking information about Anthem, Inc. (“Anthem”), that is intended to be covered by the safe harbor for "forward-looking statements" provided by the Private Securities Litigation Reform Act of 1995. Forward-looking statements are statements that are not historical facts. Words such as "expect(s)", "feel(s)", "believe(s)", "will", "may", "anticipate(s)" and similar expressions are intended to identify forward-looking statements. These statements include, but are not limited to, financial projections and estimates and their underlying assumptions; statements regarding plans, objectives and expectations with respect to future operations, products and services; and statements regarding future performance. Such statements are subject to certain risks and uncertainties, many of which are difficult to predict and generally beyond the control of Anthem, that could cause actual results to differ materially from those expressed in, or implied or projected by, the forward-looking information and statements. These risks and uncertainties include: those discussed and identified in public filings with the Securities and Exchange Commission (“SEC”) made by Anthem; trends in health care costs and utilization rates; our ability to secure sufficient premium rate increases; competitor pricing below market trends of increasing costs; increased government regulation of health benefits and managed care; significant acquisitions or divestitures by major competitors; introduction and utilization of new prescription drugs and technology; a downgrade in our financial strength ratings; litigation targeted at health benefits companies; our ability to contract with providers consistent with past practice; our ability to achieve expected synergies and operating efficiencies in our acquisition of Trigon Healthcare, Inc. (“Trigon”) and to successfully integrate our operations; and general economic downturns. You are cautioned not to place undue reliance on these forward-looking statements that speak only as of the date hereof. Anthem does not undertake any obligation to republish revised forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events. You are also urged to carefully review and consider the various disclosures in Anthem's various SEC filings, including but not limited to the registration statement on Form S-3, filed by Anthem on December 18, 2002, Anthem's Annual Report on Form 10-K for the year ended December 31, 2001, and Anthem's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2002.

Please note this transcript has been edited for accuracy.

PRESENTATION

Operator

Ladies and gentlemen, thank you very much for standing by and welcome to Anthem fourth quarter results conference call. At this time all lines are in a listen-only mode. Later there will be an opportunity for questions and answers, with instructions given at that time. Should you require assistance from a specialist, please press zero and then star, and you will be assisted offline. As a reminder, today's conference call is being recorded.

I would now like to turn the conference call over to Anthem management. Please go ahead.

Tami Durle - ***Anthem - Vice President of Investor Relations***

Thank you, and good morning. Welcome to Anthem's fourth quarter 2002 conference call. I'm Tami Durle, vice president of investor relations, and joining me this morning is Larry Glasscock, Anthem's president and chief executive officer, and Mike Smith, our chief financial officer.

Larry will begin the call with an overview of our 2002 performance. Mike will then discuss our financial results in detail, and Larry will conclude our prepared remarks with the earnings outlook for 2003.

On this morning's call we will be making some forward-looking statements. Listeners are cautioned that there are factors that could cause actual results to differ materially from our current expectations. These risk factors are discussed in our press release last evening, the Form S3 registration statement we filed with the SEC in December of last year and other periodic filings we have made with the SEC -- Larry.

Larry Glasscock - ***Anthem - President and CEO***

Thank you, Tami, and good morning everyone. We are pleased with our financial performance for the fourth quarter and with our full year 2002 results.

Last year as you know was Anthem's first full year as a public company and the execution of a disciplined business strategy is driving record results for our company. Anthem reported full year 2002 earnings of $4.12 per diluted share, excluding the impact of net realized gains and non-recurring items, representing a 30 percent growth in earnings on a FAS 142 comparable basis.

2002 operating revenue reached almost 13 billion dollars, operating gain exceeded 644 million dollars, and a five percent operating margin reported for the year are all record achievements for our company.

As I look back at our goals and accomplishments for 2002, I'm pleased to report that careful focus on delivering innovative products and distinctive services to our customers contributed to results that exceeded our own expectations for the year.

For example, same store membership growth in 2002 was eight percent, which was above the four to five percent target we projected for the year. In addition, 2002 earnings per share growth was 30 percent, also above the expectations we had at this same time last year. And then finally, operating margin improved from 3.2 percent in 2001 to five percent in 2002.

The Trigon acquisition contributed 40 basis points of this improvement, but we are very pleased by the same store improvement of 140 basis points compared to our target of about 100 basis points.

During 2002, Anthem increased membership in all nine states and in every customer segment.

Our enrollment now exceeds 11 million members, a same store increase of 621,000 members in 2002. We also added 2.5 million members as a result of the Trigon acquisition. Anthem is the market leader in eight of our nine states and we continue to leverage the breadth and quality of our product portfolio to attract new members and, very importantly, retain existing accounts.

In 2002, the Midwest added 380,000 members, the East increased enrollment by 174,000, the West grew by 67,000 and in the Southeast membership grew by 143,000. As we look ahead in 2003 we are optimistic we'll continue to expand membership, improve operating margin and achieve between 15 to 18 percent growth in earnings per share.

But before we jump ahead to 2003 I'd like to review highlights of 2002. First, we continue to pursue our disciplined strategy of growing profitable enrollment. As I mentioned, 2002 same store membership growth of eight percent was better than we planned, even in this tough economic environment.

Second, operating margin reached five percent in 2002, 180 basis points better than 2001 and the highest in our company's history. A little over one year ago we set a goal of reaching four and a half to five percent margins over the next couple of years and we've accomplished this goal. We're optimistic we can further improve our margins as we work to close the gap in margin performance between Anthem and our top performing peers by demonstrating and delivering the value that our customers have come to expect from us.

Third, we've introduced several more affordable product solutions in 2002, as well as the roll out of a defined contribution product, Anthem ByDesign, which highlights our product innovation efforts. These new products give employers flexibility in managing health care costs while providing employees with greater control, choice and involvement in their health care decisions.

Fourth, our Midwest and East regions migrated more than one and a half million members to new operating platforms during the year. Over 85 percent of our membership in these two regions is now on its system of choice, and we expect this migration to be essentially complete by the end of 2003.

Very importantly, we have also provided uninterrupted distinctive customer service throughout this migration process, as evidenced by our membership retention levels remaining above 90 percent throughout 2002.

Fifth, the expansion of our Specialty businesses, including the acquisition of a behavioral health company in June of 2002, and investments in our vision company, improved our competitive position and enhanced the product offerings available to our customers.

And lastly, the acquisition of Trigon, which was completed on July 31st of last year, added a fourth region for Anthem. The integration of the new Southeast region has been even more productive than originally planned, driven largely by a disciplined approach to integration and tremendous leadership from our new partners in Virginia. We could not be more pleased with the performance of the Southeast region and anticipate the realization of additional efficiencies in the future as we integrate our businesses.

2002 was a great year for Anthem and we are very excited about the opportunities to further improve our performance in the future.

More specifically, for 2003 we will continue to build on the accomplishments we achieved in 2002.

For instance, our ability to grow profitable membership will be the result of listening to the marketplace and responding with new products. We did this in 2002 and we will continue to enhance our product portfolio by delivering high quality products and services to our customers.

Also, the further development of our Specialty products over the next few years will enhance our competitive position. By offering a full range of dental, vision, life, behavioral health and pharmacy benefit management products, we will be able to expand our role as a one stop shop for employee benefits.

And collaboration with health care providers will remain a top initiative, as well as the implementation of disease management and advanced care management programs which will result in improved health for our members.

Now, before I turn the call over to Mike, I'd like to also announce that on January 27th, Anthem's Board of Directors approved a new share repurchase program, authorizing a total of 500 million dollars in repurchases.

The new authorization, which extends to February of 2005, reflects our commitment to strategically execute this program.

We think this is yet another demonstration of our commitment to manage our cash flow wisely and to enhance shareholder value.

Here is Mike Smith who will discuss our fourth quarter and full year 2002 results in more detail -- Mike.

Michael Smith ***- Anthem - CFO***

Thanks, Larry. And good morning.

For the fourth quarter of 2002, net income was 171.9 million dollars, or $1.19 per diluted share. Excluding 17 million dollars of net realized investment gains, net income was 160.9 million dollars. This represents 57 percent year-over-year growth on a FAS 142 comparable basis.

I'm also pleased to report that fourth quarter earnings of $1.12 per diluted share on the same adjusted basis were better than we had expected.

In our short period as a public company, we are continuing to build on our reputation as a company that delivers on promises made.

Before I discuss the details of our financial results, I would like to highlight the fact that the fourth quarter includes three months of Trigon's operating results, whereas the third quarter included the operating results of our new region for the months of August and September only, as the acquisition was completed on July 31st.

Also, when I refer to same store growth this morning, I'm excluding the impact of the Trigon acquisition.

Specific to the fourth quarter, operating revenue was 3.9 billion dollars, a 50 percent increase compared to the fourth quarter of 2001, or a 16 percent growth on a same store basis.

The 16 percent same store increase in operating revenue was primarily driven by strong gains in membership as well as disciplined pricing.

Operating gain was 225.8 million dollars in the fourth quarter, an increase of 118.7 million dollars compared to the fourth quarter of 2001.

On a same store basis, operating gain improved 49 million dollars or 46 percent year-over-year. All core operating segments performed at or above the forecast we provided on last quarter's conference call.

I would like to provide a brief overview of the fourth quarter results for each of our operating business segments. In the Midwest, Anthem reported an 88.7 million dollar operating gain in the quarter, an increase of 110 percent year-over-year.

The Midwest remains our largest business segment in terms of membership and operating revenue and the 5.6 percent operating margin reported in the quarter was the best ever for Midwest.

Operating gain in the East was 66.1 million dollars in the fourth quarter of 2002, a 32 percent increase year-over-year. The full year 2002 operating margin was a record high 5.4 percent for the East segment.

The operating gain in the West segment improved by 15.6 million dollars year-over-year.

We're also pleased with our nine percent membership growth in the West, particularly in light of our strategy to proactively execute a very disciplined pricing practice in the West.

The Southeast region reported a 69.7 million dollar operating gain in the fourth quarter. Integration activities remain on schedule and we continue to project 40 to 50 million dollars of synergies in 2003 and at least 75 million dollars by 2004.

We captured approximately seven million dollars of synergies in the fourth quarter, primarily related to corporate overhead and information technology cost savings. In all respects, including both financially and operationally, the integration has progressed very smoothly.

Our Specialty segment reported a 12.1 million dollar operating gain in the fourth quarter. This represents a 53 percent growth rate compared to the fourth quarter of 2001.

For the year, the Specialty segment’s operating margin improved from 8.3 percent in 2001 to 9.7 percent in 2002. We expect further improvement over the next few years in this segment as we continue to expand our product offerings and increase our penetration rates.

The Other segment reported a 36.2 million dollar operating loss in the quarter. This loss was higher than our forecast, primarily due to higher incentive compensation expenses reflecting better than expected financial results.

Year-over-year, the benefit expense ratio improved 180 basis points to 80.9 percent in the fourth quarter and was better than our expectations primarily due to lower than anticipated medical costs in our Midwest and West segments.

Medical cost trends for our fully insured group business came in at 12 percent for 2002. Anthem's medical cost trends have been in the 12 to 13 percent range for the past two years, and we expect to stay in that range for 2003 as well.

Trends by cost component for 2002 were as follows: Inpatient costs were up about nine percent. Outpatient 12 percent. Professional fees approximately 12 percent, and pharmacy costs were up about 16 percent.

Our administrative expense ratio was 19.8 percent in the fourth quarter of 2002, versus 20.1 percent reported in the same quarter of 2001.

The 30 basis points of improvement reflected disciplined focus on leveraging administrative expenses over a larger membership base. This was partially offset by higher incentive compensation associated with above target results, reclassified expenses associated with a service contract of AdminaStar Federal, our Medicare intermediary, and expenses incurred as part of the dissolution of a small Midwest joint venture. Excluding these items, the ratio declined by about 120 basis points year-over-year to 18.9 percent.

Sequentially, administrative expenses increased by 89 million dollars, primarily due to an additional month of Trigon's results in the fourth quarter, increased volume related expenses associated with higher membership, and modest discretionary spending on advertising, promotion and medical management initiatives.

Going forward, we would expect our administrative expense ratio to trend downward by about 100 to 150 basis points in the first quarter of 2003 compared to the fourth quarter of 2002 on a reported basis.

Now turning to the balance sheet.

Anthem's balance sheet remains very strong, with cash and investments exceeding six billion dollars, and total assets in excess of 12 billion dollars.

Compared to year-end 2001, total assets increased by about six billion dollars, primarily due to the acquisition of Trigon and the investment of current cash flow.

Operating cash flow was 367 million dollars in the fourth quarter and 991 million dollars for the full year 2002, a little better than we expected and exceeding net income by a wide margin.

Anthem has substantial liquidity in our holding company, with approximately 200 million dollars of cash and investments at December 31st, and we expect approximately 425 million dollars of dividends to be upstreamed from our insurance operations during 2003.

We will continue to evaluate alternatives for the use of these cash balances, including investments in our current businesses, opportunistic acquisitions and the repurchase of our stock.

During 2002, Anthem used 256 million dollars of cash to repurchase 4.1 million shares of our common stock at an average share price of 62 dollars and 17 cents. Approximately 2.4 million shares were repurchased during the fourth quarter using about 147 million dollars of cash.

Our asset and liability management strategies reflect conservatism on both sides of our balance sheet. To illustrate, we've included in this press release a detailed analysis of our approach to establishing policyholder reserves. Days claims payable declined by four days to 57, compared with September 30th of 2002. The decline in days claims payable was due to the following: First, almost two days represented the reclassification of a case specific reserve from our IBNR reserves to a separate liability account not included in the days claims payable calculation.

Second, about one day was attributable to paying claims faster, primarily in our Midwest region. Improved efficiencies are coming from migrating membership to our new system in the Midwest, the FACETS system. During 2002, we moved almost one million members in this region alone to our new operating system. About 55 percent of the membership migration took place in the third and fourth quarter. Our provider network's electronic connectivity with FACETS is also much better than the legacy systems that are being retired.

In addition, the Midwest has benefited from efficiency gains in the new system with auto adjudication rates increasing from about 62 percent at year-end 2001 to almost 66 percent at December 31st of 2002.

About another day was attributable to overall lower than anticipated medical costs in our fourth quarter results, as well as our normal pattern of lower utilization of medical services in the fourth quarter.

As I've mentioned, and to give you additional visibility on our reserve practices, we included in our press release a preview of our annual disclosure around the reconciliation of reserve balances. This will be part of the footnotes to our Form 10-K, which will be filed in March.

This summary shows that on a consistent annual basis our reserves are being strengthened at a faster rate than reserve redundancies are being recognized and the overall conservatism has not declined in the past several years.

We continue to follow a consistent methodology in estimating our unpaid claims liability each year. This is demonstrated by comparing prior year redundancies to prior year total incurred claims. This metric illustrates an increased level of conservatism from 1.3 percent in 2000 to 1.9 percent in 2002.

When this metric remains constant or increases, it is another indication of the quality of reserves.

A detailed analysis provided in the table also illustrates that we are paying claims faster. The percentage of claims paid in the same year they were incurred increased to 84.3 percent in 2002 compared with 83.1 percent in 2001, and 81.3 percent in 2000. This is primarily attributable to our investment in new systems and improved connectivity with our networks.

Moving to our capital position, Anthem's total debt of 1.8 billion dollars at year-end 2002 is unchanged from the last quarter. 100 million dollars of our debt has been classified as short-term and is included in the other current liabilities line on our balance sheet as the debt will mature on July 15th of this year.

Anthem's total debt to capital ratio was 25 percent at December 31st, down from 28 percent reported at year-end 2001.

If I could quickly summarize Anthem's 2002 financial performance, I would like to highlight the following items.

Financial momentum continued with a 30 percent increase in earnings per share in 2002. We sustained profitable enrollment growth, which, along with a disciplined pricing strategy, resulted in improved performance.

The integration of our new Southeast region is progressing beyond our original plan, while Anthem's other business segments continue to improve their competitive position.

And finally, operating cash flow was almost one billion dollars in 2002, which enhanced an already strong balance sheet and reflects a very high quality of earnings for the year.

Now Larry will share with you our earnings guidance for 2003.

Larry Glasscock - ***Anthem - President and CEO***

Thanks, Mike.

Consistent with our past practice, our earnings guidance for 2003 does not include the pending acquisition of Blue Cross/Blue Shield of Kansas. The Supreme Court of Kansas has now set a date to hear oral arguments on March 5th, and we remain optimistic the court will render a favorable decision allowing the acquisition to move forward later this year.

In addition, our guidance does not include the projection of additional share repurchases in 2003.

We now expect full year 2003 diluted earnings per share to be in the $4.75 to $4.85 range which represents an increase of ten cents per share to the guidance of $4.65 to $4.75 per share we provided on our last conference call.

This earnings guidance assumes approximately 143 to 145 million average shares for 2003.

This guidance represents a 15 percent to 18 percent increase in earnings per share for 2003.

We expect first quarter earnings per share to be in the $1.00 to $1.05 range with sequential improvement in the earnings per share for the second, third and fourth quarters of the year. The sequential decline in earnings per share from the fourth quarter of 2002 to the first quarter of 2003 is primarily due to seasonality, including a higher benefit expense ratio in the first quarter for our Medicare Supplement business, since we began covering a new deductible period starting on January 1st.

We have consistently demonstrated even more conservatism early in the year as we track current year cost trends against new pricing levels.

Anthem's operating revenue is projected to exceed four billion dollars in the first quarter, with a full year reaching approximately 17 billion dollars. The approximate four billion dollar increase in operating revenue as compared to 2002's reported 13 billion dollars will be principally driven by three items: First, membership is expected to grow four to six percent in 2003. As we previously projected, we're still forecasting an increase of 250,000 to 300,000 members in the first quarter of 2003. Second, premium yields on our fully insured group business will cover medical cost trends, which are expected to be about 12 to 13 percent in 2003. And third, 2003 will include a full year impact of the Trigon acquisition whereas 2002 included only five months of results.

Operating gain is expected to increase 45 percent to 50.percent in 2003 on a reported basis, with a first quarter operating gain forecast of 195 to 205 million dollars.

We are projecting first quarter 2003 operating gain for each of our business segments as follows: In the Midwest, in the 75 to 80 million dollar range. East, 60 to 65 million dollars, Southeast, 55 to 60 million dollars. In the West, in the 15 to 17 million dollar range. Specialty in the nine to twelve million dollar range, and the Other segment operating loss should be modestly lower compared to the fourth quarter of 2002.

Anthem's operating margin should improve from five percent in 2002 to the mid five percent range in 2003, based on this guidance. Anthem's benefit expense ratio is projected to be in the 82 and a half to 83 and a half percent range for 2003, relatively consistent with 2002.

The administrative expense ratio for 2003 should improve by approximately 100 to 150 basis points to 17.8 percent to 18.3 percent range on a reported basis.

And then lastly, our effective tax rate in 2003 will be in the 36 percent to 37 percent range. This compares to 31.6 percent for 2002, which was impacted by the reduction in our tax valuation allowance recorded during the third quarter of 2002.

As you digest this detailed guidance, I hope you see that our financial momentum is expected to continue into 2003. We are projecting membership growth in the four to six percent range. Operating margin is expected to continue to improve during the year, and earnings per share growth for 2003 will be in the 15 percent to 18 percent range.

Now, if we could, let's open the call up for questions.

QUESTION AND ANSWER

Operator

Ladies and gentlemen, if you do wish to ask a question, please press the 1 on your touchtone telephone.

If you have pressed the one prior to this announcement, please press the 1 again at this time. You will hear a tone indicating you've been placed in queue and you may remove yourself from the question queue by pressing the pound key. If you are using a speaker phone, pick up your handset before pressing the numbers.

One moment please for our first question.

First question comes from Charles Boorady with Salomon Smith Barney.

Charles Boorady ***- Salomon Smith Barney***

Thanks. Good morning. I have a couple of quick questions, if you can indulge me. First of the 36.7 million dollars and the three administrative expense items you mentioned, comp and the amounts reclassified and the dissolution of the joint venture, can you tell us approximately how much you would call nonrecurring, like the joint venture dissolving which is now a nonrecurring event or perhaps break the 36.7 million into how much was in those three buckets?

Michael Smith ***- Anthem - CFO***

Charles, specifically the three buckets are as follows. Compensation, 18.5 million, the dissolution of the joint venture, 6.2 million, and the reclassification of expenses associated with the AdminaStar contract, 12 million. We believe that the Paragon dissolution is clearly a one-time nonrecurring expense. And arguably the cost associated with the AdminaStar contract, which has now been notified to be in a nonrenewal status is nonrecurring.

With regard to the compensation expense, we have continued our past practice of reporting this item to allow you visibility around our long-term incentive plan. We record in the Other segment those top expenses that are beyond the targeted payout for the incentive plan. So they will recur, we hope, until that program ends and it is a program that ran 2001 through 2003.

Charles Boorady ***- Salomon Smith Barney***

Next question, can you give us an example of a case specific reserve that was reclassified in the quarter?

Michael Smith ***- Anthem - CFO***

Yes. It is in fact a fairly widely discussed, if you reference prior public releases. It is a case that was in litigation, the reserve had been fully established. It was referenced in an 8-K filed on December 23rd. And we've moved the reserve out of the claims reserve into a specific account reserve.

Charles Boorady ***- Salomon Smith Barney***

And just lastly, the reserve adjustments in the quarter, can you quantify what the amount was in the quarter? You had commented in the third quarter on a specific region's reserve strengthening and I'm curious what the reserve looked like in that region in particular in light of the action you took in the third quarter.

Michael Smith ***- Anthem - CFO***

There was no need to disclose any extraordinary release beyond normal patterns of redundancies associated with the run out of prior reserves. When we recognized an excess of redundancy as we did in the third quarter, we disclose the amount that is other than through the normal rateable runout. No such prior year reserve extraordinary releases were recorded in the fourth quarter.

Charles Boorady ***- Salomon Smith Barney***

Terrific. Thanks. I'll sign out now.

Operator

The next question will come from the line of Scott Fidel with JP Morgan.

Scott Fidel ***- JP Morgan***

You provided the guidance for 4-6% enrollment growth, could you go into detail how you expect each of the regions to flush out. And obviously given the weak economy we're not seeing much growth in the enrollment for the industry, can you talk about what your expectations are for you overall industry growth. Obviously you're looking at market share gains I would assume, so what your expectations would be there as well.

Larry Glasscock ***- Anthem - President and CEO***

Sure. Well, I wouldn't have any estimates as to what the industry overall is going to do. I've heard people in the past say that growth in enrollment tends to be the growth of the labor force, which might be in a good year one or two percent. As you know, we're guiding for the full year, as you mentioned, Scott, four to six percent enrollment growth. In the Midwest, we're seeing it about the same as the overall Inc. number in the four to six percent range. In the East we think we'll be slightly above. In the Southeast, perhaps slightly below. And in the West, we think about where we are at the corporate level. So we are -- we're very pleased. We're seeing enrollment growth in the first quarter is what I reported earlier 250 to 300,000 net new members. The first quarter is being driven primarily with national and individual business growing the largest percentage. And so we think we feel very good about this enrollment growth, particularly in light of the economy itself.

The other thing I mentioned in our third quarter call was our very good retention levels. For example, in our national accounts, we retained 100 percent of those. And of course when you had that kind of retention rate, any new growth is a net increase, obviously. So that's helping us tremendously in achieving this four to six percent guidance that I've given you.

Scott Fidel ***- JP Morgan***

Great. Thank you.

Operator

We'll now go to the line of Matthew Borsch with Goldman Sachs. Please go ahead.

Matthew Borsch ***- Goldman Sachs***

Hi. Thanks. Just had a quick question on first on the medical cost trend. I'm trying to understand. You experienced a trend now of about 12 percent for 2002. And you're saying 12 to 13 percent for 2003.

Is that just a rounding difference or are you conservatively forecasting a slightly higher medical cost trend in 2003?

Larry Glasscock ***- Anthem - President and CEO***

Well, for most of 2002, we saw a trend in the high 12 percent, 13 percent range. And as a result of the lower medical costs in the fourth quarter, we saw the 2002 trend number drop to really low 12. I think it was 12.3. So as always, we continue to remain conservative in our expectations for medical costs, as we look out into 2003 and that's why we've given you this trend number of 12 to 13 percent.

Matthew Borsch ***- Goldman Sachs***

So the actual trend in the fourth quarter then was 12.3 percent or was that what you realized for the full year?

Larry Glasscock ***- Anthem - President and CEO***

That was for the full year.

Matthew Borsch ***- Goldman Sachs***

Can you comment on what the trend was for the fourth quarter?

Larry Glasscock ***- Anthem - President and CEO***

We tend to comment on the trend for the full year, but it was around 12.

Matthew Borsch ***- Goldman Sachs***

And on a different topic, can you give us some guidance on your expectations for days claims payable reserves, going into 2003, do you expect to see the continued impact of an acceleration in the claims payment cycle?

Michael Smith ***- Anthem - CFO***

We don't really provide a forward look around that metric. I can give you the following comments: We remain encouraged that we will continue to capture additional efficiencies from the new systems. We're not changing anything that would drive the metric away from its past pattern as we remain conservative in our reserving practices and, frankly, just do not expect any material change of the variety that we reported in this quarter. This quarter's changes after all were largely driven by the reclassification. So we're not expecting dramatic changes in the future, but we don't provide a granular guidance around that metric.

Matthew Borsch ***- Goldman Sachs***

Last question is on cash flow. I didn't hear whether you had a cash flow target for 2003. I know it was one billion on your last call.

Michael Smith ***- Anthem - CFO***

We remain confident that operating cash flow in '03 will exceed one billion dollars.

Matthew Borsch ***- Goldman Sachs***

Thanks.

Operator

The next question will come from the line of Roberta Goodman. She's with Merrill Lynch. Please go ahead.

Roberta Goodman - ***Merrill Lynch***

Can you hear me okay?

Larry Glasscock - ***Anthem - President and CEO***

We sure can, Roberta.

Roberta Goodman - ***Merrill Lynch***

Two quick questions. What was the impact of benefit buy down for the quarter and what would you expect going into 2003? And then I'll have a follow-up on a different topic.

Larry Glasscock - ***Anthem - President and CEO***

Well, let me talk about, first of all, the 2002 buy downs. We were around 300 basis points for the full year. I don't recall the number specifically, Roberta, for the fourth quarter. As you know, we provided guidance on '03 in the past. We continue to expect to see more shifting of the costs in 2003. So we think buydowns are going to be in the 300 to 350 basis point range.

Roberta Goodman - ***Merrill Lynch***

And is there any particular nature of the buy down that's shifting or is it just more of the same?

Larry Glasscock - ***Anthem - President and CEO***

Based on what we see, it's more of the same, Roberta.

It's adding or increasing co-pays on certain outpatient procedures like MRIs, for example, and some other diagnostic imaging, increasing co-pays on things like ER visit, specialty visits and some outpatient surgeries. There are some higher deductible plans coming in. So I think it's just more of what we've been experiencing.

Roberta Goodman - ***Merrill Lynch***

And separately, following up on Matthew's question about the cost trends, could you dissect them a little bit in terms of the impact of utilization versus pricing and intensity, if you look at the different components?

Larry Glasscock - ***Anthem - President and CEO***

Sure. Why don't we - I can talk a little bit about, say, 2002. Let me start with inpatient. What we saw in the way of trends for 2002 in inpatient, it was driven about 75 percent by actual unit costs and about 25 percent by utilization. Just to give you a little granularity on that, year-over-year admits per thousand were up about two percent or so. And our average length of stay was essentially flat. Slightly less than four days. And then our inpatient costs per visit increased about seven percent for '02. In outpatient, the trend is pretty equally driven by both unit cost and utilization. Professional, again, office visits, laboratory, things like radiology, continue to lead the utilization, and in professional I think it's fair to say it's both utilization and cost. And then in pharmacy, also utilization and cost driven.

Roberta Goodman - ***Merrill Lynch***

What percentage of your pharmacy would be on three tier and how is that changing going into '03?

Larry Glasscock - ***Anthem - President and CEO***

It's about, let's see, I think three tier was at the end of last year about 60 percent. I think we're up to 65 or 70.

Roberta Goodman - ***Merrill Lynch***

Thank you very much.

Operator

We'll now go to the line of John Rex. He's with Bear Stearns. Please go ahead.

John Rex - ***Bear Stearns***

Good morning. First just back on your comment on your pricing outlook for '03. I think you indicated you were pricing to your trend expectations, which you stated at 12 to 13 percent. Should we read that you priced your January business at 12 to 13 percent or did you price that kind of under the assumptions that when you were showing a bit higher trend?

Michael Smith - ***Anthem - CFO***

John, it's Mike. We priced renewal business to meet the expected range. No anticipatory pricing, no expectation that '03's trends would go down and therefore no departure from our discipline in setting those prices, based upon the best knowledge we had of trend at the time of renewal. So we expect the premium yield to meet the trend as we've discussed.

John Rex - ***Bear Stearns***

So it would be fair for us to think of January business as being 12 to 13 percent on the commercial business?

Michael Smith - ***Anthem - CFO***

At the high end of that range.

John Rex - ***Bear Stearns***

Thank you. On the prior period adjustments, as you think about that. The last quarter you disclosed the amount in the different segments. Was this quarter's impact lower than we saw last quarter, or was it just kind of seasonally higher for 4Q impact from favorable adjustments? I guess the follow-up on that, as you look towards your '03 and your $4.75 - $4.85 guidance, do you incorporate kind of an assumption of the same magnitude of conservatism impacting those results?

Michael Smith - ***Anthem - CFO***

Let's deal with the second part of your question. Our guidance for '03 assumes that we will enjoy the impact of a consistent reserving practice and a consistent procedure of looking at the run out of the so-called prior year-end redundancy. We do not anticipate in any quarter, in any segment in our guidance the pick up so to speak of a benefit from release in a single entry of prior year-end redundancy. So if you go to the table we've provided, one would assume that the counterpart to the 150 million dollar redundancy indicated that, that was included in the beginning of the '02 reserve, that counterpart number in 2003 will come in naturally as the prior run-ins take place.

No significant acceleration of that in any segment or in any quarter.

John Rex - ***Bear Stearns***

Is it fair to say that seasonally disproportionately weighted to the Q4 as when it's realized?

Michael Smith - ***Anthem - CFO***

That speaks to the second issue in reserve accounting. After all, claims expense and reserves actually represent sort of a convergence of two or three accounting and actuarial activities. The release of a prior year redundancy as we have just discussed happens naturally throughout the year as we complete the payment of claims incurred in the prior year.

And when we are able to detect that, that prior year balance has an excess, we release it and disclose it as we did in the third quarter. With regard to your question about any excess reserve that may be generated in a current year, there is no doubt that as we establish the reserve for the current incurred but not yet reported claim we bake in the cost trend assumptions that you've heard. If as the year passes, getting into the zone, as you call the back end zone, we're able to validate as we did this year, then our 13 to 15 percent cost estimate, cost trend estimate is closer to 12 as we're able to validate that throughout the year we're able to adjust the reserve to reflect that then establish conservatism.

John Rex - ***Bear Stearns***

If I look at the first three-quarters of the year-end, I know you never want to get too far into going quarter by quarter into this, but it would be correct to say the 25 to 30 million dollars you saw in Q3 has been fairly consistent in the first three-quarters of the year?

Michael Smith - ***Anthem - CFO***

Absolutely not. The announcement in the third quarter was to signal that, that was higher than the normal redundancy release being experienced as we paid the run out. I would like to point out to you around this quarterly dispersion, if you look historically at Anthem's benefit expense ratio, let me reference about eight quarters of activity here -- Q1 2001, %85.2. Q2, %85.2. Q3, %85.1. Q4, %82.7 -- reflecting that as we were completing the year we could validate that the cost trend assumptions had conservatism in them. 2002, Q1,%84.5. Q2, %83.6. Q3, %81.5. And Q4, the %80.9 we discussed today. Each reflecting a pattern of consistent and conservative risk management allowing us to progress enough through the year to recognize a difference between the cost trend assumptions that were used to establish the current IBNR and the actual payment, in our case of nearly 84 percent of those claims in the current year.

John Rex - ***Bear Stearns***

That's very helpful. The roll forward is very helpful. In terms of your Q1 guidance, maybe the sequential down tick in earnings is something you had been looking for last quarter, looks just a little bit higher than we've seen in prior years. Is there any, in terms of the down tick, is there anything in particular going on in the seasonality this year?

Michael Smith - ***Anthem - CFO***

There really isn't. We have substantial Medicare business in our Midwest, East and Southeast regions, and we're reflecting in the guidance the normal seasonality that results from starting with a new deductible period to cover for the Med Supp book.

John Rex *- Bear Stearns*

Great. Thank you very much.

Operator

We'll now go to the line of Michael Baker with Raymond James.

Michael Baker *- Raymond James*

I was wondering if you noted recently any change in hospital contracting methods.

Larry Glasscock *- Anthem - President and CEO*

No, Michael. We are -- again contracting occurs at Anthem at the region level. So let me just give you sort of a frame of reference. And these percentages could vary by region, but essentially in hospital contracting, about 40 percent of our reimbursements are done based on case rate or DRG based, about 30 percent would be off of what we call bill charges and then 30 percent would be on per diems. We're moving where we can more and more to a case rate basis. Midwest, for example, is skewed more towards case rates and also per diems. The West is more a percent off of bill charges. In the Southeast, for example, it's almost all per diem and case rate. So again this is all varying based on what we're able to accomplish in each market.

Michael Baker *- Raymond James*

Thank you.

Operator

We'll now go to the line of Christine Arnold with Morgan Stanley.

Christine Arnold *- Morgan Stanley*

On the plan period positive developments it's great that you release this incremental information. I want to make sure I understand it. Were the prior period positive developments that you experienced in the fourth quarter of this year 2002 equal to in magnitude what you experienced in the prior year fourth quarter?

Michael Smith *- Anthem - CFO*

Christine, although we don't release or don't disclose the, at this point, the precise quarterly release of that prior year redundancy, you should assume, based upon our discussion, that these releases have happened ratably in all quarters except Q3, when we identified the additional release. No other seasonal pattern appeared to us to be unreasonable or inconsistent with the recognition in the prior year of the 96 million dollars.

Christine Arnold *- Morgan Stanley*

So what we're saying here is that we have pretty clean fourth quarter year-over-year MLR comp?

Michael Smith *- Anthem - CFO*

We certainly believe so and have made every effort to report in that fashion.

Christine Arnold *- Morgan Stanley*

And then could you talk about some of the new products you've launched, defined contribution product, how does it work? Are you offering it fully insured or self-insured and what are some of the other innovative products look like that you've launched and what kind of reception have you gotten.

Larry Glasscock *- Anthem - President and CEO*

It's early on the reception side. We're getting an awful lot of interest. Maybe what I can do is first take you to our strategy of what we've done increasing the price differential, because I think that's a key point of our strategy. And that's, as we've talked about before, to increase the difference between our lowest cost product and our most expensive product. And to do that by working on the affordability end. So, for example, just looking at '01 versus '02, we're able to increase that spread in New Hampshire again from low to high from 41 percent to about 66 percent.

So what you can take away from that is that we've made the products much more affordable. For example, in Maine, we still have some work to do there. But we've increased the range low to high from 24 percent to about 34 percent. Up in Connecticut , we've increased that range from 29 percent to about 40 percent. And very significantly in the Midwest we've increased it from about 24 percent to 46 percent.

The West has done a really nice job in this area. They've got about a 55 percent spread from low to high. And in the Southeast of about mid 50s as well. So a lot of this has focused around getting higher deductibles, co-pays, that sort of thing.

So that's sort of '02. '03, the emphasis is around this new product we've developed called Anthem ByDesign. And at this stage we launched that 1- 1- '03 for basically large self-insured groups. And it's still too early to know exactly where it's going. We do not have any membership in the product at this point because of its recency. But what we are seeing is very substantial interest in it.

What we have with this Anthem ByDesign is basically a personal care account, which basically the employer sets aside varying amounts from a thousand to almost 2,000 dollars. And the whole theory, obviously as we've talked about before, is to get the consumer more invested in what health care at the point of service actually costs.

So we're seeing a lot of interest. We've had lots of meetings. But I think it's still too early to tell how much adoption we'll see.

Christine Arnold ***- Morgan Stanley***

Why are you introducing this on a self-insured basis? I assumed that the SG&A load is fairly high. And correct me if I'm wrong, but employers for some reason continue to look at SG&A load instead of total cost, at least from the benefits perspective. And I would think if you launched this on a fully insured basis, smaller groups and mid-sized groups maybe move a little bit quicker than larger employers you can get more in there and also see some positive selection.

Larry Glasscock ***- Anthem - President and CEO***

Good point. The area where we were getting the most interest and inquiry was on the large national account, self-insured. And the reason for that was a lot of companies wanted to include those descriptions as part of the RFP process. So we thought it was very important to get it launched there timely.

The local product development takes place in our regions principally. And there are locally delivered products that will be available during the course of '03, with I think the latest implementation date 1-1-04. This would be around smaller groups and other insured business.

Christine Arnold ***- Morgan Stanley***

Great. You plan to do it for both insured and self-insured?

Larry Glasscock ***- Anthem - President and CEO***

Absolutely.

Christine Arnold ***- Morgan Stanley***

Thanks.

Operator

Next question comes from the line of Josh Raskin with Lehman Brothers.

Josh Raskin ***- Lehman Brothers***

Good morning. Two quick questions, first on the days claims payable calculation, again I know in the release and then today in your comments you mentioned half of the decline was due to the reclassification. I was wondering if you could walk us through that on the balance sheet, just it looks like the health care claims line items sequentially was down about 100 million, conversely the other policy liabilities was up about 440. And I'm just wondering if I do sort of calculations based on call it total policy liabilities, I have the number going up much more dramatically than just that two-day impact. I was wondering if you could help me through some of the logistical math I guess there.

Michael Smith ***- Anthem - CFO***

Happy to do so. And thank you very much for the question, because the financial statements made part of the release leave a number of questions open there. First of all, the reclassification of reserve balances have nothing to do with our fully insured business other than the discussion we had earlier regarding the specific case reserve when Charles Boorady asked. In fact, anecdotally, we get where you are, Josh, if we included our other policy liabilities in the calculation, our days claims would go north of 72 days.

Recall in our presentation, we isolated the unpaid accident and health claims which have been set out as you observed at a billion 411 million dollars, which is net of the reclassification for the specific case. Our future policy benefits are essentially for our life business. And our other policyholder liabilities largely represent the accounting for our participation in the FEP program.

We were advised by Blue Cross/Blue Shield association and by our auditors that to be more consistent with the presentation of other FEP participants, we needed to move about 121 million dollars from unearned income into the other policyholder liability account.

None of that reclassification or activity impacted reported income and none of it reflects any change in the demographics of the unpaid health claims in the IBNR reserve.

Josh Raskin ***- Lehman Brothers***

That's helpful. You can see some of the reclassification. So I think that is helpful in the unearned income coming down as well.

Michael Smith - ***Anthem - CFO***

I don't want to lose the opportunity again to point out that reporting of days claims payable is, we believe, widely inconsistent across the industry. Had we left in our calculus the other policyholder liability, the days claims payable metric would have shot up dramatically.

Josh Raskin - ***Lehman Brothers***

I was calculating a ten day boost.

Thanks for all the detail there.

On the national account side, I'm wondering, strong growth last couple quarters and it sounds like, according to Larry's comments, that's going to continue going forward as well.

Looks like it's been driven this year at least pretty much exclusive by the Blue Card with I guess some other accounts declining even. I was wondering if that is sort of a cannibalization, has there been a movement from sort of other classification into Blue Card membership and what's the expectation going forward?

Larry Glasscock - ***Anthem - President and CEO***

Thank you for raising that, because this is an issue that we would have covered in a previous call but I think it's helpful to bring it up here again, because with the passage of time we can lose sight of it. We are growing our non-Blue Card self funded membership in national accounts. And it was back in I believe it was the first quarter of '02 we really reclassed a membership from national non-Blue Card to Blue Card. And we did that because of a classification there. So if you'll look at that reclass and go back and adjust the - '01 membership, the Blue Card membership would be about a million 759 thousand members.

So the actual increase in Blue Card membership from year-end 2001 would have been around 335,000 members.

So if you look at those adjustments, the self-funded membership growth was about almost 400,000 members and that was above the 335,000 Blue Card membership growth.

So we are growing non-Blue Card. What we're looking at this year for January 2003 was, as we talked about on the last call, we sold a lot of new accounts -- actually, 21 either new control or what we call home accounts.

And this is consistent with really our refocus on this national business which up until about two years ago it was not separated as a separate business unit.

So we are -- we're getting some very nice growth. And as I mentioned earlier on the call, we have great retention.

So we are extremely pleased with our national account growth. We're up in 2002, up, I don't have it in front of me, about 14 percent, if I remember.

Josh Raskin - ***Lehman Brothers***

Thanks for the reminder.

Larry Glasscock - ***Anthem - President and CEO***

We have time for one more call.

Operator

The final question will come from Eric Veiel with Deutsche Bank.

Eric Veiel - ***Deutsche Bank***

Just a quick question to follow up on the seasonality for one Q '03. If we look back, the first quarter is actually from an earnings standpoint last year was one of the better quarters. This year would be somewhere, in '03 rather, would be somewhere around 10%, which I guess I'm just a little bit confused on given the strong growth in enrollment that we're going to see and the addition of Trigon this year that wasn't in '02. So what I'm wondering, is there significantly higher percentage of Med Supp enrollment that's really driving an enhanced seasonality effect in '03 or is there something else that's sort of exaggerating the seasonality effect here?

Michael Smith - ***Anthem - CFO***

Actually, there are a couple of things we should remind you of. First quarter of '02 also had benefit in it around investment income of not yet disbursed proceeds from the demutualization. And actually Trigon therefore is neutral to this seasonality issue. It is the natural growth of our Med Supp business which is up about seven percent year-over-year but is contributing to a slightly higher degree of seasonality. But I would not want you to overlook the fact that we did have in Q1 of '02 some investment income from the not yet disbursed proceeds.

Eric Veiel - ***Deutsche Bank***

But the med sub business as a whole is up about seven percent?

Michael Smith - ***Anthem - CFO***

That is correct.

Eric Veiel - ***Deutsche Bank***

In '03?. Okay. Thanks.

Operator

We'll now turn back to Larry Glasscock for closing comments.

Larry Glasscock - ***Anthem - President and CEO***

Again, I want to thank all of you for your interest in Anthem this morning. We apologize for the 8:00 nature of the call. But it's what worked for today.

Again, 2002 we think was a great year for Anthem. And we firmly believe that we're well positioned for continued improvement in 2003. Longer term, we recognize that to add value for our members and shareholders, we must proactively address the issue of affordability of health care and further implement disease management and advanced care management programs that will improve the health of our members while also reducing costs.

We are very committed to collaborating with our provider networks to enhance the health care system and improve patient care. So we believe we will be successful in meeting these challenges and we remain very excited about our future.

So, again, thank you for participating in our fourth quarter call. Hope you have a great day and we'll look forward to catching up with you again soon.

Operator

Ladies and gentlemen, this conference will be made available for replay beginning today at 1:45 p.m. Eastern time, continuing through Monday, the 17th of February, at midnight. To access AT&T executive play back service at any time, please dial 1-800-475-6701 or, internationally, at area code 320-365-3844 and enter the access code 667827. Again, those numbers, 800-475-6701 or 320-365-3844 and enter the access code 667827.

That does conclude your call for today. Thank you very much for your participation and for using AT&T executive teleconference. You may now disconnect.