

**Anthem, Inc. Third Quarter Results Conference Call**  
**Moderator: Tami Durlle**  
**November 14, 2001**

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*Please note this transcript has been edited for accuracy.*

TAMI DURLE, VICE PRESIDENT INVESTOR RELATIONS, ANTHEM, INC.: Morning, everyone, and thank you for participating in Anthem's first earnings conference call. This is Tami Durle, Vice President of Investor Relations. And joining me today is Larry Glasscock, Anthem's President and Chief Executive Officer; and Mike Smith, Executive Vice President and Chief Financial Officer.

Larry will be providing a summary of recently completed demutualization and initial public offering, along with an overview of our third quarter results. Mike will discuss Anthem's consolidated and segment financial results for the third quarter as well as earnings guidance for 2001 and 2002. Larry will then provide some additional comments before taking your questions. The call is expected to end around 9:30 this morning.

A press release was issued this morning by Peer Newswire and it is posted on our Web site, Anthem.com, where you will also find a replay of this conference call later today.

On today'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 the final prospectus which was filed with the SEC in October.

Now I will turn the call over to our CEO, Larry Glasscock.

LARRY GLASSCOCK, PRESIDENT AND CEO, ANTHEM, INC.: Thank you, Tami, and good morning everyone.

We're extremely pleased with our third quarter 2001 results and our recently completed demutualization and initial public offering. Before I begin I want to publicly thank all of our 15,000 associates who worked so hard to really make these transactions possible. Anthem's indeed fortunate to have so many talented and dedicated people focused on our commitment to create value both to our members and to our shareholders.

Before I discuss our third quarter results I'd like to provide an overview of our demutualization and initial public offering. As you know, we began trading as a public company on October 30th when we issued a total of 103.1 million shares, 47.9 million shares to eligible statutory members of Anthem, and 55.2 million shares to the public. In addition, 230 million of equity security units were issued. The equity security units consist of a mandatory contract to purchase shares of our common stock in three years at a conversion premium of 22 percent, as well as a subordinated debenture with a cash yield of six percent.

The combined net proceeds from the offerings were \$2.1 billion, nearly all of which is expected to be paid to eligible statutory members who requested cash in lieu of shares of common stock. We are very pleased to now be a publicly traded company and we are delighted that our members overwhelmingly approved the plan of conversion. The process approved by our board on June 21st of this year took less than five months to complete. And focus by our management, members, the regulatory authorities, and our board, allowed us to accomplish these very important processes in what we believe is a record timeline.

Converting from a mutual form of ownership to a publicly traded company will provide Anthem financial flexibility and access to capital markets. This will help us maintain and improve our ability to offer high-quality products and services and allow us to remain opportunistic to growth opportunities including future acquisition.

Now, turning to third quarter results, excluding net realized gains on our investments and demutualization expense, third quarter net income was \$78.2 million, or 76 cents per share, an increase of 33 percent in earnings per share. All of our business segments, Midwest, East and West, as well as our Specialty business, reported year-over-year improvement in operating gain. Consolidated operating gain was \$79.1 million in the third quarter, up 48 percent compared to the third quarter of 2000.

The improvement in our financial results was driven by the following four key points. One, we are growing medical membership in all of our regions. Anthem's total membership at the end of September 2001 was 7.8 million members, up 12 percent year-over-year on a same store basis. Excluding Medicare+Choice all customers segments experienced net enrollment gains from the prior year. We are enjoying strong growth in our National Accounts and Local Large Group businesses, up 19 percent and eight percent respectively compared to the third quarter of 2000. Sequentially, in the third quarter alone, Anthem added 55,000 members across all of our customer segments.

Our focus too is around disciplined pricing strategies in order to achieve profitable growth. This focus, consolidated operating margin improved 3.1 percent in 2001, up from 2.4 percent in last year's third quarter and 2.9 percent in the second quarter of this year. Further evidence of this discipline was our announced exit from the Medicare+Choice market, which impacted about 9,500 members in our West region, effective January 1, '02, again demonstrating that we will not sacrifice bottom line results for top line growth.

Three, we continue to integrate our acquisitions completed in late 1999 and 2000, allowing for further reduction in our administrative expenses. The integration strategy includes consolidation of systems, improvements in processes from leveraging best practices, as well as the roll out of our shared service staff model, which eliminates the duplication of back office function. The success of these initiatives has contributed to the 150 basis point year-over-year improvement in our administrative expense ratio.

And then fourth, our operating gain also includes an increase from our specialty business as we expanded our pharmacy benefit service to all regions of our health operations in late 2000 and early 2001.

Overall we are very pleased with our results this quarter and we continue our pursuit of further earnings growth. We have a very clear line of sight on the need to provide our customers a selection of competitively priced products, broad provider networks, and excellent customer service.

Mike Smith will discuss earnings guidance for the next quarter and full year of 2002 later, but I'd like first to share a few observations regarding our future. Our pending acquisition of Blue Cross Blue Shield of Kansas remains on track. We expect this acquisition to close sometime in early to mid 2002. Team members from both Anthem and Kansas are working diligently to ensure the integration is a smooth one. We continue to expect this acquisition to be neutral to earnings per share in 2002 and accretive in 2003.

Looking at new business in 2002 we continue to be optimistic. About 30 percent of our business renews on January 1st and the next biggest renewal month is July, where another 25 percent renews. Our distribution of renewals is not overly weighted towards the first quarter, which we feel provides for more flexibility in pricing products throughout the year. We are expecting three to four percent membership growth in 2002, which reflects our view that the economy will continue to be sluggish next year.

In terms of the economy we have been preparing for an economic slowdown or a recession for over a year now. And since the tragic events that occurred on September 11th we have been further reviewing the status of our top accounts in each region. Fortunately, we are not seeing a significant trend of employment

dislocation or benefit buy-downs, and our customer base has a very low concentration of membership in the travel, leisure, or other sectors, which appear to have been hit particularly hard. Furthermore, we have seen a modest slowdown in claims volume but have conservatively reserved for the likelihood that the September 11th tragedies may have delayed claims paperwork.

We feel that Anthem's diversified product portfolio and the visibility we enjoy from both significant market shares in each of our states and very strong brand recognition will serve us well in this environment. In addition, Anthem's geographic dispersion across eight states with broad diversification of our membership mitigates business risk during a slowing economy. And even during a downturn we feel that there will be growth opportunities in our markets, particularly in our West Region, which has one of the fastest growing populations in the country and where we have a significant opportunity for market share growth.

We also expect our specialty businesses to continue its growth. This lower risk revenue stream will further diversify our income and the value of these offerings add to our core health products should serve to further increase our customer retention. We plan to continue to increase specialty penetration in 2002 and beyond by cross selling to existing members as well as expanding our product offerings.

We introduced our pharmacy benefits throughout the company in late 2000 and early 2001 and our penetration rates in other specialty products are relatively modest with significant opportunities for growth.

Now I'd like to introduce Mike Smith, our Chief Financial Officer, who will walk you through more details on the third quarter financial results as well as provide guidance for the fourth quarter 2001 and the full year 2002.

Mike.

MIKE SMITH, EXECUTIVE VICE PRESIDENT AND CFO, ANTHEM, INC.: Thank you, Larry, and good morning.

Third quarter net income was \$111.5 million or \$1.08 per share. During the quarter we recognized \$72.1 million in net realized gains on investments, most of which was the result of restructuring our investment portfolio in late August to an approximately 95 percent allocation in favor of fixed-income securities. Third quarter 2001 net income excluding the net realized investment gains and non-recurring expenses related to our demutualization was \$78.2 million or 76 cents per share, a 33 percent increase in earnings per share as compared to the third quarter of 2000.

Our consolidated operating revenue increased 12 percent to \$2-and-a-half billion in the quarter, compared to third quarter 2000. Excluding the impact of the sale of our TRICARE business in May 2001, the year-over-year operating revenue growth was 16 percent. This 16 percent increase in operating revenue was due both to growth in our membership, which Larry mentioned was up 12 percent year-over-year, and to price increases on our fully insured group business, which on average were in the mid teens throughout the first nine months of this year.

Operating gain or operating revenue less benefit and administrative expenses was \$79.1 million for the third quarter of 2001, an increase of 48 percent year-over-year. We believe that operating gain is the key metric to track our performance and we use this measurement as a focal point for our management and all Anthem associates. All segments of our business achieved improvement in operating gain compared to the prior year. Major contributions to the 48 percent growth in year-over-year operating gain came from our Midwest segment, which increased \$10 million. We also improved the operating margin in our West segment, a new region formed by the acquisition of Blue Cross and Blue Shield of Colorado and Nevada in November 1999. Operating gain increased \$7.1 million in the third quarter 2001 as compared to the prior year for the West region. We continue to view the West segment as a market with excellent growth potential.

Our specialty segment more than doubled its operating gain in the third quarter compared with the third quarter in 2000, primarily as a result of increased mail-order penetration and retail script volume in our pharmacy benefit company, Anthem Prescription Management. In fact, mail-order scripts grew by 41 percent over the last 12 months while retail scripts have grown by 36 percent.

Our overall growth in operating gain is the result of our focus on the following key fundamentals: profitable membership gains, disciplined pricing strategies, and initiatives that focus on both optimizing the cost of care while controlling our administrative expenses.

Anthem's consolidated benefit expense ratio decreased 40 basis points to 85.1 percent in the third quarter of 2001 as compared to the third quarter in 2000, and decreased 10 basis points sequentially from the second quarter. Excluding \$21 million of pretax effects of reserve strengthening during the third quarter 2001, this ratio improved 130 basis points year-over-year and 100 basis points sequentially. This year-over-year improvement can primarily be attributed to four factors: our exit from the Medicare Choice market in Connecticut in January of 2001, contributing about 20 basis points; the sale of our TRICARE operations on May 31st, 2001, a business that historically had a higher loss ratio than our core business; the improved underwriting results from our West segment as we have fully integrated this acquisition; and finally, pricing and cost care initiatives across all of the other regions contributing about 43 basis points.

Our medical cost trend for fully insured group business was approximately in a range of 12 percent to 13 percent through the third quarter 2001 measured on a rolling 12-month basis. This trend was within our expectations and was principally driven by outpatient and pharmacy expense increases. We project the medical cost trend for our fully insured group business to continue to increase in 2002. We expect the trend to be between 13 and 15 percent next year and our pricing reflects this higher trend.

Our consolidated administrative expense ratio was 18.7 percent in the third quarter, an improvement of 150 basis points over the third quarter of 2000. We take great pride in our progress with the integration of recent acquisitions and in process improvements made possible with new technology installed in each region. As we further consolidate our systems and continue to improve processes, we believe we can achieve at least an additional 100-basis-point improvement over the next few years.

Let me shift our discussion to our balance sheet. Cash and investments were \$4.3 billion at September 30, 2001, up from \$3.7 billion at year end 2000. During the quarter our operating cash flow was \$251 million. For the nine months ended September 2001 Anthem's operating cash flow was \$512 million, up six percent compared to the prior year, and this was the key driver to our growth in our investment portfolio. Excluding the aggressive balance sheet management activities taken during 2000, which resulted in our converting non-strategic items on our balance sheet into cash, the year-over-year growth in operating cash flow was 63 percent.

On the liability side of our balance sheet total policy liabilities were down slightly at September 30, 2001, as compared to year end 2000. However, excluding the TRICARE reserves from the yearend 2000 balance sheet, policy liabilities were up \$102 million. Furthermore, the reserves increased 6.5 percent compared with June 30, 2001. Days claims in payable were 63-and-a-half days at September 30, 2001, up seven-tenths of a day sequentially.

In terms of our capital structure, the debt-to-capital ratio was 22 percent at the end of the third quarter 2001. On a pro forma basis post IPO this ratio increases to 28 percent as a result of our issuance of \$230 million of equity security units.

Before I turn the call back over the Larry, I would like to walk through our guidance for the fourth quarter of 2001 and the full year 2002. We expect earnings per share of 86 cents to 91 cents per share in the fourth quarter of 2001, excluding realized gains and other non-recurring items such as demutualization expense. Our earnings per share guidance assumes 103.1 million shares outstanding, and this is subject to change pending the final distribution of cash and shares to policyholders resulting from our demutualization and the

potential pop-up provision included in that plan. We also keep in mind that the guidance which we are providing for the fourth quarter includes about five cents per share of one-time benefit associated with the net investment income earned on the IPO proceeds prior to distribution to our policyholders in December.

Full year 2001 earnings per share on the same outstanding share basis I just described is expected to be in the \$2.95 to \$3.00 range. This represents a 45 to 48 percent increase in 2001 net income as compared to 2000.

Consolidated operating revenue is projected to increase in the mid to high teens for the full year 2001. Operating gain is projected to increase 65 to 70 percent for the full year 2001. In terms of operating gain growth by segment, we are expecting the following for the full year 2001: in the Midwest operating gain increases should be in the 80 to 85 percent range; East growth is expected to be in the 20 to 25 percent range; West in the 600 to 650 percent range; and specialty in the low 40 percent range. Our other segment loss is expected to be slightly above the 2000 reported loss.

Anthem's 2001 medical membership is projected to increase by six to eight percent on a reported basis. Excluding the effect of the TRICARE sale the growth rate is expected to be approximately eight to 10 percent.

For 2002 the following guidance excludes our pending acquisition of Blue Cross Blue Shield of Kansas, which is expected to close in early to mid 2002. As we have stated earlier, we expect Kansas results to be neutral to our net income guidance for next year. We expect earnings per share in the \$3.40 to \$3.50 range for 2002 before the effects of FAS 142 and assuming 103.1 million shares outstanding in 2002. This represents at least a 15 percent increase in earnings per share as compared to 2001. Including the effect of FASB 142, 2002 earnings per share would be in the \$3.55 to \$3.65 range.

In terms of quarterly earnings development for 2002, we expect sequential improvement in the second, third and fourth quarters, with the first quarter of 2002 down slightly from the fourth quarter of this year due to normal seasonality associated with Medicare deductibles being paid primarily in the first quarter and holiday postponement of medical services.

Operating revenue for 2002 on a consolidated basis is projected to increase in the high single to low double-digits as a result of three to four percent membership growth, double-digit rate increases on our commercial business, offset then by the TRICARE disposition and by the Medicare+ Choice market exit in our West segment.

Growth in consolidated operating gain is expected to be in the 18 to 23 percent range in 2002. Growth by segment is anticipated as follows: Midwest and East slightly above the high end of the consolidated guidance; West and Specialty each in the 25 to 35 percent range; and the other segments loss is expected to be up a good bit from the 2001 loss reflecting new costs associated with being a public company.

As for our benefit expense ratio, we expect both 2001 and 2002 to be roughly flat with our 2000 results as we maintain our approach to disciplined pricing and medical cost management. And finally, our effective tax rate is expected to be in the 32 to 34 percent range, below the full year 2001 rate, due to the non-deductible demutualization expenses and goodwill amortization included in 2001's guidance.

It is now my pleasure to turn the call back over to Larry for final comments.

GLASSCOCK: Thank you, Mike.

I think it's fair to say we are very encouraged by our results through the first nine months and we're extremely confident about our ability to sustain earnings growth in the future. As we discussed during our IPO road show, we feel there are five key reasons why Anthem is and will continue to be successful. First, Anthem is a diversified leader in the health benefits and managed care industry. We hold the leading market

share by a wide margin in seven of our eight core markets, and with Kansas, eight out of our nine markets. And as you know, we also offer a broad product set to a very diverse customer base.

Second, Anthem is associated with the most highly recognized brand name in healthcare, Blue Cross Blue Shield. We have the exclusive use of the names and marks in all of our markets, and this brand identity helps us achieve enrollment growth as well as retain customers.

Third, we have a disciplined focus on our business. This includes our focus on quality in medical management, pricing and underwriting, and administrative expense control.

Fourth, as evidenced by our results this quarter, Anthem continues to gain momentum in financial performance. We are very pleased with our progress over the last few years. And finally, we feel that Anthem is well positioned for growth in all of our segments.

Again, we appreciate your time this morning and thank you for being part of this call. And I'd like to now open it up for questions.

And could I turn to the AT&T operator please?

OPERATOR: Certainly.

And, ladies and gentlemen, if you do wish to ask a question, please press the one on your touch-tone phone. You'll hear a tone indicating you've been placed in queue, and you may remove yourself from queue at any time by pressing the pound key. If you are using a speakerphone, you may need to pick up your handset before pressing any of the numbers.

So once again, if you do have a question, please press one at this time. And one moment please for our first question.

And our first question comes from Charles Bruady (ph) with Goldman Sachs. Please go ahead.

CHARLES BOORADY (ph), GOLDMAN SACHS: Thanks. Good morning and congratulations on the quarter. I have just two brief questions. The first one relates to the growth in the specialty business. And can you explain how much of that growth resulted from rolling out the pharmacy benefit to all the regions versus a same customer growth number tied to the increase in prescription volumes and other factors you mentioned?

GLASSCOCK: Charles, thank you for your question. The majority of the growth in our PBM came from the fact that we rolled this out to additional territories. As you may know, with the acquisitions of New Hampshire in late '99, Colorado and Nevada in '99, and Maine then in June of 2000, that is the principal reason that the business has continued to grow very sharply. Our penetration rate in the Midwest business has been fairly high given the fact that that product has been available for quite some time.

BOORADY (ph): Thanks, Larry. And the timing to get Kansas, assuming it closes at the time frame you indicated, how long would it take to convert over to your in-house PBM?

GLASSCOCK: Well, we have a very complete group working on this issue right now. In fact, in Kansas we have about 11 different integration teams working on various aspects of the business. I expect their final report here in the next four to six weeks. And so I'm going to defer on the answer to that question until I see their recommendations to me.

BOORADY (ph): Thanks, Larry. A point -- another point of clarification on Kansas, the neutral in 2002, did you say whether that was before or after FASB 142?

GLASSCOCK: It's after FASB 142.

BOORADY (ph): OK, great. My final question, if I -- if I may, is just to ask if you can highlight what the key factors were that led to the improved earnings outlook for the fourth quarter? And for next year and whether we should expect to see a similar seasonality in 2002, i.e., a much stronger fourth quarter or would that be spread more over the second half as opposed to just the fourth quarter ...

GLASSCOCK: Charles ...

BOORADY (ph): (INAUDIBLE)

GLASSCOCK: Yes. Charles, I'm going to ask Mike Smith to comment on that and I'll add further if I need to or want to.

BOORADY (ph): Thanks, Larry.

SMITH: Charles, the strengthening in third quarter earnings came from several factors, primarily the progress that we continue to enjoy in our West region in terms of advancing the integration there and growing its membership dramatically. We also enjoyed strength across the entire region from a continued enrollment gain. And finally, we are seeing substantial improvement in the East region as Maine and New Hampshire are being integrated into the Connecticut systems environment.

Therefore, to your question, while we expect, as I mentioned earlier, steady sequential improvement throughout all of 2002, I would hesitate to predict as much of a dramatic sequential gain in Q3 '02 compared to Q2 '02.

BOORADY (ph): Got it. And should we read into this further, Mike, that even coming off of a base of a very strong year that you still expect to achieve the target 15 percent earnings growth?

SMITH: Absolutely.

BOORADY (ph): Great. Thanks and congratulations again.

GLASSCOCK: Thank you -- thank you, Charles.

OPERATOR: Thanks. And our next question comes from Roberta Goodmannfein (ph) with Merrill Lynch. Please go ahead.

ROBERTA GOODMAN (ph), MERRILL LYNCH: Thanks. I actually had two questions. First, the administrative fee revenue was down slightly sequentially. Could you separate out the impact of the TRICARE sale from what was going on in the core operations? And then I have a separate question.

GLASSCOCK: Roberta, I'm sorry, but if you could speak up. I don't know if you're far from the phone or -- could you just repeat?

GOODMANN (ph): Sure. The administrative fee revenue was down somewhat sequentially. And I was wondering if you could tease out the impact of the TRICARE sale from what was going on in the core operations?

GLASSCOCK: Sure. Mike, do you want to take that?

SMITH: I'd be happy to.

Exit from TRICARE, obviously, Roberta, did influence that comparison. Excluding the impact on the year-over-year comparison, our not having TRICARE for all nine months this year, administrative fee income on a same store basis was up \$35 million or 22 percent year-over-year. So the sale of TRICARE dramatically influences that comparison.

GOODMAN (ph): OK. And separately you referred to some reserves strengthening. Could you elaborate on what the reasoning was behind that and where we should expect to see it?

SMITH: Sure. As you would observe studying Anthem's historical results, we have maintained a very conservative posture in our reserving practice. As both Larry and I observed in our comments, the events in September give one pause for concern about the flow of claims and the overall productivity of the provider community and the behavior of our members. We simply believed it was prudent to strengthen the general reserves. While it is a dramatic \$21 million and does influence sequential days claims payable, on balance it was our deference to a conservative style of reflecting those reserves.

GOODMAN (ph): OK. Thanks so much.

GLASSCOCK: Thank you, Roberta.

OPERATOR: Thank you. And we do have a question then from Christine Arnoldswine (ph) with Morgan Stanley. Please go ahead.

CHRISTINE ARNOLD (ph), MORGAN STANLEY: Good morning and good quarter. One question on the -- on the guidance for 2002 over 2001. It seems that an improved medical loss ratio -- flat year-over-year -- we've been expecting a bit of an increase as part of the increase in the guidance for 2002 numbers relative to '01. Can you tell us what factors lead to the better than previously anticipated MLR guidance for '02? Is it pricing or is it cost? And is your cost guidance on a net or gross basis?

SMITH: Christine (ph), I'm happy to take that answer. The guidance that we are providing on cost trends is net. And we have spoken before about our current experience with benefit buy-downs and overall utilization trends. We do expect, net of buy-downs, trends to increase between 13 and 15 percent. And as I reported earlier, we have baked those assumptions into 2002 pricing. So it is the dual influence of slight continued acceleration in both utilization and pricing offset by a very disciplined underwriting and pricing strategy.

ARNOLD (ph): So it sound like the change here is that perhaps rates are coming through even stronger than previously anticipated?

SMITH: I think that is a reasonable deduction, yes.

ARNOLD (ph): Great, thanks.

OPERATOR: Thank you. And we do have a question then from Josh Raskenkline (ph) with Lehman Brothers. Please go ahead.

JOSH RASKEN (ph), LEHMAN BROTHERS: Thanks. I just have two quick questions. One, if you could just break out a little bit more color on your pharmacy cost trends in particular. I know it was mentioned as a highlight as to what's driving the overall trend, but is that still in line with expectations or is that even accelerated beyond expectations? And then I have a follow-up as well.

SMITH: Josh, thank you. The trend in pharmacy cost is very much in line with our expectations. We have expected and are experiencing a continued approximately 14 percent trend in pharmacy cost. That is fairly consistent across the entire enterprise except in the West where the recent introduction of Anthem Prescription Management is allowing us to slow that trend below our consolidated overall trend.

RASKENK (ph): OK, that's helpful. And then I guess speaking of the West, just wondering what some of the key initiatives there that are still remaining. Is there still some further re-contracting to do or is it another round of re-pricing that you think will be beneficial sort of to get the margins back in line with the rest of the operation?

GLASSCOCK: Well, Josh, this is Larry. As you can see our margin there in the third quarter was very strong. Basically, the issues still in front of us in Colorado are continuing to prove -- improve the business across the board. We know, for example, that we still have considerable opportunity in the administrative cost side. We've essentially completed our re-contracting work. We know -- we have a new medical management team that we brought in there are focusing on some new programs. So there isn't any one single item that's going to account for all the ongoing improvement, it's basically continuing what we've been doing which is just much better execution and much better job in the selling arena coupled, of course, with the very disciplined focus that we've had on pricing.

RASKENK (ph): OK, that's helpful. I appreciate it. And congrats.

GLASSCOCK: You're welcome.

OPERATOR: Thank you. And our next question comes from William McKeever's (ph) line with U.S. -- UBS Warburg. I apologize. Please go ahead.

WILLIAM MCKEEVER (ph), UBS WARBURG: Yes, good morning. I have a question about the growth in your small individual national accounts. It looks as if against the year-ago period that the small group was very strong and individual was lagging that. I'm wondering, given the economy, if you're seeing perhaps the individual sales beginning to pick up and the small group begin to slow down so that we might see changes in growth rates in '02? Or perhaps you see the current trends continuing into next year?

GLASSCOCK: Yes, I think it's fair to say that we see the trend sort of continuing. Actually, we've had -- we've had growth both in small group and individual. And we're expecting -- we expecting growth in each category for next year.

MCKEEVER (ph): Any new product launches in the -- in the -- either the PPO area that you have in any of your regions for next year?

GLASSCOCK: Yes, we continue to assess product offerings. But based on what we're seeing in the marketplace, we've got a very good product set. Much of what's going on now is employers are passing more of the cost increase along to their associates or employees. And we've got a very good set in terms of deductibles and co-pay options that are available. So I think on balance we're in really good shape.

MCKEEVER (ph): OK, great. And my last question has to do with regions. Any major system integration initiatives in any of the regions in '02?

GLASSCOCK: Yes, this is Larry again. That basically continues much of the process that's been going on during '01. As you know, we have a migration strategy and we move that business over as it renews. So by the end of next year we'll have in the neighborhood of about 80 percent of all of our business actually on the system of choice, with the exception of our National Accounts business which will be closer to a hundred percent. So it's just a continuation of what we've been doing which has really been performing quite well. And our customer service levels have stayed very high through all of this.

MCKEEVER (ph): Great. Thank you very much and congratulations.

GLASSCOCK: Thank you for your question.

OPERATOR: Thank you. And once again, if anyone does have a question, please press the one on your phone at this time. And we do have a question from Don Rex's (ph) line with Bear Stearns. Please go ahead.

JOHN REX (ph), BEAR STEARNS: Yes, John Rex (ph), Bear Stearns.

Just wonder if I could get a little more detail on the -- on the membership outlook that you provided in your forecast for three to four percent in '02. Clearly, you're exercising some caution in that with -- given the economy, but coming off, I guess, a 12 percent same store number in this quarter. Could you help us understand the moving parts, at least as you see them at this point, that brings it down to that level in terms of is it -- do you see some account losses in January? Do you see just slowed growth at existing accounts? Or anything else that might be impacting that number in terms of how you -- how you view the impact of the slowing economy coming from 12 to three to four?

GLASSCOCK: Mike?

SMITH: John (ph), thank you. We are reflecting our best judgment given the overall condition of the economy. Again, if you reflect on the membership table provided with the release, given a very substantial growth rate in our National Account and Large Local Group business, we are exercising an abundance of caution in the guidance believing that if we are to experience dislocation or slowed enrollment it will be in those customer segments.

As Larry just responded to Bill, we remain focused on our long-term ambition of richening our mix in the higher-margin, small group fully insured segments and individual segments and believe that the current growth rates of about six percent may be sustainable in those segments, but have applied substantial caution to our ability to extend the trend of north of 17 percent in our National Account business and the current six to eight percent trend in our Large Local Group business.

REX (ph): And just one follow-on then, have you -- do you -- are you aware of any significant large group account losses for January at this point?

SMITH: No, we are not. We have very recently, and we do persistently, review the enrollment in particular of our very largest accounts, the top 26 accounts. And as we prepare for their open enrollment for '02 we are not noticing any downturn in their current enrollment.

REX (ph): Great. Thank you very much.

GLASSCOCK: Thank you, John (ph), appreciate your questions.

OPERATOR: Thanks. And once again, if anyone does have a question, please press one on your phone at this time. And we do have a question then from Norman Fidel's (ph) line with Alliance Capital. Please go ahead.

NORMAN FIDEL (ph), ALLIANCE CAPITAL: Yes, good morning. As a follow-on to the questions about the effects of 9/11, as you look at your claims volume in October, did it sort of return back to normalcy or is there still a hang-over effect that you can see?

GLASSCOCK: Norm, it has returned to normal. We certainly saw a -- lower volumes in September. But we're back to levels that we would have expected.

FIDEL (ph): OK, thank you.

GLASSCOCK: Thank you.

OPERATOR: And our last question comes from the line of Dan Johnson (ph) with Brenson (ph) Partners. Please go ahead.

DAN JOHNSON (ph), BRENSON (ph) PARTNERS: Thank you very much. Can you talk a little bit about, please, the trends you're seeing in your customers' requests for benefit design changes, whether it's things that have actually been implemented for 1/1 or maybe more likely that are under discussion for your 7/1 renewals? What are your customers looking for in order to try to bring the prices down just a notch?

GLASSCOCK: (INAUDIBLE). Thank you, Dan, for your question. What we're seeing particularly now for the 1/1 renewals is not much, frankly, in the way of benefit buy-downs. We're seeing a little but very little. What we are seeing is increases in deductible, increases in co-pays. And from what we can tell, more cost increase being passed along to the employees.

But in terms of, you know, redesigning products and making dramatic changes in what they're offering, we're just simply not seeing it.

JOHNSON (ph): Are you seeing any increased interest or any discussions amongst the sales folks for changes that these folks might be wanting to make either in July this year -- I know January of '03 is a long ...

GLASSCOCK: Yes. But ...

JOHNSON (ph): ... ways away?

GLASSCOCK: We're not hearing much. What we are hearing is -- would tie into what I said earlier and that is that employers are looking for a way to increase the deductibles, increase the co-pays, and then in turn pass along more of the increase in cost to the employee. But we're not seeing, you know, interest in, you know, dramatically different products. In fact, we're continuing to see the interest in the PPO product, which is, you know, as you know, one of -- one of our many strengths. So we think we're well positioned for what's being asked for.

JOHNSON (ph): And finally related to that, in the -- within the pharmacy segment -- or within the pharmacy cost trends, the penetration that you currently have of three tier pharmacy -- and what are you seeing as the highest tier price point on average these days?

GLASSCOCK: Let me -- let me turn it to Mike.

SMITH: Dan, we are still seeing a trend of more tiered benefit design for pharmacy. About 65 percent of those plans where pharmacy benefit is included are now embracing a tiered design with \$50 at the high end of that triple tier.

JOHNSON (ph): Is that an average high end or just kind of that's the ...

SMITH: I am -- I am unaware of any substantial volume above \$50.

JOHNSON (ph): Great. Thanks and again (INAUDIBLE).

GLASSCOCK: Thanks, Dan.

OPERATOR: And we do have one further question that came into queue from Michael Stanski (ph) with Tudor Investment. Please go ahead.

MICHAEL STANSKI (ph), TUDOR INVESTMENTS: Mike, could you give some more detail on the dramatic -- what was behind the dramatic margin improvement on the East and West side? And more specific, what was your admin leverage on the West in Q3 please?

SMITH: I will. Michael, good morning and thank you. Again, to put color around the East, I think it's -- and I could say a very powerful statement of our strategy to leverage the administrative services of the Connecticut plan to further reduce redundancies in both Maine and New Hampshire without a new data point, without the reserve strengthening recorded in the East. Operating margins actually grew to 4.2% in the quarter and that is a function of three activities: continued dramatic enrollment gains in New Hampshire; substantial progress made in moving the New Hampshire business to the Connecticut platform without a glitch in service and allowing us to eliminate the licensing fees that were in place in New Hampshire and in part in Maine; and an overall further amount of progress made in what we call the non-customer touch areas of our administrative expense. Take my own financial service group, we have been able to continue through attrition and other efforts to lower staff deployment in the East.

In the West similar story. With our bias to restore service to market acceptable rates we have for an extended period of time in the first two quarters staffed with temporary employment to reduce the backlog of claims and unanswered client communication. We have now been able to remove that staffing compliment in large proportion and fully enjoy the leverage of between 25 and 28 percent growth on top of what is now a stabilized level of admin expense.

It is also true in the West that the pricing strategy executed in late 2000 and first quarter in 2001 is now starting to play out in a full impact as we see the margins in the PPO product being offered by the West display strength.

STANSKI (ph): Did the admin costs break 20 percent? Were they in the high teens in the quarter in the West?

SMITH: I did not -- I did not pick up your question completely.

STANSKI (ph): You had a 20 percent level or so on admin expense going on a six-month basis. Did that go below 20 percent in the ...

SMITH: It did slightly below 20 percent for the quarter. As you are aware, we are not giving full reporting of admin expense ratio or benefit expense ratios by region. But to the point of your question, we did see the West converge closer to Inc's overall rate of admin expense.

STANSKI (ph): Thank you.

GLASSCOCK: Thank you.

OPERATOR: Thanks. And we do have a couple additional questions in queue, the next one coming from Greg Soloman (ph) with SAC Capital. Please go ahead.

GREG SOLOMAN (ph), SAC CAPITAL: Hi, good morning. Couple of just real quick ones. On the operating cash flow line is -- are you at a normalized run rate here? Like can I just kind of annualize that and assume it grows with EPS or is there something that was any non-recurring plus or minuses in there?

SMITH: There were a couple of non-recurring items in the quarter and let me give you some detail around that. Operating cash flow for the quarter was 251 million, an increase of 132 million over the third quarter of last year. There were several drivers of that cash flow, obviously, the earnings momentum that we enjoyed in the quarter. But the following one-off item should be considered. We received four payments from CMS, formerly HCFA, in the third quarter of 2001 versus three payments in the second quarter of '01. That accounted for about a \$50 million sequential increase Q3 versus Q2. Further, we had interesting timing of the payment of a third quarter 2001 estimate federal income tax payment paid on October 1, normally paid at the end of the quarter. That was another \$24 million impact in the quarter.

SOLOMAN (ph): That was positive or negative? That was ...

SMITH: That would have positively influenced the third quarter because the payment was made the first day of the fourth quarter.

SOLOMAN (ph): Yes, got you -- got you.

SMITH: On an overall basis we think the normalized cash flow for '01 would be in the -- in the neighborhood of 600 million and would suspect that that will grow in '02 in proportion to the improvement in operating gain that we've guided you for in '02.

SOLOMAN (ph): OK. And then a clarification on this concept of I guess lower claims given what happened in September. Did you -- do I remember you said about 30 million in additional reserves that you added for that? And if that's the number is that basically what you calculated to be the relative claim slowdown?

SMITH: If we caused you to believe that it was 30 million that was an error on our part. The precise amount booked in the third quarter was 21 million ...

SOLOMAN (ph): I'm sorry, OK.

SMITH: ... split between the East and Midwest regions. That, as I commented earlier, did reflect our expectation that we had had some slowdown. As Larry indicated, we have now seen -- we have now experienced claims flows returning back to their normal level.

SOLOMAN (ph): And the 21 million appears like it was the accurate number to take?

SMITH: We believe so.

SOLOMAN (ph): OK, great. Thank you very much.

OPERATOR: Thank you. And we do have a follow-up question then from Charles Bruady (ph) with Goldman Sachs. Please go ahead.

BOORADY (ph): Thanks.

Larry, this may be premature to get a full read on but I'm just curious what was the initial response of your IPO among other Blue Cross Blue Shield plans so far? And how do you think the success of your IPO might impact the decision of other plans to think about converting and potentially coming public?

GLASSCOCK: Yes, Charles, it's a -- it's a little premature. I'll be seeing many of them face-to-face here over the next couple of days. But I can tell you I've received more phone calls than I could even imagine congratulating our company on the success of the offering. And I believe as we -- as we said during the road show that this will give us financial flexibility that will allow us to continue to invest in the future. And hopefully part of that investment will be ongoing acquisitions.

But, again, I think the reception from my fellow licensees in the Blue Cross Blue Shield system has been extremely positive overall.

BOORADY (ph): Great, thanks.

OPERATOR: Thank you. And finally we do have a question, a follow-up, from Roberta Goodmann (ph) with Merrill Lynch. Please go ahead.

GOODMANN (ph): Hi. Not to keep harping on the claims slowdown but I was hoping that you could provide some flavor as to the relative types of services that you saw being delayed? And whether in October -- in response to Norm's question when you were saying that the volumes were back to normal whether you saw a catch up and then additional volume or just more a resurgence to normal levels?

SMITH: Roberta, let me try to be more clear around that point. I don't have the level of granularity that I know you would like in terms of what types of claims did not come through following September 11th. I would give you a broad guidance that these were primarily around physician office visits and I would call them the lower end of the acuity of our healthcare benefits.

With regard to the catch up, again, as we have described, we've seen -- and I'll pick our Midwest Region as the best example. Midwest represents about 68 percent of our claims inventory. There was a four percent decrease in inventory at the end of Q3 compared to the end of 2Q. We have no factor to point to other than the predicted influence of the September 11th activity or tragedies. And with regard to the resumption of normal volume, we're now seeing inventories not surge -- to use your word -- above normal levels but simply return to a level that we are accustomed to. About 670,000 claims in inventory at the end of the third quarter, looking much more reasonable in light of our analysis. And we expect that that number will come back to a traditional third quarter or early fourth quarter level which is about 750,000 claim in inventory. So no surge, just a return to normal flow.

GOODMANN (ph): OK, great. Thank you.

OPERATOR: Thank you. And that was our final question. I'd now like to turn the call back over to the Anthem management team.

DURLE: Thank you. This concludes our call for today. But if you have additional questions, feel free to contact me, Tami Durle, or my colleague Mike Hall, after the call. Thank you for your interest in Anthem and have a great day.

OPERATOR: Thank you. And, ladies and gentlemen, this call will be available for replay starting today, Wednesday, November the 14th, 2001, at 1:45 p.m. Eastern time. And it will be available through next Wednesday, November the 21st at midnight Eastern time. You'll be able to access the AT&T Executive Playback Service by dialing 1-800-475-6701 from within the United States, or 320-365-3844 from outside the United States, and then enter the access code of 607820. Those numbers once again are 1-800-475-6701 from within the United States, or 320-365-3844 from outside the United States, and again, then enter the access code of 607820.

That does conclude our conference for today. Thank you for your participation and for using AT&T's Executive Teleconference. You may now disconnect.

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