

**Anthem, Inc. (ATH)  
Q1 2003 Financial Release Conference  
Call**

*Wednesday, April 30, 2003 8:30 am*

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

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Please note this transcript has been edited for accuracy.

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**THE OPERATOR**

Ladies and gentlemen, thank you for standing by and welcome to the Anthem first-quarter earnings conference call. At this time all participants are in a listen-only mode. Later we will conduct a question-and-answer session. (CALLER INSTRUCTIONS) As a reminder this conference is being recorded. I'd like to

turn the conference call over to our host, Ms. Tami Durle. Please go ahead.

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**MS. TAMI DURLE**

Good morning and thank you for joining us to discuss Anthem's first-quarter 2003 results. I'm Tami Durle, Vice President of Investor Relations, and with me this morning are Larry Glasscock, Anthem's President and Chief Executive Officer, and Mike Smith, Chief Financial Officer. On this morning's call Larry will provide an overview of our first-quarter performance followed by Mike who will review the financials in more detail. Before taking your questions Larry will update our financial outlook for the rest of 2003.

We will be making some forward-looking statements on this call and 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 this morning, the Form 10-K we filed with the SEC on March 7th of this year, and other periodic filings we have made with the SEC. Also, in connection with the new FCC guidelines we have provided a reconciliation of non-GAAP measures in our press release and on our web site, [www.Anthem.com](http://www.Anthem.com), for reported net income per share to adjusted net income per share. Larry.

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**MR. LARRY GLASSCOCK**

Thanks, Tami and good morning everyone. As noted in our press release Anthem is off to a great start in 2003. Operating revenue, operating margin, membership gains and adjusted net income per share for the quarter were all record achievements for our company. We preannounced as you know our quarterly performance on April 17th, and we provided further details of these results in our full press release which was issued earlier this morning. Diluted net income was \$1.36 per share in the first-quarter. Excluding the positive impact of net realized investment gains and resolved litigation, net income was \$1.18 per diluted share representing a 27 percent year-over-year increase.

Although our history as a public company is a relatively short one, we are very proud that we have met or beat our earnings expectations every quarter which is now seven consecutive quarters. We expect our financial momentum to continue throughout the rest of 2003, and consistent with our April 17th announcement, we are projecting 2003 adjusted net income of \$5.00 to \$5.05 per share. This represents an increase of 20 to 25 cents per share compared to our previous expectations and a 21 percent to 23 percent growth rate in net income per share for the year.

Please recall that adjusted net income excludes net realized gains on investments as well as the \$24.5 million positive impact from litigation resolved during the first-quarter. Our operating revenue increased by 46 percent and exceeded \$4 billion in the first-quarter. On a same-store basis excluding the acquisition of Trigon, operating revenue increased by 13 percent year-over-year driven by premium rate increases and membership gains in all of Anthem's states.

Premium yields on our fully insured group business were approximately 13 percent and we continue to price our business to cover medical cost trends that are now expected to be in the 11 percent to 12 percent range for 2003. This is a modest improvement in our outlook for 2003 trends as medical costs slightly moderated in the first-quarter to a rolling twelve-month trend of 11 percent. We believe our disease and advance care management programs along with our pay for quality performance initiatives with hospitals are contributing to enhance patient health and optimizing the overall cost of care.

Medical enrollment increased by a record 483,000 members in the first three months of 2003, and we now have 11 1/2 million members in our health plans. Compared to the first-quarter of 2002, membership has increased by 41 percent on a reported basis and almost 10 percent on a same-store basis. You will recall that we originally projected approximately 250,000 to 300,000 new members in the first-quarter and we have significantly exceeded our expectations. This was primarily due to enrollment gains in our National customer segment which alone expanded by 437,000 members in the quarter.

We are also very pleased that overall membership retention continues to track above 90 percent.

Delivering distinctive customer service and offering a broad product portfolio are contributing to our ability to grow, as well as retain profitable membership. Membership gains were achieved in all four geographic regions in the quarter with the largest gains coming from the Midwest and East. The Midwest enrollment increased by 264,000 new members while the East added 148,000 new members in the first-quarter. National accounts which include our BlueCard business generated about 90 percent of Anthem's membership gains in the quarter.

We have mentioned on previous earnings calls that Anthem's National product continues to gain strength in the marketplace. Recent examples of this strength include the fact that we retained 100 percent of our January 1st controlled account renewals, and that's very important for this segment. And in addition, we won 23 new accounts in the first-quarter. From 1999 through 2002, we've grown our National account membership by 12 percent to 18 percent per year on a same-store basis and this momentum should continue in 2003 given our start.

Let me quickly highlight some of the additional details of our National accounts business. First, the value of our Blue brand enhances our ability to attract new customers and retain existing accounts. Second, the BlueCard product has the advantage of broad provider networks in all 50 states with very competitive network reimbursement rates. Third, the development of a proprietary tool called ClaimsQuest allows us to display potential medical cost savings that clients and prospects can gain by accessing the Blue Cross national network. And then finally, Anthem's dedication to provide a high level of customer service remains attractive to our national employers.

Membership gains in National accounts continues in the second quarter with another major account being added in April. This account alone should add at least 30,000 members to our enrollment. Continuing the positive trend we've seen over the past couple of years, our individual businesses added 36,000 new members since December. We reported enrollment growth in the individual businesses in all of Anthem's regions, with the Midwest being especially strong.

Compared to the first-quarter of 2002 our individual membership has increased by 13 percent excluding the

impact of the Trigon acquisition. Year-over-year the Local Large Group membership growth was 4 percent on a same-store basis. However, since December the enrollment in this segment declined by 31,000. This decline was due to three factors. First, we reduced the number of counties in which we offer coverage for State of Kentucky employees and retirees. We exited 50 counties in January 2003 resulting in the loss of 27,000 members.

Second, due to profitability considerations we also exited one account with approximately 18,000 members in Virginia. And finally, due to an overall weak economy, we continue to see a lack of growth and enrollment within our existing accounts. Looking at the mix of our membership Anthem has a balanced portfolio of both self-funded and fully insured membership. At the end of the first-quarter 53 percent of our membership was in self-funded arrangements with 47 percent being fully insured.

This business mix has changed somewhat from year end 2002 when we reported a 51 percent and 49 percent split between self-funded and fully insured membership respectively. Compared to year end 2002, fully insured membership declined by 42,000 members primarily due to the changes in Local Large Group membership I just discussed. Also, approximately 20,000 members in the State of Indiana account in our Midwest region converted from being fully insured to self-funded effective January 1st.

We expect about another 90,000 fully insured members primarily from other state accounts to convert to a self-funded product later this year. We will continue to provide our customers a broad selection of products with fully insured and self funded options and expect to maintain our operating performance even with this shift. If you have followed Anthem since our initial public offering in late 2001, I hope that you have come to associate our company as one attentive to the details of this business as well as being very disciplined.

We continue to be disciplined in pricing our business appropriately, disciplined in delivering distinctive customer service, disciplined in improving our administrative cost structure, and also disciplined in integrating acquisitions. I mentioned before that we will continue to price our business to cover medical cost trends. We know that diligent underwriting is one

of the most important skills necessary to be successful. Also, our customers expect us to answer their phone inquiries on a timely basis and pay claims in an accurate and efficient manner.

We are very attentive to the needs of all of our stakeholders and that includes our members, our clinical networks and our brokers. Although customer satisfaction is very high at Anthem we will work to further improve our service to all of our partners. Great progress has been made also to optimize our cost structure over the past few years, and we're targeting very importantly further improvement. In 1998, our administrative expense ratio was 26.3 percent or 850 basis points higher than our first-quarter 2003 ratio.

The acquisitions in the East and West that were completed in late 1999 and 2000 required intense focus on process enhancement across multiple states in the formation of new geographic regions. Now our focus is moving towards cross regional sharing of best practices to leverage and improve our cost structure on an enterprise-wide basis. We also expect the completion of our systems consolidation initiatives to create more efficiencies. The migration of membership to new systems of choice in our Midwest and East region remains on plan to be essentially complete by the end of this year. And in fact, the migration in the Midwest will be essentially completed by the end of the second quarter.

Consistent with the results from integration efforts in our prior acquisitions, the integration activities in the Southeast are also tracking to our plan. We remain confident that we will capture \$40 to \$50 million of synergies this year and at least \$75 million in 2004. Included in our synergies for 2004 is the benefit from transitioning 1,700,000 pharmacy members from Trigon's outsourced pharmacy benefit manager to our integrated PBM, Anthem Prescription Management. Now, before I turn it over to Mike I want to summarize very quickly the highlights of our first-quarter.

We achieved a record performance with adjusted net income of \$1.18 per share, a 27 percent increase compared to the first-quarter of 2002. Membership gains in the quarter, also a record for Anthem, were above our plan primarily due to strong customer retention and market share gains in the National customer segment. And we expect our financial

momentum to continue as we raised our earnings guidance by 20 to 25 cents per share, and now project adjusted net income of \$5.00 to \$5.05 per share in 2003. Now, here is Mike who will discuss our first-quarter 2003 financial results in much more detail. Mike.

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#### **MR. MICHAEL SMITH**

Thank you, Larry and good morning. Net income was \$191.7 million for the first-quarter or a \$1.36 per diluted share. Excluding \$8 million after-tax of net realized investment gains and a \$16 million after-tax benefit associated with the resolution of previously disclosed litigation, net income was \$167.4 million. Therefore adjusted net income was \$1.18 per diluted share. We have historically provided a reconciliation of reported net income to adjusted net income in our quarterly press releases and this practice will be continued this morning with the announcement of our results.

Consistent with Larry's comments, when I mentioned same-store performance I'm excluding the impact of the Trigon acquisition. We completed this transaction on July 31st of 2002, and as a result the first-quarter of 2002 did not include results from Trigon. Anthem's consolidated operating gain was \$262.9 million in the first-quarter, an increase in \$156.3 million compared to last year's first-quarter. On a same-store basis operating gain improved by \$86 million, or 81 percent year-over-year. Operating gain results were about \$58 million better than we had projected for the quarter, of which \$25 million was due to the benefit of the resolved litigation.

The remaining \$33 million was due to above plan performance in all segments except our East region which reported solid results in line with our guidance. Better than plan membership gains in the quarter, administrative cost control, and slightly lower than expected medical cost trends drove operating results in the quarter allowing us to beat our expectations. Now, reviewing the performance for each business segment.

In the Midwest segment, first-quarter operating gain was \$110.6 million or \$86.1 million without the litigation benefit.

On this same adjusted basis, the Midwest operating margin was 5.3 percent, up 160 basis points compared to the first-quarter of 2002. The improvement in operating performance in the Midwest was primarily due to better underwriting results in our group business and membership gains of 8 percent year-over-year.

Operating gain in our East region was \$62.9 million in the first-quarter, a 49 percent increase year-over-year. Operating margin improved from 4.3 percent in the first-quarter of 2002 to 5.7 percent in the current year's first-quarter.

All customer segments in the East are showing operating gain improvement compared to the first-quarter of 2002. Also in the East, we have been integrating operations and refining strategies from all three states over the past couple of years, and one result of this process was identifying the National markets as an underserved customer segment. From year end 2000 to the first-quarter of 2003, National account enrollment in the East has grown by almost 80 percent.

We think this is a very good example of how Anthem has shared best practices across our regions to improve the overall performance of our company.

Our West segment reported a \$25.9 million operating gain in the first-quarter of 2003. This performance was about \$10 million better than we expected, primarily due to a \$6.3 million reduction of the liability for a large case specific claim which was resolved in early April.

In addition, administrative expenses were lower than plan in the West. Later this year the West will begin migrating approximately 300,000 members from its AMISYS operating system to new FACETS technology, and we expect spending on this project to gradually increase during the remainder of the year. As a result, quarterly margins in the West should decline slightly throughout 2003 with a full year operating margin in the 8 percent range for this segment.

In the Southeast, operating gain was \$70.3 million in the first-quarter, which is also about \$10 million better than our expectations.

Similar to the East, the operating results in Virginia were better for every line of business comparing the first-quarter of 2003 to last year's first-quarter. The integration efforts which are being led by a committee co-chaired by Tom Snead and me, are proceeding as planned and we were able to realize approximately \$10 million of synergies in the first-quarter. This was up from a total of about \$7 million in the fourth quarter of 2002.

The operating gain in the Specialty segment was \$12.9 million for the quarter with an operating margin of 8.1 percent. In January our new behavioral health company converted 287,000 Colorado members from a third party vendor to our company, Anthem Behavioral Health. Due to the build out of our new behavioral health business we expect a flat or slight decline in the margin for our Specialty segment in the second quarter with margin expansion resuming in the third and fourth quarter.

Larry mentioned that Anthem Prescription Management will gain about 1.7 million members when we convert Anthem's Southeast pharmacy management to our PBM. We are very excited about this opportunity and upon conversion Anthem's PBM will have approximately 7 million members and will be among the largest pharmacy benefit managers in the country.

Finally, in the Other segment, the first-quarter operating loss was \$19.7 million, slightly better than we expected.

Moving below the operating gain line, net investment income was \$71.5 million in the first-quarter, which was below our expectations and also down about \$2 million sequentially.

I want to quickly highlight the fact that investment yields have declined dramatically from last year. In the first-quarter of 2003, our fixed maturity portfolio yield was approximately 4.9 percent versus a yield of almost 6.3 percent in the first-quarter of 2002. Very importantly though, our investment policy remains conservative and we have not lowered the quality of our investment portfolio in pursuit of enhanced yields. Over the last five quarters we have reported net realized gains on our investment portfolio, all of which have been excluded from our adjusted net income.

This is in sharp contrast to many other investor owned companies and reflects the very high quality of our portfolio. Our ability to report a 27 percent growth in adjusted net income per share for the quarter, and a declining investment yield environment, further indicates the strength of our operating performance. Anthem's consolidated benefit expense ratio was 82.2 percent in the first-quarter, an improvement of 230 basis points year-over-year. The improvement in this metric was due to the following items.

Approximately 60 basis points can be attributed to the favorable resolution of litigation in the quarter. Thirty basis points is due to the Trigon acquisition, and the remaining 140 basis points of improvement was primarily from disciplined pricing strategies, lower than anticipated medical costs and the selective market exits in Kentucky and the fully insured to self-funded conversions that Larry spoke about earlier. Medical cost trends for our fully insured group business were 11 percent on a rolling twelve-month basis through the first-quarter.

Inpatient trends were about 7 percent, outpatient services were up about 13 percent, professional services approximately 11 percent and pharmacy costs about 14 percent. All components were lower than we had expected except for outpatient services which are in line with our projections. The medical cost trends for the first three months alone compared with the first-quarter of 2002 was about 10 percent. In the past we have not disclosed quarter only trends, but there has been increased interest in the patterns of health-care consumption in the first-quarter and we wanted to provide this additional detail this morning.

This measure for only three months of activity must be kept in context and could easily be impacted by environmental factors and therefore may not be representative of trends for the full year. For example, the pharmacy utilization trend actually declined about 2 percent from the fourth quarter of 2002. The cold and flu season was relatively mild in all of our states except Indiana, and severe weather in certain states may have impacted the lower trends we witnessed in the quarter as members made fewer physician visits. In addition, Claritin moving to over-the-counter status resulted in a significant decline in utilization in this class of drugs overall.

While we are pleased by the trends we've experienced through the first three months of the year, we are cautious about assuming that the moderating trend can be sustained throughout 2003. At this time we expect 2003 medical cost trend to be in the 11 to 12 percent range. This is consistent with the trend reported for the last twelve-months as well as our full 2002 results. Our administrative expense ratio was 17.8 percent in the first-quarter, an improvement of 60 basis points year-over-year and better than our expectations.

Excluding the impact of the Trigon acquisition and volume related spending, administrative expenses in dollars increased by only \$15 million year-over-year. We remain very committed to improving our operational efficiency and thereby becoming even easier to do business with. Now, focusing on our balance sheet and cash flow, cash and investments were \$6.9 billion at the end of the quarter, an increase of \$215 million from year end 2002. Total assets now exceed \$12.5 billion. The unpaid life, accident and health claim liability was \$1.9 billion at the end of the first-quarter, up 7 percent from year end 2002.

Days claims payable were 56.7 days, down 3/10 of a day sequentially. The quality of our reserves remains consistently strong, and we continue to follow the same methodology in estimating our unpaid claims liability. Based upon completion of claims paid in the first-quarter, and our current estimates for medical cost, there were no impacts to our earnings in the quarter from unusual prior year reserve development. Anthem's total debt of \$1.8 billion was unchanged from last quarter, and our debt to capital ratio at the end of the quarter was 24 percent.

Operating cash flow in the quarter was \$249 million, well above net income and further indicating strong quality financial results. We continue to project at least \$1 billion of operating cash flow in 2003. We have substantial liquidity in our parent company with \$275 million of cash and investments on hand at March 31<sup>st</sup>. We expect a total of at least \$425 million of dividends will be paid from our insurance operations to the holding company in 2003. In fact, thus far \$50 million has been upstreamed to the parent in the first-quarter and another \$347 million dividend was paid in the month of April.

In the first-quarter we repurchased almost 1.6 million shares of our common stock for \$91 million at an average price of \$57.44 per share. The share repurchases had a neutral impact to quarterly net income per share, due to the fact that the majority of the buybacks occurred in the mid to late part of the quarter. We have remaining authorization to use \$409 million under our share repurchase program, and we will continue to be opportunistic in repurchasing Anthem's stock. Now here is Larry who will provide our earnings outlook for the rest of the year. Larry.

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### **MR. LARRY GLASSCOCK**

Thanks, Mike. As you know our earnings guidance does not include the projection of additional share repurchases in 2003, or results from the pending acquisition of Blue Cross and Blue Shield of Kansas. The Supreme Court of Kansas heard oral arguments on March 5th, and we would expect the court to render a decision late in the second quarter or in the third quarter of this year. We now project full year 2003 diluted net income per share to be in the \$5.00 to \$5.05 per share range on an adjusted basis, which excludes the impact of net investment gains and losses and the benefit from resolving litigation in the first-quarter.

Second-quarter adjusted net income per share is expected to be in the \$1.20 to \$1.25 range, an increase of 21 percent to 26 percent compared to last year's second quarter. A reconciliation of projected net income per share to projected net income per share on an adjusted basis is included in our press release. Please keep in mind that the remainder of the guidance I will give you this morning is on a reported basis unless otherwise indicated.

Our earnings guidance assumes approximately 141 to 142 million average diluted shares outstanding for the second quarter and full year 2003. Operating revenue is projected to approach \$16.5 billion for full year 2003. This is down from our prior guidance of almost \$17 billion primarily due to the membership exits in the Local Large Group market, and the fully insured to self funded conversion in certain state accounts that I spoke about earlier.

We would also remind you that we intend to remain disciplined with our pricing practices and continue to price for an appropriate margin, not share gains. Based on the strength of the first-quarter membership gains we are raising our guidance for membership growth from 4 to 6 percent, to a range of 5 to 7 percent for 2003. Premium yields are expected to continue to cover medical cost trends of 11 to 12 percent for our fully insured group business in 2003. Full year 2003 reported operating gain is expected to slightly exceed \$1 billion. Operating gain for each business segment is projected as follows for the year. Midwest, in the \$410 to \$420 million range; East, \$265 to \$275 million; Southeast, \$285 to \$295 million; West, \$90 to \$95 million range; Specialty in the \$60 to \$65 million range; and the Other segment operating loss should be fairly comparable to 2002.

Operating margin should reach the low 6 percent range in 2003, both on a reported and adjusted basis. The benefit expense ratio is projected to be relatively consistent with 2002. Although operating revenue is projected to decline from our previous guidance due to strategic membership exits and fully insured to self funded enrollment conversions, the administrative expense ratio is still expected to improve by 100 to 150 basis points in 2003. And finally, the effective tax rate in 2003 will be in the 36 percent to 37 percent range or comparable to the 36.3 percent tax rate reported in the first-quarter. Now if we can, let's open the call up for questions.

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### **THE OPERATOR**

Roberta Goodman from Merrill Lynch.

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### **THE CALLER**

I was wondering if you could talk a little bit about the acceleration in the trend to 11 percent and how the components have moved, specifically whether the reduction in the various components would be due to changes in pricing or changes in utilization?



**MR. MICHAEL SMITH**

Roberta, we saw trends of about 12 percent through 2002 as you will recall. Trends in the quarter on a rolling twelve-month basis as we have described this morning were 11 percent. And we frankly expect the trend to be in that 11 to 12 percent range for 2003 as full year. The drivers that we are observing, are first in inpatient. Trend is being driven by unit cost as hospitals continue to negotiate rates with our various health plans and our guidance in that element of cost remains in the 8 to 9 percent range. Our fourth-quarter call you might recall we provided guidance of 9 to 10 percent.

Outpatient utilization increases from diagnostic services and outpatient surgery continue to drive the impact of that portion of our health care cost and in fact, our guidance remains in the 12 to 13 percent range. For professional services, it is still both utilization and new fee schedules and our guidance for the full year for professional service expense remains in the 11 to 12 percent range. You might recall earlier our guidance was 12 to 13 percent, and our 2002 trend in professional services was actually 12 percent. In pharmacy, utilization remains a driver, our guidance for '03 remains at low to mid teens and consistent with our fourth-quarter guidance.

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**THE CALLER**

Great. One separate question. What was the impact of benefit design changes on the premium?

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**MR. LARRY GLASSCOCK**

The benefits buydowns for the quarter were right in line with our expectations. You may recall we had said last winter that we expected 300 to 350 basis points, and we ended up at about 300 basis points, Roberta, in the first-quarter.

**THE CALLER**

Any flavor on the nature of those?

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**MR. LARRY GLASSCOCK**

First of all there was some regional variation, we saw the largest amount of buydowns in our West region. And then we followed that in the Midwest, East and Southeast at a relatively consistent level. But as you would expect and as we have talked about before, we've put in on an inpatient basis higher copays and hospital services. In outpatient we have been again increasing copays. In professional as you would expect, we've increased the copays on physician visits. In pharmacy we have continued to adjust the three tier pricing rates.

So it's very consistent with what we really talked about last year. And obviously layering in on all of this are increases and deductibles. The other thing that I want to add that we have been doing and we discussed this again last year, was increasing fairly dramatically the price points between our least expensive and most expensive products. So much of this has gone on by customers buying into a slightly different product set.

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**THE CALLER**

Great, thank you.

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**THE OPERATOR**

(CALLER INSTRUCTIONS). William McKeever from UBS Warburg.

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**THE CALLER**

A couple of questions on the PBM business. It looked as if the mail-order volume was up quite strongly. I'm wondering who's driving that. Is that the employer trying to increase mail-order penetration or is that your



focus to try to save cost there? Where do you think mail-order penetration could go?

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**MR. LARRY GLASSCOCK**

We are doing a great deal to drive increased volume in mail order. And if you look at -- I'm trying to recall the exact volumes. I don't have those actually committed to memory, but I will try to get a number for you Bill. In fact, the script, the script volume is up at the retail level. In terms of our mail-order scripts volume we are up about 20 percent Bill from the first-quarter of '02. We now have a mail order penetration rate of about 5.5 percent and that is up from the low five percent range in 2002. So we are driving quite a lot of this through member education.

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**THE CALLER**

And just related on the Specialty care side, you have a number of services of health, vision, dental. Wondering what sort of opportunities you have just to penetrate your own base of membership and how aggressive are you selling these services to nonaffiliated members?

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**MR. LARRY GLASSCOCK**

Bill, in terms of where we're trying to sell these Specialty products, we are really focused with the exception of PBM, our energies is really around penetrating our existing customer base. And with the PBM as we mentioned last fall we have begun to market that to third parties. Again, we have so much in the way of opportunity just within our existing base, that we want to make sure we put our energy there. Our penetration rate as we talked about before in our PBM is in the mid 80 percent range and that excludes Southeast for the moment. They will be moving over over the next number of months.

The reason we have moved outside there is because of the very substantial penetration rate we have already achieved. In Life membership we are at about 800,000

lives there and that's penetration around the 20 percent level, actually a little above 20 percent. But we think there's some real opportunity there well above where we are currently. Dental membership currently is around 2 million members and again a very similar penetration rate to what we have in Life.

And as you know in Vision we are really just getting started there. And the same is true in Behavioral Health except that I do want to mention just since last summer we've now moved or migrated about one million of our own members over to the Behavioral Health company. So we're very pleased with where that is headed. I think we still have tremendous upside here as we go into this year and beyond.

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**THE CALLER**

That's great. Thanks and congratulations on the quarter.

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**THE OPERATOR**

Christine Arnold from Morgan Stanley. Ms. Arnold, your line is open. Next question will come from Scott Fidel with J.P. Morgan.

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**THE CALLER**

Good morning. Question as to focus on the West region's enrollment particularly impressive ten percent when you think about Colorado and that the economy out there has been generally pretty soft with the telecommunications exposure out there. I just wondered if you could give us some more color on the growth out there, where that is being driven from and then also just a breakdown between Colorado and Nevada? Thanks.

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**MR. MICHAEL SMITH**

I'm happy to do that. First of all some of the excitement in the West region is consistent with Larry's report of progress that we are making with National account wins. We have had two significant wins in the West region and they are contributing in very significant proportion to our progress in the West. You are correct, given the challenges of the telecommunications industry, it is a real, we believe, a real statement of the progress that Caz Matthews and her team are making in taking share in both Colorado and in Nevada.

We do not report as you know on any of our states and rather confine our reports generally to segments. But given that the membership data is available to you from other sources, I will spike out the Nevada membership and the Colorado membership. Control business, that is business that we enter into the contract with payors or individuals, splits about 350,000 in Colorado and about 70,000 in Nevada. The balance of the membership in that region is dispersed among National accounts and BlueCard membership that reside in one or the other of those states. And I hope that is helpful to you.

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**THE CALLER**

Yes, that is. I also just had a follow-up question on the system conversion now that you are essentially completing up at least in the second quarter in the Midwest, if you can talk about the difference that you are seeing in your auto adjudication and EDI rates in the new system as compared to the older system? Thanks.

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**MR. LARRY GLASSCOCK**

Well first of all, the auto adjudication rates vary by region but on our target systems that we are migrating to were in the 65 percent to 75 percent range. So we are very pleased with where this is. I must say though that we were also increasing our auto adjudication rates in the previous systems as well. So there is some improvement on the new system, but we weren't dissatisfied with where we were on the old.

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**THE CALLER**

Thank you.

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**THE OPERATOR**

Charles Boorady from Smith Barney.

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**THE CALLER**

Thanks and good morning. I have one question on medical costs and then a follow-up and I'm not sure if Sam is on the line to address this or if he can add some color to this. In terms of any changes you are seeing in utilization of inpatient or outpatient services, can you quantify or are you able to quantify what the impact of any benefit design changes or disease management programs or other factors outside of a weak flu season might be that are contributing to any changes in utilization patterns that you are seeing?

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**MR. LARRY GLASSCOCK**

Let me just give you, Charles, some detail as I can recall it. Sam is not with us but I will give you at least an overall sense of where we are. In the pharmacy side, the utilization trend actually declined about 2 percent from the fourth quarter, but utilization actually increased by about 4 percent in the fourth quarter of '02 but then declined to a 2 percent increase in the first-quarter here. Some of this lower utilization and we talked a lot about this, we think may have been the result of the harsh weather.

And the reason I say that is in our East region, our scripts per member per year declined by one percent year-over-year, and one percent sequentially. So we do think there is some potential implication from weather. In the area of antihistamine and estrogen classes for example, both of those had 20 percent plus declines in scripts per member when you look at the first-quarter of '03 compared to the first-quarter of '02. In the area of

inpatient, I think it's fair to say that what we are seeing there is about 80 percent of this spend is being driven by unit cost and Mike indicated that earlier, about 20 percent or so is being driven by utilization.

So again, for inpatient, utilization really isn't the key driver. In the area of outpatient just as you would expect, the utilization there is remaining very strong in the first-quarter and the trend is about evenly split between unit cost and utilization. And in the professional arena, utilization was lower in the first-quarter versus our trend that we had witnessed obviously in the previous quarter.

Office visits were increasing but they were in the low single digit range as opposed to mid-high to single digit for '02. So again, it moves around as I have described. In terms of our programs, Charles, we do as you know a lot of measurement of our disease management and advanced care management programs. We believe they're having a difference and some of the changes that I spoke about just a few minutes ago, in part can be attributed to what we are doing on the medical management side.

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#### **THE CALLER**

Thanks, Larry for all of those details. It was extremely helpful. On the pharmacy side, one of the stories that I've heard from a few different sources was that because of the high benefit design changes going into effect January 1 of '03, that some people would have loaded up on more months worth of lower copay scripts before getting into the new design year after seeing in October what kind of changes their employers were putting through. Does your data bear that out? Did you see that take place?

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#### **MR. LARRY GLASSCOCK**

Charles, we certainly don't see any evidence of that.

#### **THE CALLER**

Great. My follow-up question was unrelated. It was on share buybacks and given the strong cash flow and your obviously very low stock price during the quarter, whether there were factors that precluded you from buying stock back in the quarter such as the Kansas transaction or anything else that precluded you, just as I try to make an assessment going forward of the pecking order and how you plan to use your cash throughout the rest of this year?

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#### **MR. MICHAEL SMITH**

Charles, there were no factors constraining our share repurchase program other than our own discipline. As we visited before, while we are opportunistic we are also very disciplined. We've committed about one-half of this year's operating cash flow in terms of an authorization to reacquire shares. We too believe that our shares were a bargain during much of the first-quarter. With the guidance of Dave Frick and his team, have actually expanded the number of business days in a quarter when we are able to be in the market and you should expect us to maintain very disciplined and very opportunistic strategies to buy these shares back. And therefore I want to make clear that there were no constraints beyond our own discipline.

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#### **THE CALLER**

When you talk about the authorization could we assume that you are going to fully use that authorization this year or would that be too aggressive or conservative of an assumption?

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#### **MR. MICHAEL SMITH**

I hardly know how to respond. A happy day for me would be one when I didn't find it necessary to be in the market buying our shares and we were getting a fair and full value for our stakeholders without our being in the market. But we will use that authorization wisely,

carefully and with discipline to address the valuation when appropriate.

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#### **THE CALLER**

When that happy day comes what do you do with the excess cash?

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#### **MR. MICHAEL SMITH**

I don't know, but what a terrific opportunity it will be to focus our other three priorities. We will restate our intention for using cash flow. Our first and highest priority is to continue to invest in technology that allow us to capture the full value of our Vision as a very efficient company driving administrative costs down, creating more value in our products and being an easier payor to do business with.

We will also, as you know, remain active and opportunistic in the M&A area and when possible deploy that capital to make acquisitions that complement our strategy. And finally as I reported in the fourth quarter, we will continue to also look at the other element of our capitalization. Anthem incurs debt cost that we believe carry and reflect the lingering high marginal cost of debt from surplus notes that we privately placed in our mutual days and we continue to examine the appropriateness of retiring debt as well as equity.

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#### **THE CALLER**

Great. Thank you very much.

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#### **THE OPERATOR**

Joshua Raskin from Lehman Brothers.

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#### **THE CALLER**

Thanks. Question on the medical cost trends, and Larry sort of mentioned that you are seeing specifically a little bit lower even than the expected trend for full year in the first-quarter. I'm wondering if that does persist, if you were to see similar trends in either 2Q or 3Q, how should we think about the impact, would we expect to see some prior period reserve development, and I know it is a little bit early but how would that impact your pricing forecast for '04 and beyond?

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#### **MR. LARRY GLASSCOCK**

First of all Josh, I want to reemphasize what Mike said earlier and that is one quarter does not really affect our thinking in terms of what we are doing in pricing. I mean we are pricing basically as we talked about in the fourth quarter when we discussed our guidance to price for trends. So we want to see this developed further before we are doing anything in terms of adjusting our pricing. So the point I want to make is we are going to stay very disciplined and I wouldn't want to project beyond that.

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#### **THE CALLER**

So until we see it, it's hard to say when you guys would reflect that as a full trend?

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#### **MR. LARRY GLASSCOCK**

That is correct.

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#### **THE CALLER**

Just a quick question on the pricing as well. Are you guys seeing any what you would characterize as competitive pricing or even irrational pricing in the markets, anywhere specific?

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**MR. LARRY GLASSCOCK**

I think that pricing still continues to be very disciplined in the marketplace and we're certainly being very disciplined in our own company. And as I talked about earlier, we've exited those situations where we didn't think they made sense for us. So again we are not experiencing on any wholesale basis irrational pricing from any of our competitors.

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**THE CALLER**

Just one last question on the membership side. The strong growth in the National accounts I take it is likely driven by a lot of BlueCard there. Can you give us just a rough percentage of that of how much was control plan for you guys?

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**MR. LARRY GLASSCOCK**

Sure, if you were to look at our membership in the quarter and exclude BlueCard we had still a very strong, about three percent growth in membership. If you look at where -- if you look at that year-over-year, I mentioned earlier we were just under 10 percent in terms of year-over-year enrollment growth. If you were to exclude BlueCard that would be approximately 6 percent growth. In the economy that we have been in, we are extremely pleased with our growth and frankly, very pleased with BlueCard as well because renting our networks is part of what we do to with other members in the Blue system.

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**THE CALLER**

Just to sort of clarify, in terms of the BlueCard wins that you are seeing, the number of accounts that you have sold, what percentage of that membership that is coming on has been in states that you guys operate as the Blues versus how much of the membership is coming through addition?

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**MR. LARRY GLASSCOCK**

To what I said earlier, all 23 accounts that we sold in the first-quarter were accounts that were headquartered in our states and therefore we are the control plan. The number you saw is the number that again is our business directly.

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**THE CALLER**

Okay.

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**MR. LARRY GLASSCOCK**

I want to make sure that I've given you enough detail.

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**THE CALLER**

I understand the sales obviously in terms of the impact, but you guys include the membership from companies that are headquartered in states that you don't operate as a Blues member. Just wondering what the impact of those have been? Has there been more growth in your core markets versus external or is the entire nation seeing --

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**MR. LARRY GLASSCOCK**

Actually the Blue plans nationally, those of us that are focused on National account business are all doing very well.

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**THE CALLER**

Thanks.

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## THE OPERATOR

John Rex from Bear Stearns.

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## THE CALLER

Just a follow-up on BlueCard. I just want to get a little more color on kind of the things you are seeing developed in that market, in particular with your vantage point on the host side and the growth there. Are you seeing that, as you see that come in more from brand new account wins that other Blues are getting in this area in the self-funded area, are you seeing it more of just further penetration of accounts that were already maybe partially Blue members? Can you just give us some of the dynamics that you see driving that market?

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## MR. LARRY GLASSCOCK

First of all I think it is fair to say we are experiencing both. But we are seeing a lot of new, just brand-new account wins. If you think of it, and I think this was a great win for the Blues, you may recall last year when Premera announced that they had won the Microsoft account. And there are many stories like that around the Blue system where we are picking up new accounts to the Blues. But having said that we are also picking up some additional members in some plans as there are some consolidation among employers but into fewer carriers.

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## THE CALLER

But a bit weighted towards outright new account wins you would say?

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## MR. LARRY GLASSCOCK

Yes, for us very significant new account wins.

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## THE CALLER

Just also following up on the trend guide you gave that is very helpful. It is fair to assume then and what I'm taking away from this is while you are seeing a 10 percent trend in the isolated Q1 that you that your accruals that you booked in Q1 would have been at the higher kind of twelve-month rolling forward trend that you saw?

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## MR. MICHAEL SMITH

John, this is Mike. That is accurate. While our risk management process will always consider the most recent trend obviously as we stated, we would not expect our actuaries to be making their adjustment of the ultimate expected liability based only on the last 90 days, they will look at the longer period. So the reserve which as you know is up about 7 percent from the end of the year, faster than the rate of growth of the fully insured membership and consistent with the longer period measured trend, you are quite right, it would reflect that longer horizon conservatism.

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## THE CALLER

Perfect, thank you.

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## THE OPERATOR

Eric Veiel from Deutsche Bank.

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## THE CALLER

Thank you. Just a quick follow-up on John's last question. I just want to make sure -- certainly the emphatic nature of your voice wasn't lost on the end of the prior period development comments that you made. I just want to make sure I understood when you said no unusual favorable development in the quarter, if we looked at sort of the last couple of years where your current period recovery of prior year incurred has been

about 2 percent, can I take from your comment then that that is about how you are tracking now? Is that a correct way to interpret your comment?

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**MR. MICHAEL SMITH**

I actually think that it is for the most part correct. Let me give you a little broader answer though. We have spiked out two isolated items related to reserves, as you've heard throughout the call. The Dardinger case which was mentioned in Q4 reclassified out of the IBNR but as that matter was settled it is reserve related, it is part of total policy liability. We also spiked out the Colorado case.

We also indicated as I have just repeated that on an overall basis policyholder liabilities have grown over \$120 million since the end of the year, up 7 percent at a time that systems were stable, methodology was consistent and membership was growing at a slower rate. It is not unreasonable for you to deduce then that when we say consistently conservative, that the margin that is in each period's restated liability is being preserved at that very conservative margin level.

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**THE CALLER**

That is very helpful Mike, thank you. Just a quick follow-up. Are you guys just going to do a roll forward at the end of the year, the table?

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**MR. MICHAEL SMITH**

Actually we are still likely to respond to the very high level of interest and put additional detail in our second-quarter release. I will make that call again based upon our grounding and our discipline around the specific GAAP guidance. If we believe a change in the estimate, a la APB 20, or the need to restate a roll forward as provided in other specific literature, calls for us to provide that on an interim basis, we will be there. Our policy remains as it has been from day one. Where we've made a material change in an estimate of a

liability, we owe you that full disclosure and will make it. And that's where we stand.

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**THE CALLER**

Perfect. That's great. My second actually is back on the PBM side, when you convert the members at Medco for Trigon over, is your mail facility capacity-wise going to be in good enough shape as it currently stands to take on all those extra members or should we be looking at some capacity expansion between now and the end of the year?

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**MR. MICHAEL SMITH**

We have ample capacity to handle that additional volume in our Mason, Ohio based facility.

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**THE CALLER**

Thank you very much.

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**THE OPERATOR**

Matthew Borsch from Goldman Sachs.

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**THE CALLER**

Thank you and congratulations on the quarter. Quick question, first is on the risk versus nonrisk enrollment. Do you have, can you give us sort of target for where you think you will be year end risk versus nonrisk on your whole book of business?

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**MR. MICHAEL SMITH**

As Larry indicated on our membership now, the 11.5 million members, we are saying maybe another 90,000



shift. So it will not be material to the overall mix of business. We are at 53/47 and I would not expect that to change dramatically over the balance of the year.

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#### **THE CALLER**

Thanks. On the subject of National accounts, can you elaborate a little bit about what you mean in terms of the market being underserved in the East and maybe in the West as well, and where you see accounts of that particular opportunity, in what way they are underserved and what type of companies you might be taking share from?

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#### **MR. LARRY GLASSCOCK**

I think if we -- I think we have used the word underserved in the past. I think if you think about it I would like to put some shape around the East. When we did the acquisitions out in the East, those plans by their strategy and by frankly their capabilities were not really focused on National accounts. And that was true in the West as well.

By virtue of their affiliation with Anthem, we have just bought much more capability in terms of the National account arena to those plans than they had previously. So we are doing very very nicely in the East, in fact of the 23 National accounts that we were able to get so far this year, seven are in the Midwest, eight are in the East, six are in the Southeast and in the West two major accounts. So it's pretty well spread out but you can see we've had very good performance in the East.

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#### **THE CALLER**

Thank you. Just one quick follow-up. Can you remind us what definition you use for National accounts and how you scope that?

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#### **MR. LARRY GLASSCOCK**

We essentially use, we put in there accounts that have more than what fifty contracts, in another non-Anthem state.

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#### **THE CALLER**

Great. Thank you.

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#### **THE OPERATOR**

Michael Baker from Raymond James.

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#### **THE CALLER**

Earlier you announced the in-house opportunity or move for Specialty pharmaceuticals. I was wondering if you could outline that opportunity for us, give us some color on that as well as indicate why you decided to go in-house versus outsource?

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#### **MR. LARRY GLASSCOCK**

First of all, you are talking about insourcing the entire PBM operation?

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#### **THE CALLER**

The Specialty pharmaceutical, the injectibles piece of it. You had a recent announcement that you were going to pursue that on an in-house basis.

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#### **MR. LARRY GLASSCOCK**

What we are doing is we are focused on bringing in essentially the Specialty pharmacy that goes currently through the pharmacy as opposed to hospital setting or

even physician office setting. We are spending as best we can determine, about \$500 million per year on these Specialty pharmacy drugs and about 30 percent of that is really held, we think by the retail pharmacies. So we think the easiest area frankly to go after on the front end is focusing as I said earlier on that retail pharmacy sector.

So we are increasing the conversion to mail order by really educating our members because a lot of our members obviously use mail order for other drugs which they use. So what we have done is just make the member aware of the fact that we now offer these Specialty drugs through our mail order delivery process. So we are seeing some real traction here. In fact in the first quarter we processed around 2,000 Specialty pharmacy scripts per month and that is up very sharply from the first quarter of '02 where we did maybe around, I'm trying to remember, maybe 1,400 per month. So again we are very pleased with the way this is going.

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#### **THE CALLER**

Larry, maybe you could talk a little about -- provide us with some color on your decision process in terms of doing that yourself versus using one of the specialty providers already out in the marketplace.

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#### **MR. LARRY GLASSCOCK**

As you can appreciate the nature of our company is to look at things in great detail. As part of this process we looked at going outside as well as doing it on our own. After a very thorough analysis which included a look at it by the Board which includes Mike Smith and Dave Frick and others, we decided we could really add value by doing it ourselves.

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#### **THE CALLER**

And finally I was wondering with the Trigon members you are bringing over, what their script volume is running or tracking at?

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#### **MR. LARRY GLASSCOCK**

I don't have that in front of me. I'd be happy to do some work on it and get back to you.

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#### **THE CALLER**

Thank you.

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#### **THE OPERATOR**

Our final question comes from Jason Moment from Farallan. There are no further questions. Please continue sir.

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#### **MR. LARRY GLASSCOCK**

Again I want to thank all of you for participating in today's call. As I said and as Mike has reenforced, we are very pleased with our first quarter performance and we are very confident that our earnings momentum will continue. We believe Anthem is very well positioned for growth in each of our four geographic regions due to the fact that as you know we had very strong market share positions. We believe we offer very distinctive service and incredible focus on this details oriented business.

Although it is still very early in the year I wanted to also let all of you know that Anthem will hold its first investor conference later this year on November 18th, and we're going to do that right here in Indianapolis. So I hope you will mark your calendars and join us. We look forward to hosting you here. Again thank you for your interest in Anthem and have a terrific day.

## THE OPERATOR

Ladies and gentlemen, this conference will be available for replay after 12:45 PM today until May the 14, 2003 at midnight. You may access the AT&T executive play back service at any time by dialing 1-800-475-6701 and entering the access code of 667897. International participants may dial 1-320-365-3844. This conference has concluded and thank you for using and -- participating and using AT&T executive teleconference. You may now disconnect.

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