

FINAL TRANSCRIPT

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WLP - Q1 2007 WellPoint, Inc. Earnings Conference Call

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Apr. 25. 2007 / 8:30AM, WLP - Q1 2007 WellPoint, Inc. Earnings Conference Call

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PRESENTATION

Apr. 25, 2007 / 8:30AM, WLP - Q1 2007 WellPoint, Inc. Earnings Conference Call

Operator

Ladies and gentlemen, thank you for standing by and welcome to the WellPoint conference call. At this time all lines are in a listen-only mode. Later, there will be a question and answer session. Instructions will be given at that time. (OPERATOR INSTRUCTIONS). As a reminder, this conference is being recorded. I would now like to turn the conference over to Mr. Wayne DeVeydt. Please go ahead, sir.

Wayne DeVeydt - *WellPoint, Inc. - Chief Accounting Officer and IR*

Thank you and good morning. Welcome to WellPoint's first quarter earnings conference call. I'm Wayne DeVeydt, Chief Accounting Officer and executive responsible for Investor Relations. With me this morning are Larry Glasscock, our Chairman, President and Chief Executive Officer; Angela Braly, our Executive Vice President, General Counsel and Chief Public Affairs Officer, who will become our President and Chief Executive Officer on June 1, 2007; and Dave Colby, our Vice Chairman and Chief Financial Officer.

Larry will begin this morning's call with an overview of our first quarter accomplishments and Angela will provide an update on our leadership transition. Dave will then offer a more detailed review of our first quarter financial performance, which will be followed by a question and answer session.

We will be making some forward-looking statements on this call. Listeners are cautioned that these statements are subject to certain risks and uncertainties, many of which are difficult to predict and generally beyond the control of WellPoint. These risks and uncertainties can cause actual results to differ materially from our current expectations. We advise listeners to review the risk factors discussed in our press release this morning and other periodic filings we make with the SEC. I will now turn the call over to Larry Glasscock.

Larry Glasscock - *WellPoint, Inc. - Chairman, President and CEO*

Good morning and thank you, Wayne. We're very pleased to report a solid first quarter of 2007 with earnings per share that exceeded our prior guidance. In the first quarter, WellPoint reported GAAP net income of \$1.26 per diluted share, up 16% year-over-year. We have met or exceeded our EPS guidance every quarter since our IPO. As a reminder, net income in the first quarter of 2006 was \$1.09, which included \$0.01 per share in net realized investment losses.

Operating revenue reached an all-time high of \$14.8 billion in the quarter, a 9% increase year-over-year. Revenue increases were driven by disciplined pricing and higher membership. We had outstanding membership growth in our enrollment, increasing by 774,000 members in the quarter and with each reportable segment posting gains. Our Commercial and Consumer business added 495,000 members in the quarter and our Senior and State Sponsored business added 254,000 medical members. We had very strong national accounts enrollment in the first quarter, exceeding our estimates, as we added 586,000 members. National accounts continued to be attracted by our superior value proposition, including networks with the largest number of providers and the best discounts, innovative products and outstanding customer service. State Sponsored membership grew by 209,000 members in the quarter, led by enrollment gains in Indiana, Ohio, and Kansas.

Sequentially, our Local Group business declined by 77,000 members and our Individual business declined by 14,000 members. Although we are introducing new products in these segments, these markets continue to be very competitive. We remain disciplined in our underwriting approach and will not trade margins for volume. We added 45,000 Senior medical members in the quarter, as Senior members are attracted to our Blue branded Medicare Supplement and Medicare Advantage plans. From a business mix perspective, approximately half of our membership was fully insured at March 31, 2007 and half was self-funded.

Our new generation of consumer-directed products has been launched in the majority of our Blue states this year and these products are being well-received. We added 291,000 CDHP members in the quarter. CDHP products now represent more than

Apr. 25, 2007 / 8:30AM, WLP - Q1 2007 WellPoint, Inc. Earnings Conference Call

1.1 million members and have grown by 34% just this year. These products use our innovative Lumenos capabilities and will be available in our largest state, California, beginning next month.

We have a number of initiatives under way to continue our strong commercial membership growth. Recent rollouts of Tonik in Connecticut, New Hampshire, and Georgia have been well-received. Tonik sales in the Georgia and Connecticut markets are strong, with the new product accounting for about 19% of sales in Georgia and 18% in Connecticut. Tonik is now available in six of the fourteen WellPoint Blue states and we're currently planning for more rollouts.

In our Individual line of business, we want to become even easier to do business with and to deliver the best web-based capabilities and experience in the industry. We have launched an online sales tool with quick quote functionality. Prospective members want to know what insurance will cost and our redesigned web quoting gets them a quote and range of plan options in seconds.

We're also rolling out voice signature technology to additional markets. This innovation is advantageous to our customers through faster enrollment and less paperwork, and it lowers administrative costs for us too.

While commercial sales remain strong, we also want to improve our retention of existing business. If we can improve our retention rate by just 1% in Individual and Small Group, that would increase our membership by 57,000 members. We are addressing this issue by increasing retention efforts with outbound calls. We have reintroduced the "Come Back to Blue" program that waives a 12-month waiting period for returning groups and we have launched a persistency bonus program. This program has been successful for us in the past, and we expect similar results as we bring it back to our operations.

In addition to adding medical members, our Specialty business continues to grow as well. This month, we smoothly transitioned 2.4 million members to WellPoint Behavioral Health in Indiana, Ohio, and Kentucky. These members were previously handled by an outside contractor and will enjoy enhanced services through the integration of both their medical and mental health benefits.

We also announced that we would not be renewing our relationship with the same third party in New York. Beginning January 1, 2008, WellPoint Behavioral Health will assume responsibility for managing behavioral health and substance abuse benefits for more than 2.0 million members in New York State.

Let me now turn from our growth to some actions targeted to improve the cost and quality of medical care. Blue Cross Blue Shield of Georgia was recently awarded a USDA Rural Development grant to expand access to quality health care for rural Georgians through its telemedicine program. Telemedicine uses the latest advances in medical and information technology to allow patients and their family doctors to consult with specialists at distant locations. The Georgia telemedicine program, the largest rollout of a telemedicine network in the country, will provide 8.8 million Georgia citizens access to the highest quality care possible without the need to travel across the state to get it.

In another initiative that improves the quality of care, we launched an ePrescribing program in January of this year in two Ohio communities that will help reduce medication errors and the time physicians spend managing prescriptions. The ePrescribing pilot provides real-time prescription support to physicians, including access to formularies, "drug to drug" and "drug allergy" alerts and a patient's medication history, including medications prescribed by physicians outside of the practice.

In another initiative, we have launched Online Communities across our member portal. These communities provide our members with a new way of connecting with professional health experts and other patients who have similar health conditions and concerns. Members may choose from more than 30 web-based message boards, monitored by trained WebMD moderators, that address a variety of health topics, including cancer, diabetes, depression, and many others. Members will access Online Communities through our secure member portal. These interactive communities are integrated with our comprehensive suite of online health tools, providing our members with a personalized online experience.

Apr. 25. 2007 / 8:30AM, WLP - Q1 2007 WellPoint, Inc. Earnings Conference Call

We are also being recognized for our quality efforts. Last month, the National Committee for Quality Assurance recognized Blue Cross of California. Blue Cross of California is among the first health plans in California to achieve Quality Plus Distinction for physician and hospital quality. The physician and hospital quality standards are focused on four areas, including standardization, transparency, collaboration, and action.

We are also being recognized for our technology initiatives. WellPoint has received four World Wide Web health awards. These awards recognize the best web-based health sites. WellPoint received awards for our online personal health record; our portal to support our growing Senior business, Blue Medicare Rx; the Tonik web site; and our corporate web site "www.wellPoint.com." Winners were selected by an independent panel who evaluated more than 1,000 entries for site quality, accuracy and success in reaching target audiences.

And we're also continuing our leadership with some important data accomplishments. WellPoint is participating in an unprecedented data sharing program developed by the Council for Affordable Quality Healthcare. The program, based on rules drafted by the Committee on Operating Rules for Information Exchange, or "CORE," is designed to link the data collected by health plans, providers and vendors so that doctors can electronically verify their patients' insurance information in 20 seconds or less, significantly improving communication between providers and insurers. WellPoint recently became one of the first health plans to be CORE certified.

Overall, our success is receiving national attention. Last month, WellPoint ranked number one among health insurance companies on Fortune's annual list of America's Most Admired Companies. The list, which Fortune refers to as the definitive report card on corporate reputations, ranks companies on eight key attributes. Fortune's list of America's Most Admired Companies recognizes WellPoint as the leading company in its industry in seven of the eight categories.

I will now turn the call over to Angela Braly, who was recently named one of the top 25 women in health care by Modern Healthcare magazine.

Angela Braly - WellPoint, Inc. - EVP, General Counsel and Chief Public Affairs Officer

Thank you, Larry. I'm pleased to speak this morning about our leadership transition and my vision for WellPoint. Our leadership transition is proceeding smoothly and according to plan. Over the past few weeks, I've met with a number of investors and analysts who follow our Company and I am currently in the process of meeting with our 3,000 managers through the semiannual town hall meetings held in major operations centers across our Company. These include fourteen meetings in thirteen states and video conferencing for many more locations. The Board of Directors chose me, an internal candidate, because of our Company's strong performance, culture, and strategy. I am fully behind our strategic plan and helped develop it. I believe that we will become the most valued Company in our industry by successfully executing our strategic plan. My personal philosophy is to do the right thing, do it for the customer, and do it right the first time. If we consistently conduct business in this manner, we will continue to build member trust in WellPoint.

We're taking a look at our entire consumer experience, doing things like simplifying communications, speaking in easier to understand language and providing prompt and helpful customer service. We have unrivaled innovation, ranging from enhanced transparency to our 360 Degree Health initiative and expansion of our consumer-directed health plans.

We recently established key measures of success for improving the lives of the members we serve through our Member Health Index. The Member Health Index is comprised of 20 clinical indicators that reflect the quality of care an individual has received. These measures focus on prevention and screening, care management, clinical outcomes, and patient safety. We're targeting improvement across all measures. Incentive compensation for all of our associates is impacted by the Member Health Index. Linking progress to incentives represents an effort to ensure that all of our associates are engaged in improving the lives of the people we serve and the health of our communities. No other company in our industry has taken such a bold and public step to improving the health of Americans.

Apr. 25. 2007 / 8:30AM, WLP - Q1 2007 WellPoint, Inc. Earnings Conference Call

Our industry faces challenges and we're taking a leading role to address public policy issues. For example, we maintain on-going relationships with lawmakers and leaders across the country. We've met with President Bush, Governor Schwarzenegger of California and Daniels of Indiana, and H.H.S. Secretary Levitt during this quarter, advocating building on our choice-based private healthcare market that will address the issues of the uninsured and the underserved in our country.

We bring a passion to our work that is motivated by an internal drive to better serve our customers. When we have given them the best service, the most convenience, the widest range of health care choices and access to the highest quality care at the best value, we will transform health care and become the most valued company in our industry. This is my goal as I lead WellPoint and I will work diligently with the executive leadership team every day to make these goals reality.

I will now turn the call over to Dave Colby, who in the first quarter was again named the Top CFO in Managed Care by Institutional Investor magazine. This is the fourth consecutive year that Dave has received this honor. He will discuss our first quarter financial results in detail. Dave?

Dave Colby - WellPoint, Inc. - Vice Chairman and CFO

Thank you, Angela, and good morning. Although we're pleased with our first quarter 2007 earnings per diluted share of \$1.26, which represented a 15.6% increase over the first quarter of last year, it was a quarter with many positive aspects and some areas of concern.

On the positive side, we saw the following favorable indicators during the quarter. Our membership growth was strong for the quarter, adding 774,000 members and is on-track for our 4% expected growth in 2007. Our operating cash flow for the quarter of \$2.0 billion was very strong and represented 2.5 times net income. This strong cash flow resulted in better than expected investment income and we repurchased \$634.9 million of our common stock in the quarter. As a result of our share repurchases, our fully diluted shares outstanding decreased 6.9% between the first quarters of '06 and '07. Also, on the positive side, due to our strong financial controls we were able to identify the higher-than-expected benefit expense ratio early and take management action to delay discretionary expenditures to achieve our targeted earnings per share.

On the negative side, however, our benefit expense ratio did increase by 180 basis points from the first quarter of 2006. While a portion of this increase was expected due to mix changes, some of it was unexpected. The reasons for the increases are as follows.

First, unfavorable trends which began in the fourth quarter of last year in our State Sponsored Program business continued into the first quarter of '07, resulting in a 630 basis points increase in the benefit expense ratio between the first quarter of '06 and the first quarter of '07. This is a problem area that I will discuss further later.

The benefit expense ratio in our senior business increased by 350 basis points from the first quarter of '06 to the first quarter of '07 due to both expected and unexpected seasonality issues. We don't believe this increase is a problem as the seasonality should reverse in future quarters.

And finally, the Commercial and Consumer businesses benefit expense ratio increased somewhat due primarily to the timing of prior period development. This too is not a problem and we remain comfortable that this ratio in 2007 will remain relatively constant with 2006.

Now, let me go through our financial performance for the quarter in more detail. First, premium revenue was \$13.8 billion in the first quarter of this year, an increase of \$1.2 billion or 9.4% due to premium rate increases in Local Group and Senior business, growth in State Sponsored business, and increased reimbursement in the FEP program. Fully insured membership increased by 231,000 members over the past 12 months, primarily due to growth in State Sponsored businesses.

Apr. 25, 2007 / 8:30AM, WLP - Q1 2007 WellPoint, Inc. Earnings Conference Call

Our administrative fees were \$925 million in the first quarter of this year, an increase of \$22 million or 2.4% over the first quarter of last year, due primarily to commercial membership growth.

As previously discussed, the benefit expense ratio was 83.1% in the first quarter of '07, a 180 basis point increase compared to 81.3 in the first quarter of 2006, with the largest part of the increase attributable to the medical businesses of the Specialty, Senior and State Sponsored business segment. A major driver of this increase in the quarter relates to State Sponsored claims experience in certain geographies, which caused the benefit expense ratio to increase by 630 basis points in that line of business between the first quarters of 2006 and 2007. Benefit expense ratios were unacceptably high in two states. We have negotiated rate increases in two California counties and we anticipate receiving rate increases in the remaining California counties effective October 1, 2007. We also anticipate a rate increase in the other state, effective July 1, 2007. Neither of these states is among the five new states we began serving in the past year.

State Sponsored is a business that we watch closely. We remain disciplined in pricing and will take appropriate action if acceptable reimbursement cannot be obtained. As we are working to get these needed rate increases, John Monahan and his team are working to optimize the medical spend by recontracting with providers and implementing additional cost of care related initiatives.

The benefit expense ratio in our Senior business increased by 350 basis points from the prior year, mostly due to Medicare Part D. Medicare Part D has a significantly higher benefit expense ratio in the early part of the year, before members reach the "doughnut hole," and then a much lower benefit expense ratio later in the year. As expected, this seasonality of Medicare Part D business was more pronounced in the first quarter of 2007 as the majority of the membership was effective for a full quarter this year, while the 2006 membership was gradually enrolled during the first five months of 2006. Unexpected, however, was the fact that certain Part D claims in 2006 were incurred in the first quarter but not recorded until the fourth quarter due to the CMS reconciliation process (i.e., claims from State Medicaid programs we discussed in our fourth quarter earnings release). As a result of this being just a timing issue, we continue to expect the Medicare Part D benefit expense ratio to be in-line with our prior full year expectation.

The Company's Commercial and Consumer business recognized a small increase in its benefit expense ratio due primarily to the timing of prior period development. If you exclude those prior period developments, the benefit expense ratio actually declined slightly from the first quarter of 2006 to the first quarter of 2007. Accordingly, we remain comfortable that this ratio in 2007 will remain relatively constant with 2006 experience.

Continued growth in the FEP business, for which we are reimbursed for costs plus a fee, also caused the consolidated benefit expense ratio to increase as this business operates with a benefit expense ratio significantly higher than the Company average. Due to adjusted seasonality estimates and expected actions, especially in our State Sponsored Programs through 2007, we now expect the benefit expense ratio to be 81.9% for the year, which is 40 basis points higher than our prior guidance.

Based upon medical cost trends in the first quarter, we still remain comfortable with our 2007 medical cost trend estimate of less than 8%. We continue to price our commercial business so that expected premium yield exceeds total cost trend, where total cost trend includes medical costs and selling, general and administrative expenses. Our operating gain continues to increase on a PMPM basis, confirming our disciplined pricing. We remain very disciplined in our underwriting approach and we do not chase business that we believe is priced below our profitability targets.

Inpatient and outpatient services continue to drive our medical trend increases. Inpatient trend is in the upper single digits and is related to unit cost increases as utilization has been flat. We continue to design and expand initiatives to optimize our inpatient spend, such as our California Bariatric Centers of Excellence benefit and associated network. We also have our on-site neonatal intensive care program. This program results in savings and was nominated for our Blue Works award.

Outpatient services trend is in the upper single digits range and is mostly unit cost driven. Outpatient services are a collection of different types of services, including outpatient surgery, radiology, laboratory services, occupational therapy, physical therapy,

Apr. 25, 2007 / 8:30AM, WLP - Q1 2007 WellPoint, Inc. Earnings Conference Call

DME, home health and others. We have innovative programs, like the program we announced this quarter, offering selected blood glucose meters at no cost. This will encourage members to improve their health by managing their diabetes well and reducing their health expenses. This is one example of the many value-added customer-focused disease management programs offered by WellPoint that improve the overall cost and quality of care.

Physician trend is in the mid-single digit range, is almost equally divided between cost and utilization and our pharmacy trend is in the mid to upper-single digit range and is about 70% unit cost and 30% utilization driven.

We continue to be innovative in addressing pharmacy trend. Over the next two years, a number of branded drugs are going to lose patent protection and go generic. This quarter, we added simvastatin, generic Zocor, to our generic select program. We're increasing generic utilization by waiving copays for four to six months on patients who switch from a branded statin. We also have initiatives underway to move more specialty drugs from retail pharmacies to our internal specialty pharmacy, where we can monitor usage better.

The SG&A ratio in the first quarter of 2007 was 14.4%, a decrease of 150 basis points from 15.9% in the first quarter of 2006. The ratio improved more than expected year-over-year as we postponed certain discretionary expenditures due to the unexpected claims seasonality experienced in the first quarter. Since we delayed certain discretionary spending until later in the year, we do expect the SG&A expense ratio to increase during the remainder of 2007 and be 14.6% for the year.

Our net investment income increased \$34.5 million or 16.3%, resulting from our strong cash flow and higher short-term investment rates.

In 2007, we now have the following three reportable segments: Commercial and Consumer businesses, or "CCB"; Specialty, Senior and State Sponsored business, or "4SB"; and Other, which includes our FEP business, our National Government Services, intersegment sales and expense eliminations, and corporate expenses not allocated to our other reportable segments. These revised segments are consistent with our new organization structure.

In our Consumer and Commercial business, operating revenue in the first quarter was \$10.4 billion, an increase of \$500 million, or 5%, from the first quarter of 2006, led by disciplined pricing. Operating gain for the Commercial and Consumer business was \$1,014 million in the first quarter of 2007, an increase of 3.2% compared with \$982 million in the first quarter of 2006. The year-over-year improvement was primarily due to premium rate increases across all lines of business and continued overhead expense control, which were partially offset by a higher reported benefit expense ratio.

4SB operating revenue in first quarter of 2007 was \$3.3 billion, an increase of \$553 million, or 19.9%, due to growth in State Sponsored, Medicare Advantage and Medicare Part D business. Operating gain for 4SB segment totaled \$143 million in the first quarter of 2007, a decrease of 13.7% compared with \$166 million in the first quarter of 2006. The decrease resulted primarily from higher seasonality in the Company's Senior business and increases in State Sponsored claims experience in certain geographies, which were partially offset by increased mail order volume in our PBM.

The Other segment operating revenue in first quarter was \$1,080 million, an increase of \$146 million, or 15.6%, due to higher premium in our FEP business. Operating gain for the Other segment totaled \$16.3 million in the first quarter of 2007, an increase from an operating loss of \$12.6 million in the first quarter of 2006. The improvement resulted primarily from lower corporate expenses and continued growth in FEP business for which the Company is reimbursed for its costs plus a fee.

Now, moving to the balance sheet, our current assets were \$14 billion at March 31, 2007, an increase of \$2.2 billion from year end 2006 due to increased cash and investments. Total assets were \$53.5 billion at March 31, 2007, up about \$1.7 billion from year end. Our medical claims payable were \$5.6 billion at the end of the first quarter, an increase of \$381 million from year end 2006.

Apr. 25, 2007 / 8:30AM, WLP - Q1 2007 WellPoint, Inc. Earnings Conference Call

Our days in claims payable as of March 31, 2007 was 44.7 days, a decrease of 0.5 days from the 45.2 days as of December 31, 2006. This decline was due to three factors: the timing of our claim payments, which brought down DCP by 0.4 days; the payment of certain provider settlements related to 2006, which brought down DCP by 0.3 days; and the timing of our PBM payments, which increased our DCP by 0.2 days.

Long-term debt was \$6.5 billion at March 31, 2007 a \$92.4 million increase from year end 2006, resulting primarily from increased commercial paper borrowings. As in the past, our practice is to not include our first quarter roll forward schedule of medical claims payable reserves in our press release because claims have not developed enough in 90 days to be much more precise than at year end. We continue to establish reserves in a consistent and conservative manner and will provide a roll forward schedule in our second quarter 2007 earnings release.

For the three months ended March 31, 2007, operating cash flow totaled \$2.0 billion or 2.5 times net income. The results included the receipt of an additional CMS payment, totaling \$429 million related to the second quarter of 2007. Excluding this additional CMS payment, the first quarter operating cash flow was 2.0 times net income.

As a reminder to our shareholders, cash flow from operations in the second quarter of 2007 will be lower, due to the CMS payment and making two federal income tax payments in the second quarter. Historically, the second quarter is the lowest operating cash flow quarter of the year.

As of March 31, 2007, we had \$2.5 billion of cash and investments at the parent holding company.

During the first quarter of 2007, we repurchased 8.2 million shares of common stock for \$634.9 million. Also, during the quarter, our Board of Directors increased its share repurchase authorization from \$1.0 billion to \$3.0 billion for the year. As of March 31, 2007, the Company's remaining Board-approved share repurchase authorization was \$2.3 billion. The Company intends to utilize that remaining authorization during 2007.

Let me now talk about our updated 2007 guidance. The Company now expects net income of \$5.54 per share, representing growth of 15% in 2006. Our year end medical enrollment is expected to be approximately 35.5 million members, representing growth for the year of 1.4 million members, or 4%. Fully insured membership is now expected to be 17.6 million and self-funded membership is now expected to be 17.9 million.

Our operating revenue is expected to total about \$61.1 billion. The benefit expense ratio, as we discussed, is now expected to be approximately 81.9%. And the SG&A expense ratio is expected to be approximately 14.6%. We continue to expect operating cash flow to exceed \$4.4 billion, or 1.3 times net income. Weighted average shares outstanding are expected to be 618 million for the full year 2007. And, we continue to expect net income of \$1.35 per share for the second quarter of this year.

With that, I will not turn the call over to Larry, to lead a question and answer session.

Larry Glasscock - WellPoint, Inc. - Chairman, President and CEO

Thank you, Dave. Before I open the call up to questions, I would like to reiterate some of Dave's comments. This was a very good quarter for WellPoint in many respects. However, we do have less than acceptable performance in our State Sponsored business in two geographies.

We have very specific action plans to improve profitability, which include: first, seeking actuarially appropriate rate increases. For example, in the majority of California counties, we have only received a 3% rate increase since 2001 despite rising medical costs.

Apr. 25. 2007 / 8:30AM, WLP - Q1 2007 WellPoint, Inc. Earnings Conference Call

Second, we are continuing to implement cost of care initiatives, such as recontracting with laboratories, adjusting physician fee schedules, moving to a closed formulary, and restructuring our hospital-provider networks.

And third, we are continuing to reduce administrative costs by improving automation and workflows in this segment.

It's important to remember that we are a diversified company and State Sponsored business represents approximately 6% of our total membership. I believe we will be successful in returning these geographies to their targeted profitability.

Now, I would like to open the call up for questions.

QUESTIONS AND ANSWERS

Operator

(OPERATOR INSTRUCTIONS). Josh Raskin, Lehman Brothers.

Josh Raskin - Lehman Brothers - Analyst

First question relates to the overall guidance. If I understand the parts, that you gave, it sounds like in terms of changes from last quarter, you beat the first quarter by a penny but you're bringing the revenues down, the MLR up, and it didn't look like there were many changes in the other areas. I'm just curious how the overall EPS number is up a penny?

Dave Colby - WellPoint, Inc. - Vice Chairman and CFO

I think if you go through it, Josh, you'll see that we kept the membership in total constant. We did increase the mix of growth between ASO and fully insured, which brought the premiums down somewhat. We ticked up the medical care ratio, primarily, again, on an annual basis because of the State Sponsored programs. The other ones should work out just fine (Senior and Commercial). And then, of course, because of the stronger cash flow, you're seeing more investment income even with the \$3.0 billion of share repurchases that are now assumed for the year.

Josh Raskin - Lehman Brothers - Analyst

Okay. So, investment income and buyback is what offsets. Then, could you just talk a little about the losses in the Individual business? Maybe if you could give us a couple of geographies? That would be helpful. And, what are you seeing from competitors? Is it just simply pricing actions or is it commissioned payouts or service issues or things like that?

Larry Glasscock - WellPoint, Inc. - Chairman, President and CEO

What I would say is, the commercial market continues to be very competitive and we remain very disciplined in our pricing; and, as I said in my remarks, we're not going to forego acceptable margins in order to either obtain or retain membership. We had a little bit of conversion, in other words a little bit of the decline -- about 40,000 lives converted from insured status to ASO during the first quarter. So, that impacted this somewhat.

But, the marketplace dynamics vary by region. In our Blue markets, we almost always have the largest provider networks and the best unit costs. So, if the competition is taking away from us there, based on price, we believe that in the short run that's possible, but over the long term, it's not sustainable, and, therefore, we will get our membership growth in the way that we think is appropriate to achieve our long-term target, which is 3% to 5% enrollment growth.

Apr. 25. 2007 / 8:30AM, WLP - Q1 2007 WellPoint, Inc. Earnings Conference Call

Dave Colby - WellPoint, Inc. - Vice Chairman and CFO

And I think most of our individuals, actually a lot of them, were in our UniCare business, where we don't have as competitive a network.

Josh Raskin - Lehman Brothers - Analyst

That's helpful. And then lastly, did you mention the second state for Medicaid? Not California, the other one?

Larry Glasscock - WellPoint, Inc. - Chairman, President and CEO

We didn't. And the reason for that is we are in negotiations and we would prefer not to negotiate publicly.

Operator

John Rex, Bear Stearns.

John Rex - Bear Stearns - Analyst

Thank you. I just wanted to focus again on the state program business. And I guess what I'm curious to understand is from when you gave your guidance in December on MCR and then reiterated it with the 4Q report, it wouldn't appear that any premiums would've changed in those markets you're talking about, given kind of the cycles that you described. So, what surprised you would seem to be a utilization issue in those markets and it wouldn't be revenue because you would've had very good visibility on where the revenues were for the year at that point. I'm just wondering if you can just help me understand if that's a correct way to interpret it? And then, what was driving that surprise versus your expectations from February?

Dave Colby - WellPoint, Inc. - Vice Chairman and CFO

I think it was a combination of factors, John, because we have been negotiating with the state for appropriate rate increases that we think are necessary. And some of that we expected to occur. Also, the state did increase the Medicaid fee schedules without increasing our reimbursement. So it increased our unit costs, not really utilization levels.

Our utilization levels have really not been much of an issue in State Sponsored. As a matter of fact, as Larry mentioned, since 2001, we've gotten a grand total of a 3% rate increase yet we've been able to manage the cost of care for that population to maintain a healthy population. But at some point, the gas runs out and it comes down to where we need a rate increase and that's what we're going to work on.

John Rex - Bear Stearns - Analyst

But I guess you would have seen the fee schedule increase by January -- the state fee schedule increase?

Dave Colby - WellPoint, Inc. - Vice Chairman and CFO

Yes. And we would've expected some rate increases too, which didn't pan out.

Apr. 25. 2007 / 8:30AM, WLP - Q1 2007 WellPoint, Inc. Earnings Conference Call

John Rex - *Bear Stearns - Analyst*

So you're saying it's not a surprise on utilization? It just seems like -- the way you describe it: a slow building, low rate -- 3% rate increases over a long period of time -- there would've been more visibility on this.

Dave Colby - *WellPoint, Inc. - Vice Chairman and CFO*

Well, we did start seeing the increases toward the end of last year.

John Rex - *Bear Stearns - Analyst*

Okay, but you had no utilization surprise in the quarter?

Dave Colby - *WellPoint, Inc. - Vice Chairman and CFO*

Well there is a little bit of utilization because obviously the trend winds up increasing because we've been so effective at controlling our costs and utilization.

John Rex - *Bear Stearns - Analyst*

And in that population, did inpatient bed days change or something; one of those components?

Dave Colby - *WellPoint, Inc. - Vice Chairman and CFO*

No, there were no significant changes there.

John Rex - *Bear Stearns - Analyst*

And just the last thing then, it appeared that you've ticked up your pharmacy trend from last quarter just a bit from where you were. I think you described it as mid-single, and now it is mid-single to upper in your outlook. Is there an offsetting component trend that comes down a little bit?

Dave Colby - *WellPoint, Inc. - Vice Chairman and CFO*

Yes, I think we're probably feeling more comfortable on the outpatient area and where that is. We anticipated early this year for the trend to be pretty stable for inpatient and pretty stable for physician. We thought that the outpatient would come down a little bit. We thought the pharmacy may increase a little bit because of some of the synergies that we've gotten through our PBM. They wear off and it just mathematically increases the trend because while those are ongoing synergies they don't repeat in incremental dollars.

Operator

Justin Lake, UBS Securities.

Apr. 25. 2007 / 8:30AM, WLP - Q1 2007 WellPoint, Inc. Earnings Conference Call

Justin Lake - UBS Securities - Analyst

Thanks. First question is around the first quarter MLR on the Commercial side, Dave. I calculate -- I guess I'm still including the FEP in there, but I calculated the -- (making a lot of assumptions) that the Commercial MLR is probably up a little over 100 basis points year over year. First, can you confirm that and then can you kind of talk about, with whatever level of granularity you can, the prior period development issues that you saw in the quarter and what else might have happened?

Dave Colby - WellPoint, Inc. - Vice Chairman and CFO

Your calculation -- I don't want to get into individual ratios -- is not too far off. But what happened throughout 2006, the easiest way to explain it, is that we always have positive prior period development -- normal redundancy. If we looked at it by quarter as it developed each year, the first quarter had less redundancy than future quarters. So, if you actually go back and you were to sort of restate 2006 seasonality based on where claims actually were incurred rather than booked, our medical care ratio in Commercial actually goes down slightly. And that's really what gives us the confidence that this book of business is going to see a relatively constant loss ratio between 2006 and 2007. The fact of the matter is we'll have a little bit easier comparison because, while we had a little bit less redundancy in that first quarter, we caught it up in the second quarter. So, the second quarter comparison will be a lot easier.

Justin Lake - UBS Securities - Analyst

Okay. So you're saying that the second -- so, do you think the MLR on the Commercial side is actually going to turn from up 100 bp to maybe down year-over-year?

Dave Colby - WellPoint, Inc. - Vice Chairman and CFO

No. I think the best guess we have right now, at least based on our book, is that it will be relatively constant.

Operator

Christine Arnold, Morgan Stanley.

Christine Arnold - Morgan Stanley - Analyst

A couple clarifying questions. First, can you confirm that there was, excluding normal claims roll off that you have every kind of first quarter relative to the prior year, that there was no negative development in this quarter related to 2006?

Dave Colby - WellPoint, Inc. - Vice Chairman and CFO

There was no -- there was absolutely no negative development and when you see our roll forward schedule it will continue to be a big number.

Christine Arnold - Morgan Stanley - Analyst

Okay, that's helpful. Then secondly, are you planning to put through focal rate increases? Is that part of your expectation for the commercial MLR improvement the rest of the year? And, if so, when and of what magnitude?

Apr. 25. 2007 / 8:30AM, WLP - Q1 2007 WellPoint, Inc. Earnings Conference Call

Dave Colby - *WellPoint, Inc. - Vice Chairman and CFO*

We're doing our normal rate increases that are planned throughout the rest of the year. Our one area where we are focused on rate increases is really the State Sponsored programs in those two geographies.

Operator

Matthew Borsch, Goldman Sachs.

Matthew Borsch - *Goldman Sachs - Analyst*

I just had a question on the outlook. You addressed this a little bit but it wasn't clear to me. You're bringing up your guidance for consolidated MCR for the year of about 40 basis points and that would appear to cost about \$200 to \$250 million pre-tax for the year, unless I'm doing the numbers wrong, which is possible. The question then is the offset; because you talked about higher investment income related to the strength in operating cash flow this quarter, but your outlook for operating cash flow for the full year I believe is unchanged, as is your outlook on the share repurchase side. So I'm still trying to figure out where the offset is and what it is driven by.

Dave Colby - *WellPoint, Inc. - Vice Chairman and CFO*

The offset is based on slightly higher earnings rates on that portfolio than what we had assumed. So, you will see more investment income. Clearly the first quarter came in higher than what our expectation was. I think that will continue. I think right now it looks like based on the progress we've made, we should be able to complete our share buyback a little bit faster than evenly throughout the year. And so far, we're able to do the repurchases at a lower price than what was originally assumed. So we are getting that benefit.

Matthew Borsch - *Goldman Sachs - Analyst*

Got it, that makes sense. And just related to that -- the question is on the Medicare Part D MCR in the quarter. You wouldn't -- is that something that you -- was there a surprise element on that? In other words, you referred to the moving year-over-year parts, which I understand, but in terms of what you were expecting when we last went over this in late January, was there anything that developed differently relative to your expectations on the Part D MCR?

Dave Colby - *WellPoint, Inc. - Vice Chairman and CFO*

No, again, on the Part D MCR, we expected it to be in that sense a little bit higher in terms of impacting all Senior business because of having all the members in January 1 rather than coming in throughout the quarter. What we had really not anticipated was that we had some claims. If you look at our seasonality in 2006 that were actually recorded in the fourth quarter, that we discussed on our fourth quarter call, related to claims that were actually paid by State Medicaid agencies in the first quarter, earlier in the year. And we had not really factored that seasonality in when we gave our guidance last December.

Operator

Charles Boorady, Citigroup.

Apr. 25. 2007 / 8:30AM, WLP - Q1 2007 WellPoint, Inc. Earnings Conference Call

Charles Boorady - Citigroup - Analyst

Just a follow-up to John Rex's question. In California, you knew the fee schedule information and the pricing ahead of time and you didn't see a utilization surprise. So it seems like this disappointment was really in your own internal planning or budgeting; and I'm wondering is that right or was there something else that took you by surprise?

Dave Colby - WellPoint, Inc. - Vice Chairman and CFO

Expectations on being able to get a rate increase.

Charles Boorady - Citigroup - Analyst

So, you actually did expect the rate increase throughout the quarter that you never got?

Wayne DeVeydt - WellPoint, Inc. - Chief Accounting Officer and IR

We have been negotiating for a rate increase and have not received it yet.

Charles Boorady - Citigroup - Analyst

Okay. On the commercial business, in the press release, you mentioned timing of a prior period development in 2006, whereas the response to Christine's question was that there was -- I might have misunderstood your response to Christine's question, so could you elaborate on this -- the timing of the prior period '06 development?

Dave Colby - WellPoint, Inc. - Vice Chairman and CFO

Yes; let's see if I can explain it a little more simply. We always book in our reserves a factor for moderately adverse development and therefore, when you see us do a roll-forward schedule, it's always a positive number and it's a significant positive number; but it's usually relatively consistent because our methodology is consistent. And, as Christine asked for 2006, we expect to continue to have a positive number rolling through into this first quarter just like we've always had.

The issue that affected the seasonality of the commercial medical care ratio was if you actually looked at the development each quarter last year, in hindsight, we should've booked probably more claims in that first quarter and less in the second because we were slightly under what our normal margin would be in the first; we caught it up in the second. And so, you will see a much more favorable comparison because if -- hindsight being 20/20 -- we would've said the first quarter was a little bit less profitable, the second quarter was a little bit more profitable. But, you book as it develops.

Operator

Carl McDonald, CIBC.

Carl McDonald - CIBC - Analyst

Just wondering if you could quantify the amount of the postponed discretionary spending?

Apr. 25. 2007 / 8:30AM, WLP - Q1 2007 WellPoint, Inc. Earnings Conference Call

Dave Colby - WellPoint, Inc. - Vice Chairman and CFO

Well I think you can calculate it because it would be the difference of what was in our guidance for spend; but it was less than \$100 million.

Carl McDonald - CIBC - Analyst

And also, you picked up some lives from Horizon in the first quarter. Is that included in the enrollment totals or is that being done under some kind of reinsurance arrangement so you don't actually include the enrollment?

Dave Colby - WellPoint, Inc. - Vice Chairman and CFO

That is included in the enrollment. And it's a very small number -- 7,000 lives or something like that; 5,000 lives.

Operator

Tom Carroll, Stifel Nicolaus.

Tom Carroll - Stifel Nicolaus - Analyst

Really quickly, just another clarification off of Charles' question; I guess Christine's too. You say in the prepared remarks on your commercial business, excluding the impact of these prior period developments, the benefit expense ratio declined slightly. Are you referring to the commercial benefit expense ratio there?

Dave Colby - WellPoint, Inc. - Vice Chairman and CFO

Yes, yes.

Tom Carroll - Stifel Nicolaus - Analyst

Okay, so not the consolidated.

Dave Colby - WellPoint, Inc. - Vice Chairman and CFO

Not the consolidated; the commercial.

Tom Carroll - Stifel Nicolaus - Analyst

Okay, okay, good.

Dave Colby - WellPoint, Inc. - Vice Chairman and CFO

If you break down our loss ratios -- our medical between State Sponsored, Senior, and commercial -- commercial really was right in-line. We feel very good there. Senior was up, but that was just more expected and unexpected seasonality. And it's really the State Sponsored where we've got to stay focused. But, as Larry said, the nice thing about being diversified, it's only about 6% of our membership so, we will manage it.

Apr. 25. 2007 / 8:30AM, WLP - Q1 2007 WellPoint, Inc. Earnings Conference Call

Tom Carroll - *Stifel Nicolaus - Analyst*

So, State Sponsored is really the big driver of the change in MLR year-over-year?

Dave Colby - *WellPoint, Inc. - Vice Chairman and CFO*

Yes, and if you look at our 40 basis point increase, a 600 basis point problem in State Sponsored multiplied by 6% or 7% would get you there.

Tom Carroll - *Stifel Nicolaus - Analyst*

Quickly on your outlook. How much of your share repurchase this year is baked into your guidance?

Dave Colby - *WellPoint, Inc. - Vice Chairman and CFO*

\$3.0 billion.

Operator

Greg Nersessian, Credit Suisse.

Greg Nersessian - *Credit Suisse - Analyst*

Bear with me please. I have a four-part Medi-Cal question. The first is, could you just remind us what your membership is in that state? I remember it being in the 800,000 range, but if you could just verify that.

Secondly, in terms of the magnitude of the rate increases that you need in these two counties where you are still negotiating for October 1, could you give us a range of what you need that to be in order for that to be acceptable or actuarially sound from your standpoint? Is it a double-digit rate increase or what?

And then, in terms of if you don't get that rate increase, in the scenario where you don't get that rate increase, do the words "take appropriate action" in the press release -- does that contemplate a potential market exit or even a county exit in California?

And then finally, are those rate negotiations contingent on the outcome of the health care reform proposal in California that's currently being negotiated? Thanks.

Dave Colby - *WellPoint, Inc. - Vice Chairman and CFO*

That is a multi-part question. Let me try to get through. In terms of Medi-Cal and the Healthy Families, we're talking about right around a million members in California, slightly more.

The appropriate action -- we really do believe that we will be able to negotiate an appropriate rate increase. Other health plans have gotten increases that we have not gotten because we've been able to control costs and run a reasonably profitable book of business through our cost of care initiatives. So, I again feel, and I think our people in our State Sponsored area feel, very comfortable that we will reach a negotiation.

Apr. 25. 2007 / 8:30AM, WLP - Q1 2007 WellPoint, Inc. Earnings Conference Call

Larry Glasscock - *WellPoint, Inc. - Chairman, President and CEO*

But we don't want to negotiate in the press.

Dave Colby - *WellPoint, Inc. - Vice Chairman and CFO*

But obviously walking away is always an option.

Greg Nersessian - *Credit Suisse - Analyst*

Okay. And then, just the other parts: what would be the magnitude of the rate increase that you would need for that to be acceptable? And again, just on the health care reform proposal in California and how this is tied up potentially in that.

Dave Colby - *WellPoint, Inc. - Vice Chairman and CFO*

I don't think it's really tied up and we're trying to keep it as separate issues, although part of this health care reform is expanding and improving funding of Medi-Cal for the state. Again, I don't want to get into public negotiations of rate increases, but we're not talking about huge rate increases. You can look at the numbers in terms of what the increase in the benefit expense ratio is and where it was the year before. We can live with.

Operator

Bill Georges, JPMorgan.

Bill Georges - *JPMorgan - Analyst*

We've been sort of going around the edges of what happened with Medicaid. What specifically is it that led the dynamic to sort of go over the breaking point in this quarter? You talked about having a number of years of insufficient rate increases. But you were able to manage a profitable book. What changed in this quarter?

And then, I will just throw my follow-up and get back in queue. What gives you comfort that it's not a secular change in medical cost trend that might spill into the broader marketplace? Or what might already be in the market?

Dave Colby - *WellPoint, Inc. - Vice Chairman and CFO*

Well, if you take California as an example, we have 8 million lives in California; a million of them in our State Sponsored program. In our commercial business in California, our trends are very good -- very consistent. You'll see actually our medical care ratio looks just fine in California on that side. So it is something that we are not seeing on the commercial side, although on the commercial side we are getting rate increases. So we certainly look at it and I don't believe it's beyond.

I think we've done actually an outstanding job -- John and his team -- of finding ways to improve the health status of our beneficiaries there and keep costs down. At some point, though, that low-hanging fruit starts disappearing.

Bill Georges - *JPMorgan - Analyst*

Okay so, those conditions that you were able to manage; eventually that catches up with you?

Apr. 25. 2007 / 8:30AM, WLP - Q1 2007 WellPoint, Inc. Earnings Conference Call

Larry Glasscock - *WellPoint, Inc. - Chairman, President and CEO*

No, what catches up with you is the fact that we've had one rate increase of 3% since 2001 and we've been able to manage that very effectively for a long period of time. And we're being very insistent on the fact that we need rate increase there.

Operator

Scott Fidel, Deutsche Bank.

Scott Fidel - *Deutsche Bank - Analyst*

Just going back to commercial, did you see any impact from higher utilization and high deductible plans in 2006 relative to 2005; just thinking about some of the issues United cited. And what are the cost trends in those products like relative to your overall commercial trends?

Dave Colby - *WellPoint, Inc. - Vice Chairman and CFO*

There's nothing that has been spiked out there. We have a long history, because of our significant Individual Small Group business. We've been in a high deductible plan business for many years and it's been a substantial part of our book. So, we have not seen any surprises or changes in seasonality in those plans. I don't have with me right now exactly what our trend is in high deductible plans versus lower deductible plans.

Scott Fidel - *Deutsche Bank - Analyst*

Just as a follow-up, do you have what your consumer-driven health plan growth was in the first quarter, and how your CDHP membership breaks out between fully insured versus self-funded?

Wayne DeVeydt - *WellPoint, Inc. - Chief Accounting Officer and IR*

Sure. First of all, we were up what 34%, if memory serves me right, in the first quarter. And the way it's breaking out is, it's about consistent with our overall portfolio. It's a 52% ASO, 48% fully insured. And the majority of the business is in health savings accounts.

Operator

Peter Costa, FTN Midwest Securities.

Peter Costa - *FTN Midwest Research - Analyst*

A couple of questions. First, can you break down the 180 basis points of MLR -- exactly what went to each of the four things that you talked about? I suppose we can calculate it if you're not going to give us exactly the numbers but I just want to confirm what it's going to be. And then also, what was the SG&A spend that was postponed specifically?

Apr. 25. 2007 / 8:30AM, WLP - Q1 2007 WellPoint, Inc. Earnings Conference Call

Dave Colby - *WellPoint, Inc. - Vice Chairman and CFO*

The type of SG&A spend that was deferred included some advertising costs and certain projects that were going to get done early in the year that we're just going to do a little bit later in the year; just the sort of normal discretionary ones. We fully intend on spending it because we think they are good expenditures. And again, as that seasonality changes, we believe that there will be room to make those expenditures later in the year.

Larry Glasscock - *WellPoint, Inc. - Chairman, President and CEO*

We feel very comfortable that in the quarter we certainly made the investment that we needed to make to continue to grow our company. So again, these are things that we felt we could postpone and not affect the business in any meaningful way.

Peter Costa - *FTN Midwest Research - Analyst*

And the 180 basis points of MLR, can you break that down to how much? I suppose 50 to 70 maybe is the Medicaid business and 30 to 40 is prescription drug and I don't know, maybe 10 is the federal employees program and then 80 or 90 or so is PPD. Is that about right or can you give us a more accurate number?

Dave Colby - *WellPoint, Inc. - Vice Chairman and CFO*

I haven't actually gone through and done those calculations, but, you can do the math on it pretty easily. FEP was not a whole lot in this -- well, quarter to quarter. The big numbers were the two in the 4SB -- the State Sponsored and Senior, then commercial had some impact too.

Operator

Norman Fidel, Alliance Bernstein.

Norman Fidel - *Alliance Bernstein - Analyst*

My question was about the timing of the favorable developments. I think that's been answered after about the fourth question on that topic. So I will defer to someone else.

Operator

Doug Simpson, Merrill Lynch.

Doug Simpson - *Merrill Lynch - Analyst*

Dave, just given a 630 basis point increase in the Medicaid MLR -- if I read that -- I think that's the number you threw out in the press release -- was Medicaid profitable in Q1?

Dave Colby - *WellPoint, Inc. - Vice Chairman and CFO*

Medicaid would be profitable. I'm not going to comment on the two geographies, though, that experienced the problem.

Apr. 25. 2007 / 8:30AM, WLP - Q1 2007 WellPoint, Inc. Earnings Conference Call

Doug Simpson - Merrill Lynch - Analyst

Okay, and then, just in terms of the rate increases, could you just -- I know this has been beaten to death but I'm just trying to get some way to kind of triangulate to it. Can you give us a sense for how many counties you were talking about for Q1 -- the rate increases you were expecting and you didn't get? And how many counties do you serve in aggregate -- just what percentage of the book would we be talking about?

Dave Colby - WellPoint, Inc. - Vice Chairman and CFO

Well, we've gotten rate increases -- we operate in 11 counties. We got rate increases in two of them. And then we contract on a county-by-county basis. And we do expect to negotiate this year rate increases in those. The other state we do on a more statewide basis and we expect to negotiate that. And I think we are having good conversations for July 1.

Operator

Our last question this morning comes from the line of Joseph France with Banc of America Securities.

Michael June - Banc of America Securities - Analyst

This is Michael June actually for Joe France. I was wondering if you could break out the commercial MLR margins excluding prior period development, since you think that should improve over the year for the last four quarters?

Dave Colby - WellPoint, Inc. - Vice Chairman and CFO

We don't get into loss ratios by segment. But I can say when you back out the difference in prior period, our Commercial loss ratio actually came down, a very small amount, but it came down, between the first quarter of '06 and '07.

Operator

Thank you, ladies and gentlemen. I will now turn the conference back to Larry Glasscock with the Company's closing comments.

Larry Glasscock - WellPoint, Inc. - Chairman, President and CEO

Thank you very much, operator. In closing, I would just like to note that this will be my last earnings call as President and Chief Executive Officer. While I intend to continue to be very active in my role as Chairman of the Board, as you all know, I will be turning the responsibility of running the Company as CEO over to Angela Braly on June 1, and again this is so I can tend to the needs of my family. I will be leaving the Company in truly excellent hands. I've worked very closely with Angela. She has the right combination of business acumen, a shared strategic vision, excellent operational experience, and very importantly, very good health policy knowledge. And I, along with the Board, believe she is absolutely the best person to lead WellPoint's future success.

During my tenure, I've had the privilege of working with some truly wonderful people, including the executive leadership team that many of you know, our associates, our customers, our analysts, and our shareholders. Our Company has a bright future with what we all believe is an excellent strategic road map to help us achieve our vision of transforming health care and becoming the most valued company in our industry. With our results to-date, we are well on our way to achieving this very important vision. So again, I want to thank each and every one of you for your interest this morning and hope you have a great day.

Apr. 25. 2007 / 8:30AM, WLP - Q1 2007 WellPoint, Inc. Earnings Conference Call

Operator

Ladies and gentlemen, this conference is available for replay. It starts today at 1:45 PM Eastern, will last until May 8 at midnight. You may access the replay at any time by dialing 1-800-475-6701. International parties please dial 320-365-3844. The access code is 857269. (OPERATOR INSTRUCTIONS). That does conclude your conference for today. Thank you for your participation. You may now disconnect.

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Apr. 25. 2007 / 8:30AM, WLP - Q1 2007 WellPoint, Inc. Earnings Conference Call

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