FINAL TRANSCRIPT

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WLP - Q3 2006 WellPoint, Inc. Earnings Conference Call

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the WellPoint conference call. (OPERATOR INSTRUCTIONS). As a reminder, this conference call is being recorded. I would now like to turn the conference over to the Company management. Please go ahead.

Wayne DeVeydt - *WellPoint - Chief Accounting Officer & Executive, IR*

Good morning and welcome to WellPoint's third-quarter earnings conference call. I am 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, and Dave Colby, Chief Financial Officer. Larry will begin this morning ™s call with an overview of our third-quarter accomplishments. Dave will offer a more detailed review of our third-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.

In addition, our discussion will include non-GAAP financial measures such as comparable basis information as defined under the SEC rules. As required by the rules, a reconciliation of those measures to the most comparable GAAP measures is available on our website at www.WellPoint.com.

I will now turn the call over to Larry Glasscock.

Larry Glasscock - *WellPoint - Chairman, President & CEO*

Thank you, Wayne, and good morning, everyone. We are very pleased to report an excellent third quarter of 2006 with record revenues and earnings and higher pre-tax and after-tax margins than in the first half of this year. In the third quarter, reported GAAP net income of $1.29 per diluted share was 26% higher than the third quarter of 2005. This included a tax benefit of $0.04 per share, resulting from a lower effective tax rate due to changes in state tax apportionment factors following the WellChoice acquisition.

In addition, it included $0.01 per share in net realized investment gains and, as expected, $0.05 per share in stock option expense. This performance marks the 20th consecutive quarter, every quarter since our initial public offering, that we have met or exceeded our earnings guidance.

During the quarter we announced a new organizational structure focused around two strategic business units: Commercial and Consumer Business and Specialty Senior and State-Sponsored Business, or as we call it internally 4SB. Effective November 1, John Watts will lead Commercial and Consumer Business and oversee individual, local group and national account businesses throughout the country. Joan Herman will continue to run 4SB. Mark Boxer, another one of my colleagues, will assume responsibility for service operations, in addition to information technology and eBusiness. And then finally, Angela Braly will lead the Federal Employees Program in addition to her current responsibilities as General Counsel and Chief Public Affairs Officer. As you know, Angela also continues to be responsible for overseeing our Medicare government services business.

This new structure will capitalize on our ability to implement a national customer-focused approach at the local market level. With this structure, we expect to achieve even greater scale and efficiency while continuing to deliver outstanding service to our customers and maintaining our strong local presence.

Turning to the quarterly results, operating revenue totaled $14.2 billion in the quarter, a 29% year-over-year increase and a 12% increase on a comparable basis. Comparable basis information throughout our discussion today has been calculated by adding the historical information for WellPoint and WellChoice. Comparable revenue increases were driven by disciplined pricing, the New York State Prescription Drug Benefit contract, the new Medicare Part D business and increased reimbursement in the Federal Employee Program. Our membership has increased by 558,000 members or 2% on a comparable basis from September 30, 2005 with every region contributing to our growth. This growth is after covering the loss of almost 410,000 members in two groups we have previously discussed.

Sequentially our fully insured business increased by 70,000 members lead by state-sponsored membership. Our self-funded business declined by 43,000 members sequentially due to the third quarter loss of the 95,000 member very low margin ASO account in California that we discussed last quarter.

At September 30, 2006, our funding mix remained one-half self-funded and one-half fully insured. National account business, including BlueCard, has been the primary driver of our membership growth over the past year with membership increasing by 765,000 members or 9%. We expect our success in this market to continue next year as our 2007 selling season for National Accounts is almost complete.

Based upon our known account wins to date, we expect robust membership growth in the first quarter of 2007. National account employer groups continue to look for ways to manage their health care costs. Some are making benefit plan changes in co-insurance and co-payment levels and some are introducing high deductible plans. In addition, many employers are looking at lower-cost network alternatives. They also are taking a more active role in managing the health of their employees through wellness programs and health incentives to improve the health of their employees and optimize benefit costs. Our investment in these programs has positioned us well to serve our customers.

National accounts continue to be attracted by our strong value proposition, including the largest provider network in the country with very competitive discounts and high-quality facilities. Our members have network access to more hospitals listed in US News & World Report's "Best Hospitals 2006" than members of any other national health plan. Our networks are a sustainable advantage and are one of the keys to our national account success.

Turning to our Large Group business, on a comparable basis, membership declined year-over-year due to the loss of two accounts previously discussed. Excluding these accounts, our Large Group membership would have increased. To stimulate sales in the smaller end of the Large Group market, we launched two new PPO plans in California that are hospital-only plans with generic only drug cards. These are designed to hit lower price points for cost-conscious employers with 51 to 250 employees.

In our state-sponsored business, we added 134,000 members on a comparable basis over the last year and are expecting even more growth. With our recently announced new contracts in Nevada, Ohio, Indiana and Kansas, we expect to add approximately 475,000 managed Medicaid members over the next few quarters. We are the largest managed Medicaid carrier in the country with more than 2 million members currently enrolled. Our success stems from our ability to manage care for this population and our disciplined overall approach to the business. We have been in the Medicaid business for a long time, since 1994, and it is one that we watch very closely.

We have to be disciplined when bidding for new contracts and have been willing to withdraw from markets if state reimbursement makes our products unsustainable. When properly constructed, managed Medicaid is a win-win-win for states, recipients and for WellPoint. States save money under managed Medicaid by paying us less than fee for service Medicaid cost. Medicaid recipients receive better care under managed Medicaid, and we can make an acceptable margin. In these times of state budgetary shortfalls, we expect additional states to expand managed Medicaid programs.

While we are the largest managed Medicaid carrier in the country, it is just one part of our very diversified membership base. Managed Medicaid comprises only 6% of our total membership at September 30 of this year.

In another of our exciting growth opportunities, we are planning to offer Lumenos CDHP products and services in all market segments across the country beginning January 1, 2007. We have already sold a number of accounts for January 1, representing tens of thousands of members and are actively quoting on many more individual and group prospects. Market support is building for this product in all states, and we have seen significant interest from brokers.

In Connecticut, for example, we hosted a sold out producer event earlier this month with 350 producers attending to hear about our innovative product rollout. This is a wonderful indication that our markets are ready to hear about our consumer directed health plan solutions, and frankly, we have a lot to say. Combining WellPoint's provider network advantages with Lumenos ™ state-of-the-art consumer-driven capabilities has given us a superior product in this growing marketplace.

We have opened dedicated CDHP call centers in Richmond and in Indianapolis. They are using our new education-focused service model to ensure consumers have the information they need to make an informed decision about these plans. Updated information about these plans is available on our websites in states where regulatory approval has been finalized.

In addition to CDHP plans, our senior business is poised for future growth. The Center for Medicare and Medicaid Services released competitor Part D bids last month, and we believe our products are well positioned. We currently have approximately 1.6 million Part D members. Based upon our bids, we will retain almost all of the dual eligible members currently assigned to us, and we will have the opportunity to add additional dual eligible members for 2007 in a majority of the regions of the country.

As we move into 2007, we have expanded our Medicare Advantage Private-Fee-For service plans throughout the country. We have very attractive Medicare Advantage plans and are actively promoting them in selected markets as we move into the open enrollment season for senior business.

The number of seniors in America will double over the next 25 years. A recent Roper/ WellPoint survey found a notable disconnect between seniors and their adult children on critical health and aging issues. The upcoming Medicare enrollment period provides an ideal opportunity to broaden conversations about health care and aging issues. The time to talk and plan is now.

We are the nation's leading health benefits company and are empowering seniors and their families to talk about health and aging through our new Connecting the Generations educational initiative. WellPoint is committed to leading the nation's changing healthcare needs and serving the growing and diverse senior population.

To help seniors make decisions, WellPoint has invested in a new Web tool for 2007. This sophisticated and easy to use œLearn, Compare and Enroll Web tool will help prospective members and their adult children, brokers and others to make informed decisions. The tools are designed to provide consumers with valuable information about the Medicare Part D program, including the ability to calculate an estimate of costs under each of our plans.

In addition to technology improvements in the senior market, voice signature technology was rolled out for individual under 65 distribution channels in Indiana, Kentucky and Ohio during the third quarter. Voice signature eliminates the need for a œmanual signature and allows an agent to close the sale over the phone.

We are also focusing on turnaround time as a key component for closing individual sales. Through process improvements in Indiana, Kentucky and Ohio, turnaround time has been reduced by more than 50% since January. These are part of our efforts to make it easier to do business with us and improve sales.

In addition to our Health products, we reached a milestone and saw some wonderful developments in our Specialty division. Anthem Life celebrated its 50th anniversary during the quarter. Our Vision business continued its rapid growth as we moved 232,000 vision members in Virginia from a competing plan to BlueView Vision. We are seeing new sales in each region and have even embedded a vision benefit in Connecticut small group plans effective July 1.

In another very important Specialty initiative, we introduced an innovative Blue dental product in the California Large Group market. Dental insurance is the second most requested employee benefit after medical insurance, but 42% of American employers do not offer dental insurance. We are offering products to meet this need.

I would now like to turn from new products to cost transparency, a topic that is receiving a lot of attention. Our CareCompare tool began operations in the third quarter. It is the nation's first online tool that is capable of generating the most comprehensive information in the industry for common medical procedures. The tool was created collaboratively through a transparency initiative with General Motors, one of our largest National Account clients. Through CompareCare, more than 300,000 members in Dayton, Ohio, including thousands of General Motors employees, will be able to access the total estimated costs associated with nearly 40 specific medical procedures performed in 10 area hospitals. The data available will not only include the cost of the procedure itself, but also the cost of the entire spectrum of care factoring in hospital, physician and anesthesia services. The costs are facility or specific based, so our members can compare what one hospital in Dayton charges for a variety of procedures to another hospital.

By offering actionable information to our members, we are better positioned to become the most trusted choice for consumers and the leader in affordable quality care. While we are focused on cost-effectiveness, we also focus on quality medical care. This quarter we were the first health plan to announce coverage of the new vaccine for HPV and cervical cancer.

In another quality initiative, our health plans in seven states are collaborating with dozens of hospitals in the 2006 Quality Insights Hospital Program known as Q-HIP. This innovative quality initiative launched initially in Virginia recently received a œBest of Blue award from the Blue Cross and Blue Shield Association. Q-HIP offers participating hospitals financial incentives linked to meeting specific performance objectives focused on improving patient safety, health outcomes and satisfaction. Short-term, Q-HIP will help reduce the rate of medical errors, improving patient health outcomes and increasing satisfaction. Long-term, reducing medical mistakes that cost the healthcare system billions each year will lower the cost of health care for everyone. This is part of our mission to improve the lives of the people we serve and the health of our communities. We continue to expand this program through hospital contracting.

Our hospital contracting distinguishes us in other ways as well. Our local decision-making model and the strategy we use of multi-year contracting drives better predictability and allows us to not have to be at the bargaining table each year. While we negotiate thoroughly, we try to position win-win situations.

In addition to our contracting initiatives, we are continuing to address selling, general and administrative expenses as a percentage of revenue. Our SG&A ratio was 15.5% in the third quarter of this year, 110 basis points lower than in the third quarter of last year on a comparable basis, despite covering $47 million in stock option expense in the third quarter of 2006.

In future years, we expect to continue to reduce our SG&A ratio, in part with better use of technology. We continue to drive greater levels of EDI transactions which yield administrative cost savings. We reached new highs this quarter with an EDI rate of over 79%, 2 percentage points higher than in the third quarter of 2005.

Another way we reduce SG&A expense is by delivering on our integration synergy commitments. Our integrations are proceeding according to plan, and we have achieved our third-quarter synergy goals. We are on target to achieve at least 100 million in incremental synergies from our WellPoint/Anthem merger and 25 million from our WellChoice merger in 2006.

Before I turn the call over to Dave Colby, I want to recognize Dave Helwig and Dr. Michael Stocker, two individuals who will soon retire from WellPoint. Dave Helwig has made countless contributions in more than 20 years with the Company. He played a key role in the merger between Anthem and WellPoint Health Networks. His plans include spending more time with his family and serving his community in California.

Dr. Michael Stocker joined WellPoint upon the closure of the Company's merger with WellChoice. He had been President and Chief Executive Officer of Empire Blue Cross and Blue Shield since 1994. He led Empire through its conversion to a for-profit company that created WellChoice, and his plans also include spending more time with his family.

I want to thank each of these gentlemen for their contributions to our Company and wish them and their families all the best.

I will now turn the call over to Dave Colby, who will discuss our third-quarter financial results in more detail. Dave?

Dave Colby - *WellPoint - CFO & EVP*

Thank you, Larry, and good morning. We are very pleased with our third-quarter 2006 earnings per diluted share of $1.29, representing yet another quarter of record earnings and a 26.5% increase in earnings per share over 2005. As Larry noted, this included $0.04 per share in tax benefits resulting from a lower effective state tax rate due to changes in the Company's state tax apportionment factors following the WellChoice acquisition and $0.01 in net realized investment gains. As expected, our earnings per share for the quarter included $0.05 per share in FAS 123R stock option expense. If you exclude the tax benefit, the net realized gains and the stock option expenses, our diluted earnings per share still increased by 26% year-over-year.

A significant driver of third-quarter year-over-year changes relates to the inclusion of WellChoice operations following the acquisition on December 28, 2005. Where appropriate, my financial commentary this morning will compare current results to three months of WellPoint and WellChoice on a combined basis for the third quarter of 2005 which I will refer to as œcomparable basis information.

In terms of premium revenue, it was $13.2 billion in the third quarter of 2006, an increase of $1.5 billion or 12.9% on a comparable basis over the third quarter of 2005, due to disciplined pricing, the addition of the New York State Drug Contract, enrollment in Medicare Part D products and increased reimbursement in the Federal Employee Program. On a comparable basis, fully insured membership increased by a 21,000 members over the past 12 months as new sales remain strong but are partially offset by lapses and in-group attrition.

Administrative fees were $868 million in the third quarter of this year, an increase of $27 million or 3.2% on a comparable basis over the third quarter of last year, primarily due to National Account membership growth. On a comparable basis, self-funded membership increased by 537,000 members or 3.3%.

Our benefit expense ratio was 81.3% in the third quarter of this year, an 80 basis point higher ratio than the third quarter of last year on a comparable basis. The 80 basis point increase primarily resulted from the addition of the New York State Prescription Drug Contract, which has a higher than average benefit expense ratio, and increased medical expenses in the Federal Employee Program, for which we are reimbursed for our costs plus a fee.

Sequentially the benefit expense ratio increased by 10 basis points from 81.2% in the second quarter of this year. Increased medical expenses in the Federal Employee Program resulted in a 20 basis point increase in the benefit expense ratio that was partially offset by other items, including a favorable sequential impact from Medicare Part D.

For the first nine months of 2006, the benefit expense ratio increased by 20 basis points on a comparable basis over the first nine months of 2005 due to New York State and Medicare Part D drug programs. This demonstrates our ability to price products to cover medical cost trends.

We continue to expect our 2006 medical cost trend to be less than 8%. Premium yield exceeded total cost trend for the 12 months ended September 30, where total cost trend included medical costs and SG&A expense, confirming our disciplined pricing. The marketplace remains competitive, but we see generally rational pricing, which allows us to achieve targeted margins. Our gross margin -- that is premium minus benefit expense -- increased on a per member per month comparable basis both year-over-year and sequentially. We remain very disciplined in our underwriting approach and will not sacrifice margin for marketshare.

Inpatient and outpatient services continue to drive our medical trend increase. The trend in outpatient services, which is now in the upper single digit range, is mostly unit cost related as we are implementing successful programs like the next generation of radiology management. In these programs, we perform a detailed credentialing process examining equipment and staffing to evaluate quality. This is combined with cost information that is utilized to guide members in selecting a provider of quality services while optimizing health care costs.

Inpatient trend is in the mid to upper single digits and is unit cost driven. Pharmacy trend, which is in the mid-single digits, is about 25% utilization and 75% unit cost driven. Generic penetration has increased to the mid-50% range. We expect it to continue to rise as more consumers recognize the cost savings and efficacy of generic drugs, and we are facilitating this process. Our HealthCore subsidiary recently completed a study on statins. They concluded that by taking Simvastatin, generic Zocor, patients reached their cholesterol level goal as effectively as patients taking branded statins such as Lipitor. When consumers are armed with the information they need to make informed decisions, the results are dramatic. For example, Lumenos' generic substitution rate is 94%. Furthermore, we applaud the actions of Wal-Mart and other retailers to make generic drugs more affordable and increase public awareness of the potential savings. Physician trend is in the mid-single digit range and is about 70% cost and 30% utilization.

The SG&A ratio in the third quarter of this year was 15.5%, 110 basis points lower than the third quarter of last year on a comparable basis. Our SG&A ratio improved significantly year-over-year as we continued to control spending, spread administrative expenses across a larger revenue base and realize integration synergies and efficiencies. We began expensing stock options in 2006, and this increased our SG&A ratio by 30 basis points. We expect to continue to see our SG&A ratio decline in future years as we control our spending and spread our administrative expenses over a larger membership base.

Net investment income was higher in the third quarter of 2006 than in prior years due to strong operating cash flow, higher interest rates and the addition of the WellChoice investment portfolio. While amortization and interest rate expense in the third quarter were consistent with the second quarter of this year, they were higher than last year due to the WellChoice transaction.

On a business segment basis, our Healthcare segment consists of our three health insurance geographic regions plus National Accounts, as well as Senior and State-Sponsored Businesses. In the third quarter of this year, operating revenue in our Healthcare segment was $13.6 billion, an increase of $1.5 billion or 12.8% on a comparable basis to the third quarter of last year led by disciplined pricing, the New York State Prescription Drug Contract and Medicare Part D products. Operating gain was $1.1 billion, an increase of $88 million or 8.7% on a comparable basis over the third quarter of 2005. The operating margin was 8%, a 30 basis point decline on a comparable basis primarily due to a business mix shift, including the addition of lower margin government business and stock-based compensation expense in accordance with FAS 123R.

The Specialty segment includes Pharmacy, Specialty Pharmacy, Dental, Vision, Life, Disability, Behavioral Health and our Workers' Compensation businesses. In the third quarter of 2006, operating revenue in that segment was $903 million, an increase of $126 million or 16.2% on a comparable basis from the third quarter of last year. The main drivers were higher script volume with the addition of Medicare Part D and an increase in our specialty drug business. Operating gain in this segment was $129 million, an increase of $29 million or 28.4% on a comparable basis, primarily due to higher prescription volume with the addition of Medicare Part D and growth in our ongoing specialty operations. Our Specialty businesses generally generate higher margins than our health business, and we expect continued growth in our Specialty businesses.

Now moving to the balance sheet. Current assets were $11.6 billion at September 30, an increase of $101 million from year-end 2005, as our receivables have increased as our revenues have grown. Total assets were $51.5 billion at September 30, an increase of $175 million from year-end 2005. Our medical claims payable were $5.3 billion at the end of the third quarter, an increase of $456 million from year-end 2005.

Days in claims payable reported at September 30 of this year were 45.6 days, an increase of 8/10 of a day in the quarter. The increase was primarily attributable to first the timing of our PBM claim payments, which increased days claims payable by .3 days. We did have an increase in our claims cycle turnaround times as we have been migrating away from certain legacy claims systems, which increased it by .2 days. The acquisition of QualChoice increased it by .1 days and then we had miscellaneous items that added another .2 days.

We have included in our press release a reconciliation and roll-forward of our medical claims payable reserves. This disclosure is comparable to the reconciliation provided in our second-quarter 2006 press release. We calculate the percentage of prior year redundancies to total incurred claims recorded in the prior year in order to demonstrate the adequacy and consistency of our prior year reserves. Including the operations of WellChoice and WellPoint Health Networks for the nine months ended September 30, 2006 and 2005, this metric was 1.5% and 1.9%, respectively, and in line with our historical pattern. I believe this schedule demonstrates that we continue to establish reserves for medical costs in a consistent and conservative manner.

Our long-term debt was $7.1 billion at September 30, 2006, a $798 million increase from year-end as we executed on our share repurchase program. Even with $4 billion of share repurchases during the first nine months of 2006, our debt to capital ratio was 23.3% at September 30 compared to 21.4% at the beginning of the year.

Cash flow from operations was strong for the quarter. While reported operating cash flow in the quarter was $615 million, or .8 times net income, this amount included only two months of CMS payments, which averaged $448 million per month. If we had received three CMS payments during the quarter, operating cash flow would have been 1.3 times net income for the third quarter. At September 30, 2006, WellPoint had 1.5 billion of free cash at the parent company.

During the third quarter, we used $400 million to repurchase 5.4 million shares of WellPoint common stock on August 17, 2006. Our Board of Directors approved an additional $500 million of share repurchases, raising our authorization to a total of $4.5 billion for 2006. During the first nine months of 2006, we used $4 billion in cash to repurchase 53.4 million shares at an average price of $74.86. As of September 30, 2006 we had remaining share buy-back authorization of $500 million that we expect to complete this quarter, subject to market conditions.

We now expect year-end membership to be 34.3 million at the end of 2006 with 17.4 million fully insured members and 16.9 million self-insured members. Our 2006 operating revenue is now expected to be about $56.1 billion. Our 2006 benefit expense ratio is expected to be 81.0%, and our SG&A ratio is expected to be 15.9% and will increase somewhat in the fourth quarter of 2006 as we spend more on marketing our CDHP and Medicare Part D products, which will benefit future periods. We now expect full-year 2006 GAAP earnings per share to be $4.81, which includes $0.04 per share in state tax benefits resulting from changes in the apportionment factors following the WellChoice acquisition and $0.01 per share in net realized investment losses. Our prior guidance of $4.74 included $0.02 per share in net realized investment losses. The increase in guidance results from our favorable performance in the third quarter. We now expect 2006 operating cash flow in excess of $3.8 billion, including settlement of the multi-district litigation. In October of this year, the court gave final approval to our negotiated settlement, and $209 million was paid to settle those claims.

Turning to 2007 guidance, we are committed to our goal of achieving 15% growth in net income per share in 2007. We are currently finalizing our 2007 plan and will share our more detailed 2007 guidance during our investor day coming up on December 12, 2006 at our California well-being Institute in Westlake Village, California. If you have not yet registered for this conference, please contact our Investor Relations Department and do so, as space is limited.

I will now turn the call back over to Larry to lead a question-and-answer session.

Larry Glasscock - *WellPoint - Chairman, President & CEO*

Thank you, Dave, and now let's open the call up for questions. So I will turn it to the AT&T operator.

QUESTIONS AND ANSWERS

Operator

(OPERATOR INSTRUCTIONS). Bill Georges, JPMorgan.

Bill Georges - *JPMorgan - Analyst*

I was wondering if you have an update on the outlook for potential conversions of existing non-profits? The regulatory environment was unfavorable over the last couple of years, and I'm wondering are you seeing any change there? What your expectations are?

Larry Glasscock - *WellPoint - Chairman, President & CEO*

Well, we believe very strongly that there will continue to be consolidation in our industry. I think, as you know, Blue plans are doing very well in the market, and I think as time goes on here with the investments required for this business and CDHP and HIPPA and all the other things coming down the road, that it is pretty clear that there truly are economies of scale in this business. So again, over time I think the system the system will continue to consolidate.

There was a survey done, now it has been several years ago. But the prevailing view of the Blue Cross and Blue Shield CEOs at the time was that over time we would probably migrate to perhaps fewer than 25 plans. But there are still 38 and they are doing well, and they will continue to look at their strategies and see what makes sense. We will continue to share with plans our strategy and hopefully at some point those strategies line up.

Bill Georges - *JPMorgan - Analyst*

Okay. And as a follow-up, also kind of a higher level question, you have definitely focused a lot recently on expansion in Medicaid. What is your view on Medicare Advantage? Any thoughts on converting members from Part D to full or Medicare Advantage policies?

Dave Colby - *WellPoint - CFO & EVP*

I think our strategy has always been to be number one customer focused. And certainly in all of our markets, we want to provide a range of product offerings to seniors that meet their needs, whether that be a supplement policy to go along with the Medicare fee for service, or a Part D plan, or Medicare Advantage plans. I don't think using the term or trying to switch people over is a terribly customer-friendly and customer first position, although certainly our Medicare Advantage plans are quite profitable. But we are really much better focused on trying to meet what that customer wants and what their needs and expectations are.

Operator

Christine Arnold, Morgan Stanley.

Christine Arnold - *Morgan Stanley - Analyst*

I was hoping you could help us define robust enrollment on the National BlueCard front. This time last year you were seeing about 600,000 members coming online. Is that a reasonable expectation entering next year? Could you also talk about what you are seeing in terms of your at-risk commercial enrollment? Going into next year just roughly speaking, not numbers, but do we see continued stability in that book, or do we see opportunities for net growth?

Larry Glasscock - *WellPoint - Chairman, President & CEO*

We're still working, as I said earlier, on the '07 plan. I guess Dave said that. So we are going to give you much more granularity on this just in the next month or so. But I would say the proposal activity for our National Accounts business has been pretty consistent with prior years. In fact, I think the last time I looked, we were down about four proposals, RFP proposals, coming in versus the previous year.

What we are seeing is, as I said earlier, employers are continuing to look for ways to tightly manage their cost. So, for the moment, I would say robust is still the right term for us to use. We still have a couple of outstanding RFPs that we expect to be finalized over the next few weeks. So again, I would like to defer the full answer on this until we get together in December, and we hope to see you there.

Dave Colby - *WellPoint - CFO & EVP*

I think we will continue to see and achieve our 3 to 5% enrollment growth targets. We will give you better specifics in December.

In terms of our commercial insured, I think that we are going to be well-positioned for growth there because of the addition of the Lumenos plans into our fully insured market. Historically we have only really had those available in our self-insured market. So I think we're in good position, and we will go through it more in December.

Operator

Scott Fidel, Deutsche Bank.

Scott Fidel - *Deutsche Bank - Analyst*

Can you talk a bit about the impact from the Federal Employee business on the MLR? And then also, talk about the impact to the P&L given that this is a cost-plus program?

Dave Colby - *WellPoint - CFO & EVP*

Well, the impact is simple. If you have higher claims in the quarter, we get more premiums to cover it because it is in essence a cost-plus contract. This quarter, the increase in trend, and therefore premiums, because it is close to almost 100% loss ratio, impacted our quarterly benefit expense ratio by 20 basis points.

Scott Fidel - *Deutsche Bank - Analyst*

Okay. And then just as a follow-up, Dave, can you just talk a bit about the potential for future SG&A reductions just in terms of percentage over the next couple of years, what your targets would be there?

Dave Colby - *WellPoint - CFO & EVP*

Well, we have said pretty publicly that we expect to take 150 - 200 basis points out of our SG&A ratio over the next three to five years. That is the type of margin expansion that we believe we need to achieve to continue to get our 15% growth targets, and I think, as Larry mentioned, part of this reorganization and restructuring of the Company is positioning us to take that. Because that is not an insignificant amount of improvement, that we need to do in our own cost structure.

Larry Glasscock - *WellPoint - Chairman, President & CEO*

And again, we spent a lot of time talking about this among our management group, and we are confident in these kinds of numbers. As Dave said, 150 to 200 basis points over the next three to five years we think is really doable.

Operator

John Rex, Bear Stearns.

John Rex - *Bear Stearns - Analyst*

Focusing on your full-year '06 MCR guidance, to get from the 81.3% for the nine months to date to the 81% for the full-year implies a seemingly pretty significant improvement in the 4Q. I am assuming there is something from Part D, but generally going the other direction, you have the impact of your high deductible products. I'm just trying to kind of see how we get that. It appears to be a quite meaningful improvement sequentially. I just wanted to understand how the factors driving that.

Dave Colby - *WellPoint - CFO & EVP*

Well, I think, if you carry the mathematics forward, it is something like an 80.5% or 80.6% loss ratio in the fourth quarter. We do expect Medicare Part D will continue to bring it down. While we do have deductible leveraging, which generally ticks our loss ratio up, the fourth quarter with Thanksgiving and Christmas and the holiday season generally mitigates some of that. Plus, we expect a 20 basis point improvement because we don't expect the FEP business to continue at the pace that they had for the third quarter.

John Rex - *Bear Stearns - Analyst*

So, with the FEP not continuing at that level, that would also impact top-line a bit, right? Because that had some impact on your top-line this quarter I assume.

Dave Colby - *WellPoint - CFO & EVP*

Absolutely.

John Rex - *Bear Stearns - Analyst*

And on the cost vein, can you give us any color in terms of what you are seeing in the hospital market just in terms of whether you are seeing any increased pressure on unit pricing in the hospital market? And also kind of what you are seeing in terms of utilization in terms of the days per thousand particularly?

Dave Colby - *WellPoint - CFO & EVP*

As I said in my prepared remarks, the inpatient trend is almost entirely unit cost driven. We have seen very flat inpatient utilization statistics, both admissions and days per thousand members. I'm not sure there is any more or less pressure there. We are just always trying to get the best deal that we can, that is, as Larry says, a win-win scenario if possible. We are trying to do more of tying increases to quality performance and more incentive payments rather than just a guaranteed rate increase. So we are trying to change our contracting methodology a little bit where that will benefit our members.

Operator

Matthew Borsch, Goldman Sachs.

Matthew Borsch - *Goldman Sachs - Analyst*

If I could just pick up on the line of questioning about utilization trends as you look forward to next year. Let me start the question on your commercial insured book. Are you guys able to track and can you share with us what the average age is in the commercial book and how you think about that impacting utilization as you have got more of the baby boomers moving into the 55 to 65 age category?

Dave Colby - *WellPoint - CFO & EVP*

I do not have the actual average age of our just commercial membership. I did look at it a number of months ago in terms of what our average age of our average member is, and it was somewhere around the 35-year range.

Matthew Borsch - *Goldman Sachs - Analyst*

Do you have any idea, Dave, if that has been increasing or is likely to increase?

Dave Colby - *WellPoint - CFO & EVP*

No, I think it is pretty stable given the markets that we are in, if you look at the type of SIC codes that we cover.

Matthew Borsch - *Goldman Sachs - Analyst*

Okay. And as you look ahead to next year, what do you think in terms of utilization - where you might see a favorable impact or generally on the unit cost side as well, relative to this year? Maybe if I could ask the other side, is there an area that you look at where you might have some concern that you want to watch most closely in terms of a potential for uptick in utilization?

Dave Colby - *WellPoint - CFO & EVP*

Well, I think the area that we continue to stay focused on, because I think it is actually the hardest to manage, is the outpatient utilization. Because it is such a collection of almost cats and dogs in terms of medical services. We're talking about outpatient surgery, imaging, clinical laboratory, home health, DME, rehab, physical therapy, and each one of those have very unique issues and in some cases individually don't seem to be that much. But when you aggregate it altogether, outpatients are a major cost issue for us.

It is also the area where I think things like our Lumenos project where there are more consumer decisions, as opposed to getting admitted to a hospital, where we will see the benefit from more consumerism.

Operator

Charles Boorady, Citigroup.

Charles Boorady - *Citigroup - Analyst*

I just wanted to make sure I captured all of the known large wins and losses you mentioned. There are about half a million in losses due to two large accounts that you knew about. There was the addition that we should be seeing in the coming several months of about half a million Medicaid lives or state-sponsored lives. We know you will be in FEP next year and can assume that is probably about flat. Correct me if I'm wrong. Any other large known wins or losses that you can share with us or backlog that you can share with us, including on Medicare Advantage where you talked about helping employers move some of their retirees into private fee-for-service plans going into '07?

Dave Colby - *WellPoint - CFO & EVP*

Yes, again, Charles, I would prefer to go over the more detailed guidance of where we think we will give adds in December when we have our 2007 plan finalized. But we did have some sizable account losses this year. We talked about two, but there are almost three big ones if you count the state of Georgia, the state of Kentucky and the motion picture deal, that ASO network rental business with 95,000 lives, and you get almost half a million lives that we lost. Yet we are going to be bringing on 475,000 Medicaid lives.

Larry Glasscock - *WellPoint - Chairman, President & CEO*

Again, we will give you more granularity on this in early December. But based on the plan we continue to look at and finalize, we still feel very comfortable, as Dave said earlier, in that 3 to 5% membership growth. As you pointed out, the Medicaid business we have done very well in of late, and that is 475,000 members. It is one of the advantages of having put together WellPoint Health Networks and Anthem, because WellPoint Health Networks brought a good bit of expertise in that Medicaid line as part of that merger, and so we are taking advantage of that in many of the states where we had the Blue license. So we are winning as you saw in Ohio. We are winning in Indiana, which were Blue states of ours. So again, we will give you more detail in about six weeks.

Charles Boorady - *Citigroup - Analyst*

How unusual was the Georgia, Kentucky and motion picture deal this year just to put it in perspective?

Larry Glasscock - *WellPoint - Chairman, President & CEO*

I think the overriding consideration -- Dave touched on this earlier -- is we're going to remain very disciplined in our pricing. If we were not doing that, you almost cannot add enough members to make up for what you give on the margin. So we are going to remain very disciplined, and sometimes that will involve some losses. But again, we are experiencing very good growth because on a net basis we continue to be committed to 3 to 5% enrollment growth. And even with what we have told you and you are aware of the losses, we are still up 2% year-over-year in enrollment growth.

Operator

Carl McDonald, CIBC.

Carl McDonald - *CIBC - Analyst*

I just want to talk about SG&A guidance for this year. It looks like you are expecting SG&A dollar expenses to rise by about $150 million sequentially between third and fourth quarter. Fourth quarter last year even with PDP marketing expenses, it was only up about $15 million. So could you sort of size up what the difference in Medicare spending will be this year and difference in consumer directed spending?

Dave Colby - *WellPoint - CFO & EVP*

I think the guidance that we have -- I think your number may be just slightly high in terms of the increase -- is we are going to put some substantial resources behind this rollout because we think there is good demand for these products. So I don't want to get into exactly what is forecast, but it is tens of millions of dollars.

Carl McDonald - *CIBC - Analyst*

And how will that breakout between PDP and private fee-for-service? Is it going to be spent heavily weighted in one area versus the other?

Dave Colby - *WellPoint - CFO & EVP*

Again, we don't per se try to market one product. You will see a lot of emphasis around trying to show the range of products that we have to try to meet the needs of that customer segment and population.

Operator

Josh Raskin, Lehman Brothers.

Josh Raskin - *Lehman Brothers - Analyst*

In the press release, you mentioned a change in claim cycle times, a little bit of lag as you guys were converting or I guess the systems migrations from the legacy systems. Could you just remind us, is that WellChoice? And then are there any other future migrations of claim systems? And then just to follow up on the tax benefit in the quarter. Is that one time in nature, or would we expect an ongoing benefit from the distribution of income amongst your subsidiaries?

Dave Colby - *WellPoint - CFO & EVP*

The majority of the tax benefit is one time. There is some small amount that goes on each quarter, but this was really a change that affected the deferred tax item on the balance sheet for WellChoice, which is mostly over a long period of time. So the quarterly impact is very small. What was your first question?

Larry Glasscock - *WellPoint - Chairman, President & CEO*

On the migration question, we are migrating Colorado and Nevada to WGS 2.0 and Star. So those are underway. I think I talked in the past about what we are intending to do in '06 and '07. So at least over the next 12 months, we're doing five migrations, the two that I mentioned, and then also a claim system that supported the state business in the East, and then we had a Medicaid system up in Connecticut that we will be retiring. And we also had systems in Missouri and Wisconsin. The majority of conversions in Wisconsin are underway now as well, and those are going well.

Operator

Tom Carroll, Stifel Nicolaus.

Tom Carroll - *Stifel Nicolaus - Analyst*

A question on Medicare: would you suggest you are accelerating your focus on Medicare products? Your prepared remarks on Medicare seemed to have more emphasis this quarter than prior calls.

Dave Colby - *WellPoint - CFO & EVP*

I don't know if we are any more focused. It is certainly a big customer segment. Probably our prepared remarks are focused more on it because we are coming up to open enrollment, a big time for the senior market. I would not read anything other than that into it.

Larry Glasscock - *WellPoint - Chairman, President & CEO*

The bottom line is we are still an incredibly diversified company, and we are expanding our options somewhat in HMO. I think we're going into perhaps seven or eight more counties. We're doing a little bit more in the private fee-for-service. But it is a very balanced approach consistent with what we have done.

Tom Carroll - *Stifel Nicolaus - Analyst*

As a follow-up, could you quantify your Part D operating earnings from first-half '06 into second-half '06? So how dramatic or not was the swing in profitability, if any?

Dave Colby - *WellPoint - CFO & EVP*

Again, I don't want to really get into product line profitability, but certainly it has improved. I mean I think we said that in the first quarter we were running pretty close to 100% loss ratio. But we would get back by the end of the year to a more sustainable government-type margin in that business, and that looks pretty much on track.

Operator

Justin Lake, UBS securities.

Justin Lake - *UBS Securities - Analyst*

My question is on your outlook for the MLR. You have seen a little bit of a change in regards to your mix of business. It looks like you are growing a little bit quicker on the government side. I am wondering what effect that has had on your MLR outlook for this year and going forward?

And then just in general, given the fact that the MLR is maybe a little bit higher than what we were looking for, I'm wondering if there is any way you can kind of give us some color around how the commercial MLR has changed sequentially or year-over-year without kind of pinpointing a number?

Dave Colby - *WellPoint - CFO & EVP*

Again, as I said, I think we are doing a pretty good job of pricing to cover the medical cost increases. Any of the increase in our ratio can be explain by new products like the New York State Drug Benefit, which is a very high loss ratio product, although profitable. Medicare Part D on a year-to-date basis is certainly higher than our average, and our state-sponsored programs, a lot of our fully insured growth is coming in that business, which will run a little bit higher. Their margins are good, and some of our improvement in SG&A is because some of these products have lower SG&A costs than our average product. But I think we are pretty much right where we want to be, which is trying to stay at least by product consistent with our medical care ratio and allow our SG&A savings to drop to the bottom line.

Larry Glasscock - *WellPoint - Chairman, President & CEO*

Again, I think the sequential change of 10 basis points, as David outlined earlier, 20 basis points of change was related to FEP, and that was offset by some favorable impact of Part D sequentially. So we are very pleased with where the third quarter landed there.

Justin Lake - *UBS Securities - Analyst*

Just a quick follow-up on the specialty business. I noticed that the specialty operating income was down $10 million sequentially. I'm wondering if there was anything there in particular?

Larry Glasscock - *WellPoint - Chairman, President & CEO*

Let's see --

Dave Colby - *WellPoint - CFO & EVP*

I think we had, and we mentioned it a little bit at the last call, we did have some one-time items that were favorable in our life business in the second quarter. So I would look at it more on a nine-month basis you will get a much better feel for the growth in specialty products. Because that actually has been pretty good, particularly in the PBM with Part D coming in, and our specialty pharma business is really doing quite well.

Operator

Douglas Simpson, Merrill Lynch.

Douglas Simpson - *Merrill Lynch - Analyst*

I was wondering if maybe you could -- and I know there was an earlier question on M&A -- but could you just remind us how you are thinking about it beyond the traditional Blue deal, and what are some of the opportunities that you are seeing out there? And if you could just give us a sense of deal flow, how many things do you look at, and then what does the activity look like relative to a year ago?

Larry Glasscock - *WellPoint - Chairman, President & CEO*

First of all, our strategy just remains very consistent with what we have talked about in the past, and that is to first of all make sure we continue to invest in the business that we have to make it as robust as we can. And in terms of acquisitions, our emphasis would be first on Blue plans where there are opportunities, specialty product areas where there are opportunities and then also non-Blue branded entities if we thought they made sense and they gave us some concentration in an area that we liked. I would say the M&A committee that we have within the Company meets every two weeks, and we are always looking at various things that we think might make sense. So it is an area that is still an important part of our strategy, and right now we are focused on making sure that we integrate WellChoice very well, and that is going very well. But again, we closed that what, nine months ago.

Douglas Simpson - *Merrill Lynch - Analyst*

Okay. And then maybe just if you could talk to any geographic variations you are seeing in the competitive landscape versus where you were a year ago?

Larry Glasscock - *WellPoint - Chairman, President & CEO*

I think just in terms of overall business, the marketplace is very competitive, but it is always very competitive, and I would not say that, as far as I know, that we are seeing it in any one area more than another. But the important thing is that not only is it competitive, but the marketplace from our view still seems to be rational overall. So, as always as we talked about in the past, you will see occasional circumstances where the pricing might be a little bit unusual at least from our perspective. But again, by and large, it is a very rational market overall.

Operator

Joe France, Banc of America.

Joe France - *Banc of America - Analyst*

There have been a number of fairly nasty provider disputes lately, and I'm just curious on two things. One, do you have any big provider contracts coming up yourself, and what opportunities do the disputes we know about in Florida, Colorado and Nevada present to WellPoint?

Larry Glasscock - *WellPoint - Chairman, President & CEO*

Well, as always, we have a lot of contracts that come up for renewal. The good news is we try to manage them in a way that they don't all come up in the same market at the same time.

I would say in terms of whether the marketplace is more contentious or not, it is always a challenge. And so I would say some of them are a little bit more public perhaps than what they had been in the past, but it is not always contentious.

As Dave said, we're trying to make sure that we do the right thing for our customers, and we are going to negotiate the best deals we possibly can. I think, as I look at the competitive marketplace in the markets you mentioned, Joe, I don't see any of our proposal activity up sharply because of some of the conflicts that exist in a given market. If that does happen, it usually takes awhile for it to happen.

Operator

Matt Perry, Wachovia Securities.

Matt Perry - *Wachovia Securities - Analyst*

I was just hoping you could provide us a little more detail on this recently announced CVS relationship? A couple of questions. One, have you made any hiring of new people to work in these stores? How many stores might you have people in nationwide?

And will they have conversations about not only the Part D but your other Medicare products, or will it be more confined to Part D conversations?

Larry Glasscock - *WellPoint - Chairman, President & CEO*

Well, first of all, we will have some people in those stores possibly. We don't have Joan on the line with us, but really what we're doing is making information available. The information or that data will be in these CVS pharmacies, and it is really about providing some more resources that can educate seniors about this open enrollment period.

So, as you know, we sell our Part D coverage through really our agents and brokers and we have a direct sales force. We also obviously use telemarketing. So that is the way we sell the product. This is about making more information available to consumers. But we have -- the last count I saw is we have about 17,000 or so agents who really sell Part D for us. I don't -- did they give any additional information on the --?

Dave Colby - *WellPoint - CFO & EVP*

I think it is just again working with CVS to try to educate members, and hopefully they will choose our plans.

Matt Perry - *Wachovia Securities - Analyst*

And just one other question. Can you help me understand the sequential declines over the last couple of quarters in the PBM script volume?

Dave Colby - *WellPoint - CFO & EVP*

The PBM script volume declines are from losses of some rebate-only wholesale customers. In terms of individual members, it is actually growing. So the actual script volume that we process for others for rebate management has come down.

Operator

I would now like to turn the conference back to Mr. Glasscock with the Company's closing comments.

Larry Glasscock - *WellPoint - Chairman, President & CEO*

Okay. Well, again, thank you all for your questions. Again, we are achieving our very strong results by, we believe, becoming and continuing to become the leader in affordable quality care and by focusing on building a company that is both customer responsive and at the same time very efficient. We are very pleased with our performance to date and obviously remain very optimistic about our future.

We are looking forward to seeing many of you -- I hope all of you -- at our Investor Day. It is going to be at the California Wellbeing Institute in Westlake Village, California on December 12, and again we hope to see many of you there. For those of you who cannot be there, we are going to make sure that it is available by webcast.

So again, thank you all for your interest this morning, and as always, I hope you have a great day.

Operator

Thank you. Ladies and gentlemen, this conference will be available for replay starting today, Wednesday, October 25 at 1:45 PM, and that is 1:45 PM Eastern time, and it will be available through Wednesday, November 8 at midnight Eastern time. And you may access the AT&T Executive Playback Service by dialing 1-800-475-6701 from within the United States or Canada, or from outside the United States or Canada, please dial 320-365-3844 and then enter the access code of 842195. (Repeats numbers).

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

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