



**Health Net, Inc.
Q3 2007 Earnings Conference Call
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8:00AM PDT**

Corporate Participants:

David Olson, Investor Relations Officer
Jay Gellert, President and CEO
Jim Woys, Interim Chief Financial Officer

OPERATOR: Good day, everyone, and welcome to this Health Net, Inc. third quarter conference call. Today's call is being recorded.

At this time, I'd like to turn the conference over to the investor relations officer, Mr. David Olson. Please go ahead, sir.

DAVID OLSON: Thank you very much, operator, and good morning, everyone. During this call we will make forward-looking statements that are subject to certain risks and uncertainties. Risk factors that may impact those statements and could cause actual future results to differ materially from currently expected results are described in our filings with the SEC as well as the Cautionary Statements in our press release issued in advance of this call.

In addition, today's press release makes, and the comments on this call will make, reference to certain measurements that are not calculated and presented in accordance with GAAP. I should note that today's press release, which is available on the company's Web site, includes an income statement reconciliation that is non-GAAP. In addition, we included a supplemental schedule showing a breakout of reserves and health care costs for capitation, provider settlements, and the impact of Part D. These supplemental items provide the basis for discussion of operating metrics, excluding the third quarter charges, and discussion of days claims payable, excluding the costs noted above.

Let me now turn the call over to our CEO, Jay Gellert.

JAY GELLERT: Thank you, David, and thank you for joining us this morning for a review of our third quarter 2007 results which include the full effect of nearly \$300 million in charges. These charges were incurred as a result of the company reaching an agreement in principle to settle three national class action lawsuits and accounting for projected liabilities arising out of related regulatory issues and certain other immaterial losses.

We know the size of these charges is probably surprising to many of you. First and foremost, it was important for the company to put these matters behind us. They were proving to be and were likely to remain distractions for management. We have great opportunities in all our lines of business. We want to be able to concentrate fully on these opportunities, not on litigation that covers issues dating back as much as 12 years.

The lawsuits center on certain out-of-network claims payment practices for the period between 1999 and this year. We don't want to get into too much detail now, as we are still finalizing the settlement agreement. It's important to put the \$201 million portion of the charge that has been allocated to health plan services in context. It represents just 3/10 of 1 percent of total commercial health care expenses over that period.

As a result of the charges, we did lose money in the quarter. Without the charges, we hit the \$0.99 consensus.

A concern that we know could develop as a result of the charges centers around cash, but cash flow adjusted for timing differences in the quarter was strong. We have cash on hand, a currently untapped \$900 million credit line, so we can meet the requirements of the settlement and continue with share repurchase. In addition, our debt-to-total capital remains quite low. To underscore our confidence, our board authorized an additional \$250 million in share repurchase authority. We remain committed to share repurchases as we believe it is one of the best ways to improve shareholder value and enhance return on equity. Including the additional \$250 million in newly authorized repurchase authority, we have approximately \$346 million in remaining authority.

Now I'd like to review our strong operating results for the quarter. These results reflect our strategy of growing the small group, individual, and mid-markets, and managing general and administrative expenses. In addition to our continued focus on our strategy, our diversified business portfolio and share repurchase program position us for further growth and margin expansion for the remainder of 2007 and 2008.

Excluding the impact of the charges, key operating results in the third quarter include the following: Our continued focus on our strategy of growing mid, small group, and individual memberships resulted in an increase in the commercial small group and individual segment of 83,000 members, or 12.1 percent, compared to the third quarter of last year. Medicare Advantage membership grew by 21.3 percent to 239,000 members compared to the third quarter of '06 and by 1.3 percent sequentially. And PDP membership grew by 24.1 percent compared to the third quarter of '06, and by almost 5 percent sequentially. We are very confident of next year in PDP also.

Commercial enrollment, including both at-risk and ASO membership, decreased by 28,000 members or 1.2 percent compared to September 30, 2006. As many of you know, we've lapsed several unprofitable large group commercial accounts this year as part of our strategy. As a result of our continued pricing discipline, commercial large group membership decreased by 91,000 members from September 30, '06. Sequentially, commercial large-group decreased by 26,000 members, or 1.8 percent, as we lapsed one large northern California account with 28,000 commercial members. We expect to continue to see some attrition in the commercial large group, both risk and ASO, in the remainder of '07. We think we're just about over this, and that over time, the rate of lapses will decrease.

In addition, we're beginning to see some attractive large group opportunities. We landed two commercial large group accounts with a January 1 effective date. Given this, we expect our January 1 enrollment to be higher than year-end '07, marking the first sequential January 1 growth for us in several years. We intend to update you on the 2008 RFP activity at next Friday's investor day in New York City.

During the third quarter, we had strong commercial sales of more than 135,000 new members, including nearly 60,000 members from the California Farm Bureau, which selected Health Net as its health plan. This is the sixth consecutive quarter where new sales have exceeded at least 50,000 members.

Growth in both Medicare Advantage and PDP exceeded our '07 guidance of 15 to 20 percent. Year-to-date, Medicare Advantage has grown 20 percent and PDP has grown 24 percent. 2008 looks very encouraging for both of these programs. Again, we intend to provide more color on this at next week's investor day.

The commercial premium yield compared to health care cost trend was positive in the third quarter of '07, excluding the charges. Obviously, it was upside down including the charges. We look to keep the relationship right side up in Q4 and next year. It's a critical part of our improved margin story.

We've been holding a line on pricing yet still growing thanks to new products and improving relationships with our distribution system.

We continue to expect our full-year '07 premium yield to be approximately 9 percent, which includes the second quarter '07 acquisition of the Guardian's 50 percent in Healthcare Solutions. Excluding the impact of the charges, we expect the health care cost trend to be 30 to 50 basis points less than premium yield this year.

With regard to Medicaid, I'd like to make a few comments. We continue to do well in Medi-Cal, the Medicaid program in California. As expected, we did not get a rate increase in October, although we did receive one last January. Membership in Medi-Cal was down slightly, as the state has been cleaning up its rolls. Medicaid in New Jersey is performing well. In Connecticut, we continue to evaluate the program and are in discussions with the state of Connecticut about what will work for all parties, including the state and the beneficiaries. We hope to have more on this next week at investor day.

Three final comments before I turn the call over to Jim. First, health reform in California. The special session is still open. Unfortunately, the Governor, key legislative members and their staffs have been diverted by the fires. We expect the process to pick up again in the next few weeks and believe that all parties, including labor, are looking for a set of proposals on which everyone can agree. Second, we will be hosting our annual investor day next Friday, November 9th, in New York City. We will give you much more detail on each of our lines of business and more specific guidance for '08 at that time. We look forward to seeing you there.

Finally, I'd like to welcome Joe Capezza to Health Net as our chief financial officer. Joe most recently served as CFO at Harvard Pilgrim and has a wealth of experience in the health care history. He's on the call today, but we won't make him answer any questions. Before I turn the call over to Jim Woys, I'd like to recognize him for his incredible work over the course of the last year. Most of you on the phone have commented to me about how credible and effective he's been in the CFO role. His work has added great value to our company. The only thing I can say about him is he's even a better operator than a financial officer and moving him back into a key operating role will enhance the company. So I thank him and I think all of us thank him for his incredible work and we look forward to working with Joe in his new role.

I'd like to now turn the call over to Jim. Jim?

JIM WOYS: Thank you, Jay, and good morning, everyone. There are four key objectives I'd like to accomplish with my comments this morning. First, I want to give you additional details on the charge we have taken this quarter so you can fully understand the character and components of the charge and how they impact the income statement, the balance sheet and, going forward, cash flow. Second, I want to spend the majority of my time on our solid operating performance in the third quarter, in health plans and in TRICARE, excluding the charge. Third, I'll spend a brief moment updating you on the TRICARE procurement, and finally I'll speak to you on Q4 expectations, our preliminary 2008 outlook, and our upcoming investor day.

Let me spend a few moments now on the charge. We know that the magnitude of this charge was surprising, but it was important for us to put this behind us and move forward to capitalize on all of our future opportunities. The \$296.8 million pretax number includes a number of items related to the impending settlement of the class action lawsuits, the regulatory issues, and some other immaterial lawsuits. The charge includes a fund for disbursements to affected members and a fund for specific claims that members may resubmit. It covers attorneys' fees, both the plaintiffs' and ours. It also covers the remediation of claims that the State of New Jersey Department of Banking and Insurance has determined that we paid improperly and a fine we expect to pay to New Jersey, and amounts related to our estimated liability for a few non-material lawsuits.

Most of these issues revolve around our out-of-network claims payment methods and cover a 12-year period. We've made operational changes and we continue to work very hard to meet the needs of our members, our providers, and our regulators. The charges do make the quarter more complex. On a GAAP basis, we incurred a net loss of \$104 million. In addition to the pretax charges, we also wrote off a \$26 million deferred tax asset as a consequence of the charge.

Overall, excluding the effect of the charge, we met the First Call consensus EPS of \$0.99 per diluted share with a fully diluted share count at 113.5 million shares. Given the complexity, we included a table with the release that reconciles the income statement to the three cost categories where the charges hit -- health care costs, G&A expenses, and the tax write-off.

The table shows you how to get to the \$0.99 in diluted per share earnings for the quarter. You need to back out the two components of the charge and use a 36 percent tax rate and approximately 113.5 million diluted shares. The tax rate is consistent with our prior guidance.

The remaining of my comments about the performance of the company for the third quarter will all be reflective of our performance without the effect of the charges. So let me now turn to our solid third quarter performance.

Total revenues rose by 11.8 percent in the third quarter to \$3.6 billion from \$3.2 billion in the third quarter of 2006, helped in part by one full quarter of a 100 percent contribution from our Healthcare Solutions small group enrollment in the Northeast. Health plan services premium revenues increased 11.7 percent to \$2.9 billion in the third quarter compared to \$2.6 billion in the third quarter of 2006. Government contracts revenues increased 14.2 percent, as expected, in the third quarter of 2007 to \$660.4 million from \$578.5 million in the third quarter of 2006. The quarter-over-quarter increases in revenue was driven by higher expected health care costs in Q3 of '07 and a lower cost in revenue experience in Q3 of 2006. We continue to expect that total consolidated revenues to be greater than \$14 billion for the full year of 2007.

As you can see, our top line continues to be very solid. Total health plan enrollment increased 29,000 sequentially and 67,000 new members year-over-year. As Jay mentioned, these enrollment gains were primarily driven by strong growth in small group and individual, which showed increases of 51,000 new members sequentially and 83,000 members or 12.1 percent increases year-over-year. We continued our strong growth in our Medicare products. For MA, we grew 3,000 new members sequentially and over 42,000 or 21.3 percent increase year-over-year. For our PDP stand-alone business, membership grew 17,000 new members sequentially and over 24 percent or 71,000 members year-over-year. These membership gains in these targeted segments continue to reinforce our strategy around gross margin expansion and reduce our reliance on lower margin, large group business.

Let me now turn your attention to yields. Our commercial yield continues to strengthen, in line with our targeted segment strategy. Commercial yield was up 10.3 percent. This included the full impact of the Healthcare Solutions membership for the entire third quarter in the Northeast, right in line with our previous guidance. Commercial health care costs rose 9.7 percent in the third quarter, also including the full impact for the quarter of the Healthcare Solutions membership, providing a positive spread for the quarter of 60 basis points. Again, this affirms our commercial mix strategy and demonstrates our ongoing pricing discipline.

We continue to see moderate trends in commercial health care costs, though our results are influenced by the Healthcare Solutions membership. Excluding the Healthcare Solutions or Guardian effect, health care costs for physicians and hospital are up in the mid-single digits and pharmacy in the low single digits. This is consistent with our view that commercial trends are moderate. At present, we expect these moderate trends to continue into next year. These moderate trends had obviously influenced our medical cost ratios. The overall health plan MCR in the quarter was flat with the prior year, but better by 180 basis points sequentially. Commercial MCR came in at 82.7 percent, 50 basis points better than the prior year and 180 basis points better sequentially. The year-over-year improvement was due to the shift in business mix, while the sequential improvement is consistent with the seasonal patterns and was helped by having a full quarter of the Healthcare Solutions small group book. Both Medicare and Medicaid MCRs were higher than prior year in the quarter. This was anticipated due to our better than expected performance last year in Medicare and a slightly more challenging Medicaid environment, especially in Connecticut.

Our government contracts activity, which includes our TRICARE contract, our Veterans Affairs business, and MHN's continued expansion of providing behavioral health and life counseling services to DoD had another outstanding quarter. The cost ratio at 92.9 percent was flat with June of 2007 quarter and just a bit better than last year. We are now in the fourth year of our five-year TRICARE contract, and performance continues to be solid. Both our customer and our beneficiaries are clearly benefiting from the overall moderation in health care costs. We're also gaining some incremental gains from the ongoing positive development from prior years in the contract. These benefits should continue in the fourth quarter, but we would expect them start to moderate as we move into next year.

A couple other P&L items that bear mentioning. Selling costs are up 40 basis points sequentially and 70 basis points year-over-year. The increase sequentially is primarily due to the addition of the California Farm Bureau book of business on July 1st, and the continued mix shift from large group non-commissioned business to the individual small group commission-based business. The year-over-year increase reflects these changes, along with the addition of the 100 percent of the Guardian book included this year. Investment income was up a bit sequentially, thanks to the uptick in short rates during the quarter. Depreciation was up as we have increased our IT investments in recent periods. Finally on the P&L, amortization rose due to our recording a full quarter of the Guardian intangible. Expect this quarterly amortization level to be consistent going forward.

Let's now take a look at the balance sheet. It continues to be solid. Debt-to-total capital is a low 18.5 percent. We had about \$80 million in cash at the parent at quarter end. We can easily fund the charges as we continue to have strong cash flow. We have not used any of our \$900 million credit line. Clearly, the balance sheet can easily handle a more leverage while still being under our targeted 30 percent.

Days claims payable on a GAAP basis were down by 6/10 of a day year-over-year and slightly up by 2/10 of a day sequentially and suggest that reserves are sound. We always include a supplemental DCP table to back out capitation, Part D and, in this quarter, the charges. On that basis, DCP is about the same, down by a half day year-over-year and down 6/10 of a day sequentially. These minimal changes are very reassuring.

As you have all seen, most of the managed care companies received a late CMS payment. We did too. It and a late payment for our Medi-Cal book caused operating cash to be negative by about \$130 million in the quarter. Adding back the two late payments would have caused cash to be positive by over \$200 million. Depending on the progress of various matters covered by the charges, we could be required to make a large payment in the fourth quarter and if that occurs, it will impact operating cash flow.

We are putting our cash to good use. We continue to repurchase stock. In the third quarter, we purchased 2,609,000 shares at an average price of \$52.94. In addition, we bought back over 353,000 shares in the month of October. From November 2006, when we restarted our repurchase program, through yesterday, we've bought back over 9.8 million shares at an average price of just over \$49. Our remaining authorization, as Jay mentioned, is at about \$346 million, after the recent board action. So we have plenty of room to be active going forward.

We've issued guidance in the release for \$1.10 in per diluted share earnings for the fourth quarter. That will get to us our \$3.66 guidance for the full year. We continue to believe that our annual 15 percent earnings growth goal is attainable. We will provide more detail on our 2008 enrollment outlook, premiums, Medicare and TRICARE next week at investor day. Right now it looks like more of the same with a strong Medicare growth, improving commercial mix, and continued margin improvement as the hallmarks of our story.

Let me close with just a few thoughts about the TRICARE repurchase process. We don't have much more information today than we had when I spoke to you on the second quarter close, except that we're still awaiting the issuance of the final RFP. Based on past experience and the best available timing information received from DoD, we expect that a formal RFP will be released sometime after Thanksgiving. If this does occur, then bids for the three regions would probably be due in early 2008. Given that schedule, the awards have to be made prior to May or June of next year for the contracts to be implemented on April 1, 2009, the expiration of our current contract. Based on past experience, this continues to be an extremely tight schedule.

We are actively engaged in the process and have been preparing for the RFP response for the past 18 months. Based on the draft that has been released, the basic geographies and statement of work activities are very similar to our current contract. Given that a formal RFP has not been issued, timing is still very uncertain. As you're aware, the National Defense Authorization Act for 2007 does provide DoD with the authority to extend the current contracts for two additional years, one year at a time. Given our long, positive experience with TRICARE, we are confident that we'll be very competitive and expect to continue to be a primary contractor for DoD for many years to come. We have an excellent partnership with our customer, and we are proud to be supporting the needs of the government and, most importantly, the health care needs of the military family.

With that, let me conclude by thanking all of you for your support during my tenure as interim CFO. I expressly want to thank the financial team here at Health Net. They have done an outstanding job and supported me for the past year. Thank you, I have enjoyed it. I happily turn the reigns over to Joe Capezza, our new CFO. During the past few months I've gotten to know Joe personally and professionally. I'm confident Joe will be a positive influence for our company and add real for our shareholders and, more importantly, a trusted team member. I'll still be here and I look forward to seeing all of you at investor day next week. Thank you again.

Operator, we can now turn it over to Q&A.

Questions and Answers

OPERATOR: Thank you. The question and answer session will be conducted electronically. If you would like to ask a question, you may do so by pressing the star key followed by the digit one on your touchtone telephone. If you're using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Once again, if you have any questions, please press star-one now.

We'll take our first question from Carl McDonald from CIBC. Please go ahead.

CARL McDONALD: Thank you. First question, just wanted an update on the competitive environment out in California. I know the pricing situation was fairly favorable for most of 2007 relative to some increased competition in prior years. So as you get through the open enrollment season now, what are you seeing from a pricing perspective?

JAY GELLERT: We believe that the pricing environment has stayed consistent with earlier this year and is stable by comparison to prior years.

CARL McDONALD: Okay. So no one out there is being terribly aggressive on a regular basis?

JAY GELLERT: I think everyone's pricing soundly.

CARL McDONALD: Okay. And then on the TRICARE extension, I know DoD has the ability to extend it for another year and do that two times. Is that an all or nothing proposition? Meaning, could they come to you and say the contract's expired on April 1st, we want you to stick around for three more months? Or does it have to be a year, that's the only choice?

JIM WOYS: There is a provision in the contract that allows the government to extend our contract one month at a time for up to six months. But that becomes a pretty difficult situation about how to negotiate that one month at a time. But it is possible.

CARL McDONALD: Got it.

JAY GELLERT: We have not seen that exercised ever in the past.

CARL McDONALD: Then last one really quick is just the -- I know you're going to give more details next week, but Medicare enrollment directionally, should we look for more growth in 2008 than we've seen in 2007?

JAY GELLERT: At least similar growth. We'll have more details next week.

CARL McDONALD: Okay. Thank you.

OPERATOR: And we'll take our next question from Joseph France with Banc of America Securities.

JOSEPH FRANCE: Thank you very much. I had just two quick questions. One is, what was the 9,000 life drop on the commercial side in Connecticut in the quarter?

JAY GELLERT: It was primarily attrition. Kind of across the board. It was not any large accounts. There was some more aggressive -- more conservative pricing that we've installed in some places, so it was nothing specific.

JOSEPH FRANCE: And have you taken an early look at large group enrollment in '08, give us some guidance for what that might look like in January?

JAY GELLERT: Yeah. The large group enrollment in January will be up and we'll have specific details on that next week.

JOSEPH FRANCE: Thanks, Jay.

JAY GELLERT: Thanks.

OPERATOR: And we'll take our next question with John Rex with Bear Stearns. Please go ahead.

JOHN REX: Thanks. First question, just on TRICARE. The book continues to outperform considerably. Every quarter you say it's going to come down and it doesn't. Can you go through again why it's going to go down in the 1Q07? What are the elements that would take it down from this run rate that's appeared to be sustainable?

JIM WOYS: I think the -- again, if we look at the TRICARE option periods, the option period ends in March for Option Period 4. We've -- again, the cost ratio, let me just remind everybody, the cost ratio that we look at not just includes TRICARE, but it includes our business with the VA and also includes a growing piece of business that MHN is doing providing behavioral and life counseling services to DoD. So that is adding a little bit to the margin, causing that ratio to look a little more favorable than just the TRICARE contract. On the TRICARE contract side, again, in Option Period 4, we're starting to see a little favorable results with all the health care costs. We've also continued to sort of clean up the prior option periods and seen the favorable results in kind of closing down the favorable adjustments from the prior option periods. So we would expect that through Q4, they're probably looking pretty close to what we look like today and it will start tailing off because of Option Period 5 will start, and unless we see some real favorable changes in where we're at in Option Period 4, we wouldn't expect any sort of retroactive adjustments there. And we're in the midst of negotiating Option Period 5 with the government right now and at this time we wouldn't know whether that would be anything that would cause it to be favorable or less favorable based upon negotiating the target health care costs.

JOHN REX: So should gross profit dollars -- you've been running in the mid-40s and kind of signaling that ultimately that should return into the 30s. Should that be dropping back into the mid-30s as you go into 2Q next year? Is that your expectation?

JIM WOYS: We'll give you more guidance next week at investor day, but I think that is directionally correct.

JOHN REX: Okay. And then a follow-up on your component cost trend comments. You talked about inpatient mid-single digits which would compare to the 9 percent trend you were talking about in the first half of '07. Just wondering if you could help us understand what caused such a big drop in inpatient trend?

JAY GELLERT: Well, part of it is the result of the mix change. As you can see that with more of the Nationwide business and the full Guardian business that it's a mix that has lower inpatient trends, but we're also seeing, even when you gross it up in same-store, at probably a 200 basis point kind of slowdown in the hospital trends.

JOHN REX: Is that all about bed days or?

JAY GELLERT: It's utilization, but also even some unit costs. But we've always been -- that's all been leading us and that's always been in the double-digit region and that's starting to come into the high singles.

JOHN REX: But we can think about ex-Guardian and those other impacts, we think about a 200 basis point deceleration from where you were in the first half?

JAY GELLERT: Yes.

JOHN REX: And just the last thing, just a little more clarity on the selling costs. I want to make sure I understand this going forward. The commentary in the release seemed to indicate that it had a lot to do with strengthening partnerships with agents and brokers, so I kind of took that to mean there was some kind of increase in commission that you're embedding in, but then the commentary you went through the on the call seemed to attribute it all to the Guardian and Farm Bureau. So I just wanted to make sure I understand the components and run rates to think about and what was driving this.

JAY GELLERT: The second explanation, the one given on the call is the correct interpretation. Primarily, the fact that in the case of the Farm Bureau business, you had 60,000 brokered lives and they basically replaced that one large account we talked about, which wasn't brokered. And then the full Guardian and there was a reconciliation of a couple million dollars that's one-time in terms of that selling cost account. So it's ongoing with the exception of that reconciliation.

JOHN REX: Okay. This is the right run rate. It's not so much that you changed your commission structure then?

JAY GELLERT: No, it's in fact the 12.1 percent we talked about in terms of the growth in that segment is commissioned business. And it replaced non-commissioned business.

JOHN REX: Great. Thank you.

OPERATOR: We'll take our next question from Scott Fidel with Deutsche Bank. Please go ahead.

SCOTT FIDEL: Thanks, good morning. First question, just if you could give an update around the California fires. Just interested if you'll see any impact around 4Q, around cost trends in terms of thinking, do you think they might come in a bit abnormally low in 4Q just given maybe a drop in utilization there, or have you seen pretty consistent trends there? Just some thoughts around that?

JAY GELLERT: I think it's too early to really tell the implications. At this point, it was in many ways, kind of, I think, though intense, a relatively brief interruption. So at this point we're not anticipating any change. Also, in our case, you have to bear in mind that a lot of our physician costs are capitated, so they would not be affected by those circumstances, and it's not our anticipation that hospitalization, for example, would be affected by that at this time. So we're operating on the assumption that it's conceivable that we could see some effect, but we're not counting on it.

SCOTT FIDEL: Okay. And then just to follow up on the question around price competition and you talked about California. Just if you can give us an update on what you're seeing in the Northeast markets as folks are pricing for 2008 -- maybe break out New York, New Jersey and Connecticut?

JAY GELLERT: I think everyone's indicated that New Jersey's a competitive environment and we don't see any change in that. We see New York as fairly stable. To Joe France's earlier question, there are some instances where people are making some quote/unquote competitive forays in Connecticut and

we're maintaining our pricing discipline, but we don't see those as long-term or disruptive. So I guess overall, it's pretty much the same as it's been.

SCOTT FIDEL: Okay. Jay, just on New Jersey, is it still Horizon that you're seeing driving the competition there, or are any changes from any of the public competitors?

JAY GELLERT: We're really careful not to specifically highlight companies, but I would say that it's more the nonprofit competitors than the for profit.

SCOTT FIDEL: And then just a last question. Do you have what the Medicaid and the Medicare MLRs were in the third quarter relative to the third quarter of last year?

JAY GELLERT: I think David will follow up with you, if that's okay.

SCOTT FIDEL: Sure.

JAY GELLERT: Or do you want to just give it?

JIM WOYS: Sure, I'll give it.

DAVID OLSON: Yeah, let's give it.

JAY GELLERT: Okay, we're going to give it.

JIM WOYS: Just to go through -- the commercial MCR was 82.7 percent, our MA-Medicare MCR was 86.1 percent. Our PDP MCR was 67.1 percent. Our Medicaid MCR was 82.1 percent. And the total MCR for all health plan business was 82.9.

SCOTT FIDEL: Got it. Great. Helpful. Thank you.

DAVID OLSON: And the commercial excludes all the charges. All the charges were allotted to the commercial line.

SCOTT FIDEL: Okay.

OPERATOR: Once again, if you have any questions, please press star-one. Star-one for questions. We'll take our next question from Bill Georges with JPMorgan. Please go ahead.

BILL GEORGES: Thanks. Good morning. Wondering if you could just help out with some still high-level metrics around your '08 guidance? Just in terms of the revenue line, I guess you talk about yields remaining essentially stable with '07. Is that correct?

JAY GELLERT: No, I think we indicated we'd be right side up in '08.

BILL GEORGES: Okay. And how about as far as membership is concerned? I'm assuming that the membership acceleration that you've experienced will continue?

JAY GELLERT: I think that we anticipate that the membership acceleration on the commercial side will be slowed a little. That's what our plan's built around. That we'd continue to see the Medicare increases that we've seen and that Medicaid there may still be some culling, but basically stable.

BILL GEORGES: Okay. And as we lump all of those factors together, how do you see the top line growing in 2008? High singles?

JAY GELLERT: No, we see the top line in the 10 to low teens range.

BILL GEORGES: Ten to low teens, okay. And then just a quick question. Looking at prior-period development, I think if I'm doing the math right, this is the second quarter where you've shown some modest negative PPD. I'm wondering, can you give us a little bit of color around what's going on?

JAY GELLERT: Yeah, as we indicated in the last quarter, we're cleaning up some of the old accounts that we dropped 1/1 and 7/1 so there's a little bit of that activity in there, but it's very minimal in Q3.

BILL GEORGES: And should we expect that to dissipate then in the fourth quarter?

JAY GELLERT: Yes.

BILL GEORGES: Okay, great. Thanks very much.

OPERATOR: Thank you. We'll take our next question with Josh Raskin with Lehman Brothers. Please go ahead.

JOSH RASKIN: Hi, thanks. First question, just on the charge, what's the cash portion? I think Jim you mentioned there was a potential payout in the fourth quarter, but what is the total cash portion for that?

JIM WOYS: The after-tax number is just around \$200 million.

JOSH RASKIN: And that -- okay, so that's all a cash payout?

JAY GELLERT: Yes.

JAY GELLERT: Yes. And it will be paid out over different periods.

JOSH RASKIN: Okay, that's helpful. Then second question, just on the Guardian relationship, any way to give an impact of -- what was the sort of basis point impact on the yield and the costs from Guardian?

JAY GELLERT: I don't think we have it exactly here. We can get that to you, but it had a significant effect.

JOSH RASKIN: Okay.

JAY GELLERT: Let us get it to you, so we give you the exact number.

JOSH RASKIN: Okay. I'll get that -- okay, I'll all set. Thanks.

OPERATOR: And we'll take our next question with Justin Lake with UBS. Please go ahead.

JUSTIN LAKE: Thanks. Just a quick follow-up on TRICARE. Can you tell us -- you mentioned there were some prior year development in TRICARE truing up some costs. Can you tell us how much that contributed to the quarter?

JIM WOYS: It contributed, if I have the exact number, I believe it was around \$10 million.

JUSTIN LAKE: \$10 million? Okay. So when we think about the run rate for the fourth quarter, should we expect that kind of contribution again in the fourth quarter?

JIM WOYS: At this point, I'd say it would be less than that.

JUSTIN LAKE: Okay. I know the official RFP has not come out yet, but the RFI looks like there might be some significant changes in the structure of a contract basically moving it from looking more like a risk contract to more like an ASO contract. Can you tell us how those -- I'm sure you've had some commentary around that. Moving it to an ASO contract and then also it looks like the cash requirements on that contract as far as moving from a payment -- I think the government pays you within five days to moving it out to 25 to 30? Which would be significantly detrimental from a cash flow standpoint. Can you tell us what kind of feedback you've given the government and how responsive they've been to those?

JIM WOYS: We've made comments on all those financial issues around the model to our customer. The way that we do that, you have to submit those issues and comments directly to the customer via the Web site. There has been, because of the sensitive natures that the government doesn't respond back to us, so we don't know what they have taken into account. I believe probably other companies within the industry have probably made similar comments, so we are sort of anxiously awaiting what the final RFP would look like subject to probably the hundreds or maybe even thousands of comments that the government received concerning what the draft RFI looked like and would expect that the final RFP would make some changes. I can't count on what they'll make, but the reason they went to the industry for comments was for things like that, to understand what the impact would be to industry and how it would impact the competition. So I would expect that the draft RFI would change when the final RFP comes out, but we have no really insight into what it would look like.

JUSTIN LAKE: Are those changes something that the government's ever tried to make in the past or the military's ever tried to make as far as taking away some of the risk-sharing and things like that?

JIM WOYS: I think over the history of the program, over the last 20 years, there's been -- the TRICARE business has been reprocured four times in that period. There has been, as we've seen historically, a draft RFP or an RFI that's come out that has got industry comment and there has been historically changes, even material changes made during that comment period that then turned into a more, you might say, contractor-friendly RFP. So they have tried to make similar sort of adjustments in the past and even the past more radical than this and they have adjusted it the other direction. But again, I think this is our customer is out there trying to figure out what to do to best manage their program. We will try to give comments about what's best, what we think for industry, but at the end of the day, we're going to support our customer and we're going to continue to bid this business and be successful in the reprocurement.

JUSTIN LAKE: That's helpful. Just two other quick questions. One on the commercial membership. Can you tell us if -- obviously, you had that big win with the Farm Bureau. Can you tell us if there were any offsetting losses in the individual and small group?

JAY: No.

JUSTIN LAKE: There weren't? So would it be -- it would seem that the commercial -- the individual and small group was down ex that rate win. Is there anything in particular given that you've had some pretty good momentum there sequentially?

JAY GELLERT: The small group and individual is sequentially up 51,000 members.

So it's down by about 3,000 in Connecticut and New Jersey, so that's -- so when you put it together, I think that Farm Bureau really came in at like 57 or 8, so it pretty much balances out.

JUSTIN LAKE: Okay. So California ex the Farm Bureau is relatively flat this quarter?

JAY GELLERT: Yeah. In fact, it's up 52,000 members. So it's relatively flat after the Farm Bureau.

JUSTIN LAKE: Last question, just on the EPS target, reaffirming at 15 percent. Does that include or exclude capital reinvestment, share repurchases, etc.?

JAY GELLERT: We'll talk about it more at investor day, but we do anticipate making some share repurchases, as we said.

JUSTIN LAKE: Okay, great. Thank you.

OPERATOR: And we'll take our next question from Matthew Borsch with Goldman Sachs. Please go ahead.

MATTHEW BORSCH: If I could ask a question just on your outlook for Medicare profit margins. Just directionally, do you expect Medicare Advantage and Medicare drug plan margins to be moving up going into next year?

JAY GELLERT: No.

MATTHEW BORSCH: No, okay. Down?

JAY GELLERT: Maybe down slightly, but in the range of flat to down maybe a little.

MATTHEW BORSCH: And commercial will be going up?

JAY GELLERT: Yes.

MATTHEW BORSCH: Okay. And what -- in Connecticut Medicaid, have you been approached by the state regarding potentially assuming enrollment from another plan?

JAY GELLERT: We have enough trouble with our own enrollment.

MATTHEW BORSCH: Okay, fair enough. And what are you seeing from some of your employer customers, if you can generalize a trend in terms of benefit buydowns, cost shifting going into next year relative to maybe the trend in the last couple of years? Any changes there?

JAY GELLERT: We're seeing it stable to a little bit even less aggressive going into this year.

MATTHEW BORSCH: Okay. Last question here, can you comment on any of the other components in medical cost trend? It was interesting commentary on inpatient, but maybe on a same-store basis, if anything else is up or down relative to your last view on it?

JAY GELLERT: Well, we've consistently had good pharmaceutical results and they continue. The physician trend is probably maybe flat to up a little bit, but not significant.

MATTHEW BORSCH: Okay. Okay. Got it. Okay. Thank you.

OPERATOR: Once again, if you have any questions, please press star-one. Star-one for questions. We'll take our next question with Christine Arnold with Morgan Stanley. Please go ahead.

CHRISTINE ARNOLD: Thank you, good afternoon. The commercial MLR you said was going to be kind of right side up, should we think 30 to 50 basis points, which has been kind of your historical year-over-year target?

JAY GELLERT: Yes.

CHRISTINE ARNOLD: Okay.

JAY GELLERT: Christine, it's the morning still. It's the morning here; it's the morning where you are.

CHRISTINE ARNOLD: Sorry. Moving forward in the day. On TRICARE, in terms of your guidance is to kind of expect the loss ratio to go up next year because you're not anticipating the same type of positive development, but given what you're seeing on hospital costs this year -- they came down through this year, are you building in conservatism in your TRICARE expectations, or is there something offsetting what would intuitively result in more positive development next year?

JIM WOYS: Christine, the issue around TRICARE is a little different on the commercial side. We're in the midst of negotiations with our customer about what the target health care costs would look like in Option Period 5. In doing so, both our customer and us lay out all of the best information available, so that gets taken into account if we see a medication or a hospital trend or physician trend or ancillary or pharmacy. Whatever that's included is laid out in front of our customer and we negotiate what we think the most reasonable sort of where the trend will be, including all components going forward, starting April 1st of next year.

CHRISTINE ARNOLD: So are you anticipating kind of a lower margin for Option Period 5 offsetting positive development? Is that what I'm hearing?

JIM WOYS: What I'm saying is that the Option Period 5 we would expect as we move into next year, because we had no other information -- the best information we used in negotiating with our customer is that we would expect that we would hit the health care cost target, which would be about a 5.5 percent margin on our TRICARE business. And right now we're experiencing higher than that because of favorable development.

CHRISTINE ARNOLD: Okay. So you're saying that your negotiations for period 5 include the fact that cost trends have been lower?

JIM WOYS: That's correct.

CHRISTINE ARNOLD: And before we would expect Option Period 5 margin to be lower. And then whatever we get in positive developments external to that?

JIM WOYS: That's correct.

CHRISTINE ARNOLD: Okay. So the period 5 margin will be lower and that offsets positive development. And then final question, did you say you had some one-time selling costs in the quarter? And were there any transitional G&A costs that go away related to the full taking on of Guardian?

JAY GELLERT: With regard to the one-time selling costs, there were a couple, \$3 million, so they were kind of relatively immaterial, but they are one-time. With regard to the Guardian, I think that we don't anticipate seeing any significant change in the SG&A going into next year.

CHRISTINE ARNOLD: Okay, and the \$3 million was selling, correct?

JAY GELLERT: What?

CHRISTINE ARNOLD: The \$3 million was selling?

JAY GELLERT: Yes, it was.

CHRISTINE ARNOLD: Perfect. Thank you.

OPERATOR: We'll take our next question from Tom Carroll with Stifel Nicolaus, please go ahead.

TOM CARROLL: Hey, good morning. Quick question on the litigation or settlement again and your continuing litigation in some other areas. Excluding everything that's been highlighted today, of the litigation items that are remaining out there outstanding -- I guess two numbers I'm looking for. How much could go against the company? So maybe a worst-case scenario dollar number. And then how much has currently been reserved for of that dollar amount? So, for example, in the AmCareCo litigation, it looks like, I guess, the worst-case number would be like \$109 million and you have reserved in the neighborhood of like \$16 million. Can you maybe give us some more color on that?

JAY GELLERT: You know, with regard to the litigation, we really work hard to make expansive disclosures in the Qs and Ks, and I think it's best to leave our comments to those disclosures.

TOM CARROLL: Okay, that's fine. That's very good. We've been looking at those. I appreciate them. And secondly, following on Christine's question on TRICARE, as well as John's, would you say that your positive cost ratio experience this quarter in TRICARE was unexpected?

JIM WOYS: Not particularly. I think we -- a little higher than expected primarily because we did see some nice improvement. Again, it's not just the TRICARE, again it's the government cost ratio, which includes the business that we're doing through MHN, which had some really nice improvement there. We've got a nice contract with the DoD to do family and life counseling with MHN and that is growing just about every day and servicing the needs of the military family there and the returning warriors. So that's a piece of that and that probably is about 90 bps for the quarter. It was probably a little better than we expected. Other than that, the positive developments of prior periods or prior contract periods, we knew some of that was going to happen and maybe a little bit better than we expected, but it's fairly online with our expectations.

TOM CARROLL: Okay. I guess my thought was your prior expectations were for it to be ticking up third and fourth quarter.

JAY GELLERT: I think the mental health stuff is really driving it.

JIM WOYS: Yeah.

JAY GELLERT: The positive surprise, which I think we anticipate to be ongoing.

TOM CARROLL: Okay. Thank you.

OPERATOR: And that does conclude our question-and-answer session. I would like to turn it back over to management for any additional or closing remarks.

DAVID OLSON: Thank you very much, everyone. Just to remind you all, next Friday, November 9th, we are having our annual investor day at the Millennium Hotel in New York. If you haven't responded yet, please do so as soon as possible to us. The phone numbers and e-mail addresses are on the press release, so let us know quickly if you're going to make it and we look forward to seeing all of you next week in New York.

JAY GELLERT: Tickets are going fast. Thank you.

OPERATOR: Once again, ladies and gentlemen, this will conclude today's conference. We thank you for your participation. You may now disconnect.

[END]