



**Health Net, Inc.
Q4 2007 Earnings Conference Call
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8:00AM PDT**

Corporate Participants:

David Olson, Investor Relations Officer
Jay Gellert, President and CEO
Joseph Capezza, Chief Financial Officer

OPERATOR: Good day, everyone. Welcome to this Health Net, Inc. fourth quarter 2007 and year-end conference call. Just a quick reminder -- this conference is being recorded.

Now at this time for opening remarks, I'd like to turn the conference call over to the investor relations officer, Mr. David Olson. Please go ahead, sir.

DAVID OLSON: Thank you very much, operator. 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 for 2007 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 charges where appropriate, and discussion of days claims payable, excluding the costs noted above.

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

JAY GELLERT: Thank you, David, and thank you for joining us this morning. It's a pleasure to report on a solid fourth quarter and full year for Health Net. We continue to deliver results consistent with our goals. Today, I'd like to review the progress we made in 2007 and highlight some key points from the fourth quarter. Then I'll turn the call over to Joe Capezza, our new CFO, for an in-depth discussion of the financials.

Going into '07, we set the following goals:

First – profitable growth from diverse sources. We have several opportunities for growth in each of our business lines. The diversity of our business is a strength for us. It helps insulate us from changes in both the political and economic environment as we enter 2008 and 2009.

Second – margin improvement. We remain focused on improving margins. Our strategic goals of growing the small end of the market, employing pricing discipline and implementing our G&A repositioning strategy provide a clear path to achieving improved margins. Q4 showed further improvement in our commercial MCR. At Investor Day last November, we went into great detail about how our operations strategy will help expand our margins. We believe that implementing our strategy in 2008 positions us to be competitive going forward. We expect to bear greater costs, particularly in the first quarter of 2008, as a result of implementing our operations strategy and restructuring plan. We should begin to see the positive effects in the second half of 2008.

Finally – cash generation. We had excellent cash flow in 2007. This gives us flexibility in 2008. We have a goal of repurchasing 3 to 5 percent of shares outstanding each year. We met that goal in 2007. It continues to be a goal for us in 2008.

Our full year 2007 results are consistent with these goals. Excluding the impact of charges, earnings per diluted share increased 20 percent for the full year 2007 compared to 2006.

Total health plan enrollment increased in 2007. Our strategy of growing the smaller end of the market resulted in the addition of 73,000 individual and small group members in 2007. As expected, our large group commercial risk declined in 2007. Total commercial risk declined by 1.2 percent during the year as we continued to focus on disciplined pricing. Our strategy is to grow membership profitably in the segments where we know we can compete.

Our commercial success in the smaller end of the market in 2007 was the result of broader product offerings and stronger relationships with our distribution channels. Also, in June 2007, we completed the acquisition of the Guardian's 50 percent interest in the Healthcare Solutions business. We did this transaction so we could be in control of our own destiny in the small group market by expanding the distribution of our products in the Northeast.

We are especially pleased with the growth in our Medicare membership. Both Medicare Advantage and Medicare Part D had excellent growth in 2007. We look forward to another year of strong membership growth in both MA and PDP. Although we did experience growth in Private Fee-for-Service membership in '07 and expect to see some further growth in '08, our focus in Medicare is on the network business. We see this as a more sustainable and stable business, especially with the changing political environment.

Our January 2008 enrollment numbers for both MA and PDP are very encouraging. We added 28,000 MA members and are on target to hit our '08 guidance of 15 to 20 percent in MA enrollment growth. We also had very good growth in our PDP business. As of January 1st, we've added more than 171,000 PDP members. As a result, we now expect PDP enrollment growth of 40 to 45 percent in '08.

Our Federal Services division had an excellent year as it continued to perform well on the North contract. In '07, we expanded our work with the DoD through our behavioral health unit, MHN. We expect that to continue in '08 as we introduce programs and services that meet the needs of our military service members and their families.

With regard to Medicaid, I'd like to make a few comments. We have a clear strategy in Medicaid. We want to be in Medicaid where it's a real managed program and where we can provide sustainable, tangible value to states. We continue to do well in Medi-Cal, the Medicaid program in California. In Connecticut, we came to an agreement with the State where we will continue to serve nearly 90,000 members on an ASO basis through March 31st of this year when we will exit from the program. Some costs related to this exit were absorbed in the fourth quarter of '07.

I know many of you are wondering about the status of the TRICARE reprocurement process. As many of you know, the release of the RFP has been imminent since the Fall of '07, so we could see a final version issued at any time. We would like to highlight that the DoD has done an exceptional job of soliciting and considering input from industry and other interested parties during the procurement. The Government's work in evaluating these comments and incorporating them into the RFP is a difficult and often lengthy process.

Finally, a brief word about health reform in California. As many of you know, the Senate Health Committee rejected Governor Schwarzenegger's efforts to reform the state health care system. There are still many paths to achieve health reform, and Health Net will continue to work on a state and federal level to achieve universal coverage.

In summary, we made some very good progress in 2007. We stabilized our commercial book while repositioning it. We have margin improvement opportunity. We have strong cash flow, and we are committed to share repurchase as a use of our capital. We have the wherewithal to invest for the future through our operations strategy and restructuring efforts. We believe that we are doing the right things to be well positioned for 2008 and beyond.

Now, I would like to turn the call over to Joe Capezza, our new CFO. Joe...

JOSEPH CAPEZZA: Thank you, Jay, and good morning everyone. It is a pleasure to be here with you today for my second earnings conference call, but my first as a speaker and the new CFO of Health Net. I've been here at Health Net for about three months now and am enjoying the challenges, the opportunities and, not least of all, the weather that has drawn me and my family here to Southern California.

I'm especially pleased to report on another quarter of solid progress here at Health Net. From a number of perspectives, the fourth quarter and all of 2007 have met many key targets and paved the way for continued success in the future.

I'd like to start the financial review by going through the P&L. We'll then move on to the balance sheet, highlight our strong 2007 cash flow, and then update and refine 2008 guidance and first quarter expectations.

In the fourth quarter, diluted earnings per share rose by approximately 53 percent to \$1.10 per share compared to \$0.72 for the fourth quarter of 2006. The fourth quarter 2006 diluted EPS was impacted by a pretax charge of \$37.1 million, or \$0.19 per share. Excluding this charge, the fourth quarter diluted EPS rose by approximately 21 percent.

The pretax margin was up slightly from prior periods, reaching 5.5 percent for the quarter and 4.7 percent for the full year excluding charges from both periods. This is the kind of steady margin progress we have been targeting.

Total revenue for the fourth quarter exceeded \$3.5 billion as health plan premium revenue rose 11.4 percent compared to last year's fourth quarter. Revenues for the full year totaled \$14.1 billion, up 9.3 percent from 2006.

Driving this growth was an 11.8 percent increase in commercial yields in the fourth quarter helped by the effect of our Guardian transaction and our continued pricing discipline.

On the enrollment front, small group and individual enrollment climbed by more than 10 percent in the fourth quarter compared to the prior year period. Total commercial fully insured enrollment actually fell only 1 percent from the fourth quarter of 2006, as we continue to execute on our strategy to shift the mix of our business toward the small group end of the market. To this end, we have also seen the expected reductions in our large group and ASO enrollment.

In fact, at December 31, 2007, 35 percent of our commercial fully insured enrollment was in small group and individual versus 31 percent just one year earlier.

As Jay noted, Medicare enrollment was a bright spot for us. Medicare Advantage enrollment rose 18.6 percent in the fourth quarter of 2007 compared to the same period last year. Medicaid enrollment was up by more than 2 percent sequentially but basically flat when compared to 2006. However, expect Medicaid enrollment to fall in the second quarter as we finally exit Connecticut Medicaid at the end of March, as planned. That will amount to approximately 90,000 members.

On the cost side, commercial health care costs rose 11 percent in the fourth quarter compared to the fourth quarter of 2006. This was high because of the impact of the Guardian joint venture, while the spread between revenues and cost was positive by 80 basis points.

Let me talk briefly about the categories of commercial health care costs. I'm going to break them down on a reported basis and excluding the Guardian impact. We believe that excluding the Guardian impact provides a clearer picture of actual, underlying trends.

In the fourth quarter of 2007 versus the prior year's fourth quarter:

- Physician costs were up by 9 percent and only 2 percent excluding the Guardian effect;
- Hospital costs were up 13 percent but only 9 percent without Guardian;
- Lastly, pharmacy costs were up 9 percent for the quarter but were essentially flat excluding Guardian, due to increases in generic utilization and lower generic costs year-over-year.

We think these commercial trends are encouraging and expect a relatively stable health care cost environment going forward.

The overall health plan MCR of 82.6 percent for the quarter was 30 basis points better sequentially, excluding the charges, and this is consistent with seasonal factors. However, it did increase by 90 basis points in the quarter compared with the fourth quarter of 2006.

More importantly, the commercial MCR improved by 60 basis points year-over-year, and 90 basis points sequentially, excluding the charges. This is further confirmation that our commercial strategy to change our business mix is driving better gross underwriting margins.

As expected, we recorded a higher Medicare Advantage MCR -- 87 percent -- compared with last year's fourth quarter. Last year's MCR was unsustainably low due to the high level of risk adjusters and subsidy revenue we accrued and the strength of the Part D business. For the full year the Medicare MCR was 86.3 percent, and that's a good number for our mix of business where we still have quite a bit of provider capitation arrangements, especially here in California.

We also saw the Medicaid MCR -- 83.4 percent -- tick up slightly both sequentially and year-over-year, as expected. Connecticut issues that we noted in prior calls drove much of this change.

The Federal Services business continued to produce outstanding results on the strength of the ongoing business. Federal Services cost ratio came in just under 90 percent and was also helped by the ongoing expansion of our behavioral health services for our men and women in uniform and their families.

Let me turn now to G&A. For the full year we achieved a 100 basis point improvement in our G&A ratio to 10.2 percent excluding charges. This is a good example of our increased focus on expense management. For the quarter, the G&A ratio also fell 100 basis points to 10.5 percent.

Depreciation climbed a bit sequentially and was up by \$9 million for the year. We expect depreciation to increase in 2008 as we begin our operations strategy effort and expect to accelerate depreciation on certain IT assets.

Amortization of \$4.8 million was flat sequentially but up year-over-year. This increase was due to the Guardian transaction that closed in June. We expect this \$4.8 million quarterly expense level to be consistent throughout 2008.

Interest expense rose just a bit due to slightly higher debt levels.

Cash flow was very strong at \$257 million for the quarter and \$605 million for the full year. The fourth quarter amount included approximately \$83 million in payments for the final 2006 Medicare Part D settlement and an extra California Medi-Cal payment that was originally due in the previous quarter. With such strong performance, we ended the year with \$275 million of cash and invested assets at the parent. This amount includes the additional \$175 million in very low-cost debt that we secured at the end of last year.

Before consideration of legal settlement costs related to the third quarter charge that we took in 2007, we expect to see cash flow from operations in excess of net income in 2008. First quarter 2008 cash flow will be impacted, however, by our payment of \$160 million of the aforementioned legal settlement costs. While we do not have a final, signed settlement as of yet, we are obligated to place this amount in an escrow fund this quarter as we complete the final agreement.

We were active in share repurchase in the fourth quarter, buying back approximately 353,000 shares. For the full year we bought back approximately 4.3 million shares. We hope to resume repurchases in the very near future. We believe that this is the best use of our cash at this time.

Reserves were down sequentially just a bit, but adjusted days claims for the quarter were up by two-tenths of a day to 54.9 days. We provide this adjusted number to give you a clearer picture of reserve strength without the noise of capitation payments, provider settlements and Part D. As we've said for some time, we expect this metric to be relatively stable so we're very pleased with the fourth quarter number.

Let me now address some minor changes to our 2008 guidance. We're tightening the full year earnings per share range to \$4.14 to \$4.17 per diluted share as we refined our view of G&A costs, especially those costs related to our operations strategy effort.

We are introducing a first quarter EPS number of approximately \$0.67 per diluted share. We expect G&A to run high in the first quarter. Our G&A guidance for the full year is 10 percent while we expect the first quarter G&A ratio to be approximately 10.7 percent. This is consistent with our guidance at Investor Day last year where we indicated there would be a steeper slope in earnings per share between the first and second half of the year, with 38 percent of the earnings coming in the first two quarters.

At the same time we believe that both the commercial and overall health plan MCRs will be lower in the first quarter of 2008 than what we reported for the same period in 2007.

Let me close by saying that we've made great progress. We still have a lot of work to do. We have to continue with disciplined pricing and underwriting. We have to stay focused on our cost reduction plan, and we need to be nimble in our approach to market conditions.

For now, I am confident that we're up to meet these challenges, and I look forward to meeting many more of you at the UBS conference next week in New York and in the many months ahead.

Now let me turn it over to Q&A.

DAVID OLSON: Operator, if you would start the Q&A queue, we would appreciate it.

Questions and Answers

OPERATOR: Thank you very much, sir. At this point, if you would like to ask a question, you may do so by pressing star-one on your telephone keypad. If you're using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. And once again, to ask a question, that's star-one.

And we'll take the first question from Charles Boorady with Citi.

CHARLES BOORADY: Thanks, good morning. Just want to ask more about the first quarter guidance for \$0.67 and what's the level of additional SG&A spend or other unusual items you'll be spending in the quarter? And also whether you plan to take a charge? Because I think you implied at your investor conference you might -- relating to some of the SG&A investments that you'll be making.

JAY GELLERT: Charles, it's Jay.

CHARLES BOORADY: Hi, Jay.

JAY GELLERT: How are you?

CHARLES BOORADY: Good.

JAY GELLERT: Let me first address the issue of the SG&A effect. As we indicated in the release, we anticipate SG&A of about 10.7 percent in the first quarter. To get to the 10 percent guidance which we have, you'd run about 9.75, 9.8 on average for the rest of the year. So that differential is the SG&A effect in the first quarter related to restructuring ops strategy and some of the things we've earlier talked about. It includes all of the costs except for severance and retirement of assets. And we anticipate that will come in at about \$8 million in -- \$6 to \$10 million in Q1. So that's kind of it. The -- everything other than that, the duplicate staff, the consulting, all of that related to the ops strategy, all is included in the \$0.67 guidance.

CHARLES BOORADY: I see. So the first quarter SG&A on an ongoing basis we should think about as really being more like 9.75 or in line with the rest of the year average. If we were to exclude those items that relate to these initiatives?

JAY GELLERT: A combination of that and that we'll begin to get some savings in the second half of the year from some of the efforts in the first quarter.

CHARLES BOORADY: And in the fourth quarter, can you quantify for us, there was a benefit from the lower tax rate. You still hit the \$1.10. To what extent was there additional discretionary SG&A spend versus other necessary spend items? I'm just wondering if the tax rate were more in line, would that have been a miss in the quarter?

JAY GELLERT: No. There are three things that I think speak to that. One is there was some additional G&A related to the ops strategy that was absorbed in Q4. In addition, as we indicated, we had costs related to exiting the Connecticut Medicaid that were included in the Q4 numbers, as well as some truing up of risk adjusters as it relates to Medicare.

CHARLES BOORADY: Got it. Finally, the new Medicare Advantage ads -- can you say roughly what percent were Private Fee-for-Service versus PPO and HMO?

JAY GELLERT: The vast majority were HMO.

CHARLES BOORADY: Great. Okay, thanks.

JOSEPH CAPEZZA: And Charles, the ratio that we were referring to was the G&A ratio, not the SG&A ratio.

CHARLES BOORADY: Got it. Thank you.

OPERATOR: We'll next take a question from Matthew Borsch of Goldman Sachs.

MATTHEW BORSCH: Hi. Good morning. I wanted to touch on a question. I know it's come up repeatedly. But just trying to understand from an outsider's perspective why you appear to not be more proactive in maybe exploring a sale of the company. And if I could just mention a couple factors that come to mind is that -- in that context is that first, it seems that you've been below scale in most of the Northeast region excluding, I suppose, Fairfield County in Connecticut for a long time. And the second is this relatively expensive East-West systems consolidation project that would seem, in a certain sense, to be money wasted in the event a sale does occur. If you could just readdress that. Then I've just got one much more specific follow-up question.

JAY GELLERT: I think that the issues you've raised will be successfully addressed through the ops strategy we're talking about.

MATTHEW BORSCH: Okay. I mean, did -- I understand, and it sounds like that you have a good payoff from -- projected from the investment that you're making. On the other hand the other way of looking at it, if the Company were to be sold, then that wouldn't be necessary in the first place and presumably those savings could be realized without the investment.

JAY GELLERT: Yes. I thought Goldman was doing fairly well and didn't need a lot more investment banking business.

MATTHEW BORSCH: [laughter] Okay. I better go on to the next one here. Can you talk about the outlook and the results on California Medicaid? Because I know there have been issues in Connecticut. But maybe just bring us up-to-date on where you are there and what the outlook is?

JAY GELLERT: Well, the results for the year have been stable, and we're comfortable as we look into '08 with the continued stability of the result.

MATTHEW BORSCH: And what about the impact from the -- or potential impact, I should say, from the Governor's proposed budget? Would that just be a pass-through in your view?

JAY GELLERT: We have to get a better view of where that lands. We've gone through this process virtually every year of people talking about potential impacts. I don't think we have a good enough line of sight. But it won't fundamentally disrupt our business in any way.

MATTHEW BORSCH: And if I could slip one last question in here. Any discussion under way about -- your leverage, debt leverage is kind of at the low end of where the -- your comparable companies are. Maybe potentially stepping up the level of share repurchase beyond the 3 to 5 percent that you've targeted?

JAY GELLERT: That's our target, and we're staying with it at this time.

MATTHEW BORSCH: All right. Thank you.

OPERATOR: We'll next take a question from Josh Raskin of Lehman Brothers.

JOSH RASKIN: Hi, thanks. Good morning. Two questions from my end. First, if you could just run through, Joe, maybe the investment income assumptions that you're using in terms of rates you're sort of expecting throughout the year? And then the second question on seasonality regarding the first quarter earnings. I'm just curious how much impact, or if there is additional impact, from the PDP membership. Obviously you guys are growing that significantly next year, and a lot of that is duals. I was just curious if that was also causing a little bit more of the lower first quarter number?

JOSEPH CAPEZZA: Okay. With regards to the investment, our market value yield to maturity is in the 4.5 percent range. Our average coupons in the 4.8 percent range. And the duration of our portfolio is only at a little over three years.

JAY GELLERT: And with regard to the second question, it has had -- it will have some effect in Q1 also. And so it's another issue that affects Q1.

JOSH RASKIN: It doesn't sound like, Jay, then that's a significant difference than what you were seeing. It seems like SG&A is the big driver? Is that--?

JAY GELLERT: Yes. G&A is the big driver, and I think it's the Q1 effect versus the rest of the year. It's had some effect, but it's more the G&A spend, as we indicated at Investor Day.

JOSH RASKIN: Okay. And I'm sorry, Joe, just on the first point, are you assuming that those are the -- that the yield maturities and the coupon remain steady throughout the year, or do you have assumptions in terms of changes there?

JOSEPH CAPEZZA: Yes, with this current market, it's tough to judge what's going to happen to the market value yield to maturity. But I think we're well positioned to take advantage of potentially declining interest rates as we see the Fed continue to ease up on their position.

JOSH RASKIN: Got you. And then just a last quick question. Medicaid MCR in 2008 -- should we just assume you're going to see a little bit of a benefit there with the exit of Connecticut?

JAY GELLERT: Yes.

JOSH RASKIN: Okay. Thank you.

OPERATOR: We'll next move to JPMorgan's Bill Georges.

BILL GEORGES: Thanks. Good morning. My first question is around your TRICARE loss ratio in the quarter. Much better than what you've historically reported. Can you sort of give us some of the drivers there? And then how should we think about that when we're forecasting that segment in '08?

JAY GELLERT: It's the result of some positive experience on the mental health program, as well as some continued benefit on the health care side. We don't anticipate it and haven't built it into our expectations for '08. And so I think we should stay with the guidance we had for '08 in terms of that program.

BILL GEORGES: And when's really the drop-dead date on getting an extension in that program? It has to be soon. Is it something that we could expect in the next couple of weeks or is it -- are we going to see rolling extensions on a monthly basis as you've mentioned the possibility before?

JAY GELLERT: Yes. Well, there are two issues. One is the timeframe of the reprocurement and the other is the extensions. They're not necessarily related because even as the reprocurement drags so that it can't be completed by the date in question, doesn't necessarily mean an extension will be immediately forthcoming. In statute, there's a 10-month transition period for the new contracts. So in theory, an award would have to be made by May 31st, in order for that contractual climate to be met. That's very hard to see with no RFP out. That's virtually impossible. So I think there will be extensions. When exactly they are forthcoming in the contractual process is unknown.

BILL GEORGES: Okay. Just one last quick one. You did mention that you still saw avenues for California health care reform. You're much closer to the situation, I think, than we are. It seemed to me from what we read in the papers, though, that everything that's going on out there with the Governor's proposal is dead. Is there still the possibility that it could be revived?

JAY GELLERT: Well, the Governor has said that he intends to continue to pursue it. It's hard to see an initiative get on the ballot in '08, given the timing. But we're in a situation where we have term limit measure on the ballot today, in fact, in California. If it doesn't pass, there'll be changes in structure and leadership in the legislature, and that conceivably could lead to some different approaches that the Governor is considering.

BILL GEORGES: Okay. Great. Thank you.

OPERATOR: We'll next take a question from Christine Arnold of Morgan Stanley.

CHRISTINE ARNOLD: Hey there. A couple of questions. First on this change in '08 guidance. Was there any change to kind of your enrollment assumptions or any of your loss ratio assumptions, or is all of the change owing to the change in G&A?

JAY GELLERT: There is some changes in enrollment between Medicare and commercial, a little bit. They're de minimus; they're kind of irrelevant. The only effect is G&A.

CHRISTINE ARNOLD: Okay. And then as we think about cost trends, it looks like relative to what you were thinking or seeing last quarter, the drug trend came down a little bit and the doctor trend looked really muted. But it looks like the hospital might have upticked. Could you talk about what you're seeing in terms of hospital pricing as you enter '08 and your expectations with respect to volumes?

JAY GELLERT: I think our hospital expectations, all in, as we enter '08 are in the high single digits. It's the combination of unit costs, some outpatient unit increases. We're not seeing an inpatient trend.

CHRISTINE ARNOLD: So the high single digit hospital trend is driven by outpatient?

JAY GELLERT: Some outpatient utilization, but primarily unit cost in both outpatient and inpatient.

CHRISTINE ARNOLD: And are unit costs rising year-over-year?

JAY GELLERT: Unit costs -- yes.

CHRISTINE ARNOLD: Accelerating?

JAY GELLERT: No, they're staying pretty consistent.

CHRISTINE ARNOLD: Okay. So that's pretty stable.

JAY GELLERT: Yes. They're not coming down, but they're not going up.

CHRISTINE ARNOLD: And then final question is, some of your competitors got rid of some of these dual-eligible PDP members. Has your view of PDP profitability changed now that you're seeing how many of these duals you're getting in and starting to see some of the drug claims?

JAY GELLERT: No.

CHRISTINE ARNOLD: Recognizing it's early?

JAY GELLERT: No.

CHRISTINE ARNOLD: Okay, thanks. Thank you.

OPERATOR: We'll next move to Doug Simpson of Merrill Lynch.

DOUG SIMPSON: Hey, good morning. You guys have been adding individual and small group at a pretty good clip. And just looking at the numbers in the release, also looks like the churn in that book has been decent -- running something around 10 percent if I'm looking at the California numbers. And I would think that both of those would help your commercial MLR this year. So I'm trying to look forward to next year and understand what are your expectations for enrollment growth in that book of business, and what should we be thinking about with the MLR on that piece of business as it matures? How do you manage that churn aspect of it?

JAY GELLERT: Yes. Well, we're being more conservative in our expectations for growth due to a combination of the softening economy in certain places, a few competitiveness issues. We really want to keep focused on the issue of pricing discipline. So we're expecting less favorable growth patterns, we could be surprised, but we're building in this expectation, so that we can take consideration of the economy and impact some of the statements that some people have made. It -- we'll continue to see growth, but it won't be as strong, at least based on our expectations, as it has been in previous -- in the last year.

DOUG SIMPSON: Okay. And there is no concern -- you're not worried at all about the churn dynamic and the aging of the book? I guess one thing that would be helpful, do you have the average age of your individual and small group contracts this year versus where they were a year ago, or maybe two years ago?

JAY GELLERT: Yes. We can get that for you. We've been monitoring it. We feel good about it. But we can get you the details.

DOUG SIMPSON: Okay. And then just -- if I could just ask--?

JAY GELLERT: I know I've -- Doug, I know I'm two years older than I was two years ago.

DOUG SIMPSON: [laughter] Just stepping back, you look -- you guys have obviously added 10.5 percent to the number and in some markets it's even been higher. I mean, what -- New York, California, you guys are obviously growing that book very rapidly. What's the reason for that? I mean, just -- your networks I wouldn't think are that much -- you probably don't have an advantage over some of the larger players. The brand -- you're competing against the bigger names. Why are you showing such robust growth in that area?

JAY GELLERT: Well, there's two important points when you look at those numbers. One is we're -- while we're growing double digits, it's -- the number isn't huge when you put it against the size of those markets.

DOUG SIMPSON: Yes.

JAY GELLERT: So as a result, we don't have to compete head-on with the "market leader" big names in order to move that kind of membership. It's more a result of a very focused strategy on building relationships with distribution. It's the result of pricing stability, and there have been some more erratic pricing by some of our competitors in these markets, which causes disruption. And third, some focused product offerings. We've talked a lot about our focus in the Latino market. We've focused on some other market opportunities. Again, when you look at the sheer number versus the size of those markets, effective execution is the key to our success, not putting ourselves in a position where we have to be "price competitive" with any of the leaders you've articulated.

DOUG SIMPSON: Okay. All right. Thank you.

OPERATOR: We'll next move to Scott Fidel of Deutsche Bank.

SCOTT FIDEL: Thanks. First question just on the Medicaid exit. And could you give us what the annualized revenue is from Connecticut Medicaid as we think about adjusting the models for that exit after the 1Q?

JAY GELLERT: About \$180 million. And the important point to note is that it went to ASO in December. So we had actually one less month of risk business in '07. The other point to note, too, which is -- relates to some of the "exit costs" is typically of the three months in the last quarter, December is the lightest month so we ended up picking up the two heavy months and not the light months.

SCOTT FIDEL: Okay and then on the MA growth, maybe if you could help us think about obviously most of it in the network-based products, but how that's trending out between SNP products and then sort of the standard medical network-based products.

JAY GELLERT: The vast majority of it is the standard networks-based products.

SCOTT FIDEL: Okay. And then can you update us on expectations for all-in commercial pricing yield and medical cost trends for 2008?

JAY GELLERT: We're staying with the guidance we gave at Investor Day, which was 8 percent commercial yields and commercial health care cost trends 30 to 50 bps better than yield.

SCOTT FIDEL: Okay. Then just one last question on sort of looking at the balance of the lower interest rates from the Fed. How do you view the offset between investment income and interest expense? Do you think they're netting out to equal, or do you think there could be some modest pressure from the lowest interest rate environment?

JOSEPH CAPEZZA: Sorry. Could you repeat that?

SCOTT FIDEL: Just in terms of -- from the lower interest rates, you've got potentially pressure on investment income, but opportunities on interest expense and sort of how do you see the two of those offsetting each other?

JOSEPH CAPEZZA: The -- we think it's going to be relatively stable between the two. Right now, investment income, we're expecting about \$120 million interest -- sorry, \$110 million for the year on 2008, interest expense up slightly to about \$34 million. And depending on what happens with the variability in the interest rates on the expense side, we might see a little savings there.

SCOTT FIDEL: Okay. Thank you.

OPERATOR: We'll move next to John Rex of Bear Stearns.

JOHN REX: Thanks. Just back to G&A in the first half. Now at your investor day, you'd sized \$15 to \$20 million, so called, above the line reorganization costs that you were going to bear during the year. What is that number now, and can you just give us how you're modeling this now in terms of how it falls?

JAY GELLERT: Those costs -- the number we gave you was a net number. Actually the costs in the first half of the year above the line are greater than that. And so we'll end up if you -- the difference in the G&A that we've talked about which is -- the 10.7 and then lower but not -- above 10 in the second quarter and then lower numbers in the second half of the year. That kind of reflects the distribution of that across the quarters.

JOHN REX: So, okay. So I didn't realize it was a net number what you gave before. So this \$15 to \$20 million is still the net number, or is it higher now?

JAY GELLERT: We probably built it -- probably when you look at the range change we made, we probably have given ourselves a little more available resource to get this done. Because it looks as though we can get it done a little quicker.

JOHN REX: Okay. And then on TRICARE again, you look at the \$63 million gross profit in the Q is up 80 percent over last year, 30-some percent over the last quarter. So is there a component of that that's due to settlements of prior period? Something that we should think about as one-time?

JAY GELLERT: Yes. I think that there's some issues with regard to how the experience basically settled out that led us to those kind of numbers. It's also some of the mental health issues with the kind of payment process on the mental health issues. We are not changing our guidance for next year from the guidance we gave regarding TRICARE. And so that's the way you should look at it.

JOHN REX: Okay. But it doesn't sound like -- you're not necessarily characterizing those as one-time, though, it sounds like, though.

JAY GELLERT: Well, no. I guess -- when you ask one-time, one of the key things is there are three or four one-time things that are moving in different directions. So you have some things that are nonrecurring on the TRICARE side. At the same time, you don't have any kind of recurring costs from the Medicaid exit in Connecticut, and some of the true-up on the other side in terms of Medicare. So when you package all them, I'd put them together and basically say they didn't move the earnings.

JOHN REX: Okay. And then it sounds like you're still guiding to about 30 to 50 basis points of commercial MCR improvement in '08. Just in terms of the way you characterize the premium yields and cost trends. Shouldn't it even be a little more than that if your book of business is shifting more heavily to individual and small group, though? Would we expect it to be better than the 30 to 50 basis points that we actually see?

JAY GELLERT: Because of some of the assumptions we've made on the economy and some of the conservatism we've built in because of the anticipation potentially of some efforts on the part of some of the competitors, we'll see less transition in the model we're building '08 off of than we did in '07. So we're not counting on the degree of shift large to small that we saw in '07 again in '08. And so as a result, the change we're talking about is as much driven by same-store pricing as it is by the shift in the book we've seen in earlier years.

JOHN REX: Okay. And I take it -- your commentary on membership earlier would also indicate you do not expect -- you had indicated one time that January would be kind of be the first time in years that you saw up commercial membership. That's not your expectation anymore, is that correct?

JAY GELLERT: Yes. We're up in all the markets except the Northeast. And we're -- and that basically brings us to the point where we're about flat.

JOHN REX: Okay. Thank you.

OPERATOR: We'll next move to Greg Nersessian of Credit Suisse.

GREG NERSESSIAN: Good morning. To follow up on that last question -- so the Northeast, with the insourcing of the Guardian, when should we expect to see some sequential growth in the Northeast in the commercial business? Is that -- obviously not happening 1/1. Is that going to flow through in the back half of the year, or should we be waiting for '09?

JAY GELLERT: I think we're looking for more like stability in the back half of the year and then growth. The growth would begin in '09.

GREG NERSESSIAN: Okay. Okay. That's helpful. Then I had another question just on the commercial book. Was there any material amount of prior period reserve development in the fourth quarter intra-year? I saw the prior year number was basically flat. But is there anything intra-year?

JAY GELLERT: It's not a significant amount. It's a de minimus amount.

GREG NERSESIAN: Okay. That's helpful. Just a couple more quick ones. The all-in cost trend and yield, I think, you answered on the previous question was about 8 percent. Does that include the Guardian, or is that the ex-Guardian number?

JAY GELLERT: The all-in.

GREG NERSESIAN: That's the all-in. What is the ex-Guardian yield and trend?

JAY GELLERT: We'll have to get that for you. I don't think we have it right here. We'll get it for you.

GREG NERSESIAN: Okay. Okay. That's fine. And then finally, could you tell us what that fourth quarter Medicare MCR was again, and did you say that was up sequentially?

JAY GELLERT: Yes. It was up -- the fourth quarter Medicare MCR was up 100 bps sequentially and came in at about 87. Yes.

GREG NERSESIAN: Okay. Was that -- I guess what was the driver of the sequential increase? Was that people coming out of the doughnut hole, or?

JAY GELLERT: I'm sorry, I was talking about MA. I wasn't talking about PDP.

GREG NERSESIAN: Okay. That's fair. Okay. That was it. Thank you.

OPERATOR: Just another quick reminder that star-one to ask a question. We'll next move to Tom Carroll of Stifel Nicolaus.

TOM CARROLL: Good morning. A quick question on Connecticut Medicaid. Your comments certainly imply you continue to plan to exit the market. But WellPoint has hinted at a possible compromise with the state. If WellPoint reaches an agreement, would you guys rethink your exit in that market?

JAY GELLERT: We'd wish them well.

TOM CARROLL: Okay. That's pretty direct. Thank you very much.

OPERATOR: Just a final reminder that is star-one if you'd like to ask a question. Again, that's star-one.

And it appears we have no further questions coming in at this point.

DAVID OLSON: All right. Thank you very much, Operator. We will see all of you down the road. And we'll be reporting first quarter numbers in late April. We'll give you an exact date shortly. Thank you again for joining the call this morning. Good-bye.

OPERATOR: That does conclude this Health Net, Inc. fourth quarter 2007 earnings conference. We thank you all for joining us, and have a wonderful day.

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