

Anthem Fourth Quarter Results Conference Call
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Please note this transcript has been edited for accuracy.

OPERATOR: Ladies and gentlemen, thank you for standing by. And welcome to the Anthem’s fourth quarter results conference call. At this time, all participant lines are in a listen-only mode. Later, there will be a question-and-answer session, and instructions will be given at that time. If you do need assistance during the call today, please press the zero followed by the star. As a reminder, today’s call is being recorded.

At this time, then, I’d like to turn the conference over to Tami Durlle. Please go ahead.

TAMI DURLE, VP INVESTOR RELATIONS, ANTHEM, INCORPORATED: Good morning, everyone, and welcome to Anthem’s fourth quarter 2001 conference call. This is Tami Durlle, Vice President of Investor Relations. And joining me today is Larry Glasscock, Anthem’s President and Chief Executive Officer, and Mike Smith, Chief Financial Officer. This morning, Larry will summarize Anthem’s 2001 results and milestones, along with our earnings outlook for 2002. Also, Mike will provide a detailed review of our fourth quarter and full year 2001 financial results.

On today’s call, we will be making some forward-looking statements. Listeners are cautioned that there are factors that could cause actual results to differ materially from our current expectations. These risk factors are discussed in our most recent 10-Q, which was filed with the SEC in December of last year.

Now, I will turn the call over to our CEO, Larry Glasscock.

LARRY GLASSCOCK, PRESIDENT, CEO, ANTHEM, INCORPORATED: Thanks, Tami, and good morning, everyone.

Today, Anthem announced full year 2001 earnings of \$3.03 per diluted share, an increase of 51 percent year over year, excluding the impact from non-recurring items and realized gains. This was Anthem's first quarter as a public company, and we are very pleased with the results. Anthem's detailed focus on our businesses and the execution of a proven strategy are driving growth and improvement throughout the company. Two thousand and one consolidated operating gain was \$319.5 million, up 74 percent from the year 2000. This operating gain performance translates into a 3.2 percent operating margin, a 100 basis point improvement compared to 2000. In addition, our 4.1 percent operating margin reported in the fourth quarter of '01 was not only the best quarterly operating margin reported during the year but also the best in Anthem's history.

We continue to expand our membership in a tough economic climate. During the fourth quarter of 2001, Anthem added 49,000 new members, and total membership at December 31, 2001 was approximately 7.9 million members, an increase of 10 percent compared to year-end 2000 on a same store basis. Membership growth in 2001 on an as reported basis was eight percent, which is consistent with our expectations shared with you last quarter. The Midwest and West membership gains came in as planned, and the East region slightly outperformed our projections during the fourth quarter. In 2001, the Midwest added 400,000 new members on a same store basis. The East increased membership by 167,000 members, and the West membership growth was 174,000 members, or a 29 percent growth rate year over year. Anthem benefited from excellent membership growth in all customer segments, except for Medicare + Choice, which declined in 2001 due to our exit from the market in Connecticut on January 1, 2001.

What we find is customers want open access products that provide choice and convenience. And in 2001, Anthem's PPO products reported growth up almost 360,000 members, or a 13 percent year over year increase. We feel that the demand for open access products will continue in 2002.

In terms of Anthem's product strategy, we offer a broad product selection for our customers, ranging from tightly managed HMO and point-of-service plans to less restrictive PPO and traditional indemnity programs, both on a non-risk and fully insured basis. In addition, our products offer broad networks with high quality providers. And we anticipate increased demand by members and employers for multiple price point products this year and beyond. And we are well positioned with products that offer price ranges with considerable spread to meet this market need.

Anthem had a great fourth quarter, and there were many other accomplishments, as you can appreciate, in 2001 as well. I'd like to take a moment and recap some of the major milestones of 2001 achievements, as we believe that we've been able to set the stage for even more improvement in our future.

First, as you know, Anthem's demutualization and initial public offering was completed on November 2, 2001. And over \$4 billion in cash and stock was distributed to policyholders in December of last year. The success of our conversion to a publicly traded company will provide Anthem with financial flexibility, as we continue to grow and invest in initiatives to offer high quality products and services.

Second, Anthem continued its earnings momentum in 2001. As I previously mentioned, net income was up 51 percent during the year and our margins improved to 3.2 percent. This improvement in operating results is due to disciplined pricing strategies, a focus on administrative cost containment, including the integration of our acquisitions completed in late 1999 and 2000, along with profitable enrollment gains. We are making solid progress in improving our mix of business and overall operating structure to further increase our competitiveness in the industry.

Third, as I mentioned earlier, Anthem's membership grew by 10 percent in 2001. This represents an increase of 741,000 members in a slowing economy. Anthem's ability to expand membership in view of the 2001 economy can be attributed to our strong brand name, our diversified product portfolio, our excellent customer service, and our very disciplined pricing strategy.

Fourth, our integration efforts in the East and West regions continue to result in improved performance. Anthem acquired the Blue Cross and Blue Shield plans of New Hampshire in 1999, Colorado and Nevada in

November '99 and Maine in June 2000. The West segment reported improving financial results in each successive quarter of 2001 due to our focus on customer service and profitable membership growth. Also noteworthy, during 2001 Anthem recaptured the number one market share position in the state of Colorado. In the East, we are leveraging our best practices of a proven operating model in Connecticut, to our acquired plans in New Hampshire and Maine.

Fifth, Anthem's focus on our core business was further solidified as we exited the Medicare + Choice market in Connecticut in January 2001 and sold our TRICARE operations in May. Both of these transactions enabled Anthem to invest dollars and human resources back into what we see as our core businesses. In addition, even though this event was not effective until January 1st of this year, Anthem made a strategic decision in 2001 to exit the Medicare + Choice market in Colorado, adding even additional focus to our target markets and products.

Sixth, our Specialty business segment, a business unit that became operational at the end of 2000, reported strong financial results and began providing pharmacy benefit management services to Colorado, Nevada and Maine health plans in 2001.

And lastly, in May '01 Anthem signed an agreement to acquire Blue Cross/Blue Shield of Kansas. Last month, 63 percent of the Kansas policyholders that voted approved the merger with Anthem. This transaction still requires approval of the Kansas insurance commissioner. We expect her decision no later than February 25th. If she approves, we expect to close the transaction in late first quarter or early second quarter. The acquisition will add scale to our west region and add a new market for our specialty businesses.

I hope you will agree that 2001 was an outstanding year for Anthem, and we remain quite optimistic as we look into 2002. We believe each of our regions has significant growth potential, and we will continue to focus on improving our performance. Anthem's earnings growth in 2002 will result from continuing the execution of our proven strategy. Anthem will grow profitable enrollment. Offering a broad selection of products with leading market positions will result in competitive advantages, cost efficiencies and greater opportunities to sustain profitable enrollment. We will remain disciplined in our pricing and ensure our members are receiving high quality, cost effective health care. Anthem will diversify its income by expanding our specialty product offerings and by marketing these services with deeper penetration in our health membership. And lastly, our focus on controlling expenses, consolidating systems and optimizing our business mix will result in margin improvement.

Now, I would like to introduce Mike Smith, our Chief Financial Officer, who will walk you through more details on the fourth quarter and the full year 2001 financial results. Mike.

MICHAEL SMITH, CHIEF FINANCIAL OFFICER, ANTHEM, INCORPORATED: Thank you, Larry, and good morning.

Our reported fourth quarter net income was \$87.7 million, or 85 cents per diluted share. Excluding \$400,000 of net realized investment losses and \$11 million of nonrecurring expenses in connection with our demutualization, net income was \$99 million, or 95 cents per diluted share, representing a 56 percent increase from the fourth quarter of 2000. The earnings per share calculation was based upon 103.8 million diluted shares.

Some detail around the components of the outstanding shares are as follows. Anthem issued 48.1 million common shares to eligible statutory members before year-end and 55.2 million shares in the initial public offering, for a total of 103.3 million common shares issued and outstanding. We also granted 100 share options to each of our nearly 15,000 non-executive associates at the time of our IPO. These options contributed approximately 300,000 diluted shares for the calculation that we referenced. Also, the dilutive impact of the \$230 million of equity security units issued during the initial public offering had a dilutive impact of 200,000 shares in the fourth quarter per share calculation.

The total of what I've just outline is 103.8 million common shares on a diluted basis. You will recall the guidance we gave last quarter was based upon a preliminary estimate of 103.1 million shares. And at that time, we did not reference dilution from options or equity security units in our guidance. Even with the increase in diluted shares, we have exceeded per share expectations in the fourth quarter.

Responding to inquiries regarding overhang, or so-called overhang following our demutualization, we have, to date, over four million shares out of 15 million shares issued in our large holder program that have been sold. The large holder program will remain in place through early May of this year, and we have not seen any negative impact on our stock price as a result of the large holder program.

Consolidated operating revenue was \$2.6 billion in the fourth quarter of 2001, representing a 12 percent increase from the fourth quarter of 2000. On a same store basis, that is, excluding the impact of the sale of our TRICARE business in May 2001, the year over year operating revenue growth was 18 percent. Anthem continues to enjoy strong top line growth as a result of both membership gains and disciplined pricing. Larry has mentioned that our 2001 membership growth was 10 percent on a same store basis. In addition, premium yields on fully insured group business were approximately 14 percent for 2001, contributing to the double digit operating revenue growth.

Operating gain was \$107.1 million for the fourth quarter, exceeding our expectations and representing an increase of \$42.9 million, or a 67 percent growth rate compared to fourth quarter 2000. Anthem's two largest business segments, our Midwest and East units, which, in the aggregate, accounted for about 86 percent of consolidated operating gain during the quarter, reported 55 percent and 27 percent year over year growth in operating gain, respectively. Our West segment reported almost \$10 million in operating gain in the fourth quarter, which represents the best quarterly performance for this segment since Anthem acquired the Blue Cross and Blue Shield of Colorado and Nevada plans in November 1999. We are very pleased with this progress in the West and continue to be excited about our prospects in these growing markets.

Operating gain of \$7.9 million in our Specialty segment was slightly below our projections for the fourth quarter of 2001, primarily due to lower pharmacy rebate income and accelerated spending related to the build out of infrastructure for our new vision business. We are extremely pleased with the progress we are making in our Specialty businesses. In the full year 2001, Anthem reported \$32.9 million in operating gain in this segment and accomplished a 32 percent growth rate over 2000. In addition, the operating margin in the specialty segment improved to 8.3 percent in 2001 from 7.5 percent in full year 2000. We are confident that we can continue to improve both operating results and margins in this segment as we penetrate and cross sell specialty products to our health benefits members, develop new products and leverage the capabilities of our pharmacy benefit company.

The Other segment, which primarily includes our Medicare processing business, inter-segment eliminations and unallocated corporate expenses, reported a better than expected result due to lower levels of unallocated discretionary corporate expenses, with that reduction more than offsetting new expenses related with our public company status. Two important performance measures that help define operating gain are our benefit expense ratio and administrative expense ratio. Anthem's consolidated benefit expense ratio was 82.7 percent in the fourth quarter of 2001, slightly better than our expectations, primarily due to favorable experience in our East segment. As we have discussed in the past, year over year comparisons of fourth quarter benefit expense ratios are somewhat difficult, given our history as a mutual and our long established, conservative reserving practices. This becomes even more clear as we consider that in late 2000 we recorded a true up of reserves totaling approximately \$20 million. Without those adjustments to last year's fourth quarter reserves, our benefit expense ratio would have shown about a 10 basis point improvement in the fourth quarter of 2001. The full year 2001 benefit expense ratio was 84.5 percent, and this ratio has been fairly steady over the past three years at 84.6 percent in 1999 and 84.7 percent in 2000.

Anthem's medical cost trend for fully insured group business was nearly 13 percent in 2001. This trend was consistent with last quarter's results and with our expectations. Excluding the impact of mix changes in our

insured business, our cost trend was approximately 12 percent for the year. During 2001, we experienced inpatient trends in the high single to low double-digit range, outpatient in the low to mid teen range, professional fees in low double-digit trends, and pharmacy costs in mid to high teen trends. We continue to believe that medical cost trends for our fully insured business will be in the 13 to 15 percent range for 2002. The increase in trend, as compared to 2001, will likely be driven by outpatient utilization and pharmacy costs. We are attentive to the possibility that the pharmacy trend could see some abatement from patent expirations over the next couple of years. However, we feel that consumption overall will continue to trend at strong rates. And, therefore, we have taken a conservative stance on our predicted medical cost trends.

Our consolidated administrative expense ratio was 20.1 percent in the fourth quarter of 2001 versus 23.0 percent reported for the same quarter of 2000. The full year 2001 administrative expense ratio was 19.6 percent, consistent with our expectations discussed last quarter and 160 basis points better than full year 2000 results. Please keep in mind that the fourth quarter of 2000 administrative expense ratio was impacted by a \$20 million contribution to a then newly formed Anthem Foundation. As we expected, fourth quarter 2001 spending was up sequentially due to new business development efforts and investments made surrounding our data warehouses and other systems improvements.

Anthem is currently consolidating several of its operating systems. And this migration of membership to the system of choice in each region should essentially be completed by the end of 2003. The systems consolidation effort, along with the further integration of acquisitions completed in 1999 and 2000 will provide for further cost reduction opportunities. Anthem will continue to be relentless in administrative cost control while at the same time investing in technology and processes that will drive improved operational efficiency and increased customer value.

Before I discuss our year-end balance sheet, I would like to focus briefly on two more line items on our income statement - net investment income and interest expense. Fourth quarter 2001 results in both items were impacted by our recent initial public offering. As we noted on our November 14th conference and included in our guidance, net investment income in the fourth quarter of 2001 included a one-time benefit associated with the income from temporary investment of IPO proceeds prior to their distribution before year-end to our policyholders. This one time benefit to net investment income in the fourth quarter was approximately \$8 million, or five cents per diluted share. Also, as you know, Anthem issued \$230 million of equity security units during our initial public offering. The equity security units consist of a mandatory contract to purchase shares of our common stock three years after their issuance at a premium of 22 percent, as well as a subordinated debenture that has a cash yield of six percent. The fourth quarter of 2001 included interest expense of approximately \$3 million on these securities from November 2, 2001 through December 31st.

Now turning to our balance sheet. Cash and investments were almost \$4.5 billion at December 31, up from \$3.7 billion at year-end 2000. The major driver to the increase in the investment portfolio was operating cash flow. Operating cash flow was \$143 million in the fourth quarter and \$655 million for the full year, exceeding our net income by a substantial margin and indicating continued strength in quality of earnings. Total policy liabilities were \$1.7 billion at year-end 2001. Excluding the TRICARE reserves from year-end 2000, policy liabilities were up \$121 million at year-end 2001. Days claims in payable were 64.4 days at December 31, 2001, up nine-tenths days sequentially and within the 63 to 65 day range we have reported throughout 2001.

Anthem's total debt increased by approximately \$220 million compared to last quarter. This increase is due to the issuance of 230 million of equity security units at the time of our IPO, net of costs incurred at that debt issuance. The debt to capital ratio was 28 percent at year-end 2001, up from 22 percent at September 30 due to the issuance of these equity security units. Note that the inclusion of the equity security units as debt in our debt to capital ratio is a conservative presentation in our view and, we believe, also from a rating agency perspective, since the debt component of the units will ultimately be replaced with equity as the units mandatorily convert.

I would now like to turn the call back over to Larry, who will walk you through our earnings guidance for the full year 2002.

GLASSCOCK: Thank you, Mike. First of all, let me just remind you that the guidance I'm about to go over does not include the Blue Cross and Blue Shield of Kansas acquisition, which, if approved, as I indicated earlier, is expected to close in late first quarter or early second quarter of this year. As we have said previously, we expect Kansas results to be neutral to our net income guidance in '02 and accretive in '03.

In addition, this guidance includes the impact of FAS 142, which increases earnings per share by 15 cents in 2002. We are pleased to announce that even though we exceeded our expectations in 2001, we remain confident that we will grow our 2002 diluted earnings per share by at least 15 percent on a FAS 142 comparable basis. Therefore, on a FAS 142 basis, we expect diluted earnings per share of \$3.65 to \$3.75 per share for full year 2002, excluding realized gains or losses. Note that diluted shares outstanding for 2002 will be impacted by the options issued to Anthem associates during the initial public offering and the equity security units that Mike referred to earlier. The earnings guidance of \$3.65 to \$3.75 per share was estimated using 105 million diluted shares outstanding for 2002.

We are also pleased to announce that earlier this week Anthem's board of directors authorized a \$400 million common stock repurchase program. During 2002, diluted shares outstanding may be affected by share repurchases, as we will look at alternative investment opportunities, including our own common stock, to enhance shareholder value. However, our guidance for 2002 does not include the impact of share repurchase activity.

Our view on the quarterly earnings per share progression in 2002 is expected to be 80 to 85 cents per diluted share in first quarter, an increase of at least 25 percent over last year on a FAS 142 comparable basis, with sequential improvement throughout 2002. Consolidated operating revenue is projected to increase in the high single to low double-digit range on a reported basis for full year 2002. Remember that Anthem disposed the TRICARE operations in May 2001 and exited the Medicare + Choice market in our West segment on January 1st of this year, impacting the year over year growth rate.

Operating gain is expected to increase 20 to 25 percent for the full year 2002, up from our previous guidance of 18 to 23 percent. Operating gain growth by segment for 2002 is projected as follows. In the Midwest, operating gain increases should be in the 25 to 30 percent range, East growth is expected to be in the 30 to 40 percent range, West in the 35 to 45 percent range, and Specialty also in the 35 to 45 percent range. And the Other segment loss is expected to be more than double the 2001 reported loss.

Anthem's 2002 medical membership is projected to increase by four to five percent on a reported basis. About 30 percent of our membership renews in January of each year. And based upon preliminary numbers for the month of January, we feel confident increasing the range from our previous expectations of three to four percent membership growth.

The 2002 benefit expense ratio is still projected to be roughly flat with our 2001 results. And we continue to expect the administrative expense ratio to decline by at least 100 basis points over the next few years. Operating cash flow was \$655 million in 2001, and we expect to achieve at least this level of cash flow in 2002.

And finally, our effective tax rate is expected to be in the 32 to 34 percent range in 2002. Note that this range is below the 2001 effective tax rate of 35 percent due to \$28 million of non-deductible demutualization expenses incurred during last year.

Based on the 2002 guidance presented in last quarter's conference call, you will observe that we have increased our expectations for 2002 in all operating segments, including the membership outlook. Two thousand one was a great year, and we are confident that the earnings improvement and momentum will continue for Anthem in 2002.

Now, Mike and I would like to open up this call for questions. So, Operator, can we take the first question, please?

OPERATOR: And, ladies and gentlemen, if you do wish to ask a question, please press the one on your touch-tone phone. You'll hear a tone indicating you've been placed in queue. And you may remove yourself from queue by pressing the pound key. If you are using a speakerphone, you may need to pick up your handset before depressing any of the numbers. Once again, if you do have a question, please press one at this time. Again - I'm sorry, please go ahead.

GLASSCOCK: I just wanted to add that as we take questions obviously Mike and I are here. I've also asked Dave Frick to join us. Dave is our chief legal and chief administrative officer at the corporation and works very closely with us on all the issues that we address at Anthem.

OPERATOR: Great. Thank you, sir. And we do have a question, then, from Lori Price's line with JPMorgan. Please go ahead.

LORI PRICE, JPMORGAN: Thank you. You had said that customers are buying a lot of your open access products. And I'm wondering if you can give us any other - any additional flavor or color on your January open enrollment results. And, specifically, if you're not comfortable giving us the preliminary enrollment adds for January, can you give us a sense as to where that growth is coming from? Is it PPO and Blue Card or is it across the board? Just give us some additional flavor.

GLASSCOCK: Lori, this is Larry. It's very much across the board. We've had very good preliminary numbers in the growth area, which is why we were comfortable in increasing our guidance on membership. We have seen obviously interest in making sure that employees of companies are more involved in sharing in the cost. But again, we're very pleased with the membership growth.

PRICE: OK. And just one quick follow-up question, if I could. Could you give us any kind of a break down in terms of member mix broken out by PPO and Blue Card and HMO and traditional, and so on?

GLASSCOCK: In terms of January?

PRICE: Well, either January or even December, just so we have the actual allocation.

GLASSCOCK: Let me turn it to Mike Smith, who has that.

PRICE: Great.

SMITH: Lori, I'd be pleased to do that. At the end of fourth quarter, let me give you first a mix by funding type. Approximately 14 percent of our 7.9 million members were insured in traditional indemnity products. Forty one percent were participating in PPO products, nine percent in point-of-service, 15 percent in HMO products, and 21 percent in our National and BlueCard programs. I misspoke. Let me clarify now with regard to funding. Approximately 51 percent of that membership were in self-funded arrangements, 49 percent in fully insured programs. By type of customer, 36 percent in local large group membership, 10 percent in small group membership, nine percent in individual, 37 percent combined in National and BlueCard programs, and approximately eight percent remaining in government programs, including Medicare + Choice, FEP, and Medicaid.

PRICE: OK. That's great. Thank you. And nice quarter.

SMITH: Thank you.

GLASSCOCK: Thank you.

OPERATOR: Thanks. And our next question, then, comes from Charles Boorady's line with Goldman Sachs. Please go ahead.

CHARLES BOORADY, GOLDMAN SACHS: Thanks, good morning and congratulations on a very successful year. And thank you for the very detailed guidance on 2002. I have a few really quick questions. First, just for clarification on that extra five cents per share investment income. Is that included in the 95-cent number or excluded from that number?

SMITH: It is in the 95 percent number, Charles.

BOORADY: In the 95 cents?

SMITH: Yeah, 95 cents.

BOORADY: OK.

SMITH: The investment income is in the 95-cent number.

BOORADY: OK. And secondly, on the specialty business can you quantify about how much in additional expenses related to the start up of the vision business and also give some color around the reduction in the rebate income?

SMITH: I'd be happy to do so. Ordinarily, we would not dwell on absolute dollar events of this small magnitude. But, clearly, we are remaining focused on and very pleased with the overall progress of this business. As Larry and I have talked with all of you in the past, blending these eight plus percent operating margins into our overall business is extremely important to Anthem's future. So, we don't want to lose a report of progress by what are, frankly, a couple of very small, distracting events. We expensed in the fourth quarter slightly more than \$1 million related to the build out of the infrastructure for our new vision business. We and the bookkeepers need to take the heat here. We also made a deliberate change in 2001, requiring the new Specialty segment to absorb what had previously been unallocated corporate expense. As this unit has matured in its role as one of our key segments, we have made a full allocation to the specialty segment in '01, impacting, again, the fourth quarter by slightly more than \$1 million.

Those two small entries, Charles, account for essentially the down that you are seeing. The slightly lower than rebate income, frankly, is a matter we are still flushing out. We have at Anthem taken a very, very conservative approach to recording rebate income earned from our pharmacy suppliers. It is merely a hybrid of an accrual and cash basis. And I believe in Q4 we're mostly seeing a timing difference and, therefore, have stayed with our guidance for '02 at the higher running rate that we had guided you to for '01.

BOORADY: Got you. That's helpful color because the - it sounds like the operating gain in the Specialty business adjusted for those items would directionally still have progressed upward in the fourth quarter from the third quarter then.

SMITH: Absolutely. And we appreciate your helping bring focus to that issue. We do not want any of the folks on the line to change their model by virtue of these two small entries that were made in Q4. We remain very confident in the Specialty segment for its full year '02 outlook.

BOORADY: Thanks. I'll let the next question get on. Thanks again.

OPERATOR: Thank you. And we do have a question, then, from Josh Raskin's line with Lehman Brothers. Please go ahead.

JOSH RASKIN, LEHMAN BROTHERS: Hi. Thanks, good morning, and congrats on the quarter, guys.

GLASSCOCK: Thank you, Josh.

RASKIN: A question, Larry and Mike, to you guys about the margin profile. And it sounds like the results would dictate sort of higher operating margins. And I would even anticipate it, especially in the West, where the ramp has been pretty steep this year. I was wondering if you can talk a little bit about the potential there and especially on the West, if you think you can get the numbers even above the - I think it was almost five percent this quarter.

SMITH: Josh, let me take a couple of shots at your question. First, let me revisit the guidance that Larry provided for full year. We are guiding you and others to an expectation of 35 to 45 percent growth in operating gain for the year. We remain confident that the West will continue to benefit from an extraordinary growth rate in membership. This unit, as we have shared with you, enjoyed membership gains of in the high 20 percents throughout '01.

We're also now seeing the business, if you will, stabilize. The late 1999 acquisition of this business was timed in an environment where the data available to the Colorado Blue Plan was less than stable. As we are seeing the data settle down, our predictive outlooks are becoming more consistent. And we are gaining in confidence our ability to continue to expand that margin.

GLASSCOCK: Having said that, let me just add to the answer just a little bit. We do not expect the margin that we had, for example, in the fourth quarter in the East or the West to be the margin that we experience in the first quarter. But what we have said to you is that what we want to achieve in margin is very nice improvement over time. So, we're guiding to - if you look at the guidance numbers we've provided, you can see that for the full year 2002 we'd be looking at another 20 to 40 basis point improvement in overall operating margin. So, again, we're very pleased with the progress we're making on margin. But what's really important to us is to make that very consistent improvement in keeping with our goal of making sure that we grow profitable enrollment.

RASKIN: That's very helpful. And then just one sort of housekeeping issue. On the guidance that you provided, I think, Larry, you mentioned that the other losses will more than double next year. And it sounds like you've done a better job of allocating those expenses even to the units. So, I was wondering what's the differential there that's going to be driving that increase?

GLASSCOCK: Well, it's good news. And I'll let Mike address that, since we hold him accountable for the Other segment.

SMITH: Josh, I used to be proud to say I was in charge of other until they started making me report to you these doubling of debits.

GLASSCOCK: Yeah.

SMITH: So, let me point you quickly to two issues that will be reported in the Other segment in '02 and differentiate them from '01. First, we will record in the Other segment incremental costs associated with our public ownership status. We will not be allocating back to the operating units those costs unique to shareholder relations and other reporting expenses now marginal to our status change.

Second, let me remind all of you that Anthem's compensation program, which we think nicely aligns management's performance accountabilities to shareholder value. We have a three year long term incentive plan and allocate to each of the business segments appropriately, based upon their headcount and their performance, expected rewards under that long term program. For 2001, those costs were essentially fully absorbed in the segments. We were recording that expense at the target or expected payout range. As our company enjoys earnings momentum so does the impact of that program drive us to a potentially larger

payout. We believe it is imprudent to be allocating in and out of the segments changes in our assessment of the likely payments above those targeted levels.

And so, in our guidance for '02, we have conservatively put what I would call the payments above target in the corporate segment as opposed to allocating them to each of the operating segments. The two issues, then, are again public ownership cost and at this point our best estimate of payments on top of what have been allocated to the segments for the long-term incentive plan. That payout, by the way, would not be made until the first quarter of '04.

GLASSCOCK: And again, that's why I said at the outset that that loss is good news in the sense that we're projecting based on our performance now that the payouts could potentially be above target and, therefore, are accruing accordingly.

RASKIN: OK. So, that's helpful. So, basically just performance base in earnings rise. You would expect the other sort of accruals, at least not necessarily payouts but the accruals, to increase.

SMITH: That's correct.

RASKIN: OK. Thanks, and congrats again.

GLASSCOCK: Thank you.

OPERATOR: Thank you. And we do have a question, then, from Christine Arnold's line with Morgan Stanley. Please go ahead.

CHRISTINE ARNOLD, MORGAN STANLEY: Good morning. First, can you update us on your progress in your systems consolidation? Are you still on track for mid 2003 Midwest and East? And update us on the fact that one million members in the Midwest that have already been transitioned. And then I have a follow-up.

GLASSCOCK: Yeah. Christine, we are absolutely on schedule with the information that we've provided in the past. The consolidation in the Midwest is going very well and right on schedule. We transitioned, as you can appreciate, a number of members in January. And I got an update as recently as a few days ago. In fact, I get one every day. And that migration is going extremely well.

In the East, again, very much on plan. So, as I mentioned, we'll be essentially complete with the migration effort in 2003. So, again, very much on schedule.

CHRISTINE ARNOLD: As a follow-up to that, have there been any issues that you've noted in the regions that you have transitioned that might be disrupting service?

And then as a follow-up, could you talk to us about some of the new products you might have on deck in '03 as employers look to transition more cost to members?

GLASSCOCK: Sure. With regard to any customer service issues surrounding the migration, I would say, again, much in accordance with our planning, we're in very good shape. We're not experiencing any adverse customer service issues. Our service for the first few days of this year in the Midwest we had an awful lot of phone calls. And that's, in part, because, as you know, in December we distributed \$4 billion in cash and in stock. And we got, frankly, more phone calls than we expected at our call center in New Jersey. And some people, in order to get through to us, called our regular customer service lines. So, in that sense, that's something we didn't fully anticipate. We got it corrected literally within a few days. And so, we're very much back on track. But we love taking phone calls from people who've gotten checks in the thousands of dollars that they didn't expect to get. And so, again, we're pleased with the way that rolled out.

With regard to product, what we are working on is making sure that we've really built in a lot of price points across our product set. And so, that's involved a number of features that have been built around higher office visit co-pays, higher deductibles - again, both of those things you would expect - higher co-pays in terms of various inpatient visits. We've also put in some out of pocket maximum changes. We're building in more pharmacy benefit options and we're experimenting with four tier out in the West. And, frankly, we are changing some of our benefit structures where it's more clear that our benefit structures in a few products have been too rich, I guess is a word that I could use. And we're trying to make sure that - in essence what we do is we widen the price limits or price points in our product. So, just as an example, we're doing - in New Hampshire, for example, the current spread on our price between the high point and the low point is about 41 percent. Well, with these new product changes we're putting in place, that spread will be more on the order of 66 percent. And we're going through each of our products across our eight states to make sure that we have widened that range.

So, again, we feel very good about our product strategy. It's one of our strengths as a company. And we're making sure that we're fully prepared to deal with employers and employees who want to spend less and be more involved in sharing the cost of the healthcare benefit.

ARNOLD: And just one clarifying question. The calls you got at your call center were related to the IPO and not to issues related to cards being wrong or ...

GLASSCOCK: That's absolutely correct. Basically, people calling and asking why did I get this stock. Believe it or not, some people don't open their mail. And even though we communicated with them many times, we still had a number of people asking questions about what they got, questioning whether it was too much or too little, et cetera, et cetera. So, those were all good calls to get actually.

ARNOLD: Excellent. Thank you.

OPERATOR: Thanks. And we do have a question, then, from John Rex with Bear Stearns. Please go ahead.

JOHN REX, BEAR STEARNS: Good morning. I was wondering if you could provide your outlook on the seasonality you expect to see in '02 on your consolidated medical loss ratio. My assumption is from your guidance you're not expecting the same level of MCR that you posted this quarter in Q4 next year. And, certainly, as we look at the first three quarters of '01 it was very consistent in MCR front, though Q3 had some impact from your reserves strengthening. I was just wondering if you could kind of just talk us through that in quarterly progression and if you have any change in the outlook you've had there.

SMITH: John, I'll respectfully decline your last request. It will not be our practice to guide you to earnings per share for each of the quarters in this call. I will reiterate Larry's guidance for Q1 and help you through that seasonality change from Q4 '01 to the first quarter of '02. This is also, frankly, in further reference to Charles Boorady's question earlier regarding the guidance. About five cents of the 10-cent change from Q4 to the first quarter of '02, as you would expect, is related to the one time impact of the investment income on the IPO proceeds. It would not be unwise for you in your model to attribute most of the rest of that 10-cent delta to the seasonality in the benefit expense trend. We have - we talked with you on November 14th about this issue, both our reserving practice and in fact the seasonality of our business, particularly given a fairly large enrollment in med supp products, where we are funding, in effect, our members' Medicare deductible during the first quarter of the year.

So, I would say to you our seasonality for quarter over quarter is not likely to have any difference in its pattern from prior years or from our discussions during the IPO. We will acknowledge, again, the one off items that were discussed as we compared Q4 '01 to Q4 2000. I do not expect noise of that nature in any of the quarters in '02.

REX: OK. So, similar patterns, though, is the overall outlook you'd call for.

SMITH: There is no change in - there is no change in product mix or in regional dispersion that would disrupt those seasonal patterns that most of you have already worked into your expectations.

REX: Great. Great. And then just on the administrative expense side, you discussed some of the things impacting the extra spending in the fourth quarter. Can you quantify how much impact you have just from the open enrollment season as you move into January and you prepare for that in the last quarter?

SMITH: Yeah. Excellent question. And I appreciate the reference. Recall our renewal pattern is nicely balanced across all four quarters. We do not see blips seasonally in marketing or enrollment cost. We have fairly even dispersion, less than, I think, 35 percent of our renewal in Q1. So, the cost associated with enrollment in Q4 were not unusual to a fairly even dispersion across the whole year.

REX: OK. And then one last, I think, very quick point here just on the state of Connecticut issue with regard to the stock distribution. Is there any update there? This doesn't appear, to me, to be anything that really impacts you guys at all, but just wondering any kind of noise or anything around that.

GLASSCOCK: I'm going to turn that question to Dave Frick, who's our chief legal and chief administrative officer. Dave.

DAVID FRICK, CHIEF LEGAL & ADMINISTRATIVE OFFICER, ANTHEM, INCORPORATED: That's a correct description of the lawsuit in Connecticut. It is called an interpleader (ph) where essentially two contestants, the state employees by virtue of the union and the state of Connecticut, are fighting over who gets the approximately \$100 million that we distributed in terms of stock to the state of Connecticut.

REX: Right. And that just plays out essentially - I think you guys are named. But essentially, you're just observers in this more than anything.

FRICK: That's correct.

REX: Great. Thank you.

OPERATOR: Thanks. And we do have a question from Jim Lane's line with Salomon Smith Barney. Please go ahead.

JIM LANE, SALOMON SMITH BARNEY: Hi. Good morning. Congrats on the quarter. I had two questions, and I apologize, Mike, if you already went through these. Could you update us on - in third quarter you conservatively booked some extra accruals, I believe, for medical cost. Could you update us on that? Did they prove out to be conservative and not necessary, or were they necessary and you actually paid the cash out on those extra accruals in, I believe, it was two business segments? And then also, Mike, I was wondering if you could just review your comments again on the year over year loss ratio comparison in light of fourth quarter reserve adjustments that were made in '00. Thanks.

SMITH: Sure, Jim. Thank you. And let me try to deal with your first question very quickly. We are pleased, in retrospect, with the decision we made, which we acknowledged made many folks on this line nervous because right in the middle of the road show we updated expectations and announced that we had strengthened reserves, you will recall, by approximately \$21 million. Our judgment has born out to have been a good judgment. That reserve was appropriate and we can now tell by claims inventory levels and the flow of mail following September 11th that we were right on the numbers. There has been, therefore, no draw down of that strengthening that was recorded in Q3.

With regard now, again, to the discussion, Jim, around Q4 '00 versus Q4 '01. I want to be very deliberate in acknowledging your question about what went on that accounted for this increase in benefit expense ratio. It's very straightforward. We, in two segments, released reserves at the end of 2000, in part, quite frankly, in preparation for our conversion. We have been very consistently conservative. I have encouraged many of

you to review our - the full text in our audited financial statements where we, we think, we take a high road of full disclosure around the redundancy, the building redundancy in our year end claims, measured, in part, by the difference between payments made in the year following the reserve to claims incurred and attributed to the year being reported. You will see again when we release, or when we file the K and when we release the annual report, a consistent and building level of redundancy. At fourth quarter 2000, we made a corporate decision that we could well afford to release part of that redundancy and use the timing to fund the Anthem Foundation - excuse me - enabling us, over time, to take care of some of our philanthropic responsibilities without disrupting the GAAP financial statements. We funded a foundation who can now respond to Anthem's corporate duties in our eight states.

LANE: Great. Thanks, Mike. One follow on regarding the share repurchase announcement that was made. I was wondering if you could sort of speak to the philosophy of the company behind share repurchase. Obviously, your internal capital position with regards to risk based capital requirements and so forth has been very strong and continues to be. What is the philosophy on that front? Is it primarily to offset options, or you just going to be opportunistic in the market? Thanks.

SMITH: Thank you, Jim. Let me be very, very clear on this point. Our primary objective is to make sure that our shareholders receive full and fair value for their ownership. When we see events in the marketplace in balance between those who wish to offer shares for sale and those who wish to buy, we feel a duty to protect the value for all of those other shareholders who are holding their interest. So, it is simply a matter of responding to the valuation of our shares relative to our confidence in what's going on in the company and relative to our peers. In every case, however, we will be governed and disciplined by a very discreet calculation of the cost of that capital that we would be willing to forego to re-acquire those shares and also, of course, disciplined by any other appropriate need for the use of capital. You are quite correct. Today, we enjoy a high level of liquidity, which has served us well and allowed us to be opportunistic. And we don't want to surrender that position.

LANE: Thanks, Mike.

OPERATOR: Thank you. And we do have a question, then, from Peter Costa with ABN AMRO. Please go ahead.

PETER COSTA, ABN AMRO: Good morning and good quarter, guys. The question on Kansas. Can you kind of go through what would happen in either situation if the insurance commissioner approves or rejects the merger transaction? What are sort of the next steps under either those two scenarios for you guys?

GLASSCOCK: I'll give it to Dave Frick.

FRICK: As Larry mentioned, the process in Kansas is unfolding. The management team and board of directors had unanimously approved the transaction. The policyholders overwhelmingly voted in favor of the transaction. We're simply awaiting the commissioner's decision. And we are hopeful that that will be a positive decision. If it is, as Larry mentioned, we will close the transaction late first quarter or early second quarter.

If there is a disapproval of the transaction, we'll have to evaluate our options. We believe we have a very strong legal position. Our briefs are posted on the Kansas Department of Insurance Web site. You're welcome to obviously get them on that Web site. And we'll have to make that decision after the decision, but we remain hopeful that she will approve this transaction.

COSTA: If it was disapproved, who would you be appealing it to?

FRICK: The appeal would go to the local judicial system in Kansas.

COSTA: OK. Thank you. And then just one other question on pharmacy trend. You talked about potentially hoping to see pharmacy trend drop but not having priced for that. Have you seen any changes so far in pharmacy trend from sort of the middle of last year to now regarding either utilization or pricing?

SMITH: Yeah. This is Mike Smith. Let me respond. The trend that we reported throughout the year has been fairly consistent in the mid to high teens. We have seen no spike, no recent activity that we would say is aberrant to the full year trend. We observed that others are speaking more optimistically about an expected early '02 change. We are simply being more conservative and are not baking into your guidance or into our thoughts any short term abatement or relief.

COSTA: Great. Thank you very much.

GLASSCOCK: Thank you. We have - I think we have four or five more questions that are still out there. We have five. So, we'll - we said we'd wrap this up in about an hour, but we'll - we want to be responsive. So, we'll take the five questions. And, obviously, for those of you who need to roll off, please feel free to do so.

OPERATOR: Thank you. Yes. And our next question comes from Roberta Goodman's line with Merrill Lynch. Please go ahead.

ROBERTA GOODMAN, MERRILL LYNCH: Thanks. Good morning. I was wondering if you could go a little bit deeper into the medical cost trends and talk a little bit about the impact of volume versus pricing, both on the 2001 trend and what you expect for 2002. And what might be the impact of any benefit design changes as you look at 2002?

SMITH: Roberta, thank you. And I'll be happy to do so. Let me first speak to kind of the volume price question you have on the table. In each element of medical cost we are seeing interesting trends, first in inpatient care. There has been no significant change - and I'm happy to report that no significant change in days per 1,000. While we have had some up tick in admits, it's been abated and moderated with offsetting reduction in length of stay.

With regard to the cost per inpatient visit, fairly stable trend in terms of what we experienced throughout most of '01 and what we saw in Q4 '01. No dramatic change in cost per inpatient visit.

With regard to outpatient visit, we did see, as we cautioned - we did see some acceleration in outpatient utilization in a couple of our regions. And on a utilization basis, saw trend move by a couple of hundred basis points in terms of visits per 1,000 members. Happily, though, again, cost per visit did not move significantly throughout the year. It remains stable, including in Q4.

We've referenced already at some detail what is going on in pharmacy trend. There were no significant changes in Q4 from those trends that were reported in mid teens throughout all of '01.

Professional fee schedules also have remained fairly stable and no dramatic change in office visitation or consumption of physician services.

And, Roberta, I'll take this as far as I can. I'm hoping that's helpful to you. We're seeing moderate up tick in pharmacy consumption, predicted up tick in outpatient utilization, fairly stable bed days, length of stay offsetting admit, and no dramatic change in all in cost per unit of visit, outpatient or inpatient.

GOODMAN: Let me just clarify. When you're talking about a high single to low double-digit hospital trend, we then should attribute that to price and intensity per unit rather than increased ...

SMITH: I would say acuity of service and price more so than overall consumption.

GOODMAN: OK. And to what extent will benefit design changes would you go into these numbers?

SMITH: Larry spoke to that at some length. And just to reiterate quickly, Larry spoke in terms of the slope and curve, we call it. And the slope in our product design technique of broadening the range of price based upon the selection of comprehensive or richness of benefit design. We are attempting to broaden that range so that the increase in consumption, for example, of outpatient services gets spread more ratably and reasonably along that product slope.

GOODMAN: So, again, just to clarify, you're assuming that as we look at the volume versus the price component that would impact the price that you are paying rather than impacting the volume trends?

SMITH: Roberta, I'm not sure I followed that question. Would you try that one more time?

GOODMAN: OK. Sure. When you're looking at the cost share and you're looking at saying more than the beneficiary will be picking up more of the cost of an existing volume of services rather than assuming that there would be a change in the volumes.

SMITH: That is accurate.

GOODMAN: OK. Great. Thank you.

OPERATOR: Thanks. And we do have a question, then, from Michael Stansky's line with Tudor Investments. Please go ahead.

MICHAEL STANSKY, TUDOR INVESTMENTS: Thank you. Could you comment on Anthem's prospects for further Blue consolidation beyond Kansas? Could we see some activity in '02 and '03?

GLASSCOCK: Well - this is Larry. Again, you've heard us say that currently there are about 44 - or last time we talked there were 44 still independent Blue Cross and Blue Shield companies. Now there are 43 with the transaction that closed on January 31st. With other things that have been announced, if they are all approved, we'll be down to 41. It's our belief, and I think if you talk to many in the industry, that over the next several years that we may get to a place where there could where there could be 20 to 25 Blue plans, perhaps 30. We believe the consolidation trend is going to continue. As we've said before, Blue Cross and Blue Shield plans talk to one another all the time about their strategies. So, we believe the consolidation trend will continue. We will be very interested in those situations, which we think fit into what our strategy is as a company. And I think that's really probably I should say about it right now.

STANSKY: Thank you.

OPERATOR: Thanks. And we do have a question, then, from Tom Carroll's line with Legg Mason. Please go ahead.

TOM CARROLL, LEGG MASON: Good morning.

GLASSCOCK: Good morning.

SMITH: Good morning.

CARROLL: With respect to the Kansas acquisition, I wonder if you could just chat a little bit about your expectations of Kansas compared to some of your prior acquisitions that you made more recently. And understanding that Kansas, I think, is a pretty good plan.

SMITH: Well, I appreciate the question very much. It's Mike Smith. Our due diligence, which, as you would imagine, continues through this regulatory process, affirms our long-term optimism for that Kansas

market, particularly in light of what you know to be our regional strategy. The up, if you will, given that Kansas has historically been a profitable plan. The ups that we have been seeking, in large part, were originally conceived to come from scale to be established in the region, that is, combining the cost structures of Kansas and Colorado to achieve a positive outcome. Kansas media has reported, however, in fact, that the Kansas Blue Cross/Blue Shield plan has undergone some pressure this year in its earnings. Remember its history, its rich legacy as a conventional Blue, I guess one would call it, has caused that plan to have incurred underwriting losses in five of the last six years. However, they have been profitable on a net income basis nine of the last 10 years. This year, '01, as has been publicized in Kansas media, two things went on. Underwriting losses deepened, particularly in a single customer segment, the small group book. And the ability to offset those losses with investment income, as all of you would expect, were mitigated by the market's performance.

We believe, still, with confidence that we could cause Kansas to be neutral to our '02 earnings and accretive in '03, however not material in either of those periods. We are not - as Larry said, our guidance for '02 does not include any significant - matter of fact, it includes no contribution from Kansas. So, we remain bullish long term that this plan could produce the same type of delta that we have seen in the three recent acquisitions in terms of overall performance and we believe that using our strategy of focusing even more intently on reducing administrative cost that there is significant upside in that plan.

CARROLL: Very good. Thank you. Just a quick - did you have a management agreement prior to your announcement of the acquisition with Kansas at all?

GLASSCOCK: Sorry, I don't ...

SMITH: Could you help us understand?

CARROLL: Have you worked with Kansas management prior to any real due diligence going in to make the acquisition?

GLASSCOCK: No, we did not.

CARROLL: OK. Great. Thanks a lot.

GLASSCOCK: Thank you. We have time - again, in the interest of time for everyone - maybe two more questions.

OPERATOR: Thank you. Yes. And we do have a question from Ray Lewis's line with McDonald Investments. Please go ahead.

RAY LEWIS, MCDONALD INVESTMENTS: Yeah. Thank you. My questions have all been answered. Thank you.

GLASSCOCK: Thank you.

OPERATOR: Thanks. And then we're going to go onto our last question, then, from James Morris with Utendahl Capital. Please go ahead.

JAMES MORRIS, UTENDAHL CAPITAL: Thank you. Good morning. Can you give us an idea of what cap ex will be for 2002 and kind of an indication on what it'll be spent on?

SMITH: Sure, happy to do that. We expect no significant change from our current rate, which has - as you know, has fairly consistently in recent years had cap ex in the - let's call it \$70 million to \$80 million range, the vast majority of which, and in fact in the '02 outlook, would be 80 to 85 percent of those expenditures for

technology, both hardware and owned versus licensed software. There are very few other capital needs in this company beyond our current focus on technology.

MORRIS: Thank you very much.

OPERATOR: Thanks. And at this time, then, I'd like to turn the conference back over to Larry Glasscock.

GLASSCOCK: OK. Again, to all of you, thanks for your questions this morning. Before we conclude the call, I'd like to take, though, just a moment and summarize why we're very excited about Anthem's future.

2001, as you just saw, was a fantastic year for our company. It was a year defined by earnings improvement and real momentum. And we expect that momentum to carry forward in 2002. The demutualization and initial public offering that we finalized in late '01 will provide Anthem with more opportunities, we believe, to grow and invest in the company in this year and beyond. We're cautiously optimistic that the economy will begin to improve this year. We think that'll provide even greater opportunities for us in our various markets.

And then finally, we believe Anthem has a proven operating strategy that works. This strategy capitalizes on our product, geographic as well as customer diversity, our affiliation with the powerful Blue brand, and our disciplined approach to this very detailed business. And just all of those items really translate into momentum. And that momentum finds its way into financial performance and, we believe, increased growth for the future.

So, again, thank you for your attention this morning and your interest in Anthem. As I'm sure may happen, there may be additional questions. If so, please feel free to contact Tami Durle or Mike Hall, both of whom, as you know, are in our Investor Relations Department. Again, thanks again, and have a great day.

OPERATOR: Thank you. And, ladies and gentlemen, this conference will be available for replay starting today, Wednesday, February 6th, at 1:45 p.m. Eastern Time, and it will be available through February 20th, Wednesday, at midnight Eastern Time. You may access the AT&T executive playback service by dialing 1-800-475-6701 from within the United States or 320-365-3844 from outside the United States, and then enter the access code of 622188. Those numbers, once again, are 1-800-475-6701 from within the United States or 320-365-3844 from outside the United States, and then enter the access code of 622188.

And 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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