

**ANTHEM, INC.**

**ATH-2Q02 EARNINGS CONFERENCE CALL  
AUGUST 5, 2002 8:30AM ET**

**FINAL TRANSCRIPT**

**CORPORATE PARTICIPANTS**

**Operator**

**Tami Durlle**

*Anthem, Inc. - VP of Investor Relations*

**Larry Glasscock**

*Anthem, Inc. - CEO*

**Mike Smith**

*Anthem, Inc. - CFO*

**Tom Snead**

*Anthem, Inc. - President of Southeast Region*

operating efficiencies in our acquisition of Trigon Healthcare, Inc. ("Trigon") and to successfully integrate our operations; our expectations regarding the accounting and tax treatments of the transactions and the value of the transaction consideration; and general economic downturns. You are cautioned not to place undue reliance on these forward-looking statements that speak only as of the date hereof. Anthem does not undertake any obligation to republish revised forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events. You are also urged to carefully review and consider the various disclosures in Anthem's various SEC filings, including but not limited to the registration statement on Form S-4, including the joint proxy statement/prospectus constituting a part thereof, filed by Anthem on June 7, 2002, Anthem's Annual Report on Form 10-K for the year ended December 31, 2001, and Anthem's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2002.

## **Safe Harbor Statement Under the Private Securities Litigation Reform Act of 1995**

This transcript contains certain forward-looking information about Anthem, Inc. ("Anthem"), that is intended to be covered by the safe harbor for "forward-looking statements" provided by the Private Securities Litigation Reform Act of 1995. Forward-looking statements are statements that are not historical facts. Words such as "expect(s)", "feel(s)", "believe(s)", "will", "may", "anticipate(s)" and similar expressions are intended to identify forward-looking statements. These statements include, but are not limited to, financial projections and estimates and their underlying assumptions; statements regarding plans, objectives and expectations with respect to future operations, products and services; and statements regarding future performance. Such statements are subject to certain risks and uncertainties, many of which are difficult to predict and generally beyond the control of Anthem, that could cause actual results to differ materially from those expressed in, or implied or projected by, the forward-looking information and statements. These risks and uncertainties include: those discussed and identified in public filings with the Securities and Exchange Commission ("SEC") made by Anthem; trends in health care costs and utilization rates; our ability to secure sufficient premium rate increases; competitor pricing below market trends of increasing costs; increased government regulation of health benefits and managed care; significant acquisitions or divestitures by major competitors; introduction and utilization of new prescription drugs and technology; a downgrade in our financial strength ratings; litigation targeted at health benefits companies; our ability to contract with providers consistent with past practice; our ability to achieve expected synergies and

## PRESENTATION

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### **Operator**

Ladies and gentlemen, thank you for standing by and welcome to the Anthem second 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 I would like to turn the conference over to Ms. Tami Durle. Please go ahead.

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### **Tami Durle - Anthem, Inc. - VP of Investor Relations**

Good morning and thanks for joining us. This is Tami Durle, vice president of investor relations. We're pleased to discuss with you today both Anthem and Trigon's second quarter 2002 results, the recently closed Anthem/Trigon merger and our expectations for combined Anthem and Trigon operating results for the full year 2002 and 2003. This morning Larry Glasscock, Anthem's chief executive officer, will provide an overview of Anthem's second quarter results. Mike Smith, Anthem's chief financial officer, will cover our financials. Next Tom Snead will present Trigon's second quarter performance as well as an update on the Trigon integration process. Larry will then provide the earnings outlook for the rest of 2002 and 2003 before opening up the call for questions. We will be making some forward-looking statements. And you're cautioned there are factors that could cause actual results to differ materially from our current expectations. These risk factors are discussed in the press release this morning. Our registration of shares issued to Trigon's shareholders on Form S4 filed in June and other periodic filings we've made with the SEC. Larry.

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### **Larry Glasscock - Anthem, Inc. - CEO**

Thank you, Tami. And good morning to everyone. As evident from our press release, both Anthem and the former Trigon has sustained operating and financial momentum. Tom Snead will walk you through Trigon's second quarter results later. But I want to quickly acknowledge we could not be more pleased that Trigon joined the Anthem family. After spending the last three months working with Tom and many other Trigon associates, we're even more enthusiastic about the benefits of this transaction. Through the efforts of many people, including Anthem and Trigon associates, as well as regulatory authorities, we were able to close the transaction 93 days after the date of the merger announcement. Later both Tom and I will touch on the integration initiatives underway since we announced the merger agreement on April 29th. But first I would like to highlight our second quarter results. Anthem's second quarter 2002 earnings were 99 cents per diluted share an increase of 32 percent year-over-year on a FAS 142

comparable basis, excluding realized gains, losses and the impact of our demutualization expenses in 2001. Our strong financial performance is the result of a sustained disciplined growth strategy along with focusing on the needs of our customers every single day. At the end of June our enrollment reached 8.3 million members. Or an increase of 542,000 members from the same period last year. On a year-over-year basis, membership has increased in all lines of business, and have also grown in each of our eight states. Most importantly, we are growing profitable enrollment. Anthem's consolidated operating gain was 118.6 million dollars. A 62 percent increase over last year's second quarter results. And operating margin improved from 2.9 percent in the second quarter of 2001 to 4.2 percent in the current quarter. The 4.2 percent operating margin reported this quarter represents the best in Anthem's history. Although we are very pleased with this progress, we remain very focused on opportunities for further improvement in our financial and operational performance. As you know, a big part of our margin improvement efforts are centered around our systems consolidation activities. Specialty product penetration integration of our acquisitions in the East, West and Southeast regions and very importantly ongoing administrative cost control. All of these margin expansion initiatives remain on track. As we have discussed previously, we feel good about our product strategy and position. Our product portfolio offers a wide selection of price points, including product breadth for tightly managed HMO plans to open access PPO plans. We have a diverse mix of fully ensured and nonrisk membership with about 53 percent of our membership enrolled in nonrisk products as of June 30th. We believe these product offerings, along with the strength of our brand, are allowing us to sustain our enrollment growth rate. During the quarter we expanded our specialty product capabilities with the acquisition of pro behavioral health which is a Colorado-based managed behavioral health company. This acquisition was completed on June 1st and an excellent addition to our specialty businesses. Pro Behavioral Health which is being renamed Anthem Behavioral Health will begin the administration of behavioral health benefits for our customers in Colorado in early 2003. And we will be seeking opportunities to convert other health membership to this insured business platform over the next few years. Before I turn the call over to Mike Smith, I'd like to provide a brief update on our pending acquisition of Blue Cross/Blue Shield of Kansas. On March 7th, Anthem and Blue Cross/Blue Shield of Kansas filed an appeal with the Shawnee County District Court seeking to overturn the Kansas insurance department's February 11th ruling to decline our application. On June 7th, the Shawnee County District Court judge ruled in our favor and ordered the commissioner to vacate her February decision. The Kansas insurance commissioner appealed and requested the case be transferred to the state supreme court, which was granted. Anthem believes consistent with the District Court judge's decision that we have met all requirements of the law to receive approval from the Kansas insurance commissioner. We do not anticipate a decision on this case from the Kansas Supreme Court until late this year or early 2003. However, both Anthem and Blue Cross/Blue Shield of Kansas remain committed to complete this transaction.

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Now, let me turn it over to Mike Smith, our chief financial officer, who will discuss our second quarter 2002 financial results. Mike.

**Mike Smith - Anthem, Inc. - CFO**

Thank you, Larry. And good morning. For the second quarter of 2002, net income was 106.2 million dollars. Excluding the after tax impact of net realized investment gains, net income was 104.5 million dollars, or 99 cents per diluted share. This performance was near the high end of our earnings guidance and resulted in a 32 percent year-over-year increase in earnings per share on a FAS 142 comparable basis. Consistent with our discussions of last quarter's results, there are no significant items that you need to consider in analyzing our year-over-year consolidated results on a same store basis, other than the sale of our TRICARE business, which was completed in May of 2001. You will recall that TRICARE was essentially break even during the first five months of last year. The impact to our second quarter financial results related to the June 1st acquisition of Pro Behavioral Health is not material. Also, since the Trigon acquisition did not close until July 31st, Anthem's second quarter results do not include any Trigon earnings. During the quarter Anthem repurchased approximately 558,000 shares of common stock at a cost of approximately 38 million dollars. For most of the quarter, our trading activity was restricted due to the pending Trigon acquisition. To put this all in context, you will recall that during February Anthem's board authorized a 400 million dollar share repurchase program. And now that the Trigon merger has been finalized, we will look very closely at opportunities to enhance shareholder value by resuming our share buy back program. As Larry has mentioned, membership reached 8.3 million members at June 30th, which represents a seven percent growth rate compared to last year and a six percent increase in membership on a year-to-date basis. Our most recent enrollment guidance was increased to four to five percent, and we have now already surpassed those expectations. This growth in enrollment, along with premium yields of approximately 14 percent on fully insured group business, drove operating revenues to 2.8 billion for the quarter. The revenue growth represents a 13 percent increase on a reported basis, and a 19 percent increase on a same store basis. We continue to build momentum and financial performance with 118.6 million dollars in operating gain in the second quarter. This represents a 45 million dollar increase or 62 percent growth over the comparable period last year. All core operating segments contributed to the year-over-year improvement in results. The Midwest segment reported almost 62 million dollars in operating gain in this year's second quarter, which represents a 46 percent year-over-year increase. Midwest enrollment gains remain strong with an additional 306 thousand members added since second quarter of 2001. Our enrollment now stands at 5.1 million members in the Midwest. The improvement in Midwest financial results continues to benefit from discipline pricing strategies and our enhanced ability to leverage the operating expense of our largest business segment. Midwest operating margin was 4.1 percent in the second quarter of 2002, 70 basis

points better than last year's comparable quarter. Anthem east segment reported 52.9 million dollars in operating gain in the quarter. This resulted in a 5.3 percent operating margin and a 105 percent improvement in operating gain compared to the second quarter of 2001. Like the Midwest segment, the east is pricing for profitable enrollment growth and enjoys good retention of membership while at the same time attracting new accounts. The east also benefited from improvement in its benefit expense ratio as medical cost trends came in lower than expected. Additionally, the New Hampshire and Maine plans which were acquired in late 1999 and mid 2000 contributed to margin improvement as they're becoming fully integrated into our East segment. Our west segment reported a 4.3 percent operating margin and a 10.1 million dollar operating gain in the second quarter of 2002 which was 270 basis points of improvement in the operating margin and more than three times the operating gain reported in last year's second quarter. The improvement was driven by operating revenue growth that accelerated at a much faster pace than administrative expenses, with the most significant contribution coming from national account business. Anthem's specialty businesses reported a 12.8 million dollar operating gain in the second quarter, resulting in a 10.1 percent operating margin. This segment's results were primarily driven by our pharmacy benefit management company, Anthem Prescription Management, which processed almost 600,000 mail order scrips this quarter, or a 31 percent increase compared to the second quarter of 2001. Note the acquisition of Pro Behavioral Health which closed on June 1st added about \$400,000 of operating revenue to the specialty segment second quarter 2002 results and was essentially neutral to earnings. The other segments operating loss was 18.7 million this quarter as compared to a loss of 5.9 million dollars in last year's second quarter. The year over year increase was primarily due to increased incentive compensation accruals as a result of above-target performance. Our consolidated benefit expense ratio was 83.6 percent in the second quarter, an improvement of 160 basis points year over year. About 70 basis points of the improvement was due to the exit from the TRICARE business in May of 2001 with the remaining 90 basis points representing improved underwriting results primarily in our east segment where we experienced lower medical cost than expected. Medical cost trends for our fully insured group business remain at the low end of the expectations we shared with you at the beginning of the year, running just below 13 percent in the second quarter, consistent with our first quarter. Inpatient trends increased approximately nine percent, down from the 11 percent trend last quarter. Outpatient has been running at 13 percent. Professional fees around 11 percent and pharmacy costs are trending at approximately 18 percent. We now expect medical cost trends of about 12 to 14 percent for the full year 2002 down from our original expectations of 13 to 15 percent. This slightly better medical cost trend guidance for 2002 is the result of lower than expected cost trends in all medical cost components except for pharmacy. The pharmacy trend remains consistent with expectations which was shared with you earlier in the year. Anthem's administrative expense ratio was 19.2 percent in the second quarter of 2002, an improvement of 50 basis points

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year over year due to the growth in operating revenue from membership gains and pricing actions, as well as from ongoing focused efforts to contain expenses in non-customer touch areas. With respect to the balance sheet, Anthem's cash and investments were 4.7 billion dollars at the end of the second quarter, up almost 188 million from year-end 2001. Policy liabilities increased 113 million dollars, since the end of 2001. Days claims payable in the second quarter were 62.6 days, down 1.6 days compared to the prior quarter. Each region, however, reported an increase in days claims payable with the exception of our east segment, which was impacted by the settlement of retroactively measured quality based incentive payments for our providers as well as seasonal patterns of claim payments in the first half of this calendar year. Similar, by the way, to patterns we experienced in the same period of 2001. For the foreseeable future we continue to expect claims days payable in the 63 to 65 day range. Anthem's debt level of 819 million dollars at June 30th remained unchanged, since the date of our initial public offering, thereby resulting in debt to capital ratio of 27 percent at the end of the second quarter. On a year-to-date basis, operating cash flow was 243 million dollars, which was 18 percent higher than net income. Operating cash flow in the quarter was 60 million dollars, down approximately 120 million dollars sequentially, due to several timing items. For example, we paid both the first and second quarter 2002 federal income tax payments during the second quarter. This reduced operating cash flow by approximately 25 million dollars sequentially. Also, the timing of the collection of a large receivable received shortly after June 30th negatively impacted operating cash flow by approximately 20 million dollars for the second quarter. Finally, the balance of our change was impacted by the timing of our checks being presented for payment at our banks. We continue to expect operating cash flow to at least reach the level achieved in 2001, which was 655 million dollars for Anthem on a stand alone basis, and therefore to exceed reported net income in 2002. I would now like to make a couple of very brief comments regarding the Trigon merger. First, beginning in the third quarter Anthem will have a new segment for public reporting, a southeast region. The level of detail disclosed from the southeast region will be consistent with the other segments we currently report on each quarter. Second, Anthem completed the permanent financing of the Trigon acquisition with a 950 million dollar public debt issue included on July 31st. We also issued 39 million common shares on July 31st to Trigon shareholders and used about 243 million dollars of cash on hand to pay transaction costs and supplement the proceeds of our debt offering. We are comfortable with our capital structure and liquidity and effective with the closing of the merger with Trigon, Anthem's total debt outstanding was approximately 1.8 billion dollars, with debt to total capital still at approximately 27 percent. I will now turn the presentation back over to Larry.

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**Larry Glasscock - Anthem, Inc. - CEO**

Thanks, Mike. Before I introduce Tom Snead to discuss Trigon's second quarter results, I'd like to take just a second and give you an

update on the integration process. The Anthem/Trigon definitive merger was announced on last quarter's conference call on April 29th. Prior to the closing of the transaction, which occurred on July 31st, teams were put in place to focus on building strong relationships and lead a smooth transition. The transition teams are guided by an executive steering committee co-chaired by Tom Snead and Mike Smith. Over 200 people from Anthem and Trigon are involved in transition planning, covering more than 16 different functional areas. Since the announcement of the merger at the end of April, the executive steering committee has met weekly to review the work of these teams and to gain assurance that recommended plans will successfully bring our two companies together. Approvals to move forward with the team's recommendations have been given by the executive steering committee and implementation of the plan began with the close of the merger transaction last week. As a result of the work that has been done over the past 90 days, we remain highly confident in our projected pretax synergies of about 40 million dollars in 2002 and at least 75 million dollars in annual pretax synergies by 2004. Since the merger did not close until July 31st, we expect to realize minimal synergies in the third quarter of this year and slightly more than five million by the fourth quarter. With that kind of background in place, I'm pleased to introduce Anthem's president of our new southeast region, Tom Snead. Tom.

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**Tom Snead - Anthem, Inc. - President of Southeast Region**

Thank you, Larry. On behalf of our 4,000 associates in Virginia, I'd like to echo the excitement we all feel in becoming part of the Anthem family. After working closely together in the integration process over the last few months I see concrete proof that the merger will produce exceptionally strong and positive results for all parties. Before I provide more details on the integration process let me quickly review the operational and financial highlights of Trigon's second quarter. In all respects the second quarter was continuation of our ongoing successes in the Virginia market, represented by solid profitable enrollment growth, disciplined pricing, effective cost management, and a steady focus on providing high level customer service. Earnings per share, excluding realized losses was \$1.29, or about ten cents above expectations. And 29 percent higher than prior year's second quarter. The higher than expected results came primarily from better than expected claims experience in categories of drug, outpatient and physician costs. With premium rate increases that were in the upper teens and sometimes even higher, we continue to realize solid enrollment gains in both self funded and fully insured business, as well as very strong retention. Excluding the Blue Card members total enrollment increased by 5.6 percent to nearly 2.2 million members. Driven by four percent growth in fully insured and about a nine percent growth in our self-funded business. Excluding our Medicare Supplement product, growth was about five percent for the fully insured business. Commercial premium revenues increased by about 15.9 percent to \$612 million. While fee income from our self-funded business increased by about 12.7

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percent to 60 million. As we have discussed in the past, our long-term objective is to maintain our medical cost ratio in the 80 to 82 percent range and for the quarter our commercial medical cost ratio declined to 78.6 percent from 81.4 percent last year. This improvement was driven by the favorable claims experience which I previously mentioned. Days in claims was basically flat with prior quarter at 65.1 days, compared with 64.8 days in the first quarter of 2002. Cash flow from operations was about 102 million for the first six months of the year, compared with almost 84 million for the comparable period in 2001. Our disease management company, health management corporation, continued to perform exceptionally well, contributing to the 67 percent increase in other operating revenues on a year to year basis. This was driven by a combination of new business in 2002, along with the full impact of new contracts signed in 2001. The pipeline of additional new business for HMC continues to be very strong for the remainder of the year. Operating income which excludes income and net realized losses from investment securities and interest expense on debt came in about 60 percent higher than the previous year at about 53 million. Now turning to the transition and integration process. We're truly committed to capturing the best of both worlds between our two organizations. And I am extremely pleased with our progress. Based upon our analysis, we are very comfortable in meeting the synergy goals we outlined in the spring. That is, 40 million in 2003 and at least 75 million in 2004. In addition, we still have a number of unanalyzed areas which show great promise. Our confidence is reinforced by the discipline process we have in place, plus the fact that about 80 percent of these synergies are cost reductions versus revenue increases. As Larry mentioned, we have more than 16 joint Anthem / Trigon teams, most of which have conducted in depth financial and operating analyses of their areas and have come back to our steering committee with specific directives and work plans. These areas include overlapping support functions such as finance, legal, human resources and corporate audit, as well as programs such as HIPAA, purchasing, Ecommerce, specialty products and facility management. As described in the past, the majority of the savings will come in the broad areas of information technology, administration and finance, the latter includes moving our investment portfolio to Anthem. And consistent with our philosophy of maintaining local control, we are not altering resources that directly impact the customer, such as sales, underwriting provider relations, network management or customer service. The savings we have identified thus far do not include a longer term plan to identify and capture best practices in such areas such as medical management, sales, underwriting, just to name a few. Now here is Larry who will provide the earnings outlook for the balance of 2002.

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**Larry Glasscock - Anthem, Inc. - CEO**

Thanks, Tom. Consistent with our past practice, I just want to reemphasize that our guidance does not include the pending Blue Cross/Blue Shield of Kansas acquisition. However, I will provide

guidance including obviously the acquisition of Trigon. With the Trigon merger being completed on July 31st, of course, only two months of results related to Trigon will be reported in the third quarter. Excluding the impact of the Trigon merger, we now expect Anthem on a stand alone basis to report earnings per share in the range of \$3.90 to \$4.00 for the full year 2002, excluding realized gains or losses. This is an increase from the \$3.85 to \$3.95 we previously expected. Including the impact of the Trigon transaction, 2002 earnings per share should be in the \$3.85 to \$3.95 range, with third quarter earnings per share in the 95 cents to one dollar range. As we expected, this guidance represents about five cents of dilution in 2002 related to the Trigon acquisition. We continue to project a neutral impact to 2003 earnings per share and accretion thereafter. For 2003, we expect earnings per share of \$4.50 to \$4.60 per share or at least a 15 percent growth as compared to Anthem's 2002 stand alone guidance of \$3.90 to four dollars per share. We note that analyst estimates are currently around \$4.56. That falls comfortably in our current \$4.50 to \$4.60 expectation for 2003. The earnings fundamentals surrounding Trigon's business remain very strong and are essentially unchanged from their guidance provided last quarter. The combined earnings guidance for 2002 was estimated using approximately 131 to 133 million diluted shares outstanding for third quarter, 144 to 147 million shares for the fourth quarter of 2002, and 121 to 123 million shares for the full year, 2002. The estimated diluted shares outstanding does not include the impact of any share repurchases in the last five months of the year. Including Trigon, operating gain is projected to be in the 150 million to 160 million range, in the third quarter. And in the 170 to 180 million range for the fourth quarter. Note that operating gain performance excluding the impact of Trigon merger results in a 45 to 50 percent increase for full year 2002, up from our previous expectations of 35 to 40 percent growth and reflects increases in guidance in every one of our core operating segments. Operating gain growth by segment for 2002 is now projected as follows. In the Midwest, we expect operating gain increases in the 45 to 50 percent range. East, 55 to 60 percent range. In the west, 105 to 115 percent range. Specialty in the 45 percent to 50 percent range, and the other segment loss is likely to be more than double the 2001 reported loss and higher than most analysts' current expectations. Again, this reflects incentive compensation accruals for above target performance. And the second quarter is closer to a reasonable run rate for the remaining quarters of the year as compared to the first quarter. Anthem's new southeast region is projected to report operating gain of approximately 30 to 35 million for two months of results in the third quarter and about 50 to 55 million in the fourth quarter. Excluding Trigon, 2002 medical membership is now projected to increase six to eight percent, up from four to five percent projected on last quarter's call. We are estimating mid to high single digit membership growth in the Midwest and the east, and low double digit growth in the west. Anthem's new southeast region reported membership of 2.2 million at the end of the second quarter. However, going forward, Trigon will include Blue Card members in their calculation in order to conform with Anthem's historic presentation. If Trigon's membership is reclassified to include Blue

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Card, the second quarter enrollment would have been about 2.5 million members. We expect Trigon's membership to increase at least six percent for the year, excluding FEP and med sup. As we look forward to 2003 enrollment, we're optimistic Anthem can achieve continued membership growth next year. Anthem's stand-alone benefit expense ratio is expected to improve 30 to 50 basis points in 2002. Including the impact of Trigon, the consolidated benefit ratio could improve another ten basis points or so in 2002. Excluding the impact of the Trigon acquisition, we are projecting about 80 to 100 basis points of improvement in the administrative expense ratio in 2002. With Trigon, we expect this ratio could see 20 basis points of additional improvement to the full year 2002 results. As Mike mentioned earlier, borrowings to fund the Trigon transaction will result in 950 million dollars of additional debt. The average interest rate on the new borrowing will be about 6.6 percent, therefore interest expense in the third quarter should be in the 30 million to 32 million range, and an increase of an additional five to six million in the fourth quarter of 2002. Approximately 350 million of amortizable intangible assets will be recorded due to the Trigon merger. As a result we expect about seven to nine million of amortization expense in the third quarter and 10 to 12 million of amortization expense in the fourth quarter on a consolidated basis. Our effective tax rate is expected to be closer to the high end of our traditional 32 to 34 percent range in both the third and the fourth quarter of 2002. We hope this rather detailed and updated guidance is helpful. I wanted to also let you know we have Tom Bird and Dave Frick available to respond to your questions as well as Tom Snead, Mike and myself. So operator, we're ready to take the first question.

## QUESTION AND ANSWER

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**Operator**

Thank you very much. And ladies and gentlemen, if you do wish to ask a question from the phone lines, please press the one on your touchtone telephone. You'll hear a tone indicating you've been placed in queue. You may remove yourself by pressing the pound key. If you are using a speaker phone, you may need to pick up the handset before pressing the one. Once again if you do have a question please press one at this time. And the first question I show in queue comes from the line of Maria Allato [ph] With Gallion [ph]. Your line is open. Did you have a question? We're going to go on then to a question from Eric Law's line with Deutsche Banc.

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**Analyst**

Good morning. First, on the SG and A line, there's a 40 million dollar sequential increase. And I was wondering, Mike, if you could just help us understand how much of that was potentially merger related for Anthem this quarter and were there any other items? I was a little bit bigger increase than I was expecting.

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**Mike Smith - Anthem, Inc. - CFO**

Actually I'm going to give you four reflection points about the G and A change from the first quarter. Second quarter versus fourth quarter included salary and incentive compensation referenced both by Larry and me. That is the accrual for incentive compensation and salary increase combined were 23.4 million of the delta. Administar Federal our intermediary operation has also been awarded a new contract which required its spending about \$5 million on a quarterly basis to secure the technology required to meet its 1-800 contract. There's exactly the same offsetting other revenue. So while it is dilute active to the admin fee and shows up as an absolute dollar increase as G and A it's fully recovered through the additional fee revenue. A myriad of other very small items make up the remaining approximately 10 million dollars.

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**Analyst**

Thanks. That's helpful.

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**Larry Glasscock - Anthem, Inc. - CEO**

I just want to reemphasize, this is a major strategic focus for us. We in the past have used the word relentless in the way we intend to focus on administrative expense. And I just wanted to let you know that very much is how we intend to continue to approach this in the future.

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**Analyst**

Okay. I appreciate that. This extra ten million, your reference Mike was much of that merger related?

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**Mike Smith - Anthem, Inc. - CFO**

Actually, relatively little, Eric. The cost associated with the transaction are being capitalized as a part of the purchase accounting treatment for that merger.

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**Analyst**

And then just my second question, I was wondering if you might be able to comment on the risks to Trigon's pharmacy trend. They've obviously had a lower trend going forward. As I understand, you're going to be switching vendors to the Anthem PBMs. Is there any discussion about potential increase in trend there? What are you going to do to help keep that a good trend Trigon has had.

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**Mike Smith - Anthem, Inc. - CFO**

Let me ground everybody with the exact set of facts. Trigon remains under a, we think, a very excellent service agreement with an outsourced PBM. That contract runs through the end of 2003. No determination has been made at this point regarding any immediate change to either the terms of that contract or any other form of pharmacy benefit management.

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**Analyst**

Okay. That's helpful. So there's no decision yet whether to move that in?

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**Mike Smith - Anthem, Inc. - CFO**

Reference Tom's comments earlier about a number of transition issues still under analysis and no final determination has been made there.

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**Analyst**

Great. Thank you.

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**Operator**

And we do have a question then from Lori Price's Line with JP Morgan.

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**Analyst**

Can you tell us relative to the days in claims decline you saw in the quarter, how much is that 1.6 days decline is related to the provider settlement payouts versus the seasonality of claims payments? To put it in perspective, what was the decline you experienced last year?

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**Mike Smith - Anthem, Inc. - CFO**

I'll try to give you a fair amount of detail around how much was seasonality and how much was the retroactive settlement. One half day in fact in the east metric is related to retroactive provider settlements. And the overall seasonality of the payment stream in the east reduced days by the other one day. So we were down 1.6 days, one half day from the provider settlement and one full day from the seasonality of payment. With regard to Q1, 2002, versus Q1, recall that, that decline we reported to earlier was 1.4. So the 1.4 compares to the 1.6, we think reflecting a very similar seasonality to what we encountered last year.

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**Analyst**

Great. Just a quick follow-up if I could. Relative to the moderation in medical cost trend you're starting to experience, how much of that is utilization driven versus unit costs. Are there any particular areas, I know you mentioned it was across the board, are there any factors or areas contributing to the decline?

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**Mike Smith - Anthem, Inc. - CFO**

It might be helpful if we brought you current with the drivers in some detail of each of the four components and shared with you our view of the contribution of pricing versus utilization. We have reported the trends are at the low end of our range at about 12 and a half percent all in. For your detailed analysis, inpatient trends have been running nine percent. On a weighted impact basis therefore contributing two percent to overall trend. About 20 percent driven by utilization. 80 percent by cost. That is to say bed days are remaining fairly stable and the driver is cost and hospital contracting. Outpatient trends have been running 13 percent. They therefore contribute 3.3 percent to overall trend. And consistent with earlier guidance we have provided you, that's roughly a two-thirds utilization driven trend, one-third pricing. Professional fees have been trending 11 percent. Thereby contributing 3.9 percent to overall trend. Pricing has remained fairly stable and therefore this is an essentially a utilization driven impact on trend. Pharmacy costs have been running as we predicted in the mid to high teens, all in at 18 percent. Contributing 3.3 percent to our overall trend. And in that instance driven about evenly utilization and cost.

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**Analyst**

Thank you for all that detail. That's great.

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**Operator**

Thank you. We do have a question from Christine Arnold's line with Morgan Stanley. Please go ahead.

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**Analyst**

Good morning. Since it seems you have seen a deceleration in cost trends for both Trigon and Anthem, can you talk about whether you think your business mix or your contracting contributed partially to this and your 2003 pricing strategy now that you have seen a deceleration in cost, will this be built into your pricing for 2003 and can you give us a general feel for enrollment trends? I know it's early but enrollment trends and pricing for 2003? Thanks.

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**Mike Smith - Anthem, Inc. - CFO**

As we've done in the past I'm going to try my best. I'm going to give you about half a dozen reflection points on your question. First it's too early for us to give guidance on premium increase for 2003. We will say as we said in the past that we are absolutely focused around pricing to cover trend and therefore as you have observed, if trend subsides a bit, that would be reflected in pricing. In terms of our product offerings, we have in the past discussed with you the so-called elusive buy down influence as folks make their choice among our very broad product offering. And remain pleased that on an overall basis the buy down we're experiencing is at the low end of the range. In fact, we've measured on a rolling 12 month basis that the influence on offered pricing to net contracted pricing, that is the so-called buy down, is in the 200 basis points range for 2001. Slightly higher in 2002 at about 300 basis points. We do continue to see more cost shifting and remain confident that on the strength of our broad product portfolio we are managing through that fairly choppy water pretty successfully.

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**Analyst**

Okay. If I'm hearing you correctly, are you seeing decelerating cost trends so you are expecting to reflect that in your pricing for next year, or are you waiting to see it trend out more before you assume that it's permanent and put it in the pricing?

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**Mike Smith - Anthem, Inc. - CFO**

We definitely want to see it trend out more. As you know we're still very, very early in any discussions for 2003 medical cost trends. But we expect to continue to do as we have done to make sure that we price for gain and not for market share.

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**Analyst**

Very helpful. Thanks.

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**Operator**

We do have a question then from Josh Raskins' line with Lehman Brothers.

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**Analyst**

Two quick questions. The first is in light of the Trigon numbers being a little bit better than at least my expectations, I was wondering was that factored into your thinking in terms of the due diligence that Anthem had done prior to the acquisition?

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**Mike Smith - Anthem, Inc. - CFO**

For certain we measured Trigon's trends carefully and had very solid confidence that the rate of increase in Trigon's performance could be sustained. Tom Snead gave you a fair amount of detail regarding the growth and operating gain for six months. And as you would expect, we measured all of the elements contributing to that momentum very carefully pre-April 29th.

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**Analyst**

Any additional outside of the Trigon numbers as opposed to our model, et cetera, going forward, would that be up side to what you're expecting now?

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**Mike Smith - Anthem, Inc. - CFO**

I'm not sure I followed your question. Try me one more time.

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**Analyst**

In terms of what we're seeing for the current rates now, sort of now it's built into everybody's number was the expectation you've given. So if Trigon were to trend a little bit better, that would be above your expectations?

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**Mike Smith - Anthem, Inc. - CFO**

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Actually, as Larry shared guidance on both a stand alone basis and on a post Trigon merger, we've tried to reflect our confidence in Trigon's momentum in our guidance.

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**Analyst**

Just one last question, on the individual book, the membership levels there were a little bit better than we expected as well. I was wondering, is that product selection or is that a bigger pool with unemployment, maybe any color on the rise in the individual book would be helpful?

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**Mike Smith - Anthem, Inc. - CFO**

First of all, we're very excited about this membership growth that we've had in individual - we're up about 54,000 members from year-end. And the drivers really are around a couple of things. First of all, this membership growth includes both our under 65 as well as our med sup product. And we're up across all of the regions. Where we believe we've benefited is from offering lower priced product options to this segment, as you know it's very price sensitive. And I think we've done a better job in promoting this product with our broker relationships. So again, I think it's across a couple dimensions.

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**Operator**

If anyone does have a question press the 1 on your touchtone telephone. I'm showing a question from James Lane with Salomon Smith Barney. Please go ahead.

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**Analyst**

Good morning. Just as a follow on to Christine's earlier question. I was wondering, on the self-funded side of your business where I think you would be renewing a lot for 2003, what cost trends are you bracing your clients for 2003 and how does that compare to 2002?

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**Mike Smith - Anthem, Inc. - CFO**

First of all, as you know we report our self-funded business in a very traditional way. And typically do not provide guidance around the pricing or the self-funded clients' expectations. There's a great deal of variability in the product design in that customer segment. I would say this to you, with the scale we're at I'm unaware of any factor that would cause the trend that we would guide our self-funded clients to expect. I'm unaware of any difference in that trend from what we would encounter in our fully insured large group business.

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**Analyst**

At this point you won't comment on what that trend is expected to be for 2003?

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**Mike Smith - Anthem, Inc. - CFO**

It's not that I wouldn't comment on it. I would simply refer you to the fact that we again use a single point of guidance around cost trend for our entire book and our outlook remains, as we shared earlier in the 12 to 14 percent range.

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**Analyst**

Thanks. Just one follow on. Just to make sure I understand how the numbers work, I think in the quarter Blue Card membership went up 123,000 and the total self-funded went up 86,000. So I was just wondering, are you seeing any economic related weakness in the overall self-funded book of business as some other companies in the sector have seen?

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**Mike Smith - Anthem, Inc. - CFO**

Let me give you again a fair amount of detail if you would like around that very dynamic. The largest contributor to our growth in membership from 2001 was Blue Card. I'm going to use a six-month reference for you, Jim. 297 thousand members gained in the Blue Card segment. Our national business also grew in other than nonBlue Card business 55,000. Larry referenced earlier the growth in individual under 65 at 43,000, when combined then with our med sup business showing even stronger growth. FEP membership up 24,000. Large group membership declined 20,000 members since 2001, driven by Midwest in particular both the economic impact of our customer segment in the Midwest and our own focused attention on pricing, the large local group ASO business properly. So if I wanted to roll you forward, maybe this would be helpful, from 12-31-01 to 6-30-2002 you might want to take note of this reconciliation also. Membership at seven million 883 at 12-31 2001. New account sales 451,000. Terminations, largely among our ASO business and small group business, 350,000. Blue Card increased 297. All other 5,000. Total membership at 6-30-2002, therefore three million 821.

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**Analyst**

Thanks.

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**Operator**

We have a question from the line of John Rex With Bear Stearns.

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**Analyst**

In your opening comments you stated as you looked at 2003 you look for further positive membership gains. I wondered if you could give us color in terms of your sense of how you see the proposals rolling in for 2003. As I recall, to follow last year, had an outlook for three to four percent enrollment growth. I believe you raised it up eight percent for full year 2002 now. I guess more color directionally in how you're seeing that shape up.

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**Larry Glasscock - Anthem, Inc. - CEO**

Let me talk about RFP first. We're seeing very good activity in this area. As Mike spoke earlier we've added 136,000 members from new account relationships in the second quarter. We're seeing very good retention. The number of RFPs that we're seeing for next year's business are up around, in terms of numbers, by 12 to 15 percent over this time last year. So we're very happy with the RFP activity. We think a lot of it was coupled around obviously the very strong brand. We've got great product breadth, focus on the customer. And so we're very happy with what we're seeing. It's still, though, I think too early to give you specific membership guidance for next year. We'll be in a much better position to do that our next call. But again I want to remind you for 2002 that we're looking at growth of as I said earlier between six and eight percent. We think we've got the right product set. We are servicing our customers extremely well, and that's coming through in our RFP activity.

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**Analyst**

And in the activity you commented on, up around 12 to 15 percent, is the average case size about the same as last year, larger or smaller?

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**Larry Glasscock - Anthem, Inc. - CEO**

I don't know that it's significantly different. It might be up somewhat. But not significantly.

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**Analyst**

Thank you.

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**Operator**

And we do have a question then from the line of Roberta Goodman with Merrill Lynch. Please go ahead.

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**Analyst**

I was wondering on Trigon if we could get a little bit of information on what the premium trend was in the quarter and what the cost trend was in the quarter. Obviously the cost trend did improve but I'd like to get some sense as to exactly how much.

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**Tom Snead - Anthem, Inc. - President of Southeast Region**

In terms of our cost trend for the quarter, as we said in the presentation earlier they were slightly better than expected. As we said primarily coming from outpatient facility and professional. Our guidance had been for inpatient trends to be up single or low double and based on the second quarter performance that's the one that we would now confirm in the low double range. That is driven really by costs and high severity case services continue its mix issue as the outpatient gets easier the inpatient gets more severe. The outpatient professional side, we've previously given low guidance and double digit guidance we're still comfortable with that the pharmacy we're pleased that remain in the mid 15.

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**Analyst**

Where does that head out to?

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**Tom Snead - Anthem, Inc. - President of Southeast Region**

We're looking at about 11 to 12 percent for the full year consistent with last quarter. Perhaps on the low end of that range.

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**Analyst**

You mentioned that some of the premiums were in the high teens but what was the weighted average for the book?

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**Tom Snead - Anthem, Inc. - President of Southeast Region**

The yield was a little over 12.

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**Analyst**

What kind of buy down activity would go into that?

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**Tom Snead - Anthem, Inc. - President of Southeast Region**

Consistent with what Mike described earlier, we're likewise going to see a slight uptick in buy down this year. I think he mentioned about 300 basis points in '02 on the Anthem book. We're likewise between three and 400 basis points as well, driven primarily in the

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small group sector of the business, as we described to you in prior calls we began to introduce low cost products last year with higher deductibles and higher copays. And certainly in the market of probably two to fifty market Segment. Those have become really the product of choice.

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**Analyst**

And a broader question. Are you seeing either at Trigon or the original Anthem any changes in competitive dynamic formerly or the other?

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**Tom Snead - Anthem, Inc. - President of Southeast Region**

On the Anthem southeast side it doesn't really change in the competitive environment. That we've seen, we're pleased with the success we have in the large self-funded sector among some of the large national carriers we spoke of earlier there's no new entrants and I think the marketplace remains about the same. Perhaps within one color I might add is on the individual sector which Larry spoke to you as well of Anthem. I believe Anthem southeast is well positioned in the individual we've grown about 13 percent and see that market playing our way quite nicely.

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**Tom Byrd - Anthem, Inc. - President of Southeast Region**

The only piece of color I could add we continue to take business from all competitors. As Tom said I think our product portfolio is well positioned. Our product portfolio is in good position and the portfolio of products has an adequate breadth so we're pleased with our continuous momentum.

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**Larry Glasscock - Anthem, Inc. - CEO**

We're not seeing any appreciable difference in the competitive environment. Again, we've done a lot this past year to expand the spread in our pricing from our least expensive to most expensive product. We are very comfortable in increasing our guidance for the balance of this year to six to eight percent growth. We're finding our rates being competitive. So we continue to be well positioned and we're not seeing any appreciable difference in the competitive landscape.

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**Analyst**

You would not expect to see measurable changes in who the competitors are and what their win rates would be relative to what yours are?

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**Mike Smith - Anthem, Inc. - CFO**

It's Mike. A fourth voice on the same topic. No, no particular dynamics. I think a couple points for you to recall from this conversation, nationally, RFP activity is up. The strength of the brand and the positioning of Anthem and Trigon in each of our regions is giving us a shot at more RFP activity. Also the breadth of the product portfolio is showing strong on the low end of the small market group and the individual market. But structurally or systemically no withdrawals from any of the markets by any major competitor.

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**Analyst**

Thank you.

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**Operator**

We do have a question then from Mark Miller's line with Bank of America securities. Please go ahead.

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**Analyst**

Good morning. Can you give us additional detail on the other \$10 million in SG and A increase sequentially? You gave us some components which amounted to 23 million and then another maybe six or seven million you mentioned there was an additional 10 million due to a myriad of issues.

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**Mike Smith - Anthem, Inc. - CFO**

Let me reflect again on that explanation. Two points, Mark, that maybe I did not emphasize. The G and A growth is being driven by annual merit increases that kick in on April 1st. This is a company with 15,000 associates. So the mere timing of our salary administration program kicking all merit increase in at April 1 is having some influence quarter over same time period. Also the growth in volume is obviously driving commissions and premium taxes up. I referenced earlier the \$5 million of Medicare business, and there are no other items that I'm aware of greater than a million dollars contributing to the all and other.

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**Analyst**

So there were several different issues and none of which on its own was a lot but combined yielded about ten million? I mean the \$10 million I thought that was your number that there were a myriad of other issues that related to about ten million of the 39 million.

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**Mike Smith - Anthem, Inc. - CFO**

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There's no - frankly as you know the convention of using other would not be to withhold from you any single large amount, it's simply indicative that in a company of this size, timingwise or seasonally, there are a handful of items making up the ten million, none of which were on the radar screen as a significant or recurring item.

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**Analyst**

Great. Thank you.

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**Tami Durlle - Anthem, Inc. - VP of Investor Relations**

We have time for one more question.

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**Operator**

Our final question is a reprompt from Christine Arnold from Morgan Stanley.

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**Analyst**

Just a follow-up and a clarifying question did you say there were no change to Trigon guidance for earnings?

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**Mike Smith - Anthem, Inc. - CFO**

This is Mike. And I'll invite Tom Snead to join me as well. Essentially we have not changed Trigon's previously issued guidance from the first quarter. Tom Byrd has given you some indication around the strength of their operating gain and their sustained revenue growth, but no material change in that guidance.

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**Analyst**

But if the company beat the quarter by so much is that just conservatism or was there something that kind of was one time and might reverse?

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**Mike Smith - Anthem, Inc. - CFO**

I think as talked about in the call we had better than expected claims experience in the quarter. You'll recall that throughout last year we communicated to you that the trends were increasing primarily through increased utilization. As time has come by, the runout has occurred, we realized more than expected from prior periods.

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**Analyst**

What you're saying is much of the better than expected results of this quarter by Trigon were prior period positive developments?

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**Mike Smith - Anthem, Inc. - CFO**

A portion of it was, yes.

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**Analyst**

I'm sorry?

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**Mike Smith - Anthem, Inc. - CFO**

A portion of it was, yes.

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**Operator**

I'd like to turn the call back over to Larry Glasscock for closing comments.

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**Larry Glasscock - Anthem, Inc. - CEO**

I want to thank you for your interest this morning. Both Anthem and Trigon reported we believe strong financial results in the second quarter and we are very excited about our future together as one company. I can assure you that we will continue to work extremely hard to meet the needs of our customers, which now reside in nine states, including Virginia, as well as making sure that we enhance the value of our company for our shareholders. In addition, we hope that our shareholders and customers feel secure with Anthem in this very unsettled market environment. Frankly, we take great pride in meeting our commitments. And Anthem's approach to management has been and will continue to be focused around honesty and conservatism in all that we do. Again, thank you very much and we hope you have a great day.

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**Operator**

Thank you. This conference will be available for replay starting today Monday August the 5th at 1:45 p.m. eastern time will be available through Monday August 19th at midnight eastern time. You may access the AT and T executive play back service by dialing 1-800-475-6701 from within the United States or Canada or 320-365-3844 from outside the United States or Canada and then enter the access code of 622194. Those numbers again are 1-800-475-6701 from within the United States or Canada or 320-365-3844 from outside the United States or Canada and then enter the access code of 62219. That does conclude our conference

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