

**Table of Contents**

1 Introduction

2 Selected Highlights in the HMO Industry

18 Selected Merger and Acquisition Activity

23 Stock Price Performance Analysis

25 Wall Street Analyst HMO Report Card

27 Financial Performance Analysis

29 Valuation Analysis

31 Closing Thoughts

**Exhibits**

A National Managed Care Companies: Public Market Valuation Analysis

B Regional Managed Care Companies: Public Market Valuation Analysis

C National Managed Care Companies: Cash and Investment Analysis

D Regional Managed Care Companies: Cash and Investment Analysis

E National Managed Care Companies: Executive Compensation Analysis

F Regional Managed Care Companies: Executive Compensation Analysis

G National Managed Care Companies: Investment Income Analysis

H Regional Managed Care Companies: Investment Income Analysis

## Introduction

Shattuck Hammond Partners LLC (“Shattuck Hammond”) is pleased to present this Report as part of an ongoing series of reports on the managed care industry. The Report focuses on financial performance, valuation, merger and acquisition activity, and industry highlights primarily among the publicly traded managed care companies. Shattuck Hammond encourages readers to distribute the Report to colleagues and other interested parties. Additional copies will be provided upon request. Please contact Keith Dickey, at 212-314-0321, with requests for additional copies as well as with any comments that you may have.

To display differences between national and regional HMOs, Shattuck Hammond’s analysis divides the publicly traded universe of HMOs into two distinct subgroups – the National HMOs, which have operations in multiple regions throughout the U.S., and the Regional HMOs, which have operations concentrated within a specific region or state. After a long hiatus, this is now our second Report in a row in which we welcome two new companies into the National and Regional HMOs. As described in more detail later in this Report, **WellChoice** joined the National HMOs with a successful IPO in November 2002, and **Molina Healthcare** (“**Molina**”) joined the Regional HMOs in July 2002. We also said goodbye to **Cobalt Corp.** (“**Cobalt**”), acquired by **WellPoint Health Networks** (“**WellPoint**”) in September, in a continuing consolidation of the publicly traded Regional HMO Blue Cross Blue Shield companies.

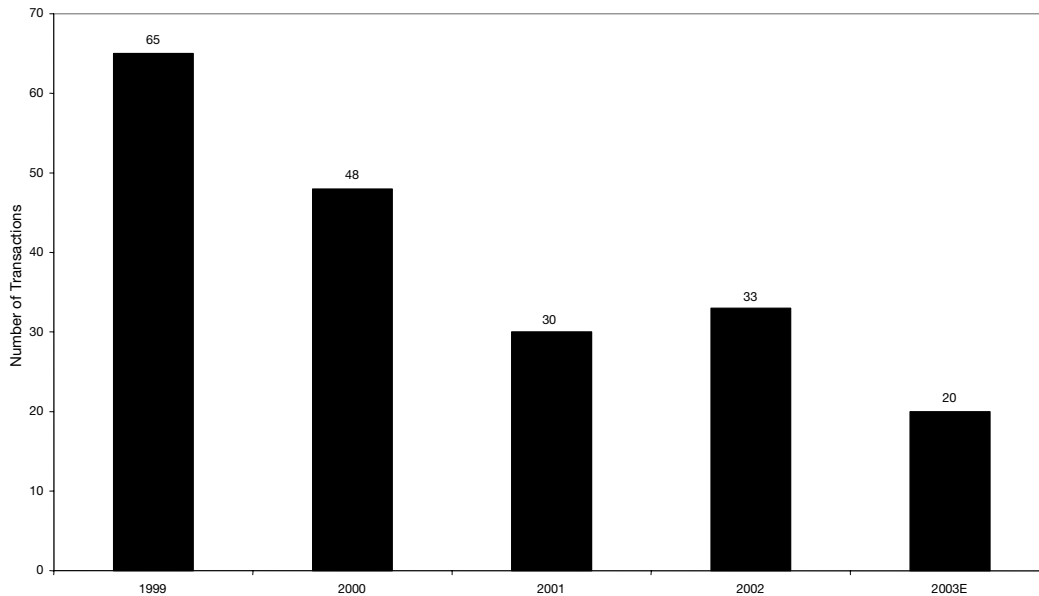
## Selected Highlights in the HMO Industry

Listed below are selected highlights (or in some cases lowlights) in the HMO industry over the past year. We believe that these events either had significant impact on the HMO market or underscored significant trends and forces within the HMO market.

### The Publicly traded Performance Party Continues, but Merger and Acquisition Activity Stays at Home

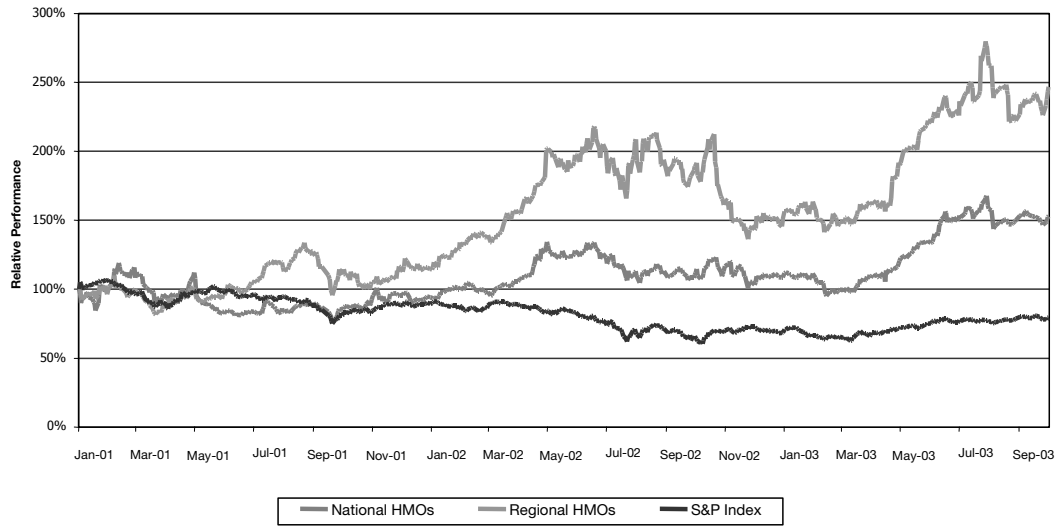
As part of a three-year trend, managed care companies continued to be outstanding investments compared to the S&P 500 Index. Premium increases and cost control initiatives continued to propel margins and share prices upward. However, despite a modest pick-up in managed care merger and acquisition activity in 2002, merger and acquisition activity in 2003 has been disappointingly slow with, according to Irving Levin Associates, only 12 transactions announced for the six months ended June 30, 2003. Unfortunately, as bad as this number is, it understates how bad the merger and acquisition environment really is, because it contains several dental and vision transactions in addition to medical HMO transactions. Moreover, if you adjust for two specific sectors (Blue Cross Blue Shield transactions and Medicaid transactions), the current state of managed care merger and acquisition activity begins to look especially lethargic.

Managed Care M&A Volume: 1999-2003E



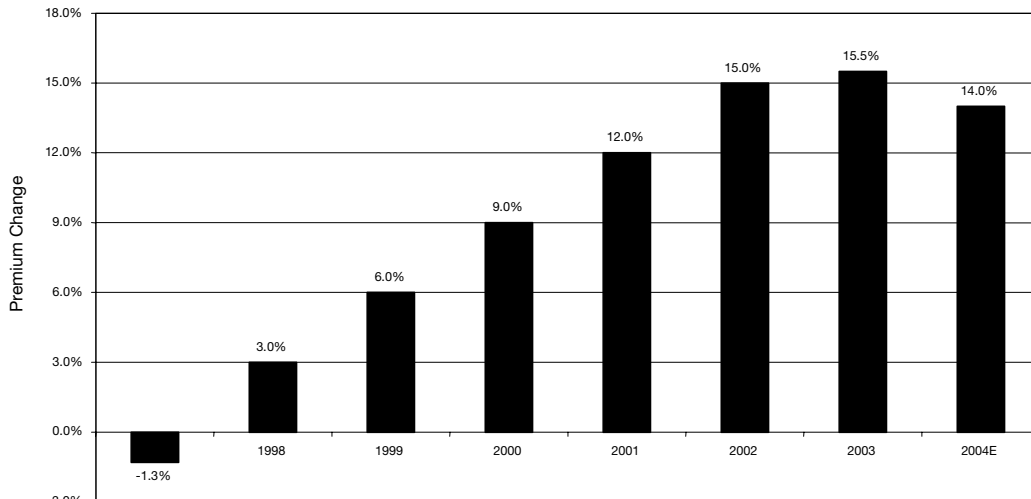
Source: Irving Levin Associates; Shattuck Hammond estimates.

HMO Index - Common Stock Comparison: January 1, 2001 to Present



In our Fall 2002 Report, we predicted that merger and acquisition activity would pickup in 2003. We were obviously wrong, but we are confident that only our timing is off, not our predictive ability. We firmly believe that, at some point, merger and acquisition activity will pick up. Why? Because it has to if managed care companies want to maintain earnings growth and increasing share prices. For now, however, earnings growth continues to be propelled by premium increases and cost controls (and, to some extent, stock buyback programs). Earnings growth through such actions is less risky than growth through acquisitions and requires little capital. However, it does not take a Wall Street analyst to understand that year-over-year double-digit premium increases can only be sustained for so long in a single-digit inflation environment. In this regard, in 2004, expected premium increases are already starting to show signs of moderation.

Change in Commercial Insurance Premiums, Percent Change versus Previous Year: 1997-2004E



Source: Watson Wyatt Worldwide; Managed Healthcare Market Report.

Moreover, over the past two years, based on our own experience we believed that the fall-off in the merger and acquisition market was partially due to the spread between the valuations that sellers wanted to receive and buyers were willing to pay. At present, we believe that this impediment has largely, although not entirely, dissipated. Lack of interest among qualified buyers who are growing organically and a dearth of quality acquisition targets are bigger impediments.

**Managed Care Tough Man Competition – The Power of Compounding vs. Sustained Double-Digit Premium Increases**

If double-digit premium increases persist, employers may increasingly try to pass along increases in healthcare costs directly to employees through mandatory employee contributions and/or high co-pays. However, assuming normal inflation, because neither wages nor prices of goods and services will likely increase at double-digits annually, the power of compounding makes clear the challenges managed care companies will have in maintaining double-digit pricing. Based on a married worker with two children who earns \$50,000 annually and whose company pays \$900 a month in health premiums for that worker, healthcare benefits represent 21.6% of compensation. Assuming wages increase at 3% and premiums increase at 12% annually, in five years healthcare costs would represent 32.8% of compensation. Over the five-year period, wages would increase 15.9%, compared to 76.2% for healthcare benefits.

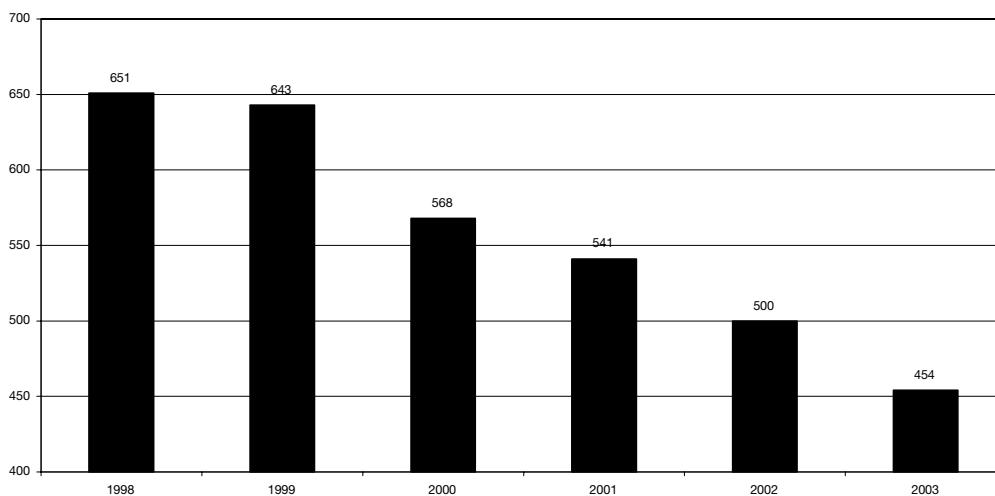
**Health Benefit Cost Analyst**

|                               |           | <u>Year 1</u> | <u>Year 2</u> | <u>Year 3</u> | <u>Year 4</u> | <u>Year 5</u> |
|-------------------------------|-----------|---------------|---------------|---------------|---------------|---------------|
| Compensation                  | \$ 50,000 | \$ 51,500     | \$ 53,045     | \$ 54,636     | \$ 56,275     | \$ 57,964     |
| <i>Inflation</i>              |           | 3.0%          | 3.0%          | 3.0%          | 3.0%          | 3.0%          |
| Health Benefits               | \$ 10,800 | \$ 12,096     | \$ 13,548     | \$ 15,173     | \$ 16,994     | \$ 19,033     |
| <i>Inflation</i>              |           | 12.0%         | 12.0%         | 12.0%         | 12.0%         | 12.0%         |
| Health Benefits/ Compensation | 21.6%     | 23.5%         | 25.5%         | 27.8%         | 30.2%         | 32.8%         |

**If You Want to Catch Fish, the Pond Better be Stocked – Merger and Acquisition Activity Will Not Return to Pre-2000 Levels**

As managed care investment bankers, it pains us to reach this conclusion, but the facts speak for themselves. The number of HMOs has steadily decreased year over year, and many of those that are currently operating may be unsaleable or have questionable long-term prospects. This is especially true for provider-sponsored managed care companies where the provider sponsors have increasingly limited resources to finance unprofitable plans. A number of these plans may be too small or require too much fixing to find a buyer. In 2002, it should be noted that the decrease is somewhat overstated due to the closure by Aetna of a large number of plans.

**Total Number of HMOs: 1998-2003**<sup>1</sup>



Source: InterStudy; Modern Healthcare.  
(1) Period ending 1/1 of each year.

### **The Universal Coverage Wild Card Could Further Depress Merger and Acquisition Activity**

According to the U.S. Census Bureau, approximately 43.6 million Americans were without health insurance in 2002. The number of uninsured Americans has grown as fewer employers offer coverage due to skyrocketing costs. The large number of working uninsured has added to the political pressures to mandate universal coverage. California, which generally serves as the harbinger for national healthcare trends, enacted legislation that will extend coverage to many working uninsured residents. Several Democratic presidential candidates have also endorsed some form of federally mandated universal coverage. If universal coverage is broadly enacted and spreads across the country, the managed care industry would see significant organic growth. Although plan designs would probably be far more limited than current commercial offerings, implying less top line growth, the push of members into managed care plans under universal coverage could be dramatic. As a result, interest in merger and acquisitions could remain depressed in 2004 and beyond as managed care plans focus on a new source of organic growth. Moreover, as discussed above, the merger and acquisition environment is not helped by the fact the number of HMOs has steadily decreased year over year.

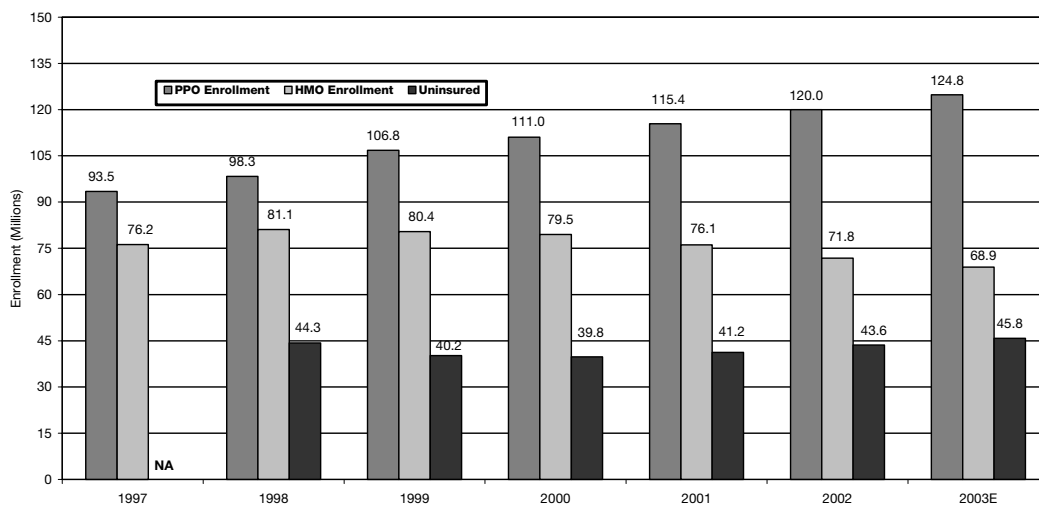
### **HMO Membership Reacts to Premium Increases by Migrating to the Better Benefits of PPO Products or Dropping Benefits Altogether.**

After peaking in 1999, HMO membership has continued a downward trend. In this regard, according to an analysis done by InterStudy, HMO penetration dropped to 28.8% in July 2002, compared to 31.3% for the same period in 2001. The question is where have the members gone? The answer is that year after year of double-digit premium increases have resulted in two divergent paths for these former HMO members. The high path leads to PPO products. Enrollees have generally considered HMOs less attractive than PPOs due to network and other restrictions, but PPOs have historically been more expensive from an employer and employee perspective. However, sustained double-digit HMO premium increases have narrowed that

difference significantly and employees have moved into PPO products or employers have decided to become self-insured and only offer a PPO option. In this regard, a recent Mercer/Foster Higgins study concluded that the difference has narrowed to less than 9%, approximately \$268 per employee per month for HMOs, compared to \$291 per employee per month for PPOs.

The low path, on the other hand, has led to a growing number of uninsured people. Increasingly, many of these uninsured are working people who either no longer have health benefits offered by their employer or do not want to pay the salary deductions associated with employer health benefits. To give a sense of the magnitude of the problem, a study by the Kaiser Family Foundation found that monthly employee contributions toward premiums for family coverage grew from \$52 to \$201 from 1988 to 2003, an increase of 287%.

PPO, HMO Enrollment and Uninsured: 1998-2003E <sup>1,2,3</sup>



Source: Interstudy; U.S. Census Bureau, Modern Healthcare; Shattuck Hammond estimates.  
 1) Uninsured and PPO data at 12/31; HMO data at 1/1 of following year.  
 2) PPO data estimated.  
 3) HMO and uninsured data actual.

**Everyone Loves a Sequel: The Rise of the Phoenixes, or False Gods, The Final Chapter – The Continuing Story of Three Regional Managed Care Consolidators**

We have written on this topic for the past two years. The subject involves the continuing saga and triumphs and tribulations of three regional consolidators (Vista Healthplan (“Vista”), Venture Health Partnership Group (“VHPG”), and AmCare Health Plans (“AmCare”)) that had benefited from a buyer’s market and a willingness to undertake turn-arounds, but had their overall acquisition plans inhibited by limited sources of capital willing to finance the managed care industry. However, as is typical in any horror movie, the final chapter is never final and a new consolidator, NewQuest LLC (“NewQuest”), has arisen over the graves of VHPG and AmCare.

- **VHPG:** The consolidator of provider-sponsored HMOs was founded by Barry Scheur, an attorney and managed care consultant. VHPG, through two subsidiaries, **The Oath of Louisiana** and **The Oath of Alabama**, acquired troubled plans in Louisiana and Alabama and often angered competitors with a controversial marketing campaign. When we last left VHPG, **The Oath of Louisiana** was declared insolvent by the regulators and its members

were transferred through a re-underwriting agreement to **UnitedHealth Group** (“**United**”). **The Oath of Alabama** had been a somewhat better story for Mr. Scheur although there were reports that it was being monitored by Alabama regulators. Unfortunately, things went from bad to worse for Scheur over the past year. In October 2002, financially troubled **The Oath of Alabama** was sold to a subsidiary of **NewQuest**, with consideration probably no more than the assumption of liabilities. Potentially more serious for Mr. Scheur was the public acknowledgement by Louisiana officials in May 2003 that **The Oath of Louisiana** was under investigation for possible criminal actions and that a grand jury had issued subpoenas. **The Oath of Louisiana** owes doctors and other providers over \$50 million. There may still be one more update in the future regarding **VHPG**.

- **AmCare**: Founded by **Tom Lucksinger**, the former head of **NYLCare’s Health Plans of the Gulf Coast (Texas)** and an experienced health care attorney, **AmCare** acquired plans in Texas, Oklahoma and Louisiana and had approximately 140,000 members at its peak. However, **AmCare** suffered from an inability to raise sufficient capital to fund its operations. As reported in our Fall 2002 Report, **AmCare** agreed with state regulators to wind-down its Oklahoma operation and, according to certain reports sell its troubled Texas and Louisiana operations to a partnership formed by **Health Care Horizons**, a New Mexico managed care company, and **MedFirst Corp.** (“**MedFirst**”), a Florida-based managed care company. Similar to **The Oath’s** experience, things went from bad to worse. **AmCare’s** Louisiana operation was put into receivership in September 2002, and **United** agreed to purchase the members through a re-underwriting agreement. The deal with **Health Care Horizons** and **MedFirst** never occurred. **AmCare’s** Texas plan also went into receivership and was sliced and diced between three area health plans in October 2002. Commercial members were transferred to **HMO Blue Texas**, Medicaid members were transferred to **Texas Children’s Health Plan**, a provider-sponsored plan owned by **Texas Children’s Hospital** and Medicare members were transferred to a subsidiary of **NewQuest**.
- **Vista**: A Florida managed care company founded by **Dr. Steven Scott**, the founder and former CEO of **Coastal Healthcare Group**, acquired four financially struggling health plans in Florida over three years, paying very little in the process. **Dr. Scott** created the fourth largest managed care company in Florida with approximately 500,000 members. In our Fall 2002 Report, we observed that **Vista** appeared to be the only one of the regional consolidators that had enjoyed success, but the last 12 months have been another story. **Vista** lost more than \$27 million in 2002, but according to Florida regulators is showing a small profit in 2003. **Vista** financed its acquisitions and operations through **Dr. Scott’s** personal resources, and in some instances, with borrowings from **National Century Financial Enterprises** (“**NCFE**”), the now defunct healthcare lender that declared bankruptcy due to alleged fraud and questionable business practices. In 2002, **Vista** stated that it no longer owed **NCFE** money or owned **NCFE** bonds. However, **NCFE’s** involvement in the financing in one of **Dr. Scott’s** acquisitions makes an interesting story and may be telling about both **Vista** and **NCFE**.

**Vista**, through a predecessor company, acquired **HIP Health Plan of Florida** (“**HIP of Florida**”) in 2000. **NCFE** provided **Vista** with a \$40 million loan. **Vista** financed the transaction by, among other things, getting **HIP of Florida’s** parent to take back a \$16.5 million note. **Vista** then used the \$40 million to buy **NCFE** bonds. The **NCFE** bonds were

then used by **Vista** as an asset for regulatory capital purposes. In addition to the acquisition of **HIP of Florida**, **NCFE** and **Dr. Scott** have had a number of other dealings together. **NCFE** financed **Dr. Scott's** 2001 acquisition of **Health Net's** Florida plan, providing as much as \$23 million. **NCFE** was also the financial backer of **Dr. Scott's** physician management company, **PhyAmerica**, which declared bankruptcy in 2002 as a direct result of a halt of funding related to **NCFE's** bankruptcy. To say the least, **Vista's** financings have been unusual, and its capital structure may still be under stress.

- **NewQuest:** While not one of our original consolidators, **NewQuest** has become an active acquirer, picking up the pieces from other plans. It was started by an investment group led by Herbert Fritch, an experienced healthcare executive based in Nashville. **NewQuest**, through one of its **HealthSpring** operating subsidiaries, acquired 50% of a managed care company, **HealthNet**, primarily owned by **Baptist Hospital** and **St. Thomas Hospital** (“**St. Thomas**”) in Nashville, TN. The acquisition represented **Baptist Hospital's** entire interest in **HealthNet**. In March 2003, **NewQuest** acquired most of **St. Thomas's** remaining interest. As discussed above, in October 2002, **NewQuest** expanded into Texas and Alabama by acquiring the Medicare members of **AmCare's** Texas operation as well as **The Oath of Alabama**. In September 2003, **NewQuest** announced that it had acquired two PPO network companies: **Signature Health Alliance** which was jointly owned by **St. Thomas** and **Vanderbilt University Medical Center**, and **Community PPO** which was 100% owned by **St. Thomas**. **Tenet Healthcare**, the publicly traded hospital company, is reported to have an ownership in the **NewQuest** subsidiary that acquired **The Oath Alabama**.

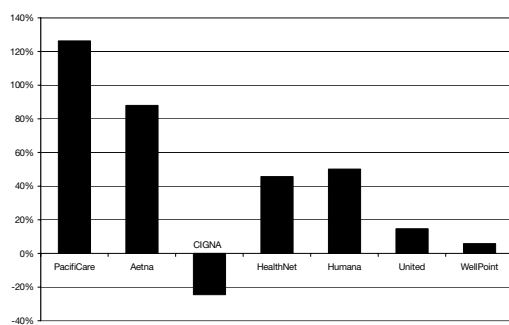
We hope that **NewQuest** has sufficient capital and can learn from any mistakes made by **Vista** and especially **AmCare** and **VHPG**.

### **Is the Glass Half Full or Half Empty: PacifiCare Health Systems (“PacifiCare”) Shares Skyrocket**

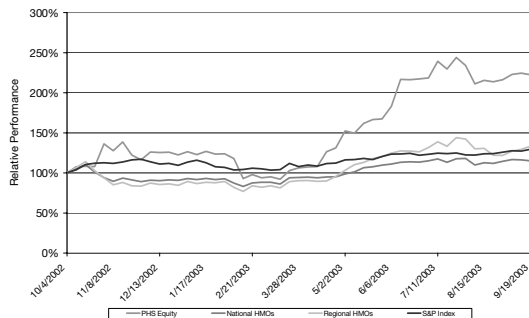
Over the past year, **PacifiCare** significantly outperformed all of the National HMOs. **PacifiCare's** share price increased despite having, as was the case in our Fall 2002 Report, the lowest valuation multiples among the National HMOs. At October 7, 2003, **PacifiCare's** EBITDA and Forward 2003 PE multiples were a paltry 3.6x and 8.9x, compared to mean multiples of 8.8x and 12.7x for the National HMOs. Furthermore, it is true that **PacifiCare's** share price increased significantly during a period that the company's balance sheet concerns were addressed, the overall outlook for the Medicare managed care market, to which **PacifiCare** has significant exposure, improved, and the company appeared to have costs under control. However, unusually low multiples and increased earnings appear to have been the driving catalyst for the improvement in share price, rather than a fundamental change in investor sentiment. The market remains concerned about **PacifiCare's** large exposure to Medicare and growth prospects. Wall Street research analysts are generally negative on the stock. The significant increase in share price appears to be driven by the fact that, if profits are up, valuation multiples at some point hit a floor and propel share price. Moreover, if **PacifiCare's** multiples begin to approach the multiples of the National HMOs, a year from now, the stock may once again significantly outperform its peers.

## The State of the HMO Industry – Fall 2003

Pacificare vs National HMO's: Change in Share Price Last Twelve Months



Pacificare Health System Relative Performance Latest Twelve Months



### HIAA/AAHP Merger: A Marriage that Makes Sense

In September, AAHP and HIAA, two leading health insurance trade organizations, announced that they would merge. While we understand that AAHP had a larger following among smaller health insurers, from where we sit as investment bankers, we saw little differentiation and often had a difficult decision regarding whose events we should attend. The merger will eliminate costly and wasted redundant efforts and will create an entity with significant political clout. Moreover, by increasing the number of members and eliminating the need by many organizations to pay dues to both organizations, the new entity should have greater financial resources to promote its agenda. HIAA and AAHP have considered a merger in the past, but have never been able to complete it. We think their members should vote in favor. We also have one piece of advice for the new organization: keep the annual convention in Las Vegas, it is cheap, fun, there are no hurricanes to worry about, and it gets the best turnout from senior executives.

### Dividends Don't Catch On at HMOs

The recent change in the tax law, reducing the federal tax on dividends to 15%, has led many publicly traded companies to instate or increase dividend payments. In this regard, a number of companies have suspended or pared back stock repurchase programs in favor of using capital to pay dividends. Similar to most healthcare payors and providers, managed care companies pay little or no dividend on their common shares. The only exception is CIGNA Corp. ("CIGNA"), whose mix of business has a significant amount of non-healthcare business. While dividend payouts are paltry, a number of managed care companies have announced or increased share repurchase programs over the past year, suggesting that these companies are generating excess cash. If current profit levels are maintained, and empirical evidence demonstrates that dividend payments result in sustained increases in shareholder value, we may see more managed care companies paying dividends in the coming years.

---

## Selected Highlights in the HMO Industry

|                               | <u>Dividend</u> | <u>Yield</u> | <u>Increased<br/>in Last 6M</u> | <u>Stock<br/>Buyback</u> |
|-------------------------------|-----------------|--------------|---------------------------------|--------------------------|
| <b>National HMOs</b>          |                 |              |                                 |                          |
| Aetna                         | \$0.04          | 0.06%        | No                              | Yes                      |
| CIGNA                         | \$1.32          | 2.87%        | No                              | No                       |
| Humana                        | N/A             | N/A          | N/A                             | Yes                      |
| PacifiCare Health Systems     | N/A             | N/A          | N/A                             | No                       |
| UnitedHealth Group            | \$0.03          | 0.03%        | Yes                             | Yes                      |
| WellPoint Health Networks     | N/A             | N/A          | N/A                             | Yes                      |
| Anthem                        | N/A             | N/A          | N/A                             | Yes                      |
| Health Net                    | N/A             | N/A          | N/A                             | Yes                      |
| <b>Regional HMOs</b>          |                 |              |                                 |                          |
| Coventry Corporation          | N/A             | N/A          | N/A                             | Yes                      |
| Mid Atlantic Medical Services | N/A             | N/A          | N/A                             | Yes                      |
| Oxford Health Plan            | N/A             | N/A          | N/A                             | Yes                      |
| Sierra Health Services        | N/A             | N/A          | N/A                             | No                       |
| WellChoice                    | N/A             | N/A          | N/A                             | No                       |
| AMERIGROUP                    | N/A             | N/A          | N/A                             | No                       |
| Centene                       | N/A             | N/A          | N/A                             | No                       |
| Molina Healthcare             | N/A             | N/A          | N/A                             | No                       |

### Statutory Capital or Financial “Architecting”

While cash is always an acceptable form of statutory capital, different states have different allowable assets that can be used for statutory purposes. Sometimes HMO owners try to be creative. In this regard, Vista’s CEO and primary owner, **Dr. Steven Scott**, while wealthy, does not have unlimited funds to finance losses and capital requirements of his Florida managed care operation. In an unusual attempt at financial engineering, **Dr. Scott** transferred a building he owns in Durham, NC to **Vista** to meet statutory requirements. Despite the fact that the building is neither in Florida nor used in the operations of **Vista**, it is an approved asset under Florida insurance regulations. Since real estate is not a liquid asset, an appropriate valuation must be agreed upon. While the regulations allow it, the regulators have never seen it proposed before.

### Blue Cross Blue Shield Conversions Grind to a Halt

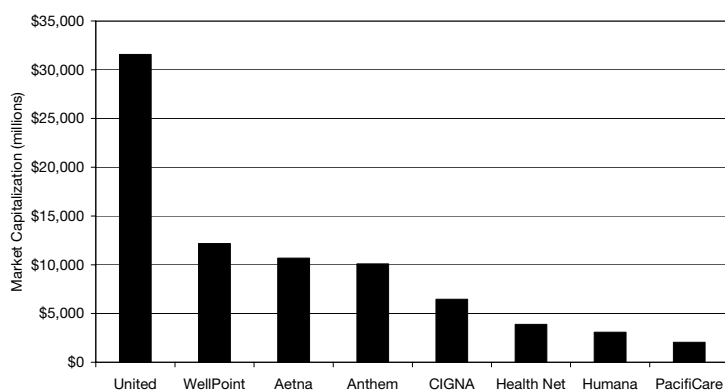
Despite the successful and long awaited conversion and IPO of **Empire Blue Cross Blue Shield (WellChoice)** in November 2002, the political environment for Blue Cross Blue Shield conversions appears to have changed dramatically over the past year. Concerns over the need for premium increases to support for-profit earnings requirements driving up the cost of healthcare, regulatory restrictions, compensation issues relating to senior executives and negative publicity from state insurance regulators, the courts, providers and consumers have all impacted the decision by four Blue Cross Blue Shield organizations to end their quest for for-profit conversion. **CareFirst** in Maryland, **Blue Cross Blue Shield of North Carolina**, and **Blue Cross Blue Shield of Kansas** gave up their plans for conversion after long, difficult and costly efforts. **Blue Cross of North Carolina** spent more than \$18 million on its effort. **Horizon Blue Cross Blue Shield** in New Jersey also abandoned its conversion effort after seeing the writing on the wall. **Premera Blue Cross** in Washington is still continuing its conversion as part of an effort to

undertake an IPO, but is facing significant opposition. State of Washington regulators have agreed to make a decision by March 15, 2004, but even if they rule in favor, other groups such as the courts could delay or derail the conversion. Fourteen Blue Cross plans have converted since 1994. While we have always questioned the substantive need for separate Blue Cross Blue Shield entities in each state (and multiples entities in certain states), it is clear that Blue Cross Blue Shield conversions have become a political football. Unfortunately, two popular, publicly traded companies that could be negatively impacted by this change in direction of the political winds are **WellPoint** and **Anthem**; both of these companies have been consolidators of the Blues and could see their growth plans stymied if there are fewer Blue acquisition targets available. On the other hand, **WellChoice** could be a beneficiary, at least from a valuation perspective, because it is the only single state publicly traded Blue's organization remaining and may become a "must have" for **WellPoint** or **Anthem**.

### **United's Market Capitalization Towers Over the Competition**

You need to look at a graph to truly appreciate how much larger **United's** market capitalization is compared to the other National HMOs. The closest competitor is **WellPoint**, a fine, well-run company in its own right, but with a market capitalization that is only about a third of **United's** valuation. While **United** is also the largest National HMO in terms of revenue, its dominant market value is clearly driven by its ability to derive superior earnings from its revenue. **United's** EBITDA and Net Income margins are the highest in the group, 9.7% and 5.9%, respectively, compared to a mean of 5.8% and 3.4% for the National HMOs. Unless mergers occur between some of the National HMOs, it is hard to imagine that **United** will ever give up its crown. If there is a crown, there must be a king. In July, **Dr. William McGuire**, the long time CEO of **United** and the architect of its success, sold 1.9 million shares, representing approximately 10% of his **United** holdings, for total gross proceeds of approximately \$101 million.

**National HMOs Market Capitalization<sup>1</sup>: October 7, 2003**



(1) Shares Outstanding multiplied by share price.

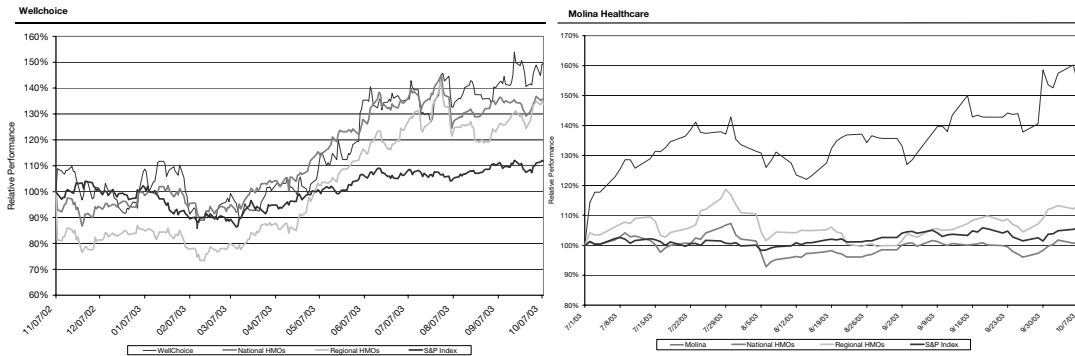
### **Capital Markets Continue to be "HMO Friendly"**

Continued and consistent growth in operating performance enabled managed care plans to access all sectors of the public markets. The Medicaid plans, which have been consistent acquirers, were especially active in the equity markets. **Centene** and **AMERIGROUP Corp.** ("AMERIGROUP"), two of three publicly traded Medicaid companies, transferred the trading of their common shares to the **New York Stock Exchange**.

- Initial Public Offerings (“IPO”).** Since our Fall 2002 Report, two managed care IPOs were completed. After a long drought of managed care IPOs, this the second year in a row when the managed care companies have been active in the IPO market despite the fact that few other IPOs of any kind were completed. The profile of the managed care companies going public was also similar to our Fall 2002 Report: Blue Cross Blue Shield and Medicaid. There has not been an IPO of a non-Blue, commercial managed care company in many years. **WellChoice**, the **Empire Blue Cross Blue Shield** parent company, completed its IPO in November. As discussed above, due to the change in the political environment surrounding conversion for Blue’s plans, **WellChoice** may be the last Blue plan to go public for a while. The IPO was a success. **WellChoice’s** share price has increased 49% since its IPO, compared to 12% for the S&P 500 Index. The Medicaid company that went public was **Molina** with membership in California, Michigan, Washington and Utah. Due to concerns about diversification, there seems implicitly to be a minimum three state rule for a Medicaid plan to go public. **Molina’s** IPO has also done well. Its share price has appreciated 54% since the IPO, compared to 5% for the S&P 500 Index.

| Managed Care IPOs: November 2002-Present |          |               |            |             |                       |
|------------------------------------------|----------|---------------|------------|-------------|-----------------------|
|                                          | IPO Date | Shares (mil.) | IPO (mil.) | Offer Price | Share Price 10/7/2003 |
| WellChoice                               | 11/02    | 16.69         | \$417      | \$25.0      | \$31.9                |
| Molina                                   | 7/03     | 6.60          | \$116      | \$17.5      | \$26.9                |

**Share Price Performance: IPO Date to October 2003**



- Secondary Offerings.** The Medicaid HMOs and one Blue’s organization were the sole participants in the secondary market. In October, **AMERIGROUP** completed a 2.8 million share offering that raised gross proceeds of \$120.8 million. In August, **Centene** completed a 3.0 million share offering. Together with the exercise of the underwriter’s over-allotment of 450,000 shares, **Centene** raised gross proceeds of \$100 million. In February, five months before **Cobalt** announced its sale to **WellPoint**, **Cobalt’s** largest shareholder, **Wisconsin United for Health Foundation** ( the “**Foundation**”), sold 5.5 million shares at \$12 per share, realizing gross proceeds of \$66 million. If the **Foundation** had waited another five months, based on the consideration offered by **WellPoint**, it could have realized another \$46.8 million.

Interestingly, despite having significant cash and liquidity, **United** filed a \$1.5 billion shelf registration in June. A shelf registration allows a company to enter the market quickly if the need or market conditions arises. The registration covers stock, debt, preferred stock and other securities. The stated use of proceeds covers the entire gamut of possibilities such as working capital, refinancing existing debt, acquisitions, general corporate purposes, etc. Recognizing the value of **United's** shares, the company has shown a reluctance to use its equity to finance acquisitions. By filing the shelf registration statement, **United** has given itself even greater financial flexibility than it already enjoys. Similar to **United**, **PacifiCare** filed a \$600 million shelf registration in September.

- **Debt Offerings.** Despite a drop in interest rates since our Fall 2002 Report and strong financial performance among the publicly traded managed care companies, borrowing through institutional long-term debt and bank term loans was limited, but did include convertible debt. The drop in borrowing may reflect the fact that without significant acquisitions or other capital intensive initiatives, there was little need for external capital and the managed care companies preferred not to borrow when the interest rate, low by historical standards, was still higher than the rate they could invest the funds at. Debt offerings completed since our Fall 2002 Report include the following:

| <b>Issuer</b> | <b>Date</b> | <b>Amount (mil.)</b> | <b>Rating</b> | <b>Interest Rate</b> | <b>Convertible/<br/>Premium<sup>1</sup></b> | <b>Term (Yrs)</b> |
|---------------|-------------|----------------------|---------------|----------------------|---------------------------------------------|-------------------|
| Humana        | 8/03        | \$300                | BB            | 6.30%                | No                                          | 15                |
| PacifiCare    | 6/03        | \$150                | BB-           | Floating             | No                                          | 6                 |
| Oxford        | 4/03        | \$400                | BB+           | Floating             | No                                          | 6                 |
| Sierra        | 3/03        | \$115                | B+            | 2.25%                | Yes/ 47.5%                                  | 20                |
| United        | 3/02        | \$450                | A             | 4.88%                | No                                          | 10                |
| PacifiCare    | 11/02       | \$125                | B+            | 3.00%                | Yes/ 37.6%                                  | 30                |

(1) Reflects convertible debt. Premium is the premium of the conversion price over the closing share price.

**Another Private Equity Backed Single State Medicaid Plan Stumbles**

Medicaid managed care has been one of the most robust sectors of managed care. Over the past few years, “smart money” private equity firms invested in at least seven Medicaid focused companies, but in few, if any, managed care companies focused on commercial business. Three of the five managed care IPOs in the last two years involved Medicaid plans. Last year one of the “smart money” plans, **Renaissance Health Systems (“Renaissance”)**, an Ohio Medicaid focused company, went into rehabilitation and liquidation. In 2002, **Great Lakes Health Plan (“Great Lakes”)**, a Michigan Medicaid plan, got into financial trouble and was put under regulatory supervision. **Great Lakes** is backed by **DFW Partners** and **Dr. Albert Waxman**, a noted and astute healthcare investor. **Great Lakes** had a reputation for strong management and impressive operating margins. In 2001, **Great Lakes** had net income of \$5.8 million; in 2002, it lost an astonishing \$11.0 million. Clearly, the Michigan Medicaid market became a market that was tough to make money in due to reimbursement levels. Three plans in Michigan, including the largest plan, **The Wellness Plan**, went into rehabilitation. However, the issues at **Great Lakes** must have run deeper than just market conditions. **Great Lakes’** CEO was replaced, and **Dr.**

**Waxman** himself took over the job of CEO. Usually, when this happens, it is sign that there were latent operational problems that might involve systems reporting and/or IBNR.

It looks like **Dr. Waxman** is getting the job done. **Great Lakes** reported a profit of \$5.0 million for the eight months ended August 31, 2003, suggesting that operational issues were the predominate driver for the loss in 2002. Moreover, investors, which we assume includes **Dr. Waxman**, invested another \$7 million into **Great Lakes** in October, probably to assure compliance with risk-based capital regulations.

Although operational issues may have materially contributed to the problems at both **Renaissance** and **Great Lakes**, a single state Medicaid focus, like any business with only one source of revenue, has its own set of unique risks and may have exacerbated the financial problems. It also interesting to note that sometimes the “smart money” private equity guys are no smarter than we regular investors.

### **Managed Care Founders End Ownership of MedUnite**

**MedUnite** was founded during the halcyon days of the Internet by seven of the largest health insurers in the country (**Aetna**, **CIGNA**, **Anthem**, **Health Net**, **Oxford Health Plans** (“**Oxford**”), **PacifiCare** and **WellPoint**) to develop an Internet based platform for claims processing, eligibility and connectivity between payors and providers. It also symbolized a strategic initiative among a large group of direct competitors. Each partner invested approximately \$11 million for a total investment of \$77 million. Although **MedUnite** had some success, its financial performance was substantially below expectations. Most of the original founders wrote down their investment over the past two years. In January 2003, **MedUnite** announced that it was sold to **Proxymed** for \$10 million in cash and a \$13.4 million, 4% convertible note. Although the proceeds represent only \$0.30 cents on the dollar (inclusive of the note), at least the founders got some of their money back.

### **Publicly Traded Managed Care Companies Continue to Keep Their Money Out of the Stock Market (See Exhibits C and D)**

Overall, the publicly traded managed care companies continued to have a relatively low exposure to the vagaries of the stock market, based on an analysis of total cash and investments (including public and private securities and real estate). A weak equity market during 2002 kept investment allocation similar to 2001. Mean equity investments as a percent of total investments was only a modest 4.4% for the National HMOs and a barely mentionable 0.3% for the Regional HMOs. Among the National HMOs, **Aetna** had the highest equity investment total at 15.8%, and among the Regional HMOs, **WellChoice** had the highest at 4.1%. The overall low amount of equity investment suggests that the publicly traded companies, in an effort to lend predictability to their earnings, have continued to rely on the relative steadiness of interest income as an important part of earnings and avoided the volatility of the equity markets. In this regard, for 2002, on average (excluding companies with pre-tax losses), investment income accounted for approximately 53.2% of pre-tax income for the National HMOs and 17.3% of pre-tax income for the Regional HMOs. As discussed in more detail below, the pre-tax earnings of publicly traded HMOs are potentially vulnerable to the drop in interest rates.

| <b>Summary Investment Analysis (12/31/02)</b> |                                                        |             |                                                          |
|-----------------------------------------------|--------------------------------------------------------|-------------|----------------------------------------------------------|
|                                               | <b>Cash &amp; Investments<sup>1</sup> (% of Total)</b> |             | <b>Investment Income/<br/>Pre-tax Income<sup>2</sup></b> |
|                                               | <b>Equity</b>                                          | <b>Debt</b> |                                                          |
| <b>Low</b>                                    |                                                        |             |                                                          |
| National HMOs                                 | 0.0%                                                   | 86.1%       | 10.5%                                                    |
| Regional HMOs                                 | 0.0%                                                   | 98.3%       | 9.6%                                                     |
| <b>High</b>                                   |                                                        |             |                                                          |
| National HMOs                                 | 15.8%                                                  | 100.0%      | 229.6%                                                   |
| Regional HMOs                                 | 4.1%                                                   | 100.0%      | 25.4%                                                    |
| <b>Mean</b>                                   |                                                        |             |                                                          |
| National HMOs                                 | 4.4%                                                   | 95.9%       | 53.2%                                                    |
| Regional HMOs                                 | 0.3%                                                   | 99.7%       | 17.3%                                                    |
| <b>Median</b>                                 |                                                        |             |                                                          |
| National HMOs                                 | 2.4%                                                   | 97.6%       | 28.6%                                                    |
| Regional HMOs                                 | 0.0%                                                   | 100.0%      | 17.6%                                                    |

<sup>1</sup> Includes current cash and investments, real estate investments and other long-term investments.

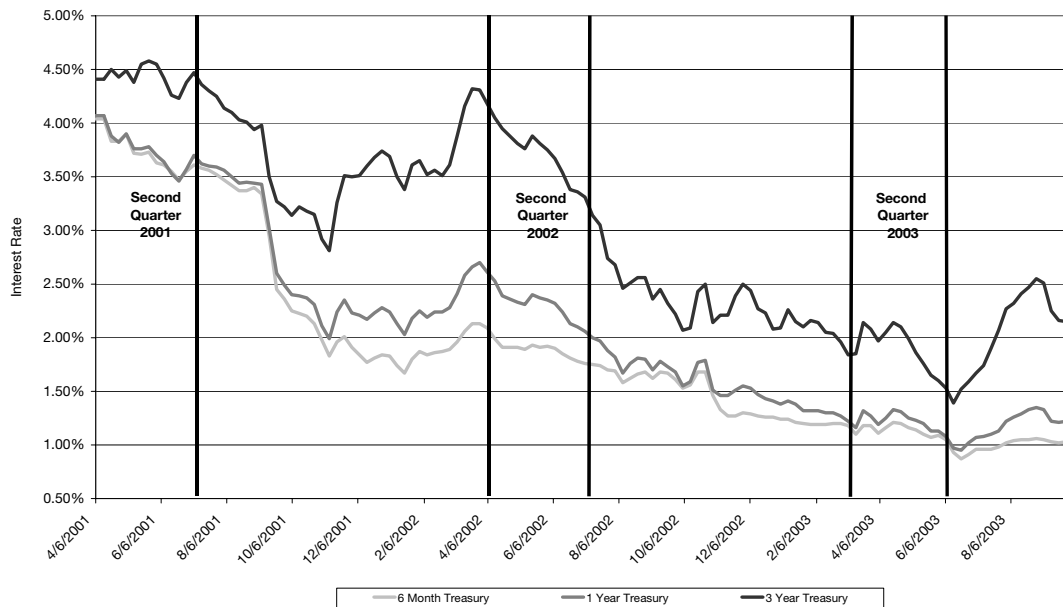
<sup>2</sup> Excludes companies with pre-tax losses.

**While Limited Investment in Equity Securities has Shielded Managed Care Companies From a Falling Stock Market, Rapidly Falling Interest Rates are Beginning to Impact Earnings (See Exhibits G and H)**

For the National HMOs and the Regional HMOs, mean investment income as a percent of revenue was 3.8% and 0.9%, respectively, for the quarter ending June 30, 2003, compared to 3.7% and 1.1%, respectively, for the quarter ending June 30, 2002. Despite the fact that interest rates significantly decreased during the period, investment income as a percent of revenue remained relatively unchanged. We believe investment income as a percent of revenue did not dramatically fall during this period primarily due to increased cash and investment balances during the period as well as, to some extent, average debt maturities and that extend beyond one year. In this regard, a higher level of cash and investments helped offset the decrease in interest rates. This view is supported not only by a review of cash and investment balances at June 30, 2003 and June 30, 2002, but also by the fact that the mean and median investment income as a percent of pretax income decreased during the period. The investment income from cash generated from strong earnings will continue to help offset the drop in rates. However, in the current environment HMOs will have to continue to lengthen the average life of their investment portfolios if they want to maintain the level of investment income to pre-tax income. A spike in interest rates could adversely affect portfolio valuation.

| <b>Quarterly Investment Earnings Analysis (6/30/03)</b> |                                            |                              |                              |
|---------------------------------------------------------|--------------------------------------------|------------------------------|------------------------------|
|                                                         | <b>Investment Income as a % of Revenue</b> |                              |                              |
|                                                         | <b>3M Ending<br/>6/30/03</b>               | <b>3M Ending<br/>6/30/02</b> | <b>3M Ending<br/>6/30/01</b> |
| <b>Low</b>                                              |                                            |                              |                              |
| National HMOs                                           | 0.5%                                       | 0.5%                         | 1.0%                         |
| Regional HMOs                                           | 0.2%                                       | 0.4%                         | 0.9%                         |
| <b>High</b>                                             |                                            |                              |                              |
| National HMOs                                           | 17.3%                                      | 16.0%                        | 17.7%                        |
| Regional HMOs                                           | 2.0%                                       | 2.1%                         | 2.7%                         |
| <b>Mean</b>                                             |                                            |                              |                              |
| National HMOs                                           | 3.8%                                       | 3.7%                         | 4.0%                         |
| Regional HMOs                                           | 0.9%                                       | 1.1%                         | 1.5%                         |
| <b>Median</b>                                           |                                            |                              |                              |
| National HMOs                                           | 1.4%                                       | 1.2%                         | 1.6%                         |
| Regional HMOs                                           | 0.8%                                       | 1.0%                         | 1.5%                         |

**Short Term Interest Rates**  
Second Quarter 2001 vs. Second Quarter 2002 vs. Second Quarter 2003



**Share Price and Profitability Performance Continue to Lift CEO Compensation (See Exhibits E and F)**

2002 was another good year to be the CEO of a managed care company. For the National HMOs, average cash compensation increased 24%, compared to a 6% average increase in share price. For the Regional HMOs, cash compensation increased 38%, compared to a 52% average increase in share price. Cash compensation excludes option grants. The increase in compensation among the Regional HMOs was primarily driven by compensation paid to the CEOs of Centene and Coventry, who saw their cash compensation increase by over 50% each. United's Dr. William McGuire remained the highest paid National HMO CEO, with cash

---

## The State of the HMO Industry – Fall 2003

compensation of \$7.1 million. As previously discussed, in July, Dr. McGuire exercised options resulting in gross proceeds of \$101 million. Coventry's Alan Wise was the highest paid Regional CEO, with cash compensation of \$3.2 million.

| CEO Compensation Analysis | % Change from 2001  |       |       |                     |             |
|---------------------------|---------------------|-------|-------|---------------------|-------------|
|                           | Annual Compensation |       |       | Annual Compensation | Share Price |
|                           | 2000                | 2001  | 2002  |                     |             |
| Mean                      | 2000                | 2001  | 2002  | Annual Compensation | Share Price |
| National HMOs             | \$2.8               | \$3.1 | \$3.5 | 24%                 | 6%          |
| Regional HMOs             | \$1.0               | \$1.6 | \$2.1 | 38%                 | 52%         |

### Plan Closures and Rehabilitations Continue at Slow Pace and are Focused on Medicaid Plans

The overall pace of closures and rehabilitations remains slow, but steady. The predominance of troubled Medicaid plans may bode well for the publicly traded Medicaid companies that could find the cost of entering new markets or expanding in existing markets significantly reduced. However, we also believe that once the current underwriting cycle cools down, and premium increases are more modest, the number of smaller plans in trouble will increase.

#### July 2003

- Michigan regulators placed **Wellness Plan**, a 117,000 member Michigan Medicaid plan, in rehabilitation. **Wellness Plan** is the third Michigan Medicaid plan to go into rehabilitation in the past two years. As previously discussed, **Great Lakes** is under state supervision and could be put into rehabilitation at the State's discretion.

#### June 2003

- **TennCare**, Tennessee's Medicaid program, which seems to be in the news a lot, announced they were closing two Medicaid plans that had no chance for rehabilitation. **Universal Care**, which covers 95,000 lives, had a negative net worth of \$48 million at March 31, 2003. **Xantus**, which covers 124,000 members, had a negative net worth of approximately \$75 million at March 31. **Universal Care** has filed suit against **TennCare** claiming that they are owed money and their negative net worth is substantially less than **TennCare's** calculation.

#### January 2003

- Colorado regulators forced the closure of **Community Health Plan of the Rockies** ("CHPR"), a 24,000 Medicaid plan that declared bankruptcy in November 2002. Regulators claimed that CHPR spent too much on administrative cost and not enough on healthcare. CHPR sued the State and in August 2003, and was awarded \$9.8 million based on a ruling that the State had violated its contract with CHPR to provide payments based on actuarially sound projections.

## Selected Merger and Acquisition Activity

### National HMOs

In the continuation of a trend we have seen over the past three years, mergers and acquisitions involving the National HMOs have been few and far between, especially in connection with the acquisition of commercial managed care plans. With the exception of one Blue Cross Blue Shield transaction and one specialized medical insurance company, they have been almost non-existent. Most merger and acquisition activity has been focused on non-core operations.

#### *September 2003*

- In a continued consolidation of the Blues, **WellPoint** completed its acquisition of **Cobalt**, a Wisconsin publicly traded Blue Cross Blue Shield organization. The transaction valued **Cobalt** at 0.55x and 14.0x revenue and EBITDA, respectively, and \$1,065 per commercial equivalent member. For the twelve months ending June 30, 2002, **Cobalt** had revenue of \$1.6 billion, EBITDA of \$61.5 million and approximately 434,500 full-risk members. The transaction reflects a premium valuation that is consistent with the prices paid for Blues plans. As previously discussed, **WellPoint** had less luck in completing its proposed acquisition of **CareFirst** which ended its effort to convert to for-profit status after stiff opposition from the courts, regulators, providers and consumers. Unless **WellChoice** decides to sell, this could be the last acquisition of a Blues plan for a while.
- As part of its continuing effort to divest non-core operations, **Health Net** announced an agreement to sell its workers' compensation network access subsidiary to **First Health Group**. The reported acquisition price of \$80 million was 2.0x the subsidiary's 2002 revenue.
- **United** entered into a definitive agreement to acquire **Golden Rule Financial**, a national company that specializes in health insurance for individuals and families, medical savings accounts, life insurance and annuities. **Golden Rule's** revenue was estimated at \$830 million in 2001. The purchase price is speculated to be \$780 million, which represents a valuation of 0.94x revenue. Analysts believe that it is the medical savings account ("MSA") and to a lesser extent the individual business that **United** is especially interested in. The acquisition of a leading MSA company, represents a strategic effort by **United** to counter the trend of decreasing HMO membership. Moreover, **United** has had a history of making niche acquisitions in areas that it wants to get into or expand. Its acquisition last year of **AmeriChoice** would fall into that category. Interestingly, **United** has not issued a press release regarding the acquisition, but the acquisition was confirmed through the filing of documents with the SEC.

#### *August 2003*

- **CIGNA** announced that it was considering the sale of its retirement and investment services business. For the six months ended June 30, 2003, the operation accounted for approximately 10% of **CIGNA's** revenue and 62% of its profits. The estimated sales price is as high as \$2 billion. Some analysts have commented that the sale reflects a failed strategy to leverage the health insurance business into related businesses such as employee benefits. Other analysts have speculated that **CIGNA** needs the liquidity that a sale would generate. There is probably some truth to both of these comments. We also note that **CIGNA's**

financials are the most difficult to compare to the other National HMOs. Hopefully, this divestiture will make CIGNA an easier company to analyze and understand.

*April 2003*

- In another transaction related to **Health Net's** effort to divest non-core operations, **Health Net** announced that it had entered into definitive agreements to sell its dental managed care subsidiary and vision benefits company to **SafeGuard Health Enterprises** ("**SafeGuard**"), a publicly traded dental benefits company. In separate agreements, **Health Net** entered into strategic relationships with **SafeGuard** to sell **Health Net** branded dental products to **Health Net** members and with **EyeMed Vision Care** to sell **Health Net** branded vision products to **Health Net** members.

*June 2003*

- **WellPoint** announced that it completed its acquisition of **Golden West Dental & Vision** in California. Unlike **Health Net** which divested its dental and vision subsidiaries in favor of providing dental and vision to its members through strategic relationships where it assumes no risk, **WellPoint** has made the strategic decision to grow its specialty businesses.

*January 2003*

- **CIGNA** announced that it completed the sale of **Lovelace Health Systems** ("**Lovelace**") in New Mexico to **Ardent Health Services**, a hospital management company. **Lovelace** is an integrated delivery system that includes a hospital, physician group and an HMO, **Lovelace Health Plan**, consisting of 167,000 commercial, Medicare and Medicaid lives. Because **Lovelace Health Plan** is so tightly integrated with the hospital and physician group, it may have been impossible to separate the provider assets from the HMO.
- In another divestiture to get out of the provider business, **CIGNA** announced that it had agreed to sell its Brazilian healthcare business, **CIGNA Saude**, to **Amil Group**. **CIGNA Saude** operates hospitals and other healthcare facilities. **CIGNA** will continue to sell health, life and accident insurance in Brazil.

*September 2002*

- As previously discussed, **AmCare's** Louisiana plan ceased operations. Replacement coverage was offered by **United** under a re-underwriting agreement. It is not know if **United** paid any consideration for members that enrolled with them.

## **Regional HMOs**

Regional HMO merger and acquisition activity was dominated by Medicaid transactions primarily by **Centene** and **AMERIGROUP** and acquisitions by **Coventry**, which kept up its torrid acquisition pace.

*October 2003*

- **Centene** announced that it exercised its option to acquire the remaining 20% interest that it did not already own in **University Health Plan**. **Centene** acquired an 80% interest in **University Health Plan** from the **University of Medicine and Dentistry of New Jersey** in January 2003. Based on a purchase price of \$2.6 million for the 20% interest and 53,000

Medicaid members, the exercise of the option values **University Health Plan** at \$245 per member.

*September 2003*

- **Centene** announced that it had entered into a definitive agreement to acquire the Medicaid assets of **Family Health Plan** in Ohio, a provider-sponsored plan owned by **Mercy Health Partners**, which is part of **Catholic Health Partners**. **Centene** will pay \$6.5 million for the assets. Based on 24,000 members and **Centene's** estimate that the acquisition will result in approximately \$42 million of revenue, the transaction is valued at approximately \$270 per member and 0.15x revenue. **Centene** stated that the acquisition will meet its criteria for a 25% IRR and will be accretive to earnings in the range of \$0.05 to \$0.06 per share in 2004. The acquisition is also in line with **Centene's** previously announced criteria of acquiring plans at \$100-\$400 per member. The transaction will allow **Centene** to enter a fifth state and continue to diversify its payor base.
- **Coventry** continues to reign supreme as the most active acquirer of non-Medicaid health plans. In many instances, they may be the only buyer. While the valuations may be low, **Coventry** gets a lot of deals done. In this regard, in September **Coventry** announced the completion of its acquisition of **Altius Health Plans**, a Utah plan with 116,000 commercial risk members, 44,000 non-risk members and revenue of approximately \$235 million. Based on an acquisition price of \$41 million which includes a capital infusion of \$13-\$14 million, the transaction was valued at approximately \$340 per commercial member equivalent and 0.17x revenue. **Coventry** expects the acquisition to increase its earnings by \$.01 next year. The acquisition enabled **Coventry** to enter a new market. Unlike most other potential acquirers, **Coventry** is willing to acquire under-performing plans, and is willing enter a new market without acquiring a dominant payor.

*August 2003*

- **Molina** announced that it had received 9,000 Medicaid members from **Community Choice Michigan**, a Medicaid plan that was in rehabilitation. The members were transitioned to **Molina** and it may not have paid any consideration.

*June 2003*

- **Centene** announced that it entered into a definitive agreement to acquire 21,000 Medicaid lives in San Antonio, TX, from **HMO Blue Texas**. Terms of the acquisition were not announced which may mean that **Centene** paid either little or nothing for the members or more than its announced acquisition criteria. **Centene** expects the acquisition to add \$.03 to \$.04 to earnings in 2003.

*March 2003*

- **Centene** and **Molina** were not the only Medicaid plans to get in on the acquisition bandwagon. **AMERIGROUP** announced that it had signed a definitive agreement to acquire the 30,000 member **St. Augustine Medicaid** division of **AvMed Health Plan** in Florida. The plan had estimated revenue of \$40 million. Based on a \$10 million acquisition price, **AMERIGROUP** valued the plan at \$333 per member and 0.25x revenue. The acquisition is expected to be modestly accretive in 2003 and add \$0.05 -\$0.10 per share to

AMERIGROUP's 2004 earnings. AMERIGROUP entered the Florida market in early 2003 through its acquisition of **Physician Health Plans of Florida**.

*February 2003*

- **Coventry** announced that it completed its acquisition of **PersonalCare Health Management** (“**PersonalCare**”), a 78,000 member, provider-sponsored plan that serves Illinois, from **Provena Health**. For 2002, **PersonalCare** had estimated revenue of \$200 million and was unprofitable. **Coventry** paid \$18 million, but adjusting for the \$6.4 million in statutory net worth, **Coventry** acquired the plan for \$149 per member and 0.06x revenue. Similar to **Coventry**'s Utah acquisition in September, the **PersonalCare** acquisition enabled **Coventry** to enter a new market.

*January 2003*

- **AMERIGROUP** completed the acquisition of the Medicaid business of **Physician Healthcare Plans** (“**PHP**”) in Florida. **PHP** had approximately 190,000 Medicaid members and \$300 million of revenue. Based on an acquisition price of \$121 million, the transaction is valued at approximately \$637 per member and 0.40x revenue. **AMERIGROUP** estimates that the acquisition will add \$0.25 - \$0.30 cents per share in earnings in 2003.
- **Centene** completed the purchase of an 80% interest in **University Health Plan**, a 50,000 member provider-sponsored Medicaid plan owned by the **University of Medicine and Dentistry of New Jersey**. The price was not disclosed, but **Centene** stated that it fell between its targeted range of \$100-\$400 per Medicaid member. The transaction allows **Centene** to enter a fourth state. **Centene** went on to say that the acquisition would boost 2003 earnings by \$0.20 to \$0.24 per share and revenue by \$115 million to \$125 million.

*December 2002*

- **Coventry** completed the acquisition of **Mid-America Health Partners** (“**Mid-America**”), a 250,000 member, provider-sponsored plan located in Kansas. **Mid-America** closed its Medicare operation as part of the transaction. The membership consists of 97,000 commercial risk members and 130,000 PPO network rental members. The acquisition expanded both **Coventry**'s Kansas operations and its overall PPO rental network. Terms of the transaction were not disclosed.

**Non-Publicly Traded HMOs**

*September 2003*

- As previously discussed, **NewQuest**, a managed care consolidator, announced that it had acquired two PPO network companies: **Signature Health Alliance** which was jointly owned by **St. Thomas Hospital** (“**St. Thomas**”) and **Vanderbilt University Medical Center** and **Community PPO** which was 100% owned by **St. Thomas**.

*July 2003*

- **Medical Mutual of Ohio** acquired **Family Health Plan**'s 36,000 member commercial business. As described above, this was the first part of a transaction that culminated in September with **Centene** acquiring **Family Health Plan** and its remaining Medicaid business. Inclusive of commercial and Medicaid members, **Family Health Plan** lost \$4.7 million on \$86.6 million of revenue in 2002.

*May 2003*

- As part of the realigning of relationships among the Pennsylvania Blues, **Highmark Blue Cross Blue Shield** (“**Highmark**”) and **Blue Cross of Northeastern Pennsylvania** (“**BCNEPA**”) announced that they had signed a letter of intent to form a strategic relationship whereby **Highmark** would buy a minority interest in **BCNEPA**’s HMO, **First Priority Health HMO** as well an interest in **First Priority Life Insurance Company**. **BCNEPA** will continue to manage the operations and **Highmark** will provide systems support.
- **Health Plan of the Upper Ohio Valley** announced that it was acquiring **HomeTown Health Network** (“**HomeTown**”), a 84,000 member provider-sponsored plan owned by **Akron General Health System** (“**Akron General**”). The acquisition includes a 10-year exclusive provider agreement with **Akron General**. Based on a reported acquisition price of \$13 million, **HomeTown** is valued at \$155 per member.
- It was reported that the provider equity owners of **ConnectiCare** were exploring the sale of the 280,000 member plan. **ConnectiCare** is primarily owned by the **Carlyle Group** and **Liberty Partners**, two leading healthcare private equity investors. The plan was acquired in January 2001 at a valuation of \$646 per member, 0.27x revenue and 4.2x EBITDA. It is believed that **ConnectiCare** was unable to attract an acceptable offer and so the investors took it off the market.
- As part of an overall realignment of relationships between **Highmark** and **Capital Blue Cross** (“**Capital**”), **Capital** acquired 50% of an HMO joint venture that it did not already own from **Highmark**. The joint venture known as **Keystone Plan Central** has approximately 200,000 members. **Capital** paid **Highmark** \$29 million which is the equivalent of approximately \$290 per member.

*January 2003*

- **Horizon Blue Cross Blue Shield** in New Jersey (“**Horizon Blue Cross Blue Shield**”) acquired the 50% of a Medicaid joint venture with **Mercy Health Plan** that it did not already own. The joint venture, known as **Horizon Mercy**, is the largest Medicaid plan in New Jersey. Terms of the transaction were not disclosed.

*October 2002*

- As previously discussed, the Texas health plan of **AmCare** went into receivership and was divided among three health plans. Commercial members were transferred to **HMO Blue Texas**, Medicaid members were transferred to **Texas Children’s Health Plan**, a provider-sponsored plan owned by **Texas Children’s Hospital** and Medicare members were transferred to a subsidiary of **NewQuest**.

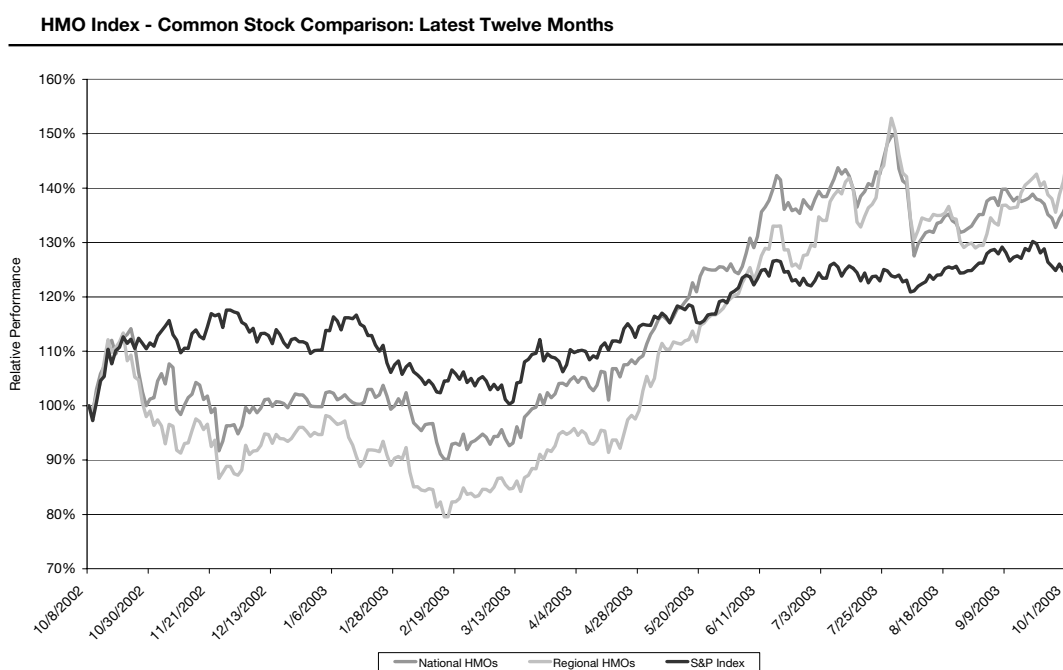
*November 2002*

- As previously discussed, **NewQuest** acquired the Alabama operations of **The Oath**.

## Stock Price Performance Analysis

The stock price performance graphs presented on the following pages demonstrate the relative performance of three indices: the National HMO Index, the Regional HMO Index, and the S&P 500 Index. The companies that comprise both the Regional and National HMO Indices represent a composite, with each company having equal weighting within its respective composite Index. It should be noted that each graph includes only companies that were publicly traded for the whole period.

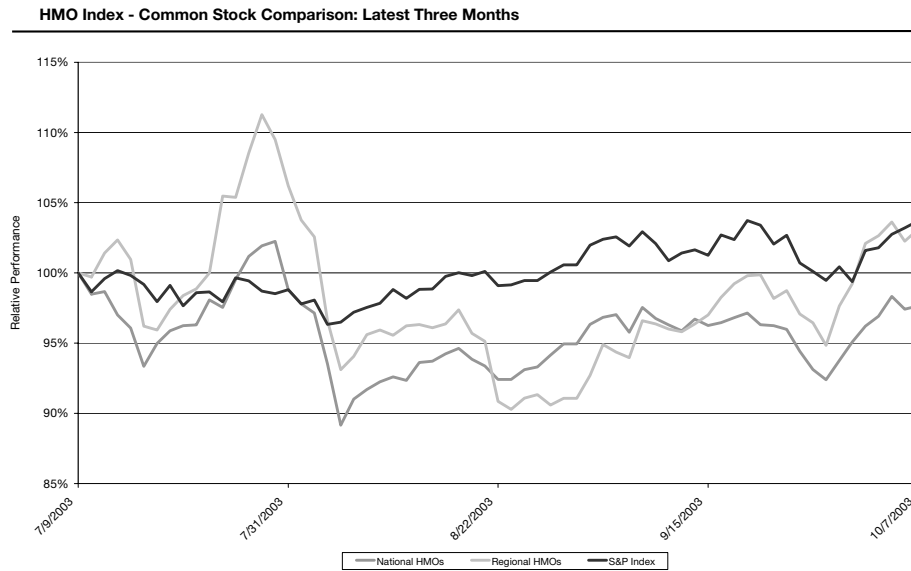
In a continuation of a trend seen in our Fall 2002 Report, for the latest twelve months (“LTM”) ending October 7, 2003, both the National HMO Index and the Regional HMO Index outperformed the S&P 500 Index. The National Index and Regional Index rose 39% and 45%, respectively, while the S&P Index increased 29%. The strong performance of the HMO Indices is consistent with the performance of many healthcare services sectors, which are often viewed as a defensive investment in a weak economy and erratic stock market, as well as a rebounding equity market.



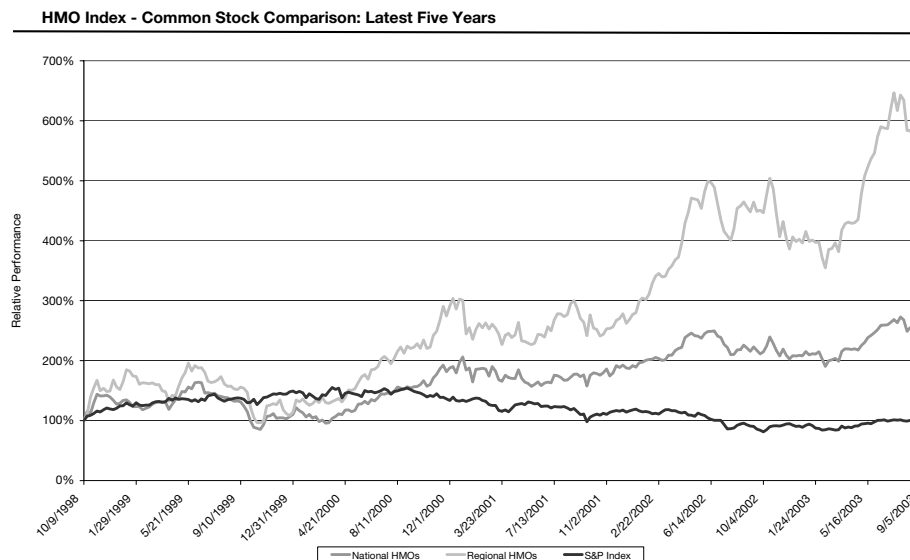
The superior performance of the Regional HMO Index over the National HMO Index continues a pattern that has been occurring for three years. We believe that the performance of the Regional HMOs reflects their strong earnings performance as well as the fact that many investors continue to focus on the small cap and mid cap areas for particularly undervalued companies. However, we continue to believe that the Regional HMO Index’s ability to outperform the National HMO Index will be a relatively short-term phenomenon, as these regional companies find that their geographic focus and relatively small size inhibit their ability to grow earnings on a consistent basis. In order to counter this inevitability **Coventry** is the sole

Regional HMO to consistently enter new markets through acquisition. As its geographic coverage expands, it may be time to move **Coventry** into the National HMOs.

For the three months ending October 7, 2003, The National HMO Index decreased 2%, while the Regional HMO Index increased 3%. The S&P 500 Index increased 3% during the period.



For the latest five-year period ending October 7, 2003, the National and Regional HMO Indices not only caught the S&P 500 Index, but also significantly surpassed it. The National and Regional HMO Indices increased 163% and 484%, respectively, compared to the S&P 500 Index that remained unchanged. The ability of the HMO Indices to outperform the market over the long-term is a watershed event. It signals that the industry has matured and developed a reputation for consistent earnings growth, strong management, adequate capitalization and staying power. The HMO sector has become an investment sector that most general-market institutional portfolio managers must have in their portfolios.



## Wall Street Analyst HMO Report Card

Shattuck Hammond believes that the collective views of Wall Street analysts represent a strong indicator of overall market sentiment regarding stock performance in the HMO industry. In an effort to measure market sentiment, Shattuck Hammond tracks the stock recommendations made by each Wall Street analyst for each of the publicly traded HMOs. We aggregate and weight these recommendations to create our Wall Street Analyst HMO Report Card. The table below summarizes our Wall Street Analyst HMO Report Card for each publicly traded HMO.

We also apply an additional weighting factor to account for the breadth of analyst coverage that a particular HMO receives. We believe that broader coverage for a particular company represents stronger and more reliable sentiment regarding that particular company. The recommendations used to calculate the table below were all issued within three months of October 7, 2003. In light of recent efforts by many brokerage houses to simplify their stock rating systems, beginning with this Report, we have decreased the number of rating categories. The categories have been simplified to buy, hold and sell.

| <b>Company</b>            | <b>Exchange/Ticker</b> | <b>Average Weighted Analyst Score</b> |
|---------------------------|------------------------|---------------------------------------|
| <b>National HMOs</b>      |                        |                                       |
| Aetna                     | (NYSE: AET)            | 0.71                                  |
| CIGNA                     | (NYSE: CI)             | -0.33                                 |
| Health Net                | (NYSE: HNT)            | 0.13                                  |
| Humana                    | (NYSE: HUM)            | -0.12                                 |
| PacifiCare                | (NYSE: PHS)            | -0.22                                 |
| United                    | (NYSE: UNH)            | 1.01                                  |
| WellPoint                 | (NYSE: WLP)            | 0.67                                  |
| Anthem                    | (NYSE: ATH)            | 1.06                                  |
| <b>Average - National</b> |                        | <b>0.36</b>                           |
| <b>Regional HMOs</b>      |                        |                                       |
| Coventry                  | (NYSE: CVH)            | 0.59                                  |
| Mid Atlantic              | (NYSE: MME)            | 1.04                                  |
| Oxford                    | (NYSE: OHP)            | -0.11                                 |
| WellChoice                | (NYSE: WC)             | 0.64                                  |
| Sierra                    | (NYSE: SIE)            | 0.00                                  |
| Molina                    | (NYSE: MOH)            | 0.80                                  |
| AMERIGROUP                | (NYSE: AGP)            | 1.06                                  |
| Centene                   | (NASDAQ: CNTE)         | 0.73                                  |
| <b>Average - Regional</b> |                        | <b>0.59</b>                           |
| <b>Overall Average</b>    |                        | <b>0.48</b>                           |

BUY: Strong Buy, Recommended List, Buy, Accumulate, Attractive, Outperform, Overweight, Sector Outperform = 1.0;  
 HOLD: Neutral, Hold, Market Perform, Equal Weight, Peer Perform = 0.0;  
 SELL: Sell, Underperform, Reduce, Underweight = -1.0.

The Wall Street Analyst HMO Report Card provides interesting insights into Wall Street analyst sentiment. The Average Weighted Analyst Scores for the National and Regional HMOs while generally modestly positive, have decreased since our Fall 2002 Report. The decrease, we believe, reflects concerns over the ability to maintain growth and margins, which have significantly expanded. Moreover, the modest Average Weighted Analyst Scores for both the National and Regional HMOs is reflective of their in-line performance with the S&P 500 Index over the past three months. The Average Weighted Analyst Score for the National HMOs ranges from -0.33 or sell for **CIGNA** to a bullish 1.06 for **Anthem**. On a combined basis, the National HMOs had an Average Weighted Analyst Score of 0.36, which is neutral to modestly positive.

For the Regional HMOs, the Average Weighted Analyst Score ranges from a slightly negative -0.11 for **Oxford** (the only negative among the Regional HMOs) to a strong positive 1.06 for **AMERIGROUP**, with a modestly positive average of 0.59. All three of the Medicaid HMOs had relatively strong scores. This is only the third Report, and second straight report, we have ever written where the Average Weighted Analyst Score for the Regional HMOs exceeded the Average Weighted Analyst Score for the National HMOs, and again this time, the score is materially higher. Moreover, we believe that the Average Weighted Analyst Score for the National HMOs may be skewed to the positive side, compared to the Regional HMOs, due to hesitancy among Wall Street analysts to put sell recommendations on large publicly traded companies. Sell recommendations often anger companies and can affect their interest in using the offending analysts' employer for investment banking transactions. As a result, an analyst may go neutral rather than issue a sell recommendation. However, due to the recent requirements on Wall Street to clearly separate research and investment banking, research and recommendations are supposed to reflect the unbiased view of the research analyst, at least that is the way is supposed to work. At the same time, it should be noted that the inclusion of the Medicaid HMOs in the Regional HMO group has increased the Average Weighted Analyst Score for the Regional HMOs.

Readers should note that the Shattuck Hammond Wall Street Analyst HMO Report Card is a synthesis of Wall Street sentiment for anticipated stock performance. The Wall Street Analyst HMO Report Card is not a direct measurement of the quality or financial strength of the underlying companies. The companies' stock prices, as well as analyst sentiment, are subject to a variety of factors, only one of which is the future prospects of the underlying companies. Moreover, each analyst uses his or her own subjective criteria for making a particular recommendation. Nonetheless, we believe that the Wall Street Analyst HMO Report Card provides a useful snapshot of both overall industry and company specific sentiment. Changes in sentiment over time also provide a useful relative comparison for the industry as a whole and for individual companies.

## Financial Performance Analysis (See Exhibit A and B)

Reflecting continued double-digit premium increases and cost control efforts, margins for both the National HMOs and Regional HMOs, on average, were significantly higher than the margins reported in our Fall 2002 Report. Also, for the first time since we began writing these Reports, on a pro forma basis, with add-backs for extraordinary and one-time items, all companies were profitable. Once again, average margins for the Regional HMOs exceeded the National HMOs. However, while in past Reports, overall margin differentials were somewhat misleading due to the high margins of the Medicaid HMOs and **Oxford** compared to the other Regional HMOs, for the Latest Twelve Months (“LTM”) ended June 30, 2003, strong earnings growth has brought the margins of the Regional HMOs closer in line with each other. As we have said in the past, over time we expect the Regional HMOs to have greater difficulty maintaining their margins than the National HMOs. The Regional HMOs are in a low margin industry where critical mass impacts the ability to minimize administrative costs, access large group accounts and arrange for national or super-regional provider contracts.

### National HMOs

- Excluding **CIGNA** and **Aetna**, the mean EBITDA margin for the LTM period ending June 30, 2003, was 5.5%, compared to 4.6% in our Fall 2002 Report. Once again, **United** achieved the highest EBITDA margin at 9.7% and **Humana** had the lowest EBITDA margin at 3.1%. **Aetna** and **CIGNA** were excluded from this analysis due to the fact that each has significant operating income generated from non-healthcare assets and various financial assets. EBITDA is often used as a proxy for cash flow, which also enables an analyst to focus on operational performance of a business by excluding the impact of balance sheet related items such as interest income and expense. **United** has generally had the strongest EBITDA margin among the National HMOs, an indication of its business, management and acquisition savvy.
- The mean net income margin for the LTM ending June 30, 2002, was 3.4%, compared to 2.5% in our Fall 2002 Report. **United** achieved the highest net income margin at 5.9% and **Humana** had the lowest net income margin at 1.9%.
- For the LTM ending June 30, 2002, medical expenses as a percentage of premium revenue (alternatively, the “Medical Loss Ratio” or “MLR”) averaged 82.2% compared to 84.0% in our Fall 2002 Report. **WellPoint** had the lowest MLR at 75.5%, and **CIGNA** had the highest MLR at 86.4%. **CIGNA** had the lowest MLR in our Fall 2002 Report, but has faced significant issues in controlling healthcare costs.

### Regional HMOs

- The mean EBITDA margin for the LTM ending June 30, 2003, was 7.8%, compared to 5.8% in our Fall 2002 Report. **Molina**, a new entrant to the Regional HMO group, achieved the highest EBITDA margin at 9.4%, just barely beating **Oxford** (9.3%), which had the highest EBITDA margin in our Reports for the last couple of years. **Oxford** was one of only two Regional HMOs to experience a decrease in EBITDA margin since our Fall 2002 Report. All other Regional HMOs experienced significant increases.

- The mean net income margin was 4.9% for the LTM ending June 30, 2003, compared to 3.7% in our Fall 2002. **Oxford** once again had the highest net income margin at 6.5%, compared to 6.8% in our Fall 2002 Report and **WellChoice** had the lowest net income margin at 3.5%.
- The mean MLR was 82.9% for the LTM ending June 30, 2003, compared to 84.3% in our Fall 2002 Report. Once again, **Oxford** and **Sierra** showed the lowest and highest MLRs at 80.4% and 86.2%, respectively. Although **Sierra's** MLR remained high, it continued to decrease from previous periods. **Sierra's** improving MLR has contributed significantly to its rising share price.

## Valuation Analysis (See Exhibits A and B)

Valuation multiples for the National HMOs continue to be driven by their long-term ability to manage expenses and generate earnings with less emphasis being placed on market share growth. With that having been said, it is important to point out that for the most part, despite increased margins and earnings, valuation multiples have decreased since our Fall 2002 Report. As discussed above, the decrease reflects concerns over the ability to maintain these margins and overall growth in an environment where premium increases may be moderating and HMO membership is falling.

**United** continues to stand out as a company commanding a premium valuation with superior valuation multiples virtually across the board. We believe this premium valuation reflects a number of factors including: (i) strong current and projected profitability; (ii) mix of business; (iii) management reputation and record; (iv) relative size; (v) balance sheet strength; and (vi) consistent earnings. In an industry that expects further consolidation, we continue to believe that **United** will be one of the strongest survivors and consolidators. Its valuation dominates the HMO industry on both a relative basis and an absolute basis. As previously discussed, **United's** market capitalization is almost three times its nearest competitor.

Similar to the National HMOs, valuation multiples for the Regional HMOs were driven largely by profitability, and especially expected future profitability. Generally, the Regional HMOs trade at a discount to the National HMOs. However, similar to the situation in our last four Reports, the spread is practically non-existent, and with regard to several valuation multiples, the Regional HMOs actually trade at a premium to the National HMOs. As previously discussed, both the National and the Regional HMOs generally experienced a decrease in valuation multiples since our Fall 2002 Report.

## National HMOs

- On a Total Market Value (equity value plus debt, less net working capital) to Revenue (“Revenue Multiple”) basis, the National HMOs had a mean multiple of 0.54x as of October 7, 2003, compared to 0.52x in our Fall 2002 Report. Once again, **United** achieved the highest Revenue Multiple of 1.17x and **PacifiCare** had the lowest Revenue Multiple at 0.14x.
- On a Total Market Value-to-Commercial Equivalent Member multiple (“Member Multiple”) basis, the National HMOs had a mean member multiple of \$1,644 per member as of October 7, 2003, compared to \$1,459 per member in our Fall 2002 Report. Similar to our last four Reports, **United** had the highest Member Multiple at \$4,618 per member and **PacifiCare** had the lowest Member Multiple at \$443 per member. Although per member valuations are a common valuation tool in the managed care industry, they have become increasingly less reliable as an index of value, especially for the National HMOs. Issues affecting this valuation methodology include: (i) growth of specialty medical businesses (dental, pharmacy, behavioral health, etc.) whose members are difficult to convert into commercial member equivalents; (ii) difficulty determining appropriate conversion factors for Medicare, Medicaid and indemnity members; (iii) difficulty determining which members are partial risk members as well as difficulty determining an appropriate conversion factor for

such members; and (iv) in the case of **CIGNA** and **Aetna**, significant non-healthcare business.

- On a Total Market Value-to-EBITDA multiple (“EBITDA Multiple”) basis, the National HMOs had a mean EBITDA multiple of 8.8x as of October 7, 2003, compared to 9.9x in our Fall 2002 report. **WellPoint** achieved the highest EBITDA Multiple of 12.5x and **PacifiCare** had the lowest multiple at 3.6x.
- On a projected price-to-earnings basis (“P/E Multiples”), the National HMOs had a calendar year 2003 mean P/E Multiple of 12.7x and a calendar year 2004 P/E Multiple of 11.1x as of October 7, 2003, compared to projected P/E Multiples of 15.5x and 12.5x in our Fall 2002 Report. **United** had the highest 2003 and 2004 projected P/E Multiple of 17.9x and 15.0x, respectively. As in our last two Reports, **PacifiCare** had the lowest projected P/E Multiples, with a 2003 projected P/E Multiple of 8.9x and a 2004 projected P/E Multiple of 8.2x. As demonstrated by **PacifiCare**’s low Average Weighted Analyst Score, Wall Street continues to be wary of **PacifiCare**’s ability to deliver on projected earnings. However, if **PacifiCare** wins more support on Wall Street, and multiples approach the mean for the National HMOs, the stock could double in value.

### **Regional HMOs**

- The Regional HMOs had a mean Revenue Multiple of 0.69x as of October 7, 2003, compared to 0.62x in our Fall 2002 Report. **Molina** enjoyed the highest Revenue Multiple at 0.86x. **WellChoice** had the lowest Revenue Multiple at 0.34x.
- The Regional HMOs had a mean Member Multiple of \$1,348 per member as of October 7, 2003, compared to \$1,493 per member in our Fall 2002 Report. **Oxford** achieved the highest Member Multiple at \$2,111 per member, while **WellChoice** experienced the lowest Member Multiple at \$574 per member.
- The mean EBITDA Multiple was 8.8x as of October 7, 2003, compared to 10.7x in our Fall 2002 Report. **Centene** had the highest EBITDA Multiple at 12.1x, while **WellChoice** had the lowest EBITDA Multiple at 6.0x.
- The calendar year 2003 mean P/E Multiple was 13.7x and the calendar year 2004 mean P/E Multiple was 12.4x as of October 7, 2003, compared to 15.0x and 13.3x, respectively in our Fall 2002 Report. **Centene** had the highest forward P/E Multiple, with a 2003 P/E Multiple of 19.2x and 2004 P/E Multiple of 16.9x. **Sierra** had the lowest forward P/E Multiple, with a 2003 P/E Multiple of 8.3x and a 2004 P/E Multiple of 7.4x.

## Closing Thoughts

### The Evolving Shape of Risk

When we began writing these reports in the late 1990s, we referred to them as our “HMO Reports.” But, over time, as the health benefits market evolved, these reports have grown to encompass many products beyond the traditional HMO, and traditional HMOs are less and less where the action is. There are several reasons for this. First, managing insurance risk in a high cost sector of the economy has always been complex, and it is becoming increasingly so. As a result, once the insurers determined that providers were no longer willing to “share” the risk with them (through risk-sharing or capitated provider contracts), the publicly traded managed care companies became more cautious about taking on the risk all by themselves. In addition, defined contribution programs, a product that would logically compel healthcare consumers to “share” some of the risk for their own healthcare – beyond simple deductibles – are making slow progress. While these programs seem to provide evidence of the ability to modify consumer behavior, they are in their infancy and are hardly in a position to demonstrate their effectiveness in any longitudinal sense. Lastly, while HMOs were never the favorite of consumers, who objected to narrow networks and gatekeepers, HMOs (with the exception of Kaiser) have had difficulty demonstrating that they either reduce costs or improve outcomes. Thus, with the declining number of independent HMOs and their enrollment declining as well, we may be seeing an acceleration away from the traditional risk-bearing HMO, at least among the commercial population. Moreover, our feeling is that the trend toward shifting more costs to consumers will continue for some time.

### Interesting Medicare Developments

We observed another interesting manifestation of this trend in one of the legislative “trial balloons” launched by the GOP in early October. While few specifics were offered, the GOP leadership announced that it would consider the possibility of introducing “means” testing as a way to address the yawning Medicare funding gap. You don’t have to be a “baby boomer” to appreciate the inadequacy of Medicare’s “entitlement” funding, so this announcement didn’t come as a surprise to us. Moreover, since the Medicare+Choice program has been a disappointment due to inadequate funding, introducing some element of individual funding to the Medicare program might provide an incentive for older citizens to enroll in programs like these that seek to manage costs. We expect strong opposition to this proposal from seniors, and possibly from “near-seniors.” But it seems inevitable, if Medicare is to survive the onslaught from the “boomers,” that a significant change in its funding or, more likely, in its benefit structure, will be required before too long.

## The State of the HMO Industry – Fall 2003

### Exhibit A: National Managed Care Companies - Public Market Valuation Analysis

\$ in millions, except per share amounts

| Company                       | Stock Price   |                  | Market Value      |                   |                   | Latest Twelve Months (b) |                  |              |                 | Price / EPS     |                  |              |              | LTM Margins  |              |               |             |
|-------------------------------|---------------|------------------|-------------------|-------------------|-------------------|--------------------------|------------------|--------------|-----------------|-----------------|------------------|--------------|--------------|--------------|--------------|---------------|-------------|
|                               | 10/07/03      | % Below 52 wk HI | Equity            | Total (a)         |                   | Revenues                 | EBITDA           | Net Income   | Mem- bers(C)(d) | Total Value/LTM |                  | LTM          | Projected    |              | MLR(e)       | EBITDA Margin | Net Income  |
|                               |               |                  |                   | Equity            | Equity            |                          |                  |              |                 | Revs            | Members          |              | 2003         | 2004         |              |               |             |
| Aetna Inc.                    | \$62.36       | 11.2%            | \$10,616.5        | \$14,322.7        | \$18,430.5        | \$1,460.7                | \$624.8          | 5,285        | 0.78x           | 9.8x            | \$2,710.1        | NMF          | 12.3x        | 10.4x        | 78.2%        | 7.9%          | 3.4%        |
| CIGNA                         | \$46.15       | 31.4%            | \$6,471.8         | \$8,428.8         | \$19,351.0        | \$989.7                  | \$428.4          | 7,684        | 0.44x           | 8.5x            | \$1,096.9        | 8.9x         | 9.3x         | 8.7x         | 86.4%        | 5.1%          | 2.2%        |
| Health Net Inc.               | \$32.02       | 10.5%            | \$3,901.1         | \$3,714.1         | \$10,629.3        | \$442.7                  | \$310.1          | 4,254        | 0.35x           | 8.4x            | \$873.2          | 12.6x        | 12.1x        | 10.6x        | 85.3%        | 4.2%          | 2.9%        |
| Humana                        | \$18.94       | -0.2%            | \$3,125.6         | \$2,766.5         | \$11,557.1        | \$358.1                  | \$218.2          | 4,014        | 0.24x           | 7.7x            | \$689.2          | 15.8x        | 13.0x        | 11.8x        | 83.6%        | 3.1%          | 1.9%        |
| Pacificare Health Systems     | \$49.75       | 16.0%            | \$2,055.2         | \$1,541.2         | \$10,911.9        | \$427.2                  | \$226.1          | 3,476        | 0.14x           | 3.6x            | \$443.4          | 9.1x         | 8.9x         | 8.2x         | 85.3%        | 3.9%          | 2.1%        |
| UnitedHealth Group            | \$51.28       | 8.8%             | \$31,428.5        | \$31,339.5        | \$26,767.0        | \$2,603.0                | \$1,574.0        | 6,786        | 1.17x           | 12.0x           | \$4,618.6        | 12.1x        | 17.9x        | 15.0x        | 82.1%        | 9.7%          | 5.9%        |
| Wellpoint Health Networks (f) | \$79.41       | 13.2%            | \$12,246.1        | \$10,811.9        | \$17,560.4        | \$864.4                  | \$697.9          | 9,204        | 0.62x           | 12.5x           | \$1,174.8        | 17.1x        | 14.0x        | 12.2x        | 75.5%        | 4.9%          | 4.0%        |
| Anthem, Inc.                  | \$72.26       | 12.8%            | \$10,069.6        | \$8,702.7         | \$15,479.2        | \$1,129.0                | \$697.4          | 5,629        | 0.56x           | 7.7x            | \$1,546.0        | 16.0x        | 14.0x        | 12.1x        | 81.3%        | 7.3%          | 4.5%        |
|                               | <b>Low</b>    | <b>-0.2%</b>     | <b>\$2,055.2</b>  | <b>\$1,541.2</b>  | <b>\$10,629.3</b> | <b>\$358.1</b>           | <b>\$218.2</b>   | <b>3,476</b> | <b>0.14x</b>    | <b>3.6x</b>     | <b>\$443.4</b>   | <b>8.9x</b>  | <b>8.9x</b>  | <b>8.2x</b>  | <b>75.5%</b> | <b>3.1%</b>   | <b>1.9%</b> |
|                               | <b>High</b>   | <b>31.4%</b>     | <b>\$31,428.5</b> | <b>\$31,339.5</b> | <b>\$26,767.0</b> | <b>\$2,603.0</b>         | <b>\$1,574.0</b> | <b>9,204</b> | <b>1.17x</b>    | <b>12.5x</b>    | <b>\$4,618.6</b> | <b>17.1x</b> | <b>17.9x</b> | <b>15.0x</b> | <b>86.4%</b> | <b>9.7%</b>   | <b>5.9%</b> |
|                               | <b>Median</b> | <b>12.0%</b>     | <b>\$8,270.7</b>  | <b>\$8,565.7</b>  | <b>\$16,519.8</b> | <b>\$927.1</b>           | <b>\$526.6</b>   | <b>5,457</b> | <b>0.50x</b>    | <b>8.5x</b>     | <b>\$1,135.8</b> | <b>12.6x</b> | <b>12.6x</b> | <b>11.2x</b> | <b>82.8%</b> | <b>5.0%</b>   | <b>3.2%</b> |
|                               | <b>Mean</b>   | <b>13.0%</b>     | <b>\$9,989.3</b>  | <b>\$10,203.4</b> | <b>\$16,335.8</b> | <b>\$1,034.4</b>         | <b>\$597.1</b>   | <b>5,791</b> | <b>0.54x</b>    | <b>8.8x</b>     | <b>\$1,644.0</b> | <b>13.1x</b> | <b>12.7x</b> | <b>11.1x</b> | <b>82.2%</b> | <b>5.8%</b>   | <b>3.4%</b> |

#### Notes

All extraordinary items are excluded. Prior periods adjusted to exclude amortization of goodwill in accordance with SFAS no. 142.

(a) Total Market Value = Total Enterprise Value (TEV) = Market Value of Equity plus Total Debt and Long-Term Liabilities minus Working Capital.

For Aetna and CIGNA, working capital is assumed to be 0.

(b) LTM = latest twelve months ended June 30, 2003. For CI, there were proforma adjustments made to reflect restructuring, reserves and other one time charges.

(c) Commercial Equivalent Members in thousands. Derived by converting Medicare-risk members at 2:1, Medicaid-risk members at 1:1, full-risk PPO/POS members at 1:1, Partial Risk members at 1:5, Tricare/Champus/Medicare Supplemental at 1:5, and non-risk (ASO/TPA) members at 1:10.

(d) Excludes specialty healthcare members and all non-healthcare members.

(e) MLR = Medical Loss Ratio: Medical Expenses divided by Net Premium Revenue.

(f) PPO/POS membership is included with commercial membership due to lack of breakout in annual report.

## The State of the HMO Industry – Fall 2003

### Exhibit B: Regional Managed Care Companies - Public Market Valuation Analysis

\$ in millions, except per share amounts

| Company                       | Stock Price |                  | Market Value |           |           | Latest Twelve Months (b) |         |            | Price / EPS      |       |           | LTM Margins |         |               |            |      |      |
|-------------------------------|-------------|------------------|--------------|-----------|-----------|--------------------------|---------|------------|------------------|-------|-----------|-------------|---------|---------------|------------|------|------|
|                               | 10/7/2003   | % Below 52 wk HI | Equity       |           | Total (a) | Revs                     | EBITDA  | Net Income | Mem- bers (c)(d) | LTM   | Projected |             | MLR (e) | EBITDA Margin | Net Income |      |      |
|                               |             |                  | Equity       | Total (a) |           |                          |         |            |                  |       | 2003      | 2004        |         |               |            |      |      |
| Coventry Corporation          | \$52.89     | 8.6%             | \$3,397.6    | \$2,973.0 | \$4,000.1 | \$292.2                  | \$193.5 | 1,781      | 0.74x            | 10.2x | \$1,669.3 | 17.6x       | 13.2x   | 11.4x         | 82.2%      | 7.3% | 4.8% |
| Mid Atlantic Medical Services | \$52.50     | 13.5%            | \$2,375.9    | \$2,060.1 | \$2,523.9 | \$204.9                  | \$133.4 | 1,745      | 0.82x            | 10.1x | \$1,180.7 | 17.8x       | 14.4x   | 14.5x         | 82.8%      | 8.1% | 5.3% |
| Oxford Health Plan            | \$41.93     | 10.2%            | \$3,740.5    | \$3,270.0 | \$5,161.4 | \$480.1                  | \$337.8 | 1,549      | 0.63x            | 6.8x  | \$2,110.7 | 11.1x       | 9.9x    | 8.9x          | 80.4%      | 9.3% | 6.5% |
| Sierra Health Services        | \$22.10     | 19.8%            | \$865.6      | \$742.7   | \$1,362.4 | \$102.4                  | \$60.6  | 463        | 0.55x            | 7.3x  | \$1,603.5 | 14.3x       | 8.3x    | 7.4x          | 86.2%      | 7.5% | 4.4% |
| WellChoice                    | \$31.86     | 4.0%             | \$2,660.0    | \$1,736.1 | \$5,112.1 | \$287.1                  | \$177.6 | 3,024      | 0.34x            | 6.0x  | \$574.1   | 15.0x       | 13.8x   | 12.0x         | 84.9%      | 5.6% | 3.5% |
| AMERIGROUP                    | \$46.70     | -0.4%            | \$1,055.0    | \$1,005.0 | \$1,386.9 | \$111.7                  | \$58.3  | 819        | 0.72x            | 9.0x  | \$1,227.1 | 18.1x       | 15.5x   | 13.5x         | 80.5%      | 8.1% | 4.2% |
| Centene                       | \$32.70     | 1.4%             | \$585.7      | \$514.0   | \$621.8   | \$42.5                   | \$31.0  | 432        | 0.83x            | 12.1x | \$1,190.4 | 18.9x       | 19.2x   | 16.9x         | 82.9%      | 6.8% | 5.0% |
| Molina Healthcare             | \$26.90     | -6.3%            | \$698.0      | \$632.9   | \$734.4   | \$68.9                   | \$40.9  | 515        | 0.86x            | 9.2x  | \$1,228.9 | 17.1x       | 15.7x   | 14.7x         | 83.0%      | 9.4% | 5.6% |
| Low                           |             | -6.3%            | \$585.7      | \$514.0   | \$621.8   | \$42.5                   | \$31.0  | 432        | 0.34x            | 6.0x  | \$574.1   | 11.1x       | 8.3x    | 7.4x          | 80.4%      | 5.6% | 3.5% |
| High                          |             | 19.8%            | \$3,740.5    | \$3,270.0 | \$5,161.4 | \$480.1                  | \$337.8 | 3,024      | 0.86x            | 12.1x | \$2,110.7 | 18.9x       | 19.2x   | 16.9x         | 86.2%      | 9.4% | 6.5% |
| Median                        |             | 6.3%             | \$1,715.4    | \$1,370.5 | \$1,955.4 | \$158.3                  | \$97.0  | 1,184      | 0.73x            | 9.1x  | \$1,228.0 | 17.3x       | 14.1x   | 12.8x         | 82.9%      | 7.8% | 4.9% |
| Mean                          |             | 6.3%             | \$1,922.3    | \$1,616.7 | \$2,612.9 | \$198.7                  | \$129.1 | 1,291      | 0.69x            | 8.8x  | \$1,348.1 | 16.2x       | 13.7x   | 12.4x         | 82.9%      | 7.8% | 4.9% |

#### Notes

Financial results adjusted to exclude extraordinary or nonrecurring items.

- (a) Total Market Value = Total Enterprise Value (TEV) = Market Value of Equity plus Total Debt and Long-Term Liabilities minus Working Capital.
- (b) LTM = 6/30/03. CBZ 06/30/03 membership is allocated based on 12/31/02 membership allocation.
- (c) Commercial Equivalent Members in thousands. Derived by converting Medicare-risk members at 5:4, Medicaid-risk members at 1:1, full-risk PPO/POS members at 1:1, Partial Risk members at 1:5, Tricare/Champus/Medicare Supplemental at 1:5, and non-risk (ASO/TPA) members at 1:10.
- (d) Excludes specialty healthcare members and all non-healthcare members.
- (e) MLR = Medical Loss Ratio: Medical Expenses divided by Net Premium Revenue.

The State of the HMO Industry – Fall 2003

Exhibit C: National Managed Care Companies - Cash and Investment Analysis

\$ in millions, except per share amounts

| Company                       | December 31, 2002          |           |         |            |            |                   |                |                |                            |                                |        |
|-------------------------------|----------------------------|-----------|---------|------------|------------|-------------------|----------------|----------------|----------------------------|--------------------------------|--------|
|                               | Total Cash and Investments | Break-out |         | Allocation |            | Investment Income | Total Revenues | Pre-Tax Income | Invest Inc.(d)/ Total Rev. | Invest Inc.(d)/ Pre-Tax Income |        |
|                               |                            | Cash (a)  | Equity  | Debt       | Other (b)  |                   |                |                |                            |                                | Equity |
| Aetna                         | \$19,395.0                 | \$1,802.9 | \$29.1  | \$13,379.1 | \$4,541.9  | 86.1%             | \$1,250.7      | \$18,593.7     | \$544.8                    | 6.7%                           | 229.6% |
| CIGNA                         | \$41,937.0                 | \$1,575.0 | \$295.0 | \$27,803.0 | \$12,264.0 | 96.6%             | \$2,716.0      | \$16,870.0     | (\$569.0)                  | 16.1%                          | NMF    |
| Health Net                    | \$1,850.1                  | \$841.2   | \$2.7   | \$1,006.3  | \$0.0      | 0.1%              | \$65.6         | \$10,136.0     | \$421.8                    | 0.6%                           | 15.5%  |
| Humana                        | \$2,415.9                  | \$721.4   | \$57.1  | \$1,637.5  | \$0.0      | 2.4%              | \$86.4         | \$11,182.3     | \$295.5                    | 0.8%                           | 29.2%  |
| PacificCare Health Systems    | \$2,190.6                  | \$995.0   | \$0.0   | \$1,195.5  | \$0.0      | 0.0%              | \$64.5         | \$11,092.0     | \$225.7                    | 0.6%                           | 28.6%  |
| UnitedHealth Group            | \$6,329.0                  | \$1,130.0 | \$150.0 | \$5,049.0  | \$0.0      | 2.4%              | \$220.0        | \$24,800.0     | \$2,096.0                  | 0.9%                           | 10.5%  |
| Wellpoint Health Networks (e) | \$6,772.8                  | \$1,355.6 | \$579.8 | \$4,837.4  | \$0.0      | 8.6%              | \$314.0        | \$17,024.5     | \$1,163.4                  | 1.8%                           | 27.0%  |
| Anthem                        | \$6,643.0                  | \$694.9   | \$150.7 | \$5,797.4  | \$0.0      | 2.3%              | \$260.7        | \$12,990.5     | \$807.6                    | 2.0%                           | 32.3%  |

|        |       |        |           |            |           |       |        |
|--------|-------|--------|-----------|------------|-----------|-------|--------|
| Low    | 0.0%  | 86.1%  | \$64.5    | \$10,136.0 | (\$569.0) | 0.6%  | 10.5%  |
| High   | 15.8% | 100.0% | \$2,716.0 | \$24,800.0 | \$2,096.0 | 16.1% | 229.6% |
| Median | 2.4%  | 97.6%  | \$240.4   | \$14,930.3 | \$483.3   | 1.4%  | 28.6%  |
| Mean   | 4.4%  | 95.9%  | \$622.2   | \$15,336.1 | \$623.2   | 3.7%  | 53.2%  |

Notes

- (a) Includes cash and short-term investments.
- (b) Allocation of other investments:

|       |    |          |                             |        |
|-------|----|----------|-----------------------------|--------|
| Aetna | \$ | 308.8    | Real Estate                 | Equity |
|       |    | 1,514.9  | Mortgage Loans              | Debt   |
|       |    | 1,754.9  | Other Long-Term Investments | Equity |
|       |    | 605.3    | Other Current Investments   | Equity |
|       |    | 358.0    | Short Term Investments      | Equity |
|       | \$ | 4,541.9  |                             |        |
| CIGNA | \$ | 8,729.0  | Mortgage Loans              | Debt   |
|       |    | 2,405.0  | Policy Loans                | Debt   |
|       |    | 253.0    | Real Estate                 | Equity |
|       |    | 791.0    | Other Long-Term Investments | Equity |
|       |    | 86.0     | Short Term Investments      | Equity |
|       | \$ | 12,264.0 |                             |        |

- (c) Includes cash.
- (d) Includes capital gains and losses.
- (e) Excludes RightCHOICE.



The State of the HMO Industry – Fall 2003

Exhibit E: National Managed Care Companies - Executive Compensation Analysis

| Company                   | Salary |              | Annual Compensation |             | Total Annual        | % Change            |             | Value of Options (a) | Long-Term Compensation |       | Total LT             | Total Compensation | # of Options   |
|---------------------------|--------|--------------|---------------------|-------------|---------------------|---------------------|-------------|----------------------|------------------------|-------|----------------------|--------------------|----------------|
|                           | 2002   | 2001         | Bonus               | Other       |                     | Annual Compensation | Stock Price |                      | Other                  | Other |                      |                    |                |
| Aetna                     | 2002   | \$ 1,000,000 | \$ 2,500,000        | \$ 89,490   | 3,589,490           | 79%                 | 25%         | \$ 5,439,000         | \$ 5,337,515           | (b)   | 10,776,515           | 14,366,005         | 350,000        |
|                           | 2001   | 1,000,000    | 1,000,000           | -           | 2,000,000           |                     |             | 2,898,149            | 1,544,242              |       | 4,442,391            | 250,000            |                |
| Anthem                    | 2002   | 980,000      | 2,352,000           | 197,877     | 3,529,877           | 12%                 | 27%         | 2,898,149            | 3,327,962              |       | 6,226,111            | 9,755,988          | 200,000        |
|                           | 2001   | 900,000      | 2,160,000           | 100,880     | 3,160,880           |                     |             | -                    | 12,514,671             |       | 12,514,671           | -                  |                |
| CIGNA                     | 2002   | 1,021,900    | -                   | -           | 1,021,900           | -72%                | -56%        | 4,682,953            | 1,169,100              | (c)   | 5,852,053            | 6,873,953          | 328,526        |
|                           | 2001   | 986,500      | 2,625,000           | -           | 3,611,500           |                     |             | 2,894,836            | 6,871,400              | (d)   | 9,766,236            | 262,026            |                |
| Health Net                | 2002   | 754,808      | 700,000             | 65,755      | 1,520,563           | 101%                | 25%         | 11,726,757           | 6,256                  |       | 11,733,013           | 13,253,576         | 325,000        |
|                           | 2001   | 686,923      | -                   | 69,853      | 756,776             |                     |             | 23,847,168           | 711                    |       | 23,847,879           | 650,000            |                |
| Humana                    | 2002   | 700,000      | 612,500             | 59,852      | 1,372,352           | -10%                | -15%        | 1,035,534            | 276,620                |       | 1,312,154            | 2,684,506          | 50,000         |
|                           | 2001   | 655,890      | 819,863             | 44,176      | 1,519,929           |                     |             | -                    | 102,677                |       | 102,677              | -                  |                |
| PacifiCare Health Systems | 2002   | 917,309      | 1,690,000           | 330,160     | 2,937,469           | 117%                | 82%         | 5,332,490            | 68,312                 |       | 5,400,802            | 8,338,271          | 400,000        |
|                           | 2001   | 900,001      | 360,000             | 95,642      | 1,355,643           |                     |             | -                    | 75,396                 |       | 75,396               | -                  |                |
| UnitedHealth Group        | 2002   | 1,896,154    | 5,275,000           | 203,211     | 7,374,365           | 30%                 | -41%        | 72,049,112           | 2,083,038              | (e)   | 74,132,150           | 81,506,515         | 650,000        |
|                           | 2001   | 1,796,154    | 3,722,000           | 163,524     | 5,681,678           |                     |             | 54,580,699           | 1,935,321              | (f)   | 56,516,020           | 650,000            |                |
| WellChoice                | 2002   | 850,000      | 622,500             | 51,290      | 1,523,790           | -10%                | 0%          | -                    | 504,050                | (g)   | 504,050              | 2,027,840          | -              |
|                           | 2001   | 836,539      | 796,875             | 52,611      | 1,686,025           |                     |             | -                    | 499,211                | (h)   | 499,211              | -                  |                |
| Wellpoint Health Networks | 2002   | 1,246,155    | 5,690,916           | 140,342     | 7,077,413           | 23%                 | 22%         | 11,981,582           | 207,382                |       | 12,188,964           | 19,266,377         | 553,042        |
|                           | 2001   | 1,176,925    | 4,437,500           | 135,559     | 5,749,984           |                     |             | 10,330,880           | 169,688                |       | 10,500,568           | 636,762            |                |
| <b>Average</b>            |        |              |                     | <b>2002</b> | <b>\$ 3,547,706</b> | <b>24%</b>          | <b>6%</b>   | <b>\$ 15,672,368</b> | <b>\$ 1,019,810</b>    |       | <b>\$ 16,692,178</b> | <b>20,239,884</b>  | <b>358,081</b> |
|                           |        |              |                     | <b>2001</b> | <b>\$ 3,119,484</b> |                     |             |                      |                        |       |                      |                    |                |

Notes

- (a) Options granted by CIGNA, PacifiCare and Wellpoint are valued using the Black-Scholes methodology. All other companies value options assuming a 10% annual increase in stock value over the option term.
- (b) Includes \$5,198,400 which represents the value of previously awarded performance units that vested upon attainment of specified performance criteria.
- (c) Other long-term compensation includes \$1,050,000 in restricted stock awards.
- (d) Other long-term compensation includes \$6,667,000 of LTIP payments.
- (e) Other long-term compensation includes \$1,798,000 of performance awards.
- (f) Other long-term compensation includes \$1,695,000 of performance awards.
- (g) Other long-term compensation includes \$452,760 of LTIP payments.
- (h) Other long-term compensation includes \$446,600 of LTIP payments.

The State of the HMO Industry – Fall 2003

Exhibit F: Regional Managed Care Companies - Executive Compensation Analysis

| Company                      | Salary | Annual Compensation |              | Total Annual | % Change            |             | Value of Options (a) | Long-Term Compensation |             | Total LT    | Total Compensation | # of Options |
|------------------------------|--------|---------------------|--------------|--------------|---------------------|-------------|----------------------|------------------------|-------------|-------------|--------------------|--------------|
|                              |        | Bonus               | Other        |              | Annual Compensation | Stock Price |                      | Other                  |             |             |                    |              |
| AMERIGROUP Corporation       | 2002   | \$ 560,083          | \$ 1,350,000 | \$ -         | 1,910,083           | 37%         | \$ 3,386,703         | \$ 1,000               | 3,387,703   | 100,000     | \$ 1,911,083       | 100,000      |
|                              | 2001   | \$ 437,419          | \$ 950,000   | \$ 3,952     | 1,391,371           |             | \$ 1,195,307         | \$ 4,195               | 1,199,502   | 50,000      |                    |              |
| Centene Corporation          | 2002   | 350,000             | 905,000      | 9,542        | 1,264,542           | 112%        | -                    | -                      | -           | -           | 1,264,542          | -            |
|                              | 2001   | 315,000             | 275,000      | 5,331        | 595,331             |             | -                    | -                      | -           | -           | -                  | -            |
| Cobalt Corporation           | 2002   | 673,751             | 515,420      | 6,317        | 1,195,488           | 31%         | 4,033,076            | 5,000                  | 4,038,076   | 230,000     | 5,233,564          | 230,000      |
|                              | 2001   | 677,505             | 223,712      | 13,577       | 914,794             |             | -                    | 4,250                  | 4,250       | -           | -                  | -            |
| Coventry Corporation         | 2002   | 892,308             | 2,100,000    | 164,230      | 3,156,538           | 50%         | 9,100,269            | 7,065,826              | 16,166,095  | 200,000     | 19,322,633         | 200,000      |
|                              | 2001   | 699,998             | 1,300,000    | 111,116      | 2,111,114           |             | -                    | 3,711,272              | 3,711,272   | -           | -                  | -            |
| MidAtlantic Medical Services | 2002   | 818,226             | 778,602      | -            | 1,596,828           | 11%         | 3,118,180            | 4,000                  | 3,122,180   | 225,000     | 4,719,008          | 225,000      |
|                              | 2001   | 759,981             | 685,055      | -            | 1,445,036           |             | 3,067,812            | 4,200                  | 3,072,012   | 300,000     | 3,004,100          | 300,000      |
| Oxford Health Plans          | 2002   | 1,000,000           | 2,000,000    | 2,242        | 3,002,242           | 1%          | -                    | 1,858                  | 1,858       | -           | 3,004,100          | -            |
|                              | 2001   | 350,000             | 2,500,000    | 110,569      | 2,960,569           |             | 8,271,000            | 803,388                | 9,074,388   | 800,000     | 3,004,100          | 800,000      |
| Sierra Health Services       | 2002   | 876,364             | 1,663,650    | -            | 2,540,014           | 22%         | 1,392,532            | 92,883                 | 1,485,415   | 75,000      | 4,025,429          | 75,000       |
|                              | 2001   | 792,993             | 1,291,300    | -            | 2,084,293           |             | 3,891,123            | 1,242,411              | 5,133,534   | 426,272     | 4,025,429          | 426,272      |
| <b>Average</b>               |        | <b>2002</b>         | <b>2001</b>  | <b>2002</b>  | <b>2001</b>         | <b>2002</b> | <b>2001</b>          | <b>2002</b>            | <b>2001</b> | <b>2002</b> | <b>2001</b>        | <b>2002</b>  |
|                              |        | \$                  | \$           | \$           | \$                  | 38%         | \$                   | \$                     | \$          | \$          | \$                 | \$           |
|                              |        | 2,095,105           | 1,643,215    | 1,988,415    | 2,346,463           | 52%         | 1,024,367            | 4,028,761              | 5,640,051   | 118,571     | 5,640,051          | 118,571      |

Notes

- (a) Options granted by AMERIGROUP and Oxford are valued using the Black-Scholes methodology. All other companies granting stock options value those options assuming a 10% annual increase in stock value over the option term. The percent change from Centene's IPO date of December 12, 2001 to year-end.
- (b) Other long-term compensation includes \$5,710,000 in restricted stock.
- (c) Other long-term compensation includes \$2,767,500 in restricted stock.
- (d) Other long-term compensation includes \$800,000 long-term compensation award.
- (e) Other long-term compensation includes \$1,172,816 in restricted stock.

The State of the HMO Industry – Fall 2003

**Exhibit G: National Managed Care Companies - Investment Income Analysis**

\$ in millions, except per share amounts

| Company                   | Revenue (a)      |                  |                  | Investment Income |                |               | Investment Income as a % of Revenue |              |              |
|---------------------------|------------------|------------------|------------------|-------------------|----------------|---------------|-------------------------------------|--------------|--------------|
|                           | 3M Ending        | 3M Ending        | 3M Ending        | 3M Ending         | 3M Ending      | Percent       | 3M Ending                           | 3M Ending    | 3M Ending    |
|                           | 06/30/03         | 06/30/02         | 06/30/02         | 06/30/03          | 06/30/02       | Change        | 06/30/03                            | 06/30/02     | Difference   |
| Aetha                     | \$4,178.1        | \$4,700.6        | \$4,700.6        | \$273.3           | \$318.2        | -44.90        | 6.54%                               | 6.77%        | -0.23%       |
| CIGNA                     | \$3,857.0        | \$4,375.0        | \$4,375.0        | \$668.0           | \$700.0        | -32.00        | 17.32%                              | 16.00%       | 1.32%        |
| Health Net                | \$2,738.3        | \$2,487.9        | \$2,487.9        | \$14.0            | \$18.0         | -4.00         | 0.51%                               | 0.72%        | -0.21%       |
| Humana                    | \$3,030.0        | \$2,807.6        | \$2,807.6        | \$44.9            | \$24.4         | 20.52         | 1.48%                               | 0.87%        | 0.61%        |
| PacificHealth Systems     | \$2,712.4        | \$2,766.5        | \$2,766.5        | \$17.8            | \$13.9         | 3.97          | 0.66%                               | 0.50%        | 0.16%        |
| UnitedHealth Group        | \$7,027.0        | \$6,027.0        | \$6,027.0        | \$60.0            | \$51.0         | 9.00          | 0.85%                               | 0.85%        | 0.01%        |
| Wellpoint Health Networks | \$4,876.3        | \$4,232.9        | \$4,232.9        | \$64.0            | \$66.1         | -2.11         | 1.31%                               | 1.56%        | -0.25%       |
| Anthem                    | \$4,059.2        | \$2,837.8        | \$2,837.8        | \$65.6            | \$59.7         | 5.90          | 1.62%                               | 2.10%        | -0.49%       |
| <b>Low</b>                | <b>\$2,712.4</b> | <b>\$2,487.9</b> | <b>\$2,487.9</b> | <b>\$14.0</b>     | <b>\$13.9</b>  | <b>-44.90</b> | <b>0.5%</b>                         | <b>0.5%</b>  | <b>-0.5%</b> |
| <b>High</b>               | <b>\$7,027.0</b> | <b>\$6,027.0</b> | <b>\$6,027.0</b> | <b>\$668.0</b>    | <b>\$700.0</b> | <b>20.52</b>  | <b>17.3%</b>                        | <b>16.0%</b> | <b>1.3%</b>  |
| <b>Median</b>             | <b>\$3,958.1</b> | <b>\$3,535.4</b> | <b>\$3,535.4</b> | <b>\$62.0</b>     | <b>\$55.4</b>  | <b>0.93</b>   | <b>1.4%</b>                         | <b>1.2%</b>  | <b>-0.1%</b> |
| <b>Mean</b>               | <b>\$4,059.8</b> | <b>\$3,779.4</b> | <b>\$3,779.4</b> | <b>\$151.0</b>    | <b>\$156.4</b> | <b>-5.45</b>  | <b>3.8%</b>                         | <b>3.7%</b>  | <b>0.1%</b>  |

Notes

- (a) Revenue excludes investment income.
- (b) Prior period investment income excludes \$11M loss from write down of MedUnite.

The State of the HMO Industry – Fall 2003

Exhibit H: Regional Managed Care Companies - Investment Income Analysis

\$ in millions, except per share amounts

| Company                       | Revenue (a)           |                       | Investment Income     |                       |                | Investment Income as a % of Revenue |                       |                       |              |
|-------------------------------|-----------------------|-----------------------|-----------------------|-----------------------|----------------|-------------------------------------|-----------------------|-----------------------|--------------|
|                               | 3M Ending<br>06/30/03 | 3M Ending<br>06/30/02 | 3M Ending<br>06/30/03 | 3M Ending<br>06/30/02 | Difference     | Percent<br>Change                   | 3M Ending<br>06/30/03 | 3M Ending<br>06/30/02 | Difference   |
| Coventry Corporation          | \$1,096.4             | \$890.1               | \$11.5                | \$9.0                 | \$2.5          | 28.3%                               | 1.05%                 | 1.01%                 | 0.04%        |
| Mid Atlantic Medical Services | \$669.0               | \$571.6               | \$4.2                 | \$3.7                 | \$0.5          | 13.3%                               | 0.62%                 | 0.65%                 | -0.02%       |
| Oxford Health Plans (b)       | \$1,334.3             | \$1,207.3             | \$26.6                | \$25.0                | \$1.6          | 6.4%                                | 1.99%                 | 2.07%                 | -0.08%       |
| Sierra Health Services        | \$364.3               | \$359.1               | \$5.9                 | \$4.8                 | \$1.1          | 22.4%                               | 1.62%                 | 1.35%                 | 0.28%        |
| AMERIGROUP Corporation        | \$392.3               | \$276.8               | \$1.7                 | \$2.1                 | (\$0.4)        | -17.6%                              | 0.43%                 | 0.74%                 | -0.31%       |
| Centene Corporation           | \$186.2               | \$107.6               | \$1.3                 | \$1.0                 | \$0.3          | 28.8%                               | 0.67%                 | 0.91%                 | -0.23%       |
| Molina Healthcare, Inc.       | \$194.7               | \$150.4               | \$0.3                 | \$0.5                 | (\$0.2)        | -39.9%                              | 0.17%                 | 0.36%                 | -0.19%       |
| WellChoice, Inc.              | \$1,361.8             | \$1,304.2             | \$11.6                | \$17.8                | (\$6.3)        | -35.2%                              | 0.85%                 | 1.37%                 | -0.52%       |
| <b>Low</b>                    | <b>\$186.2</b>        | <b>\$107.6</b>        | <b>\$0.3</b>          | <b>\$0.5</b>          | <b>(\$6.3)</b> | <b>-39.9%</b>                       | <b>0.2%</b>           | <b>0.4%</b>           | <b>-0.5%</b> |
| <b>High</b>                   | <b>\$1,361.8</b>      | <b>\$1,304.2</b>      | <b>\$26.6</b>         | <b>\$25.0</b>         | <b>\$2.5</b>   | <b>28.8%</b>                        | <b>2.0%</b>           | <b>2.1%</b>           | <b>0.3%</b>  |
| <b>Median</b>                 | <b>\$530.7</b>        | <b>\$465.4</b>        | <b>\$5.0</b>          | <b>\$4.3</b>          | <b>\$0.4</b>   | <b>9.9%</b>                         | <b>0.8%</b>           | <b>1.0%</b>           | <b>-0.1%</b> |
| <b>Mean</b>                   | <b>\$699.9</b>        | <b>\$608.4</b>        | <b>\$7.9</b>          | <b>\$8.0</b>          | <b>(\$0.1)</b> | <b>0.8%</b>                         | <b>0.9%</b>           | <b>1.1%</b>           | <b>-0.1%</b> |

Notes

(a) Revenue excludes investment income.

(b) Prior period investment income excludes \$11M loss from write down of MedUnite.

## Addendum at Press Time

The world of managed care is always evolving and changing. At press time, there were two transactions announced that we thought required an addendum to our Report.

- In a colossal transaction involving a further consolidation of the Blues, on October 27, 2003, **Anthem** announced that it was acquiring **WellPoint** for \$16.4 billion. Although **Anthem** is smaller than **WellPoint** based on revenue, membership and equity value, it will be the acquirer in this transaction due to certain restrictions under Indiana law that were placed on **Anthem** as part of its demutualization. Consideration consists of cash and stock. The transaction includes a 20% premium over **WellPoint**'s pre-announcement closing price. Based on **Anthem**'s stock price prior to the announcement, the transaction values **WellPoint** at 0.85x revenue, 17.3x EBITDA and \$1,626 per commercial member equivalent.<sup>1</sup> While **Anthem** is the technical acquirer, there were a number of compromises between the companies that make the transaction look more like a merger of equals and show how badly both companies want the transaction to happen. Assuming that the transaction is completed, the combined company will operate under the name **WellPoint**, but **Anthem**'s Board will maintain majority control and **Anthem**'s CEO, **Larry Glasscock**, will be CEO of the new company. However, **WellPoint**'s CEO, **Leonard Schaeffer**, will become Chairman. Furthermore, the CFO position will go to **WellPoint**'s **David Colby**, and the combined company will be headquartered in Indianapolis, not Woodland Hills.

Strategically, the transaction makes sense. The combined company will be the largest managed care company in the country with regard to members and revenue. This critical mass creates significant opportunities for realizing synergies, especially with regard to administrative expense. Moreover, although the number of acquisition candidates from the ranks of the Blues is modest at this time, the merger eliminates the competition for deals that has existed, and would continue to exist, between these two companies. Lastly, the transaction will create a true nationwide Blue Cross company, with membership from New England to California.

On page 11 of our Report, we noted prior to the announcement of the **Anthem/WellPoint** transaction that **United**'s equity value towered above the other National HMOs. While **United** will no longer be the largest National HMO with regard to membership and revenue, it still will be the largest in terms of equity value.

- Although coincidental, **United**, arguably the 600-pound gorilla of the National HMOs, also announced a sizable transaction on October 27. In a \$2.6 billion transaction, **United** announced that it was acquiring **Mid Atlantic**, a publicly traded Regional HMO. The cash and stock transaction valued **Mid Atlantic** at 1.03x revenue, 12.7x EBITDA and \$1,497 per commercial member equivalent.<sup>1</sup> The acquisition will undoubtedly be accretive to **United**'s 2004 earnings and will give it greater presence in the Mid Atlantic region. Although **United**

(Over)

---

<sup>1</sup> Multiples based on Business Enterprise Value defined as Market Value of Equity plus Total Debt and Long-Term Liabilities minus Working Capital.

easily could have paid cash for **Mid Atlantic**, its willingness to include a stock component represents a promise of future participation in its growth to the shareholders of **Mid Atlantic**.

Initial stock market reaction to these transactions was somewhat curious. After the announcement, **Anthem's** share price went down, **WellPoint's** share price increased, and on a combined basis there was virtually no change in value. Although in transactions involving stock consideration the share price of the acquirer often initially decreases, we would have expected there to be a net increase in the combined value of the two companies in a strategic transaction of this size and nature.

The market's reaction to the **United/Mid Atlantic** deal was somewhat different. Although **Mid Atlantic's** stock rose as arbitrageurs worked the merger premium, the price of **United's** stock was virtually unchanged.

These two transactions are consistent with one of our themes in our Report that merger and acquisition activity must pick up if the publicly traded managed care companies want to maintain earnings growth. However, while these transactions may be a harbinger of a larger consolidation for the industry, we believe that merger and acquisition activity will be overwhelmingly strategic in nature and that a large number of smaller, unprofitable plans may be of little or no interest to potential acquirers.

Moreover, it should be noted that the valuations represented by the **Anthem** and **Mid Atlantic** transactions are, in general, not indicative of valuations that could be realized by private managed care plans with smaller operations. Transactions involving private managed care plans are often consummated at a significant discount to valuation multiples of publicly traded plans.