

FINAL TRANSCRIPT

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WLP - Q2 2010 WellPoint, Inc. Earnings Conference Call

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. Welcome to the WellPoint conference call. At this time, all participants are in a listen-only mode. Later we will conduct a question-and-answer session. Instructions will be given at that time. (Operator Instructions). As a reminder, this conference is being recorded. I would now like to turn the conference over to the Company's management.

Michael Kleinman - WellPoint, Inc. - VP of IR

Good morning, and welcome to WellPoint's second-quarter earnings conference call. I'm Michael Kleinman, Vice President of Investor Relations. With me this morning are Angela Braly, our Chair, President and Chief Executive Officer and Wayne DeVeydt, Executive Vice President and Chief Financial Officer.



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Angela will begin this morning's call with an overview of our second-quarter results, actions, and accomplishments. Wayne will then offer a detailed review of our second-quarter financial performance and current guidance, which will be followed by a question-and-answer session. Ken Goulet, Executive Vice President and President of our Commercial Business and Brian Sassi, Executive Vice President and President of our Consumer Business are available to participate in the Q&A session.

During this call, we will reference certain non-GAAP measures. A reconciliation of these non-GAAP measures to the most directly comparable measures calculated in accordance with GAAP is available in our press release and on the Investor Information page of our Company website at www.WellPoint.com.

We will also be making some forward-looking statements on this call. Listeners are cautioned that these statements are subject to certain risks and uncertainties, many of which are difficult to predict and generally beyond the control of WellPoint. These risks and uncertainties can cause actual results to differ materially from current expectations. We advise listeners to review the risk factors discussed in our press release this morning and in our quarterly and annual filings with the SEC. I will now turn the call over to Angela.

Angela Braly - *WellPoint, Inc. - Chair, President and CEO*

Thank you, Michael, and good morning. Today, we are pleased to report a strong second quarter of 2010 with earnings per share of \$1.71 including \$0.04 per share of net investment gain. Earnings per share in the second quarter of 2009 totaled \$1.43 and included \$0.07 per share of net investment losses. Excluding the net investment gains and losses in each period, our adjusted EPS was \$1.67 for the second quarter of 2010, which represents an increase of 11% over adjusted EPS of \$1.50 in the same period of last year.

Our quarterly results exceeded our expectation, primarily due to higher than anticipated favorable reserve development and continued strong performance in our capital management areas. We're also seeing positive results in our core operations from many of the strategic initiatives we put in place over the last two years.

Based on our results through the first six months of the year, we've increased our full-year 2010 EPS guidance to at least \$6.30 per share, including \$0.08 per share of net investment gain, partially offset by an impairment charge of \$0.03 per share.

Medical enrollment totaled 33.5 million members at June 30, 2010, a decline of 343,000 members or 1% from March 31, 2010, which is in line with our expectation. Enrollment in the non-Blue business decreased by 85,000 members, reflecting our exit from certain markets in our UniCare business, while the remaining decline was driven by in-group attrition in the National and Local Group businesses, and included a sequential reduction of 103,000 in our BlueCard enrollment.

The unemployment rate in our Blue states is down slightly from the first quarter to 10%, but we expect that it will remain elevated through at least the end of 2010. We continue to generate solid sales with group sales running 5% better than our 2010 plan and our group retention rates remain above 90%.

While most of our business units are managing well through this difficult economy, in-group attrition remains high. Once the employment situation begins to improve meaningfully, we expect to benefit from in-group membership growth.

We also expect to continue gaining share in the National accounts marketplace due to our strong and distinct value proposition. We found that these large, national employers are increasingly attracted to our broad and cost-effective provider networks and our care management in-house improvement programs. We have achieved market-leading growth in the National accounts segment of approximately 300,000 net new members in 2010, and we currently anticipate further growth in 2011. We already have several sizable wins for January 1, 2011, and we expect to finalize more in the next few months.



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The market is competitive again this year, but has been generally rational, and we are pleased with our expectation for further growth.

Fully insured enrollment ended the second quarter slightly better than we expected at \$14.1 million. As we have previously discussed, its 873,000 member low-margin municipal account converted to a self-funding arrangement on April 1. After adjusting for this conversion, our fully insured enrollment fell modestly in the quarter.

While down in total, a positive data point is that Small Group membership grew slightly in the month of June. This was the first month of positive membership growth for Small Group in over a year. And we believe it's one of several positive indicators reflecting the strength of our product offering and suggesting that the current business environment may be improving.

Results in our Local Group business are running ahead of plan so far this year, and have improved significantly from a year ago. Our state-sponsored programs are also performing better this year. We implemented a series of strategic and tactical changes over the past several quarters that have improved our results.

Membership continues to grow as more people become eligible for public programs during periods of high unemployment. State Sponsored business will continue to be a growth area in the coming years, and we'll participate in programs where we can provide long-term value for our customers while obtaining actuarially-sound rates.

Last month, we were awarded a contract with the State of Indiana that will enable us to continue managing both the Hoosier Healthwise Medicaid Managed Care Program and the Healthy Indiana Program. This contract builds on the award we received earlier this year for the BadgerCare Plus Program in Wisconsin. We look forward to serving beneficiaries of these programs over the next several years.

We also view the Senior business as a growth segment, considering the demographic change that will begin next year when the first baby boomers begin turning 65. Nearly 40% of the baby boomers who will age into Medicare in the next five years live in one of our 14 Blue states. Accordingly, in June, we expanded our successful state-covered member age-in program across the country.

This program focuses on current members of group health plans who are approaching Medicare eligibility. These members are provided with information about their Medicare options and our participating agents or internal sales team, then work with these members to help them better understand their health coverage options upon turning 65. This member age-in program was first launched for select small groups late in 2009, and now encompasses businesses in all of our 14 Blue states.

We recently submitted our 2011 Medicare Advantage bids and expect to be well-positioned for the open enrollment period. We have been improving our service and offerings in the Medicare Advantage marketplace for more than two years now, and continue to believe that there will be strong demand for Medicare Advantage products as the overall senior market grows.

Healthcare reform will gradually reduce Medicare Advantage reimbursement levels, but we believe we will be well-positioned to increase volume in this business due to the changing demographics, and we will continue to focus on the new quality-based incentive payment opportunities beginning in 2012.

At the same time, we are the second largest writer of Medicare supplement policies in the nation and a major Medicare Part D carrier, so we have a balanced portfolio of products to offer consumers as they age out of commercial healthcare plans and into the senior marketplace.

While the Individual market is currently facing challenges through the economy; selection issues; and in certain markets, the inability to obtain timely rate increases sufficient to cover rising medical costs, we expect that over time, appropriate rates will be granted in order to sustain this important market segment for the many Americans it will serve. This market is projected to



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expand by 16 million people over the next decade as a result of healthcare reform, and creating a fundamentally sustainable marketplace will be critical.

In California, we recently submitted revised rate filings that will take effect later this year pending approval by state regulators. These rates have an average increase of 14%, but this will not cover our costs, and we currently project that we will lose money in California on our existing Individual contracts this year.

While we made the decision to move forward with these revised rates given the unique circumstances of the California individual market, this situation is not sustainable over the long term. WellPoint remains committed to serving individual members. However, in order to continue to serve customers, a carrier must be able to receive actuarially-sound rates.

The introduction of the minimum medical loss ratio requirements in 2011 will require changes to the individual market business model. While these regulations are still being developed with thoughtful deliberation by the National Association of Insurance Commissioners, we will make adjustments to our business model later this year in order to compete effectively in the changing individual marketplace.

Based on our current expectation, our individual business will likely experience margin compression in certain states next year. However, it's important to recognize that at a consolidated level, individual business comprises less than 6% of our membership, and this year is expected to contribute less than 5% of our operating gain. We have a mature block of individual business that generates a comparatively high MLR already; and our size and scale generally provides for a lower administrative cost ratio because we are able to spread our fixed costs over a larger membership base.

Smaller competitors will have difficulty competing in this new environment, and we have already heard that some smaller plans have indicated that they will leave certain markets unless the regulatory environment allows for a fundamentally sustainable market.

The Small Group market will also be affected by healthcare reform, but we expect our Small Group business to be less impacted by new MLR requirements than individual, as Small Group typically runs a higher MLR today.

It's our goal to make healthcare reform work for our customers and the country. This is why we've adopted multiple provisions earlier than required by law, including an extension of dependent eligibility to age 26 beginning on June 1. Managed care organizations will play an important role in the implementation of healthcare reform legislation, and we will continue working collaboratively with our industry partners, the healthcare delivery system, and governmental agencies as the regulations are developed. We continue to believe that in order to provide Americans with access to affordable, quality health care, the underlying drivers of rising costs must be addressed.

We're taking a leadership role in transforming healthcare delivery and are in the midst of several discussions with provider groups across our states to change the method of provider payment to a system that rewards the value, quality, and coordination of care received, more than just the volume of care administered.

We recently announced our collaboration with two of California's leading physician-governed medical groups to launch an accountable care organization, or ACO, pilot project. An ACO is a provider-led organization willing to be accountable for the full continuum of care for its patients. This model encourages physicians, hospitals, and insurance companies to work together to coordinate care, improve quality, and slow medical cost growth. We believe this model holds great promise for improving quality and enhancing patient outcome.

As health reform expands access to millions of Americans, the growing shortage of primary care physicians will be an increasing concern. Primary care physicians are also often the front line of prevention and care, particularly for chronic illness. So the success and sustainability of their practices are vital to the health of our members.



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One of the ways we are supporting primary care is through patient-centered medical home programs, which provide incentives to primary care physicians for enhanced care coordination, improved quality, patient satisfaction, and the adoption of health information technology.

While most of these programs are relatively young, our Colorado program, which includes participation from Colorado Medicaid, has demonstrated significant one-year improvement on care outcomes in chronic illness and medication compliance. The key to success here is partnership, partnership with the healthcare delivery system and with other private and public payers. So we will continue to advance and evaluate these programs and look for additional opportunities for collaboration.

Other payment innovation programs we're advancing across a number of our markets include bundled payments for many common procedures, including coronary artery bypass graft, knee and hip replacement and colonoscopy. We're also providing our members with information on quality and cost-effective sites, and which services can be performed, many of which guarantee or warranty their work.

One definition of quality includes doing it right the first time, and many providers under these types of bundled payment arrangements are incented to provide quality care as they are paid a flat fee and don't get paid additional amounts for readmission if complications arise. These initiatives support our goal of providing the best healthcare value to our customers.

Over the last two years, we have launched several strategic initiatives across the Company in support of our healthcare value strategy, and we are seeing positive results from our action. For example, the sale of the NextRx PBM subsidiary to Express Scripts and the related ten-year contract are proving to be beneficial to both our customers and shareholders. As of July 1, we're approximately halfway through the migration process, having successfully migrated nearly 8 million members to the Express Scripts platform already. The remaining members will be migrated over the balance of this year.

The Express Scripts transaction has lowered overall drug costs for our members, while providing a significant return of capital to our shareholders. Total claims inventory, which was a priority performance improvement item for the Company two years ago, has remained at historically low levels, and is approximately 20% lower than at year end 2007. This has contributed to a second consecutive year of higher-than-anticipated favorable reserve development.

From an efficiency perspective, our auto adjudication rates are above 80%, more than 150 basis points higher than at this time last year and significantly higher than in June of 2008. Our electronic data interchange rates, or the percentage of claims that we receive electronically, are running at nearly 90%, up steadily from a year ago. We are continuing to implement our building a better WellPoint program and cost savings from these efforts are ahead of our plan so far this year. We're also executing on our strategic information technology initiative and are in the process of retiring an additional two legacy claims systems this year. And while we are executing with greater administrative efficiency, I am pleased to report that our customer service results have simultaneously improved.

In the first part of 2010, WellPoint achieved its strongest results ever on a key measure of success, the member touch point measure, or MTM scores, reported as part of the Blue Cross and Blue Shield Association service performance metrics. The MTM scores help monitor how well we are performing at the activities that touch our members each and every day, such as enrollment and billing, claims processing, and member and provider services. These results are a testament to the process improvements we have implemented across the Company, and the hard work and dedication of our associates who serve our customers.

In summary, we are performing well and expect a good 2010. Membership is in line with the expectations we had coming into the year. Our financial results are meaningfully improved in most of our businesses. And we have raised our full-year EPS outlook. We foresee long-term growth opportunities for WellPoint and for our shareholders, and we are making investments and adjusting our business strategy to enhance our competitive advantages and prepare us for continued success in the changing environment of healthcare reform. We'll continue to be engaged as the regulations for healthcare reform are developed and finalized, and we will work to make the implementation as successful as possible.



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And most importantly, we will remain intensely focused on ways to effectively lower the healthcare cost trends our members are experiencing while improving the quality of care they would receive. When we take care of our customers, we take care of our shareholders.

And now, I will turn the call over to Wayne DeVeydt to discuss our second-quarter results and current guidance in detail.

Wayne DeVeydt - *WellPoint, Inc. - EVP and CFO*

Thank you, Angela, and good morning. Premium income was \$13.3 billion in the quarter, a decrease of \$866 million or 6% from the second quarter of 2009. Approximately \$550 million of this decline related to the conversion of the large municipal account to a self-funded arrangement, effective April 1 of 2010. The remaining reduction was attributable to the transfer of UniCare business in Texas and Illinois and lower fully insured membership resulting from continued high unemployment and overall economic conditions.

Administrative fees were \$949 million in the second quarter, down \$28 million or 3% from the same period of last year, due primarily to reductions in certain PBM-related revenues earned in 2009 and lower revenue in the National Government Services business. These declines offset an increase in our Commercial ASO fee revenue. Other revenue, which historically consisted almost entirely of revenue associated with the sale of mail-order drug by the NextRx PBM, declined by \$147 million from the second quarter of last year, reflecting the sale of NextRx in December 2009.

The benefit expense ratio for the second quarter of 2010 was 82.9%, a decline of 100 basis points from second quarter of 2009. The decline was driven by the Local Group business and over half of the decline resulted from the large municipal account conversion.

This account historically maintained a benefit expense ratio higher than our Company average. The decline in the Local Group benefit expense ratio was partially offset by an increase in the individual business due to the delay in implementing rate increases in California. In the second quarter of 2010, we recognized an estimated \$100 million of higher than anticipated favorable prior-year reserve development. This is equivalent to the estimated \$100 million of higher than anticipated reserve development that was recognized in the second quarter of 2009. Therefore, the comparison to the prior-year quarter's benefit expense ratio was not impacted by changes in net favorable reserve development.

We now expect that our benefit expense ratio will be approximately 83.9% for the full year of 2010. The ratio is projected to increase during the second half of 2010, due in part to the seasonality of our Commercial and Individual product design. We believe the seasonality of these businesses will be even more pronounced this year due to costs related to healthcare reform implementation, including the extension of dependent coverage to age 26.

The individual benefit expense ratio will also rise as a result of the California rate delay. Additionally, while we had higher-than-expected favorable reserve development in the second quarter, our guidance assumes that we do not have additional net favorable reserve releases during the second half of the year.

We continue to price our Commercial Business so that expected premium yield exceeds total cost trends, where total cost trend includes medical costs and selling, general, and administrative expense. For full year 2010, we continue to project that the underlying Local Group medical cost trend will be in the range of 8% plus or minus 50 basis points, and we currently expect it to be at the lower end of this range.

Medical cost trend continues to be driven predominantly by unit cost increases. However, utilization remains a significant contributor to our reported trends due to influences like H1N1 flu and increased COBRA membership that are still impacting our experience period, which encompasses the rolling 12 month ended June 30, 2010, and therefore includes the second half of 2009 when flu costs were unusually high.



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Inpatient hospital trends in the low double-digit range and is approximately 80% unit cost driven and 20% utilization driven. We understand that current unit cost trends are not sustainable, especially for hospital services which account for a significant portion of healthcare spending. In all our states, we're working to lower hospital cost trends, as we negotiate with hospitals and health systems.

We have had success with many health systems we've negotiated with this year, agreeing to moderate unit price increases as we work together to address the cost pressures faced by employers and consumers. A handful of hospitals still do not comprehend this pressure, and we will make the tough decision by altering our network where necessary.

Outpatient trend is in the low double-digit range and is 60% cost driven and 40% utilization driven. Outpatient care is the fastest-growing component of the US healthcare system, part of which is due to changing medical technology and expansion of outpatient medical and surgical facilities. This results in the continued shift of certain procedures from the inpatient to the outpatient setting. Angela discussed some of our new reimbursement methods designed to slow the increase in outpatient trend.

Physician services trend is in the mid-single digit range, and is 75% utilization driven and 25% cost driven. Increases in physician services were driven by increased utilization in late 2009 related to the H1N1 flu and contracting changes. As provider fee schedules are adjusted, we are enhancing fee-for-service payment methods to better align reimbursement with value. For example, we are paying increased fees for vaccines in many markets while simultaneously negotiating more aggressive fees for the technical component of advanced imaging services in order to more closely reflect the cost of operations.

Pharmacy trend is in the high single-digit range and is 70% unit cost related and 30% utilization driven. Increases in costs per prescription are being impacted by recent inflation in wholesale drug pricing. We're utilizing comparative effective research or CER evaluation criteria to help determine optimal health outcomes for our members. Our evaluation criteria have become a model for the managed care industry. One of the ways WellPoint has put CER to use is in conducting comparisons among members using drugs to treat osteoporosis.

In comparing three different medications, we found that members taking one of the drugs were less likely to adhere to the required maintenance schedule, likely explaining high bone fracture rates for that drug. By keeping this drug at a higher tier and encouraging members to first try another medication on a more economical tier, we anticipate that we will help our members reduce fracture rates and increase their quality of life while saving them money due to lower out-of-pocket expenses.

Moving now to selling, general administrative expenses or, SG&A, the SG&A ratio was 15.3% in the second quarter of 2010, up 90 basis points from the second quarter of 2009. The increase reflected lower operating revenue, partially offset by a reduction in operating expenses.

Total SG&A expense in the second quarter of 2010 was 1% lower than in the 2Q of '09. We believe there continues to be opportunities to reduce our SG&A costs in the future, and we believe doing so will be critical in the health reform environment.

Turning to our reportable segments, Commercial operating revenue was \$8.5 billion in the second quarter of 2010, an \$851 million or 9% production from Q2 of '09. This was driven by the municipal account conversion as well as fully insured membership decline due to the UniCare member transition and the economy.

Operating gain was \$746 million in the second quarter of 2010, an increase of \$163 million or 28% from the prior-year quarter. The increase was driven by operating improvements in the Local Group business and included an estimated \$40 million of higher than anticipated favorable reserve development in the current-year quarter.

Our Consumer segment operating revenue was just under \$4 billion in the second quarter of 2010, declining by \$99 million or 2% from 2Q of '09. This is due to the loss of Medicare Part D auto-assigned membership, lower individual enrollment, and a



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change in the providers of pharmacy benefits for the Indiana Medicaid Program in 2010, partially offset by growth in the Medicare Advantage program.

Operating gain for the Consumer Business segment was \$301 million in the second quarter of 2010, a decrease of \$81 million or 21% compared with the second quarter of last year. The decline in operating gain was driven primarily by lower performance in individual as a result of the rate delay in California and also reflected a decline in Medicare Advantage results due primarily to the reduction in federal reimbursement rates for 2010.

We recognized an estimated \$60 million of higher-than-anticipated favorable reserve development in the Consumer segment during the second quarter of 2010, while we recognized approximately \$100 million of higher-than-anticipated favorable development in the second quarter of last year.

Operating gain in the Other segment totaled \$11 million for the second quarter of 2010. This represented a decline of \$112 million from the second quarter of 2009 and was due to the sale of NextRx.

Net investment income totaled \$202 million in the second quarter, down \$3 million or 2% from the second quarter of '09 due to lower short-term yields in the second quarter of 2010, partially offset by higher investment income balances. Interest expense was \$100 million, down \$17 million or 14% predominately due to lower debt balances and lower short-term rates.

In the second quarter, we recognized net investment gains of \$30 million pretax, consisting of net realized gains from the sale of securities totaling approximately \$36 million, partially offset by approximately \$6 million of other-than-temporary impairments. As of June 30, 2010, the portfolio's net unrealized gain position was \$807 million, consisting of net unrealized gains on fixed maturity and equity securities totaling \$671 million and \$136 million, respectively.

Medical claims payable totaled \$5.1 billion as of June 30, 2010, a decrease of \$370 million or 7% from December 31, 2009. Approximately \$217 million of the decline related to the municipal account conversion in the second quarter. Included in our press release is a reconciliation and roll-forward of the medical claims payable balance. This disclosure is comparable to the reconciliation provided in our fourth-quarter 2009 press release.

We report prior-year redundancies in order to demonstrate the adequacy of prior-year reserves. Medical claims reserves established at December 31, 2009, continued to develop favorably. For the six months ended June 30, 2010, we have significant positive prior-year reserve development of \$668 million. Of this amount, we estimate that approximately \$100 million was not reestablished in our June 30, 2010 balance sheet. We continue to believe our balance sheet is conservatively stated, and it is possible that additional reserves could be released during the second half of 2010.

However, as I stated earlier, this potential has not been reflected in our current financial guidance, and if it does materialize, we will separately identify it for the investment community like we've done today.

As of June 30, 2010, days in claims payable was 42.1 days, a decrease of 1.3 days from 43.4 days at March 31, 2010. DCP declined primarily due to the prior-period reserve development in the second quarter. Remaining decline related to the timing of pharmacy claim payments and a seasonal decrease in claim payment cycle times, partially offset by the impact of the large municipal account conversion.

Turning now to cash flow and capital deployment, for the year-to-date period ended June 30, 2010, we reported a net cash outflow from operations of \$67 million, primarily driven by the \$1.2 billion of tax payments made during the first quarter related to the sale of NextRx. Operating cash flow totaled \$256 million for the second quarter of 2010, down from \$378 million in the second quarter of last year due to higher income tax payments in the current year.



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Please also recall that the second quarter is traditionally a very low cash flow period for WellPoint, as we make two estimated federal income tax payments in the quarter. Importantly, though, operating cash flow results are favorable to our plan through the first half of 2010, and we've increased our outlook for the full year to \$1.2 billion.

We utilize our capital to invest in our businesses and enhance our returns for our shareholders. Following the sale of our NextRx subsidiaries, we repurchased nearly 50 million shares of our common stock during the first two quarters of 2010 or over 11% of the shares we had outstanding at 12/31/09, for approximately \$2.9 billion.

As of June 30, 2010, we had approximately \$1 billion of Board-approved repurchase authorization remaining.

As of June 30, 2010, we had approximately \$2.1 billion of cash and investments at the parent Company and available for general corporate use. We expect to receive approximately \$1.8 billion in additional ordinary dividends from our subsidiaries during the second half of 2010. We intend to utilize \$1 billion for share repurchases, subject to market and industry conditions, and we expect all other items to combine for a net use of \$100 million of parent cash in the second half of the year. This would leave an estimated \$2.8 billion at our parent company as of 12/31/2010.

Our insurance subsidiaries remain well-capitalized and highly rated. The statutory capital level is \$6.6 billion above state requirements, and \$3.7 billion above Blue Cross Blue Shield requirements as of June 30, 2010. This provides our customers security that WellPoint companies will be able to pay future claims even under adverse circumstances.

Our debt-to-capital ratio ended June at 26.4%, up slightly from 25.5% at March 31, 2010, but still at the lower end of our targeted range, so we have significant financial flexibility which we value in light of the current economy and the changing health benefits marketplace.

In terms of our updated outlook for 2010, we have raised our full-year guidance for earnings per share and operating cash flow based on our strong year-to-date results. Specifically, we now expect net income to be at least \$6.30 per share, which includes \$0.08 per share of net investment gains from the first six months of 2010, partially offset by \$0.03 per share impairment charge recorded the first quarter. This outlook does not include any investment gains or losses or impairment charges other than those recorded through the first half of 2010. It also is subject to our ability to secure and maintain sufficient premium rates.

We continue to expect that year-end medical enrollment will be approximately 33.1 million, consisting of 19.5 million self-funded members, and 13.6 million fully-insured members. Operating revenue is now expected to be approximately \$58 billion.

The benefit expense ratio is now expected to be approximately 83.9%. The SG&A expense ratio is now expected to be approximately 14.8%. Operating cash flow is now expected to total approximately \$1.2 billion, and this includes the unfavorable impact of the \$1.2 billion of first-quarter tax payments for NextRx. Our diluted share count is now expected to be approximately 421 million shares for the full year.

Also, while it is too early to talk in detail about our 2011 guidance, I will touch briefly on some of the more significant EPS headwinds and tailwinds that we are evaluating as we prepare our business plans. The most significant headwind is the minimum MLR requirements, components of which we are still being formulated. The new requirements will likely result in margin compression in some of our individual and Small Group states.

We have also recognized an estimated \$100 million of higher-than-anticipated favorable reserve development this year, which we do not expect to recur in 2011. And State Sponsored has been a solid performer this year. However, federal matching provisions are scheduled to decline next year, and we'll be incurring startup expenses associated with our new contract awards.

We are currently viewing the economy as a net neutral impact for next year, as unemployment has essentially leveled off. If employment begins to pick up, that would likely benefit our results.



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In terms of tailwinds for next year, as Angela noted, the marketplace must be fundamentally sustainable. We are assuming it will be able to obtain sufficient premium rates to cover our cost trends in the Commercial and Individual markets, which would drive positive operating leverage.

In the Senior market, while federal reimbursement rates will increase only slightly for 2011, we currently believe there's an opportunity to increase membership during the changes taking place in that market. And we also anticipate that our diluted share count will be lower in 2011 given the repurchase activity that is taking place this year.

Please keep in mind that this is a preliminary look at some of the major drivers both positive and negative for 2011. We are pleased with our performance so far this year and are optimistic about our future growth prospects. I will now turn the conference call back over to Angela to lead the question-and-answer session.

Angela Braly - *WellPoint, Inc. - Chair, President and CEO*

Operator, please open the queue for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Justin Lake, UBS.

Justin Lake - *UBS - Analyst*

Good morning, thanks. First question on the impact of reform costs. We've seen there's a number of benefits out there that are being mandated by the government for reform. I'm just curious as to your estimate of what you think the impact is going to be there in -- as you go into the fourth quarter, specifically and then in the 2011 from a cost trend and pricing standpoint.

Angela Braly - *WellPoint, Inc. - Chair, President and CEO*

Justin, this is Angela. Thanks for the question. Clearly, we are working on implementation of health-care reform and are diving deep into the work around pricing for the new products and for 2011.

In terms of being more specific, though, in terms of the range and the impact, we are hesitant to do that for obvious reasons, and we don't want to affect the marketplace in ways that are not going to benefit our members. So, I'm not sure that we can give much more detail in terms of the pricing trends right now.

Wayne DeVeydt - *WellPoint, Inc. - EVP and CFO*

This is Wayne. Good morning. A couple of things though, to give you at least some, maybe some direction. I think is Angela said, until we get final clarity on some of the rules and regulations, this will be more directional than anything.

But, I think it's important to recognize that when we look at the Commercial book, and we consider the age in to 26, lifetime limits going away and preventive care -- so when you look at those components, we think that will have a low single-digit impact on pricing for next year. When you look at relative to the fourth quarter, it's lower than that, primarily because of how the rules are actually implemented, meaning that while they effective in the fourth quarter, many of those do not become



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effective until the re-enrollment period. So if you think about the age in of 26, unless you were to turn within an age group in the fourth quarter, you won't be able to enroll for it until the next open enrollment period.

The other thing to recognize is that, with our Commercial book, we generally have a more robust product design. So we generally offer preventive care in a lot of our product designs. And so to the extent that we offer that already, we will have less of an impact versus say other competitors that may have had a more skinny down version of a product that did not have preventive care. So from our perspective, we do not see as much of an impact in the fourth quarter as we do for next year. But we think in pricing, you're probably looking at low single-digit impact on pricing for next year.

Angela Braly - WellPoint, Inc. - Chair, President and CEO

And we have to keep in mind, too, Justin, that every customer is coming from a different place, and their benefits are different, so when you give these kind of norms, it all depends on where their benefits are and if they hit aging increments and other things.

Justin Lake - UBS - Analyst

That's helpful. And then just in terms of the guidance change, it appears the \$0.30 increase there, it appears that was basically a function of the investment gains plus the lower share count and the reserve releases. I'm just curious, as you think of the fundamentals, as you are going into the back half of the year, can you give us an idea of how you see that playing out as far as the continued potential for declines and cost trends, and the jumping off point for 2011, how we should think of that. Thanks.

Wayne DeVeydt - WellPoint, Inc. - EVP and CFO

Yes, Justin, I would say that, when you look at the change in guidance, it is due to those components, the favorable reserve development and better performance below the line. I would say the core operations looked very solid at this point, which is one of the reasons we raised our cash flow guidance for the year. We are taking a cautious and conservative view for the second half of the year, as we wait to see some of the impacts of health reform. We believe we've appropriately baked that into our guidance. But, right now, I would say underlying trends look good.

And as it relates to next year, that's really going to vary based on how the final MLR rules are defined. At this point I think in some states we may do a little better, some a little bit worse. So it's really hard to say at this point until we get more clarity on the rules, but, overall trends really have stabilized and in many areas have come down.

Angela Braly - WellPoint, Inc. - Chair, President and CEO

And Justin, you were talking about the last six months of this year. You know, we don't put into the guidance prospectively reserve releases, and we never have. And also, as we look at trends, as we said, we are experiencing towards the lower end of the range that we provided around overall trend. And as you will remember, the last quarter in particular, but the last six months of the year, more and more each year now reflects more seasonality, reflecting kind of the nature of our product designs and the deductibles wear off, we see kind of more seasonality in the third and fourth quarter. But all of that is planned for in our guidance.

Operator

Josh Raskin, Barclays Capital.



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Josh Raskin - *Barclays Capital - Analyst*

Angela, you mentioned you would need to make changes to your individual product and the business model there. I'm assuming that includes distribution costs. Could you talk a little bit about what you meant when you said fundamental changes to that business model?

Angela Braly - *WellPoint, Inc. - Chair, President and CEO*

Yes, I will, Josh. You know, Brian is here though, and he could probably speak in more detail about that. Brian?

Brian Sassi - *WellPoint, Inc. - EVP & President and CEO, Consumer Business*

Good morning, Josh. What Angela was referring to is, we're taking a look at basically all aspects, including distribution costs, G&A expenses; obviously we're working on our product changes to be compliant post 9/23.

Not in a position to kind of get ahead of our announcements, but, one of the components is distribution costs. And so we're looking at that across the board, and we will be announcing potential changes in some markets later this year to take effect next year. It's not as simple as announcing one thing across the board because we pay both our internal distribution and external distribution differently in each of our states. And so we are looking to primarily get alignment. But, again, we've been talking with our distribution channel across the country, getting their input. But not in a position to kind of release the details, particularly since a lot of the regulations surrounding MLR are still outstanding.

Josh Raskin - *Barclays Capital - Analyst*

Of course. That makes sense. Logistically, Brian, when would you need to make announcements to your distribution partners in order to have something set up for January 1?

Brian Sassi - *WellPoint, Inc. - EVP & President and CEO, Consumer Business*

Typically, all of our contracts have a minimum of 30 day. We would at least provide that to our distribution partners. Again, a lot of this is predicated on when we are going to get the MLR final regs.

Josh Raskin - *Barclays Capital - Analyst*

Right. And then just a quick follow-up on the drug trends with Express Scripts; I think, Wayne, you had given RX coming in at high single digits. Could you maybe give us a sense on the procurement side that the cost of buying drugs with Express -- what sort of savings do you think you are seeing relative to where the WellPoint PBM was?

Brian Sassi - *WellPoint, Inc. - EVP & President and CEO, Consumer Business*

Yes, Josh, this probably won't answer your question completely, since it's a little more complicated than just a percentage decrease. But what I can tell you is that on every product line that we have, so whether we're looking at generic drug distribution, specialty drug distribution, retail distribution, mail order versus non-mail, there was a discount that could range from a few percentage points to say mid single-digits across the board. In some cases it was even higher, but those were on less frequently used drugs.



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What's interesting though is because overall utilization is down, so we are seeing the savings we expected by drug, but the volume isn't there because of overall utilization being down. So when you're looking on a percentage basis though, I don't think it's unreasonable to assume that you are saving mid-single digit range in general relative to previous contracted terms.

Angela Braly - *WellPoint, Inc. - Chair, President and CEO*

Let me also add to that. There was a strategic value -- many strategic elements of that transaction. But as we are migrating this membership onto the Express Scripts system, part of the value we get is that they have some capabilities that deal with mail order, getting the member to lower-cost drugs, working with the member on compliance in terms of their medication regimen, so -- but we are beginning to see the benefits of that as well and will so even more as the rest of that membership has migrated over to their platform.

Operator

John Rex, JPMorgan.

John Rex - *JPMorgan Securities Inc. - Analyst*

Thanks. So, just a follow-on to your commentary on reform the impact of reform provisions that go live later this year and impact -- so you grouped up kind of three of the important ones. And the other one I was curious about your view on was the impact of the pre-existing condition clause for children, and how you size that. Was that -- were you including that in your commentary of kind of the young adults lifetime limits and preventative care? Or is that separate?

Angela Braly - *WellPoint, Inc. - Chair, President and CEO*

You know, John, I think we need to start thinking about, as we get into the reform discussion, a couple of things. One, we're going to have this body of membership which is grandfathered. And, for the grandfathered membership, there are certain changes that went into effect for healthcare reform -- will go into effect this fall on the grandfathered book, but those are fairly minimal. So, they are going to be kind of one body of membership. Then, we have new products that are being -- will be filed and issued going forward that would be kind of the non-grandfathered healthcare reform provision.

And those, obviously -- you will have a different experience and a different pricing base, and as we look at increases over time, those will reflect the nature of the benefit.

In terms of some of the more explicit provisions around healthcare reform that are coming forward, including additional regulations that are coming forward, we didn't really speak to that specifically. A lot of it is still to be defined, and there are still even some moving parts around the child only policy or the pre-ex for kids. There's some discussion about additional regulation around that, and so, we're still evaluating that guidance. It's difficult for us to speculate on what that means in terms of the impact overall, or -- and we've got to assess what our options are around that business as well.

Wayne DeVeydt - *WellPoint, Inc. - EVP and CFO*

And John, so for those reasons, the numbers I spoke about previously were only on the Local Group business. So until we get more clarity on that, and what product designs we have and how we may change those, and some more clarity, we're not including anything for the guaranteed issue for kids.



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John Rex - JPMorgan Securities Inc. - Analyst

So maybe I'll just throw this out and see if I can get your reaction on it. So a number of plans have spoken to this -- the preexisting clause, potentially in an individual book, being worth a few hundred basis points of cost pressure on the adverse selection risk. Would you agree with that directionally?

Wayne DeVeydt - WellPoint, Inc. - EVP and CFO

I think directionally, yes; yes, it's going to have an impact. But again, we really want to get a little more feedback on the regulations and whether or not -- you know, late last night, the provision was added that there may be an open enrollment period. And so, we really want to get more clarity around that and what that would impact. But yes, John, I would say directionally that's reasonable.

John Rex - JPMorgan Securities Inc. - Analyst

Yes. And I'm glad you brought that up. Because I was referring specifically to that so that that reg that came up on the HHS site late last night where now there will be open enrollment period -- how important is that in terms of mitigating what could have been quite a bit of pressure there?

Angela Braly - WellPoint, Inc. - Chair, President and CEO

I think that is important. I think there's a lot of good work being done right now in evaluating what the consequences of some of these provisions are, and really understanding what it means in terms of the sustainability of these products in these markets over time. So, we appreciate the guidance there, and we need to study it a little bit and study what our options are relative to that.

John Rex - JPMorgan Securities Inc. - Analyst

With that, I guess with an open enrollment period though, would that essentially mostly mitigate what could have been a few hundred basis points of pressure in your view when you kind of think about how that impacts the book?

Angela Braly - WellPoint, Inc. - Chair, President and CEO

Not necessarily, John. So we're going to evaluate that carefully and think about what actions we need to take with respect to that.

John Rex - JPMorgan Securities Inc. - Analyst

Okay, okay. No, that's helpful. And just your view on cost trend in general, so a lot of commentary kind of utilization being slack in the Q. Could you just -- commentary as you think about your books of business, commercial and the government books, are you seeing different trends in the utilization there? Or are you seeing kind of weaker utilization trends across all books regardless of the class?



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Angela Braly - WellPoint, Inc. - Chair, President and CEO

Let me say this, because I want to clarify when I was responding I think to Justin's comment earlier. We're looking at overall trend and we were at 8 plus or minus 50 bps, but we are trending in the lower end of that range. But let me turn it over to Ken; he can speak to some of the commercial experience that we're having. And he and Wayne might comment more.

Ken Goulet - WellPoint, Inc. - EVP & President and CEO, Commercial Business

John, we've -- this is Ken. We have seen favorable trends as we indicated and for a variety of different reasons. But the trends -- Brian and I both have seen lower trends in general there, maybe spiked out in different areas of the business slightly. But in general, there is a lower utilization on both books.

Wayne DeVeydt - WellPoint, Inc. - EVP and CFO

And John, the one thing I would add is beyond just the State Sponsored that Brian is seeing positive in as well, when we look at our FEP business, one of the reasons for the change in our revenue guidance, as you know, is FEP is essentially a cost plus program. And about 40% of that change in the revenue guidance is due to us having overall lower claims experience on FEP, which of course translates in overall lower revenue as well.

Brian Sassi - WellPoint, Inc. - EVP & President and CEO, Consumer Business

Yes, and this is Brian. You know, I agree with what Ken said across most of our business, but we are seeing in some of our regions an uptick in individual utilization and trend.

Operator

Doug Simpson, Morgan Stanley.

Doug Simpson - Morgan Stanley - Analyst

Good morning. Wayne, could you just talk to the \$2.8 billion, I think was the number you threw out, for cash at year end? Is that the sort of working capital you plan to hold for some period? Or is that just sort of where you see yourself winding up? I mean, just -- if you could also connect the dots to the debt to total cap down at 26%, how much dry powder do you need to keep around? And just maybe give us a sense for how that may play out.

Wayne DeVeydt - WellPoint, Inc. - EVP and CFO

Yes, Doug, I just want to remind all those on the call that we have approximately \$1 billion of debt coming due in January of 2011. So, when we look our working capital, short of us refinancing, and I would fully anticipate that we would be able to refinance the debt, the markets are favorable at this point. But subject to that ability, no, we would not need to maintain \$2.8 billion for working capital purposes. We do want to have an opportunity though first to refinance that debt, though, before we would discuss with our board opportunities on how to deploy that additional excess capital at this point.

But, ultimately, we like to keep enough cash on hand to cover at least 12 months of interest and principal payment. And outside of that, we have very few requirements at all at the parent level. So we would anticipate meeting with our Board later this year to discuss those capital levels.



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Doug Simpson - Morgan Stanley - Analyst

Okay. And then maybe if you could just talk to the in-group attrition; is there any data you could help us with on the characteristics of the lives you are losing as a result of that; just thinking about the incremental margin and the negative leverage carry from that. If we got 100 basis point lift in employment, how would that impact the business and the risk pool overall?

Angela Braly - WellPoint, Inc. - Chair, President and CEO

You want to take that one?

Ken Goulet - WellPoint, Inc. - EVP & President and CEO, Commercial Business

Yes, it's -- we've experienced attrition since the recession began on both our -- on really all of our books of business, but it's been predominantly in the small micro group market; almost a third of the business that we lose is not going to a competitor, but is going through attrition of dropping coverages or transitioning to individual coverages.

And the Larger group business, or multistate National account, it is attributed to layoffs as well as to off sourcing.

What we saw this month in Small Group was we did have growth for the month overall in membership, and that was because attrition was down. We had been seeing it go down in each of our books of business, but it is still a fairly large negative, whereas 18 months ago, it was a positive month over month. So, we anticipate as the business turns, we will see both Small Group and National with increases, and it's the Small Group that will impact our margins the most.

Angela Braly - WellPoint, Inc. - Chair, President and CEO

In terms of experience, too, I think you have to keep in mind we've had higher than kind of the normal run rate of COBRA as a result of unemployment. And some of that is beginning to essentially age off because it was subsidized for a period of time. And so we're getting to the point where we've seen that experience from the COBRA membership. And as we go through the rest of the year, some of that, we anticipate will be dropping off.

Operator

Matthew Borsch, Goldman Sachs.

Matthew Borsch - Goldman Sachs - Analyst

Yes, thank you. And apologize if I missed this, although I don't think I did. Did you indicate directionally whether you think operating earnings will be up or not in 2011, or is it too early at this point?

Angela Braly - WellPoint, Inc. - Chair, President and CEO

Too early at this point to really comment on 2011, Matt, so you didn't miss it.

Matthew Borsch - Goldman Sachs - Analyst

All right, okay. And, as you look at this the grandfathering by your employer groups, do you have any sense for how broadly employers are going to try to hold onto grandfathered status and where that might make it difficult for them to make the



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necessary benefit design changes to offset cost trend pressure? Do you have -- are you starting to get some fix on that at least for 2011?

Angela Braly - WellPoint, Inc. - Chair, President and CEO

Yes, Matt, I'm going to let Ken answer that. I have to tell you, from an operational point of view and implementation point of view, we are assisting our group to either maintain their grandfathering or move forward to change their benefits as they might desire knowingly -- so that they know whether or not they're going to impact the grandfathering. So Ken, you want to talk about how that's being received?

Ken Goulet - WellPoint, Inc. - EVP & President and CEO, Commercial Business

Yes, Matt, we've been working hard. We made the decision; of course, we could have saved operational dollars by not allowing grandfathering across the board. We want to leave the options open for our employer groups, and we've been working with them and educating our brokers and groups in doing that. We've done a lot of primary market research. There's still some confusion about the bill and how it will impact. But we have seen a lot of questions and individual companies making choices about the benefits they have. Of course, we have some flexibility on the buydown benefits and still stay grandfathered. That was important in the provisions that were being offered.

I can't give a percentage yet, but we felt it was extremely important to keep the books open for two reasons. One, to give the flexibility to the groups; and secondly, for the groups deciding to remain under grandfathered programs tend to be better risk groups; it will preserve the better risk pool for those individuals and let them keep their rates and benefits at the levels they are more accustomed to.

Operator

Scott Fidel, Deutsche Bank.

Scott Fidel - Deutsche Bank - Analyst

Thanks. First question is, we've seen some reports recently of some of your peers talking about considering expanding or diversifying into markets outside of health benefits, just given some of the expectations for reform pressure. And, just interested in your thoughts around that in terms of the product and market mix and whether you would consider expanding into certain markets outside of sort of the core health benefits markets.

Angela Braly - WellPoint, Inc. - Chair, President and CEO

Well, we do have an important element of what we call our specialty business. So, our dental business is growing rapidly; vision, life disability, other kind of ancillary product offerings. We are evaluating all of the strategic options as well as geography. We have operations and some other opportunities to expand more globally. So, we are considering those issues.

We, first and foremost, though, are very focused on serving and satisfying our members, and taking care of them. And there's a lot of additional value that they could receive from us through expanding the portfolio of offerings that we have available for them.



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Scott Fidel - Deutsche Bank - Analyst

And Angela, would that include looking at expanding into new products and markets or really just expanding some of the specialty and other offerings that you already currently offer?

Angela Braly - WellPoint, Inc. - Chair, President and CEO

I would say we look at -- we talk about the core business as being the medical insurance business, and the non-core business being specialty and other opportunities. So we're expanding our view of non-core growth opportunities as well, and there are many ways in which -- synergistic ways in which our customers would benefit by that expanded relationship.

Operator

Carl McDonald, Citigroup.

Carl McDonald - Oppenheimer & Co. - Analyst

Thanks. You've had more direct experience with the difficulty raising rates than probably anybody. It certainly makes sense that you ultimately get a rate increase in places like California and Maine where you not making money right now. But you also have a lot of Individual and Small Group markets where you do very well now. So, why shouldn't we be worried about pricing pressure in those markets next year?

Angela Braly - WellPoint, Inc. - Chair, President and CEO

You know, I'll let Brian talk a little bit to the experience that we're having across the states. As we commented earlier in the remarks, it's really important to think about this from a long-term perspective, and we need a sustainable marketplace. And, so, I think as these issues continue to be evaluated, people understand the actuarial principles, the dynamics of what the rates need to reflect. And I think that's going to find an equilibrium over time. But Brian, do you want to talk about the experience you're having (multiple speakers)?

Brian Sassi - WellPoint, Inc. - EVP & President and CEO, Consumer Business

Sure. Carl, I'm sure you're well aware, the rate review process has been in place in most of our geographies. So this is kind of a normal course of doing business. I think one of the things that we've learned is that becoming as transparent as possible with the regulators in terms of our rates, what's needed with our rates; following the additional scrutiny in California, we've had a number of inquiries across our states. A number have reaffirmed our rates. Others have posed additional questions, and we continue to work with the regulators.

We anticipate that into 2011, some states are going to look closer, and I think other states have been pleased with our level of rate development and the levels of transparency, which we only expect to continue and to get better.

Angela Braly - WellPoint, Inc. - Chair, President and CEO

Operator, I think we have time for one more call. One more question.



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Operator

Tom Carroll, Stifel Nicolaus.

Tom Carroll - *Stifel Nicolaus - Analyst*

Hey, good morning. Angela, you indicated that less than 5% of your operating gain comes from your individual book. What is the corresponding number for Small Group?

Angela Braly - *WellPoint, Inc. - Chair, President and CEO*

Wayne, do you want to speak to that? We don't typically --

Wayne DeVeydt - *WellPoint, Inc. - EVP and CFO*

Yes, we don't typically break out by segment. The one thing I would say, Tom, is obviously it's more than what our individual is. I would highlight though that on the Small Group business, the exposure from the MLR is not as significant at all compared to the Individual. Most of our Small Group already runs a higher MLR. And so, I think the bigger issue we wanted to highlight for shareholders is where the concerns might be around Individual, that the exposure isn't what many believe it is, and we believe we'll be able to manage it.

Tom Carroll - *Stifel Nicolaus - Analyst*

So as a follow-up on the Small Group, would you suggest that I don't know, a quarter of your Small Group business, perhaps, is going to feel some pressure? Or is it more like a half, some magnitude of the actual size of the Small Group book that perhaps is going to get pressured?

Wayne DeVeydt - *WellPoint, Inc. - EVP and CFO*

You know, it's difficult to answer until we get the final rules around the MLR. I would love to give you more clarity, but until we can get further clarity on it is really a difficult question to be able to answer.

Angela Braly - *WellPoint, Inc. - Chair, President and CEO*

And let me just say, the Small Group market is one where we have lots of expertise. And, in this economy and with the challenges that Small Groups have, they're really looking carefully at their benefits. And we're working with them on whether they should be grandfathered or have other benefit designs. So we're really partnering with them and working together to make sure that they can have benefits that are affordable.

I'm going to have to apologize for others who were in the queue and didn't get to ask their questions. We're going to be respectful of the fact that many of you guys might have to get off pretty quickly. And I want to thank you all for the questions that you have provided us.

In closing, I want to reiterate that we are performing well in 2010, and we do remain confident in the future. Our underlying business is doing well, and we benefited in the quarter from certain non-run rate items that have had a favorable impact on our quarterly results.



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We are taking a leadership role in our industry and making changes to our business model to enhance the quality of care while holding down increases in future medical costs and operating expenses in order to further enhance our strong value proposition. We believe we are well positioned to drive increased value for our current and our future customers, and our shareholders.

I want to thank everybody for participating on our call this morning, and we're looking forward to speaking with you on our third-quarter earnings call that we've currently scheduled for November 3, 2010. Operator, please provide the call replay instructions.

Operator

Thank you. Ladies and gentlemen, this conference will be available for replay after 10 AM Eastern time today through August 11. You may access the AT&T Teleconference Replay System at any time by dialing 1-800-475-6701, and entering the access code 123546. International participants, dial 320-365-3844. (Operator Instructions).

That does conclude your conference for today. Thank you for your participation and for using AT&T Executive Teleconference. You may now disconnect.

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