

Pre-Hearing Brief Regarding Case No. 3014-DM

Demutualization and Subsequent Acquisition of Blue  
Cross Blue Shield of Kansas by Anthem

Summary of Work Performed by Bear Stearns

# Table of Contents

- I. Brief Background on Bear Stearns and David Platter
- II. Transaction Summary
- III. Discussion of the Auction Process Run by Blue Cross Blue Shield of Kansas (“BCBSKS”) and Dresdner Kleinwort Wasserstein (“Wasserstein”)
- IV. Summary of Bear Stearns’ Due Diligence
- V. Valuation Analysis
- VI. Background on BCBSKS
- VII. Background on Anthem Insurance Companies, Inc. (“Anthem”)
- VIII. Additional Matters Outside the Scope of The Fairness Opinion
- IX. The Fairness Opinion

## I. Brief Background on Bear Stearns and David Platter

### A. Bear Stearns' Engagement







1. Hired by the Kansas Department of Insurance (the "KID") based on an engagement letter dated August 17, 2001.
2. Role is to act as the KID's financial advisor.
3. KID has asked Bear Stearns to render an opinion **to the KID** as to whether the Aggregate Consideration to be received by eligible policyholders of BCBSKS in the Transaction as defined below, is fair, from a financial point of view, to such policyholders, as a group.
4. KID has asked Bear Stearns to testify at this public hearing.

### B. General

1. A leading global investment banking, securities trading and brokerage firm which employs approximately 10,500 people worldwide that serves corporations, governments, institutions and individuals on a worldwide basis.
2. Bear Stearns' parent company became a public company in 1985 and is traded on the NYSE under the ticker BSC.
3. Leader in global mergers and acquisitions across a wide range of industries.
4. Bear Stearns' parent company had approximately \$170 billion in total assets and \$29 billion in total capital as of August 31, 2001.

### C. Managed Care and Demutualization Experience

#### Selected Managed Healthcare Advisory Highlights

	(1)	■ Advising Cobalt Corporation (Wisconsin Blue Cross & Blue Shield Plan) on various strategic alternatives.
	(1)	■ Advised BlueCross & BlueShield United of Wisconsin on its acquisition by United Wisconsin Services, Inc.
	(2)	■ Advised Blue Cross & Blue Shield of New York on its pending conversion to a for-profit company.
	(2)	■ Advised the Commonwealth of Virginia on the demutualization and IPO of Trigon Blue Cross & Blue Shield.
	(2)	■ Advised Highmark on the acquisition of Davis Vision.
	(2)	■ Advised Anthem on a proposed merger with Blue Cross & Blue Shield of New Jersey.

- (1) Bear Stearns team members worked on deal at Bear Stearns.  
(2) Bear Stearns team members worked on deal at another firm.

## Selected Life Insurance Demutualization Highlights

---



- (1) Bear Stearns team members worked on deal at Bear Stearns.  
(2) Bear Stearns team members worked on deal at another firm.

### D. Investment Banking Team

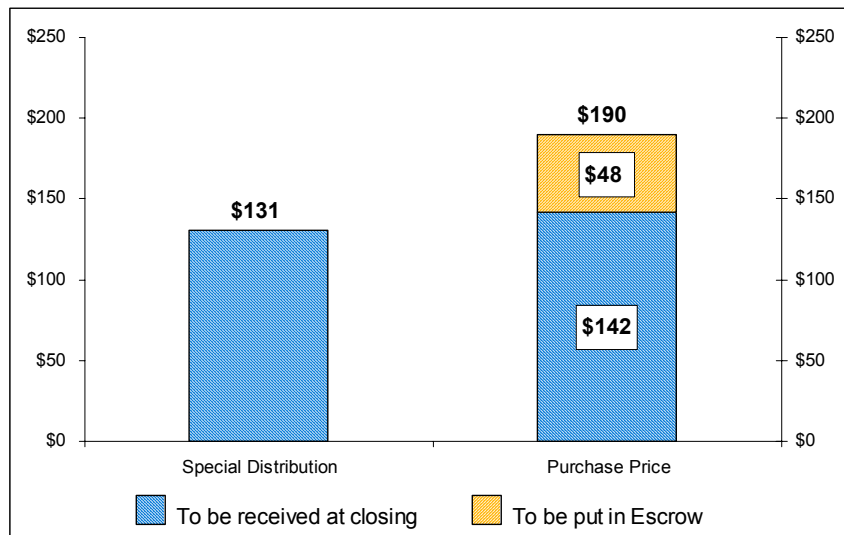
1. David Platter is a Senior Managing Director and head of the Financial Institutions Group. David has been involved in providing mergers and acquisitions advice and capital raising for insurance companies, healthcare companies and other financial institutions since 1985. **David is responsible for Bear Stearns' Blue Cross & Blue Shield coverage effort and has extensive familiarity with Blue Cross and Blue Shield plans. In addition to this Transaction, David's "Blue" experience includes serving or having served as advisor to Blue Cross & Blue Shield United of Wisconsin on its acquisition by United Wisconsin Services, Inc., Cobalt Corporation on various strategic alternatives, Empire in their proposed conversion in New York, the Insurance Commission of the Commonwealth of Virginia in the Trigon demutualization and Anthem on a proposed merger with Blue Cross & Blue Shield of New Jersey.** During his career, he has served as an advisor or underwriter to demutualizing companies such as Prudential, Principal Financial, MetLife, John Hancock, and Stancorp. He has also advised CNA, Hartford, Trenwick, Allied Mutual, Life USA, RGA, Conning, Nationwide, and Transamerica in a variety of M&A and capital raising projects in the insurance arena. Prior to joining Bear Stearns, David was a managing director in the Investment Banking Division of Donaldson, Lufkin & Jenrette, specializing in the insurance industry. He is a Phi Beta Kappa and honors graduate of the University of California at Berkeley and received his M.B.A. from Stanford University.
2. David Grill is a Vice President in Bear Stearns' Mergers and Acquisitions Group. David has worked on a number of advisory and capital raising assignments for insurance and managed care companies while at Bear Stearns. Prior to joining Bear Stearns in 2000, he was the Treasurer of Reliance Group Holdings, where he was responsible for the Company's merger and acquisition and corporate finance activities. Previously, David was a Vice President in the Corporate Finance Division at National Westminster Bank. David received his M.B.A. from New York University in 1994 and his B.S. from Cornell University in 1988.
3. Other Investment Banking Team members include Neal Jacobs, an associate in the Financial Institutions Group, James Farrell, an analyst in the Financial Institutions Group and Michael Fairchild, an analyst in the Financial Institutions Group.

## II. Transaction Summary

### A. Transaction (collectively, the Conversion, Purchase Price and Special Distribution) Summary

1. Pursuant to the Plan of Conversion adopted by the BCBSKS Board of Directors (the “Board”) on October 25, 2001, as amended (the “Plan”), BCBSKS plans to convert from a mutual insurance company to a stock insurance company (the “Conversion”).
2. Conversion is contingent upon the sale of all shares of BCBSKS common stock immediately following the Conversion to Anthem (collectively with the Conversion, the “Sale”). For more details on the terms summarized below, please see the Alliance Agreement.

#### Aggregate Consideration Eligible Policyholders Will Receive



3. **Purchase Price** - Anthem will purchase BCBSKS for \$190 million. Eligible policyholders will receive \$142 million upon consummation of the Sale and \$48 million will be put in escrow pending the outcome of the Contingent Litigation Matter discussed below.
4. **Special Distribution** - The Board has declared a Special Distribution that is payable to eligible policyholders upon consummation of the Sale, that will be equal to the amount, if any, by which the consolidated closing book value of BCBSKS, as defined in the Plan, at consummation of the Conversion exceeds \$155,000,000, which BCBSKS currently estimates to be \$131,000,000 (the “Special Distribution”).
5. **Contingent Litigation Matter** - BCBSKS was served with a subpoena on 2/28/01 by the Office of the Inspector General, US Department of Health and Human Services (“OIG”) regarding an investigation by the OIG of possible improper claims against Medicare by BCBSKS. BCBSKS management has stated they do not have any details on the case because the filing in court is under seal. BCBSKS management has stated they cannot estimate the potential dollar amount of the liability or when the case will be resolved.

6. **Escrow Account** - The \$48 million to be deposited in escrow will be used to pay for all costs relating to the Contingent Litigation Matter including fees, fines, settlements, judgments and other related costs including any tax implications due to the Contingent Litigation Matter. In addition, the cost to keep track of eligible policyholders until the Contingent Litigation Matter is closed will be borne by the escrow fund. We have assumed, with the consent of BCBSKS, that any amounts deposited into the escrow fund but not ultimately distributed to eligible policyholders will be paid in connection with satisfying BCBSKS' obligations arising out of the Contingent Litigation Matter.

### III. Discussion of the Auction Process Run by BCBSKS and Wasserstein

#### **A. Auction Process**

Bear Stearns was hired by the KID after Anthem was selected as the winning bidder. Wasserstein advised BCBSKS during its auction process. BCBSKS management stated that the process was not set up to maximize value but rather to pick the best partner for BCBSKS. The following is a summary of the auction process based solely on extensive discussions with BCBSKS and Wasserstein and review of correspondence between BCBSKS and the potential bidders provided to Bear Stearns by Wasserstein and BCBSKS.

1. **Early January 2001** – BCBSKS sent out non-disclosure agreements and requests for expressions of interest (“RFEI”) to seven companies. Those companies were Anthem, B, C, D, E, F and G. The focus of the RFEI was strategic issues such as medical provider, policyholder and employment issues. No valuation indications were requested.
2. **Early February 2001** – Anthem, C, E and G submitted responses to the RFEIs, B and D (herein referred to as B) jointly submitted a response to the RFEI and F did not respond. Two sets of questions were sent to each of these respondents asking more detailed questions that still focused solely on strategic issues. One set was general questions sent to every party and the other was questions specific for each respondent based on their answers to the RFEI.
3. **Throughout February 2001** – Each of the five respondents gave a presentation to BCBSKS management and its advisors. Presentations were guided by the questions sent to the respondents. There was no discussion of valuation at this point and only public information was available to the respondents.

**Anthem, B and C were invited to participate in a second round while E and F were excluded. We had lengthy discussions with BCBSKS and Wasserstein to try to gain an understanding of why E and F were excluded from the second round. BCBSKS’ and Wasserstein’s explanations are summarized below.**

4. **E** – BCBSKS management excluded E from the second round mainly due to concerns regarding control because BCBSKS management believed that even a combined company would eventually need to do another transaction. Subsequent to the announcement of BCBSKS’ sale to Anthem, E announced its was being acquired by another company. BCBSKS wanted to have control regarding any future transaction. Therefore, BCBSKS wanted to structure the transaction as a merger of equals with equal board representation but E proposed an acquisition in its response to the RFEI. However, in the second set of questions sent by BCBSKS to E prior to its presentation to BCBSKS, the only specific question for E was regarding how E could finance a cash acquisition. There was no question regarding the desire by BCBSKS to structure a merger of equals. BCBSKS management did not believe it was in the best interest of policyholders to lose local control. BCBSKS management stated that E’s response to the RFEI and its presentation did not give them the assurances they were looking for regarding local control.

E's answer to the RFEI stated their belief that services that directly touch the customer or provider are best delivered at the local level and they were supportive of BCBSKS' desire to maintain a workforce in Kansas. They would only look to potentially centralize functions such as data processing, technology investments and certain compliance activities. E suggested an acquisition to be paid for in cash or stock in which BCBSKS would be a subsidiary of E. Some BCBSKS directors would be invited to join E's board, an Advisory Board for BCBSKS would be created that consisted of BCBSKS' current board. The BCBSKS subsidiary would maintain its Topeka headquarters.

5. **F** – BCBSKS management excluded F from the second round mainly due to a fear regarding centralized operations and significant job losses. BCBSKS management believed that they would lose all control of operations if acquired by F. BCBSKS management also was concerned about the length of time it was taking for F to complete its acquisition of another managed care company. BCBSKS management stated that the CEO of F told them that F only wanted to be invited to the second round if there was a reasonable chance of winning. Since BCBSKS management did not believe this to be the case, F was excluded from the second round.

F's answer to the RFEI stated that the transaction would be structured so that BCBSKS would be a subsidiary of F and that subsidiary would not have its own board of directors. There would be no changes made to F's board of directors. Three advisory boards would be created in Kansas to focus on customers, hospitals and physicians. The current BCBSKS Board would be retained as an advisory board to the F Board to provide key input to the combined company regarding the Kansas market. Management of the Kansas subsidiary would have full profit and loss responsibility and they would be empowered to manage the business as they deemed appropriate. The subsidiary would be supported by corporate functions such as legal, treasury and tax. All customer specific local functions such as product development, marketing, provider relations, medical management and customer service would be conducted by the Kansas subsidiary with people employed in Kansas. However, based on the verbal presentation given by F's CEO, BCBSKS management believed that a transaction with F would result in a significant loss of local control.

6. **Early April 2001** – Anthem, B and C were invited to a data room to review non-public information and BCBSKS management made a presentation to each of the parties.
7. **Mid April 2001** – BCBSKS management and Wasserstein conducted reverse due diligence on each of the three parties focusing on each participant's suitability for a strategic partnership in various areas.
8. **Late April 2001** – A draft of a purchase agreement was sent to Anthem and C and a draft of a merger agreement was sent to B with structures of transactions that BCBSKS would recommend to its board. Key terms including consideration were left blank. Shortly after receiving the purchase agreement, C dropped out of the process.
9. **Early May 2001** – Anthem and B submitted their proposals. This was the first time that parties had provided BCBSKS with any valuation information but since B's transaction

was a mutual to mutual transaction, only Anthem submitted a purchase price. The two remaining parties gave presentations to the board of BCBSKS detailing their proposals and their companies.

10. **Late May 2001** –The BCBSKS held a board meeting to evaluate and vote on the proposals. The key reason that BCBSKS rejected B was that B has a potential charitable contribution liability. BCBSKS settled its lawsuit with the Attorney General of Kansas in 1999 by paying \$75 million to a charitable foundation. BCBSKS management was concerned that if B was required to make a contribution to a charitable foundation after merging with BCBSKS, then Kansas policyholders would essentially pay for a second charitable foundation since this payment would reduce policyholder surplus. BCBSKS and B could not structure a transaction that guaranteed that Kansas policyholders would not be responsible for this potential liability. At this meeting, the BCBSKS Board approved the Anthem deal.

It should be noted that Bear Stearns advised C in connection with its exploration of a possible business combination transaction with BCBSKS for which Bear Stearns received a customary fee for such service. This exploration was abandoned by C prior to our engagement by KID. Our engagement and termination with C was disclosed to the KID prior to being engaged by the KID.

**B. Final Proposals Received by BCBSKS Management**

1. The following table summarizes the Anthem and B proposals that the BCBSKS Board considered when it made its decision to approve a transaction with Anthem in late May and is based solely on a review of documents provided to Bear Stearns by Wasserstein and BCBSKS.

	Anthem	B
<b>Structure</b>	BCBSKS demutualizes and Anthem purchases Kansas for \$190M.	Merger of BCBSKS into B, the surviving corporation. B remains a mutual company.
<b>Special Dividend</b>	BCBSKS may declare a special distribution for any surplus in excess of \$155M (expected to be \$180M when deal was announced) to be paid to policyholders at closing.	BCBSKS may declare a Special Dividend up to \$50M to be put into an escrow account.
<b>Escrow Account</b>	Purchase price of \$190M will be put into escrow and any claims related to the contingent litigation will be paid out of the escrow, net of tax. When all litigation claims are resolved, remaining funds are paid to policyholders.	Any litigation claims prior to the merger over \$2M will be paid out of the escrow account, net of tax. When all litigation claims are resolved, any remaining funds are paid to policyholders.
<b>Contingent Litigation</b>	If litigation claims exceed the escrow balance, Anthem is liable for the difference	If litigation claims exceed the escrow balance, B is liable for the difference (“Excess Litigation Damages”).
<b>Payment to Kansas Policyholders Excluding Special Dividend</b>	\$190M purchase price will be put into an escrow account and when all litigation claims are resolved, any remaining funds are paid to policyholders.	If B demutualizes, BCBSKS policyholders will receive at least their surplus at the time of the merger less the Special Dividend less any Excess Litigation Damages.
<b>Liquidated Damages</b>	If BCBSKS accepts another offer, Anthem gets \$12 million.	If BCBSKS accepts another offer, B gets \$10 million.
<b>Termination Fee</b>	None	If B terminates agreement, BCBSKS gets \$10 million.
<b>Board Representation</b>	Anthem helps elect one person selected by BCBSKS to its Board for two years.	B helps elect two people selected by BCBSKS to its Board for three years. After their terms expire B will help elect one person for an additional three years.
<b>Employment in Kansas</b>	Anthem will maintain employee levels for three years in Kansas in proportion to operations in other Anthem states based on membership levels in each state as required by Anthem’s business judgment.	B will maintain employee levels in Kansas for 3 years at the same ratio of employees to revenue as ratio of B employees to B revenues for those years. For 3 years, B won’t reduce the number of Kansas employees that receive base pay of at least \$50,000.

## IV. Summary of Bear Stearns' Due Diligence

### **A. Due Diligence Summary**

In the course of performing our review and analyses for rendering this opinion, Bear Stearns has:

1. reviewed the Alliance Agreement dated November 9, 2001 (the "Alliance Agreement") by and between BCBSKS and Anthem;
2. reviewed the Policyholder Information Statement dated November 9, 2001 (the "Policyholder Information Statement");
3. reviewed the Plan;
4. reviewed audited and unaudited financial statements of BCBSKS for the years ended December 31, 1998, 1999 and 2000 and the quarters ended March 31, 2001, June 30, 2001 and September 30, 2001;
5. reviewed audited and unaudited financial statements of Anthem for the years ended December 31, 1998, 1999 and 2000 and the quarters ended March 31, 2001, June 30, 2001 and September 30, 2001;
6. reviewed annual statutory financial statements for the years ended December 31, 1998, 1999 and 2000 and quarterly statutory financial statements for the quarters ended March 31, 2001 and June 30, 2001 for BCBSKS and Anthem;
7. reviewed certain operating and financial information, including projections for the five years ended December 31, 2005, provided to Bear Stearns by BCBSKS management relating to BCBSKS' business and prospects;
8. met with certain members of BCBSKS' senior management to discuss BCBSKS' business, operations, historical and projected financial results and future prospects;
9. met with certain members of Anthem's senior management to discuss Anthem's business, operations, historical and projected financial results and future prospects;
10. met with the KID and the legal, accounting, actuarial and tax advisors hired by the KID to discuss a draft of the Conversion Order, Alliance Agreement, Policyholder Information Statement and other appropriate regulatory guidelines;
11. reviewed publicly available financial data, stock market performance data and trading multiples of companies which Bear Stearns deemed generally comparable to BCBSKS and Anthem;
12. reviewed the terms of recent acquisition transactions of companies which Bear Stearns deemed generally comparable to BCBSKS and Anthem;
13. performed discounted cash flow analyses based on the projections for BCBSKS furnished to Bear Stearns;

14. conducted such other studies, analyses, inquiries and investigations as Bear Stearns deemed appropriate.

#### **B. Timeline of Events Related to Projection Information Requested by Bear Stearns**

1. **September 5, 2001** – Requested five year projections from (i.) BCBSKS based on its current operating philosophy and based on a goal of maximizing profits and (ii.) Anthem based on how it would operate in Kansas.
2. **September 7, 2001** – Conference call with BCBSKS and Anthem explaining Bear Stearns’ requests.
3. **During September 2001** – Received financial projections from BCBSKS for 2001 and 2002 showing negative underwriting margins. Received actuarial projections from BCBSKS for 2001 to 2005 showing underwriting margins growing to 1.9% by 2005.
4. **September 28, 2001** – Met with BCBSKS, Wasserstein and Anthem. Received a copy of Wasserstein’s board presentation dated May 24, 2001 that contained financial projections through 2004. Underwriting margins only grew to 0.3% by 2004. We discussed with BCBSKS and Wasserstein the reasonableness and achievability of the projections in the Wasserstein board presentation as well as the assumptions used to generate the projections. Bear Stearns asked for verbal guidance regarding future underwriting performance and BCBSKS management mentioned 1.5% to 2.5% underwriting margins which Anthem agreed were achievable over a reasonable period of time. BCBSKS subsequently denied that they ever provided Bear Stearns with verbal guidance regarding 1.5% to 2.5% future underwriting margins. In addition, BCBSKS told Bear Stearns that the actuarial projections were not a financial forecast and they should not be relied upon.
5. **October 2001** – Discussed future prospects for Kansas with Anthem who stated that they would not purchase BCBSKS if they did not believe they could achieve 2.5% underwriting margins.
6. **October 19, 2001** – Met with Wasserstein to discuss valuation methodology. Bear Stearns and Wasserstein agreed that both sides used a similar methodology to perform a discounted cash flow (“DCF”) analysis but different underwriting margin assumptions. This caused differences between Wasserstein’s and Bear Stearns’ DCF results.
7. **October 24, 2001** – Received written communication from BCBSKS that stated the actuarial projections were irrelevant and not an expectation of future financial results but rather a financial modeling tool to analyze price rating actions.
8. **October 30, 2001** – Learned from KID’s actuarial consultants that BCBSKS and its actuaries were using the actuarial projections in the actuarial contribution memo to calculate how the Aggregate Consideration would be divided among the eligible policyholders. This was brought to the attention of BCBSKS to help them prepare for the November 2, 2001 meeting discussed below.

9. **November 2, 2001** – Met with BCBSKS and Wasserstein to discuss the different sets of projections Bear Stearns received. Bear Stearns was told there was an error in the actuarial projections. The assumption used in the actuarial projections regarding pricing for new small group customers was incorrect which led to an overstatement of premium income.
  
10. **November 6, 2001** – Met with BCBSKS and Wasserstein and received a new set of projections through 2005 called the Marketing and Finance Task Force Projections based on the actuarial projections with a new pricing assumption for the small group business. These financial projections showed underwriting margin only growing to 0.4% in 2005 which is consistent with the projections used by Wasserstein in their May 24, 2001 board book. We again discussed the reasonableness and achievability of these projections as well as the assumptions used to generate the projections. Management stated that these projections are BCBSKS' current best estimate of future performance and the Marketing and Finance Task Force Projections will also be used for calculations in the actuarial contribution memo. After significant discussions with BCBSKS and Wasserstein, Bear Stearns ultimately accepted the Marketing and Finance Task Force Projections and relied upon those projections for rendering the Fairness Opinion.

## V. Valuation Analysis

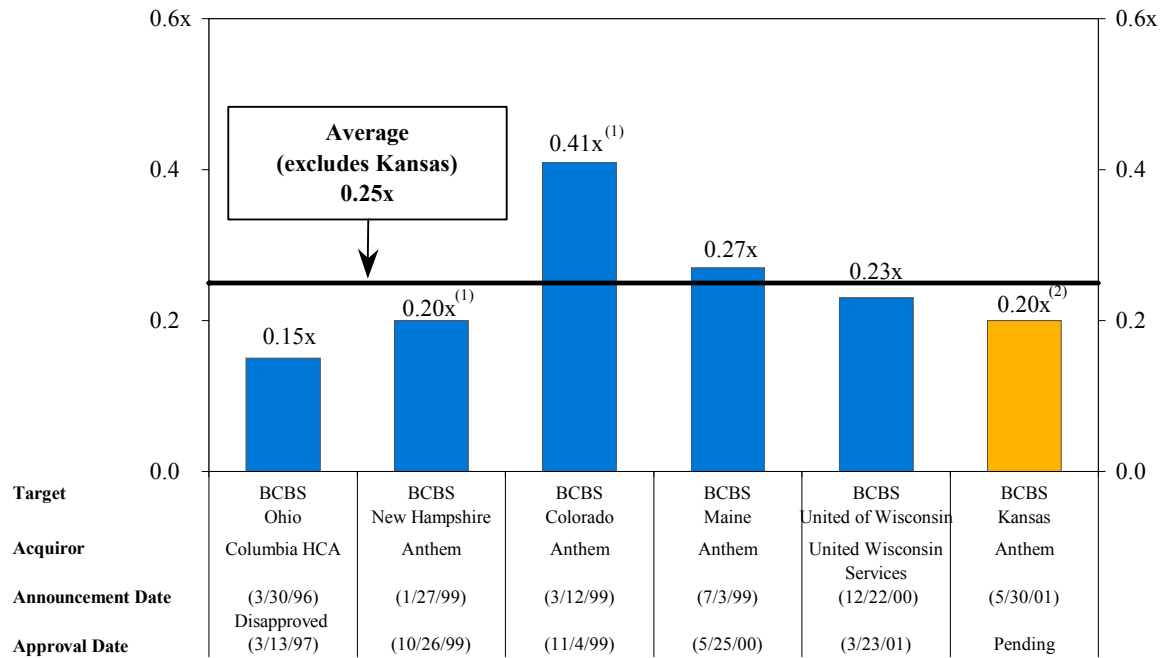
### **A. Qualification of Analysis**

1. The following is a brief summary of all the material valuation, financial and comparative analyses considered by Bear Stearns in connection with the rendering of its opinion. This summary is qualified in its entirety by reference to the full text of Bear Stearns' opinion.
2. Bear Stearns has relied upon and assumed, without independent verification, the accuracy and completeness of the financial and other information, including without limitation the projections and actuarial reports, provided to us by BCBSKS and Anthem. With respect to BCBSKS' and Anthem's projected financial condition and results, Bear Stearns has relied upon representations that they have been reasonably prepared on bases reflecting the best currently available estimates and judgments of the senior managements of BCBSKS and Anthem as to the expected future performance of BCBSKS and Anthem, respectively, including the closing book value of BCBSKS at consummation of the Conversion. In the case of BCBSKS, Bear Stearns has relied on representations that such projections are based on BCBSKS' current not-for-profit operating model. Bear Stearns has not assumed any responsibility for the independent verification of any such information or of the projections and estimates provided to Bear Stearns, and Bear Stearns has further relied upon the assurances of the senior managements of BCBSKS and Anthem that they are unaware of any facts that would make the information, projections and estimates provided to Bear Stearns incomplete or misleading.
3. Bear Stearns has not performed or obtained any independent appraisal of the assets or liabilities (contingent or otherwise) of BCBSKS and Anthem, nor has Bear Stearns been furnished with any such appraisals. Bear Stearns has assumed that the Transaction will be consummated in a timely manner and in accordance with the terms of the Plan and the Alliance Agreement without any limitations, restrictions, conditions, amendments or modifications, regulatory or otherwise, that collectively would have a material effect on BCBSKS or Anthem. In addition, Bear Stearns has assumed, with the consent of BCBSKS, that any amounts deposited into the escrow fund referred to above but not ultimately distributed to eligible policyholders will be paid in connection with satisfying BCBSKS' obligations rising out of the Contingent Litigation Matter. Bear Stearns also has assumed, with the consent of BCBSKS, that the Special Distribution declared by the Board will be \$131,000,000.

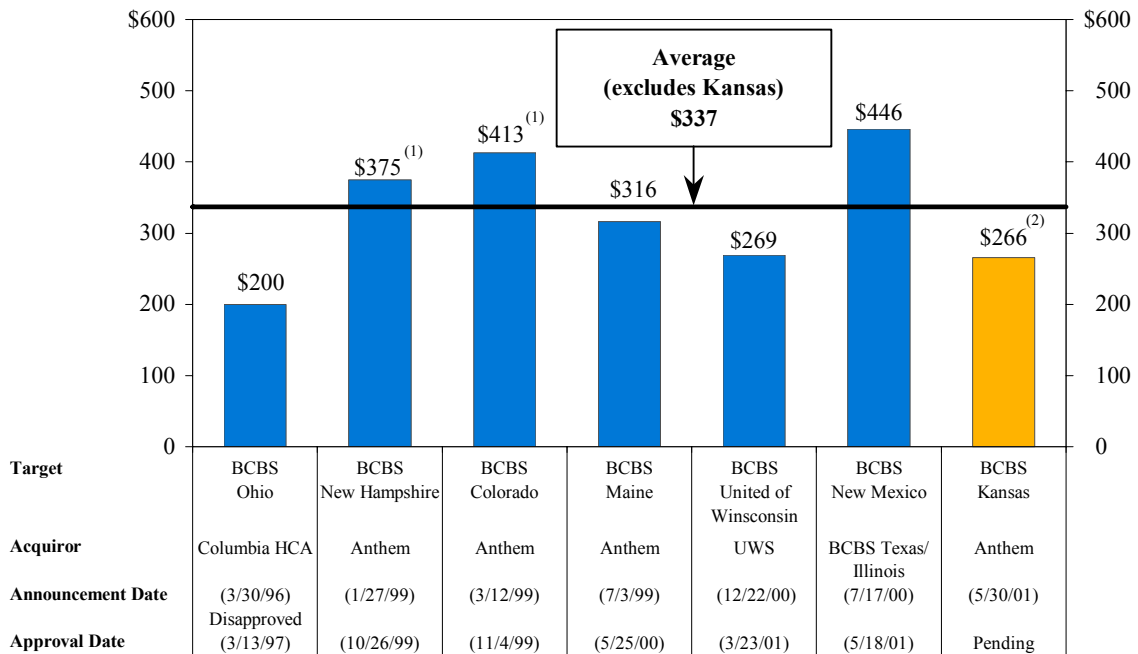
## **B. Comparable M&A Transaction Analysis**

1. Bear Stearns noted that none of the transactions reviewed were identical to the Transaction. Bear Stearns further noted that the analysis of merger and acquisition transactions of comparable companies necessarily involves complex considerations and judgments concerning differences in financial and operating characteristics and other factors that would necessarily affect the acquisition value of BCBSKS as compared to the acquisition value of any other comparable company in general and the transactions below in particular.
2. Bear Stearns reviewed nine publicly announced transactions involving BCBSA licensees in the last couple of years.
3. For each of the transactions, we calculated the multiples of transaction value to (i) Last Twelve Months (“LTM”) revenues and (ii) total members.
4. These precedent transactions were grouped into Low Performers and High Performers.
5. M&A Transaction Low Performers - Includes six transactions involving poorly performing targets that were reporting losses and were under capitalized. All the targets were mutual companies and Anthem was the acquirer in three of the transactions. Bear Stearns compared the M&A multiples of these transactions to BCBSKS’ transaction multiples based on only the \$190 million purchase price so that the multiples are not impacted by BCBSKS’ excess capital. Bear Stearns’ analysis indicates that the M&A multiples implied by the Purchase Price are closer to the low end of the range of the Low Performer M&A multiples.

### Low Performer Revenue Multiples



### Low Performer Price Per Total Member



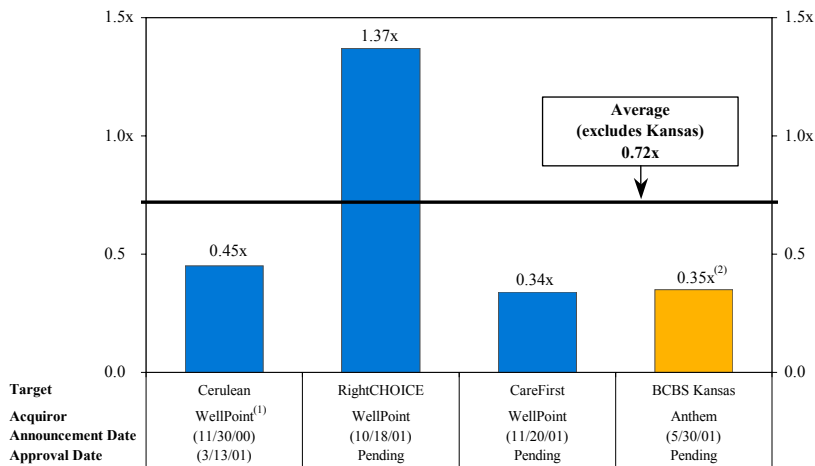
Note: Multiples based on total consideration as of announcement date. Revenue and member information from press releases for private transactions and Company reports and proxy statements for public transactions.

(1) Includes surplus notes.

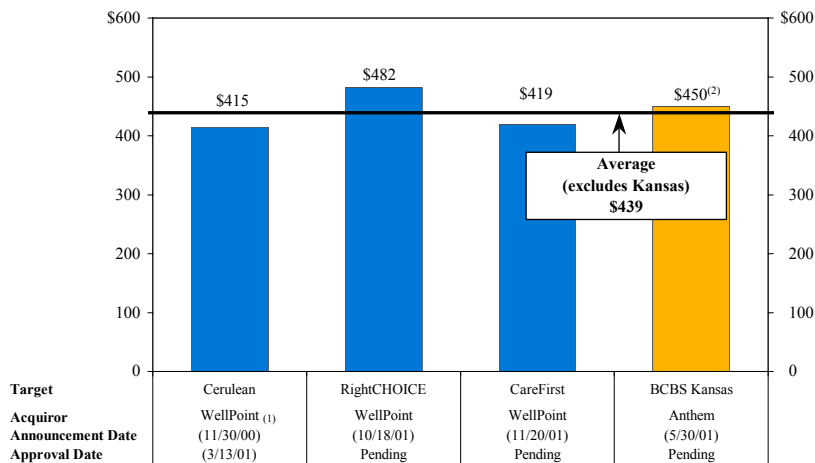
(2) Based on the \$190 million Purchase Price.

6. M&A Transaction High Performers - Includes acquisitions by WellPoint of (i) RightCHOICE, a public Blue company in Missouri, (ii) Cerulean, a mutual Blue company in Georgia and (iii.) CareFirst, a not-for-profit Blue company in Northern Virginia, DC, Maryland and Delaware. All three companies were generating positive underwriting margins at the time each transaction was announced and were at least adequately capitalized. Since these companies have some level of excess capital, Bear Stearns compared the M&A multiples of these transactions to BCBSKS' transaction multiples based on the total of the \$190 million purchase price and the anticipated \$131 million of excess capital at closing estimated by management. Bear Stearns' analysis indicates that the M&A multiples implied by the Aggregate Consideration are closer to the low end of the range of the High Performer M&A multiples.

**Premium Revenue Multiples**



**Price Per Total Member**



Note: Multiples based on total consideration as of announcement date. Revenue and member information from press releases and proxy statements. Total members equals risk and non-risk health members.

(1) WellPoint changed its bid from \$500 million to \$700 million on November 30, 2000.

(2) Based on \$321 million Aggregate Consideration consisting of the \$190 million Purchase Price and the \$131 million Special Distribution.

### C. Discounted Cash Flow

1. Bear Stearns noted that a discounted cash flow analysis is highly dependent on growth rates and margin assumptions relating to the underlying projections and that such projections are difficult to forecast due to the rapidly changing nature of BCBSKS' business plan and the capital markets climate. Consequently, Bear Stearns observed that the resulting discounted cash flow valuation is inherently theoretical due to the difficulty in forecasting projected operating results as well as assumptions relating to, among other factors, availability of sufficient capital, cost of such capital and assessing terminal multiples in the final year of the projection period.

<u>Management Projections</u>	(\$ in millions)				
	<i>Projected</i>				
	<i>Year Ended December 31,</i>				
<b>Income Statement</b>	2001 <sup>(1)</sup>	2002 <sup>(1)</sup>	2003 <sup>(1)</sup>	2004 <sup>(1)</sup>	2005 <sup>(1)</sup>
Total Insurance Revenue	\$1,014.5	\$1,136.4	\$1,279.7	\$1,427.3	\$1,580.2
<i>Growth</i>	16.2%	12.0%	12.6%	11.5%	10.7%
Healthcare Expense	931.4	1,030.5	1,147.0	1,277.0	1,406.0
<i>Healthcare Expense Ratio</i>	91.8%	90.7%	89.6%	89.5%	89.0%
Administrative Expense	110.5	128.4	142.8	155.5	168.3
<i>Administrative Expense Ratio</i>	10.9%	11.3%	11.2%	10.9%	10.7%
<b>Underwriting Income (Loss)</b>	<b>(\$27.4)</b>	<b>(\$22.5)</b>	<b>(\$10.1)</b>	<b>(\$5.2)</b>	<b>\$5.9</b>
<i>Underwriting Margin</i>	-2.7%	-2.0%	-0.8%	-0.4%	0.4%
Net Investment Income	23.5	21.6	23.7	26.2	28.8
Operating Income (Loss)	(\$10.6)	(\$0.9)	\$13.6	\$21.0	\$34.7
<i>Operating Income Margin</i>	-1.0%	-0.1%	1.0%	1.4%	2.2%
Net Income (Loss)	(\$6.9)	(\$0.9)	\$8.6	\$13.4	\$22.3
<i>Net Income Margin</i>	-0.7%	-0.1%	0.7%	0.9%	1.4%
<b>Balance Sheet</b>					
Investment Portfolio	\$336.2	\$386.4	\$447.8	\$512.9	\$579.9
Total Assets	\$592.7	\$657.0	\$735.3	\$817.9	\$902.3
Reserves	\$193.6	\$214.2	\$238.4	\$265.4	\$292.2
Policyholders' Surplus	\$155.0	\$170.5	\$192.0	\$214.1	\$237.0

(1) Underwriting income (loss) based on documents Bates BCTOPDR006108-6112.  
Balance sheet assumptions consistent with 2000 audited financial statements.

2. The above Marketing and Finance Task Force Projections were prepared by BCBSKS management and were provided to Bear Stearns on November 5<sup>th</sup>. These projections were prepared by BCBSKS solely to meet a due diligence request from Bear Stearns and BCBSKS management heavily discounted their reliability.
3. These projections are based on BCBSKS' current operating philosophy of pricing its products to grow membership and to provide financial security.
4. Bear Stearns performed a discounted cash flow value analysis based on the projections above. The discount rates and terminal multiples ranges used in the analysis were estimated based on data for the companies used in the Comparable Company Analysis.

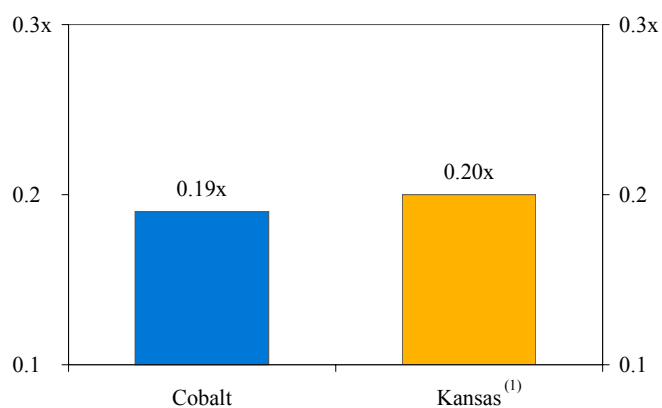
The range of discount rates used was 11% to 15% and the range of terminal multiples of net income used was 14x to 16x.

5. Bear Stearns' analysis indicated an enterprise value ranging from \$280 to \$334 million compared to the Aggregate Consideration which assumes the Special Distribution is \$131 million.

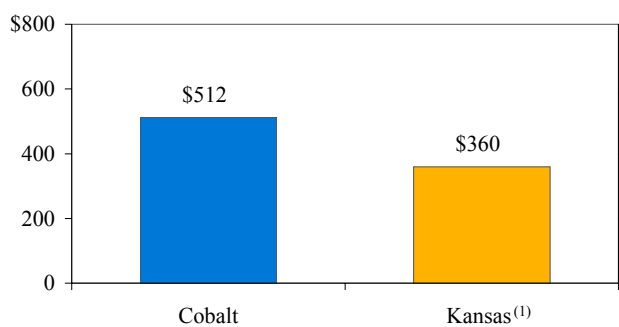
#### **D. Comparable Company Analysis**

1. No company utilized in the peer group comparison is identical to BCBSKS, and accordingly, Bear Stearns' analysis of comparable companies necessarily involved complex considerations and judgments concerning differences in financial and operating characteristics and other factors which would necessarily affect the relative transaction values of BCBSKS and of the companies to which it was compared.
2. Bear Stearns compared BCBSKS to all of the publicly traded licensees of the BCBSA trademark along with one large public managed care company.
3. For the comparable companies, we calculated multiples of enterprise value to (i) LTM premium revenues, (ii) risk members and (iii) total members.
4. These comparable companies were grouped into Low Performers and High Performers.
5. Comparable Company Low Performer - The only Low Performer is Cobalt which was created in 2001 through the merger of the Blue plan of Wisconsin, a mutual company, and United Wisconsin Services, a public diversified managed care company. The Blue plan of Wisconsin has negative underwriting margins and only recently became part of a public company. We believe that companies with a ratio of book equity to LTM revenues of at least 15% could potentially have excess capital but Cobalt's ratio is only 14%. Bear Stearns compared the Cobalt trading multiples to BCBSKS' transaction multiples based on only the \$190 million purchase price so that the multiples are not impacted by BCBSKS' excess capital. Bear Stearns' analysis indicates that the revenue M&A multiple implied by the Purchase Price is consistent with the Cobalt trading multiple and the member M&A multiples implied by the Purchase Price are below the Cobalt trading member multiples.

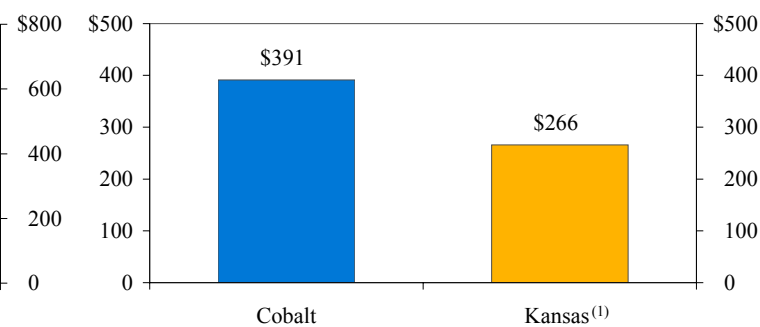
### Enterprise Value to LTM Premium Revenue Multiples



### Enterprise Value to Risk Member



### Enterprise Value to Total Member

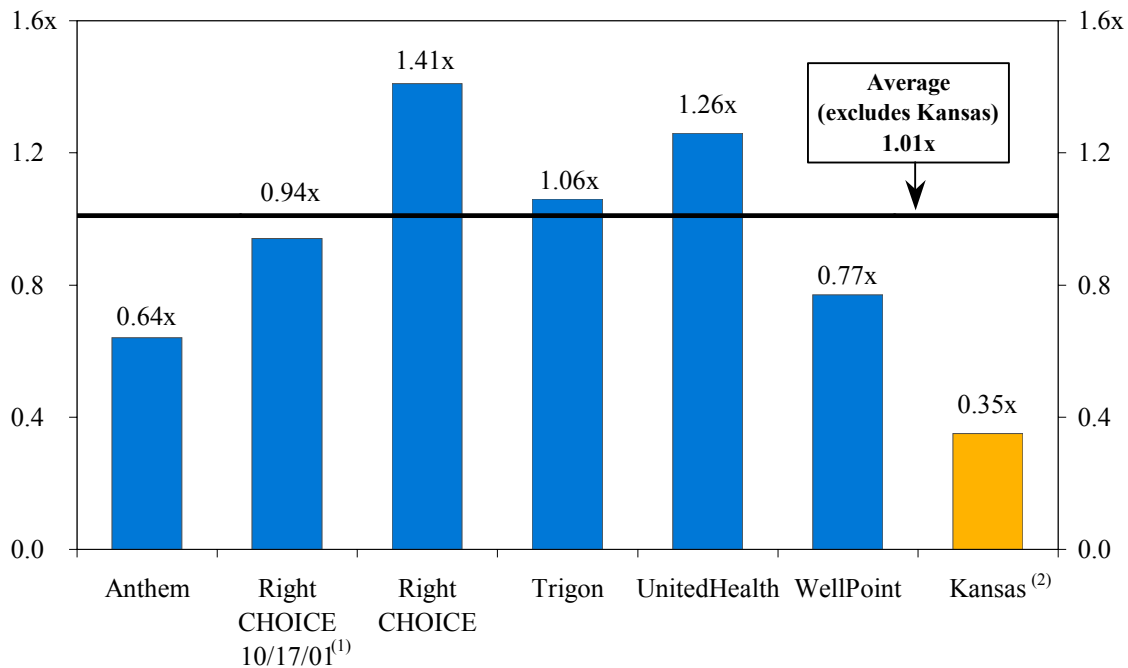


Note: Stock prices as of December 10, 2001. Data from 10-Q and proxy statements. Total members equals risk and non-risk health members.

(1) Based on the \$190 million Purchase Price.

6. Comparable Company High Performers - Includes Anthem, RightCHOICE both before and after its sale to WellPoint on October 18<sup>th</sup>, Trigon, UnitedHealth and WellPoint. In 2001, these companies are projecting underwriting margins between 2.7% and 6.4%. With the exception of Anthem which went public on October 29<sup>th</sup>, the remaining companies have been public for a number of years. These companies all have book equity to LTM revenue ratios exceeding 15% (range is 16% to 34%) indicating these companies could potentially have some level of excess capital. Therefore, Bear Stearns compared the trading multiples of these companies to BCBSKS' transaction multiples based on the total of the \$190 million purchase price and the anticipated \$131 million of excess capital at closing estimated by management. Bear Stearns' analysis indicates that the M&A multiples implied by the Aggregate Consideration are below the trading multiples of the High Performer trading multiples.

**High Performer Enterprise Value to LTM Premium Revenue Multiples**

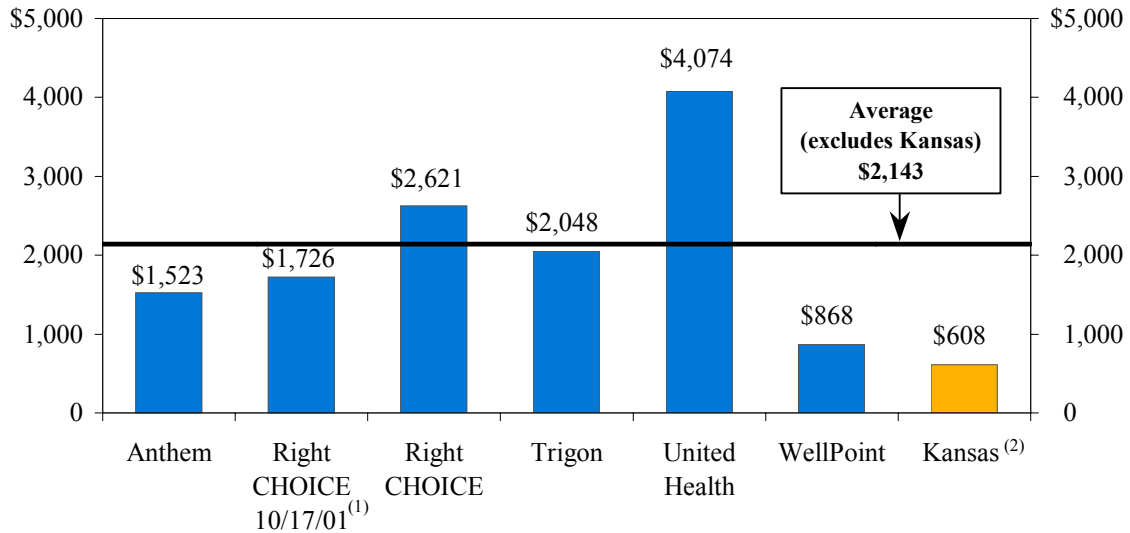


Note: Stock prices as of December 10, 2001. Data from 10-Q and proxy statements.

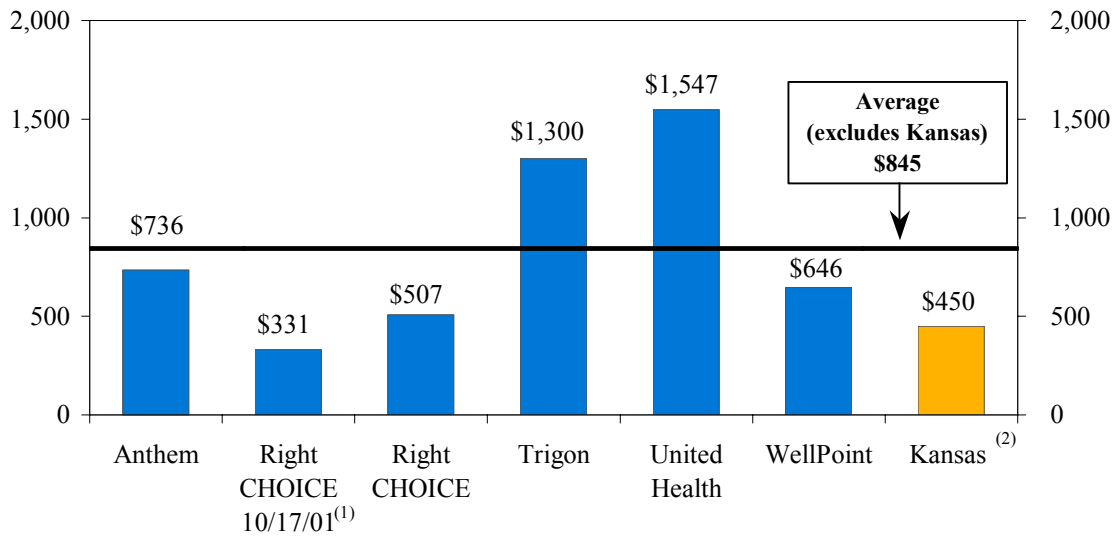
(1) RightCHOICE was acquired by WellPoint on October 18, 2001.

(2) Based on \$321 million Aggregate Consideration consisting of the \$190 million Purchase Price and the \$131 million Special Distribution.

**High Performer Enterprise Value to Risk Member Multiples**



**High Performer Enterprise Value to Total Member Multiples**



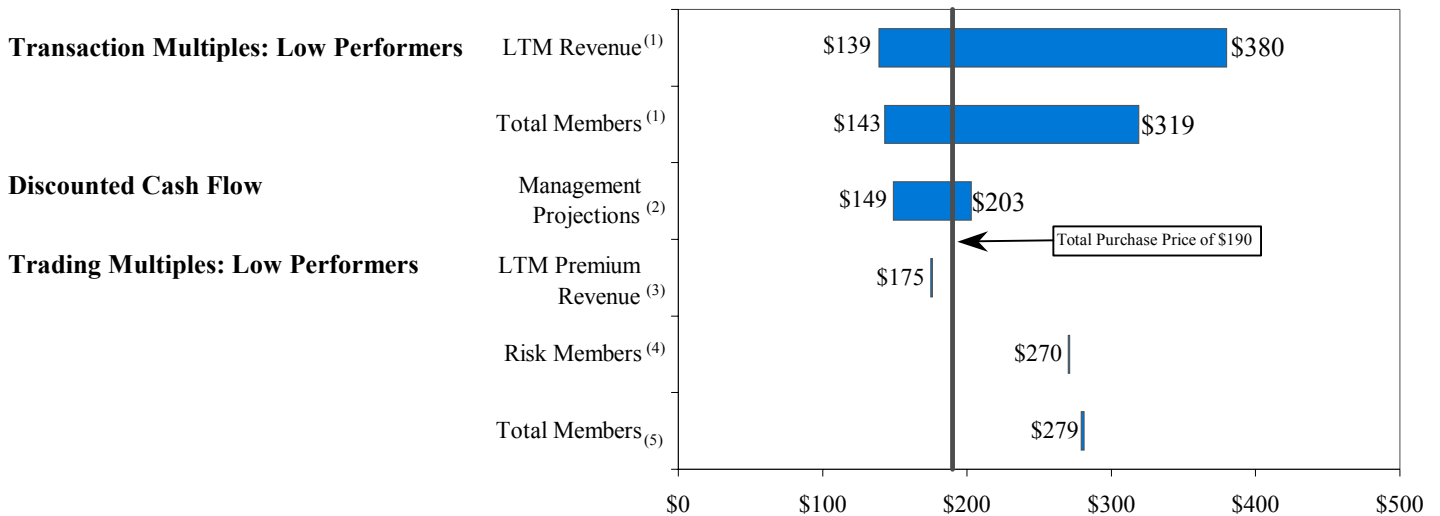
Note: Stock prices as of December 10, 2001. Data from 10-Q and proxy statements. Total members equals risk and non-risk health members.

(1) RightCHOICE was acquired by WellPoint on October 18, 2001.

(2) Based on \$321 million Aggregate Consideration consisting of the \$190 million Purchase Price and the \$131 million Special Distribution.

## E. Valuation Summary

(\$ in millions)



Note: Stock prices as of December 10, 2001. Transaction multiples based on total consideration as of announcement date.

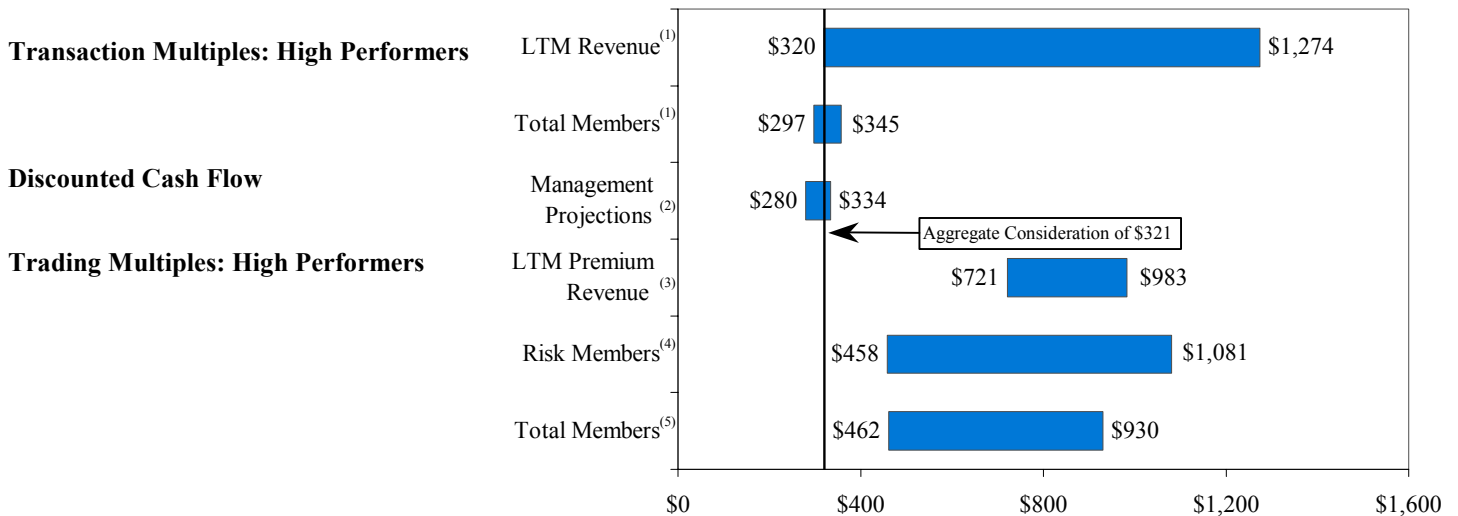
(1) Based on LTM BCBSKS revenues and total members and the Ohio and Colorado or New Mexico transaction multiples.

(2) Based on revenue and underwriting assumptions as reported by BCBSKS management on Bates BCTOPDR006108-6112; excluding \$131M of estimated excess capital.

(3) Based on LTM BCBSKS revenues from the policyholder information statement and the Cobalt trading multiple.

(4) Based on 528K risk members which excludes 187K ASO members based on discussions with Wasserstein and the Cobalt trading multiple.

(5) Based on 715K total members from the policyholder information statement and the Cobalt trading multiple.



Note: Stock prices as of December 10, 2001. Transaction multiples based on total consideration as of announcement date.

(1) Based on LTM BCBSKS revenues and total members and the Cerulean or CareFirst and RightCHOICE transaction multiples.

(2) Based on revenue and underwriting assumptions as reported by BCBSKS management on Bates BCTOPDR006108-6112; including \$131M of estimated excess capital.

(3) Based on LTM BCBSKS revenues from the policyholder information statement and WellPoint and Trigon trading multiples.

(4) Based on 528K risk members which excludes 187K ASO members based on discussions with Wasserstein and the WellPoint and Trigon trading multiples.

(5) Based on 715K total members from the policyholder information statement and the WellPoint and Trigon trading multiples.

## VI. Background on BCBSKS

The description below is based solely on a review of materials provided to Bear Stearns by Wasserstein and BCBSKS.

1. BCBSKS is the oldest and largest health benefits company in the state of Kansas with 2,100 employees.
2. Its service area includes all of Kansas except two counties in the Kansas City metropolitan area.
3. More than 715,000 Kansas residents have private health coverage insured or administered by BCBSKS representing a 35% market share in Kansas.
4. BCBSKS, an independent licensee of the Blue Cross Blue Shield Association (“BCBSA”), offers a diverse range of health benefit products to group and non-group customers.
5. BCBSKS also has two non-health insurance subsidiaries. Advance Insurance Company offers life, disability, dental and other non-health ancillary insurance products. Administrative Services of Kansas (ASK) is a claims clearinghouse for BCBSKS and other insurers.
6. Leading competitors for BCBSKS are provider-owned organizations that offer insurance products and network rentals.
7. In 1999, BCBSKS settled a case brought by the Kansas Attorney General regarding a charitable obligation to the state of Kansas by paying \$75.0 million to a charitable foundation.
8. BCBSKS had LTM premium revenues and net loss as of June 30, 2001 of \$929.8 million and (\$7.0) million, respectively. As of June 30, 2001, policyholder surplus was \$310.4 million.

## VII. Background on Anthem

The description below is based solely on a review of materials provided to Bear Stearns by Wasserstein and BCBSKS and Anthem's public documents.

1. Anthem, a publicly traded insurance company headquartered in Indianapolis with 14,800 employees, is one of the nation's leading health benefits companies serving over seven million members in Indiana, Kentucky, Ohio, Connecticut, New Hampshire, Maine, Colorado and Nevada.
2. Anthem's reportable segments are three geographic regions; (i.) The Midwest which includes Indiana, Kentucky and Ohio, (ii.) The East, which includes Connecticut, New Hampshire and Maine and (iii.) The West, which includes Colorado and Nevada.
3. Anthem, an independent licensee of BCBSA, offers a diverse range of health benefit products to group and non-group customers and provides administrative services and specialty products.
4. Anthem went public on October 29, 2001 raising \$2.2 billion through the issuance of approximately 55.2 million shares of common stock and 4.6 million units of convertible securities with most proceeds going to Anthem policyholders that elect to receive cash rather than stock in Anthem's demutualization.
5. After the offering, there was approximately 103 million shares outstanding creating an initial market capitalization of \$3.7 billion based on the IPO price of \$36 a share.
6. Anthem had LTM revenue and net income as of June 30, 2001 of \$9.6 billion and \$278.7 million, respectively. As of June 30, 2001, policyholder surplus was \$2.1 billion.

## VIII. Additional Matters Outside the Scope of The Fairness Opinion

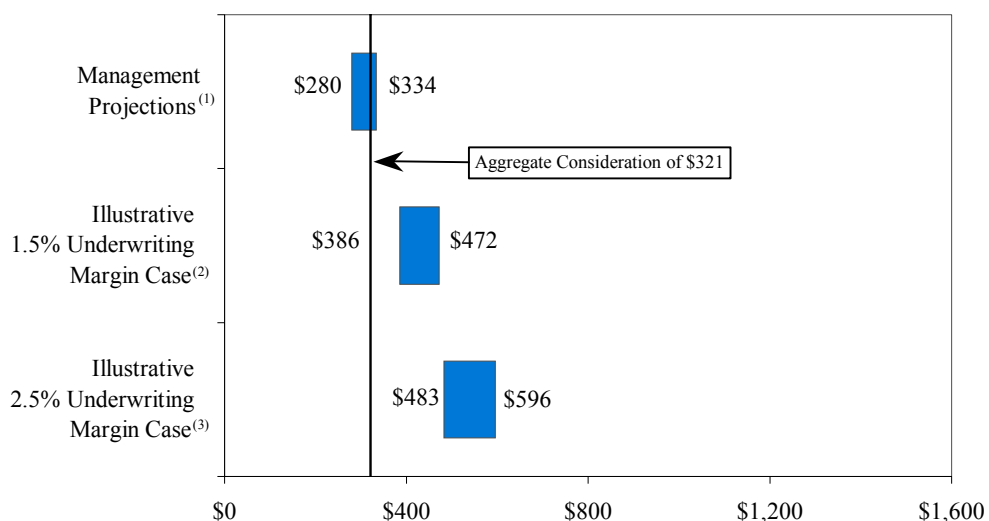
The KID requested that Bear Stearns perform the following additional discounted cash flow analysis. The following analysis was performed solely to meet this request from the KID and is outside the scope of the Fairness Opinion. We do not express any opinion regarding the following analysis.

BCBSKS provided us with the Marketing and Finance Task Force Projections which we relied upon to perform our valuation analysis as discussed in Section V and to issue our Fairness Opinion as discussed in Section IX. Those projections showed underwriting margins growing to 0.4% by 2005. The KID requested that Bear Stearns perform a discounted cash flow analysis assuming underwriting margins grew to 1.5% by 2005 or 2.5% by 2005. BCBSKS has not been able to achieve 1.5% or 2.5% underwriting margins over the past few years and has told us that they do not believe that they could achieve that level of underwriting margin in the future and that they believe underwriting margins of 0.4% in 2005 is the best that could be achieved. Therefore, Bear Stearns has no reason to believe that margins greater than 0.4% could be achieved. Of course, if we were requested to assume lower margins in the future than those in the Marketing and Finance Task Force Projections, valuation ranges would be lower.

The following graph estimates a range of possible values for BCBSKS based on (i) the Marketing and Finance Task Force Projections, (ii) a case requested by the KID, for illustrative purposes only, assuming underwriting margins growing to 1.5% by 2005 and (iii) a case requested by the KID, for illustrative purposes only, assuming underwriting margins growing to 2.5% by 2005.

### Illustrative Range of Discounted Cash Flow

(\$ in millions)



- (1) Based on underwriting assumptions in the Marketing and Finance Task Force Projections on Bates BCTOPDR006108-6112 which assume an underwriting margin of 0.4% in 2005.
- (2) Assumes underwriting margins increase equally from 2001 to 2005 so that the underwriting margin increases to 1.5% in 2005.
- (3) Assumes underwriting margins increase equally from 2001 to 2005 so that the underwriting margin increases to 2.5% in 2005.

## IX. The Fairness Opinion

### **A. Definition**

1. Professional judgment offered for a fee by an investment banker regarding only the fairness, from a financial point of view, of the consideration being received in a change of control transaction as of the date of the written opinion.

### **B. Issues NOT Covered by a Fairness Opinion**

1. Does not constitute a recommendation to the KID or BCBSKS as to whether to approve the Transaction.
2. Does not address the underlying business decision of BCBSKS' board to recommend this Transaction.
3. Does not address the underlying business decision of BCBSKS to enter into the Alliance Agreement or the relative merits of the Transaction as compared to any other alternative business strategy that might exist for BCBSKS or the effects of any other transaction in which BCBSKS might engage.
4. Does not express any view on any other term in the Alliance Agreement other than the Aggregate Consideration offered to eligible policyholders, as a group.
5. Does not express an opinion regarding Anthem's or BCBSKS' current or future claims paying ability.
6. Does not express an opinion regarding the financial projections, forecasts and analyses of BCBSKS and Anthem provided to Bear Stearns or the assumptions upon which they are based.
7. Bear Stearns has not performed or obtained any independent evaluation or appraisal of the assets or liabilities (contingent or otherwise) of BCBSKS.
8. Is not a recommendation to any policyholder as to how to vote with respect to the Transaction.
9. Does not address which of BCBSKS' policyholders are eligible to receive compensation as part of this Transaction.
10. Does not address the fairness of the consideration to be paid to any individual policyholder or to any class of policyholders.
11. Does not express any opinion with respect to whether the Transaction complies with any aspect of Kansas State law.

### **C. Other Considerations**

1. The preparation of a fairness opinion is a complex process that involves various judgments and determinations as to the most appropriate and relevant methods of financial and valuation analysis and the application of those methods to the particular circumstances.
2. Bear Stearns believes that its analysis must be considered as a whole and that selecting portions of its analyses and the factors considered, without considering all of the analyses and factors, would create a misleading and incomplete view of the processes underlying its opinion. Bear Stearns did not form any opinions as to whether any individual analysis or factor, whether positive or negative, considered in isolation, supported or failed to support its opinion. In arriving at its opinion, Bear Stearns did not assign any particular weight to any analysis or factor considered, but rather made qualitative judgments based upon its experience in providing such opinions and on then-existing economic, monetary, market and other conditions as to the significance of each analysis and factor.
3. Any assumed estimates implicitly contained in Bear Stearns' opinion or relied upon by Bear Stearns in rendering its opinion do not necessarily reflect actual values or predict future results or values. Any estimates relating to the value of a business do not purport to be appraisals or to necessarily reflect the prices at which companies may actually be sold.

December 14, 2001

Kansas Department of Insurance  
420 SW 9<sup>th</sup> Street  
Topeka, KS 66612-1678

Ladies and Gentlemen:

We understand that Blue Cross and Blue Shield of Kansas (“BCBSKS”), pursuant to the Plan of Conversion adopted by the BCBSKS Board of Directors (the “Board”) on October 25, 2001, as amended (the “Plan”), is proposing to convert (the “Conversion”) from a mutual insurance company to a stock company and subsequently sell newly-issued shares of common stock to Anthem Insurance Company, Inc., an Indiana mutual insurance company (“Anthem”), Anthem West, Inc., an Indiana company and wholly-owned subsidiary of Anthem, or the public holding company to be formed in connection with a demutualization of Anthem to hold all of the shares of its common stock (such sale in any event, the “Sale”). In the Conversion, all policyholders’ membership interests in BCBSKS will be extinguished. Eligible policyholders will receive aggregate consideration consisting of: (i) a special distribution previously declared by the Board and payable to eligible policyholders upon consummation of the Sale, that will be equal to the amount, if any, by which the consolidated closing book value of BCBSKS, as defined in the Plan, at consummation of the Conversion exceeds \$155,000,000, which BCBSKS currently estimates to be \$131,000,000 (the “Special Distribution”) and (ii) up to \$190,000,000, \$142,000,000 of which will be paid to eligible policyholders upon consummation of the Sale and \$48,000,000 of which will be deposited into an escrow fund, subject to later distribution to eligible policyholders as more fully described in the Plan and Alliance Agreement (as defined below). Collectively, the Conversion, the Sale and Special Distribution are referred to herein as the “Transaction” and the amounts to be received by eligible policyholders pursuant to the Sale and the Special Distribution are referred to herein as the “Aggregate Consideration”.

You have asked us to render our opinion as to whether the Aggregate Consideration to be received by eligible policyholders of BCBSKS in the Transaction is fair, from a financial point of view, to such policyholders, as a group.

In the course of performing our review and analyses for rendering this opinion, we have:

- reviewed the Alliance Agreement dated November 9, 2001 (the “Alliance Agreement”) by and between BCBSKS and Anthem;
- reviewed the Policyholder Information Statement dated November 9, 2001 (the “Policyholder Information Statement”);
- reviewed the Plan;

- reviewed audited and unaudited financial statements of BCBSKS for the years ended December 31, 1998, 1999 and 2000 and the quarters ended March 31, 2001, June 30, 2001 and September 30, 2001;
- reviewed audited and unaudited financial statements of Anthem for the years ended December 31, 1998, 1999 and 2000 and the quarters ended March 31, 2001, June 30, 2001 and September 30, 2001;
- reviewed annual statutory financial statements for the years ended December 31, 1998, 1999 and 2000 and quarterly statutory financial statements for the quarters ended March 31, 2001 and June 30, 2001 for BCBSKS and Anthem;
- reviewed certain operating and financial information, including projections for the five years ended December 31, 2005, provided to us by BCBSKS management relating to BCBSKS' business and prospects;
- met with certain members of BCBSKS' senior management to discuss BCBSKS' business, operations, historical and projected financial results and future prospects;
- met with certain members of Anthem's senior management to discuss Anthem's business, operations, historical and projected financial results and future prospects;
- met with the Kansas Department of Insurance (the "KID") and the legal, accounting, actuarial and tax advisors hired by the KID to discuss a draft of the Conversion Order, Alliance Agreement, Policyholder Information Statement and other appropriate regulatory guidelines;
- reviewed publicly available financial data, stock market performance data and trading multiples of companies which we deemed generally comparable to BCBSKS and Anthem;
- reviewed the terms of recent acquisition transactions of companies which we deemed generally comparable to BCBSKS and Anthem;
- performed discounted cash flow analyses based on the projections for BCBSKS furnished to us ;
- conducted such other studies, analyses, inquiries and investigations as we deemed appropriate.

We have relied upon and assumed, without independent verification, the accuracy and completeness of the financial and other information, including without limitation the projections and actuarial reports, provided to us by BCBSKS and Anthem. With respect to BCBSKS' and Anthem's projected financial condition and results, we have relied upon representations that they have been reasonably prepared on bases reflecting the best currently available estimates and judgments of the senior managements of BCBSKS and Anthem as to the expected future performance of BCBSKS and Anthem, respectively, including the closing book value of BCBSKS at consummation of the Conversion. In the case of BCBSKS, we have relied on representations that such projections are based on BCBSKS' current not-for-profit operating model. We have not assumed any responsibility for the independent verification of any such

information or of the projections and estimates provided to us, and we have further relied upon the assurances of the senior managements of BCBSKS and Anthem that they are unaware of any facts that would make the information, projections and estimates provided to us incomplete or misleading.

In arriving at our opinion, we have not performed or obtained any independent appraisal of the assets or liabilities (contingent or otherwise) of BCBSKS and Anthem, nor have we been furnished with any such appraisals. We have assumed that the Transaction will be consummated in a timely manner and in accordance with the terms of the Plan and the Alliance Agreement without any limitations, restrictions, conditions, amendments or modifications, regulatory or otherwise, that collectively would have a material effect on BCBSKS or Anthem. In addition, we have assumed, with the consent of BCBSKS, that any amounts deposited into the escrow fund referred to above but not ultimately distributed to eligible policyholders will be paid in connection with satisfying BCBSKS' obligations rising out of the Contingent Litigation Matter (as defined in the Alliance Agreement). We also have assumed, with the consent of BCBSKS, that the Special Distribution declared by the Board will be \$131,000,000. Neither you nor BCBSKS have asked us to solicit indications of interest for BCBSKS from third parties. We did not participate in any solicitations of interest for BCBSKS nor does this letter express any views as to whether any solicitation process conducted by BCBSKS and its financial advisors was reasonably likely to have resulted in eligible policyholders receiving maximum value in the Transaction. This opinion does not address which of BCBSKS' policyholders constitute eligible policyholders entitled to receive consideration as part of this Transaction, nor does it address the fairness of the consideration to be paid to any individual policyholder or to any class of policyholders. Therefore, we do not express an opinion as to the allocation of consideration among the policyholders of BCBSKS. We did not review and do not express any opinion with respect to whether the Transaction complies with any aspect of Kansas State law.

We have acted as a financial advisor to the KID in connection with the Transaction and will receive a customary fee for such services. In addition, we advised a third party in connection with its exploration of a possible business combination transaction with BCBSKS for which we received a customary fee for such service. This exploration was abandoned by such third party prior to our engagement by KID. In the ordinary course of business, Bear Stearns may actively trade the equity or debt securities of Anthem for our own account and for the account of our customers and, accordingly, may at any time hold a long or short position in such securities.

It is understood that this letter is intended solely for the benefit and use of the KID and does not constitute a recommendation to the KID as to whether to approve the Transaction or to any policyholders of BCBSKS as to how to vote in connection with the Transaction. This opinion does not address BCBSKS' underlying business decision to pursue the Transaction, the relative merits of the Transaction as compared to any alternative business strategies that might exist for BCBSKS or the effects of any other transaction in which BCBSKS might engage. This letter is not to be used for any other purpose, or be reproduced, disseminated, quoted from or referred to at any time, in whole or in part, without our prior written consent; provided, however, that this letter in its entirety may be disclosed at a public hearing conducted by the KID. Our opinion is subject to the assumptions and conditions contained herein and is necessarily based on economic, market and other conditions, and the information made available to us, as of the date hereof. We

assume no responsibility for updating or revising our opinion based on circumstances or events occurring after the date hereof.

Based on and subject to the foregoing, it is our opinion that, as of the date hereof, the Aggregate Consideration to be received by the eligible policyholders of BCBSKS in the Transaction is fair, from a financial point of view, to such policyholders, as a group.

Very truly yours,

BEAR, STEARNS & CO. INC.

By: \_\_\_\_\_  
David M. Platter  
Senior Managing Director