

BEFORE THE COMMISSIONER OF INSURANCE OF THE STATE OF KANSAS

In the Matter of the Plan of Conversion of
BLUE CROSS AND BLUE SHIELD OF
KANSAS, INC.

Docket No. 3014-DM

WRITTEN STATEMENT OF PAUL G. ADAMS

I. Introduction

I am Paul G. Adams, a Managing Director of the investment banking firm Dresdner Kleinwort Wasserstein, Inc. (“DrKW”). I have held that position since 1996 and have been the head of the Firm’s Health Care Group since July of 1998. I focus on health care services and insurance practices and specialize in mergers, acquisitions and financings. Prior to joining DrKW, I was a Vice President in the Mergers and Acquisitions Group of Kidder, Peabody & Co., Inc. specializing in health care transactions. Prior to that, I was in the Private Equity Group of Bankers Trust which sponsored leveraged buyouts, and I was an insurance industry specialist with Arthur Andersen & Co. and Coopers & Lybrand LLP. I hold a B.S. in Accounting from the University of Illinois and an M.B.A. from the University of Chicago.

I have been involved in a number of the major transactions in the health services and insurance sector. Among them, I was the leading financial advisor to the following companies:

- Aetna in its \$8.3 billion acquisition of U.S. Healthcare;
- FHP in its \$2.1 billion merger with PacifiCare;
- TakeCare in its \$1.1 billion merger with FHP;

- Aetna in its \$1.05 billion acquisition of NYLCare;
- Aetna in its \$1.0 billion acquisition of Prudential HealthCare;
- The California Wellness Foundation (the majority shareholder of Health Net) in the \$640 million merger of Health Net and QualMed; and
- NovaCare in its divestitures of its Orthotics & Prosthetics Division, its Long-term Care Services Division, its majority ownership in NovaCare Employee Services, and its Physical Rehabilitation and Occupational Health Division.

In the not-for-profit sector, my recent transactions include the sale of Kaiser Permanente's Texas operations and Blue Cross Blue Shield of New Hampshire's acquisition of Matthew Thornton Health Plan and subsequent divestiture to Anthem. I was also the financial advisor to FPA in its restructuring.

A. Dresdner Kleinwort Wasserstein's Qualifications

DrKW is an investment banking firm engaged, among other things, in the valuation of businesses and their securities in connection with mergers and acquisitions, negotiated underwritings, competitive biddings, secondary distributions of listed and unlisted securities, private placements and valuations for corporate and other purposes. Blue Cross and Blue Shield of Kansas, Inc. ("BCBSKS" or the "Company") selected us to advise it on pursuing a strategic partnership because we are a nationally recognized investment banking firm and because of our experience in the valuation of companies, including companies in the healthcare industry.

Our health care investment banking practice consists of 20 professionals in the U.S. and Europe. The team has been responsible for over \$60 billion in merger and acquisition advisory assignments with a wide range of transaction sizes. Although our advisory capabilities cover the full breadth of health care products and services, the

group's primary focus has been in health benefits, as indicated by the following

illustrative transactions:

- Represented Aetna in its \$8.3 billion merger with U.S. Healthcare;
- Represented SmithKline Beecham in the \$2.3 billion acquisition of Diversified Pharmaceutical Services (DPS) and in the formation of a strategic alliance with the former parent of DPS, United HealthCare;
- Represented FHP in its \$2.1 billion merger with PacifiCare;
- Represented Aetna in its \$1.05 billion acquisition of NYLCCare;
- Represented Aetna in its \$1.0 billion acquisition of Prudential HealthCare;
- Represented Aetna, Inc. in its divestiture of the commercial operations of NYLCCare Health Plans of the Gulf Coast and NYLCCare Health Plans of the Southwest to Health Care Service Corporation;
- Represented Aetna in evaluating the fairness of the repurchase of the equity held by Aetna in Criterion Communications by Criterion;
- Represented Aetna in the consolidation of the legal entities comprising its HMO business;
- Represented Aetna in its acquisition of a minority interest in Med Southwest, Inc. from Baylor Health Care System;
- Represented Blue Cross Blue Shield of New Hampshire in its sale to Anthem Inc.;
- Represented Blue Cross Blue Shield of New Hampshire in its acquisition of Matthew Thornton Health Plan;
- Represented The California Wellness Foundation in the public offering of a partial stake in Health Systems International;
- Represented Medicon in its sale of a minority interest to Chemical Venture Partners and JH Whitney;
- Represented Merit Behavioral Care (KKR) in its acquisition of CMG Health;
- Represented Kaiser Foundation Health Plan in the divestiture of its health plan operations in Texas;
- Represented PARTNERS Health Plan of Pennsylvania in its sale to Coventry;
- Represented Preferred Provider Organization of Michigan in its sale to Blue Cross Blue Shield of Michigan; and

- Represented Prescription Delivery Systems in its sale to Diversified Pharmaceutical Services, a unit of SmithKline Beecham.

II. Summary of Dresdner Kleinwort Wasserstein’s Engagement by BCBSKS

On May 30, 2001, BCBSKS entered into an Alliance Agreement with Anthem Insurance Companies, Inc. (“Anthem”), dated as of May 30, 2001, as amended as of September 28, 2001 and November 9, 2001 (the “Alliance Agreement”), to convert from a mutual insurance company to a stock insurance company and to simultaneously sell 100% of its stock to Anthem West, Inc., a subsidiary of Anthem. On May 24, 2001, as part of our engagement by BCBSKS, DrKW issued an opinion, based upon the matters considered, the limits of review and the qualifications and assumptions, all as set forth in such opinion, as to the fairness, from a financial point of view, of the Purchase Price (as defined in that opinion) payable to BCBSKS Eligible Policyholders pursuant to the terms of the Alliance Agreement.¹

On October 25, 2001, the BCBSKS Board of Directors unanimously adopted a Plan of Conversion to effect its conversion to a stock insurance company. The Plan of Conversion is contingent upon the sale of all of the shares of BCBSKS common stock to Anthem at the same time as the conversion. The terms and conditions of the Conversion and the sale of the Common Stock at the same time as the Conversion to the Purchaser are set forth in more detail in the Alliance Agreement and the Plan of Conversion.

At the request of the Board and as required by the Plan of Conversion, we issued to the BCBSKS Board a second opinion, dated November 9, 2001, confirming, as of the

¹ Capitalized terms used in this statement, unless otherwise defined herein, have the meanings set forth in the Alliance Agreement.

date of such opinion, and based upon the matters considered, the limits of review, and the qualifications and assumptions all as set forth in the November 9, 2001 fairness opinion, the fairness, from a financial point of view, of the aggregate of the Purchase Price and the Special Distribution payable to Eligible Policyholders and into the Escrow Fund for the benefit of Eligible Policyholders of BCBSKS, pursuant to the terms of the Alliance Agreement and the Plan of Conversion. I understand that a copy of the November 9, 2001 fairness opinion has been submitted to be made part of the record. The full text of the November 9, 2001 fairness opinion sets forth the qualifications and assumptions made, matters considered and limits of the review undertaken by DrKW in connection with the opinion, and the discussion of the opinion in this statement is qualified in its entirety by reference to the opinion itself.

Pursuant to the terms of an engagement letter dated December 12, 2000, BCBSKS agreed to pay DrKW an advisory fee customary for the services provided in connection with the transactions contemplated by the Alliance Agreement, as well as a fee for rendering the opinion.

In the ordinary course of our business, as we advised BCBSKS, we may actively trade the equity and debt securities of Anthem or an affiliate for our own account and for the accounts of customers and, accordingly, may at any time hold a long or short position in such securities. In addition, subsequent to the issuance of the May 24, 2001 fairness opinion, we have acted as a co-manager in connection with the initial public offering of common stock of Anthem effective October 29, 2001 and as a lender in connection with the Anthem's senior revolving credit facility, dated November 5, 2001. In June 2001, we

advised BCBSKS of our investment banking relationship with Anthem, to which BCBSKS did not object, and we received customary fees in the rendering of such services.

III. Review of BCBSKS' Business by Dresdner Kleinwort Wasserstein

In connection with providing the May 24, 2001 fairness opinion, DrKW reviewed with the members of the BCBSKS Board of Directors certain financial, industry and market information with respect to BCBSKS, and the procedures used and the analyses underlying that opinion. Prior to delivering the November 9, 2001 fairness opinion, we reviewed on a regular basis BCBSKS' financial condition and business prospects with members of BCBSKS' Marketing and Finance Task Force and Steering Committee.

In connection with rendering our November 9, 2001 fairness opinion, we reviewed the Alliance Agreement, dated as of May 30, 2001 and amended as of September 28, 2001 and November 9, 2001, and the Plan of Conversion, dated October 25, 2001. We have also reviewed and analyzed certain internal business and financial information relating to BCBSKS for recent years and interim periods to the date of the opinion, including financial forecasts, analyses, and projections prepared by or on behalf of BCBSKS and provided to us for purposes of our analysis, and we met with management of BCBSKS to review and discuss such information and, among other matters, BCBSKS's business, operations, assets, liabilities, financial condition and future prospects.

We reviewed and considered certain financial data relating to BCBSKS and we have compared that data with similar data for certain other companies, the securities of

which are publicly traded, that we selected as being relevant or comparable in certain respects to BCBSKS or one or more of its businesses or assets, and we have reviewed and considered the financial terms of selected recent acquisitions/business combination transactions that we selected as being reasonably comparable to the transactions contemplated by the Alliance Agreement or otherwise relevant to our inquiry. We also performed such other financial studies, analyses, and investigations, and reviewed such other information as we considered appropriate for purposes of the opinion.

As discussed in more detail in our November 9, 2001 fairness opinion, in our review and analysis, and in formulating our opinion, we assumed and relied upon the accuracy and completeness of the information that BCBSKS provided to or discussed with us or the information publicly available, including historical financial information, financial projections, forecasts, and analyses, and the advice of BCBSKS' legal and tax advisors. We also assumed and relied upon the reasonableness and accuracy of the financial projections, forecasts, and analyses provided to us, and assumed that such projections, forecasts and analyses were reasonable, prepared in good faith and on bases reflecting the best currently available judgments and estimates of BCBSKS' management. We expressed no opinion with respect to such projections, forecasts or analyses or the assumptions upon which they were based. We did not assume any responsibility for independent verification of any such information.

We also assumed that obtaining all regulatory and other approvals and third party consents required for consummation of the transactions described in the Plan of Conversion will not have an adverse impact on BCBSKS or on the anticipated benefits of

those transactions, and we have assumed that the transactions will be consummated without waiver or modification of any of the material terms or conditions contained therein by any party thereto. For purposes of our opinion, we did not take into account the economic or financial impact, if any, of any litigation matter or claim, including the Contingent Litigation Matter (as hereinafter defined).

IV. Consideration Payable to Eligible Policyholders

The cash consideration payable to Eligible Policyholders under the Plan of Conversion has two elements. *First*, Eligible Policyholders will receive the Purchase Price (as defined below) of \$190 million, subject to certain contingencies. *Second*, Eligible Policyholders will receive a Special Distribution, estimated to be \$131 million. Subject to the assumptions and limitations set forth in our November 9, 2001 opinion letter, it is our view that the aggregate of the Purchase Price and the Special Distribution to be payable to the Eligible Policyholders and into the Escrow Fund for the benefit of the Eligible Policyholders is fair to the Eligible Policyholders from a financial point of view.

A. Purchase Price

Pursuant to the Plan of Conversion and Alliance Agreement, Anthem will pay BCBSKS \$190 million in cash for 100% of BCBSKS stock (the "Purchase Price"). At the closing of the transaction, BCBSKS will deposit \$48 million of the Purchase Price into an interest bearing Escrow Fund pursuant to an Escrow Agreement. The remaining portion of the Purchase Price not deposited into the Escrow Fund will be paid to Eligible Policyholders pursuant to the Plan of Conversion, as soon as reasonably practicable following resolution of the Final Closing Balance Sheet.

The Escrow Fund will provide funding for the payment of costs and expenses related to a matter involving a subpoena received by BCBSKS from the U.S. Department of Health and Human Services on February 28, 2001 (the “Contingent Litigation Matter”), and such other costs as specified in the Plan of Conversion, Escrow Agreement and the Alliance Agreement. Upon final disposition of the Contingent Litigation Matter, the balance of the Escrow Fund will be distributed to Eligible Policyholders in accordance with the Plan of Conversion.

B. Special Distribution

The BCBSKS Board of Directors has declared a Special Distribution to Eligible Policyholders equal to the excess of the Company’s Closing Book Value over the \$155 million. Management has stated that the amount to remain in surplus, \$155 million, is a sufficient level of capital to meet the level of capital required of an insurance company under Kansas law and the levels required by the Blue Cross Blue Shield Association of a member plan. Management of BCBSKS advised us that it estimated the amount of the Special Distribution on January 31, 2002 to be approximately \$131 million, which includes the deduction of customary transaction and demutualization costs and expenses (the “Estimated Distribution”). We relied on the accuracy of management’s determination of the Estimated Distribution and we assumed that the full amount of the Special Distribution will be declared and paid by BCBSKS to the Eligible Policyholders, and the applicable regulatory authorities will approve the distribution to Eligible Policyholders of the full amount of the Special Distribution. We express no opinion as to

the amount of any adjustment to the Estimated Distribution in connection with the determination of the Closing Book Value.

V. BCBSKS Valuation

We used three methods to determine an appropriate valuation range for BCBSKS: comparable company analysis; comparable transaction analysis; and discounted cash flow analysis. In each case, we calculated a range of BCBSKS' implied enterprise and transaction values. For purposes of determining an appropriate valuation range, we assumed BCBSKS would maintain a capital surplus equal to \$155 million, which, as noted above, management stated is a sufficient level of capital required of an insurance company under Kansas law and the levels required by the Blue Cross Blue Shield Association of a member plan. According to management forecasts as of the date of the opinion, BCBSKS capital surplus at January 31, 2002 was expected to be in excess of this amount by approximately \$131 million. This amount was expected by management of BCBSKS to be immediately available for distribution and was expected to be paid to Eligible Policyholders as a Special Distribution at Closing. References to BCBSKS enterprise value assume the Special Distribution is made.

As is customary in the managed care industry, BCBSKS enterprise value, which was based on market information as of November 8, 2001, was calculated as the sum of the market value of equity, preferred stock, minority interest and debt. BCBSKS transaction value equals the amount of the BCBSKS enterprise value plus the Special Distribution. Based on our three methods of financial analysis, we determined that the

range of BCBSKS' enterprise value was \$93 million to \$232 million, and the range of its transaction value was \$224 million to \$363 million.

A. Comparable Company Analysis

To determine BCBSKS' valuation range under the comparable company analysis, we used publicly available information to compare selected financial and other data of BCBSKS with similar data of four companies engaged in businesses that we considered to be comparable to the business of BCBSKS. For each of the four selected companies, we calculated the underwriting margin and ratios of enterprise value to (a) the sum of its premiums plus fees for the twelve-month period ended June 30, 2001, and (b) health membership. In conducting the membership valuation analysis, we adjusted for the effect of BCBSKS' substantial medicare supplement and dental membership relative to the selected comparable companies by calculating health membership as the sum of indemnity, preferred provider organization (PPO), point-of-service (POS) and health maintenance organization (HMO) members plus 4% of medicare supplement members and 8% of dental members. We compared the premium and fee multiples and health member equivalent multiples against each company's underwriting margin to determine a range of appropriate multiples based upon underwriting profitability. We then used the range of multiples of underwriting profitability to determine a multiple range for BCBSKS' enterprise value: 0.10x to 0.15x with respect to premiums and fees, and \$200 to \$350 with respect to health memberships. We applied the selected results of this analysis to corresponding data for BCBSKS to calculate enterprise and transaction value ranges for BCBSKS. Based on this analysis the enterprise value range is from \$93

million to \$220 million, and the transaction value ranges from \$224 million to \$351 million.

B. Comparable Transaction Analysis

We used publicly available information to determine BCBSKS' valuation range under the comparable transaction analysis. We reviewed five merger and acquisition transactions involving Blue Cross Blue Shield Association targets announced from July 1998 to October 2001. For each of the selected companies, we calculated the underwriting margin and ratios of acquisition value to (a) the sum of its premiums plus fees for the last twelve months ended on the date of the closing of the transaction (and in the case of the Rightchoice Managed Care, Inc./Wellpoint Health Networks transaction, for the last twelve months ended the date of announcement of the transaction), and (b) health membership (calculated as described above). Acquisition value, based as of the relevant announcement dates, was calculated as the sum of purchase price and debt. We compared the premium and fee multiples and health member multiples against each company's underwriting margin to develop a trendline of appropriate multiples based on underwriting profitability, and then used the range of multiples of underwriting profitability to determine a multiple range for BCBSKS' enterprise value: 0.14x to 0.25x with respect to premiums and fees and \$200 to \$336 with respect to membership. We then applied the selected results of this analysis to corresponding data for BCBSKS to arrive at an implied enterprise value range of \$130 million to \$232 million, and a transaction value range of \$257 million to \$363 million.

C. Discounted Cash Flow Analysis

To determine an appropriate valuation range for BCBSKS under a discounted cash flow analysis, we used estimates provided by BCBSKS' management for the years ending December 31, 2002 to 2005. Using a range of discount rates of 11% to 15%, based on an estimated cost of capital for BCBSKS, and a range of terminal multiples of 13x to 16x, we calculated a range of net present values of estimated future cash flows of BCBSKS. Based upon these parameters, we determined the enterprise value of BCBSKS to be in the range of \$150 million to \$222 million. For purposes of the discounted cash flow analysis, the Base Case free cash flow excludes the impact (on an after tax basis) of the estimated \$131 million of excess capital which is to be paid as a Special Distribution. By adding the Special Distribution, estimated to be \$131 million, to the enterprise value, the implied transaction value range of BCBSKS is \$281 to \$353 million.

We noted that the selection of an appropriate discount rate for a discounted cash flow analysis is an inherently subjective process and is affected by such factors as BCBSKS's cost of capital, the uncertainty associated with achieving the projections provided by management of BCBSKS and transaction risk generally. We also noted that while discounted cash flow analysis is a widely used valuation methodology, it relies on numerous assumptions regarding the future performance of a company and the future economic environment, including earnings growth rates, unlevered free cash flows, terminal values and discount rates, all of which are inherently uncertain because they are predicated upon future events and circumstances.

In addition to the analyses outlined above, we performed such other valuation analyses as we deemed appropriate in determining the fairness, from a financial point of view, of the aggregate of the Purchase Price and Special Distribution payable to the Eligible Policyholders and into the Escrow Fund for the benefit of the Eligible Policyholders.

VI. Conclusion

In our judgment, on the date of our November 9, 2001 opinion, subject to the various assumptions, qualifications and limitations summarized herein, all of which are described in greater detail in our November 9, 2001 fairness opinion, and subject to the terms of our engagement by BCBSKS, it is our opinion that the aggregate of the Purchase Price and Special Distribution payable to Eligible Policyholders and into the Escrow Fund for the benefit of Eligible Policyholders pursuant to the Alliance Agreement and the Plan of Conversion is fair to Eligible Policyholders from a financial point of view.

Paul G. Adams

Dated: December 17, 2001
Sworn to before me this 17th day of December, 2001

Notary Public