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AETNA INC. 1st QUARTER 2003 FINANCIAL EARNINGS CONFERENCE CALL

-- Hartford, CT, April 24, 2003 8:30 A.M. ET --
-- Prepared Remarks --

Introduction – Dennis Oakes, VP and Head of Investor Relations

Good morning and welcome to Aetna's first quarter 2003 earnings call and webcast. My name is Dennis Oakes and with me this morning are Aetna's Chairman and CEO, Dr. Jack Rowe; President, Ron Williams and Alan Bennett, our Chief Financial Officer. Following their prepared remarks, we will answer your questions.

During the call, we will make forward-looking statements. Risk factors that may impact those statements and could cause actual future results to differ materially from currently expected results are described in our 2002 Form 10-K. Pursuant to the new SEC Regulation G, we have provided reconciliations in our First Quarter Financial Supplement of metrics relating to the Company's performance that are non-GAAP measures. Those reconciliations are available on the Investor Information portion of the Aetna.com website. Also, as you know, Regulation FD limits our ability to respond to certain inquiries from investors and analysts in non-public forums, so we invite you to ask all questions of a material nature on this conference call.

We will begin now with Dr. Rowe.

Chairman's remarks – John W. Rowe M.D., Chairman and CEO

Good morning everyone.

I am extremely pleased to report Aetna's operating earnings of $2.03 per share for the first quarter of 2003. These results include $1.34 per share for the quarter and $0.69 of favorable claim development relating to prior periods. Our net income for the quarter, which includes net realized capital gains of $0.09 per share, was $2.12 per share. The key driver of this exceptional first quarter performance was significant moderation in health care utilization trends.

Before proceeding further, I would like to point out that the greatest portion of the approximately $107 million of after tax, prior period favorable claim development reported today is attributable to the fourth quarter of 2002. After considering that favorable development, we now estimate that the Commercial Risk cost trend for the fourth quarter was approximately 10.5% as opposed to a trend of approximately 12% that was our view when we reported our fourth quarter results.

Our Commercial Risk cost trend declined further in the first quarter of this year to a range of 8-9%. Despite our confidence that the specific initiatives begun early in our turnaround would continue to impact medical trends in 2003 and beyond, the magnitude of the improvement over the past two quarters has been greater than we expected and we consider it premature to assume that our first quarter trend is fully sustainable. Moderating utilization is the most important factor in the decline, but it is also encouraging to note that unit cost increases were in line with our expectations. Our analysis indicates the following:

- First overall pharmacy utilization trend has declined significantly, driven by a number of important drug classes and higher penetration of three-tier formularies.
- A second important factor in our lower trend was the lapsing in the first quarter of business with higher than average medical costs. More than half of our Commercial Risk business renewed in the first quarter and the 2002 Medical Cost Ratio for cases that lapsed was several hundred basis points higher than the business we retained. With the completion of our final phase of repricing, our business is priced to reflect medical costs and we have not experienced adverse selection. Thus, we now feel we have a very "clean" book of business.
- A third contributor to the lower trend was newly implemented contract and benefit design changes - primarily higher co-pays and deductibles in response to employer requests for affordable products.
- Fourth, we are beginning to see meaningful benefits from disease management and case management initiatives.
- Some "environmental factors" may also be affecting utilization. These include the effect of a poor economy on certain discretionary medical expenditures, and it is possible that increased fraud and abuse scrutiny in recent months from the federal government may be putting pressure on physician and, especially, hospital billing.

Our unit costs reflect:

- Hospital contracting activities, as we continue to focus on minimizing both variable cost exposure and carve-outs, and
- Targeted recontracting in other areas such as specialty pharmacy.

While we will continue to evaluate the impact of these various factors, it is clear that over the course of our turnaround to date Aetna has experienced a definite and sustained reduction in the level of medical cost inflation. That deceleration began in early 2002 and the cumulative impact of the deliberate medical cost actions we have taken is continuing to yield additional benefits in 2003.

Turning now to other first quarter metrics which contributed to our strong performance – let me emphasize that each of the following numbers excludes the impact of the prior period favorable claim development:

- The first quarter premium yield for our entire book of Commercial Risk business was approximately 16.5%, net of geographic differences and benefit buy-downs of approximately 250-300 basis points.
- The Commercial Risk Medical Cost Ratio was 77%.
- As expected, medical membership was slightly above 13 million at March 31st, and
- The overall company pre-tax operating margin was 8.2%.

These results are extremely encouraging as we pursue our key objectives for 2003 and position Aetna for a return to industry leadership. With significantly better than anticipated results this quarter, we are revising our full-year guidance as follows:

- We now project full-year total company operating earnings, excluding other items, of approximately $755-780 million or $4.75-4.90 per share, including the $0.69 per share of prior period favorable claim development reported this quarter. We are raising our estimates for the Health Care segment to $710-730 million, before amortization of intangibles.
- We are currently projecting a Commercial Risk Cost Trend in the 10-11% range for each of the remaining quarters, which would result in a full year trend for Aetna of approximately 10%.
- We expect a full year premium yield for our Commercial Risk business of approximately 14%.
- The combined pricing and trend should yield a full year Medical Cost Ratio for our Commercial Risk business of approximately 80%, excluding any favorable development.
- The projected level of earnings would result in a full-year total company pre-tax operating margin of approximately 6.5% - excluding favorable development, interest expense, amortization and net realized capital gains and losses.
- Finally, we still expect year-end medical membership of approximately 13.2 million, composed of approximately 65% administrative services and 35% risk accounts. This is despite continued attrition due to layoffs at certain of our large national accounts in industries that have been particularly hard hit by recent economic conditions. In the first quarter alone, we lost nearly 40,000 members at in-force customers.

Looking ahead to the second quarter, we expect operating earnings of approximately $0.85 per share. Our results will be lower than the underlying operating earnings this quarter because of seasonally higher medical costs and a lower premium yield increase for the 13% of our Commercial Risk business renewing in the second quarter.

Though our recent financial performance is satisfying, we continue to implement a number of strategic initiatives to enhance our future growth and position Aetna as an industry leader. One recent example is our decision to extend our contract with Magellan for mental and behavioral health services until December of 2005. As part of that extension, Magellan will establish three Aetna-dedicated service sites and we will move to more strongly integrate mind and body care with an increased focus on clinical and network management. Specifically, we will concentrate on the detection and treatment of behavioral health issues associated with chronic medical illness. We believe this will allow our members to receive higher quality care while reducing aggregate medical costs.

Our decision to retain our pharmacy benefit management business is already paying dividends in terms of our reduced pharmacy trend and increased business opportunities as more of our self-insured customers consider Aetna for their pharmacy benefits carrier. We are ramping up operations at the mail order facility we purchased in January. It is now fully operational and we are processing approximately 28, 000 prescriptions per week, accounting for approximately 35% of Aetna's current mail order volume. By year-end, we will be processing 100% of our prescriptions at this facility and will have expansion capacity as well.

A third area of very significant strategic importance is the use of available capital. We are carefully evaluating the best uses of the capital generated by our increasing profitability. Our strong bias, at the moment, is to invest in our businesses in order to accelerate future growth. Clinical and marketing improvements that we are making in our PBM, together with increased IT expenditures and the strengthening of our Group Insurance workforce are examples of investments made during the first quarter of this year. We will be disciplined about achieving the highest return for our investors while maintaining our financial strength. Right now, we see the greatest opportunity in such internal investments.

A word about governance….Over the past year, we have made several changes to Aetna's Corporate Governance practices including the termination of our shareholder rights plan. Additional modifications to the Company's Articles of Incorporation and By-Laws regarding the approval of mergers; the right of shareholders to call special meetings; and the required level of shareholder support for amendments to certain portions of the Company's By-Laws were also recommended by our Board of Directors and will be voted upon by Aetna shareholders at tomorrow's Annual Meeting. We believe that good governance practices are an important means of aligning corporate activity with the interests of our shareholders, so we were gratified to learn earlier this month that Aetna earned very high ratings from Institutional Shareholder Services. According to ISS, our governance practices outperformed more than 96% of the companies in the Standard & Poor's 500 and more than 99% of the companies in their Health Care Equipment and Services group.

As we proceed throughout 2003, we have clarity of purpose and momentum generated by our recent financial performance which will propel the Company through the remainder of our turnaround into 2004. Our overriding goal is the pursuit of profitable growth for the entire Aetna enterprise. Ron Williams will now give you a sense of what we have done operationally to contribute to the performance levels we are announcing this morning for the first quarter of 2003 and how we intend to sustain that progress.

Ron…

Operational Report – Ronald A. Williams, President

Good morning. Thank you Jack.

Clearly, our customer focused operating model and our "back to basics" strategy have worked well. Our focus this year is on four business goals:

1) First, we seek market differentiation through innovation. The Aetna HealthFund is a good example of both leadership and innovation in response to plan sponsor interest in consumer directed care products. We currently have in excess of 55 customers with approximately 40,000 members enrolled in fully-insured and self-insured HealthFund arrangements. Within the past several months we have also introduced a number of other innovative products and associated services including:

- A suite of standardized small group plans in ten states and a new point of service product in New York State designed to provide the affordability and flexibility small companies are looking for.
- We have also introduced our Simple Steps To A Healthier Life, which is a unique web-based wellness product aimed at enhancing employee health and productivity. The Simple Steps Program incorporates information on disease prevention, condition education, behavior change programs and health promotion services into a streamlined web-based product.
- In the middle market we have piloted a packaged portfolio of medical and Group Insurance products for employers in our 51-300 employee segment. After a successful trial in the Mid-Atlantic region, we are now introducing the product nationally. Overall, middle market sales are up 45% over the first quarter of 2002 due largely to our renewed focus on brokers as the primary distribution channel, improved service levels, and the reintroduction of alternative funding programs.

2) A second essential goal is profitable growth in our Health Care and Group Insurance businesses.
    - We have indicated that our medical membership will grow modestly throughout the balance of 2003 and we are working diligently this year to position the company for long-term profitable growth. Work has already begun on 2004 National Account renewals. We are encouraged that our review of RFPs received to date shows that we have substantially more opportunity to gain market share than we have business up for renewal. Second quarter sales activity in our small, middle and national account markets is also encouraging.
    - Profitable growth will also depend upon continued strengthening of our broker and consultant distribution channels. We have made a concerted effort through our Broker Advisory Council and other activities to engage in a consistent dialogue and to build business relationships with key producers. Jack and I meet personally with groups of brokers and consultants regularly, and we are receiving very positive feedback that the products and administrative tools we have developed make Aetna an attractive sale to their customers. We are confident that these activities will produce superior results in the months ahead.
    - In our Group Insurance segment we have also seen higher sales activity and better retention of existing accounts in the first quarter, attributable to the increased number of sales and account management staff who have raised Aetna's visibility in the Group Insurance market place.
    - Successful pursuit of the TriCare opportunity is another important objective for 2003, with significant 2004 enrollment impact if we are successful. As previously announced, we have submitted a bid with Humana for the North region, but have not yet made our oral presentation. We expect awards will be announced by the Department of Defense in the late summer or early fall.

3) Our third goal is achieving "best in class" medical cost and quality management status. Doing so will provide a competitive advantage in the market place. Our first quarter trend of 8-9% represents significant progress in that regard and demonstrates our ability to achieve results.
    - The major components of the lower first quarter Commercial Risk cost trend were as follows:

  - The Pharmacy trend was approximately 5%.
  - In-patient Services were approximately 8%.
  - Out-patient Services for the quarter were approximately 12%, and
  - Physician Services were approximately 6%.
- As Jack mentioned, though it is too early to conclude that the first quarter medical cost trend can be fully sustained throughout 2003, we are confident that our full-year trend will represent substantial year-over-year improvement. Our efforts to maintain the lower trend will be focused on the approaches that have been the primary drivers of our recent success, including:
  - Enhancement of our PBM to maximize its effectiveness.
  - Continued development of innovative plan designs which give our members an economic stake in health care and provide the tools necessary for them to be informed consumers.
  - Ongoing provider recontracting to maintain competitive contract rates and contract provisions.
  - Rigorous monitoring of sixteen medical cost categories for each customer segment, region and key local markets.
  - Focused disease and case management activities, and
  - Finally, a disciplined approach to medical management programs and operational activities, greatly aided by our Executive Management Information System.
- "Best in Class" medical cost management will also require the continuous refinement of our disease management programs. As we add to our capacity in this area, we are very encouraged by the early results from our chronic heart failure, diabetes management and end-stage renal disease programs. We currently estimate that our medical costs will be reduced significantly this year for our members enrolled in these programs.
- Achieving our goal of "Best in Class" status in medical quality is reflected in many of our activities. For example:
  - We recently announced initiatives to address racial and ethnic disparities in access to care and in health outcomes.
  - InteliHealth, our online consumer health information subsidiary, was among the nation's first health websites to receive independent quality accreditation last year from URAC and was recently re-accredited.
  - Our genetic testing site on InteliHealth, launched last November in cooperation with Harvard Medical School, also received a quality award from the Health Information Resource Center earlier this month.

4) Our fourth goal is employing process improvements and technology to lower Aetna's operational cost structure. We have invested resources to achieve productivity gains through:
   - Enhancements to our EDI platform, including the addition of EDI vendors.
   - Improvements in our imaging technology for claims and eligibility.
   - Expanded opportunities for self service utilization by members and providers utilizing our IVR technology, and
   - Continued upgrades to our HR administrative systems which has increased automation and self-service capabilities.

My confidence in our ability to achieve these goals is reinforced by the elements of cultural change that we have accomplished as a company, including:

- Conducting our business with a laser-like focus on the needs of our customers.
- A universal commitment to achieve our "back to basics" deliverables.
- A company-wide commitment to change and a bias toward action.
- A sustained sense of urgency throughout Aetna.
- Extraordinary collaboration, dedication and hard work by Aetna's employees.
- Finally, as we go forward we are beginning to plan for financial and operational leadership and profitable growth in a multi-year context.

My sense is that the Aetna team is up to the challenge of achieving our business goals and that we will continue to improve our capacity for peak operational and financial performance.

Thank you for listening. Alan Bennett will now elaborate on the important financial aspects of our recent performance.

Financial Report – Alan Bennett, Senior Vice President and Chief Financial Officer

Thank you, Ron.

From a financial perspective, our first quarter results exceeded our targets. Compared to the fourth quarter of 2002, we experienced improved operating margins and profits, while continuing to drive down our administrative expense base. Our balance sheet and liquidity position remain very strong. We were very pleased to receive independent confirmation of our progress from Moody's earlier this week when they raised the outlook on our credit to a "positive" rating.

Our Health Care earnings for the first quarter were $293.3 million, after amortization expense of $8.2 million. Group Insurance contributed $32.6 million to our first quarter results and we now expect slightly higher full year Group Insurance earnings of $137-140 million. Higher operating expense levels in Group Insurance were partially offset by a lower benefit cost ratio, higher net investment income and a slightly lower effective tax rate compared to the fourth quarter of 2002. Large Case Pensions earnings for the quarter were $6.8 million, on track for our previously stated full year earnings of $16-18 million.

As expected, Health Care costs payable of $1.96 billion at March 31 were $233 million lower than December 31, reflecting our continued payment of claims for lapsed members as well as the positive claim development from prior quarters. Health care days payable of 74.6 remain at high levels due primarily to membership lapses. At March 31 we held approximately 4 days for lapsed members. Additionally, the favorable reserve development recognized this quarter will cause a decline of approximately 4-5 days in subsequent quarters. In short, we continue to expect that health care costs payable, as measured in days of claims payable, will decline to more normal levels – reduced by as many as 8-9 days for these two items alone in the very near future.

Operating cash flow in the first quarter was $375 million, which compares favorably to the fourth quarter level of $222.4 million. Operating cash flow represents net income plus pre-tax intangibles amortization and depreciation, less capital gains and other items but before balance sheet changes. After changes to our balance sheet accounts in the first quarter, we experienced positive net cash flow of $30.8 million. This cash flow includes net outflows which we anticipated of approximately $150 million in payments from medical cost reserves held for lapsed members and approximately $68 million in payments from previously established severance and facilities reserves. In addition, we made a voluntary $65 million payment to our pension plan in March. As always, this analysis of cash flow excludes changes to Large Case Pensions reserves, as those liabilities are satisfied by related investment assets and, as such, do not impact our operating cash flow. All of the cash flow numbers just discussed can be found in our First Quarter 2003 Financial Supplement released earlier this morning.

Our level of cash and marketable securities at the Parent Company at March 31 was approximately $520 million, which is $155 million higher than the year-end 2002 level. In addition, approximately $410 million was also available for dividends from our subsidiaries without regulatory approval. The amount available for dividends will continue to decline throughout the year, from the 12/31/02 level of approximately $500 million, as dividends are paid to the Parent.

Total company SG&A in the first quarter declined approximately $52 million from the first quarter 2002 level. Savings were due primarily to reduced personnel costs, though a variety of other initiatives also contributed. In the Health Care segment alone, the decline was $59 million. Those savings were offset somewhat by increased investment in our Group Insurance business. We expect that expense reductions resulting from the 2002 severance and facilities charges, particularly those announced in the third and fourth quarters, will have the greatest impact in the second half of this year.

Achieving the increased level of profitability for 2003 reflected in our revised guidance will likely impact our administrative costs for the year in two ways. First, we are now considering the acceleration of certain high value IT projects and other business investments that were not part of our original 2003 plan. We also anticipate higher variable incentive compensation expenses based on the level of our full year financial performance. An example would be the payment of an incremental 401(k) match for all employees, which would add up to $42 million to our annual compensation costs. Even considering potential additional projects and variable pay programs, however, we still anticipate net year-over-year SG&A savings in the range of $200 million this year. We will update our SG&A savings progress on each of our quarterly earnings calls.

We mentioned on our fourth quarter call in February that our Pension and post-retirement expenses were projected to increase $110 million this year, before taking actions designed to reduce the increase by $60 million while maintaining a competitive benefits package for employees and keeping costs in line with industry peers. We achieved more than half of our goal in the first quarter by phasing out the health insurance subsidy for future Aetna retirees, resulting in a pre-tax pension curtailment benefit of $34 million. We will continue throughout the year to examine other opportunities in order to reach our $60 million target.

Other important financial metrics for the first quarter include the following:

- Our interest expense was $16.8 million, which is lower than the fourth quarter 2002 level because we experienced a full quarter benefit from the additional interest rate swap completed last December. We now expect our full year interest expense will be approximately $75 million.
- We had no commercial paper outstanding as of March 31 and our long term debt remains at approximately $1.6 billion, representing an 18.8% debt to capital ratio.
- First quarter total company revenue was approximately $4.5 billion and we now expect full year revenue of approximately $18.0 billion. This is below our previous projection of approximately $18.5 billion, due primarily to lower than originally anticipated premium yield in the first quarter and for the full year.
- Finally, the weighted average shares including equivalents for the first quarter was 155.4 million shares, a small increase from the fourth quarter 2002 level of 154.9 million shares.

Our first quarter was excellent from both a financial and operational perspective, but significant work remains. I can assure you that we are firmly committed to the company-wide efforts necessary to drive down operating costs and we recognize that success in this area will be an important driver of future profitable growth and operating margin expansion.

Thank you for listening. Dennis will now introduce the question and answer session.

Dennis Oakes – Q&A Session

Thank you, Alan. For everyone's convenience, a summary of the revised 2003 Guidance we have provided this morning, together with the reconciliations required by Regulation G, has been posted on the Investor Information section of the aetna.com web site.

-- End of Prepared Remarks --

ADDITIONAL INFORMATION; CAUTIONARY STATEMENT -- Certain information in this presentation is forward looking. Forward-looking information is based on management's estimates, assumptions and projections, and is subject to significant uncertainties and other factors, many of which are beyond Aetna's control. Important risk factors could cause actual future results and other future events to differ materially from those currently estimated by management. Those risk factors include, but are not limited to: unanticipated increases in medical costs (including increased medical utilization, increased pharmacy costs, increases resulting from unfavorable changes in contracting or recontracting with providers, changes in membership mix to lower-premium or higher-cost products or membership-adverse selection; as well as changes in medical cost estimates due to the necessary extensive judgment that is used in the medical cost estimation process, the considerable variability inherent in such estimates, and the sensitivity of such estimates to changes in medical claims payment patterns and changes in medical cost trends); continued decreases in membership levels; increases in medical costs or Group Insurance claims resulting from any acts of terrorism; the ability to achieve targeted savings from work force reductions and to otherwise reduce administrative expenses in light of significant membership reductions recently experienced; the ability to maintain targeted levels of service, and improve relations with providers, as well as operating performance, while making significant staff reductions and taking actions to reduce medical costs; the ability to continue to successfully implement Aetna's new operating model; lower levels of investment income from continued lower interest rates; adverse government regulation (including legislative proposals to eliminate or reduce ERISA pre-emption of state laws that would increase potential litigation exposure, and other proposals, such as the Patients' Bill of Rights, that would increase potential litigation exposure or mandate coverage of certain health benefits); adverse pricing actions by government payors; changes in size, product mix and medical cost experience of membership in key markets; and the outcome, including any negotiated resolution, of various litigation and regulatory matters, including multiple health care class actions and ongoing reviews of business practices by various regulatory agencies. For more discussion of important factors that may materially affect Aetna, please see the risk factors contained in Aetna's 2002 Annual Report on Form 10-K, on file with the Securities and Exchange Commission. You also should read Aetna’s 2002 Annual Report on Form 10-K and Aetna's 2003 First Quarter Report on Form 10-Q when filed with the Securities and Exchange Commission for a discussion of Aetna's historical results of operations and financial condition.

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