TODAY'S NEWS

SEPTEMBER 02, 2010

Continued Strong Showing by Health Net: An Update from Steve Sell

As one of Health Net's strategic partners, I wanted to take this opportunity to give you an update on Health Net's continuing progress.

Health Net reports a solid second quarter

Health Net, Inc. recently reported a strong second quarter that exceeded our expectations. Our performance remains linked to our key strategic initiatives to position Health Net for health care reform and the challenges in the years ahead. These initiatives include our continuing G&A reductions and our new product introductions, particularly our California narrow networks.

Our financials are strong

You and your clients can remain confident that our financials remain strong:

- We have total assets of $4.2 billion.
- We have cash and investments of $1.9 billion.
- We have $934.9 million in reserves for claims and other settlements.
- And our risk-based capital exceeds our 400 percent target level.

The Western Region is looking good

As you likely already know, we are winding down our operations in the Northeast and are now laser-focused on our Western Region core markets: Arizona, California and Oregon.

While the economy has taken its toll on our commercial membership counts, we are buoyed by some economic indicators, and we see the potential for some growth in the second half of the year.

We already see some positive signs, with a recent major sale in Arizona and some big renewals in California and Oregon that take effect in January.

And our narrow network plans in California continue their strong growth. Membership in these networks

grew 9 percent compared to the second quarter of 2009 – and enrollment in these cost-effective networks now represents 24 percent of our total Western Region commercial membership. And we are making preparations to launch the cost-effective network concept in Oregon – likely next year.

With unemployment rates remaining high, we are seeing growth in our Medi-Cal business. It's up 6 percent compared to the same period last year. And we see further growth potential through health care reform.

As for Medicare, our Medicare Advantage and Part D business is stable and on track for solid full-year performance.

Broker guide is coming your way

We are making great strides to succeed in the new economy and the reform environment. As the emphasis on affordable, quality care increases, we know that this is the opportunity for us to demonstrate the value of managed care and cost-effective networks. A Broker Guide to health care reform is in the works here, and you should be receiving it the near future.

For more information

If you'd like to listen to a replay of our Q2 financials, click here (guestbook sign-in required). Or you may view the printed transcript. And our press release is here.

I'm interested in your suggestions

We remain optimistic that we are moving forward in the right direction while staying appropriately focused on your needs. There is always room for improvement and so I hope you will let me know what we can do better. I look forward to your suggestions and comments.

Sincerely,

Steven J. Sell
President, Western Region Health Plan

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Health Net of California, Inc. • 21281 Burbank Boulevard • Woodland Hills, CA 91367

Health Net, Inc.
Q2 2010 Earnings Conference Call
August 3, 2010
8:00AM PDT

Corporate Participants:
Angie McCabe, Vice President, Investor Relations
Jay Gellert, President and Chief Executive Officer
Jim Woys, Chief Operating Officer

OPERATOR: Good morning, everyone and welcome to this Health Net, Inc. second quarter 2010 conference call. Today's call is being recorded.

At this time I would like to turn the call over to Ms. Angie McCabe, vice president of Investor Relations. Please go ahead, ma'am.

ANGIE McCABE: Thank you, Janeshia. Good morning, and thank you for joining us for a discussion of Health Net's second quarter 2010 results.

During this call, we will make forward-looking statements that are subject to certain risks and uncertainties. Risk factors that may impact those statements and could cause actual future results to differ materially from currently expected results are described in our filings with the SEC as well as the "Cautionary Statements" in our press release issued in advance of this call.

In today's call, we will refer to adjusted days claims payable which excludes reserves and health plan services expenses for the company's divested Northeast businesses, capitation payable, provider and other claim settlements and Medicare Part D. This adjusted metric is not being presented in accordance with GAAP.

Please refer to today's press release, which is available on the company's website, for a reconciliation of this non-GAAP financial measure with the most directly comparable GAAP financial measure, days claims payable.

We will begin our call today with formal remarks by Jay Gellert, Health Net's CEO. Jim Woys, our chief operating officer, and Joe Capezza, Health Net's chief financial officer, will be available during Q&A.

I will now turn the call over Jay Gellert. Jay?

JAY GELLERT: Thank you, Angie.

In my remarks this morning, I want to review our second quarter results and link this performance to the key strategic efforts we've embarked on over the past couple of years.

We believe that these strategic initiatives – such as the sale of the Northeast, G&A reductions, and new product introductions – position Health Net to address the challenges of 2011 and health care reform. We also remain focused on steady and consistent near-term performance that is in line with our long-term strategies. With this in mind, we are pleased to report on a strong second quarter that exceeded expectations.

As a result of this performance and based on our confidence about the second half of 2010, we are raising our full year diluted EPS guidance to a range of $2.07 to $2.17 on a GAAP basis and $2.50 to $2.55 for the combined Western Region and Government Contracts segment.

Driving better-than-expected second quarter results are a number of factors. We continue to produce ahead-of-expectations yield/cost spreads in commercial. We continue to see Medicare and Medicaid on track. We continue to keep TRICARE consistent and predictable, and we continue to drive significant G&A reductions.

In line with this focused approach, overall margins expanded in the second quarter, a direct result of our sale of the Northeast and our ongoing operational focus.

Let me turn to enrollment to start. In the quarter, health plan enrollment reflected the economic times in our Western markets. Medi-Cal enrollment was up while commercial was down, both trends being impacted by the high unemployment.

However, there's good news in the commercial markets. We believe the second quarter represents the end of our commercial enrollment declines. We expect to grow commercial enrollment in the second half. Our low cost plans, characterized by selective provider networks, continued to grow in the second quarter, bucking the economic headwinds. They were up by approximately 9 percent and now account for nearly one-quarter of our commercial enrollment. These products will be part of the brighter second half story, as we expect to see enrollment growth in all commercial segments.

Because we've linked our low-cost HMO products to our established capitated provider networks in California, we believe we have secured a key competitive advantage as the market in narrow network products heat up.

There were other positive commercial signs in the second quarter. The rate of in-group losses was 53 percent lower than the second quarter of '09. New sales and account lapses improved as well. So we believe the commercial enrollment story is in the early stages of a turnaround. At the same time, we're very pleased that we continue to expand the gross margin PMPM. It was up by 10.5 percent year-over-year in the second quarter, and it rose sequentially as well. We expect it to continue expanding in the second half. That's an especially strong indicator in light of our building enrollment momentum.

The gross margin gains drove a 20 basis point improvement in the commercial MCR year-over-year. We were right-side up by the same amount comparing yields and costs. The yield/cost spread was ahead of expectations and gave us comfort to our second half commercial MCR guidance. The year-over-year comparison primarily reflects certain issues from the second quarter of '09, such as a retroactive adjustment for one large account that was recorded in last year's second quarter and certain health care cost items that are not part of the run rate so the comparisons are skewed.

In Medicaid and Medicare, we are seeing stability. In Medicare, we continue to emphasize established network-model markets. The MCR, at 88.5 percent in the quarter, is higher than last year but is in line with expectations. We believe we're on track to end the year at around 88 percent and that's a reasonable ratio given the high percentage of capitation in our Western MA markets.

Medi-Cal continues to meet our expectations. We're not expecting any significant move on rates in the near future. We remain committed to Medi-Cal with the prospect of further growth as a result of health care reform.

We see evidence of moderating trends in all health plan segments in the second quarter. An important point to note is that 40 percent of our health care costs are capitated. Therefore, costs will be more predictable over time but less responsive to changes in health care trends. In addition, we're more conservative in booking claims changes than would be the case in a pure fee-for-service plan.

Part D is doing fine. Margins are on track but membership is down due to a CMS true-up. We've taken a stronger stand regarding members who haven't been paying their premiums.

We're honored that we've been selected, once and for all, as the contractor for the new TRICARE North Region contract. It starts next April, and our transition work is well under way. As I noted earlier, TRICARE's steady, consistent performance continues. The cost ratio of 95.1 percent is in line with expectations. Costs are rising at a rate close to overall inflations and revenues follow. We expect the performance to continue in the second half.

The MFLC program, administered by our behavioral health subsidiary MHN, continues to meet the growing need for such services among uniformed men and women both in the U.S. and overseas.

Let me now turn to the financials. Cash flow's on track, though affected by timing issues and a healthy paydown in claims inventory in the quarter. If you look at the first half of '10, cash flow was approximately $111 million, or more than 1.4 times net income plus D&A. We still believe cash flow will be between $300 and $325 million for the full year.

With strong cash flow and increased cash at the parent, we continued to buy back stock. We purchased 2.9 million shares for approximately $70 million in the quarter. Prudent share buybacks remain a priority for capital deployment.

Let's now look at the balance sheet. Claims payments increased by more than $58 million in the second quarter compared with the first. Overall, reserves were down due to higher paid claims, an adjustment to a litigation reserve and the shared risk settlement from the prior year that occurs every year in the second quarter. It was these changes that caused days in claims payable to decline sequentially.

Importantly, as receipts volume declined and payment cycles sped up, the Western Region claims inventory declined by approximately $40 million from December 31, 2009 to June 30, 2010. Despite this decline, the Incurred but Not Reported portion of the reserves related to the Western Region is up by $16 million from year-end 2009.

We recorded approximately $20 million in positive prior period development – $7 million was from '09 and prior periods. In line with our reserving policies, we re-established this amount in our reserves so it didn't affect the income statement but did help drive IBNR higher.

Let me close with some comments about our efforts to reduce G&A. First, we've been committed to this effort for more than two years. It is now clear that health care reform implementation will require greater G&A efficiencies and we believe we've got a good head start.

The operations strategy effort that we launched more than two years ago is nearly complete. We believe we've reduced the annual G&A run rate by more than $100 million as a result of this program – that's approximately a dollar of annual savings for every dollar invested in severance and other charges – a compelling rate of return.

We are on track to right-size our corporate overhead to reflect the sale of the Northeast and the new TRICARE contract. We will eliminate $80 to $100 million of G&A costs in 2011, as planned.

Let me summarize where we are strategically. We have a strong managed care model with cost-effective networks; we have a broad range of products and attractive opportunities in multiple lines of business; our product characteristics are consistent with the likely requirements of health care reform; TRICARE is solid and predictable; we are financially strong, and our balance sheet gives us ample flexibility as we address the challenges of the future; and we have built a business mix that is less volatile and more predictable in all of its elements.

We think this is the right strategy for health care reform. We believe the second quarter performance affirmed the progress we are making, and we look forward to what we believe will be a strong second half and a successful 2011.

Thanks for your time. Let me now go to Q&A.

ANGIE McCABE: Janeshia, we're ready for the first question.

Q&A

OPERATOR: At this time if you would like to ask a question, please press star and the number one.

Again that's star and the number one.

ANGIE McCABE: Janeshia, are we having connection problems with the queue?

OPERATOR: One moment.

OPERATOR: Your first question comes from the line of Joshua Raskin.

JOSHUA RASKIN: Hi. Thanks. Can you guys hear me?

JAY GELLERT: Yes, Josh. We can hear you.

JOSHUA RASKIN: Alright, we're up and running. First question is on the commercial membership, Jay, you talked about a second half growth. I think, I calculate to get to sort of the low end of guidance you need about 30,000 adds and that comes on the heels of 60,000 losses in the first half. So just curious if you could sort of help us bridge that change and maybe if you gave us a July 1 number, just so we knew where we were starting, that would be helpful.

JAY GELLERT: Well, the June 30 number is here. July was basically flat, but we have sold groups that will be coming in later in the year, mainly September and October. And they -- so, we have line of sight to the membership direction we're giving. We don't have line of sight in terms of the individual market, and some of the things that are going on in terms of the rate approval, but in terms of the other segments we have line of sight to the guidance we've been talking about.

JOSHUA RASKIN: Okay. So, you have sold groups that you have --

JAY GELLERT: Yes, yes. This is not hypothetical. This is really what we see at the present moment. It could go up or down a little, but in terms of the direction to the guidance, it's consistent with what we know.

JOSHUA RASKIN: Got you, and then, I know you guys got the contract, I think it was a day or two after the conference call last quarter, with TRICARE. Can you talk a little about the financial expectations starting in April 1 of next year? How do you guys anticipate booking revenues? Were we still going to see premiums or do you think that moves more towards fees, and what would your expectations in terms of absolute dollars under the new contract versus (inaudible)?

JAY GELLERT: In terms of the first question, I think that that's still being studied. So, I don't think we've reached a conclusion exactly how we'll treat that. But, we'll get back to you as soon as we've concluded that. In terms of the second point, we've indicated that this contract will be in the range of $50 million less profitable than the other contract. There are some transition money that we have that will be included next year. But, we've incorporated all of that into our thinking.

JOSHUA RASKIN: Okay. On an annual basis?

JAY GELLERT: Annualized basis, so you take three quarters of that.

JOSHUA RASKIN: Alright, thanks.

OPERATOR: Your next question comes from the line of Christine Arnold.

CHRISTINE ARNOLD: Hey, there.

JAY GELLERT: Hey.

CHRISTINE ARNOLD: Couple questions. You said you don't have line of sight on rate approvals. Could you talk about where you stand in that process?

JAY GELLERT: Yes. We've submitted our rate requests regarding the individual market. It's in process. We don't have any time commitment from the Department of Insurance. But, as we said, it's only about 90,000 members companywide, so, it's not that material, but it could affect by a couple thousand one way or the other our actual membership.

CHRISTINE ARNOLD: Right. I'm more interested in the environment. Have you included the costs associated with mandated benefits in your rates?

JAY GELLERT: To date, we've only filed for rates pre-October. We've not made a filing yet for after October the 1st or January 1st in terms of the filing.

CHRISTINE ARNOLD: Do you have a sense for how much reform related costs from the mandates will increase small group and individual costs, respectively?

JAY GELLERT: We haven't really reached a conclusion on that. We're in the process of going through that at this point in time. And so, until we really complete the review process, I don't think I'm in a position to comment.

CHRISTINE ARNOLD: Okay. And then is there is an opportunity, in your mind, under the MLR floors to take those MLRs in small group that are above the floor down or not?

JAY GELLERT: I think we have an opportunity to improve our MLR in the cases that it's above the floors. That's a focus of our activities next year and it's one of the reasons why I think we focused on trying to complete the G&A resizing and complete -- and be conservative this year.

CHRISTINE ARNOLD: Okay. Thank you.

OPERATOR: Your next question comes from the line of Ana Gupte of Sanford Bernstein.

ANA GUPTE: Yes, thanks. Good morning. I was wondering if you could give us a perspective on the other constituents in the California and the Western markets as a result of reforms? So you're starting with competitors with the Blue's and Kaiser and the publics. Are you seeing the competitive pricing posture likely to be -- will they take a conservative stance on the loss ratio floors and possibly price lower to meet the floor, or would they likely just price as is and then wait for things to true up and give out the rebates?

JAY GELLERT: Based on, and this is more me speaking from the discussions that I've heard in public comments, my sense is that people aren't doing all that well in California right now. And that the concern over the MLR floors, particularly if they're done correctly, is a lot less substantial in California. So, at this point in time, there are occasional instances we should see people pricing with some zeal. But, the market, at present, is not at all disrupted as a result of the MLR floors.

ANA GUPTE: Thanks. Then on the hospitals? Can you give us a sense of -- are they responding to some of the media criticisms and so on? It's usually focused on insurers, but there is a little bit on hospitals as well, in terms of, reducing the unit costs expectation.

JAY GELLERT: We're beginning to see some encouraging signs with hospitals that they really recognize we all have to work together if we are going to get the premium cost down. So I've been really encouraged over the course of the last couple, or three months, that there's an increasing sensitivity responsiveness, and I have the feeling that in California, in particular, there's an opening for us all to be part of the solution that rather than for us all to be at the other side of criticism.

ANA GUPTE: That's encouraging. Then finally on employers, there is a couple of things going on in the economy but then they are getting, some of them are getting premium tax credits and dealing with these grandfather clauses. In general, are they showing a tendency in California to opt out of benefits? Stay in benefits but go the lower cost plan design, even if it means switching carriers and then more in the middle market area, is there more of a tendency to go to self-insured at this point?

JAY GELLERT: At this point, we're seeing a lot of interest in the variable network models. So, all the way up to large groups and in California since you really can't capitate in self-insured, we're actually seeing more of a movement in that direction. California is third in the country, or fourth in the country, in the

percentage of risk employers because of the capitation phenomena. We're seeing people really look at different kinds of models, different kinds of networks, as a way to deal with some of the cost issues.

ANA GUPTE: Okay. Thanks very much.

OPERATOR: Your next question comes from the line of Kevin Fischbeck of Bank of America.

SCOTT GREEN: Hi, this is Scott Green in for Kevin. Could you tell us what the Medi-Cal MLR was in the period?

JAY GELLERT: We will get that for you. The Medi-Cal MLR in the period was 86.7 percent.

SCOTT GREEN: Okay. So, down about 30 basis points sequentially?

JAY GELLERT: Yes.

SCOTT GREEN: Okay. Could you elaborate on Medi-Cal rates for the new fiscal year? Is it a matter of waiting for a budget, or is there more known there?

JAY GELLERT: There's not more known yet. There, though, is the requirement for a formula that is actuarially sound. We won't know specifically 'til October. But, we always remind people that California is the lowest cost state in the country in terms of Medi-Cal. So, we expect it will remain economically sound.

SCOTT GREEN: Got it. And then lastly, Jay, I think I read in a California budget draft it included moving some ABD beneficiaries to managed care from fee-for-service. From your perspective, do you see any momentum building there?

JAY GELLERT: Yes.

SCOTT GREEN: So, you think that's something that will --

JAY GELLERT: I think we're going through a waiver process and that's one of the issues involved in the waiver. There are negotiations going on between the administration, the legislature, providers, et cetera, interest groups. But, I definitely think there'll be some movement in that area. The specifics aren't known yet.

SCOTT GREEN: Okay. And that could be more of a near term phenomenon in the next 12 months or so?

JAY GELLERT: Definitely.

SCOTT GREEN: And any idea the size of the population that's being negotiated?

JAY GELLERT: I think it's -- I'm a little reluctant to get ahead of myself, because I don't think any of us know all the details what's being negotiated, but it's definitely an upside opportunity.

SCOTT GREEN: Okay, and based on what you know today, is that something that would be RFP'd or maybe just allocated to the current vendors?

JAY GELLERT: The understanding I have is that it would be included in the existing system.

SCOTT GREEN: Okay. Great. Thank you.

JAY GELLERT: Sure.

OPERATOR: Your next question comes from the line of Carl McDonald of Citigroup.

CARL McDONALD: Thank you. What was the cash of the parent at the end of the quarter? Any major variances expected, say over the next 12 months, in terms of dividends coming from the subsidiaries? And also if you can just remind us of the timing around the United payment?

JAY GELLERT: We had $145 million of cash at the parent at quarter end. The United transition is moving a little faster than everyone expected. So, there's some additional costs in 2010. But, there'll also be a speed up of some of the membership payments. The big payments still will be the TNE payments that come in December of 2010, and December of 2011, of about $80 million and the membership true-up, which will likely be in the first quarter or second quarter of 2011, when we complete the January 1 transition. So, that timing has been a little quicker, but it's not going to materially change the numbers we anticipated. We feel comfortable with the guidance we've given on cash at the parent. When you subtract the amount we put in to buy back which we didn't include in our target and we see nothing unusual occurring over the course of the next 12 months.

CARL McDONALD: Okay, thank you.

OPERATOR: Your next question comes from the line of Peter Costa of Wells Fargo.

PETER COSTA: Peter Costa. Question, Jay, for you. Some of the other companies posted a little bit more upside to their quarter from prior period development coming in more favorable. You had a little bit less of it.

JAY GELLERT: Right.

PETER COSTA: Did that come about because of your higher use of capitation than others, or do you think there's something else going on that others are doing releasing extra reserves? Then the second question, regarding your GAAP EPS versus your Western Region EPS, there's a bigger differential in terms of what you've already passed, in terms of the first half of the year versus the second half of the year, that implies there's a $0.07 positive effect coming from the back half of the year in terms of the performance of the Northeast operation payments. How is that going to play out between the third quarter and the fourth quarter?

JAY GELLERT: Let me answer the first question and then look for help maybe if anyone even is aware of the split, but, let me do the first one first.

There are two or three things that relate to the question of the prior period. One, you're correct, about 40 percent of our health care payments are capitation. So they don't flex in the same period. We generally get the benefit of reductions in utilization when we renegotiate, so they have more of a gradual and predictable effect. So, that's one point.

Secondly, we've decided that it makes sense to, even though we've seen some utilization decreases to be more conservative in terms of booking them, to just basically wait 'til we're fully confident. They're all real and they're all going on, and that's maybe because we're not really concerned about the MLR floor issue. So, in our view, it allows us to kind of be as conservative as we'd traditionally be without kind of feeling any kind of risk in terms of doing that. And you know, for us, it wouldn't be the worst thing in the world even if it ended up with us having to give a couple of refunds. But, I think we feel comfortable that

this is a good year to be normally conservative and that the combination of that and capitation has led us to that. We're seeing some of the moderating trends that people are seeing. But, I think, what we'd say is that we're being a little slower maybe in making the call because of those phenomena.

With regard to the other question, why don't we just get back to you on that, because I think that everyone is furiously trying to figure out rather than have them add and subtract, we'll just give you a call on that final point.

PETER COSTA: Okay, thank you.

OPERATOR: Your next question comes from the line of Scott Fidel of Deutsche Bank.

SCOTT FIDEL: Thanks. First question if you can maybe talk a bit about your Medicare bidding strategy for 2011 and how you approach benefits and supplemental premiums. It sounds like some of the competitors are holding benefits tight and talked about maybe looking to gain share and just how you guys approached the MAC's for 2011?

JAY GELLERT: I think we approached it pretty consistently to what others are saying. So, we feel comfortable we won't be at a competitive disadvantage. We felt it was important that in '11 there not be much disruption to our members.

SCOTT FIDEL: So, pretty stable.

JAY GELLERT: Yes.

SCOTT FIDEL: Okay. And then I have just a follow-up on the transition in the Northeast and you mentioned that's moving along pretty quickly. Do you have an estimate of how many members or groups United renewed in the second quarter or maybe just how many members or groups you're estimating that they'll renew for January 1, 2011, if that's easier?

JAY GELLERT: Let me try and speak to the aggregate, because I think, quite honestly we have more discussions at our level about directionally where we're going and then we can maybe get you more information on timing. We had assumed 50 percent. I think we're confident that that number is the low end and that if the trends we're seeing now lead us to believe it could be above that. So, we're pretty encouraged by the process of transition.

SCOTT FIDEL: Okay. Then one last question. Just, Jay, when you mentioned the individual membership at 90,000, was that for California or is that companywide of the 440,000 ISG -- that 90,000 of those are individual and the rest are small group?

JAY GELLERT: That's companywide.

SCOTT FIDEL: Okay. Thank you.

OPERATOR: Your next question comes from the line of Justin Lake of UBS.

JUSTIN LAKE: Thanks, good morning. Questions just on some of the charges you took this quarter. Can you give us some specifics around what the charges are related to, and also hopefully walk us through, do you expect as you're going through some of these cost cutting actions you're taking here, do you expect more charges to come?

JAY GELLERT: Well, let me talk about the charges and then, maybe, I can turn it over to Jim to talk about some of the impact of it. The charges were specifically -- $6.9 million was related to the ops strategy and then $16 million was related to the Northeast stranded costs. When we gave our guidance at our Investor Day, we targeted about $69 million in total and we're on track to do that. So, we're operating in a manner consistently to what we did. Now let me make just a couple of overview comments and then let Jim talk a little bit about the specifics. The key to this whole strategy in our mind is as follows, that we absolutely need to do the things we need to do this year to make sure that as the Northeast goes away ,and with the reduction in TRICARE, we get the G&A savings to compensate. That's the $80 to $100 million that we've targeted and we are confident we will get that. So, that's point one. Point two. A key part of our strategy, when we embarked on it a couple years ago, was a result of the fact we went through California health care reform where we also had this MLR issue. And I think a key point that struck us, at that point, is that getting G&A down in advance of reform was a critical thing. That's why we embarked on the operations strategy. So we feel like the investments we've made, and I just articulated what they were for this quarter and what they'll be for the year, will yield critical return next year in those two areas. Let me turn it over to Jim and he'll give you a little detail on the position reductions and some of the savings.

JIM WOYS: Sure. If we go back and revisit ops strategy, as Jay said, over $100 million run rate savings in 2008 and 2009 that we achieved. We took down staff by approximately 1,500 positions. A lot of restructuring going on. We sort of declared that we were done with ops strategy. The remaining charges this year were primarily related to the movement of our data center to IBM in Boulder, Colorado, which is pretty much over with now in the end of the second quarter. The charges that we've incurred now are around how we reduce stranded costs to take that $80 to $100 million out of the company that Jay talked about. Those charges are primarily all related to severance costs. Some minor restructuring costs around investments in some assets but, mainly around severance costs. We've taken out, in the first half of this year, about 200 additional positions in the company and we'll continue to take another, between now and sometime mid-next year, another 200 to 400 people out of the company to get us down to the run rate that we need to get to.

JUSTIN LAKE: Okay. What is the remaining charges you expect to take to get those lives out?

JIM WOYS: So, we expect in the balance of the year that we will have approximately another $15 million of charges in 2010 and then we will, we haven't really looked at what the 2011 number is. It will be fairly insignificant for us to get to where we need to be.

JUSTIN LAKE: And then just a follow up, there is, obviously, you're going to see some benefit from keeping the TRICARE contract. Out of those $80 to $100 million of charges, can you specify for us how much of that was associated with offsetting the loss at TRICARE and, therefore, could kind of benefit the bottom line now that that contract is actually stick?

JAY GELLERT: Justin, it's Jay. Let me go back to where we've been. About half of it is Northeast related so it's a net zero. The other half we're basically using to compensate for the reduction in the earnings in the TRICARE contract. As I earlier indicated, it's down by about 50 so, that second set of G&A will basically stabilize us over time.

JUSTIN LAKE: Okay. That's helpful. Thanks.

OPERATOR: Your next question comes from the line of Matthew Borsch of Goldman Sachs.

MATTHEW BORSCH: Yes. Hi. Good afternoon.

JAY GELLERT: It's morning still here, Matt.

MATTHEW BORSCH: Right. You know what; it still is here as well. I retract.

JAY GELLERT: It sounds like you're calling from your Bermuda headquarters.

MATTHEW BORSCH: You got me. So, my question -- couple things. We want to think about a steady state, or I should really say, target admin cost ratio for your remaining West Region. Are you trying to get to about 8 percent, 8.5 percent? I don't mean five years out but kind of --

JAY GELLERT: I think those are fair targets for next year.

MATTHEW BORSCH: Okay. And 2.5 percent, 2 to 2.5 percent on selling, I would expect?

JAY GELLERT: I think that's reasonable. If the mix changes a little, that can change a little. But I think that you're right. We really believe that being able to accomplish that is really critical to success in the new environment.

MATTHEW BORSCH: Okay. Can you remind us, how many of your commercial risk lives are in groups below 100 lives, or that category?

JAY GELLERT: You know the problem, -- we can tell you below 50 -- below 50 we have 440,000 members.

MATTHEW BORSCH: Okay.

JAY GELLERT: Including individuals. So 1 to 50 would be 440.

MATTHEW BORSCH: Right. 350 excluding individuals.

JAY GELLERT: That's correct.

MATTHEW BORSCH: Then on the topic of grandfathering, where do you think employers are falling out on that? Do you see them intent on holding on to that or is something that's probably a secondary consideration next to getting the benefit adjustments the way that they want them to respond to trends?

JAY GELLERT: I think there are three phenomena going on simultaneously and I think, it may be a little too early to make a definitive call, but let me outline them.

One, I do believe that people are reacting to trend and, that if, as you said, if trend is too significant that there's clearly they'll forsake grandfathering. I think that's particularly true for very broad network products, whether they be PPO or even HMO. I think the alternative of a narrower network that retains the same benefits is something that's more prevalent in California and more developed. And so, in many cases, there's interest in that as kind of a second leg. And then third, we're seeing that in some cases employers have really pushed the benefits pretty far and they're looking at other network alternatives, and lower price point products with the same level of benefits, just because they've gone pretty far with their employees in a time that employees don't have much disposable income. So, what I'd say is that the broad products have -- that people are forsaking grandfathering for trend. They have the alternative of moving to the narrower products and that they're getting pressure from just the general economy to look at the narrower products because people can't afford continued shift of costs to them given the lack of disposable income, and that's particularly prevalent, we're seeing in areas of high foreclosure, high housing under water, high unemployment, deterioration in income, high public employees.

MATTHEW BORSCH: Yes. Okay. Makes sense. And last question, can you just give us an update of how you see the health plans performing in Oregon and Arizona?

JAY GELLERT: We're continuing to get solid performance from them. The problem we had in the Northeast was a scale problem and the fact it was a relatively undeveloped managed care market. In these cases, we can almost treat them as other California counties and so, as a result, we can get the economies of scale and we're evolving more towards a managed product market in both of those states. So, they're doing well and they don't have the difficulties we had when we looked at the Northeast.

MATTHEW BORSCH: Okay. Thank you.

OPERATOR: Your next question comes from the line of John Rex of JPMorgan.

JOHN REX: Thanks. So, you mentioned in your prepared commentary looking forward to successful '11, so since you brought it up, I guess the question is when you take into context adjusting pricing for the reform provisions that go live and what you can get into it, MCR mins, the economy, other things you are doing, where is your degree of confidence on earnings growth for '11 over '10? Kind of initial thoughts on that potential?

JAY GELLERT: At this -- we feel comfortable that even with the TRICARE change, and with all of the conditions you've articulated, that we should see operating earning improvement in 2011 over 2010. We also will inherently have a lower share count. So, we're not just saying EPS improvement, we're saying operating earnings improvement and a lower share count, and we see a line of sight to that in '11.

JOHN REX: And is there one factor, or one or two factors that you think are the primary lever on that? Is the commercial member adds something that you just point to and say this is the real key here?

JAY GELLERT: No, I think the key for us is the stable health care, the stably reducing health care costs trends. The earlier question we had was why aren't you seeing as big a decrease this year in terms -- bigger increase in PPIA? The stability and improvement we're seeing in '10 we now feel pretty comfortable will stay with us in '11. So that's probably the most critical issue. And we don't -- I think other people have discussed concerns about MLR; discussed concerns about trends and some of that. I think the business we have gives us probably more insight a year ahead now and eliminates some of the speed bumps that others see. So, that combined with the fact we've already made the investments in the SG&A reductions. So, the confidence we have in the SG&A reductions, both related to the TRICARE contract and related to the Northeast, combined with the more predictable, stable health care trends, so that while we're seeing a decline, it will be more level. And then adding on top of that fewer legislative disruptions because we're already in the California market and it has many of the features of what's going on, and we're not unduly dependent on the individual market. That package of things, I think, are the things that give us confidence as we look ahead.

JOHN REX: So, on the latter point that you mentioned on the costs, I just wanted to see if I could get any more commentary on that in terms of are you seeing major differences between the payor buckets? That is, in terms of the trend you are seeing in commercial versus Medicare and how different that is? And then, also, because you do have all of these capped arrangements, what are you hearing from the field? That is, from some of the larger California capped groups there? Any kind of color commentary you're getting from them? Unlike others, they make money when patients don't show up in the office.

JAY GELLERT: I think our expectation is that the utilization experience we're all seeing is also being seen some by them. So, I think that's an encouraging sign. We're particularly kind of encouraged that in some

of the more efficient networks we're beginning to see lower unit costs, which makes sense, because we're in a situation where they're more focused on lower cost suppliers. So, we're seeing both utilization and unit costs improvement in some of those cases. So I think the medical groups, from what we've heard to date, are seeing some improvement. But for us, as is indicated, and particularly in Medicare where we have even more capitation, the net effect isn't felt until you renegotiate -- until you look to the next year. So, I think we have a sense that the utilization trends others are seeing, we're seeing much of them, but that we don't have as rapid recognition but we have more of a smoothing, which will be really good, a natural smoothing, in the context of the new environment.

JOHN REX: And just because you have line of sight into another book, there's been some indications that federal employee utilization down also, even TRICARE down. When you look at your claims data there, are you seeing similar trends across all those books where one would expect might even be less economics sensitivity than commercial?

JIM WOYS: TRICARE looks fairly stable. It's a little down, but I think, again ours is in the Northeast, so it's hard to -- we get geographic differences but the TRICARE utilization is slightly down, sort of inconsistent with everything else. Even in TRICARE, we have a risk-sharing arrangement so it's shared 80/20 between us and our customer.

JAY GELLERT: The other thing I would say about TRICARE that would make it somewhat different, and Jim can tell me I'm wrong, but the pressure on the military and the military families promote a different environment. I think less the economy, less anything else, it's the fact we're in the ninth year of these very, very harrowing activities outside of the country that put a different stress on those families and lead to different kind of health issues. I think that's been widely discussed. So, I don't think, as Jim said, I don't think we've seen the same diminution and utilization, but I think it's because they're in a totally different factor state.

JOHN REX: And I guess my point was that it's because of that, especially, it's surprising almost that even it's slightly down. And I'm just thinking beyond economy, because it shouldn't be the economy that's impacting this demographic, beyond the economy still struggling for what else is driving this lower trend and the fact that you're even seeing any of it over there is interesting.

JAY GELLERT: Yes, although I'd say that some of the TRICARE members also have employment and they have other things going on. So, I would not -- I think the trend is, from our sense, remarkably consistent with previous recession trends and given the steepness of this recession and the joblessness of this recession, this doesn't seem incredibly unusual. The big challenge we all have, and I mean this extends beyond our industry, is historically we get a doubling up as the economy comes out and that's the one thing that would really present some serious cost problems across the entire health care sector in America.

JOHN REX: Great. Thank you.

OPERATOR: Your final question comes from the line of Tom Carroll of Stifel Nicolaus.

TOM CARROLL: Good morning. Most questions answered. I wanted to come back to, I think it was something Peter said, regarding the reserving and positive development. Just tell me if this is fair? Make sure I get the story correct. Medical trends impact Health Net on a lagging basis because of your capitated position. Trends have been favorable, but all the positive development in the quarter is re-established despite a decrease in the claims payable for a host of reasons that you outlined. Is it fair to assume that if things continue as expected that, or rather fair to say, that Health Net is in a very good

reserve position for the remainder of the year and we potentially see some releases towards future quarters?

JAY GELLERT: I think it's fair to say we're in a strong and solid reserve position. It would be inconsistent with good accounting to foresee releases. But I don't think we have any discomfort with our position and feel that it's very safe.

TOM CARROLL: Excellent. One other follow-up here on your narrow network products. The 23,000 growth membership you mentioned in your press release, is that all the narrow network products? Is that what you are referring to there?

JAY GELLERT: Yes, sir.

TOM CARROLL: Does that group of membership have a lower MLR relative to your consolidated number?

JAY GELLERT: Typically those products do slightly better than overall.

TOM CARROLL: And then of --

JAY GELLERT: Let me make one comment on that, though. And again, when we talk about caution and booking, one of the key things that we've been really trying to be careful about is, historically sometimes, the early people into a product show better results and then people jump to draw conclusions that it's product driven and not necessarily early or doctor driven. One of the other areas of our conservatism, as I've articulated, is we've been conservative in our bookings in that regard, so the results look good. I think we've been careful not to do what's gone on, for example in terms of some of the HSA products, where people thought they were getting wonderful results and then a year later they had huge premium increases. I think we're seeing evidence of good results, but we're being reasonably conservative in booking them.

TOM CARROLL: How much of your new sale visibility that you mentioned is narrow network product?

JAY GELLERT: About half.

TOM CARROLL: Great. Thank you.

ANGIE McCABE: Do we have any final questions, Janeshia?

OPERATOR: There are no further questions.

ANGIE McCABE: With that, we will conclude our call. Thank you all for joining us.

OPERATOR: This concludes today's conference call. You may now disconnect.

[END]