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SELECTED FINANCIAL DATA

(in thousands except per share data)	Years Ended December 31,				
	1996 <sup>1</sup>	1997 <sup>2</sup>	1998	1999	2000
Statement of operations data:					
Revenues	\$ 247,804	\$ 388,975	\$ 503,077	\$ 458,493	\$ 506,741
Operating expenses:					
Cost of services	72,284	154,513	228,108	215,480	225,783
Selling and marketing	29,148	42,376	49,574	45,588	48,377
General and administrative	13,745	29,204	42,724	36,549	34,201
Health care benefits	5,479	8,870	18,542	6,192	13,044
In-process research and development	—	80,000	—	—	—
Depreciation and amortization	12,334	17,185	25,235	29,445	38,389
Interest income	(13,581)	(15,013)	(20,470)	(6,293)	(6,639)
Interest expense	—	6,273	12,642	15,017	14,731
Total operating expenses	119,409	323,408	356,355	341,978	367,886
Income before income taxes	128,395	65,567	146,722	116,515	138,855
Income taxes	(49,400)	(58,492)	(58,719)	(47,218)	(56,236)
Net income	\$ 78,995	\$ 7,075	\$ 88,003	\$ 69,297	\$ 82,619
Weighted average shares outstanding - basic <sup>3</sup>	68,886	65,048	61,670	50,270	47,849
Net income per common share - basic <sup>3</sup>	\$ 1.15	\$ .11	\$ 1.43	\$ 1.38	\$ 1.73
Weighted average shares outstanding - diluted <sup>3</sup>	70,488	66,832	62,658	51,003	49,870
Net income per common share - diluted <sup>3</sup>	\$ 1.12	\$ .11	\$ 1.40	\$ 1.36	\$ 1.66
Balance sheet data:					
Cash and investments	\$ 265,897	\$ 286,167	\$ 199,776	\$ 128,596	\$ 127,582
Working capital	167,544	80,524	15,409	31,425	40,270
Total assets	360,546	707,878	557,879	488,734	491,596
Total liabilities (excluding debt)	37,340	248,271	194,752	162,002	182,683
Long-term debt	—	200,000	225,000	240,000	127,500
Stockholders' equity	\$ 323,206	\$ 259,607	\$ 138,127	\$ 86,732	\$ 181,413

<sup>1</sup> On February 1, 1996, the Company completed the acquisition of American Life and Health Insurance Company and its subsidiary insurance company. Under the terms of the acquisition, which was accounted for as a purchase, the Company paid a purchase price of approximately \$12 million.

<sup>2</sup> On July 1, 1997, the Company completed the acquisition of FIRST HEALTH Strategies, Inc. ("Strategies") and FIRST HEALTH Services Corporation ("Services"), excluding the stock of Viable Information Processing Systems, Inc., a wholly owned subsidiary of Services, from First

Financial Management Corporation and First Data Corporation for a net purchase price of approximately \$196 million. In connection with this acquisition, the Company recorded a one-time non-cash charge of \$80 million for in-process research and development costs which had no alternative future use for the Company. The acquisition was financed with a \$200 million credit agreement underwritten by the Company's bank group.

On August 30, 1997, the Company completed the acquisition of Loyalty Life Insurance Company for a purchase price of approximately

\$12 million in cash. Both acquisitions in 1997 were accounted for under the purchase method of accounting. Consequently, prior period results were not restated.

<sup>3</sup> All historical common share data have been adjusted for a 2-for-1 stock split in the form of a 100% stock distribution paid on June 23, 1998, to stockholders of record on June 2, 1998.

MANAGEMENT'S DISCUSSION *and* ANALYSIS OF FINANCIAL  
CONDITION *and* RESULTS OF OPERATIONS

This Management's Discussion and Analysis of Financial Condition and Results of Operations may include certain forward-looking statements, within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, including (without limitation) statements with respect to anticipated future operating and financial performance, growth and acquisition opportunities and other similar forecasts and statements of expectation. Words such as "expects," "anticipates," "intends," "plans," "believes," "seeks," "estimates," "could" and "should" and variations of these words and similar expressions are intended to identify these forward-looking statements. Forward-looking statements made by the Company and its management are based on estimates, projections, beliefs and assumptions of management at the time of such statements and are not guarantees of future performance. The Company disclaims any obligation to update or revise any forward-looking statement based on the occurrence of future events, the receipt of new information or otherwise.

Actual future performance, outcomes and results may differ materially from those expressed in forward-looking statements made by the Company and its management as a result of a number of risks, uncertainties and assumptions. Representative examples of these factors include (without limitation) general industry and economic conditions; interest rate trends; cost of capital and capital requirements; competition from other managed care companies; the ability to expand certain areas of the Company's business; the ability to achieve improved operating results that are anticipated with the completion of the consolidation of the commercial claims processing business; shifts in customer demands; changes in operating expenses including employee wages, benefits and medical inflation; governmental and public policy changes; and the continued availability of financing in the amounts and on the terms necessary to support the Company's future business. In addition, if the

Company does not continue to successfully implement new contracts and programs and control health care benefit expenses, the Company may not achieve its projected 2001 financial results (discussed below).

**Recent Developments.** On July 1, 1997, the Company acquired all of the outstanding shares of capital stock of FIRST HEALTH Strategies, Inc. and FIRST HEALTH Services Corporation (collectively "FHC"), excluding the stock of Viable Information Processing Systems, Inc., a wholly owned subsidiary of FIRST HEALTH Services Corporation, from First Financial Management Corporation and First Data Corporation for a purchase price of approximately \$196 million. In connection with the acquisition, which was accounted for as a purchase, the Company recorded a charge to earnings of \$80 million for purchased in-process research and development that was not deductible for income tax purposes. In-process research and development relates to the next generation of FHC's claims processing system software that had not yet reached the stage of technological feasibility and had no alternative future use; therefore, the ultimate revenue generating capability of these projects was uncertain. The research and development acquired required additional development efforts to become commercially viable. Such modifications include the enhancement of various modules to perform claims adjudication, reporting, imaging, and correspondence and are expected to be substantially completed within the next six to 12 months. Management believes the technology will be commercially viable subsequent to these modifications, and such technology will be fully implemented into operations on or about June 2002. Use of this technology is expected to ultimately decrease claims processing costs by up to 20% per claim.

At the date of acquisition, management estimated the Company would spend approximately \$10 million in additional development expenditures over

a two- to three-year period to make the purchased research and development commercially viable. Total development costs are now expected to approximate \$15 million, of which approximately

\$11 million has been expended as of December 31, 2000. The increase in estimated total costs is due to enhancements beyond those originally planned by the Company.

**Results of Operations.** The following table presents the Company's sources of revenue and percentages of those revenues represented by certain statement of operations items.

Sources of revenue: (\$ in thousands):	Years Ended December 31,					
	1998	%	1999	%	2000	%
PPO services	\$ 223,328	44	\$ 223,143	49	\$ 272,196	54
Claims administration	182,537	36	158,388	35	152,901	30
Clinical management services	44,094	9	33,768	7	31,715	6
Fee schedule services	30,981	6	33,062	7	36,848	7
Premiums, net	18,991	4	7,673	2	12,175	3
Service	3,146	1	2,459	—	906	—
Total	\$ 503,077	100	\$ 458,493	100	\$ 506,741	100

Percent of revenue:	Years Ended December 31,		
	1998	1999	2000
Expenses:			
Cost of services	45%	47%	45%
Selling and marketing	10	10	10
General and administrative	8	8	7
Health care benefits	4	1	2
Depreciation and amortization	5	6	7
Interest income	(4)	(1)	(1)
Interest expense	3	3	3
Subtotal	71	74	73
Income before income taxes	29	26	27
Net income	17%	15%	16%

**Revenues.** The Company's revenues consist primarily of fees for cost management services provided under contracts on a percentage of savings basis (PPO) or on a predetermined contractual basis (claims administration, fee schedule, pharmacy benefit management and clinical management services). As a result of the Company's insurance company acquisitions, revenues also include premium revenue. Total revenues increased \$48,248,000 (11%) from 1999 to 2000 and decreased \$44,584,000 (9%) from 1998 to 1999. The increase in revenues from 1999 to 2000 is due primarily to strong

growth in PPO revenue (from CNA for the Mailhandlers Benefit Plan along with numerous other clients) and fee schedule revenue which are the Company's most profitable services. The decrease in revenue from 1998 to 1999 was due primarily to the Company's focus on larger, multi-sited national employers in the group health area.

Revenue from PPO services increased from 1998 to 2000 as a result of increased utilization of the PPO network by existing clients, expansion of the PPO network and new client additions such as CNA.

Claims administration primarily represents revenue earned from processing claims in client-sponsored health care plans. The decrease from 1998 to 2000 reflects the expected loss of business due to the Company's focus on serving multi-sited, national employers. Revenue from clinical management services decreased from 1998 to 2000 also due to the loss of business. Fee schedule services revenue increased from 1998 to 2000 due to new and expanded contract activity with several existing clients. Premium revenue increased from 1999 to 2000 and decreased from 1998 to 1999. The increase from 1999 to 2000 is due primarily to new stop-loss insurance clients. The decrease from 1998 to 1999 was due primarily to the planned loss of several clients as a result of price increases implemented by the Company. The majority of risk-related service revenue represents stop-loss insurance for self-funded ERISA plans. The decrease in this revenue from 1998 to 2000 reflects the planned termination of unprofitable business. Management estimates that the majority of risk-based revenue will be attributable to stop-loss insurance for the foreseeable future.

**Cost of Services.** Cost of services consists primarily of salaries and related costs for personnel involved in claims administration, PPO administration, development and expansion, clinical management programs, fee schedule, information technology and other cost management and administrative services offered by the Company. To a lesser extent, it includes telephone expenses, facility expenses and information processing costs. Cost of services as a percent of revenue increased from 45% in 1998 to 47% in 1999 but decreased to 45% in 2000. The decrease from 1999 to 2000 is due to cost-cutting measures the Company initiated in 1999 and continued in 2000. The Company has made significant technology infrastructure investments between 1998 and 2000 which are intended to further improve the efficiency of its operations. Historically, the Company has invested 10 percent to 12 percent of revenue in its technology infrastructure and currently expects to continue this level of investment.

**Selling and Marketing.** Selling and marketing expenses increased \$2,789,000 (6%) from 1999 to 2000 due primarily to the focused national marketing campaign the Company introduced in

the first quarter of 2000. Selling and marketing expenses decreased \$3,986,000 (8%) from 1998 to 1999 due to the consolidation of FHC sales activities into the traditional Company sales activities. As a percentage of revenues, selling and marketing expenses have remained approximately 10% from 1998 to 2000.

**General and Administrative.** General and administrative costs decreased from 8% of revenues in 1998 and 1999 to 7% of revenues in 2000 primarily due to the elimination of duplicate functions within the Company and increased efficiency.

**Health Care Benefits.** These expenses represent medical losses incurred by insureds of the Company's insurance entities. The medical loss ratio (health care benefits as a percent of premiums) was 98% for 1998, 81% for 1999 and 107% for 2000. The Company's insurance business is small and volatile, so the loss ratio is somewhat unpredictable. The Company has reviewed this book of business and is taking measures to reduce the loss ratio in subsequent years.

**Depreciation and Amortization.** These expenses increased from 1998 to 2000 principally as a result of the significant technology infrastructure investments made over the past several years. As a percentage of revenues, these costs increased from 5% in 1998 to 6% in 1999 to 7% in 2000. Depreciation expense will continue to grow primarily as a result of continuing investments the Company is making in its information technology infrastructure.

**Interest Income.** The Company invests a significant portion of its available cash in various interest-bearing instruments. The net interest income realized from such investments represented 4% of revenues in 1998, 1% of revenues in 1999 and 1% of revenues in 2000. Interest income decreased substantially in 1999 due to the repurchase of approximately \$229 million of the Company's common stock during 1998 and approximately \$123 million of Company common stock in 1999. These common stock repurchases resulted in a decrease in the balance of cash equivalents and investments in 1999 compared with 1998. Interest income was comparable between 1999 and 2000 as cash equivalents and investments remained fairly constant.

**Interest Expense.** Interest expense represents interest incurred on the revolving credit agreement entered into on July 1, 1997, to finance the FHC acquisition. The floating interest rate incurred was between 6% and 7.5% from 1998 to 2000.

**Income Taxes.** Income taxes were provided at an effective rate of 40% in 1998 compared to 40.5% in 1999 and 2000. The higher-than-statutory rate for the three years includes provisions for state income taxes and expenses that are not deductible for income tax purposes.

**Seasonality.** The Company has historically experienced increases in salaries and related costs during its first and fourth calendar quarters in anticipation of an increase in the number of new members in client-sponsored health care plans. Since group health care plans typically offer an open enrollment period for new members during January of each year, the Company anticipates that its future first and fourth quarters will continue to reflect similar cost increases. The Company's future earnings could be adversely affected if the Company were to incur costs in excess of those necessary to service the actual number of new members resulting from the open enrollment.

**Inflation.** Although inflation has not had a significant effect on the Company's operations to date, management believes that the rate at which health care costs have increased has contributed to the demand for PPO, clinical cost management and other cost management services, including the services provided by the Company.

**Other Information.** Since 1993, there has been considerable discussion of health care reform. Although specific features of any legislation that ultimately may be enacted into law cannot be predicted at this time, based on the Company's review of legislation previously considered by Congress and various state legislatures, management believes that the Company's existing programs and those under development provide a foundation that will prevent any material adverse affect on the operations of the Company.

**Liquidity and Capital Resources.** The Company had \$40,270,000 of working capital at December 31, 2000, compared to \$31,425,000 at December 31, 1999 and \$15,409,000 at December 31, 1998.

The increase from 1998 to 2000 is due primarily to the timing of common stock repurchases as the Company repurchased \$25,000,000 of its common stock at the end of 1998, which it did not do in 1999 or 2000. Otherwise, working capital would be consistent between 1998 and 2000. Total cash and investments of the Company amounted to \$127,582,000 at December 31, 2000; \$128,596,000 at December 31, 1999; and \$199,776,000 at December 31, 1998.

During the three-year period ended December 31, 2000, the Company generated \$414,323,000 of cash from operating activities. Investment activities used \$67,270,000 in cash during 2000 representing net purchases of investments of \$4,828,000 and capital expenditures of \$62,442,000. Investment activities generated \$3,765,000 in cash during 1999, representing net sales of investments of \$53,436,000 partially offset by capital expenditures of \$49,671,000. Investment activities generated \$353,000 in cash during 1998, representing net sales of investments of \$52,954,000 partially offset by capital expenditures of \$52,428,000. Financing activities used \$116,044,000 in cash during 2000, representing \$112,500,000 in net reductions of long-term debt and \$46,059,000 in purchases of treasury stock partially offset by \$40,907,000 in proceeds from the issuance of common stock, \$1,228,000 in repayments of loans to employees to finance the exercise of stock options (net of \$3,637,000 in loans extended to employees) and \$380,000 in sales of put options. Financing activities used \$130,477,000 in cash during 1999, representing \$148,077,000 in purchases of treasury stock (of which \$125,185,000 was purchased on the open market including \$25,000,000 payable at December 31, 1998, with the balance being purchased through the exercise of put options for common stock), \$4,429,000 in exercises of put options for cash, and \$2,859,000 in loans to employees to finance the exercise of stock options (net of \$180,000 in repayments of loans) partially offset by \$15,000,000 in net proceeds from the issuance of long-term debt, \$6,632,000 in proceeds from issuance of common stock and \$3,256,000 in sales of put options. Financing activities used \$158,948,000 in cash during 1998, representing \$190,594,000 in purchases of treasury stock (of which \$159,919,000 was purchased on the open market with the balance being purchased through

the exercise of put options for common stock) partially offset by \$25,000,000 in proceeds from the issuance of long-term debt and \$7,269,000 in proceeds from the issuance of common stock.

On July 1, 1997, the Company entered into a \$200 million revolving credit agreement (the "Agreement") to facilitate the acquisition of FHC. In August 1997, the Agreement was amended to increase available borrowings to \$350 million. As of December 31, 2000, \$127.5 million was outstanding under the Agreement.

The Company believes that its working capital, long-term investments, amounts available under the Agreement and cash generated from future operations will be sufficient to fund the Company's operations and anticipated expansion plans.

**Market Risk.** Market risk is the risk that the Company will incur losses due to adverse changes in interest rates and prices. The Company's market risk exposure is limited to the \$60,257,000 and \$61,115,000 of marketable securities owned by the Company at December 31, 2000 and 1999, respectively, and the \$127,500,000 and \$240,000,000 of variable rate debt held by the Company at December 31, 2000 and 1999, respectively. The Company does not hold any market risk sensitive instruments for trading purposes. The Company has established policies and procedures to manage sensitivity to interest rate and market risk. These procedures include the monitoring of the Company's level of exposure to each market risk and the use of derivative financial instruments to reduce risk.

The Company's marketable equity and debt securities are classified as available for sale and are recorded in the consolidated balance sheets at fair value with unrealized gains or losses reported as a separate component of other comprehensive income (loss) in stockholders' equity, net of applicable deferred taxes. As of December 31, 2000, the fair value of the Company's marketable securities was \$60,257,000, consisting of \$52,893,000 invested in debt securities and \$7,364,000 invested in equity securities. As of December 31, 1999, the fair value of the Company's marketable securities was \$61,115,000, consisting of \$53,163,000 invested in debt securities and \$7,952,000 invested in equity securities. The Company measures its interest rate

risk by estimating the net amount by which potential future net earnings would be impacted by hypothetical changes in market interest rates related to all interest rate sensitive assets and liabilities, including derivative financial instruments.

Assuming a hypothetical 20% increase in interest rates as of December 31, 2000, the estimated reduction in future earnings, net of tax, would be less than \$1.0 million. Assuming the same 20% increase in interest rates as of December 31, 1999, the estimated reduction in future earnings, net of tax, would also have been less than \$1.0 million. Equity price risk arises when the Company could incur economic losses due to adverse changes in a particular stock index or price. The Company's investments in equity securities are exposed to equity price risk and the fair value of the portfolio is correlated to the S&P 500. At December 31, 2000, management estimates that an immediate 10% decrease in the S&P 500 would result in a decrease in the fair value of its equity securities of less than \$1.0 million. Management estimated that a 10% decrease in the S&P 500 at December 31, 1999 would have affected the fair value of its equity securities by less than \$1.0 million.

**Derivative Financial Instruments.** As discussed in Note 11 to the financial statements, the Company uses derivative financial instruments to reduce interest rate risk and potentially increase the return on invested funds and to manage the cost of its common stock repurchase programs. In addition, collateralized mortgage securities have been purchased that have relatively stable cash flow patterns in relation to interest rate changes. Investments in derivative financial instruments are approved by the Audit Committee or Board of Directors of the Company.

**2001 Outlook.** The Company currently anticipates that its earnings per share ("EPS") in 2001 will grow in the high-teen area with revenue growth of approximately 10%. The Company currently estimates revenue in 2001 of approximately \$560 million and EPS of \$1.95.

Revenue growth will be led by the PPO business, which is expected to grow in the mid-teen area. It is currently anticipated that our claims administration business will grow in the low double digits area and that fee schedule revenue will be flat or

slightly decline due to a loss of business from General Motors.

**Potential Managed Care Litigation.** Much has been recently written about the plaintiff's bar attacking managed care organizations. We believe **First Health** is very well positioned to avoid litigation for the following reasons:

Counsel for class action plaintiffs is sophisticated and understands the differences between HMOs, which offer little or no choice to their subscribers regarding provider selection, and the PPO services the Company provides.

The Company does not encourage or penalize its network physicians through capitation, risk sharing, cash incentive bonuses or other methods for denying or limiting care. Its "control" over physicians is limited to qualifying them for participation in the network based on objective criteria related only to their credentials, licensure, malpractice history, insurance, etc. Network physicians are truly independent contractors, solely responsible for the health care of their patients.

Consistent with many state law requirements and national accreditation standards, there is no direct or indirect financial bonus or remuneration paid to individuals involved in the recommendation of medical care based on medical necessity.

Most importantly, participants in our customers' plans have choice. Commonly, our customers offer two or more plan options; the PPO option alone inherently provides choice with a meaningful (but compared to an HMO, modest) benefit differential. The choice of medical specialists is solely within the control of the treating physician and the patient.

**HIPAA Administrative Simplification.** The Health Insurance Portability and Accountability Act of 1996 ("HIPAA") directs the Department of Health and Human Services ("HHS") to issue regulations setting standards for the electronic exchange of health care claims information among health care providers, payors and plans ("EDI"), as well as security for the exchange of information via the Internet ("E-Commerce"). This directive is

commonly referred to as "HIPAA Administrative Simplification." HHS has issued its first final rule with an implementation date of October 16, 2002 ("First Final Rule"). The Company is in the process of reviewing its readiness to implement the First Final Rule and anticipated future rules.

The Company has instituted a corporate HIPAA Administrative Simplification Committee and Workgroup to identify processes, systems or policies that will require modification and to implement appropriate remediation and contingency plans to avoid any adverse impact on its ability to perform services in accordance with the applicable standards. The Company will also be communicating with significant third-party business partners to assess their readiness and the extent to which the Company will need to modify its relationship with these third parties when conducting EDI or E-Commerce.

The cost for this compliance effort has not been determined, but it is expected that the cost will not be material and that portions of the expenses are already included in the Company's current EDI and E-Commerce initiatives. However, there can be no guarantee that the costs will not materially differ from those anticipated or that the Company will not be materially impacted. Additionally, the Company expects to receive reimbursement directly from a number of its clients due to the nature of the contractual arrangement with these entities.

**Year 2000 Matters.** The Company has not experienced any material adverse impact on its operations or in its relationships with customers, vendors or others as a result of Y2K issues. The Company did not incur any material Y2K costs during the twelve months ended December 31, 2000, nor does it expect to incur any material Y2K costs going forward.

**New Accounting Pronouncements.** In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard No. 133 ("SFAS No. 133"), "Accounting For Derivative Instruments and Hedging Activities." SFAS No. 133 requires that all derivative instruments be recognized as either assets or liabilities in the balance sheet and that derivative

instruments be measured at fair value. This statement also requires changes in the fair value of derivatives to be recorded each period in current earnings or comprehensive income depending on the intended use of the derivatives. This statement is effective for the Company beginning January 1, 2001. The Company has prepared an inventory of derivative instruments and has determined that SFAS No. 133 will not have a material effect on its results of operations and financial position.

**Legal Proceedings.** The Company and its subsidiaries are subject to various claims arising in the ordinary course of business and are parties to various legal proceedings which constitute litigation incidental to the business of the Company and its subsidiaries. The Company's wholly owned

subsidiary, **First Health Services Corporation** ("Services") continues to be subject to an investigation by the District of Columbia Office of Inspector General ("OIG"). In July 2000, the OIG issued a report evaluating the District of Columbia's (the "District") Medicaid program and suggesting ways to improve the program. Services, a subsidiary of the Company that was acquired in July 1997, has acted as the program's fiscal agent intermediary for 20 years. The OIG report included allegations that from 1993 to 1996 Services, in its role as fiscal agent intermediary, made erroneous Medicaid payments to providers on behalf of patients no longer eligible to receive Medicaid benefits. The Company does not believe that the claim or the investigation will have a material adverse affect on the Company's business or financial position.

Board of Directors and Stockholders,  
**First Health Group Corp.**, Downers Grove, Illinois

We have audited the consolidated balance sheets of **First Health Group Corp.** and Subsidiaries as of December 31, 2000 and 1999, and the related consolidated statements of operations, of comprehensive income, of cash flows and of stockholders' equity for each of the three years in the period ended December 31, 2000. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of **First Health Group Corp.** and Subsidiaries as of December 31, 2000 and 1999, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2000, in conformity with accounting principles generally accepted in the United States of America.

*Deloitte & Touche LLP*

Deloitte & Touche LLP  
Chicago, Illinois

February 19, 2001

Management is responsible for the preparation and integrity of the consolidated financial statements and financial comments appearing in this annual report. The financial statements were prepared in accordance with accounting principles generally accepted in the United States of America and include certain amounts based on management's best estimates and judgments. Other financial information presented in the annual report is consistent with the financial statements.

The Company maintains a system of internal accounting controls designed to provide reasonable assurance that assets are safeguarded and that transactions are executed as authorized and are recorded and reported properly. This system of controls is based upon written policies and procedures, appropriate divisions of responsibility and authority, and careful selection and training of personnel. Policies and procedures prescribe that the Company and all employees are to maintain the highest ethical standards and that business practices are to be conducted in a manner that is above reproach.

Deloitte & Touche LLP, independent auditors, has audited the Company's consolidated financial statements, and its report is presented herein. Management has made available to Deloitte & Touche LLP all the Company's financial records and related data, as well as the minutes of the Board of Directors' meetings. Management believes that all representations made to Deloitte & Touche LLP during its audit were valid and appropriate.

The Board of Directors has an Audit Committee composed solely of outside Directors. The independent auditors have direct access to the Audit Committee and periodically meet with the Audit Committee to discuss accounting, auditing and financial reporting matters.

**First Health Group Corp.**  
Downers Grove, Illinois

February 19, 2001

CONSOLIDATED BALANCE SHEETS

Assets	December 31,	
	1999	2000
<b>Current assets:</b>		
Cash and cash equivalents	\$ 35,639,000	\$ 23,538,000
Short-term investments	78,000	2,015,000
Accounts receivable, less allowances for doubtful accounts of \$10,844,000 and \$10,811,000, respectively	59,482,000	57,137,000
Deferred taxes	14,925,000	16,480,000
Other current assets	10,609,000	14,443,000
<b>Total current assets</b>	<b>120,733,000</b>	<b>113,613,000</b>
<b>Long-term investments:</b>		
Marketable securities	61,037,000	58,242,000
Other	31,842,000	43,787,000
<b>Total long-term investments</b>	<b>92,879,000</b>	<b>102,029,000</b>
<b>Property and equipment:</b>		
Land, building and improvements	64,765,000	71,135,000
Computer equipment and software	124,614,000	148,846,000
Office furniture and equipment	14,235,000	16,597,000
	203,614,000	236,578,000
Less accumulated depreciation and amortization	(75,602,000)	(80,861,000)
<b>Total property and equipment, net</b>	<b>128,012,000</b>	<b>155,717,000</b>
Goodwill, less accumulated amortization of \$8,701,000 and \$12,355,000, respectively	93,629,000	89,975,000
Reinsurance recoverable	50,810,000	28,215,000
Other assets	2,671,000	2,047,000
	<b>\$ 488,734,000</b>	<b>\$ 491,596,000</b>

*See Notes to Consolidated Financial Statements.*

CONSOLIDATED BALANCE SHEETS

<i>Liabilities and Stockholders' Equity</i>	December 31,	
	1999	2000
Current liabilities:		
Accounts payable	\$ 49,507,000	\$ 31,727,000
Accrued expenses	27,680,000	28,603,000
Claims reserves	10,628,000	13,013,000
Income taxes payable	1,493,000	—
Total current liabilities	89,308,000	73,343,000
Long-term debt	240,000,000	127,500,000
Claims reserves	50,810,000	28,215,000
Deferred taxes	20,306,000	58,621,000
Other non-current liabilities	1,578,000	22,504,000
Total liabilities	402,002,000	310,183,000
Commitments and contingencies	—	—
Stockholders' equity:		
Preferred stock, par value \$1.00; authorized 1,000,000 shares; none issued	—	—
Common stock, par value \$.01; authorized 155,000,000 shares; issued 76,796,000 and 79,501,000 shares, respectively	770,000	795,000
Additional paid-in capital	189,383,000	252,092,000
Retained earnings	450,581,000	534,428,000
Accumulated other comprehensive loss	(4,401,000)	(1,509,000)
Treasury stock, at cost; 29,320,000 and 31,298,000 shares, respectively	(549,601,000)	(604,393,000)
Total stockholders' equity	86,732,000	181,413,000
	\$ 488,734,000	\$ 491,596,000

*See Notes to Consolidated Financial Statements.*

CONSOLIDATED STATEMENTS  
OF OPERATIONS

	Years Ended December 31,		
	1998	1999	2000
Revenues	\$ 503,077,000	\$ 458,493,000	\$ 506,741,000
Operating expenses:			
Cost of services	228,108,000	215,480,000	225,783,000
Selling and marketing	49,574,000	45,588,000	48,377,000
General and administrative	42,724,000	36,549,000	34,201,000
Health care benefits	18,542,000	6,192,000	13,044,000
Depreciation and amortization	25,235,000	29,445,000	38,389,000
Interest income	(20,470,000)	(6,293,000)	(6,639,000)
Interest expense	12,642,000	15,017,000	14,731,000
	356,355,000	341,978,000	367,886,000
Income before income taxes	146,722,000	116,515,000	138,855,000
Income taxes	(58,719,000)	(47,218,000)	(56,236,000)
Net income	\$ 88,003,000	\$ 69,297,000	\$ 82,619,000
Weighted average shares outstanding - basic	61,670,000	50,270,000	47,849,000
Net income per common share - basic	\$ 1.43	\$ 1.38	\$ 1.73
Weighted average shares outstanding - diluted	62,658,000	51,003,000	49,870,000
Net income per common share - diluted	\$ 1.40	\$ 1.36	\$ 1.66

See Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF  
COMPREHENSIVE INCOME

	Years Ended December 31,		
	1998	1999	2000
Net income	\$ 88,003,000	\$ 69,297,000	\$ 82,619,000
Other comprehensive income (loss), before tax:			
Unrealized gains (losses) on securities:			
Unrealized holding gains (losses) arising during period	(7,640,000)	(356,000)	5,119,000
Less: reclassification adjustment for losses included in net income	(2,759,000)	(1,833,000)	(313,000)
Other comprehensive income (loss), before tax	(10,399,000)	(2,189,000)	4,806,000
Income tax benefit (expense) related to items of other comprehensive income (loss)	4,077,000	887,000	(1,914,000)
Other comprehensive income (loss)	(6,322,000)	(1,302,000)	2,892,000
Comprehensive income	\$ 81,681,000	\$ 67,995,000	\$ 85,511,000

*See Notes to Consolidated Financial Statements.*

CONSOLIDATED STATEMENTS  
OF CASH FLOWS

	Years Ended December 31,		
	1998	1999	2000
Cash flows from operating activities:			
Cash received from customers	\$ 508,355,000	\$ 466,325,000	\$ 510,915,000
Cash paid to suppliers and employees	(335,923,000)	(303,559,000)	(310,540,000)
Health care benefits paid	(10,230,000)	(10,423,000)	(8,486,000)
Interest paid	(12,639,000)	(14,697,000)	(14,506,000)
Interest income received	17,010,000	7,126,000	5,357,000
Income taxes paid, net	(35,550,000)	(32,685,000)	(11,527,000)
Net cash provided by operating activities	131,023,000	112,087,000	171,213,000
Cash flows from investing activities:			
Purchases of investments	(284,961,000)	(62,290,000)	(25,242,000)
Sales or maturities of investments	337,915,000	115,726,000	20,414,000
Acquisition of businesses, net of cash acquired	(173,000)	—	—
Purchases of property and equipment	(52,428,000)	(49,671,000)	(62,442,000)
Net cash provided by (used in) investing activities	353,000	3,765,000	(67,270,000)
Cash flows from financing activities:			
Proceeds from issuance of long-term debt	25,000,000	30,000,000	25,000,000
Principal payments of long-term debt	—	(15,000,000)	(137,500,000)
Purchase of treasury stock	(190,594,000)	(148,077,000)	(46,059,000)
Stock option loans to employees	—	(3,039,000)	(3,637,000)
Stock option loan repayments	—	180,000	4,865,000
Proceeds from issuance of common stock	7,269,000	6,632,000	40,907,000
Exercises of put options on common stock	(1,763,000)	(4,429,000)	—
Proceeds from sales of put options on common stock	1,140,000	3,256,000	380,000
Net cash used in financing activities	(158,948,000)	(130,477,000)	(116,044,000)
Net decrease in cash and cash equivalents	(27,572,000)	(14,625,000)	(12,101,000)
Cash and cash equivalents, beginning of period	77,836,000	50,264,000	35,639,000
Cash and cash equivalents, end of period	\$ 50,264,000	\$ 35,639,000	\$ 23,538,000
Supplemental cash flow data:			
Non-cash financing activity:			
Treasury stock purchase payable	\$ 25,000,000	\$ —	\$ —
Stock options exercised in exchange for common stock	\$ 13,625,000	\$ —	\$ 8,733,000

See Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS  
OF CASH FLOWS

	Years Ended December 31,		
	1998	1999	2000
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Reconciliation of net income to net cash provided by operating activities:			
Net income	\$ 88,003,000	\$ 69,297,000	\$ 82,619,000
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Adjustments to reconcile net income to net cash provided by operating activities:			
Change in provision for uncollectible accounts receivable	1,087,000	(307,000)	(33,000)
Depreciation and amortization	25,235,000	29,445,000	38,389,000
Provision for deferred income taxes	14,937,000	14,202,000	34,846,000
Tax benefits from stock options exercised	5,787,000	1,087,000	12,714,000
(Gains) losses on sales of investments	(3,857,000)	2,195,000	329,000
Other, net	(1,081,000)	(672,000)	(1,779,000)
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Changes in assets and liabilities:			
Accounts receivable	1,310,000	4,407,000	2,378,000
Other current assets	916,000	1,752,000	(3,834,000)
Reinsurance recoverable	85,087,000	5,169,000	22,595,000
Accounts payable and accrued expenses	(8,863,000)	(8,766,000)	4,342,000
Claims reserves	(77,928,000)	(11,151,000)	(20,210,000)
Income taxes payable	2,611,000	(1,118,000)	(1,493,000)
Non-current assets and liabilities	(2,221,000)	6,547,000	350,000
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Total adjustments	43,020,000	42,790,000	88,594,000
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Net cash provided by operating activities	\$ 131,023,000	\$ 112,087,000	\$ 171,213,000
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*See Notes to Consolidated Financial Statements.*

CONSOLIDATED STATEMENTS OF  
STOCKHOLDERS' EQUITY

	Common Stock Shares	Common Stock Amount
Balance, January 1, 1998	37,567,000	\$ 376,000
2-for-1 stock split effective June 23, 1998	37,567,000	376,000
Issuance of common stock through stock option and purchase plans	1,348,000	13,000
Purchase of treasury stock	—	—
Tax benefit related to stock options exercised	—	—
Change in unrealized holding loss on marketable securities	—	—
Sale of put options on common stock	—	—
Exercise of put options on common stock	—	—
Net income	—	—
Balance, December 31, 1998	76,482,000	765,000
Issuance of common stock through stock option and purchase plans	494,000	5,000
Purchase of treasury stock	—	—
Tax benefit related to stock options exercised	—	—
Change in unrealized holding loss on marketable securities	—	—
Sale of put options on common stock	—	—
Exercise of put options on common stock	—	—
Loans granted to employees to exercise stock options	—	—
Repayment of employee stock option loans	—	—
Net income	—	—
Balance, December 31, 1999	76,976,000	770,000
Issuance of common stock through stock option and purchase plans	2,525,000	25,000
Purchase of treasury stock	—	—
Tax benefit related to stock options exercised	—	—
Change in unrealized holding loss on marketable securities	—	—
Sale of put options on common stock	—	—
Loans granted to employees to exercise stock options	—	—
Repayment of employee stock option loans	—	—
Net income	—	—
Balance, December 31, 2000	79,501,000	\$ 795,000

See Notes to Consolidated Financial Statements.

	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock Shares	Treasury Stock Amount
	\$ 157,173,000	\$ 296,140,000	\$ 3,223,000	5,622,000	\$ (197,305,000)
	(376,000)	—	—	5,622,000	—
	20,881,000	—	—	—	—
	—	—	—	11,775,000	(229,219,000)
	5,787,000	—	—	—	—
	—	—	(6,322,000)	—	—
	1,140,000	—	—	—	—
	(1,763,000)	—	—	—	—
	—	88,003,000	—	—	—
	182,842,000	384,143,000	(3,099,000)	23,019,000	(426,524,000)
	6,627,000	—	—	—	—
	—	—	—	6,301,000	(123,077,000)
	1,087,000	—	—	—	—
	—	—	(1,302,000)	—	—
	3,256,000	—	—	—	—
	(4,429,000)	—	—	—	—
	—	(3,039,000)	—	—	—
	—	180,000	—	—	—
	—	69,297,000	—	—	—
	189,383,000	450,581,000	(4,401,000)	29,320,000	(549,601,000)
	49,615,000	—	—	—	—
	—	—	—	1,978,000	(54,792,000)
	12,714,000	—	—	—	—
	—	—	2,892,000	—	—
	380,000	—	—	—	—
	—	(3,637,000)	—	—	—
	—	4,865,000	—	—	—
	—	82,619,000	—	—	—
	\$ 252,092,000	\$ 534,428,000	\$ (1,509,000)	31,298,000	\$ (604,393,000)

## 1. Summary of Significant Accounting Policies:

**The Company:** First Health Group Corp. (the "Company") is a full-service, integrated national health benefits company. The Company specializes in serving large, national employers with a single source for their group health programs providing integrated, comprehensive, cost-effective and innovative solutions for all the health benefits needs of their employees nationwide. Through its workers' compensation service line, the Company provides a full range of workers' compensation services for insurance carriers, state insurance funds, third-party administrators and large, self-insured national employers. Through its **First Health Services** service line, the Company provides services to various state Medicaid and entitlement programs for claims administration, pharmacy benefit management programs, and medical management and quality review services.

**Principles of consolidation:** The financial statements include the accounts of the Company and its wholly owned subsidiaries. Material inter company balances and transactions have been eliminated.

**Use of estimates:** The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**Cash and cash equivalents and investments:** Cash and cash equivalents are defined as all highly liquid investments with original maturities of three months or less at date of purchase.

Investments with maturities between three months and 12 months and other investments needed for current cash requirements are classified as short-term investments. All remaining investments are classified as long-term. Investments, which are classified as available-for-sale securities, are

reported at fair value. The fair value of marketable securities is estimated based on quoted market prices, when available. If a quoted price is not available, fair value is estimated using quoted market prices for similar financial instruments. The difference between amortized cost and fair value is recorded as an adjustment to stockholders' equity and other comprehensive income (loss), net of applicable deferred taxes. Realized gains and losses from sales of investments are based upon the specific identification method.

**Property and equipment:** Property and equipment are stated at cost. Expenditures for the maintenance and repair of property and equipment are charged to expense as incurred. Expenditures for major replacement or betterment are capitalized. Computer equipment and software include approximately \$24.7 million of work-in-progress as of December 31, 2000, related to internally developed software programs. There were approximately \$22.0 million of such work-in-progress amounts as of December 31, 1999.

Depreciation is provided over the estimated useful lives of the related assets using the straightline method. These lives range from five years to 31.5 years for buildings and improvements, 1.5 years to five years for computer equipment and software, and three years to five years for office furniture and equipment. Leasehold improvements are amortized over the shorter of the estimated useful life of the asset or the term of the lease.

**Long-lived assets:** The carrying amount of all long-lived assets is evaluated periodically to determine if adjustment to the depreciation and amortization period or to the unamortized balance is warranted. Such evaluation is based principally on the expected utilization of the long-lived assets and the projected, undiscounted cash flows of the operations in which the long-lived assets are deployed.

**Fair value of financial instruments:** The carrying amounts for cash and cash equivalents, accounts receivable and accounts payable are reasonable esti-

mates of their fair value. The fair value of marketable securities and investments is discussed in Note 2 to the consolidated financial statements. The carrying value of long-term debt is a reasonable estimate of its fair value as amounts are borrowed at current market rates.

**Revenue recognition:** The Company receives revenues for PPO services, claims administration services, fee schedule services, clinical cost management and other services on a predetermined contractual basis (such as a percentage of the derived savings). Revenues on a percentage of savings basis for PPO services are recognized based upon client claims processed. Additionally, the Company records revenues based upon a fixed fee per covered member, and the fee varies depending upon the programs selected or on a per-transaction basis.

**Insurance operations:** Insurance premiums are earned on a pro rata basis over the terms of the policies.

**Claims Reserves** - Claims reserves include traditional life insurance, such as whole life insurance, term life insurance and accident and health insurance, as well as universal life insurance policies and annuity contracts that do not have significant mortality or morbidity risk. Reserves for future policy benefits on traditional life insurance policies are computed using a net level premium method based upon historical experience of investment yields, mortality and withdrawals, including provisions for possible adverse deviation. Reserves for universal life-type and annuity contracts are equal to the accumulated policy holder account values, determined in accordance with the terms of the underlying policies.

**Reinsurance Recoverable** - Reinsurance recoverable represents the amount due from other insurance companies as a result of the cession of a portion of the Company's insurance risk to such companies. All of this balance is due from National Farmers Union Life Insurance Company ("National Farmers").

Reinsurance recoverable and the related claim reserves are reported separately in the consolidated balance sheets.

**Net income per common share:** Net income per common share-basic is based on the weighted average number of common shares outstanding during the period. Net income per common share-diluted is based on the weighted average number of common shares and common share equivalents outstanding during the period. In calculating earnings per share, earnings are the same for the basic and diluted calculations. Weighted average shares outstanding increased for diluted earnings per share by 988,000, 733,000 and 2,021,000 for 1998, 1999 and 2000, respectively, due to the effect of stock options. Diluted net income per share decreased by \$0.03 for 1998, decreased by \$0.02 for 1999 and decreased by \$0.07 for 2000.

All historical common share data have been adjusted for a 2-for-1 stock split in the form of a 100% stock distribution paid on June 23, 1998, to stockholders of record on June 2, 1998.

**Segment information:** The Company has determined it currently operates in one reportable segment. Each of the Company's products and services has similar long-term financial performance and similar economic characteristics. All of the Company's products and services relate to programs that provide the Company's customers with a single source for all of their group health programs, providing comprehensive, cost-effective and innovative solutions for all the health benefits needs of their employees.

**New Accounting Pronouncements:** In 1999, the Company adopted Statement of Position 98-1, ("SOP 98-1"), "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use." SOP 98-1 provides guidance on accounting for the costs of computer software developed or obtained for internal use. Specifically, certain internal payroll and payroll-related costs should be capitalized during the application development stage of a project and depreciated over the computer software's useful life. The Company capitalized approximately \$4.9 million of such internal costs during 2000 and \$5.4 million of such costs during 1999 that would have previously been expensed.

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting

Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS No. 133"). SFAS No. 133 requires that all derivative instruments be recognized as either assets or liabilities in the balance sheet and that derivative instruments be measured at fair value. This statement also requires changes in the fair value of derivatives to be recorded each period in current earn-

ings or comprehensive income depending on the intended use of the derivatives. This statement is effective for the Company beginning January 1, 2001. The Company has prepared an inventory of derivative instruments and has determined that SFAS No. 133 will not have a material effect on its results of operations and financial position.

## 2. Marketable Securities and Investments:

Information related to the Company's marketable securities and investments at December 31 is as follows:

	Amortized Cost	1999 Fair Value	Amortized Cost	2000 Fair Value
United States Government securities	\$ 18,399,000	\$ 18,101,000	\$ 15,810,000	\$ 16,078,000
State and municipal securities	4,956,000	4,561,000	4,429,000	4,052,000
Foreign government securities	455,000	431,000	460,000	440,000
Corporate securities	30,878,000	30,070,000	31,813,000	31,641,000
Mortgage and asset-backed securities	—	—	684,000	682,000
Total debt securities	54,688,000	53,163,000	53,196,000	52,893,000
Equity securities	12,818,000	7,952,000	8,652,000	7,364,000
Total	\$ 67,506,000	\$ 61,115,000	\$ 61,848,000	\$ 60,257,000
Less classified as current		78,000		2,015,000
Classified as long term		\$ 61,037,000		\$ 58,242,000

Gross unrealized gains and (losses) were \$289,000 and \$(6,680,000), respectively, at December 31, 1999 and \$896,000 and \$(2,487,000), respectively, at December 31, 2000.

Contractual maturities of marketable debt securities at December 31 are as follows:

	Amortized Cost	1999 Fair Value	Amortized Cost	2000 Fair Value
Due in one year or less	\$ 90,000	\$ 78,000	\$ 2,038,000	\$ 2,015,000
Due after one year through five years	34,144,000	33,694,000	34,156,000	34,538,000
Due after five years through ten years	11,653,000	11,200,000	8,470,000	8,200,000
Due after ten years	8,801,000	8,191,000	8,532,000	8,140,000
Total debt securities	\$ 54,688,000	\$ 53,163,000	\$ 53,196,000	\$ 52,893,000

Gross realized gains and (losses) on sales or maturities of marketable securities were \$5,717,000 and \$(2,289,000), respectively, for the year ended December 31, 1998, \$1,564,000 and \$(5,510,000), respectively, for the year ended December 31, 1999 and \$1,795,000 and \$(2,124,000) respectively, for the year ended December 31, 2000.

Included in other long-term investments at December 31, 1998, 1999 and 2000 is an investment in a limited partnership which invests in equipment that is leased to third parties. The investment is accounted for on the equity method since the Company owns between 20% and 25% in each particular tranche of the limited partnership. The total investment in this limited partnership was \$28,218,000 at December 31, 1999 and \$39,203,000 at December 31, 2000 including \$10,000,000 invested during 2000. The Company's proportionate share of the partnership's income was \$1,222,000 in 1998, \$1,605,000 in 1999 and \$2,300,000 in 2000 and is included in interest income.

### 3. Reinsurance:

On October 1, 1996, in anticipation of being acquired by the Company, Loyalty Life Insurance Company ("Loyalty") entered into a reinsurance agreement whereby it ceded 100% of its life insurance and annuity contracts in force ("preacquisition business") to a former affiliate, National Farmers. Under the terms of the reinsurance agreement, all premiums and deposits received by Loyalty that relate to preacquisition business are transferred to National Farmers. Additionally, the cash and investments transferred by Loyalty to National Farmers which support ceded insurance liabilities are held in escrow for the benefit of Loyalty's policyholders. Premiums and policy benefits, which are not material in amount, are ceded to National Farmers and shown net of such cessions in the consolidated statements of operations. Loyalty is currently seeking approvals from the insurance regulators and policyholders of each state, as necessary, which would result in the legal replacement of Loyalty by National Farmers. Such approvals would release Loyalty from future liability for its preacquisition business and result in the removal of such policy liabilities from the Company's consolidated balance sheets. The Company anticipates that it will take several years to receive the remainder of these approvals.

The Company also assumes and cedes reinsurance with other insurance companies in the normal course of business. Reinsurance is ceded primarily to limit losses from large exposures and to permit recovery of a portion of direct losses. The

Company continues to have primary liability as the direct insurer for all ceded risks. Reinsurance is assumed to increase the Company's revenues and to provide additional diversification of its insured risks. The effects of reinsurance on premiums and contract charges earned are as follows:

	Years Ended December 31,		
	1998	1999	2000
Life and health premiums and contract charges:			
Direct	\$ 28,384,000	\$ 15,588,000	\$ 17,678,000
Assumed	2,093,000	1,483,000	1,256,000
Ceded	(11,486,000)	(9,398,000)	(6,759,000)
Net	\$ 18,991,000	\$ 7,673,000	\$ 12,175,000

The recoverable amounts at December 31, 2000, include \$28,215,000 estimated by the Company with respect to ceded unpaid losses (including claims incurred but not reported) which are not billable until the losses are paid. Estimating amounts of reinsurance recoverable is impacted by the uncertainties involved in the establishment of loss reserves. Management believes the recoverables are appropriately established; however, the amount ultimately recovered may vary from amounts currently recorded.

### 4. Accrued Expenses:

Accrued expenses at December 31, 1999, include approximately \$5,149,000 for merger-related restructuring expenses; \$10,355,000 for accrued salaries, wages and benefits; and \$3,703,000 for insurance accruals. Accrued expenses at December 31, 2000, include approximately \$4,249,000 for merger-related restructuring expenses; \$12,917,000 for accrued salaries, wages and benefits; and \$3,025,000 for insurance accruals.

### 5. Long-Term Obligations:

On July 1, 1997, the Company entered into a \$200 million revolving credit agreement (the "Agreement") to facilitate the acquisition of FHC. In August 1997, the Agreement was amended to increase available borrowings to \$350 million. As of December 31, 2000, \$127.5 million was outstanding under the Agreement. The revolving credit

facility expires on June 30, 2002. The Agreement provides for interest at the LIBOR rate adjusted for the ratio of outstanding debt to earnings before interest, taxes, depreciation and amortization. As of December 31, 2000, the interest rate was approximately 7.1% per annum. The credit facility also has a compensating fee arrangement calculated at approximately 0.2% per annum of the total amount of the available borrowings.

The Agreement contains provisions that require the Company to maintain a specified level of net worth and comply with various financial ratios and includes, among other provisions, restrictions on investments, dividend payments and incurrence of additional indebtedness. At December 31, 2000, \$350,000,000 was available for dividend distributions under these provisions.

## 6. Income Taxes:

Components of the provision for income taxes are as follows:

	Years Ended December 31,		
	1998	1999	2000
Current provision:			
Federal	\$ 36,717,000	\$ 27,667,000	\$ 17,556,000
State	7,065,000	5,349,000	3,834,000
	43,782,000	33,016,000	21,390,000
Deferred provision:			
Federal	12,135,000	11,515,000	28,771,000
State	2,802,000	2,687,000	6,075,000
	14,937,000	14,202,000	34,846,000
Provision for income taxes	\$ 58,719,000	\$ 47,218,000	\$ 56,236,000

Deferred tax assets and (liabilities) comprise the following, as of December 31, 1999 and 2000:

	1999	2000
Current assets:		
Purchase accounting reserves	\$ 2,061,000	\$ 1,680,000
Revenue adjustments	2,853,000	5,612,000
Allowance for doubtful accounts	4,340,000	4,272,000
Vacation accrual	2,752,000	3,068,000
Other, net	2,919,000	1,848,000
Total current assets	14,925,000	16,480,000
Non current assets (liabilities):		
Tax benefit of limited partnership investment	(29,426,000)	(46,774,000)
Internally developed software	—	(19,179,000)
Depreciation	3,200,000	4,094,000
Intangible assets	1,668,000	1,301,000
Market value adjustment	2,538,000	624,000
Other, net	1,714,000	1,313,000
Total non current liabilities	(20,306,000)	(58,621,000)
Net deferred tax liabilities	\$ (5,381,000)	\$ (42,141,000)

Income tax benefits associated with the exercise of stock options were \$5,787,000 in 1998, \$1,087,000 in 1999 and \$12,714,000 in 2000. Such amounts are credited to additional paid-in-capital.

	Years Ended December 31,		
	1998	1999	2000
Provision for income taxes at federal statutory rate	\$ 51,353,000	\$ 40,780,000	\$ 48,599,000
State taxes, net of federal benefit	7,336,000	5,584,000	6,506,000
Expenses not deductible for income tax purposes	1,109,000	1,269,000	1,339,000
Non-taxable interest income and dividends	(1,079,000)	(415,000)	(208,000)
Provision for income taxes	\$ 58,719,000	\$ 47,218,000	\$ 56,236,000

## 7. Employment Agreements:

The Company has employment agreements that expire between 2001 and 2002 with certain officers and key employees. The agreements provide for, among other things, annual base salaries aggregating \$3,243,000 plus additional incentive compensation. The Company recorded incentive compensation to certain key officers and employees in the aggregate amount of \$471,000 in 1998 and \$2,487,000 in 2000. No incentive compensation was recorded in 1999.

## 8. Stockholders' Equity:

**Employee Stock Purchase Plan:** The Company maintains an Employee Stock Purchase Plan that allows employees of the Company and its subsidiaries to purchase shares of common stock on the last day of two six-month purchase periods (i.e., February 28 or 29 and August 31 of each year) at a purchase price that is 85% of the closing sale price of the shares as quoted on the Nasdaq national mar-

ket on the first or last day of such purchase period, whichever is lower. A maximum of 2,000,000 shares has been authorized for issuance under the plan. As of December 31, 2000, 1,478,000 shares had been issued pursuant to the plan.

**Stock options:** The Company maintains an Employee Stock Option Plan which provides for the granting of options to employees and consultants of the Company and its subsidiaries to purchase common stock at a price not less than 85% of fair market value at date of grant. These grants have contractual lives that range from five to ten years.

The Company also maintains a Stock Option Plan that provides for the granting of options to purchase common stock at fair market value at date of grant to non-employee members of its Board of Directors. These grants have a ten-year contractual life. The Company has also granted options to certain of its employees and members of its Board of Directors under individual option agreements, which expire between 2000 and 2001.

The following table summarizes changes in common stock under option plans.

	Years Ended December 31,					
	1998		1999		2000	
	Number of Shares	Wtd. Avg. Exercise Price	Number of Shares	Wtd. Avg. Exercise Price	Number of Shares	Wtd. Avg. Exercise Price
Number of Shares:						
Outstanding at beginning of the year	6,682,000	\$ 18.95	6,049,000	\$ 20.11	8,530,000	\$ 19.27
Granted	845,000	23.26	3,533,000	17.95	777,000	33.31
Exercised	(1,243,000)	15.14	(352,000)	13.33	(2,429,000)	19.64
Canceled/expired	(235,000)	24.60	(700,000)	22.66	(231,000)	22.20
Outstanding at end of the year	6,049,000	20.11	8,530,000	19.27	6,647,000	20.68
Exercisable at December 31	3,118,000	\$ 18.73	3,859,000	\$ 19.60	2,908,000	\$ 21.45
Available for grant	3,111,000		268,000		838,000	

The following table summarizes information about stock options outstanding and exercisable at December 31, 2000:

Range of Exercise Price	Options Outstanding			Options Exercisable	
	Shares	Wtd. Avg. Remaining Contractual Life In Years	Wtd. Avg. Exercise Price	Shares	Wtd. Avg. Exercise Price
\$ 1.00 to \$ 10.00	158,000	2.24	\$ 8.45	158,000	\$ 8.45
\$ 10.01 to \$ 20.00	2,678,000	5.07	16.11	724,000	17.25
\$ 20.01 to \$ 30.00	3,076,000	5.17	22.25	1,782,000	22.81
\$ 30.01 to \$ 40.00	685,000	7.18	32.27	244,000	32.31
\$ 40.01 to \$ 50.00	50,000	6.93	\$ 48.39	—	\$ —

The Company has adopted the disclosure-only provisions of the Statement of Financial Accounting Standards No. 123 ("SFAS No. 123"). The following table presents pro forma financial results if compensation cost had been recorded consistent with the provisions of SFAS No. 123:

	Years Ended December 31,		
	1998	1999	2000
Compensation cost - pretax	\$ 11,923,000	\$ 12,687,000	\$ 18,091,000
Proforma net income	80,849,000	61,751,000	71,855,000
Proforma net income per common share - basic	1.31	1.23	1.50
Proforma net income per common share - diluted	\$ 1.29	\$ 1.21	\$ 1.44

The weighted average fair value at date of grant for options granted during 1998, 1999 and 2000 were \$9.11, \$7.51 and \$16.09, respectively, and were estimated using the Black-Scholes option pricing model with the following assumptions:

	Years Ended December 31,		
	1998	1999	2000
Risk-free interest rate	4.85%	5.08%	6.06%
Dividend yield	—	—	—
Expected volatility	34.03%	47.21%	49.03%
Expected life in years	1 to 8	1 to 5	1 to 7

**Treasury Stock:** The Company's Board of Directors has approved the repurchase of up to 15 million shares of the Company's outstanding common stock under its current authorization. Purchases may be made from time to time depending on market conditions and other relevant factors. The Company had approximately 5.2 million shares available for repurchase under its current repurchase authorization as of December 31, 2000.

During 1998, the Company repurchased 9,983,000 shares of its outstanding common stock on the open market for a total cost of approximately \$184,919,000 (of which \$25,000,000 was payable on December 31, 1998). During 1999, the Company repurchased 5,324,000 shares of its outstanding common stock in the open market for a total cost of \$100,185,000. During 2000, the Company repurchased 1,705,000 shares of its outstanding common stock in the open market for a total cost of \$46,059,000. The repurchased stock was recorded as treasury stock, at cost, and is available for general corporate purposes. In connection with the exercise of options to purchase 850,000 shares of common stock during 1998, a certain employee paid the exercise price by delivering to the Company approximately 492,000 shares of previously acquired stock. In connection with the exercise of options to purchase 416,000 shares of common stock during 2000, certain employees paid the exercise price by delivering to the Company approximately 273,000 shares of previously acquired stock. These shares were also recorded as treasury stock, at cost, and are available for general corporate purposes.

In connection with its stock repurchase program, at December 31, 1999, the Company had outstanding put options which obligated the Company, at

the election of the option holders, to repurchase up to 1,500,000 shares of common stock at prices ranging from \$20.50 to \$21.00 per share. No such put options are outstanding as of December 31, 2000. During 1998, 1,300,000 shares were put to the Company at a total cost of \$30,675,000. During 1999, 977,000 shares were put to the Company at a total cost of \$22,892,000. These shares were recorded as treasury stock, at cost, and are available for general corporate purposes. In addition, during 1998, the Company settled 200,000 puts by delivering \$1,763,000 in cash to the option holders. In 1999, the Company settled 573,000 puts by delivering \$4,429,000 in cash to the option holders.

**Employee Benefit Plan:** The Company maintains a Savings and Investment Plan that allows eligible employees to allocate up to 15% of their salary, through payroll deductions, among various mutual funds. The Company matches 75% of the employee's contribution, up to 6% of his or her salary. The cost of this plan (net of forfeitures) was \$3,970,000 in 1998, \$3,708,000 in 1999 and \$3,442,000 in 2000.

## 9. Commitments and Contingencies:

**Litigation:** The Company and its subsidiaries are subject to various claims arising in the ordinary course of business and are parties to various legal proceedings that constitute litigation incidental to the business of the Company and its subsidiaries. The Company's wholly owned subsidiary, **First Health Services Corporation** ("Services") continues to be subject to an investigation by the District of Columbia Office of Inspector General ("OIG"). In July 2000, the OIG issued a report evaluating the

District of Columbia's (the "District") Medicaid program and suggesting ways to improve the program. Services, a subsidiary of the Company that was acquired in July 1997, has acted as the program's fiscal agent intermediary for 20 years. The OIG report included allegations that from 1993 to 1996, Services, in its role as fiscal agent intermediary, made erroneous Medicaid payments to providers on behalf of patients no longer eligible to receive Medicaid benefits. The Company does not believe that the claim or the investigation will have a material adverse effect on the Company's business or financial position.

**Leases:** The Company leases office facilities under leases through 2010. At December 31, 2000, future minimum annual rental commitments under these leases were as follows:

Years Ending December 31,	Amount
2001	\$ 7,790,000
2002	6,288,000
2003	4,548,000
2004	4,433,000
2005	4,365,000
Thereafter	15,672,000
<b>Total</b>	<b>\$ 43,096,000</b>

Total rent expense, recognized under the straight-line method, was \$7,908,000 in 1998, \$7,336,000 in 1999 and \$7,849,000 in 2000.

**Agreement with EDS:** The Company has an agreement (the "EDS Agreement") with Electronic Data Systems Corporation ("EDS"), primarily for the purpose of developing and jointly marketing medical and administrative cost management services to workers' compensation payors. The initial term of the EDS Agreement was to January 1, 2005, and has been extended to at least 2010. EDS provides data processing, electronic claims trans-

mission and marketing support services to the Company. Fees paid by the Company to EDS for its medical cost management services are based upon the greater of a specified minimum annual payment (based on 1999 fees) or a per-bill charge plus a percentage of savings method.

EDS processes all of the workers' compensation fee schedule bills for the Company. Although there are other data processing service organizations available, a loss of EDS's services would adversely affect the operating results of the Company's fee schedule service business.

#### 10. Major Customers:

During 1998, 1999 and 2000, the Company had no customers that individually accounted for 10% or more of revenues.

#### 11. Derivative Financial Instruments:

The use of derivatives by the Company has not been material although they have been used to reduce interest rate risks, potentially increase the return on invested funds and manage the cost of common stock repurchase programs. During 1998, the Company had invested \$12,561,000 in a limited partnership fund that used long and short positions, leverage and certain derivative securities to manage portfolio and interest rate risk. The investment was accounted for on the cost basis as the Company owned less than 5% of the assets of the limited partnership. The investment was liquidated in 1998 for \$14,797,000, of which \$1,666,000 was received in 1999. Investments in derivative financial instruments are approved by either the Audit Committee or the Board of Directors of the Company.

## 12. Quarterly Financial Data (Unaudited):

The following is a summary of unaudited results of operations (amounts in thousands except per share data) for the years ended December 31, 1999 and 2000.

	Year Ended December 31, 1999			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Revenue	\$ 117,361	\$ 115,430	\$ 113,421	\$ 112,281
Net income	\$ 17,580	\$ 16,950	\$ 17,149	\$ 17,618
Net income per common share - basic	\$ .33	\$ .34	\$ .35	\$ .37
Weighted average shares outstanding - basic	52,752	50,426	49,599	48,042
Net income per common share - diluted	\$ .33	\$ .33	\$ .34	\$ .36
Weighted average shares outstanding - diluted	53,108	50,787	50,388	49,321

  

	Year Ended December 31, 2000			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Revenue	\$ 122,475	\$ 125,884	\$ 128,065	\$ 130,317
Net income	\$ 19,612	\$ 20,533	\$ 20,753	\$ 21,721
Net income per common share - basic	\$ .41	\$ .43	\$ .43	\$ .45
Weighted average shares outstanding - basic	47,712	47,970	47,894	47,790
Net income per common share - diluted	\$ .40	\$ .41	\$ .42	\$ .43
Weighted average shares outstanding - diluted	49,531	49,984	49,875	50,034

A REPRESENTATIVE LISTING OF OUR  
DISTINGUISHED CLIENTS

<b>A</b>	Amalgamated Life Insurance Co.	American Youth Hostels	Benchmark Management Company
Academy of General Dentistry	Amalgamated Retail Fund	Amoco Fabrics and Fibers Company, A Business Unit of BP	Benefit Administrative Systems
Acterna	American Association of Orthodontists	Anderson Copper and Brass	Benesight
Advanced Drainage Systems Inc.	American Association of Petroleum Geologists	Arbitrade Holdings	Benicorp Insurance Company
AFS Insurance Services Inc.	American Baptist	Archdiocese of Chicago	Berkley Risk Administrators Company, LLC
Agilent Technologies, Inc.	American Bar Insurance	Arkansas Department of Human Services	BEST Life Assurance Company
AHRC of Suffolk County	American Chiropractic Association	Arthur J. Gallagher & Co.	Bethpage Federal Credit Union
AIG Claim Services, Inc.	American Compensation Insurance Company	Assemblies of God	Blue Cross and Blue Shield of North Carolina
Alameda County Schools Insurance Group	American Contractors Insurance Group	Associated Food Stores, Inc.	Blue Cross and Blue Shield of Tennessee
Alaska Division of Medical Assistance	American Freightways, Inc.	Association Group Insurance Trust	Blue Grass Occupational Health Network, Inc.
Albertson's, Inc.	American Heritage Publishing	Atlantic Medical Insurance	Boilermakers National Health & Welfare Fund
Alliance Health Benefit Plan	American Institute of Architects	Aurora East School District #131	Borma- City of Harrison
ALP Industries, Inc.	American Postal Workers Union Health Plan	Aurora Health Care, Inc.	Borma- City of Sandusky
Amalgamated Clothing Fund	American Psychological Association	Automotive Investment Group	BOX USA
Amalgamated Cotton Fund	American Society of Civil Engineers	<b>B</b>	BPB America, Inc.
Amalgamated Industrial Service Workers Benefit Fund	American Technical Ceramics Corp.	Bank of Bermuda	British Caymanian Insurance
		Banner Industries of New York Inc.	
		Bay Area Schools Insurance Cooperative Trust	

A REPRESENTATIVE LISTING OF OUR  
DISTINGUISHED CLIENTS

Brothers Trading	Clark District Co. of Versailles	Court TV	Donatos Pizza
Brunswick Hospital	Clementina-Clemco Holdings, Inc.	Crawford & Company	Dow Corning Corporation
Burger King Corporation	Clements and Company	<b>D</b>	<b>E</b>
Butler International	CMC Steel Group	Dairy Farmers of America	Eagle Insurance Group
<b>C</b>	Coastline Distribution, Inc.	Dakotas and Western Minnesota Electrical Industry Health and Welfare Fund	Eastern Alloy's, Inc.
C.P. Distribution, Inc.	College of American Pathologists	Danbury Health Systems	Eaton Corporation
Caremark Rx, Inc.	Colonial Casualty Insurance Company	Danisco US, Inc.	EMPLOYERS INSURANCE OF WAUSAU, A Mutual Company
CareSource (Dayton Area Health Plan)	Colonial Group International, LTD	Delphi Automotive Systems	Engineering & Scientific Associations Accident and Health Insurance Trust
Carisch, Inc.	Colonial Medical Insurance	Deltak Corp.	Essex Plaza Management
Carlson Restaurants Worldwide	Columbia Helicopters, Inc.	Desa International	<b>F</b>
Cash America International, Inc.	Commercial America	Deseret Mutual Benefit Administrators	Fab Con
Caterpillar Inc.	Commercial Envelope	DesignTex Fabrics, Inc.	FCCI Insurance Group
Cellnet	Commercial Wire	DHL Airways, Inc.	Festo Corporation
Celotex Corporation	ConAgra, Inc.	Diamond Auto Glass Works	Fidelity National Financial, Inc.
Central Parking System, Inc.	Consolidated Delivery and Logistics, Inc.	Dickard Widdard Industries	Fireman's Fund Insurance Company
Centris Risk Management	Consolidated Manufacturing, Inc.	Discovery Health	First Health Group Corp.
Ceres Group, Inc.	Consolidated Stores, Inc.	District of Columbia Medical Assistance Administration	Florida AHCA Office of Medicaid Program Development
Cerner Corporation	Continental Casualty		Foreign Mission Division
Chrysler Corporation	Contract Freighters, Inc.		Friends Academy
Cincinnati Reds			
Citizens Insurance Company of America			
City of Prague			
Clare Rose			

A REPRESENTATIVE LISTING OF OUR  
DISTINGUISHED CLIENTS

<p><b>G</b></p> <p>G &amp; S Assoc.</p> <p>Gallagher Bassett Services, Inc.</p> <p>Gallagher Benefit Administrators, Inc.</p> <p>Gemaire Distributing Inc.</p> <p>Gencor Industries, Inc.</p> <p>General Parts, Inc.</p> <p>General Scientific Corporation</p> <p>GENEX Services, Inc.</p> <p>Georgia Department of Medical Assistance</p> <p>Georgia Department of Mental Health and Mental Retardation</p> <p>Getz Bros. &amp; Co., Inc.</p> <p>GFT (USA) Corp.</p> <p>Global</p> <p>Global Care Individuals</p> <p>Global Care Scholars</p> <p>Global Missions Associated</p> <p>Gold Coast Joint Benefits Trust</p> <p>Gotcha Covered, Inc.</p> <p>Grand Court Lifestyles, Inc.</p>	<p>Grayson County</p> <p>Great Lakes Dredge &amp; Dock Company</p> <p>Greenman Brothers, Inc.</p> <p>Greenway Electric, Inc.</p> <p>Greenwich Associates</p> <p>Grinnell Mutual Reinsurance Company</p> <p><b>H</b></p> <p>Hanover American Insurance Company</p> <p>Harrington Benefit Services</p> <p>Health and Welfare Luggage</p> <p>Health Management Associates, Inc.</p> <p>Health Midwest</p> <p>Health Plan of San Joaquin</p> <p>Helmsman Management Services, Inc.</p> <p>Hewitt, Coleman and Associates, Inc.</p> <p>Heyworth CUSD Number 4</p> <p>Hotel/Motel Associates, Inc.</p> <p>Howe Barnes Investments</p> <p>Hyatt Hotels Corporation</p>	<p><b>I</b></p> <p>Indy Plus</p> <p>Ingram Industries</p> <p>Inland Truck Parts Company</p> <p>Insurance Management Services Group</p> <p>Insurance Specialists Inc. Insurance Trust</p> <p>International Medical Group</p> <p>International Mission Board</p> <p>International Service Corp.</p> <p>Interstate Hotels Corp.</p> <p>Intratech Dental Products</p> <p>IPRO</p> <p>Isle of Capri Casinos, Inc.</p> <p><b>J</b></p> <p>J. D'Addario &amp; Company, Inc.</p> <p>J. D. Edwards &amp; Company</p> <p>J M Lynne Co., Inc.</p> <p>Jenkins &amp; Gilchrist</p> <p>Jockey International, Inc.</p>	<p><b>K</b></p> <p>Keller Grain &amp; Feed</p> <p>Kentucky Department of Medical Services</p> <p>Keystone Foods</p> <p>Koch Industries, Inc.</p> <p><b>L</b></p> <p>Labor Ready, Inc.</p> <p>Laborers Health &amp; Welfare Trust Fund for Southern California</p> <p>Laborers Local No. 231 Welfare Fund</p> <p>Lake Grove Experience</p> <p>Land O Frost</p> <p>L. B. Smith, Inc.</p> <p>Leroy Community School District Number 2</p> <p>Levitz Furniture Corporation</p> <p>Liberty Mutual Group</p> <p>Liberty Northwest Companies</p> <p>Life University (formerly Life College)</p> <p>Lincoln Automotive</p> <p>Lincoln Industrial</p> <p>Lincolnway Area Affiliation of Participating School Districts</p>
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A REPRESENTATIVE LISTING OF OUR  
DISTINGUISHED CLIENTS

Line Construction Benefit Fund	Massachusetts Division of Medical Assistance	Missouri State Colleges and Universities Group Insurance Consortium, Inc.	NECA/IBEW Florida Benefit Fund
Litton/Ingalls Shipbuilding, Inc.	Masters, Mates and Pilots Health and Benefit Plan	Missouri State Medical Association	Netcong Heights Apartments
Long Island Network of Community Services, Inc.	McDermott, Will & Emery	Modern Italian Bakery	Network Multi-Family Security
Los Angeles County Community Health Plan	McDonald's Corporation	Montana Department of Public Health and Human Services	New Jersey Division of Medical Assistance and Health Services
Lumbermen's Underwriting Alliance	McGean-Rohco, Inc.	Morning Star Ford	New York Early Intervention Program
Lutheran Church Synod	McKay Benefits Corp.	Mueller Industries	New York Life Insurance Company
Lynch Management Forum	Mediamatrix	Musicland Group, Inc.	New York State EPIC Program
	Medical Mutual of Ohio	N	Niagara Geriatric Center
	Mendocino Coast District Hospital	Nalco Chemical Company	NMU Pension and Welfare Plan
M	Metcraft, Inc.	Nalco/Exxon Energy Chemicals, LP	North American Health Plans, Inc.
Mailhandlers Benefit Plan	Meteor Industries, Inc.	National Association of Letter Carriers Health Benefit Plan	North Carolina Division of Medical Assistance
Majestic Insurance Company	Metromedia Restaurant Group	National Casualty Company	North Dakota Medical Services Division
Marchon	Michigan Department of Community Health	National Standard Company	O
Martin Gillet & Co.	Midland Coal	National Telephone Cooperative Association	Ohio Department of Human Services, Bureau of Medicaid Policy
Maryland Department of Health and Mental Hygiene	Midwest Veterinarians	National Travelers Life Co.	Ohio Department of Mental Health
Mary Shields Hospital	Milwaukee Painters Local 781 Health Fund	Nebraska Department of Public Institutions	Ohio Retirement System
Massachusetts Bar Association	Mission Plus	Nebraska Department of Social Services	
Massachusetts Bay Insurance Company	Missouri Consolidated Health Care Plan		
	Missouri Division of Medical Services		

A REPRESENTATIVE LISTING OF OUR  
DISTINGUISHED CLIENTS

Oklahoma Health Care Authority	Post Road Iron Works, Inc.	Sapa Anodizing, Inc.	St. Francis Preparatory School
Old Dominion Freight Line, Inc.	Prairie Central Community Unit	SBC Holdings, Inc.	Stamford Marriott
1 800 FLOWERS	<b>Q</b>	SCI Management Corporation	Sun Healthcare Group, Inc.
Oregon Office of Medical Assistance Programs	Quoizel	Select Providers, Inc.	Sweetwater County School
O'Reilly Auto Parts	<b>R</b>	Sentry Insurance	Swift Newspapers
Outside Electrical Welfare Fund	Radio Shack	Service Management Corp.	Swifty Serve Corporation
Oxford Health Plans, Inc.	Ralcorp Holding, Inc.	Services Group of America	<b>T</b>
<b>P</b>	Rallye Motors, Inc.	Sheet Metal Workers Local Union 38	T C Industries
PACE Industry Health and Welfare Fund	Rayonier, Inc.	Sisters of the Holy Family	Teamsters Joint Council No. 83 of Virginia Health & Welfare and Pensions Funds
PacifiCare Life & Health Insurance Co.	Real Estate Appraisers	Smithtown Nissan Incorporated	Teamsters Miscellaneous Security Trust Fund
Pacific Atlantic Administrators	RehabCare Group	SMR	Telex Communications, Inc.
PacificSource Health Plans	Rexel, Inc.	Sound Enhancements	Tennessee Division of Mental Health Services
Pall Corporation	Richmond Bakery Workers Health and Welfare Fund	South Carolina Department of Human Services	Teutopolis CUSD 50
Paper Chemicals, Inc.	Rival Company	South Carolina Health and Human Services Finance Commission	Texas Dental Association
Peace Corps Volunteers	Riverside School District	Southern California Dairy Industry Security Trust Fund	Texas Instruments Employees Health Benefit Trust
Pearl Brewing Company	Rosenbluth International, Inc.	Southern Container	Texas Society of Certified Public Accountants
Pennsylvania PACE Program	Roundy's, Inc.	Special Agents Mutual Benefit Association	Textile Staff fund
Performance Bankers	Ryan International Airlines	Specialty Accident Sickness	Texwipe Company
Picadilly Cafeteria	<b>S</b>	Spectrum Managed Care	
Pictorial Offset Corporation	Safeco Insurance Company		
Placer County	Sam Ash Music Corp.		
	Samuel Bingham		

A REPRESENTATIVE LISTING OF OUR  
DISTINGUISHED CLIENTS

The American College of Surgeons Insurance Trust	The Stony Brook School	United Staff Health Benefit Plan	<b>W</b>
The American Jewish Committee	The Wilderness Society	United States Catholic Conference	Wesleyan Church
The AVMA Group Health & Life Insurance Trust	Tidewater Publishing Company	United States Postal Service	Westbury Transport, Inc.
The Cretex Companies, Inc.	Title Serve	Universal Underwriters Group	Western Illinois School Benefit Association
The Episcopal Church Medical Trust	Tokio Marine Management, Inc.	US Marine SG	Westminster Presbyterian Center
The Hanover Insurance Company	Trans Union	Usco Distribution Services	Willis Administrative Services Corporation
The Hartford	Travelers Property Casualty	USF Dugan, Inc.	Wilsey Bennett Company
The Institute For Urban Family Health	Triangle Tool Corp. & A-1 Tool	USF Reddaway, Inc.	Wisconsin UFCW Unions and Employers Health Plan
The Marmon Group, Inc.	Trinity University	USI Administrators	World Insurance Company
The NPD GROUP	Troy Community Consolidated School District 30C	USI Insurance Services Corp.	World Travel Protection Canada Inc.
The Pillsbury Company	TTX Company	<b>V</b>	
The PMA Insurance Group	Turner Industries	Vahl, Inc.	
The Quaker Oats Company	Tyson Foods, Inc.	Van Enterprises	
The RETA Trust	<b>U</b>	Viajero International	<b>X</b>
The Sage Company	U.S. Cable Television Group	Village of Elk Grove Village	Xerxes Corporation
The Salvation Army	U.S. Home Corporation	Virginia Department of Medical Assistance Services	<b>Z</b>
The Sherwin-Williams Company	Underwriters Safety & Claims, Inc.	Volvo and GMC Trucks of Knoxville Nacaroto Division	Zurich of Mexico
	Union Tank Car Company		

BOARD OF DIRECTORS

EXECUTIVE OFFICERS

**James C. Smith**  
Chairman of the Board and Chief Executive Officer

**First Health**

**Thomas J. Pritzker**  
President and CEO  
Hyatt Corporation  
*(Diversified real estate and hotel management company)*

**Michael J. Boskin, Ph.D.**  
Tully M. Friedman Professor of Economics and Senior Fellow, Hoover Institution, Stanford University, Adjunct Scholar, American Enterprise Institute and Research Associate, National Bureau of Economic Research

**Daniel S. Brunner**  
Executive Vice President, Government Affairs  
**First Health**

**Robert S. Colman**  
Principal  
Colman Partners, LLC  
*(Merchant banking firm)*

**Ronald H. Galowich**  
Chairman  
Madison Group Holdings, Inc.  
*(Business and real estate development)*

**Harold S. Handelsman**  
Senior Vice President, General Counsel, Secretary  
Hyatt Corporation  
*(Diversified real estate and hotel management company)*

**Don Logan**  
Chairman and CEO  
Time, Inc.  
*(Diversified publishing and marketing company)*

**David E. Simon**  
CEO  
Simon Property Group  
*(Shopping center development)*

**Edward L. Wristen**  
President and Chief Operating Officer  
**First Health**

**James C. Smith**  
Chairman of the Board and Chief Executive Officer

**Edward L. Wristen**  
President and Chief Operating Officer

**Daniel S. Brunner**  
Executive Vice President, Government Affairs

**Mary Anne Carpenter**  
Executive Vice President, Service Products

The annual meeting is scheduled for May 22, 2001, at the Company's corporate headquarters.

**A. Lee Dickerson**  
Executive Vice President, Provider Networks

**Patrick G. Dills**  
Executive Vice President, Sales

**Susan T. Smith, Esq.**  
Secretary, Vice President and General Counsel

**Joseph E. Whitters**  
Vice President, Finance and Chief Financial Officer

CORPORATE INFORMATION

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