UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

# FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 1999

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number 1-5975

HUMANA INC.
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| Delaware | 61-0647538 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |
| 500 West Main Street<br>Louisville, Kentucky | 40202 |
| (Address of principal executive offices) | (Zip Code) |

(502) 580-1000
(Registrants' telephone number, including area code)

Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to such filing requirements for the past 90 days.

YES X NO ______

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date.

| Class of Common Stock | Outstanding at April 30, 1999 |
|---|---|
| $.16 2/3 par value | 167,569,138 shares |



Humana Inc.
March 31, 1999
Form 10-Q

Part I: Financial Information

Item 1. Financial Statements

Exhibits:

Exhibit 10 - Employment Agreement - Kenneth J. Fasola
Exhibit 12 - Ratio of Earnings to Fixed Charges
Exhibit 27 - Financial Data Schedule



Humana Inc.
Condensed Consolidated Statements of Operations
For the quarters ended March 31, 1999 and 1998
Unaudited
(Dollars in millions, except per share results)

| | 1999 | 1998 |
|---|---|---|
| Revenues: | | |
| Premiums | $ 2,428 | $ 2,352 |
| Interest and other income | 49 | 50 |
| Total revenues | 2,477 | 2,402 |
| Operating expenses: | | |
| Medical | 2,136 | 1,955 |
| Selling, general and administrative | 325 | 324 |
| Depreciation and amortization | 31 | 32 |
| Total operating expenses | 2,492 | 2,311 |
| (Loss) income from operations | (15) | 91 |
| Interest expense | 10 | 12 |
| (Loss) income before income taxes | (25) | 79 |
| (Benefit) provision for income taxes | (9) | 29 |
| Net (loss) income | $ (16) | $ 50 |
| (Loss) earnings per common share | $ (.10) | $ .30 |
| (Loss) earnings per common share - assuming dilution | $ (.10) | $ .30 |

See accompanying notes.



Humana Inc.
Condensed Consolidated Balance Sheets
Unaudited
(Dollars in millions, except per share amounts)

| | March 31, 1999 | December 31, 1998 |
|---|---|---|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | $ 636 | $ 913 |
| Marketable securities | 1,555 | 1,594 |

| | | |
|---|---|---|
| Premiums receivable, less allowance for doubtful accounts $59 - March 31, 1999 and $62 - December 31, 1998 | 278 | 276 |
| Other | 338 | 336 |
| Total current assets | 2,807 | 3,119 |
| | | |
| Long-term marketable securities | 337 | 305 |
| Property and equipment, net | 430 | 433 |
| Cost in excess of net assets acquired | 1,180 | 1,188 |
| Other | 436 | 451 |
| Total assets | $ 5,190 | $ 5,496 |
| | | |
| Liabilities and Stockholders' Equity | | |
| Current liabilities: | | |
| Medical and other expenses payable | $ 1,513 | $ 1,470 |
| Trade accounts payable and accrued expenses | 433 | 395 |
| Book overdraft | 197 | 234 |
| Unearned premium revenues | 66 | 294 |
| Short-term debt | 200 | 250 |
| Total current liabilities | 2,409 | 2,643 |
| | | |
| Long-term medical and other expenses payable | 413 | 438 |
| Long-term debt | 579 | 573 |
| Professional liability and other obligations | 121 | 154 |
| Total liabilities | 3,522 | 3,808 |
| | | |
| Commitments and contingencies | | |
| | | |
| Stockholders' equity: | | |
| Preferred stock, $1 par; authorized 10,000,000 shares; none issued | | |
| Common stock, $.16 2/3 par; authorized 300,000,000 shares; issues and outstanding 167,578,638 shares - March 31, 1999 and 167,515,362 shares - December 31, 1998 | 28 | 28 |
| Other | 1,640 | 1,660 |
| Total stockholders' equity | 1,668 | 1,688 |
| Total liabilities and stockholders' equity | $ 5,190 | $ 5,496 |

See accompanying notes.



Humana Inc.
Condensed Consolidated Statements of Cash Flows
For the quarters ended March 31, 1999 and 1998
Unaudited
(Dollars in millions)

| | 1999 | 1998 |
|---|---|---|
| Net cash flows from operating activities | $ (192) | $ (310) |
| | | |
| Cash flows from investing activities: | | |
| Purchases of marketable securities | (167) | (198) |
| Maturities and sales of marketable securities | 169 | 271 |
| Purchases of property and equipment | (30) | (21) |
| Dispositions of property and equipment | 25 | |
| Other | (2) | 2 |
| Net cash (used in) provided by investing activities | (5) | 54 |
| | | |
| Cash flows from financing activities: | | |
| Repayment of line of credit | (93) | (300) |
| Net commercial paper borrowings | 49 | 258 |
| Change in book overdraft | (37) | 52 |
| Other | 1 | 23 |
| Net cash (used in) provided by financing activities | (80) | 33 |
| | | |
| Decrease in cash and cash equivalents | (277) | (223) |
| Cash and cash equivalents at beginning of period | 913 | 779 |
| | | |
| Cash and cash equivalents at end of period | $ 636 | $ 556 |
| | | |
| Interest payments | $ 10 | $ 11 |

| | |
|---|---|
| Income tax refunds, net | $ 39 |

See accompanying notes.





(A) Basis of Presentation

The accompanying condensed consolidated financial statements are presented in accordance with the requirements of Form 10-Q and consequently do not include all of the disclosures normally required by generally accepted accounting principles or those normally made in an annual report on Form 10-K. Accordingly, for further information, the reader of this Form 10-Q may wish to refer to the Form 10-K of Humana Inc. (the "Company") for the year ended December 31, 1998.

The preparation of the Company's condensed consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect (a) the reported amounts of assets and liabilities, (b) disclosure of contingent assets and liabilities at the date of the financial statements and (c) reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

The financial information has been prepared in accordance with the Company's customary accounting practices and has not been audited. In the opinion of management, the information presented reflects all adjustments necessary for a fair statement of interim results. All such adjustments are of a normal and recurring nature.

(B) Additional Medical Claims Expense and Tangible Asset Gain

The Company recorded $90 million ($57 million after tax, or $.34 per share) in additional medical claims expense during the first quarter of 1999. Included in this expense were approximately $50 million related to a provision for probable future losses (premium deficiencies), $35 million to strengthen medical claims payable and $5 million for a payment to Columbia/HCA Healthcare Corporation ("Columbia/HCA") to resolve certain contractual issues. The premium deficiency was the result of management's regular assessment of the profitability of its contracts for providing health care services to its members. Contributing to the premium deficiency was the impact from a March 31, 1999, Columbia/HCA contract for hospital services in certain Florida markets, as well as increasing medical costs in markets where the Company had been sharing medical cost risk with providers. The $35 million medical claims payable strengthening resulted from higher than expected medical cost trends in the Company's preferred provider organization ("PPO") products and Medicare business identified by the Company's analysis of February and March, 1999, claims payments, concluded in April 1999. Partially offsetting these additional medical costs was a $5 million ($3 million after tax, or $.02 per share) favorable claim liability development in the Company's run-off workers' compensation business. Also during the first quarter of 1999, the Company recorded a $12 million ($8 million after tax, or $.04 per share) gain on the sale of a tangible asset which has been included in interest and other income in the accompanying condensed consolidated statements of operations.





(C) Contingencies

The Company's Medicare HMO contracts with the federal government are renewed for a one-year term each December 31 unless terminated 90 days prior thereto. Legislative proposals are being considered which may revise the Medicare program's current support of the use of managed health care for Medicare beneficiaries and future reimbursement rates thereunder. Management is unable to predict the outcome of these proposals or the impact they may have on the Company's financial position, results of operations or cash flows. The Company's Medicaid contracts are generally annual contracts with various states except for the two-year contract with the Commonwealth of Puerto Rico. The Company previously announced its intention to close this market when the contract expired on April 30, 1999, because it did not expect to be able to renew the contract under favorable terms. The Company is currently in discussion with the Puerto Rico Health Insurance Administration regarding maintaining its presence in Puerto Rico at premium rates which would allow a reasonable margin. Although an agreement has not been reached, the Company is continuing to provide services for its Puerto Rico members under the existing agreement. Additionally, the Company's TRICARE contract is a one-year contract renewable annually for up to two additional years. The loss of these contracts (other than the contract in Puerto Rico) or significant changes in these programs as a result of legislative action, including reductions in payments or increases in benefits without corresponding increases in payments, would have a material adverse effect on the revenues, profitability and business prospects of the Company. In addition, the Company continually contracts and seeks to renew contracts with providers at rates designed to ensure adequate profitability. To the extent the Company is unable to obtain such rates, its financial position, results of operations and cash flows could be adversely impacted.

The Company reached an agreement in principle with the United States Justice Department and the Department of Health and Human Services on a settlement relating to Medicare premium overpayments. The settlement, totaling $15 million, arises out of the erroneous designation of certain Medicare enrollees as eligible for Medicaid, resulting in higher payments to the Company by the federal government related in large part to the years 1991 and 1992. The Company had established adequate liabilities for the resolution of this issue and, therefore, the settlement did not have a material impact on the Company's financial position or its results of operations.

During the ordinary course of business, the Company is subject to pending and threatened legal actions and audits by the agencies that regulate the Company. Management of the Company does not believe that any of these actions will have a material adverse effect on the Company's financial position, results of operations or cash flows.





(D) Earnings Per Common Share

Detail supporting the computation of earnings or loss per common share follows:

Dollars in millions, except per share results

| | Net (Loss) Income | Shares | Per Share Results |
|---|---|---|---|
| Quarter Ended March 31, 1999 | | | |
| Loss per common share | $ (16) | 167,559,428 | $ (.10) |
| Effect of dilutive stock options | - | | |
| Loss per common share - assuming dilution | $ (16) | 167,559,428 | $ (.10) |
| Quarter Ended March 31, 1998 | | | |
| Earnings per common share | $ 50 | 164,857,526 | $ .30 |
| Effect of dilutive stock options | | 2,331,930 | |
| Earnings per common share - assuming dilution | $ 50 | 167,189,456 | $ .30 |

For the quarter ended March 31, 1999, all outstanding options to purchase shares of 10,473,660 were excluded from the computation given the Company's net loss for the quarter. Options to purchase 2,015,160 shares for the quarter ended March 31, 1998 were excluded in the computation of earnings per common share-assuming dilution because the options' exercise prices were greater than the average market price of the common shares.

(E) Comprehensive Income or Loss

Comprehensive loss totaled $22 million for the quarter ended March 31, 1999 and was comprised of net loss of $16 million and net unrealized investment losses of $6 million. Comprehensive income totaled $51 million for the quarter ended March 31, 1998 and was comprised of net income of $50 million and net unrealized investment gains of $1 million.

(F) Long-Term Debt

The Company maintains a revolving credit agreement ("Credit Agreement") which provides liquidity under a line of credit of up to $1.5 billion. The Company also maintains a commercial paper program and issues debt securities thereunder. Commercial paper borrowings outstanding at March 31, 1999, were $779 million and are backed by the Credit Agreement. The Credit Agreement contains usual and customary covenants including, but not limited to, financial tests for interest coverage and leverage ratios. As of March 31, 1999, the Company was in compliance with these covenants. The average interest rate on commercial paper borrowings was 5.5 percent for the quarter ended March 31, 1999.





The Company intends to pay an additional $200 million of its outstanding debt with proceeds from operating subsidiary dividends expected to be received during 1999. Borrowings under the commercial paper program, except the planned 1999 payments, have been classified as long-term debt based on management's ability and intent to refinance borrowings on a long-term basis.

(G) Segment Information

The segment results for the quarters ended March 31, 1999 and 1998 are as follows:

| Dollars in millions | 1999 | 1998 |
|---|---|---|
| Premium revenues: | | |
| Commercial | $ 1,351 | $ 1,290 |
| Public sector | 877 | 877 |
| TRICARE | 200 | 185 |
| Total for reportable segments | 2,428 | 2,352 |
| Non-allocated revenues - interest and other income | 49 | 50 |
| Total consolidated revenues | $ 2,477 | $ 2,402 |
| | | |
| Underwriting margin: | | |
| Commercial | $ 180 | $ 235 |
| Public sector | 72 | 125 |
| TRICARE | 40 | 37 |
| Total for reportable segments | 292 | 397 |
| Other, non-allocated revenues and expenses: | | |
| Interest and other income | 49 | 50 |
| Selling, general and administrative | (325) | (324) |
| Depreciation and amortization | (31) | (32) |
| Interest expense | (10) | (12) |
| Total consolidated (loss) income before income taxes | $ (25) | $ 79 |

Commercial and Public Sector underwriting margin include $49 million and $41 million of additional medical claims expense recorded during the quarter ended March 31, 1999, respectively.





(H) Impact of Recently Issued Accounting Pronouncements

In June 1998, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133"). In general, SFAS 133 requires that all derivatives be recognized as either assets or liabilities in the balance sheet at their fair value, and sets forth the manner in which gains or losses thereon are to be recorded. The treatment of such gains or losses is dependent upon the type of exposure, if any, for which the derivative is designated as a hedge. This statement is effective for periods beginning after June 15, 1999. Management of the Company anticipates that, due to its limited use of derivative instruments, the adoption of SFAS 133 will not have a significant effect on the Company's results of operations or its financial position.

(I) Reclassifications

Certain reclassifications have been made to the prior year's condensed consolidated financial statements to conform with the current year presentation.





## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

This discussion and analysis contains both historical and forward-looking information. The forward-looking statements may be significantly impacted by risks and uncertainties, and are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. There can be no assurance that anticipated future results will be achieved because actual results may differ materially from those projected in the forward-looking statements. Readers are cautioned that a number of factors, which are described herein and in the Company's Annual Report on Form 10-K for the year ended December 31, 1998, could adversely affect the Company's ability to obtain these results. These include the effects of either federal or state health care reform or other legislation, changes in the Medicare reimbursement system, medical and pharmacy cost trends, the ability of health care providers (including physician practice management companies) to comply with current contract terms, renewal of the Company's Medicare contracts with the federal government, renewal of the Company's contract with the federal government to administer the TRICARE program and renewal of the Company's Medicaid contracts with various state governments. Such factors also include the effects of other general business conditions, including but not limited to, the Company's ability to integrate its acquisitions, the Company's ability to appropriately address the "Year 2000" computer system issue, government regulation, competition, premium rate and yield changes, retrospective premium adjustments relating to federal government contracts, changes in commercial and Medicare HMO membership, operating subsidiary capital requirements, the effect of provider contract rate negotiations, compliance with debt covenants, general economic conditions and the retention of key employees. In addition, past financial performance is not necessarily a reliable indicator of future performance and investors should not use historical performance to anticipate results or future period trends.

### Introduction

The Company is a health services company that facilitates the delivery of health care services through networks of providers to its approximately 6.1 million medical members. The Company's products are marketed primarily through health maintenance organizations ("HMOs") and preferred provider organizations ("PPOs") that encourage or require the use of contracted providers. HMOs and PPOs control health care costs by various means, including pre-admission approval for hospital inpatient services, pre-authorization of outpatient surgical procedures, and risk-sharing arrangements with providers. These providers may share medical cost risk or have other incentives to deliver quality medical services in a cost-effective manner. The Company also offers various specialty products to employers, including dental, group life and workers' compensation, and administrative services ("ASO") to those who self-insure their employee health plans. In total, the Company's products are licensed in 47 states, the District of Columbia and Puerto Rico, with approximately 21 percent of its membership in the state of Florida.

The Company markets and distributes its products to three distinct customer groups and, therefore, reports operations in three business segments. Results of each segment are measured based on premium revenues and underwriting margin (premium revenues less medical expenses). The

Company does not allocate assets or administrative costs to the segments and, therefore, does not measure results based on segment assets or pretax profits. Members from all three segments generally utilize the same medical provider networks, enabling the Company to obtain more favorable contract terms with providers. As a result, the profitability of each segment is somewhat interdependent. In the Commercial segment, the Company markets and distributes its fully-insured HMO, PPO, and specialty and its ASO products to large group employers (over 100 employees) and small group employers. Premium revenue pricing to large group employers has historically been more competitive than that to small group employers, resulting in less favorable underwriting margins for large groups. In the Public Sector segment, the Company markets and distributes its Medicare and Medicaid products to individuals eligible for these government-sponsored programs. The Medicare HMO product provides health care services that include all Medicare benefits and, in certain circumstances, additional services. The Company's third segment is TRICARE. In this segment, the Company facilitates health care services for the dependents of active military personnel and retired military personnel and their dependents located in the Southeastern United States. The Company is in the third year of its contract with the United States Department of Defense, which is renewable annually for up to two additional years. As encouraged by government regulation, TRICARE is managed by a separate management team and is more autonomous than the Company's Commercial and Public Sector segments, which generally share sales, marketing, customer service, medical management and claims processing functions of the Company.

Additional Medical Claims Expense and Tangible Asset Gain

The Company recorded $90 million ($57 million after tax, or $.34 per share) in additional medical claims expense during the first quarter of 1999. Included in this expense were approximately $50 million related to a provision for probable future losses (premium deficiencies), $35 million to strengthen medical claims payable and $5 million for a payment to Columbia/HCA to resolve certain contractual issues. The premium deficiency was the result of management's regular assessment of the profitability of its contracts for providing health care services to its members. Contributing to the premium deficiency was the impact from a March 31, 1999, Columbia/HCA contract for hospital services in certain Florida markets, as well as increasing medical costs in markets where the Company had been sharing medical cost risk with providers. The $35 million medical claims payable strengthening resulted from higher than expected medical cost trends in the Company's PPO products and Medicare business identified by the Company's analysis of February and March, 1999, claims payments, concluded in April 1999. Partially offsetting these additional medical costs was a $5 million ($3 million after tax, or $.02 per share) favorable claim liability development in the Company's run-off workers' compensation business. Also during the first quarter of 1999, the Company recorded a $12 million ($8 million after tax, or $.04 per share) gain on the sale of a tangible asset which has been included in interest and other income in the accompanying condensed consolidated statements of operations.



Comparison of Results of Operations

In order to enhance comparability, and to present an estimated baseline against which historical and prospective periods should be measured, the following discussion comparing results for the quarters ended March 31, 1999, and March 31, 1998, excludes the impact of the $90 million additional medical claims expense and a tangible asset gain discussed previously, but includes the beneficial effect of the premium deficiency included therein and the $5 million run-off workers' compensation reserve adjustment. The beneficial effect from the premium deficiency for the quarter ended March 31, 1999, was approximately $6 million ($4 million after tax, or $.02 per share).

Income before income taxes totaled $53 million for the quarter ended March 31, 1999 (the "1999 quarter"), compared to $79 million for the quarter ended March 31, 1998 (the "1998 quarter"). Net income was $33 million or $.20 per share in the 1999 quarter, compared to $50 million or $.30 per share in the 1998 quarter. The decrease in earnings was primarily the result of medical cost increases exceeding the related premium increases for the Company's commercial and Medicare lines of business and lower realized investment gains and other income. Partially offsetting these items was lower administrative cost spending.

The Company's premium revenues grew $76 million or 3 percent from the 1998 quarter. Combined commercial and Medicare premium yield resulted in a 4 percent increase which was partially offset by a decline in membership in both lines of business. Commercial premium yields increased 6.3 percent while Medicare HMO premium yields increased 2.1 percent. The Company's fully-insured commercial membership declined 89,800 members during the 1999 quarter, reflecting the effects of the Company's premium pricing discipline intended to maintain profitability. Medicare HMO membership declined 21,300 during the 1999 quarter, the result of closing the Treasure Coast and Sarasota, Florida, markets. For the remainder of 1999, commercial membership is expected to increase 3 percent to 5 percent, while Medicare membership is expected to be flat to slightly down. Medicaid membership was about flat with year-end. The Company is currently in discussions with the Puerto Rico Health Insurance Administration regarding maintaining its presence in Puerto Rico at premium rates which would allow a reasonable margin. Although a new contract has not been renegotiated, the Company has agreed to continue to provide services to its members under the existing agreement.

The Company's medical expense ratio for the 1999 quarter was 84.3 percent, increasing from 83.1 percent from the same period in 1998. The higher medical expense ratio was the result of medical cost trends exceeding premium yield increases in the Company's commercial and Medicare lines of business. Commercial cost trends of 8.3 percent primarily result from higher hospital outpatient and pharmacy costs which have increased 11 percent and 21 percent, respectively. Increased inpatient hospital cost per day and increased pharmacy costs have caused a 3.1 percent increase in Medicare medical costs. Also contributing to the medical expense ratio increase was the inability of certain capitated risk-sharing providers to manage medical costs within their contractual obligations.





As a result, the higher actual claim costs incurred by these risk-sharing providers has been recognized as expense by the Company rather than the capitated contract amount. There can be no assurance that the medical cost trends will not continue to increase.

Partially offsetting the increasing medical cost trends is a favorable claim liability development in the Company's run-off workers' compensation business acquired in connection with its acquisition of Physician Corporation of America ("PCA") in 1997. After evaluating the workers' compensation claim liabilities against claim payments and file closings, the Company reduced these liabilities by $5 million ($3 million after tax, or $.02 per share) during the quarter.

As more fully described previously, the medical expense ratio discussion excludes the impact of the additional $90 million medical claims expense. Including this item increases the 1999 quarter medical expense ratio from 84.3 percent to 88.0 percent.

During the 1999 quarter, the Company's administrative cost ratio improved to 14.7 percent from 15.2 percent in the 1998 quarter. This year-over-year improvement in the administrative cost ratio reflects efforts to streamline the organization, as well as synergy savings from the acquisition of PCA and ChoiceCare Corporation in 1997.

Interest income totaled $34 million and $41 million for the 1999 and 1998 quarters, respectively. The decrease is primarily attributable to realized investment gains included in the 1998 quarter. The tax equivalent yield on invested assets approximated 6.7 percent and 8.5 percent for the 1999 and 1998 quarters, respectively.

Business Segment Information

Commercial premium revenues increased 4.7 percent for the 1999 quarter as a result of premium yield increases of 6.3 percent partially offset by a 89,800 decline in fully-insured membership. The membership decline was the result of the Company's commitment to price its commercial products commensurate with the underlying risk. The Commercial segment medical expense ratio for the 1999 quarter was 83.0 percent, increasing from 81.8 percent in the 1998 quarter. The medical expense ratio increase was the result of premium yield increases being insufficient to offset medical cost trend increases. Increased medical costs were noted in hospital outpatient and pharmacy costs. As more fully discussed previously, the medical expense ratio discussion excludes a portion of the $90 million additional medical claims expense. Including $49 million of the additional medical expense related to the Commercial segment results in a medical expense ratio of 86.7 percent for the 1999 quarter.

Public Sector premium revenues for the 1999 quarter were generally flat with the 1998 quarter. A 2.1 percent Medicare HMO premium yield increase was offset by a decline in membership. The premium yield increase was slightly higher than the 2 percent statutory increase as a result of the





changing geographic mix of membership toward higher reimbursement areas. This change was due in large part to closing the Treasure Coast and Sarasota, Florida, markets. Medicare HMO membership declined 21,300 during the quarter primarily from closing these under-performing markets in Florida. The Public Sector medical expense ratio for the 1999 quarter was 87.1 percent, increasing from 85.7 percent for the 1998 quarter. The medical expense ratio increase was primarily the result of Medicare HMO premium yield increases being insufficient to offset medical cost trend increases. Increased medical costs were noted in inpatient hospital rates and pharmacy costs. As more fully discussed previously, the medical expense ratio discussion excludes a portion of the $90 million additional medical claims expense. Including $41 million of the additional medical expense related to the Public Sector segment results in a medical expense ratio of 91.8 percent for the 1999 quarter.

TRICARE premiums increased 8.1 percent for the 1999 quarter on stable membership due to contract modifications. TRICARE's medical expense ratio did not change significantly from the 1998 quarter.

Liquidity

During the 1999 quarter, $192 million was used in the Company's operating activities, compared to $310 million being used in operations in the 1998 quarter. This net cash used in operations during the 1999 and 1998 quarters can be attributed to the following:

| | 1999 | 1998 |
|---|---|---|
| Cash used in operating activities | $ (192) | $ (310) |
| Timing of Medicare premium receipts | 234 | 235 |
| Workers' compensation claim payments | 28 | 30 |
| Paydown of medical claim backlogs related to acquired companies | | 50 |
| Severance payments related to acquired companies | | 25 |
| Pro forma operating cash flows | $ 70 | $ 30 |

The Company's subsidiaries operate in states which require certain levels of equity and regulate the payment of dividends to the parent company. As a result, the Company's ability to use operating subsidiaries' cash flows is restricted to the extent of the subsidiaries' abilities to obtain regulatory approval to pay dividends.

The National Association of Insurance Commissioners has recommended that states adopt a risk-based capital ("RBC") formula for companies established as HMO entities. The RBC provisions may require new minimum capital and surplus levels for some of the Company's HMO subsidiaries. The Company does not expect that the RBC provisions will have a material impact on its financial position, results of operations or cash flows.





The Company maintains a revolving credit agreement ("Credit Agreement") which provides liquidity under a line of credit of up to $1.5 billion. The Company also maintains a commercial paper program and issues debt securities thereunder. Commercial paper borrowings outstanding at March 31, 1999, were $779 million and are backed by the Credit Agreement. The Credit Agreement contains usual and customary covenants including, but not limited to, financial tests for interest coverage and leverage ratios. As of March 31, 1999, the Company was in compliance with these covenants. The average interest rate on commercial paper borrowings was 5.5 percent for the quarter ended March 31, 1999.

The Company intends to pay an additional $200 million of its outstanding debt with the proceeds from operating subsidiary dividends expected to be received during 1999. Borrowings under the commercial paper program, except the planned 1999 payments, have been classified as long-term debt based on management's ability and intent to refinance borrowings on a long-term basis.

Management believes that existing working capital, future operating cash flows and funds available under the existing revolving Credit Agreement and commercial paper program are sufficient to meet future liquidity needs. Management also believes the aforementioned sources of funds are adequate to allow the Company to fund capital requirements.

Capital Resources

The Company's ongoing capital expenditures relate primarily to administrative facilities and related information systems necessary for activities such as claims processing, billing and collections, medical utilization review and customer service. Planned capital spending in 1999 will approximate $80 to $90 million for the expansion and improvement of these items.

The Company's Y2K Readiness Disclosure Statement

The Company operates one of the largest managed care data centers in the nation. The primary computing facility is located in Louisville, Kentucky. The Company's application systems are largely developed and maintained in-house by a staff of 400 application programmers who are versed in the use of state-of-the-art technology. All application systems are fully integrated and automatically pass data through various system processes. The information systems support marketing, sales, underwriting, contract administration, billing, financial, and other administrative functions as well as customer service, authorization and referral management, concurrent review, physician capitation and claims administration, provider management, quality management and utilization review.

The Year 2000 issue is the result of two potential malfunctions that may have an impact on the Company's systems and equipment. The first potential malfunction is the result of computers being programmed to use two rather than four digits to define the applicable year. The second potential





malfunction arises where embedded microchips and micro-controllers have been designed using two rather than four digits to define the applicable year. As a result, certain of the Company's date-sensitive computer programs, building infrastructure components and medical devices, may recognize a date using "00" as the year 1900 rather than the year 2000. If uncorrected, the problem may result in computer system and program failures or equipment malfunctions that could result in a disruption of business operations (such as the payment of medical claims, premium billing and collection, and membership enrollment verification).

Humana's Information Systems organization operates in a centralized manner. The Company's data center and the majority of its programming and support staff are located at its corporate offices in Louisville, Kentucky. A Year 2000 project management office is in place to oversee the progress made in the assessment and correction of the Company's Year 2000 exposures.

In general, the Company's Year 2000 project consists of four phases - assessment, remediation, validation, and implementation - and is categorized into the following four components:

Information Technology (IT) - software essential for day-to-day operations including both internally developed software and third party software which interfaces therewith.

IT Infrastructure - mainframe, network, telecommunications interfaces and self-contained operating systems.

Third party business partners and intermediaries - entities on which the Company relies for transmission and receipt of claims, and encounter, membership and payment information, including federal and state governmental agencies such as the Health Care Financing Administration.

Non-IT Infrastructure - telecommunications equipment, elevators, public safety equipment (i.e., security and fire), medical equipment and HVAC systems.

The Company commenced the assessment of its Year 2000 exposures in 1996. Remediation efforts of internally developed software and third party software applications are almost fully complete. As of March 31, 1999, the Company had remediated 95% of its core systems identified in the assessment. These systems are currently operating in the production environment using the updated Year 2000 logic. The Company's plan is to have all production applications fully remediated by the end of the third quarter of 1999. In addition, the Company is in the process of contacting vendors, third party business partners and intermediaries in an effort to ascertain their Year 2000 readiness. The Company anticipates completing, in all material respects, its Year 2000 project by the end of the third quarter of 1999. The Company's efforts are currently progressing on plan.

The Year 2000 project is currently estimated to have a minimum total cost of approximately $26 million. Project to date costs total $21.7 million, including $4.1 million during the quarter ended





March 31, 1999. Year 2000 expenses are projected to represent less than 6 percent of the Information Systems budget during 1999. Year 2000 costs are expensed as incurred and funded through operating cash flow.

The extent and magnitude of the Year 2000 project, as it will affect the Company both before and for some period after January 1, 2000, are difficult to predict or quantify. As part of the Company's Year 2000 readiness, it has undertaken the development of business continuity and contingency plans. These plans will be in place to mitigate issues that arise in the event that the Year 2000 project is not completed in an accurate or timely manner, or third party constituents have failures due to the millennium change. The Company has identified six major functional areas, covering 22 operational subdivisions, that will require contingency plans. The six major functional areas are: providers, service centers, suppliers and vendors, customers and brokers, banking and finance, and legal services. The Company's business continuity and contingency planning efforts, which encompasses alternate operating procedures, are anticipated to be complete by the end of the third quarter of 1999.

While the Company presently believes that the timely completion of its Year 2000 project will limit exposure so that the Year 2000 will not pose material operational problems, the Company does not control third party systems. Although the Company is contacting third parties, the Company has not received assurances that all third parties and/or their interfaces will be converted in a timely manner. Additionally, if Year 2000 modifications or upgrades are not accomplished in a timely manner or proper contingency plans are not implemented, Year 2000 failures which may result could have a material adverse impact on the Company's results of operations or its financial position.

The costs of the Year 2000 project and the date on which the Company plans to complete Year 2000 modifications are based on management's best estimates, considering assumptions of future events including the continued availability of certain resources and other factors. There can be no guarantee that these estimates will be achieved and actual results could differ materially from plan. Specific factors that might cause such material differences include, but are not limited to, the availability and cost of personnel trained in this area, the ability to locate and correct all relevant computer codes, and the ability of the Company's significant suppliers, customers and others with which it conducts business, including federal and state governmental agencies, to identify and resolve their own Year 2000 issues.

Impact of Recently Issued Accounting Pronouncements

In June 1998, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133"). In general, SFAS 133 requires that all derivatives be recognized as either assets or liabilities in the balance sheet at their fair value, and sets forth the manner in which gains or losses thereon are to be recorded. The treatment of such gains or losses is dependent upon the type of





exposure, if any, for which the derivative is designated as a hedge. This statement is effective for periods beginning after June 15, 1999. Management of the Company anticipates that, due to its limited use of derivative instruments, the adoption of SFAS 133 will not have a significant effect on the Company's results of operations or its financial position.





| Quarterly Membership | 1999 | 1998 |
|---|---|---|
| Commercial: | | |
| Fully-insured members at: | | |
| March 31 | 3,171,700 | 3,249,600 |
| June 30 | | 3,260,700 |
| September 30 | | 3,235,800 |
| December 31 | | 3,261,500 |
| Administrative services members at: | | |
| March 31 | 617,900 | 682,200 |
| June 30 | | 693,400 |
| September 30 | | 673,900 |
| December 31 | | 646,200 |
| Total Commercial members at: | | |
| March 31 | 3,789,600 | 3,931,800 |
| June 30 | | 3,954,100 |
| September 30 | | 3,909,700 |
| December 31 | | 3,907,700 |

| | | |
|---|---|---|
| Pubic Sector: | | |
| Medicare HMO members at: | | |
| March 31 | 480,700 | 495,800 |
| June 30 | | 501,000 |
| September 30 | | 502,800 |
| December 31 | | 502,000 |
| | | |
| Medicaid and other members at: | | |
| March 31 | 704,300 | 696,800 |
| June 30 | | 692,000 |
| September 30 | | 696,500 |
| December 31 | | 700,400 |
| | | |
| Total Public Sector members at: | | |
| March 31 | 1,185,000 | 1,192,600 |
| June 30 | | 1,193,000 |
| September 30 | | 1,199,300 |
| December 31 | | 1,202,400 |
| | | |
| TRICARE: | | |
| TRICARE eligible members at: | | |
| March 31 | 1,085,700 | 1,103,500 |
| June 30 | | 1,096,300 |
| September 30 | | 1,090,400 |
| December 31 | | 1,085,700 |
| | | |
| Total medical members at: | | |
| March 31 | 6,060,300 | 6,227,900 |
| June 30 | | 6,243,400 |
| September 30 | | 6,199,400 |
| December 31 | | 6,195,800 |
| | | |
| Specialty members at: | | |
| March 31 | 2,771,900 | 2,647,800 |
| June 30 | | 2,477,800 |
| September 30 | | 2,597,800 |
| December 31 | | 2,633,300 |





## Item 3. Quantitative and Qaulitative Disclosures about Market Risk

Since the date of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1998, no material changes have occurred in the Company's exposure to market risk associated with the Company's investments in market risk sensitive financial instruments, as set forth in the "Management's Discussion and Analysis of Financial Condition and Results of Operations" included in such Form 10-K.





## Part II: Other Information

### Item 1: Legal Proceedings

Between November 19, 1997 and December 11, 1997, three related, purported class action complaints entitled (i) Medhat Reiser v. PCA, et al, Civil Action No. 97-3678 (S.D. Fla.)(Middlebrooks, J.), (ii) Janice Wells and Stewart Colton v. PCA, et al, Civil Action No. 97-3832 (King, J.), and (iii) David Applestein v. PCA, et al, Civil Action No. 97-4030 (Nesbitt, J.), were filed in the United States District Court for the Southern District of Florida by purported former stockholders of Physician Corporation of America ("PCA") against PCA and certain of its former directors and officers. By order entered February 13, 1998, the three actions were consolidated into a single action entitled In re Physician Corporation of America Securities Litigation, Civil Action No. 97-3678 (S.D. Fla.)(Middlebrooks, J.). The Reiser, Wells and Applestein complaints contain the same or substantially similar allegations; namely, that PCA and the individual defendants knowingly or recklessly made false and misleading statements in press releases and public filings with respect to the financial and regulatory difficulties of PCA's workers' compensation business. Count I of all three complaints is premised on alleged violations of Section 10(b) of the

Securities Exchange Act of 1934 (the "1934 Act") and SEC Rule 10b-5, and Count II on alleged violations of Section 20(a) of the 1934 Act. All three complaints seek certification of a class of stockholders who purchased shares of PCA common stock from May 1996 through March 1997, as well as money damages plus prejudgment interest in an unspecified amount, and costs and expenses including attorneys fees. On February 19, 1999, the U.S. District Court denied PCA's motion to dismiss. This matter has been set for trial beginning January, 2001. The Company believes that the allegations in the above complaints are without merit and intends to pursue the defense of the consolidated action vigorously.

Damages for claims for personal injuries and medical benefit denials are usual in the Company's business. Personal injury claims are covered by insurance from the Company's wholly-owned captive insurance subsidiary and excess carriers, except punitive damages generally are not paid where claims are settled and generally are awarded only where a court determines there has been a willful act or omission to act.

Government regulators conduct reviews from time to time to audit compliance with government regulations and statutes, and those reviews may result in fines or other payments.

Management does not believe that any pending and threatened legal actions and audits by agencies that regulate the Company will have a material adverse effect on the Company's financial position, results of operations or cash flows.

Items 2 - 3:

None.





Item 4: Submission of Matters to a Vote of Security Holders

(a) The regular annual meeting of stockholders of Humana Inc. was held in Louisville, Kentucky on May 6, 1999, for the purpose of electing the Board of Directors.

(b) Proxies for the meeting were solicited pursuant to Section 14(a) of the Securities Exchange Act of 1934 and there was no solicitation in opposition to management's solicitations. All of management's nominees for directors were elected.

(c) One proposal was submitted to a vote of security holders as follows:

(1) The stockholders approved the election of the following persons as directors of the Company:

| Name | For | Withheld |
|---|---|---|
| K. Frank Austen, M.D. | 136,398,798 | 14,868,526 |
| Michael E. Gellert | 136,391,376 | 14,875,948 |
| John R. Hall | 136,394,172 | 14,873,152 |
| David A. Jones | 136,431,940 | 14,835,384 |
| David A. Jones, Jr. | 136,430,260 | 14,837,064 |
| Irwin Lerner | 136,393,668 | 14,873,656 |
| W. Ann Reynolds, Ph.D. | 136,437,727 | 14,829,597 |
| Gregory H. Wolf | 136,400,536 | 14,866,788 |

Item 5:

None.

Item 6: Exhibits and Report on Form 8-K

(a) Exhibits:

Exhibit 10 - Employment Agreement - Kenneth J. Fasola dated March 29, 1999, filed herewith.

Exhibit 12 - Statement re: Computation of Ratio of Earnings to Fixed Charges, filed herewith.

Exhibit 27 - Financial Data Schedule

(b) On April 8, 1999, the Company filed a report on Form 8-K regarding its intention to record $90 million additional medical claims expense during the first quarter, as discussed in both Items 1 and 2 of this Form 10-Q.



Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

HUMANA INC.

Date: May 17, 1999

/s/ James E. Murray
James E. Murray
Chief Financial Officer
(Principal Accounting Officer)

Date: May 17, 1999

/s/ Kathleen Pellegrino
Kathleen Pellegrino
Vice President and
Associate General Counsel

# EMPLOYMENT AGREEMENT

EMPLOYMENT AGREEMENT made as of March 29, 1999 by and between HUMANA INC. (hereinafter "Company"), a Delaware corporation having its principal place of business in Louisville, Kentucky, and Kenneth J. Fasola (hereinafter "Employee"):

WITNESSETH:

WHEREAS, Employee desires to render faithful and efficient service to the Company; and

WHEREAS, the Company desires to receive the benefit of Employee's service; and

WHEREAS, Employee is willing to be employed by the Company; and

WHEREAS, both Company and Employee desire to formalize the conditions of Employee's employment by written agreement;

NOW, THEREFORE, in consideration of the premises and the mutual covenants hereinafter set forth, the parties agree as follows:

1. Office. The Company hereby employs Employee as Senior Vice President of Company and Employee hereby agrees to serve the Company in such capacity.

2. Term of Employment. Employee's employment shall be for the "Employment Period" with the initial term commencing on March 29, 1999 and extending through March 29, 2001. The initial term shall be automatically renewed and extended upon the expiration thereof for successive periods of one (1) year until such time as the Employment Period shall terminate pursuant to the terms of this Agreement, or until the Company on the one hand, or Employee on the other hand, shall terminate the Employment Period by giving written notice to the other party on or before sixty (60) days prior to the expiration date of the initial or any renewal term. The renewal and extension of this Agreement shall also be referred to as the "Employment Period." The effective date of Employee's termination of employment for whatever reason under this Agreement shall be the "Termination Date."

3. Responsibilities. During the Employment Period, Employee shall devote his entire business time and attention, except during reasonable vacation periods, to, and exert his best efforts to promote, the affairs of the Company, and shall render such services to the Company as may be required by the Board of Directors of the Company ("Board") consistent with his employment as Senior Vice President of the Company. Nothing herein contained shall preclude service by Employee on a reasonable number of boards of directors or trustees of other entities not engaged in any business competitive with the business of the Company, provided that Employee shall discuss any such board service in advance with the Company's Board.

4. Incapacity. If, during the Employment Period, Employee should be prevented from performing his duties or fulfilling his

responsibilities by reason of any incapacity or disability for a continuous period of six (6) months, then the Company's Board, in its sole and absolute discretion, may, based on the opinion of a qualified physician, consider such incapacity or disability to be total and may on ninety (90) days written notice to Employee terminate the Employment Period. Benefits and payments shall be made under this Agreement following incapacity as if it were a termination without Good Cause in accordance with Section 8(a).

5. Death. The Employment Period shall automatically terminate upon the death of Employee, and payments will be made to the Employee's estate as if it was a termination without Good Cause in accordance with Section 8(a).

6. Compensation. During the Employment Period, Employee shall (i) receive a base salary (hereinafter "Annual Base Salary") that shall be an annual amount of not less than Four Hundred and Seventy Thousand Dollars ($470,000) payable in accordance with the payroll practices of the Company, and shall (ii) participate in an incentive plan providing for a target incentive compensation amount of not less than seventy-five percent (75%) of his Annual Base Salary. Employee shall be guaranteed a minimum of fifty percent (50%) of base salary as bonus for the 1999 Performance Year.

7. Benefit Plans and Programs. During the Employment Period, Employee shall be eligible for participation in all benefit plans and programs, including those for executive employees, made available by the Company to its respective employees.

8. Severance Payments.

   (a) In the event that (i) Employee's employment is terminated by the Company while this Agreement is in effect without Good Cause, (ii) the Employment Period is terminated by reason of incapacity or disability in accordance with Section 4, or (iii) the Employment Period is terminated by reason of death in accordance with Section 5:

      (1) The Company shall pay to Employee or his estate, no later than thirty (30) calendar days after such Termination Date, an amount equal to any unpaid current Annual Base Salary accrued through the Termination Date, his bonus, calculated at one hundred percent (100%) of his Annual Base Salary prorated for the current fiscal year through the Termination Date, plus one (1) times the sum of his then current Annual Base Salary, calculated at one hundred percent (100%) of his Annual Base Salary. The Company shall continue to keep in full force and effect all plans or policies of medical, accident and life insurance benefits with respect to Employee and his dependents with the same level of coverage available to employees

under the terms of those employee benefit plans for a period of twelve (12) months, upon the same terms, costs and otherwise to the same extent as such plans are in effect for employees of the Company who were similarly situated to Employee as of the Termination Date.

(2) All restricted shares previously awarded to Employee but not yet vested shall become vested and non-forfeitable as of the Termination Date.

(3) To the extent stock options granted to Employee have not become fully vested and exercisable as of the Termination Date, such options shall become fully vested and all vested stock options shall be exercisable for two (2) years commencing on the Termination Date.

(b) In the event that Employee's employment is terminated by the Company with Good Cause or if employee voluntarily terminates his employment:

(1) The Company shall pay to Employee, no later than thirty (30) calendar days after the Termination Date, an amount equal to his then current Annual Base Salary accrued but unpaid through the Termination Date; and Employee shall have a period of ninety (90) days after such Termination Date in which to exercise any exercisable vested stock options, subject to the provisions of any applicable stock option agreement.

(2) Any restricted shares or stock options previously granted but still subject to restriction or unvested at the Termination Date shall be forfeited.

(c) Good Cause shall mean the Company's Board has determined in good faith, without being bound by the Company's progressive discipline policy for employees:

(1) that Employee has engaged in acts or omissions against the Company or any of its subsidiaries constituting dishonesty, intentional breach of fiduciary obligation or intentional wrongdoing or misfeasance; or

(2) that Employee has been arrested or indicted in a possible criminal violation involving fraud or dishonesty; or

(3) that Employee has intentionally and in bad faith acted in a manner which results in a material detriment to the assets, business or prospects of the Company or any of its subsidiaries; or

(4) that after due consideration and with notice to the Employee, Employee has performed poorly.

(d) In the event that Employee's employment is terminated (I) by the Company for Good Cause as defined in Section 8(c)(4) above, (ii) because either the Company or Employee terminated the Employment Period pursuant to Section 2 of this Employment Agreement, or (iii) because Employee voluntarily leaves the employ of the Company during the Employment Period, then the Company shall pay to Employee, no later than thirty (30) calendar days after such Termination Date, an amount equal to any unpaid current Annual Base Salary accrued through the Termination date, plus one (1) times his then current Annual Base Salary. Any bonus finally determined to be payable at the end of the fiscal year in which the Termination Date is included shall be prorated for the period up to and including the Termination Date and shall be promptly paid to Employee at the same time any other similar bonuses are paid to any other employee of the Company for such fiscal year. The Company shall continue to keep in full force and effect all plans or policies of medical, accident and life insurance benefits with respect to Employee and his dependents with the same level of coverage available to employees under the terms of those employee benefit plans for a period of twelve (12) months, upon the same terms, costs and otherwise to the same extent as such plans are in effect for employees of the Company who were similarly situated to Employee as of the Termination Date.

(e) Following the Employment Period, Employee shall be eligible for continuation of health and dental insurance coverage pursuant to the Consolidated Omnibus Budget Reconciliation Act (COBRA) for eighteen (18) months. For the first twelve (12) months, Employee's cost will be an amount equal to the normal employee contribution. Thereafter, the cost will be an amount equal to the COBRA cost of such coverage. During the first eighteen (18) months, Employee may elect any of the coverages available to Humana employees. Thereafter, Humana agrees that Employee may elect coverage under any of the insured products offered by Humana's health insurance or HMO subsidiaries for Employee, his spouse as of the date hereof ("Spouse"), and any eligible dependent until the later of Employee's age sixty-five (65) or eligibility for Medicare coverage (hereinafter "Extended Coverage"). At the earlier of Employee attaining Medicare eligibility or death, Employee's Spouse and any now current eligible dependent of Employee and Spouse will be eligible for Extended Coverage until the later of Spouse's age sixty-five (65) or Medicare coverage eligibility. If at any time during which the Extended Coverage is in effect Employee or his Spouse obtains Medicare or becomes eligible for other employee group health insurance coverage which does not exclude a pre-existing condition of Employee, Spouse or dependent, Humana's obligation will cease as to the one who has obtained Medicare or, in the case of other employee group health coverage, as to that person and their eligible dependents. Employee's premium for the Extended Coverage and Spouse's premium, if she retains Extended Coverage, will be amount equal to the COBRA cost of such coverage. If Humana hereafter adopts a retiree health insurance program and Humana still has obligations under this provision, Employee will be offered the option of participating in that program in lieu of the Extended Coverage described herein. The health and dental insurance benefits hereunder shall be administered in conjunction with any other similar benefits which the Employee has from the Company but in no case shall be duplicative.

9. Termination After A Change in Control. In the event of a "Change in Control" of the Company (as defined as of the date hereof in the Company's 1996 Stock Incentive Plan for Employees), if, within twenty-four (24) months following the closing of such a Change in Control (or at any time prior thereto but in contemplation thereof):

(i) There is a material reduction in the Employee's title, authority or responsibilities, including reporting responsibilities;

(ii) The Employee's Annual Base Salary is reduced;

(iii) The Employee's office at which he is to perform his duties is relocated to a location more than thirty (30) miles from the location at which the Employee performed his duties prior to the Change in Control;

(iv) The Company fails to continue in effect any incentive, bonus or other compensation plan in which the Employee participates, unless the Company substitutes a substantially equivalent benefit;

(v) The Company fails to continue in effect any employee benefit plan (including any medical, hospitalization, life insurance, dental or disability benefit plan in which the Employee participated) or any material fringe benefit or perquisite enjoyed by the Employee at the time of the Change in Control, unless the Company substitutes benefits which, in the aggregate, are substantially equivalent;

(vi) The Company breaches any material provision of this Employment Agreement; or

(vii) The Company fails to obtain a satisfactory agreement from any successor or assign of the Company to assume and agree to perform this Employment Agreement;

Then the Employee shall have the option to voluntarily terminate his employment and the Company shall:

(a) Pay the Employee his full base salary earned but not yet paid through the Termination Date at the greater of the rate in effect at the time of the Change in Control or the Termination Date ("Higher Annual Base Salary"), plus any bonuses or incentive compensation which, pursuant to the terms of any compensation or benefit plan, have been earned and are payable as of the Termination Date. For purposes of this Agreement, bonuses and incentive compensation shall be considered payable if all conditions for earning them have been met and any requirement that Employee be actively employed as of the date of payment shall be disregarded.

(b) Pay the Employee a lump sum in an amount equal to one and one-half (1.5) times the amount equal to the sum of (1) the Employee's Annual Base Salary plus (2) the maximum target bonus or incentive compensation which could have been earned by the Employee calculated as if all relevant goals had been met during the then current fiscal year of the Company pursuant to the terms of the incentive compensation plan in which he participates. If there is no incentive compensation plan in effect as of the Termination Date, then for purposes of this Agreement it shall be assumed that the amount of incentive compensation to be paid to the Employee shall be the maximum target amount under any incentive compensation plan in which he participated at the date of the Change in Control or the most recent plan participated in, whichever would be greater.

(c) Maintain in full force and effect for the benefit of the Employee and the Employee's dependents and beneficiaries, at the Company's expense, all life insurance, health insurance, dental insurance, accidental death and dismemberment insurance and disability insurance under plans and programs in which the Employee and/or the Employee's dependents and beneficiaries participated immediately prior to the Termination Date, provided that continued participation is possible under the general terms and provisions of such plans and programs ("Extended Benefits"). The Extended Benefits shall be continued until the earlier of (A) the second (2nd) anniversary of the Termination Date, (B) the effective date of the Employee's coverage under equivalent benefits from a new employer (provided that no such equivalent benefits shall be considered effective unless and until all pre-existing condition limitations and waiting period restrictions have been waived or have otherwise lapsed), or (C) the death of the Employee. If participation in any such plan or program is barred, the Company shall arrange at its own expense to provide the Employee with benefits substantially similar to those which he was entitled to receive under such plans and programs. At the end of the period of coverage, the Employee shall have the right to have assigned to him, at no cost and with no apportionment of prepaid premiums, any assignable insurance policy relating specifically to him. Employee shall be entitled to continuation coverage as provided by COBRA at the conclusion of the coverage provided under this Section.

The amount of any payment or benefit provided for in this Section 9 shall be offset by any lump sum cash payments due the Employee upon termination under any other provisions of this Employment Agreement.

10. Restrictive Covenants. Employee shall not during the Employment Period, directly or indirectly, alone or as a member of a partnership or association, or as an officer, director, advisor, consultant, agent or employee of any other company, be engaged in or concerned with any other duties or pursuits requiring his personal services except with the prior consent of the Company's Board. Nothing herein contained shall preclude the ownership by Employee of stocks or other investment securities.

11. Confidential Information and Trade Secrets.

(a) Employee recognizes that Employee's position with the Company requires considerable responsibility and trust, and, in reliance on Employee's loyalty, the Company may entrust Employee with highly sensitive confidential, restricted and proprietary information involving Trade Secrets and Confidential Information.

(b) For purposes of this Agreement, a "Trade Secret" is any scientific or technical information, design, process, procedure, formula or improvement that is valuable and not generally known to competitors of the Company. "Confidential Information" is any data or information, other than Trade Secrets, that is important, competitively sensitive, and not generally known by the public, including, but not limited to, the Company's business plans, business prospects, training manuals, product development plans, bidding and pricing procedures, market strategies, internal performance statistics, financial data, confidential personnel information concerning employees of the Company, supplier data, operational or administrative plans, policy manuals, and terms and conditions of contracts and agreements. The terms "Trade Secret" and "Confidential Information" shall not apply to information which is (i) already in Employee's possession (unless such information was used in connection with formulating the Company's business plans, obtained by Employee from the Company or was obtained by Employee in the course of Employee's employment by the Company), or (ii) required to be disclosed by any applicable law.

(c) Except as required to perform Employee's duties hereunder, Employee will not use or disclose any Trade Secrets or Confidential Information of the Company during employment, at any time after termination of employment and prior to such time as they cease to be Trade Secrets or Confidential Information through no act of Employee in violation of this Section 11.

(d) Upon the request of Company and, in any event, upon the termination of employment hereunder, Employee shall surrender to the Company all memoranda, notes, records, plans, manuals or other documents pertaining to the Company's business or Employee's employment (including all copies thereof). Employee will also leave with the Company all materials involving Trade Secrets or Confidential Information of the Company. All such information and materials, whether or not made or developed by Employee, shall be the sole and exclusive property of the Company, and Employee hereby assigns to the Company all of Employee's right, title and interest in and to any and all of such information and materials.

12. Covenant Not To Compete.

Employee hereby covenants and agrees that for a period commencing on the date hereof and ending twelve (12) months after ceasing employment with the Company for whatever reason, he shall not:

(a) Compete in any way with the Company without the Company's prior written consent.

(b) Interfere with the relationship of the Company and any employee, agent, broker, or representative.

(c) Divert, or attempt to cause the diversion from the Company, any business with which the Company has been actively engaged in during any part of the past two (2) year period preceding the Termination Date, nor interfere with relationships of the Company with policyholders, dealers, distributors, marketers, sources of supply or customers.

Employee further specifically acknowledges that the geographic area to which the covenants contained in this Section 12 apply is the same geographic area in which the Company transacted its business during any part of the twelve (12) month period immediately prior to the Termination Date. The time period during which the prohibitions set forth in this Section 12 apply shall be tolled and suspended as to Employee for a period equal to the aggregate quantity of time during which Employee violates such prohibitions in any respect.

13. Specific Enforcement. Employee specifically acknowledges and agrees that the restrictions set forth in Sections 11 and 12

hereof are reasonable and necessary to protect the legitimate interest of the Company and that the Company would not have entered into this Agreement in the absence of such restrictions. Employee further acknowledges and agrees that any violation of the provisions of Sections 11 or 12 hereof will result in irreparable injury to the Company, that the remedy at law for any violation or threatened violation of such Section(s) will be inadequate and that in the event of any such breach, the Company, in addition to any other remedies or damages available to it at law or in equity, shall be entitled to temporary injunctive relief before trial from any court of competent jurisdiction as a matter of course, and to permanent injunctive relief without the necessity of proving actual damages.

14. Effect of Termination of the Employment Period. Upon the termination of the Employment Period, this Agreement shall terminate, and all of the parties' obligations hereunder shall forthwith terminate, except that rights and remedies accruing prior to such termination or arising out of this Agreement shall survive.

15. Notice. Any notice required to be given by the Company hereunder to Employee shall be in proper form and signed by an officer or Director of the Board of the Company. Until one party shall advise the other in writing to the contrary, notices shall be deemed delivered:

    (a) To the Company if delivered to the Chief Executive Officer of Humana Inc., or if mailed, certified or registered mail postage prepaid, to Humana Inc., 500 West Main Street, Louisville, Kentucky 40202; Attention: Chairman of the Board, with a copy to the Company's General Counsel.

    (b) To employee if delivered to Employee, or if mailed to him by certified or registered mail, postage prepaid, to Kenneth J. Fasola at 7407 Pine Knoll Circle, Prospect, Kentucky 40059.

16. Benefit. This Agreement shall bind and inure to the benefit of the Company and the Employee, their respective heirs, successors and assigns.

17. Severability. If a judicial determination is made that any of the provisions of this Employment Agreement constitutes an unreasonable or otherwise unenforceable restriction against Employee, such provision shall be rendered void only to the extent that such judicial determination finds such provisions to be unreasonable or otherwise unenforceable. In this regard, the parties hereto hereby agree that any judicial authority construing this Employment Agreement shall be empowered to sever any portion of the territory or prohibited business activity from the coverage of Sections 11 or 12 and to apply the provisions to the remaining portion of the territory or the remaining business activities not so severed by such judicial authority. Moreover, notwithstanding the fact that any provisions of this Employment Agreement are determined not to be specifically enforceable, the Company shall nevertheless be entitled to recover monetary damages as

a result of the breach of such provision by Employee.

18. Conditions. This Agreement shall become effective upon approval by the Compensation Committee of the Board of Directors of the Company.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement as of the day and year first above written.

| | |
|---|---|
| Attest: | HUMANA INC. |
| /s/Kathleen Pellegrino<br>Kathleen Pellegrino<br>Vice President and<br>Assistant Secretary | BY:/s/Gregory H. Wolf<br>Gregory H. Wolf<br>Chief Executive Officer<br>Humana Inc. |
| /s/Kathleen Pellegrino<br>Kathleen Pellegrino<br>Witness | /s/Kenneth J. Fasola<br>Kenneth J. Fasola<br>"EMPLOYEE" |

Exhibit 12

Humana Inc.
Ratio of Earnings to Fixed Charges
For the quarters ended March 31, 1999 and 1998
Unaudited
(Dollars in millions)

| | 1999 | 1998 |
|---|---|---|
| Earnings (Loss): | | |
| (Loss) income before income taxes | $ (25) | $ 79 |
| Fixed charges | 13 | 15 |
| | $ (12) | $ 94 |
| Fixed charges: | | |
| Interest charged to expense | $ 10 | $ 12 |
| One-third of rent expense | 3 | 3 |
| | $ 13 | $ 15 |
| Ratio of earnings to fixed charges | (a) | 6.1 |

The one-third of rent expense included in fixed charges is that proportion deemed representative of the interest portion.

(a) Earnings (loss) for the quarter ended March 31, 1999 were not adequate to cover fixed charges. Exclusive of the additional medical claims expense of $90 million ($57 million after tax, or $.34 per share) and a $12 million ($8 million after tax, or $.04 per share) gain on the sale of a tangible asset, the ratio of earnings to fixed charges for the quarter would have been 5.0.

<ARTICLE> 5
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| | |
|---|---|
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| <PREFERRED> | 0 |
| <COMMON> | 28 |
| <OTHER-SE> | 1,640 |
| <TOTAL-LIABILITY-AND-EQUITY> | 5,190 |
| <SALES> | 2,428 |
| <TOTAL-REVENUES> | 2,477 |
| <CGS> | 2,136 |
| <TOTAL-COSTS> | 2,492 |
| <OTHER-EXPENSES> | 0 |
| <LOSS-PROVISION> | 0 |
| <INTEREST-EXPENSE> | 10 |
| <INCOME-PRETAX> | (25) |
| <INCOME-TAX> | (9) |
| <INCOME-CONTINUING> | (16) |
| <DISCONTINUED> | 0 |
| <EXTRAORDINARY> | 0 |
| <CHANGES> | 0 |
| <NET-INCOME> | (16) |
| <EPS-PRIMARY> | (.10) |
| <EPS-DILUTED> | (.10) |