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

FORM 10-Q

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

For the quarterly period ended March 31, 2000

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**  
(State or other jurisdiction of  
incorporation or organization)

**61-0647538**  
(I.R.S. Employer  
Identification Number)

**500 West Main Street**  
**Louisville, Kentucky 40202**  
(Address of principal executive offices, including zip code)

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

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  No

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

| <u>Class of Common Stock</u> | <u>Outstanding at<br/>April 30, 2000</u> |
|------------------------------|--|
| \$0.16 2/3 par value         | 167,738,460 shares                       |

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**Form 10-Q**  
*Humana Inc.*  
*March 31, 2000*

**INDEX**

Part I: Financial Information

Page

|            |  |    |
|------------|--|----|
| Item 1.    | Financial Statements   |    |
|            | Condensed Consolidated Statements of Operations for the quarters ended March 31, 2000 and 1999 | 3  |
|            | Condensed Consolidated Balance Sheets at March 31, 2000 and December 31, 1999                  | 4  |
|            | Condensed Consolidated Statements of Cash Flows for the quarters ended March 31, 2000 and 1999 | 5  |
|            | Notes to Condensed Consolidated Financial Statements   | 6  |
| Item 2.    | Management's Discussion and Analysis of Financial Condition and                                | 12 |
| Item 3.    | Results of Operations  | 23 |
|            | Quantitative and Qualitative Disclosures about Market Risk                                     |    |
| Item 1.    | <u>Part II: Other Information</u>  | 24 |
| Item 6.    | Legal Proceedings  | 27 |
| Signatures | Exhibits and Reports on Form 8-K   | 28 |
| Exhibit 12 |  |    |
| Exhibit 27 | Ratio of Earnings to Fixed Charges   |    |
|            | Financial Data Schedule  |    |

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**Condensed Consolidated Statements of Operations**

*Humana Inc.*

*For the quarters ended March 31, 2000 and 1999*

*Unaudited*

*(In millions, except per share results)*

|  | Quarters Ended |
|--|----------------|
|  |                |

|  | <u>2000</u>    | <u>1999</u>      |
|--|----------------|------------------|
| Revenues:                                |                |                  |
| Premiums                                 | \$ 2,611       | \$ 2,428         |
| Interest and other income                | <u>31</u>      | <u>49</u>        |
| Total revenues                           | <u>2,642</u>   | <u>2,477</u>     |
| Operating expenses:                      |                |                  |
| Medical                                  | 2,220          | 2,136            |
| Selling, general and administrative      | 353            | 325              |
| Depreciation and amortization            | <u>34</u>      | <u>31</u>        |
| Total operating expenses                 | <u>2,607</u>   | <u>2,492</u>     |
| Income (loss) from operations            | 35             | (15)             |
| Interest expense                         | <u>8</u>       | <u>10</u>        |
| Income (loss) before income taxes        | 27             | (25)             |
| Provision (benefit) for income taxes     | <u>6</u>       | <u>(9)</u>       |
| Net income (loss)                        | <u>\$ 21</u>   | <u>\$ (16)</u>   |
| Basic earnings (loss) per common share   | <u>\$ 0.13</u> | <u>\$ (0.10)</u> |
| Diluted earnings (loss) per common share | <u>\$ 0.13</u> | <u>\$ (0.10)</u> |

See accompanying notes to condensed consolidated financial statements

**Condensed Consolidated Balance Sheets**

*Humana Inc.*

*Unaudited at March 31, 2000*

*(In millions, except per share results)*

**March 31,**  
**2000**

**December 31,**  
**1999**

**ASSETS**

|   |                 |                 |
|---|-----------------|-----------------|
| Current assets:   |                 |                 |
| Cash and cash equivalents                                 | \$ 897          | \$ 978          |
| Marketable securities                                     | 1,336           | 1,507           |
| Premiums receivable, less allowance for doubtful accounts | 262             | 225             |
| of \$62 at March 31, 2000 and \$61 at December 31, 1999   | <u>328</u>      | <u>354</u>      |
| Other   | 2,823           | 3,064           |
| Total current assets                                      | 158             | 253             |
|   | 426             | 418             |
| Long-term marketable securities                           | 844             | 806             |
| Property and equipment, net                               | <u>170</u>      | <u>359</u>      |
| Cost in excess of net assets acquired                     | <u>\$ 4,421</u> | <u>\$ 4,900</u> |
| Other   |                 |                 |
| Total assets  |                 |                 |

|  |              |              |
|--|--------------|--------------|
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  | \$ 1,360     | \$ 1,432     |
| Current liabilities:                         | 363          | 482          |
| Medical and other expenses payable           | 165          | 215          |
| Trade accounts payable and accrued expenses  | 402          | 349          |
| Book overdraft                               | <u>679</u>   | <u>686</u>   |
| Unearned premium revenues                    | 2,969        | 3,164        |
| Commercial paper                             |              |              |
| Total current liabilities                    |              | 324          |
|  | <u>153</u>   | <u>144</u>   |
| Long-term medical and other expenses payable | <u>3,122</u> | <u>3,632</u> |
| Professional liability and other obligations |              |              |
| Total liabilities                            |              |              |

## Commitments and contingencies

## Stockholders' equity:

|  |                 |                 |
|--|-----------------|-----------------|
| Preferred stock, \$1 par; authorized 10,000,000 shares; none issued  |                 |                 |
| Common stock, \$0.16 2/3 par; authorized 300,000,000 shares; issued and outstanding 167,746,710 shares at March 31, 2000 and 167,514,710 shares at December 31, 1999 | 28              | 28              |
| Capital in excess of par value   | 901             | 899             |
| Deferred compensation - restricted stock   | (1)             | (2)             |
| Retained earnings  | 392             | 371             |
| Accumulated other comprehensive loss   | <u>(21)</u>     | <u>(28)</u>     |
| Total stockholders' equity   | <u>1,299</u>    | <u>1,268</u>    |
| Total liabilities and stockholders' equity   | <u>\$ 4,421</u> | <u>\$ 4,900</u> |

See accompanying notes to condensed consolidated financial statements

**Condensed Consolidated Statements of Cash Flows**

Humana Inc.

For the quarters ended March 31, 2000 and 1999

Unaudited

(In millions)

|  | Quarters Ended |
|--|----------------|
|--|----------------|

|  | <u>2000</u>   | <u>1999</u>   |
|--|---------------|---------------|
| <b>Net cash used in operating activities</b>           | \$ (70)       | \$ (192)      |
| <b>Cash flows from investing activities:</b>           |               |               |
| Acquisition, net of cash and cash equivalents acquired | 3<br>60       |               |
| Disposition, net of cash and cash equivalents disposed | (249)<br>179  | (211)<br>103  |
| Purchases of marketable securities                     | 88            | 110           |
| Maturities of marketable securities                    | (33)          | (30)          |
| Proceeds from sales of marketable securities           | 6             | 25            |
| Purchases of property and equipment                    | (8)           | (2)           |
| Proceeds from sales of property and equipment          | 46            | (5)           |
| Other  |               |               |
| Net cash provided by (used in) investing activities    | (7)           | (93)<br>49    |
| <b>Cash flows from financing activities:</b>           | (50)          | (37)          |
| Repayment of line of credit                            |               | 1             |
| Net commercial paper (repayments) borrowings           | (57)          | (80)          |
| Change in book overdraft                               |               |               |
| Other  | (81)          | (277)         |
| Net cash used in financing activities                  | 978           | 913           |
|  | <u>\$ 897</u> | <u>\$ 636</u> |
| Decrease in cash and cash equivalents                  |               |               |
| Cash and cash equivalents at beginning of period       | \$ 8          | \$ 10         |
| Cash and cash equivalents at end of period             | \$ (1)        | \$ (39)       |
| <b>Supplemental cash flow information:</b>             |               |               |
| Interest payments                                      |               |               |
| Income tax refunds, net                                | \$ 83<br>(86) |               |
| Details of business acquired in purchase transaction:  | <u>\$ 3</u>   |               |
| Fair value of assets acquired                          |               |               |
| Less: liabilities assumed                              |               |               |
| Cash acquired, net of cash paid, for business acquired |               |               |

See accompanying notes to condensed consolidated financial statements.

**Notes to Condensed Consolidated Financial Statements**

*Humana Inc.*  
*Unaudited*

**A. Basis of Presentation**

The accompanying condensed consolidated financial statements are presented in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they 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. For further information, the reader of this Form 10-Q should refer to th

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 the amounts reported in the financial statements and accompanying notes. Although these estimates are based on knowledge of current events and anticipated future events, actual results may ultimately 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.

Effective January 1, 2000, the Company adopted a 20 year amortization period, from the date of acquisition, for goodwill previously amortized over 40 years. The change in the amortization period of goodwill will increase amortization expense \$25 million annually, while the Company's fourth quarter 1999 long-lived asset impairment will decrease depreciation and amortization \$13 million annually.

#### **B. First Quarter 1999 Additional Medical Expense and Tangible Asset Gain**

During the first quarter of 1999, the Company recorded \$90 million of additional medical expense for premium deficiency, reserve strengthening and provider costs. As a result of management's assessment of the profitability of its contracts for providing health care services to its members in certain markets, the Company recorded a provision for probable future losses (premium deficiency) of \$50 million. Ineffective provider risk-sharing contracts and the impact of the March 31, 1999 C

#### **Notes to Condensed Consolidated Financial Statements, continued**

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*Humana Inc.*

*Unaudited*

Prior period adverse claims development primarily in the Company's PPO and Medicare products initially identified during an analysis of February and March 1999 medical claims resulted in the \$35 million reserve strengthening. The Company releases or strengthens medical claims reserves when favorable or adverse development in prior periods exceed actuarial margins existing in the reserves. In addition, the Company paid Columbia/HCA \$5 million to settle certain contractual issues associ

Also during the first quarter of 1999, the Company recorded a \$12 million 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) Acquisitions and Dispositions**

Between December 30, 1999 and February 4, 2000, the Company entered into definitive agreements to sell its workers' compensation, Medicare supplement and North Florida Medicaid businesses for proceeds of approximately \$115 million. The Company recorded an estimated \$118 million loss in 1999 related to these sale transactions. There was no change in the estimated loss during the first quarter of 2000. Revenues associated with these businesses was \$45 million in the first quarter of 200

On March 31, 2000, the Company completed the sale of its run-off workers' compensation business. The loss from this sale was previously estimated and accrued in 1999. On April 10, 2000, the Company completed the sale of its workers' compensation administrative services business. Management believes that the remaining liability for accrued losses on asset sales of \$18 million is adequate to cover the losses from completing the sales of its Medicare supplement, North Florida Medicaid and wo

On January 31, 2000, the Company acquired the Memorial Sisters of Charity Health Network ("MSCHN"), a Houston based health plan for approximately \$50 million in cash.

On June 1, 1999, the Company reached an agreement with FPA Medical Management, Inc. ("FPA"), FPA's lenders and a federal bankruptcy court under which the Company acquired the operations of 50 medical centers from FPA for approximately \$14 million in cash. The Company has subsequently transferred operating responsibility for substantially all acquired FPA medical centers under long-term provider agreements.

The above acquisitions were accounted for under the purchase method of accounting. As a result of a preliminary allocation of the purchase price, the Company recorded goodwill

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#### **Notes to Condensed Consolidated Financial Statements, continued**

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*Humana Inc.*

*Unaudited*

of \$68 million. The goodwill is being amortized over periods ranging from six to 20 years. Proforma results approximate historical results.

On May 10, 2000, the Company acquired Wisconsin National Life Insurance Company for approximately \$12 million in cash.

#### **(D) 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, re

During the ordinary course of its business, the Company is or may become subject to pending or threatened litigation or other legal actions. Management does not believe that any pending or threatened legal actions against the Company or audits by agencies will have a material adverse effect on the Company's financial position or results of operations. However, the likelihood or outcome of current or future suits cannot be accurately predicted, and they could adversely affect the Company's

#### **(E) Earnings (Loss) Per Common Share**

Basic earnings (loss) per common share is computed on the basis of the weighted average number of common shares outstanding. Diluted earnings (loss) per common share is computed on the basis of the weighted average number of common shares outstanding plus the dilutive effect of outstanding stock options using the "treasury stock" method.

There were no adjustments required to be made to net income (loss) for purposes of computing basic earnings (loss) per common share and diluted earnings (loss) per common share. Options whose exercise price is greater than the average market price of common shares are antidilutive and, therefore, have been excluded from the computation

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**Notes to Condensed Consolidated Financial Statements, continued**

Humana Inc.

Unaudited

of diluted earnings (loss) per common share. Reconciliations of the average number of common shares outstanding used in the calculation of basic earnings (loss) per common share and diluted earnings (loss) per common share for the quarters ended March 31, 2000 and 1999 are as follows:

|   | Quarters Ended     |                    |
|---|--------------------|--------------------|
|   | <u>2000</u>        | <u>1999</u>        |
| Shares used to compute basic earnings (loss) per common share   | 167,752,402        | 167,559,428        |
| Dilutive effect of common stock options                         | <u>99,246</u>      | <u>      </u>      |
| Shares used to compute diluted earnings (loss) per common share | <u>167,851,648</u> | <u>167,559,428</u> |
| Number of antidilutive common stock options                     | 9,686,003          | 10,473,660         |

**(F) Comprehensive Income (Loss)**

The following table presents details supporting the computation of comprehensive income (loss) for the quarters ended March 31, 2000 and 1999 (in millions):

|  | Quarters Ended |                |
|--|----------------|----------------|
|  | <u>2000</u>    | <u>1999</u>    |
| Net income (loss)                                    | \$ 21          | \$ (16)        |
| Net unrealized investment gains (losses), net of tax | <u>7</u>       | <u>(6)</u>     |
| Comprehensive income (loss), net of tax              | <u>\$ 28</u>   | <u>\$ (22)</u> |

**(G) Long-Term Debt**

The Company maintains a revolving credit agreement ("Credit Agreement") which provides a line of credit of up to \$1.0 billion and expires in August 2002. Principal amounts outstanding under the Credit Agreement bear interest at either a fixed rate or a floating rate, ranging from LIBOR plus 35 basis points to LIBOR plus 80 basis points, depending on the Company's credit ratings. The Credit Agreement contains customary covenants and events of default including, but not limited to, fina

**Notes to Condensed Consolidated Financial Statements, continued**

Humana Inc.

Unaudited

**(H) Segment Information**

The following table presents financial information for the Company's Health Plan and Small Group segments for the quarters ended March 31, 2000 and 1999 (in millions):

|                   | Quarters Ended |             |
|-------------------|----------------|-------------|
|                   | <u>2000</u>    | <u>1999</u> |
| Premium revenues: |                |             |

|   |          |          |
|---|----------|----------|
| Health Plan                             | \$ 1,806 | \$ 1,677 |
| Small Group                             | 805      | 751      |
| Total premium revenues                  | \$ 2,611 | \$ 2,428 |
| Underwriting margin:                    |          |          |
| Health Plan                             | \$ 235   | \$ 166   |
| Small Group.                            | 156      | 126      |
| Total underwriting margin               | \$ 391   | \$ 292   |
| Income (loss) before income taxes:      |          |          |
| Health Plan                             | \$ 24    | \$ (13)  |
| Small Group                             | 3        | (12)     |
| Total income (loss) before income taxes | \$ 27    | \$ (25)  |

Health Plan and Small Group underwriting margin and pretax results include \$66 million and \$24 million, respectively, of additional medical expense recorded during the quarter ended March 31, 1999.

#### (I) Impact of Recently Issued Accounting Pronouncements

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"). In general, SFAS No. 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 exp

#### Notes to Condensed Consolidated Financial Statements, continued

Humana Inc.  
Unaudited

#### (J) 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

Humana Inc.

This quarterly report on Form 10-Q 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 t

#### Introduction

Humana is one of the nation's largest publicly traded health services companies that facilitates the delivery of health care services through networks of providers to its approximately 5.9 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 pr

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

Humana Inc.

plans. In total, the Company's products are licensed in 49 states, the District of Columbia and Puerto Rico, with approximately 20 percent of its membership in the state of Florida.

The Company is organized into two business units: the Health Plan segment and the Small Group segment. The Health Plan segment includes the Company's large group commercial (100 employees and over), Medicare, Medicaid, ASO, and military or TRICARE business. The Small Group segment includes small group commercial (under 100 employees) and specialty benefit lines, including dental, life and short-term disability. Results of each segment are measured based upon results of operations before i



**First Quarter 1999 Additional Medical Expense and Tangible Asset Gain**

During the first quarter of 1999, the Company recorded \$90 million of additional medical expense for premium deficiency, reserve strengthening and provider costs. As a result of management's assessment of the profitability of its contracts for providing health care services to its members in certain markets, the Company recorded a provision for probable future losses (premium deficiency) of \$50 million. Ineffective provider risk-sharing contracts and the impact of the March 31, 1999 Colum

Prior period adverse claims development primarily in the Company's PPO and Medicare products initially identified during an analysis of February and March 1999 medical claims resulted in the \$35 million reserve strengthening. The Company releases or strengthens medical claims reserves when favorable or adverse development in prior periods exceed actuarial margins existing in the reserves. In addition, the Company paid

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

*Humana Inc.*

Columbia/HCA \$5 million to settle certain contractual issues associated with the March 31, 1999 hospital agreement in Florida.

Also during the first quarter of 1999, the Company recorded a \$12 million 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 as well as to provide a baseline against which historical and prospective periods can be measured, the following discussion comparing results for the quarters ended March 31, 2000 (the "2000 quarter") and 1999 (the "1999 quarter"), excludes the previously described medical expenses and tangible asset gain recorded in the 1999 quarter, but does include the beneficial effect related to premium deficiency in operating results for the period shown. Th

|   | 1999 Quarter     |                       |                  |
|---|------------------|-----------------------|------------------|
|   | Reported Results | Excluded Expenses (a) | Adjusted Results |
| Condensed Consolidated Statement of Operations Caption items that are adjusted: |                  |                       |                  |
| Interest and other income   | \$ 49            | \$ (12)               | \$ 37            |
| Total revenues  | 2,477            | (12)                  | 2,465            |
| Operating expenses:   |                  |                       |                  |
| Medical   | 2,136            | (90)                  | 2,046            |
| Total operating expenses  | 2,492            | (90)                  | 2,402            |
| (Loss) income before income taxes   | (25)             | 78                    | 53               |
| Net (loss) income   | \$ (16)          | \$ 49                 | \$ 33            |
| Basic (loss) earnings per common share  | \$ (0.10)        | \$ 0.30               | \$ 0.20          |
| Diluted (loss) earnings per common share  | \$ (0.10)        | \$ 0.30               | \$ 0.20          |

|  | 1999 Quarter    |                                      |                 |
|--|-----------------|--------------------------------------|-----------------|
|  | Reported Ratios | Ratio Effect of Excluded Expenses(a) | Adjusted Ratios |
|  |                 |                                      |                 |

|                         |              |               |              |
|-------------------------|--------------|---------------|--------------|
| Medical expense ratios: |              |               |              |
| Health Plan             | 90.1%        | (3.9)%        | 86.2%        |
| Small Group             | <u>83.2%</u> | <u>(3.2)%</u> | <u>80.0%</u> |
| Totals                  | <u>88.0%</u> | <u>(3.7)%</u> | <u>84.3%</u> |

(a) The item excluded from interest and other income is the \$12 million gain on sale of a tangible asset. The items excluded from 1999 medical expenses are the \$50 million premium deficiency, \$35 million reserve strengthening and \$5 million of provider costs.

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations,**  
**continued**

*Humana Inc.*

The Company's premium revenues increased 7.5 percent to \$2.6 billion for the 2000 quarter, compared to \$2.4 billion for the 1999 quarter. Higher premium revenues resulted from increased average premium yields of 11.4 percent and 6.2 percent for the Company's commercial and Medicare HMO products, respectively. This increase was partially offset by a decline in commercial membership of 194,200, or 6.5 percent, resulting from the impact of the Company's premium increases delivered to cus

The Company's medical expense ratio for the 2000 quarter was 85.0 percent, compared to an adjusted medical expense ratio of 84.3 percent for the 1999 quarter. This increase was the result of the absence of a \$5 million adjustment recorded in the 1999 quarter related to favorable development in workers' compensation reserves, and higher utilization in five of the Company's Medicare markets and various small group commercial markets without Health Plan membership overlap. Partially offsetti

The administrative expense ratio for the 2000 quarter was 14.8 percent, compared to 14.7 percent in the 1999 quarter. This increase was the result of higher spending on the Company's information technology initiatives and the increase in amortization expense from the change to a 20 year life for goodwill previously amortized over 40 years.

Interest income totaled \$29 million and \$34 million for the 2000 and 1999 quarters, respectively. This decrease resulted from lower average invested balances and investment yields. The tax equivalent yield on invested assets approximated 5.0 percent and 6.7 percent for the 2000 and 1999 quarters, respectively.

Income before income taxes totaled \$27 million for the 2000 quarter, compared to adjusted income before income taxes of \$53 million for the 1999 quarter. Net income was \$21 million, or \$0.13 per diluted share in the 2000 quarter, compared to adjusted net income of \$33 million, or \$0.20 per diluted share in the 1999 quarter. The earnings decline is due to the absence of favorable development in workers' compensation reserves, higher medical cost trends in five Medicare markets and various

On an interim basis, the provision or benefit for income taxes is provided for at the anticipated effective tax rate for the year. The Company's effective tax rate for the 2000 quarter was approximately 21 percent. This lower effective tax rate, in comparison to the 1999 quarter of approximately 35 percent, is the result of recognizing the benefit of anticipated capital gains for which the Company has available capital loss carryforwards created from the sale of the workers' compensation

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations,**  
**continued**

*Humana Inc.*

**Business Segment Information for the Quarters Ended March 31, 2000 and 1999**

The following table presents certain financial data for the Company's two segments for the 2000 quarter and 1999 quarter (in millions):

| <b>Quarters Ended</b> |                 |
|-----------------------|-----------------|
| <u>2000</u>           | <u>1999 (a)</u> |

|                                      |              |              |
|--------------------------------------|--------------|--------------|
| Premium revenues:                    |              |              |
| Health Plan                          | \$ 1,806     | \$ 1,677     |
| Small Group                          | <u>805</u>   | <u>751</u>   |
|                                      | \$ 2,611     | \$ 2,428     |
| Adjusted income before income taxes: |              |              |
| Health Plan                          | \$ 24        | \$ 46        |
| Small Group                          | <u>3</u>     | <u>7</u>     |
|                                      | \$ 27        | \$ 53        |
| Adjusted medical expense ratios:     |              |              |
| Health Plan                          | 86.9%        | 86.2%        |
| Small Group                          | <u>80.7%</u> | <u>80.0%</u> |
|                                      | 85.0%        | 84.3%        |
| Administrative expense ratios:       |              |              |
| Health Plan                          | 12.7%        | 12.3%        |
| Small Group                          | <u>19.5%</u> | <u>20.0%</u> |
|                                      | 14.8%        | 14.7%        |

(a) Excludes \$90 million (\$66 million Health Plan and \$24 million Small Group) of medical expense related to premium deficiency, reserve strengthening and provider costs and \$12 million (\$7 million Health Plan and \$5 million Small Group) gain on the sale of a tangible asset.

#### **Health Plan**

The Health Plan segment's premium revenues increased 7.7 percent to \$1.8 billion for the 2000 quarter across all product lines primarily from significant increases in premium yields. Large group commercial premiums increased 1.0 percent to \$599 million during the 2000 quarter from \$593 million in the 1999 quarter. This increase was due to higher premium yields ranging from 10 to 11 percent during the 2000 quarter compared to a range of five to six percent for the 1999 quarter, ref

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

*Humana Inc.*

implementation of a member premium component for many of the Company's Medicare members combined with a shift in the mix of members to markets with higher HCFA reimbursement rates. Medicare membership increased by 37,300 members comparing the 2000 quarter with the 1999 quarter despite the exit of 30 counties on January 1, 2000. This increase was the result of strong sales initiatives in key markets coupled with the acquired membership from the MSCHN acquisition. Medicaid premiums incr

The Health Plan segment's medical expense ratio for the 2000 quarter was 86.9 percent, increasing from an adjusted medical expense ratio of 86.2 percent in the 1999 quarter. This increase was primarily the result of the absence of a \$5 million adjustment recorded in the 1999 quarter related to favorable development in workers' compensation reserves, and increasing Medicare medical cost trends from higher than expected utilization in five Medicare markets. Medicare cost trends in these five

The administrative expense ratio for the 2000 quarter increased to 12.7 percent compared to 12.3 percent for the 1999 quarter. This increase was the result of higher spending on the Company's information technology initiatives and an increase in amortization expense from the change to a 20 year life for goodwill previously amortized over 40 years.

Income before income taxes totaled \$24 million for the 2000 quarter compared to adjusted income before income taxes of \$46 million for the 1999 quarter. The earnings decline is due to the absence of favorable development in workers' compensation reserves, higher medical cost trends in five Medicare markets and increased administrative costs.

#### **Small Group**

The Small Group segment's 2000 quarter premium revenues increased 7.2 percent compared to the 1999 quarter to \$805 million. This increase was due to higher premium yields ranging from 12 to 13 percent in the 2000 quarter compared to 6 to 7 percent in the 1999 quarter, reflecting the Company's aggressive pricing actions. Small group commercial membership declined 107,700 members or 6.4 percent from the 1999 quarter due to attrition in reaction to significant rate increases.

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

*Humana Inc.*

The Small Group segment's medical expense ratio for the 2000 quarter was 80.7 percent, increasing from an adjusted medical expense ratio of 80.0 percent for the 1999 quarter. This increase was the result of higher small group commercial cost trends which ranged from 12 to 13 percent in the 2000 quarter compared to 9 to 10 percent in the 1999 quarter. Medical cost trends were more severe in two markets, Colorado and Texas, and in various small group commercial markets that did not have

The Small Group segment's administrative expense ratio for the 2000 quarter was 19.5 percent compared to 20.0 percent for the 1999 quarter.

Income before income taxes totaled \$3 million for the 2000 quarter. This decline from the 1999 quarter's adjusted income before income taxes of \$7 million is attributable to higher medical costs in two markets and in various small group commercial markets that lack Health Plan membership

overlap.

### **Liquidity and Capital Resources**

The following table presents pro forma cash flows for the quarters ended March 31, 2000 and 1999, excluding the effects of previously funded workers' compensation claim payments and the timing of the Medicare premium receipts (in millions):

|   | Quarters Ended |              |
|---|----------------|--------------|
|   | <u>2000</u>    | <u>1999</u>  |
| Cash used in operating activities                               | \$ (70)        | \$ (192)     |
| Timing of Medicare premium receipts                             | (19)           | 234          |
| Funded workers' compensation claim payments                     | <u>30</u>      | <u>28</u>    |
| Pro forma cash flows (used in) provided by operating activities | <u>\$ (59)</u> | <u>\$ 70</u> |

Pro forma operating cash declined primarily from lower income tax receipts, slower premium receipt collections, partially the result of a billing system conversion, a reduction in claims inventory and claim payments related to terminated membership.

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

*Humana Inc.*

On March 31, 2000, the Company received \$125 million from the disposition of its workers' compensation business (\$60 million, net of cash and cash equivalents included in the disposed operating subsidiary). The operating subsidiary sold included total assets of \$595 million, primarily consisting of marketable securities and reinsurance recoverables and total liabilities of \$407 million, primarily consisting of workers' compensation reserves. The Company expects to use the proceeds from

The Company's subsidiaries operate in states that require minimum 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' ability 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, similar to the current requirement for insurance companies. The RBC provisions may require new minimum capital and surplus levels for some of the Company's HMO subsidiaries. Many states have not yet determined when they will adopt the RBC formula or if they will allow a phase-in to the required levels of capital and surplus .<

The Company currently maintains approximately \$774 million of capital and surplus in its health insurance and HMO entities, compared to the minimum statutory required capital and surplus levels of approximately \$626 million. If the states in which the Company conducts business adopt the proposed RBC formula, without a phase-in provision, the Company estimates it would be required to fund additional capital into its various subsidiaries of approximately \$62 million. After this capital infu d have \$100 million of capital and surplus above the required RBC level.

The Company maintains a revolving credit agreement ("Credit Agreement") which provides a line of credit of up to \$1.0 billion and expires in August 2002. Principal amounts outstanding under the Credit Agreement bear interest at either a fixed rate or a floating rate, ranging from LIBOR plus 35 basis points to LIBOR plus 80 basis points, depending on the Company's credit ratings. The Credit Agreement contains customary covenants and events of default including, but not limited to, financia

Management believes that funds from future operating cash flows and funds available under the existing 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.

The Company's ongoing capital expenditures relate primarily to information systems and administrative facilities necessary for activities such as claims processing, billing and

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

*Humana Inc.*

collections, medical utilization review and customer service. Excluding acquisitions, planned capital spending for the remainder of 2000 will approximate \$100 million to \$110 million for the funding of the Company's technology initiatives and expansion and improvement of its administrative facilities.

### **The Company's Year 2000 Readiness Disclosure Statement**

To date, the Company has experienced no outages or problems related to the Year 2000 date rollover. All business systems are functioning normally and the Company has not experienced any disruptions in service with third party organizations with which it interacts related to the century change. The Company developed business continuity and contingency plans as a result of its Year 2000 project. These plans would be enacted if Year 2000 problems were to occur within the Company, or

### **Impact of Recently Issued Accounting Pronouncements**

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"). In general, SFAS No. 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

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

*Humana Inc.*

| <b>Quarterly Membership</b>         | <u><b>2000</b></u> | <u><b>1999</b></u> |
|-------------------------------------|--------------------|--------------------|
| <b>Health Plan:</b>                 |                    |                    |
| Large group commercial members at:  |                    |                    |
| March 31                            | 1,409,000          | 1,495,500          |
| June 30                             |                    | 1,478,300          |
| September 30                        |                    | 1,424,400          |
| December 31                         |                    | 1,420,500          |
| Medicare HMO members at:            |                    |                    |
| March 31                            | 518,000            | 480,700            |
| June 30                             |                    | 484,800            |
| September 30                        |                    | 489,300            |
| December 31                         |                    | 488,500            |
| TRICARE members at:                 |                    |                    |
| March 31                            | 1,060,000          | 1,085,700          |
| June 30                             |                    | 1,064,600          |
| September 30                        |                    | 1,065,500          |
| December 31                         |                    | 1,058,000          |
| Administrative Services members at: |                    |                    |
| March 31                            | 657,000            | 617,900            |
| June 30                             |                    | 636,700            |
| September 30                        |                    | 641,000            |
| December 31                         |                    | 648,000            |
| Medicaid and other members at:      |                    |                    |
| March 31                            | 697,400            | 704,300            |
| June 30                             |                    | 707,200            |
| September 30                        |                    | 695,000            |
| December 31                         |                    | 661,100            |
| Total Health Plan members at:       |                    |                    |
| March 31                            | 4,341,400          | 4,384,100          |
| June 30                             |                    | 4,371,600          |
| September 30                        |                    | 4,315,200          |
| December 31                         |                    | 4,276,100          |
| <b>Small Group:</b>                 |                    |                    |
| Small group commercial members at:  |                    |                    |
| March 31                            | 1,568,500          | 1,676,200          |
| June 30                             |                    | 1,695,700          |
| September 30                        |                    | 1,706,800          |
| December 31                         |                    | 1,663,100          |
| <b>Total medical members at:</b>    |                    |                    |
| March 31                            | 5,909,900          | 6,060,300          |
| June 30                             |                    | 6,067,300          |
| September 30                        |                    | 6,022,000          |
| December 31                         |                    | 5,939,200          |
| <b>Specialty members at:</b>        |                    |                    |
| March 31                            | 2,980,100          | 2,771,900          |
| June 30                             |                    | 2,837,600          |
| September 30                        |                    | 2,890,100          |
| December 31                         |                    | 2,961,300          |

**Item 3. Quantitative and Qualitative Disclosure about Market Risk**

*Humana Inc.*

Since the date of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1999, 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**

*Humana Inc.*

### Item 1: Legal Proceedings

#### *Securities Litigation*

Six purported class action complaints have been filed in the United States District Court for the Western District of Kentucky at Louisville, by purported stockholders of the Company against the Company and certain of its current and former directors and officers. The six complaints contain the same or substantially similar allegations; namely, that the Company and the individual defendants knowingly or recklessly made false or misleading statements in press releases and public filing ncial condition, primarily with respect to the impact of the negotiations over renewal of the Company's contract with Columbia/HCA which took effect April 1, 1999. The complaints allege violations of Section 10(b) of the Securities Exchange Act of 1934 (the "1934 Act") and SEC Rule 10b-5, and Section 20(a) of the 1934 Act and seek certification of a class of stockholders who purchased shares of Humana common stock starting either (in four complaints) in late October 1998 or (in two complaints) on February 9 omplaints) on April 8, 1999. All seek money damages in unspecified amounts, plus (in certain of the complaints) pre-judgment and post-judgment interest, and costs and expenses including attorney and expert fees. Plaintiffs moved for consolidation of the actions, now styled *In re Humana Inc. Securities Litigation*, and have filed a Consolidated Complaint. On April 28, 2000 the defendants filed a motion requesting dismissal of the Consolidated Complaint. The Company believes that the above allegations a pursue the defense of the Consolidated Complaint vigorously.

#### *Managed Care Industry Litigation*

Since October 1999, the Company has received thirteen purported class action complaints filed on behalf of various named plaintiffs who seek to represent a class consisting of present and former Humana subscribers but excluding persons insured by Medicare or Medicaid. All of the cases were filed in federal courts, eleven in the Southern District of Florida, one in the Southern District of Mississippi and one in the Northern District of Alabama. Eight of the cases filed in the Southern were ordered to be dismissed subject to the plaintiffs' right to re-file as part of a consolidated complaint with the case of *Price v. Humana Inc.* filed in the same court. In each case, the plaintiffs seek a recovery (including statutory treble damages) under the Racketeer Influenced and Corrupt Organizations Act ("RICO") for all persons who are or were Humana subscribers at any time during the four-year period prior to the filing of the complaints. In addition, plaintiffs seek to represent a subclass d their Humana coverage through their employers' health benefits plans governed by ERISA, and who are or were Humana subscribers at any time during the six-year period prior to filing the complaints.

The complaints, which are generally the same, allege, among other things, that Humana intentionally concealed from its members information concerning the various ways Humana decides what claims will be paid, what procedures will be deemed medically

## **Part II: Other Information, continued**

*Humana Inc.*

necessary, and what criteria and procedures are used to determine the extent and type of their coverage. Plaintiffs also allege that Humana concealed from members the existence of direct financial incentives to treating physicians and other health care providers to deny coverage. The plaintiffs generally do not allege that any of the alleged practices resulted in any named plaintiff, or any other specific member, being denied coverage for services that should have been covered but, i n ed the purported class with health insurance benefits of lesser value than promised. Humana requested the Federal Judicial Panel on Multidistrict Litigation ("MDL Panel") to consolidate the management of the cases in a single court. On April 13, 2000, the MDL Panel ordered the cases consolidated in the federal court in the Southern District of Florida as *In Re Humana Managed Care Litigation*. On May 10, 2000, an amended complaint was filed in one of the consolidated cases. The amendment, filed in the ., which had been filed originally in Mississippi, joins five other managed care organizations as defendants and adds allegations of industry-wide conspiracy as the basis for the joinder. The other defendants are United HealthCare, Foundation Health Systems, Inc., Aetna, Inc., Pacificare Health Systems, Inc., The Prudential Insurance Company of America, and Cigna Corporation. The amended complaint, which seeks a class consisting of members of all of the named managed care companies, alleges that the def ontainment measures and to conceal these from their members.

Humana has also received a class action suit filed in state court in Louisville, Kentucky, by named plaintiffs who seek to represent a purported nationwide class of providers who allege that the Company has improperly paid them and has "downcoded" their claims by paying lesser amounts than they billed for. The Company has removed the case to federal court and has asked the MDL Panel to consolidate that case with the ones described above as well as with another case brought by a physician hers brought by physicians in South Florida. Each of these cases was filed in state court and removed to federal court by the defendants. The plaintiffs in each are seeking to remand the cases to state court. In one of the cases in South Florida, *Landa v. Humana*, the court issued a remand order which the defendants challenged before the Court of Appeals for the Eleventh Circuit; that challenge was rejected on May 8, 2000.

The Company believes these actions are without merit and intends to pursue the defense of these actions vigorously.

Damages for claims for personal injuries and medical benefit denials are usual in the Company's business. Personal injury and medical benefit denial claims are covered by insurance from the Company's wholly owned captive insurance subsidiary and excess carriers, except to the extent that claimants seek punitive damages, which may not be covered by insurance if awarded in states in which insurance coverage for punitive damages is not permitted. In connection with the case of *Chippis v. H of Florida, Inc.*, the carriers have preliminarily indicated that they

## **Part II: Other Information, continued**

*Humana Inc.*

believe no coverage may be available for a punitive damages award. Other potential liabilities may not be covered by insurance, insurers may dispute coverage, or the amount of insurance may not be enough to cover the damages awarded. In addition, insurance coverage for all or certain forms of liability may become unavailable or prohibitively expensive in the future.

Due to the nature of its business, the Company is or may become subject to pending or threatened litigation or other legal actions relating to the

failure to provide or pay for health care or other benefits, poor outcomes for care delivered or arranged under the Company's programs, nonacceptance or termination of providers, failure to return withheld amounts from provider compensation, and failure to disclose network discounts and various provider payment arrangements and claims relating

Recent court decisions and legislative activity may increase our exposure for any of these types of claims.

Management does not believe that any pending or threatened legal actions against the Company or audits by agencies will have a material adverse effect on the Company's financial position or results of operations. However, the likelihood or outcome of current or future suits cannot be accurately predicted, and they could adversely affect the Company's financial position, results of operations or cash flows.

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**Part II: Other Information, continued**

*Humana Inc.*

Item 2: Changes in Securities

None.

Item 3: Defaults Upon Senior Securities

None.

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

None.

Item 5: Other Information

None.

Item 6: Exhibits and Reports on Form 8-K

(a) Exhibit Index

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

Exhibit 27 Financial Data Schedule (filed electronically).

(b) Other than the Form 8-K filed on January 3, 2000 and February 3, 2000 and referenced in the 1999 Form 10-K, there were no other reports filed on Form 8-K.

## 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.  
(Registrant)

Date: May 15, 2000

By: /s/James E. Murray  
James E. Murray  
Chief Operating Officer - Health  
Plan Division and  
Chief Financial Officer  
(Principal Accounting Officer)

Date: May 15, 2000

By: /s/Arthur P. Hipwell  
Arthur P. Hipwell  
Senior Vice President and  
General Counsel



Exhibit 12  
Ratio of Earnings to Fixed Charges  
Humana Inc.  
For the quarters ended March 31, 2000 and 1999  
Unaudited  
(Dollars in millions)

|                                    | Quarters Ended |          |
|------------------------------------|----------------|----------|
|                                    | 2000           | 1999 (a) |
| Earnings:                          |                |          |
| Income (loss) before income taxes  | \$ 27          | \$ (25)  |
| Fixed charges                      | 14             | 13       |
|                                    | \$ 41          | \$ (12)  |
| Fixed charges:                     |                |          |
| Interest charged to expense        | \$ 8           | \$ 10    |
| One-third of rent expense          | 6              | 3        |
|                                    | \$ 14          | \$ 13    |
| Ratio of earnings to fixed charges | 2.97           | (a)      |

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 \$90 million medical expense related to premium deficiency, reserve strengthening and provider costs and a \$12 million gain on the sale of a tangible asset, the ratio of earnings to fixed charges for the quarter ended March 31, 1999 would have been 5.0.

<ARTICLE> 5  
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This schedule contains summary financial information extracted from the accompanying financial statements and is qualified in its entirety by reference to such financial statements.

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