Yale SCHOOL *of* MANAGEMENT
New Haven, Connecticut

Oxford Health Plans, Inc.

Solid Earnings Outlook Supports Higher Stock Price

Stock Information	
Company	Oxford Health
Ticker	OHP
Price	$46.62
Recommendation	BUY – Target $50

Ratings Definitions	
Strong Buy	At least 20% under valued
Buy	Likely to out perform market
Hold	Fairly valued, likely to perform in line with overall market
Sell	Likely to under perform market by at least 10%
*Ratings assume a 12-18 month time horizon	

Operating History		
Year	Revenue (millions)	EPS
1997	$4,630	($3.70)
1998	$4,179	($7.79)
1999	$4,198	$3.26
2000	$4,112	$2.02
2001	$4,421	$2.91
2002E	$4,634	$3.40
2003E	$5,004	$3.67

Fundamentals	
Market Capitalization	$3.79B
Price to 2001 Earnings	16.0
Price to 2002 Earnings Est.	13.7
Price to 2003 Earnings Est.	12.7

April 22, 2002

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S&P 500 – 1,125.17

Morgan Stanley Healthcare Payor Index – 585.71

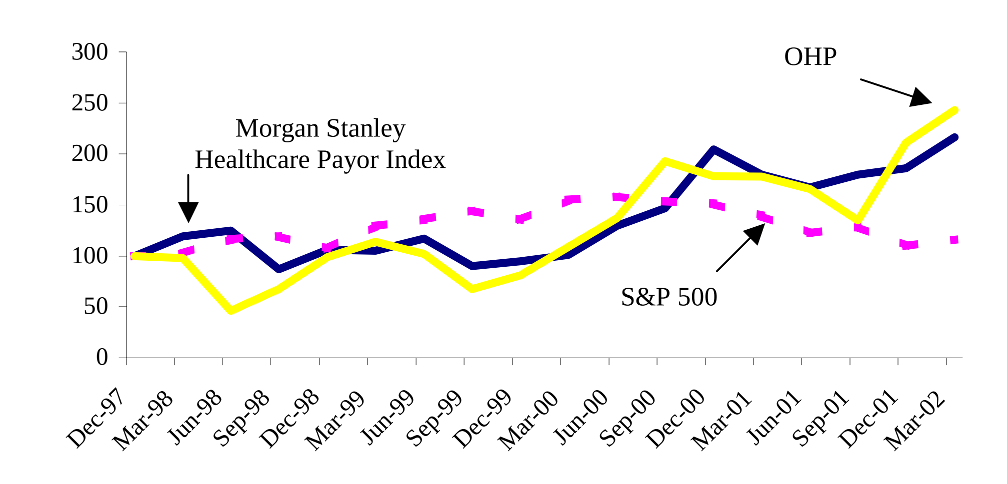
10-Year Treasury Yield – 5.19%

Please see the disclaimer at back of this report for important information.
Co-author John Dusza owns shares of OHP in his personal account.

Investment Rating

- We are initiating coverage of Oxford Health Plans with a Buy rating.

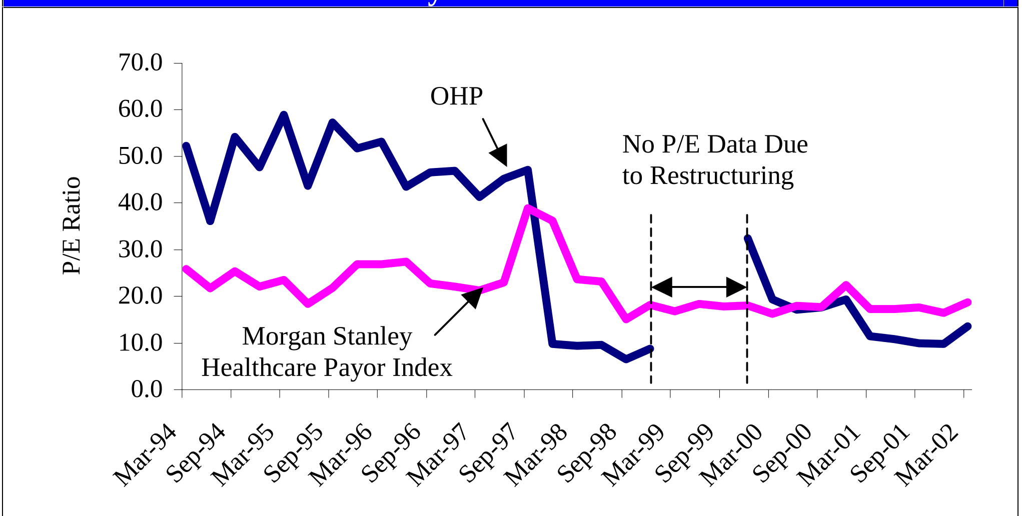
Oxford's Stock Has Outperformed Its Peers and the Market



Source: Bloomberg, Yale School of Management.

- Although the stock has now more than quadrupled from its low in 1998 (see chart above), its P/E ratio has actually declined since its return to profitability in 1999 (see chart below).

Oxford Has Historically Traded at a Premium to Its Peers

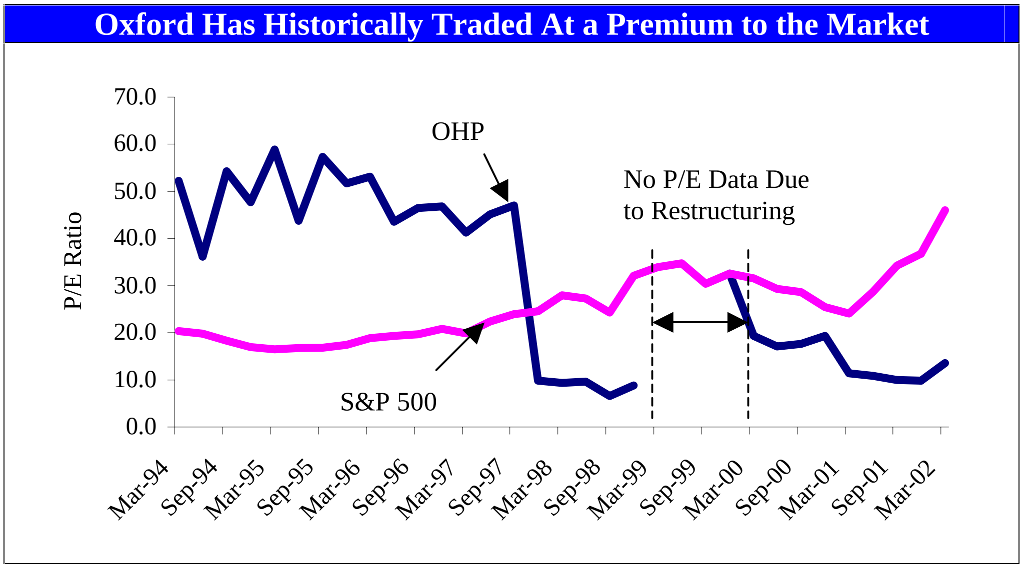


Source: Bloomberg, Yale School of Management.

- Based on current earnings projections, we believe OHP shares are still about 10% undervalued.

- Currently, the stock trades at 13.7 times expected 2002 earnings and 12.7 times 2003 estimates.

- On a P/E basis, OHP trades at a significant discount to the market, as well as a discount to its peer group (see chart below).



Source: Bloomberg, Yale School of Management.

- Based on OHP trading at a P/E ratio just marginally higher than its 5-year estimated earnings growth rate of 10-12%, we arrive at a 12-month target price of $50, 10% above its current price. At $50, OHP would be trading at 13.6 times expected 2003 earnings.

- We believe a PEG ratio of 1 is appropriate for this stock, but think a PEG ratio of 1.5 would not be unreasonable given its earnings visibility. At a P/E ratio of 18, OHP would still trade at a P/E discount to the S&P 500.

- Our DCF analysis arrives at a similar price objective based on a cost of capital of 8.1%, a discount rate of 11.5% and a terminal growth rate of 4.5%. (We believe health care spending will continue to grow faster than GDP, especially as the Baby Boom ages). [1]

- These assumptions are supported by:
  - A favorable premium pricing environment
  - Oxford's reduction in Medicare/Medicaid patients
  - Continued operating efficiencies and cost controls instituted as part of OHP's 1998 restructuring

[1] Medical costs have significantly exceeded overall inflation over the past few years. In addition, U.S. healthcare spending continues to grow faster then the overall economy. According to the Centers for Medicare and Medicaid Services Office, healthcare spending rose 8.9% in 2001 and will rise 9.4% in 2002.CMMS projects that healthcare spending will grow at a rate 250 basis points above GDP growth through 2011. Healthcare spending would then consume 17% of GDP vs. 13.2% in 2000.

A Snapshot of Our Universe

Fundamental Data for Our Managed Care Universe									
		Current	1-year	Market Cap	Earnings Per Share			Price/Earnings	
Company	**Ticker**	**Price**	**Return**	**($ million)**	**2001**	**2002E**	**2003E**	**2002E**	**2003E**
Oxford Health Plans	OHP	46.62	78.5%	$4,098	2.91	3.40	3.67	13.7	12.7
WellPoint Health Networks	WLP	71.54	61.8%	$10,247	3.15	3.89	4.49	18.4	15.9
Anthem	ATH	68.36	n/a	$7,067	3.32	3.74	4.32	18.3	15.8
Health Net	HNT	28.15	45.1%	$3,478	0.69	2.08	2.38	13.5	11.8
Humana	HUM	15.99	76.7%	$2,700	0.70	1.19	1.37	13.4	11.7
Aetna	AET	44.42	70.7%	$6,428	-2.03	0.56	1.72	79.3	25.8
Coventry Health Care	CVH	27.45	43.3%	$1,610	1.23	1.67	1.92	16.4	14.3
Mid Atlantic Medical Services	MME	33.00	73.7%	$1,339	1.41	1.74	2.01	19.0	16.4
PacifiCare Health Systems	PHSY	26.01	-15.2%	$606	0.55	3.28	3.61	7.9	7.2
Trigon Healthcare	TGH	79.72	54.7%	$2,652	3.10	4.75	5.45	16.8	14.6
Morgan Stanley Health Care Payor Index			**38.4%**					**15.5**	
S&P 500			**-9.5%**					**26.1**	

Source: Yahoo!Finance, Bloomberg, Yale School of Management.

Industry Overview

Managed care companies provide health insurance coverage to customers through corporations and through direct marketing. Customers may purchase policies themselves or through commissioned brokers. Many firms also offer health care insurance to individuals eligible for Medicare and Medicaid and are reimbursed by the federal government, although more restrictive pricing policies have made non-commercial business less attractive.

HMO's seek to manage medical reimbursement costs by working with physicians and hospitals to ensure appropriate benefit design and patient treatment and care programs. Although they have recently leveled off, enrollment trends have been favorable for the industry for the past decade, rising from 41 million members in 1993 to 79.5 million members last year.[2]

[2] SG Cowen, Perspectives: Managed Care & HMO's, January 10, 2002.

Company Overview

Founded in 1984, Oxford Health Plans operates health benefit plans serving approximately 1.37 million commercial, 77,800 Medicare, and 60,000 self-insured members primarily in the New York metropolitan region. Its physician network includes over 50,000 doctors and 200 hospitals. It offers a point of service plan that allows members to seek care from doctors outside its network while still getting insurance coverage. Oxford employs a direct sales staff and also has a network of 10,500 insurance agents and brokers who offer its plans. Revenues last year rose to $4.4 billion from $4.1 billion in 2000.

Oxford's Freedom Plan gives members the option of using the network of providers contracted by Oxford or using providers outside of Oxford's network. It had approximately 1.12 million members at year-end 2001 and accounted for 70.1% of total premium revenue last year. The plan's customer base is extremely diversified, with the 10 largest employer groups accounting for less than 5% of total plan premiums. The target market for this plan is small to mid-sized companies with between 10 and 1500 employees.[3]

CEO Background

CEO Dr. Norman C. Payson, M.D. joined Oxford in 1998 as CEO after the company's missteps in 1997 caused its stock price to collapse. Dr. Payson has gone after customers who are willing to pay more and has focused on providing services for less. Since 1997, Oxford's average premium per customer has increased 6.6% annually, while its medical loss ratio[4] has decreased from 94% to 79%. The result of these initiatives has been an increase in net margin to 6.8% in 2001 versus a –13.5% margin in 1998. Shareholders have been rewarded with a quadrupling of their stock.

Previously Payson was CEO of Healthsource, Inc. from its founding in 1985 until its sale to CIGNA Corporation in 1997. Healthsource was one of the nation's largest managed healthcare companies, operating in 15 states with more than three million members.

Payson serves on the board of directors of the American Association of Health Plans and is also on the faculty of the Dartmouth Medical School. He attended the Massachusetts Institute of Technology and received his M.D. from Dartmouth Medical School.[5]

1997-98 Write-offs and Turnaround

In May 1998, Oxford initiated a major restructuring effort that resulted in a $629 million loss during the year and forced the company to raise additional capital. Several serious problems converged in 1997, which produced a $291 million loss that year. Previously, Oxford had expanded into new markets beyond metropolitan New York in Illinois, Florida, New Hampshire and Pennsylvania, where its revenues failed to meet projections. Also, it had experienced serious billing, payments, and customer service problems after a new computer operating system

[3] Oxford Health Plans 2001 Annual Report.
[4] Medical loss ratio is calculated by dividing claims paid by premiums received.
[5] 1998-2001 Oxford Health Plans Annual Reports.

installed in September 1996 suffered unexpected delays. In addition, legislative changes in the 1997 Balanced Budget Act adversely impacted the company. The act made changes in Medicaid reimbursement levels that particularly hit insurers in high cost metropolitan areas with a large number of teaching hospitals such as New York. As a result of these legislative changes, Oxford largely exited the Medicaid market in 1998-99.

By the end of 1998, Oxford had installed a new senior management team, withdrawn from the Illinois market and shut down its specialty management business. During 1999, Oxford substantially completed its withdrawal from the Florida, New Hampshire and Pennsylvania markets and disposed of its wholly-owned mail order pharmacy subsidiary, Direct Script, Inc. It also stabilized its computer operations, reduced claims payment to approximately 10 days on average and deleted certain unprofitable products, all of which contributed to a medical loss ratio (" MLR") in the fourth quarter of 1999 of 81.8% (exclusive of favorable prior period reserve developments). It reduced its full-time staff count from over 7,200 in the beginning of 1998 to approximately 4,200 at the end of 1999, and vacated over 1,000,000 square feet of space.

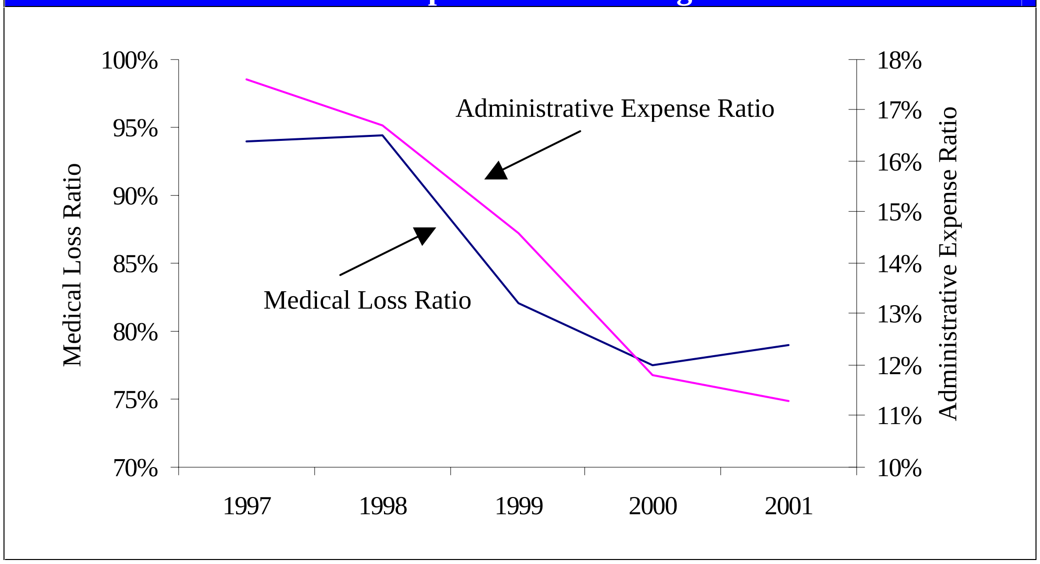
As a result of the 1997-98 losses, Oxford had to raise additional capital to meet regulatory standards. In February and March 1998, Oxford issued $200 million in secured notes to an affiliate of DLJ. It also raised $350 million from the Texas Pacific Group in exchange for preferred stock and warrants to buy up to 22.5 million shares of common stock. Last, CEO Norm Payson invested $10 million of his own cash in exchange for 643,000 OHP shares.[6]

[6] 1998-2001 Oxford Health Plans Annual Reports.

Competitive Advantages

Intense Focus on Cost Control. At its nadir in 1998, Oxford's expenses were out of control. Since the restructuring, Oxford's management has worked hard to bring expenses down. Oxford's MLR has fallen from 94.4% in 1998 to 78.9% in 2001, while its administrative expense ratio has fallen from 17.6% in 1997 to 11.3% in 2001 (see chart below). Even as hospitals and drug companies try to exert pressure on Oxford's costs, management still expects an MLR of 79-79.5% in 2002.[7]

Oxford's Expenses Are Coming Down



Source: Oxford Health Plans annual reports, Yale School of Management.

Efficient Operator. Management has done such a good job at managing costs, that Oxford is one of the lowest cost providers in the managed care industry (see table below). Oxford's MLR, the lowest in our coverage universe, is 400 basis points below the industry average. Its administrative expense ratio is the second lowest, over 200 basis points below its peers. As a result, Oxford also has profit margins that are three times the industry average. Management has been able to do this while reducing outstanding debt.

Efficient Operations Have Led to Superior Profits

(For fiscal year 2001)	WellPoint	Anthem	Health Net	Humana	Aetna	Coventry	Mid-Atlantic	PacifiCare	Trigon	Industry Averages	Oxford
Profit Margin	3.4%	3.2%	1.4%	1.1%	-1.2%	2.7%	3.2%	0.2%	4.0%	**2.6%**	**7.5%**
MLR	81.5%	84.5%	85.4%	83.3%	80.5%	86.0%	85.4%	89.7%	N/A	**83.9%**	**78.9%**
Admin Expense	13.7%	14.1%	13.9%	15.3%	19.4%	12.0%	11.7%	10.3%	N/A	**13.5%**	**11.3%**
LT Debt (millions)	$838.0	$818.0	$593.9	$578.5	$1,591.3	$0.0	$0.0	$794.3	$200.0	**$554.1**	**$126.9**
Debt/Equity	0.39	0.40	0.51	0.38	0.17	0.00	0.00	0.39	0.24	**0.28**	**0.33**

Source: 2001 Annual Reports, Yale School of Management.

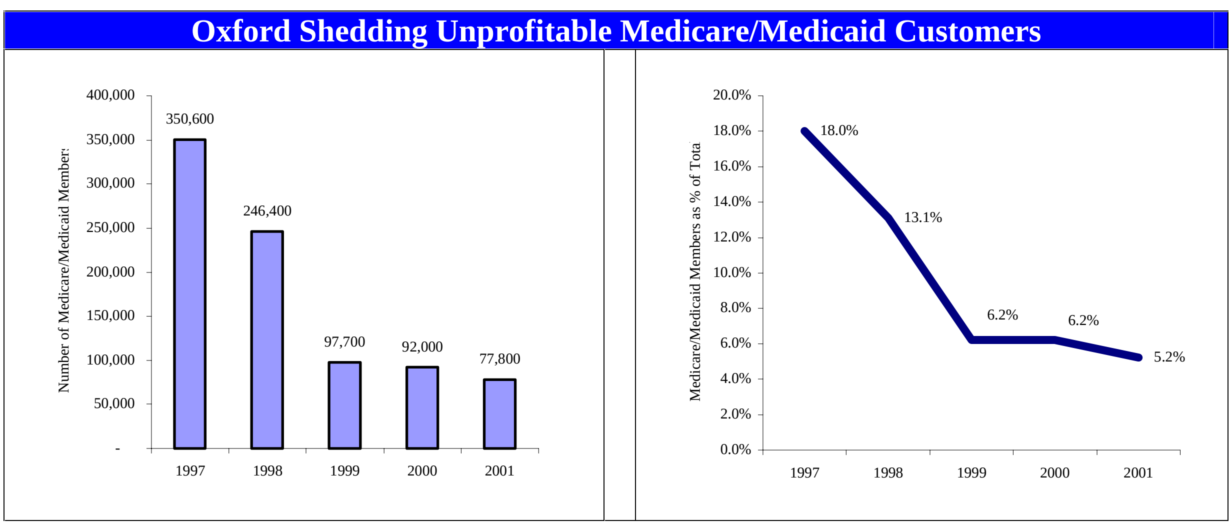
[7] Lehman Brothers: "Q4 upside – another boost to estimates and targets" February 15, 2002.

Cost Advantage in Market. Because of its superior efficiency, Oxford has been able to offer more affordable insurance coverage. For example, it recently introduced new low cost products called Freedom Plan Access and Freedom Plan Direct, which are targeted to mid sized employers. The company uses different co-pays between primary care and specialists and a three-tier drug benefit design. The company enrolled about 6,000 members in Q4 2001, about half of whom were new customers.[8]

The company stresses its position as a lower cost provider, which is becoming increasingly important as insurance costs continue to rise sharply. Commenting on results last year, Norm Payson stated: “Oxford's outstanding financial results in 2001 were due in significant part to our success in working with the health care community to keep quality health care affordable. These same efforts have allowed our premium increases to be more modest than many of our competitors. We are also enthusiastic about our enrollment growth and future growth prospects largely because of our initiatives on health care premium affordability.”[9]

Brand Name Recognition and Reputation. The Oxford brand is well known in the metropolitan New York marketplace. Management expects to use Oxford’s brand as an asset to further expand in the tri state market and possibly into new markets nearby.

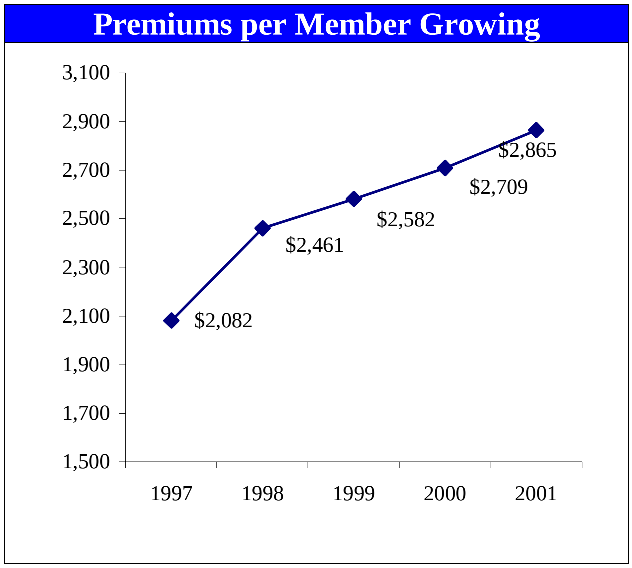
Profitable Customer Mix. At the time of Oxford’s restructuring, 18% of its enrollment was comprised of Medicare and Medicaid customers. These are considered the most unprofitable group of customers. The government has limited how much it is willing to subsidize these customers. Additionally, Medicare patients are older, thus requiring more expensive treatments more frequently. Since 1997, Oxford has worked hard to lose these customers (see charts below).



Source: Oxford Health Plans 2001 Annual Report, Yale School of Management.

[8] Oxford Health Plans 2001 Annual Report.
[9] Oxford Health Plans 2001 Annual Report: “Letter to Shareholders”

Oxford has focused its attention on gaining and retaining highly profitable commercial customers. As the chart below indicates, Oxford's average premium per member has grown from $2,082 in 1997 to $2,865 in 2001.



Source: OHP Annual Reports, Yale School of Management.

Oxford's commercial customers are price inelastic enabling Oxford to increase enrollment and premium rates simultaneously. These corporations will take on some of the increase and pass the rest on to their employees. Additionally, commercial members, who are generally in their 20's-50's, are rather inexpensive to service. It is no surprise then that Oxford has one of the lowest MLR's in the managed care industry.

Increasing Cash Balance and Strong Cash Flow from Operations. At the end of 2001, OHP's cash balance was $345 million, up from $198 million at the end of the previous year. Net cash flow from operations during 2001 was $613 million, compared to reported net income of $289 million. We believe this is a significant advantage for the company since it gives management flexibility to make opportunistic acquisitions and stock repurchases. In fact, on April 16 Standard & Poor's raised its counter party credit rating on OHP two notches to double-'B'-plus, citing the company's sustained earnings and cash flow strength, improved balance-sheet quality, and good risk-adjusted capitalization.[10]

[10] April 17th Oxford news release: "S&P Raises Oxford Health Plans, Inc. Ratings to BB+"

Shareholder Oriented Management Team

Since new management took over in 1998, it has focused on building shareholder value through disciplined cost controls and stock repurchases. Just in Q4 of 2001 alone, Oxford bought back 4.7 million shares at an average price of $28 per share. During all of 2001, the company bought back 12.98 million shares for $366 million, an average price per share of $28.20. According to Morgan Stanley, each $100 million in share repurchases is worth approximately $0.05 per share in annual EPS.[11] In July 2001 the board authorized an additional $250 million stock repurchase program through 2003. In November of 2001, it added another $250 million to this authorization.[12]

In addition to stock repurchases, insider ownership at Oxford has increased. Total insider holdings equaled 6.3 % of shares outstanding at the end of Q1, up from 4.9% last year. CEO Payson owns 5.7% of shares outstanding, or 5.0 million shares, up from 3.9 million shares last year.[13]

In the past two months, however, there have been some significant insider sales as the stock has surged. Both Payson and the Texas Pacific Group have filed to sell approximately 4.5 million shares, including 610,000 held in Payson's trust account. Although these shares are most likely going to be block trades, they represent approximately 4.5 days of average NYSE trading volume in OHP shares. At the end of February, director David Bonderman sold 3.7 million shares for $143.4 million in a privately negotiated transaction.[14] We do not believe this is a warning signal, but rather rational profit taking by large shareholders who still retain very sizable positions in the stock. Excluding options, Norm Payson, for example, will still hold over $180 million worth of OHP stock at its current price after completing his trust fund sale.

"Healthy" Skepticism from the Street

Despite Oxford's solid operating results and aggressive efforts to increase shareholder value, the Street remains less than enthusiastic about the stock. For example, among the three largest brokerages that cover it, Morgan Stanley and Salomon Smith Barney are currently not recommending the stock to clients. Merrill Lynch is more favorably highlighting other stocks within the managed care sector, specifically WellPoint and Anthem.[15]

From a contrarian perspective, this may actually be a positive. Continued strong earnings from OHP could cause bearish analysts to upgrade the shares and lead to higher share prices. There is no question the Street has mostly missed OHP's rally in the past year by remaining skeptical. Over the past 52 weeks, OHP shares have risen 78%, out performing the S&P 500 by more than 97 percentage points. Year to date in 2002, OHP shares are up about 50%.[16]

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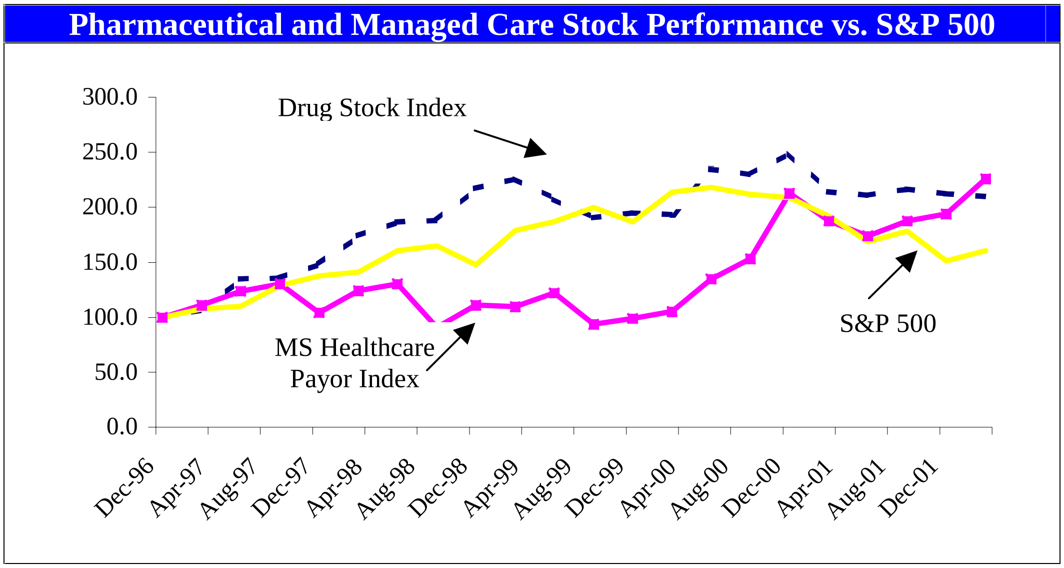
[11] Morgan Stanley, "4Q01 Results: Beat Us Again" February 8, 2002.
[12] Oxford Health Plans 2001 Annual Report.
[13] 2001 Proxy Statement filed with SEC, March 29, 2001.
[14] Yahoo! Finance.
[15] Merrill Lynch, "Managed Care: Medical Cost Visibility and Operating Leverage Drive Results" February 28, 2001.
[16] Yahoo! Finance.

Intra – sector Rotation Supporting Managed Care Stocks

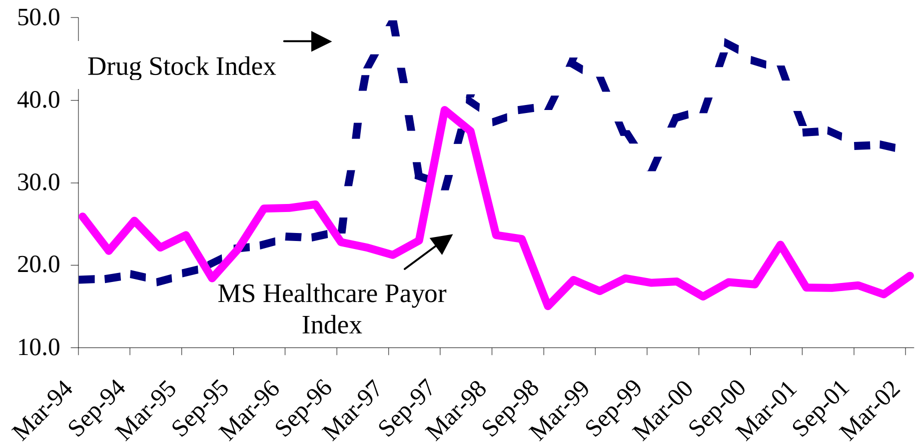
The managed care stocks seem to be benefiting from increased interest from portfolio managers who want to increase their healthcare sector exposure outside of large cap pharmaceuticals.



Source: Bloomberg. Yale School of Management.

This sector has rallied over the past 12-18 months (see chart above) while large cap drug stocks such as Merck and Bristol Myers have fallen. We believe this trend will continue since valuations for large cap pharmaceuticals are still so much higher than managed care stocks despite less favorable projected earnings growth rates. Merck, for example, trades at over 18 times trailing earnings, while its five-year projected earnings growth rate is approximately 10%, according to consensus estimates from Thompson Financial Network. Oxford Health, on the other hand, trades at 13 times earnings with an estimated five-year growth rate of 12%. As the chart below illustrates, this example is typical of how pharmaceutical stocks still trade at much higher valuations than managed care stocks.

Managed Care P/E's vs. Pharmaceutical P/E's



Source: Bloomberg, Yale School of Management.

In fact, several of the largest healthcare sector funds have been building positions in managed care stocks while reducing exposure to drug stocks. The $2-billion Janus Global Life Sciences fund, for example, has been adding shares of Oxford while reducing its holdings in Wyeth (formerly American Home Products) and Pfizer. Janus is now one of the largest single shareholders of Oxford, controlling over 8% of outstanding shares.

The $16-billion Vanguard Specialized Healthcare Fund has been adding to its position in Aetna recently, according to Morningstar. It now owns 4% of Aetna's shares and 6% of Humana's outstanding shares. Although they have been increasing, both positions combined are still smaller than the fund's $430 million investment in Merck.[17]

Sector Momentum Extremely Strong

Since we wrote our Strong Buy recommendation on the managed care sector ("The Cure for an Underperforming Portfolio," April 1, 2002) health care insurance stocks have surged. Oxford, WellPoint, and Anthem have each set new highs as investors seek reliable profits at attractive prices (see table below).

Managed Care Stocks Continue to Rally

Stock	April 1 Closing Price	April 19 Closing Price	% Change
Anthem	57.73	68.36	19.2%
Oxford	41.73	46.62	11.7%
WellPoint	63.45	71.54	12.8%
S&P 500	1,150	1,125	-2.0%

Source: Yahoo!Finance, Yale School of Management.

[17] www.morningstar.com, Both sector funds are rated 5 stars by Morningstar, their highest rating.

Although we remain bullish on the sector, we are tempering our positive outlook for these stocks given their strong rally in the past few weeks. We would not be surprised to see some near term profit taking in these shares even if first quarter earnings are better than expected. As a result, we believe short-term, momentum oriented traders should be careful not to chase performance, but rather wait and see if a "buy on anticipation, sell on the news" scenario develops.

For longer-term investors, we recommend shares at current prices, as we do think they are likely to outperform the market over the next 12-18 months. We still believe long-term investors should build positions, especially on any stock price weakness. Oxford reports first quarter earnings on May 1st.

Valuation

Our bullish outlook on OHP shares is based on a continuation of favorable earnings trends, driven by disciplined cost controls and modest increases in enrollments and revenues. Trading at 12.7 times expected 2003 earnings, we believe the market is undervaluing OHP's near term earnings prospects. Therefore, P/E multiple expansion remains the key driver for the stock.

Before the 1997-98 crisis, OHP shares traded at a significant P/E premium to the market. Now, OHP trades at a 37% discount to the S&P 500 based on expected 2002 earnings. We recognize that the shares may not achieve a market multiple as long as the 1997-98 debacle remains in investors' and analysts' memories, but we do think a 37% discount to the market is too much.[18]

In addition, OHP trades at a discount to its peer group. We believe it should trade in line with the sector given its solid performance since Payson and his management team took over in 1998, which suggests its P/E ratio should be 15.5 times 2002 earnings.

On a P/E to Growth (PEG) basis, we think a ratio of 1 is appropriate, which further supports our projected modest P/E ratio expansion over the next 12 months. Oxford's near term earnings outlook may be even better than the market expects given the company's flexibility. For example, it has unrealized capital gains and ample cash to repurchase shares or make acquisitions.

Discounted Cash Flow Analysis

We performed a discounted cash flow analysis on Oxford based on our earnings model (see appendix).

Assumptions
For revenues we assumed a 1.5% increase in membership. This is realistic considering the competitive advantages we outlined above. For the next two years we modeled a 7% increase in premiums followed by a 5% increase going forward. We felt these numbers were conservative given the anticipated double-digit growth in premiums over the next couple of years.

The two most important expenses, cost of services and administrative costs, we left at last years levels. We think management will be able to maintain its cost consciousness going forward, but aren't certain how much lower these expenses can go. We assumed a tax rate of 39%. All other expenses were taken as a percent of sales.

For a terminal growth rate of earnings we chose 5%. We are assuming that healthcare will be growing faster than the economy over the next decade because of the aging of the population.

We used a discount rate of 11%. There is some risk involved with a stock like Oxford, but its premium revenues are pretty consistent and its management focuses on the bottom line. That is why we felt it should be discounted slightly more than our expected rate of return on the market of 10%.

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[18] Several sell side analysts who have covered Oxford for years have been reluctant to enthusiastically recommend the stock despite the company's continued strong operating performance. Morgan Stanley's Christine Arnold, for example, has covered Oxford since before its 1997-98 debacle. Despite increasing her earnings estimates, she retains a neutral rating on OHP shares.

The table below shows our weighted average cost of capital (WACC) calculation.

WACC Calculation	
Target Debt/Equity Ratio	3.6%
Unlevered Beta	0.76
Levered Beta	0.77
Risk-Free Rate	5.2%
Market Return on Equity	10.0%
Cost of Debt	5.5%
Cost of Equity	8.8%
WACC	8.7%

The table below shows our discounted cash flow model.

DCF Model					
($ millions, except per customer and per share data)	**2002**	**2003**	**2004**	**2005**	**2006**
Revenue	$4,744	$5,122	$5,435	$5,771	$6,129
Cost of Services Provided	3,661	3,953	4,194	4,454	4,730
Selling and Administrative Expenses	564	609	646	686	729
Income From Operations (EBIT)	519	560	594	631	670
Taxes on EBIT	203	219	232	246	262
Deferred Taxes	71	76	81	86	91
Depreciation	23	25	26	28	30
Change in Working Capital	183	198	210	223	237
Capital Expenditures	23	25	26	28	30
Free Cash Flow	204	220	234	248	263
Terminal Value					7,217
Discounted Free Cash Flow	$184	$179	$171	$163	$4,439
Discount Rate	11.0%				
WACC	8.7%				
Terminal Growth Rate	5.0%				
PV(FCF)	5,136				
Cash	345				
Long Term Debt	127				
Equity Value	$4,664				
Shares (million)	93				
Price per Share	**$50.15**				

After discounting projected earnings for five years plus a terminal value we arrived at a share price of $50.15.

Risks

- ***Political and Regulatory Risks***. Rising health care insurance premiums are becoming more of an issue. Recently, CalPERS made news by dropping PacificCare Health because its rate hikes made coverage too expensive. Despite the failure of healthcare reform efforts in 1994, legislation that would restrict pricing flexibility remains a very real risk for the industry. Over 40 million people are uninsured in the U.S. Especially for small businesses, adequate healthcare insurance is simply unaffordable at current rates.[19]

- ***Medical Costs Continue to Rise Much Faster Than Overall Inflation***. If HMO's are unable to continue to raise premium rates to compensate for higher medical payments either because of regulation or reduced pricing power, profitability would suffer.

- ***Reduction of Premium Pricing Power***. Oxford's profit margins are among the highest in the industry, which has driven its earnings growth and highlights the success of its strategy. Falling premium rates would adversely impact profit margins and could have a disproportionate impact on earnings.

- ***Valuation***. On a price to earnings and a PEG basis, OHP shares appear reasonably valued. On a market value/members basis, however, the stock appears less attractively priced at $2,500 per customer.[20]

- ***Interest Rate Risk***. Falling interest rates have boosted OHP's earnings over the past year. The Street has largely discounted realized capital gains in assessing earnings (i.e. focused on core operating earnings), but the market may not be as tolerant of realized losses if interest rates rise sharply. During Q4, OHP realized $10 million in capital gains, worth approximately $0.07 per share.[21]

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[19]The Wall Street Journal, April 15, 2002.

[20] In 2001, Oxford's average revenue per member was $2,865. Average profits per member were $195. Without discounting or membership growth, each customer would have to stay with Oxford for 13 years to justify the $2,500 valuation the market has placed on each member.

[21] Salomon Smith Barney: "OHP: Raising Target, But Maintaining Neutral Rating" February 5, 2002.

Recommendation

- Despite its sharp rally in the past three weeks, we remain positive on OHP shares. We rate it a Buy with a 12-month target of $50, although we believe it could reach that price level considerably sooner.

- Especially given the valuation of the S&P 500 and the general lack of earnings visibility for most companies, we believe the managed care sector will remain in favor. We believe disappointing earnings results and reduced guidance from large and mega cap pharmaceuticals (BMY, MRK, LLY and PFE in particular) continue to add to the HMO sector rally.

- For long term investors seeking above average earnings visibility and growth, we think managed care stocks still trade at reasonable levels.

- At 12.7 times 2003 earnings, we rate OHP shares a "Buy" as we expect them to outperform the S&P 500 over the next 12 months. We would be more enthusiastic about the shares around $40, but given our $50 target, we think there is still upside to the stock in the mid $40s.

Earnings Model								
($ millions, except per customer and per share data)	**1999**	**2000**	**2001**	**2002E**	**2003E**	**2004E**	**2005E**	**2006E**

Membership (000's)								
Freedom Plan	1,204	1,115	1,154	1,171	1,189	1,207	1,225	1,243
Commercial HMO	235	222	218	221	225	228	231	235
Medicare	98	92	78	63	55	49	44	39
Total Insured	1,537	1,429	1,450	1,456	1,468	1,484	1,500	1,517
Self Funded	50	62	60	61	62	63	64	65
Total Enrollment	1,587	1,491	1,510	1,516	1,530	1,546	1,564	1,582
Average Premiums per Customer	$2,583	$2,698	$2,856	$3,056	$3,270	$3,433	$3,605	$3,785
Total Premiums	$4,100	$4,023	$4,312	$4,634	$5,004	$5,309	$5,638	$5,987
Third-party administration, net	16	15	14	17	18	19	20	22
Investment and other income, net	83	73	95	93	101	107	113	120
Total revenues	4,198	4,112	4,421	4,744	5,122	5,435	5,771	6,129
Expenses:								
Health care services	3,365	3,117	3,401	3,661	3,953	4,194	4,454	4,730
Marketing, general and administrative	599	476	489	546	589	625	664	705
Interest and other financing charges	50	34	19	19	20	21	23	24
Total expenses	4,034	3,627	3,909	4,225	4,562	4,841	5,140	5,458
Operating earnings before income taxes and extraordinary items	164	485	512	519	560	594	631	670
Income tax expense (benefit)	-156	199	189	203	219	232	246	262
Net earnings before extraordinary item	320	285	322	316	342	362	385	409
Extraordinary items		-20	-33					
Net Income	320	265	289	316	342	362	385	409
Less preferred dividends	-46	-74						
Net Income attributable to common shares	$274	$191	$289	$316	$342	$362	$385	$409
Earnings per common share – Diluted	$3.26	$2.02	$2.88	$3.40	$3.67	$3.90	$4.14	$4.39
Common Shares - Diluted (millions)	84	95	101	93	93	93	93	93
Key Assumptions								
Medical loss ratio	82.1%	77.5%	78.9%	79.0%	79.0%	79.0%	79.0%	79.0%
Marketing, general and administrative	14.3%	11.6%	11.1%	11.5%	11.5%	11.5%	11.5%	11.5%
Income Tax Expense	-95.5%	41.1%	37.0%	39.0%	39.0%	39.0%	39.0%	39.0%
Change in Enrollment		-6.0%	1.3%	1.5%	1.5%	1.5%	1.5%	1.5%
Change in Average Premiums		4.5%	5.8%	7.0%	7.0%	5.0%	5.0%	5.0%

Important Disclaimer

Please read this document before reading this report.