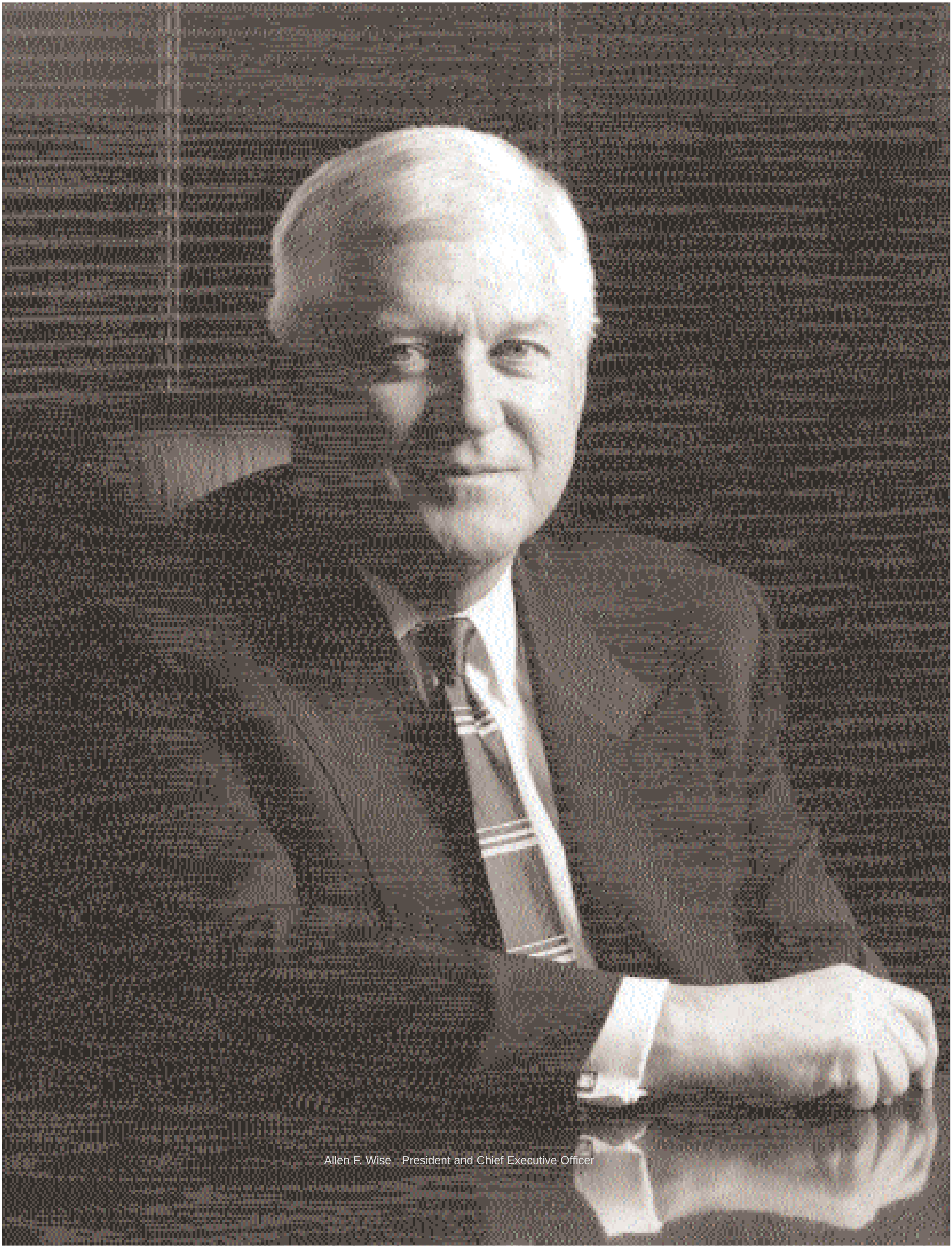
COVENTRY
HEALTH CARE

1999 Annual Report



Allen F. Wise   President and Chief Executive Officer

COVENTRY
HEALTH CARE

Selected Consolidated Financial Data
(in thousands, except per share data)

Operations Statement Data (1)	December 31, 1999	1998	1997	1996	1995
Operating revenues	$2,162,372	$2,110,383	$1,228,351	$1,057,129	$852,390
Operating earnings (loss)	47,855	(36,195)	5,739	(91,346)	(1,275)
Net earnings (loss)	43,435	(11,741)	11,903	(61,287)	18
Net earnings (loss) per share – basic (3)	0.74	(0.22)	0.36	(1.87)	–
Net earnings (loss) per share – diluted (3)	0.69	(0.22)	0.35	(1.87)	–
Weighted average common shares outstanding – basic (3)	59,025	52,477	33,210	32,818	31,526
Weighted average common shares outstanding – diluted (3)	64,159	52.477	33,912	32,818	32,150

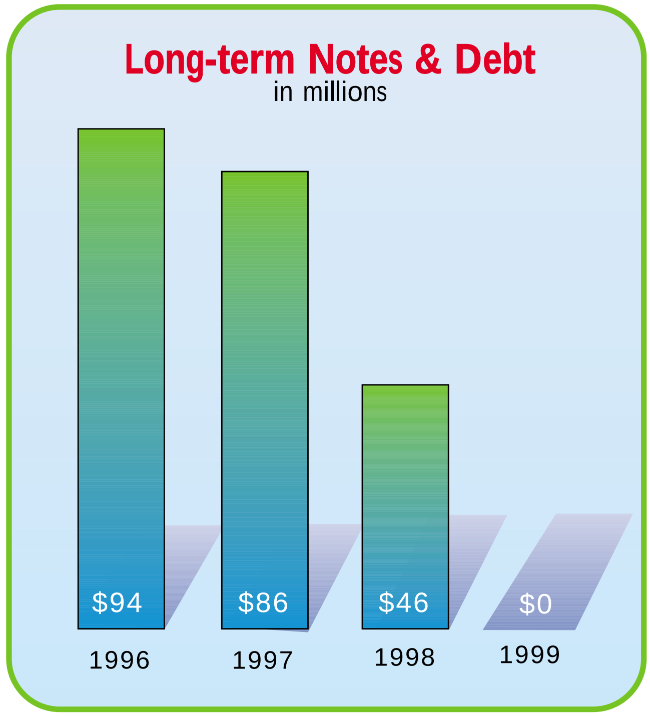
Balance Sheet Data (1)	December 31, 1999	1998	1997	1996	1995
Cash and investments	$ 614,603	$ 614,583	$240,091	$168,423	$147,777
Total assets	1,081,583	1,091,228	487,182	448,945	385,675
Redeemable, convertible preferred stock	47,095	–	–	–	–
Stockholders' equity and partners' capital (2)	480,385	436,539	117,818	100,427	153,851

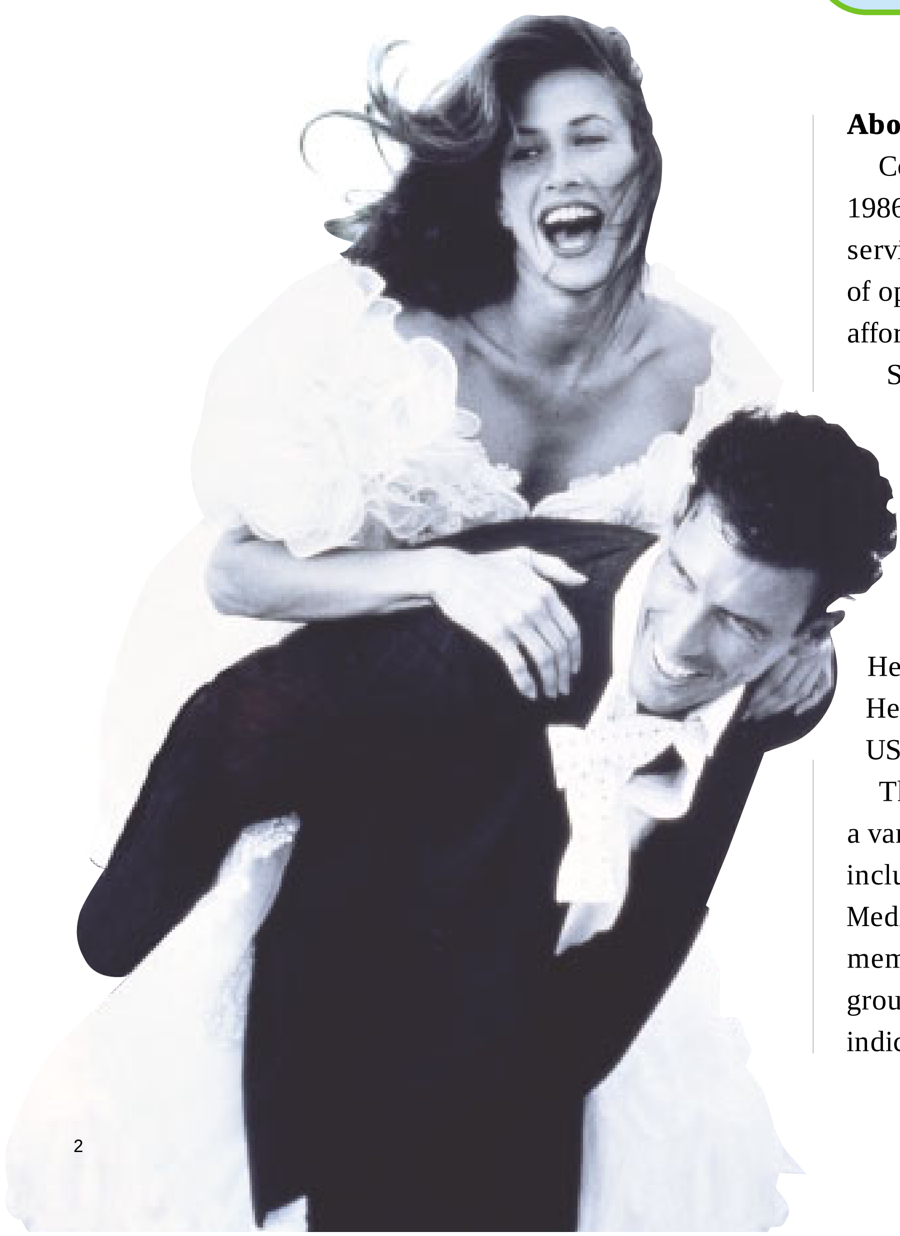
(1) Balance Sheet Data for 1998 reflect the acquisition of the Principal Life Insurance Company health plans as of December 31, 1998 and Operations Statement Data for 1998 include the results of operations of the acquired PHC health plans beginning April 1, 1998, the date of acquisition.

(2) Predecessor company of a wholly owned subsidiary of the Company was an S Corporation.

(3) Restated to comply with SFAS 128, "Earnings per share."

The Joy of Good Health ...in People and Business





About Coventry Health Care

Coventry Health Care was established in 1986 as a provider of managed health care services, offering members a wide choice of options, high standards of care and affordable rates.

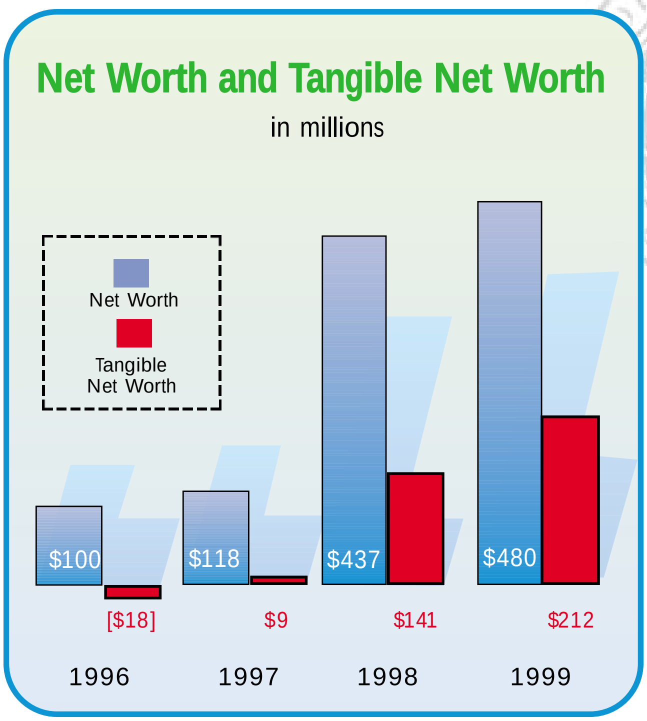
Since our founding, Coventry has experienced dramatic growth, increasing membership and an expansion of its service areas.

Today, Coventry operates health plans and insurance companies under the names Coventry Health and Life, Coventry Health Care, Carelink, HealthAmerica, Group Health Plan, Health Assurance, HealthCare USA, SouthCare and Southern Health.

Through these subsidiaries, Coventry offers a variety of managed care products and services including HMOs, PPOs, POSs, Medicare, Medicaid and self-insured products to 1.5 million members in employer and government-funded groups in 15 markets located in the 13 states indicated on the map on page 6.

To Our Shareholders

1999 was a year of steady growth and increasingly profitable operation for Coventry Health Care. It was a year in which the final pieces of our restructuring plan were put into place, providing a strong growth platform for the coming year. And it was a year that underscored the wisdom of our merger with Principal Health Care, the results of which include our steadily improving performance, the strengthening of our management team and our expanding potential for continued growth.



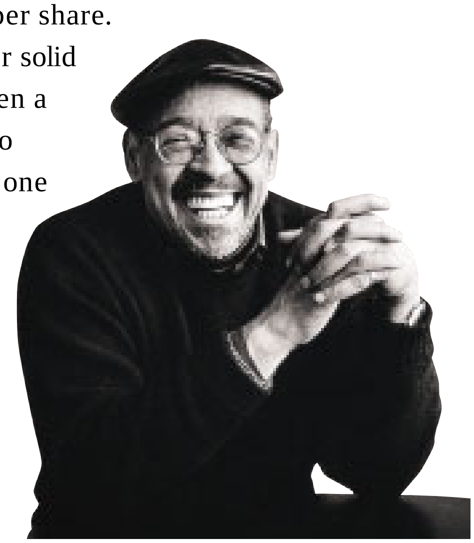
Results of Operations

Notable among the financial results for 1999 was a return to profitability, with net income, including non-recurring items, rising to $43.4 million, or $0.69 per diluted share, compared with net losses in 1998 of $11.7 million, or $0.22 per share.

Our financial achievements are even more dramatic when compared with where we were just three years ago when the current management team came on board.

Operating revenues for the year ended December 31, 1999, for example, were $2.2 billion, more than double the 1996 figure of $1.1 billion. Since year-end 1996, cash and investments have increased from $168 million to $615 million. Long-term debt has decreased from $94 million to zero. Tangible net worth has grown from a negative $18 million to a positive $212 million and book value has gone from $3.04 to $8.12 per share.

Contributing to our solid financial base has been a concentrated effort to reduce expenses. As one example, we are in the process of reducing the number of local

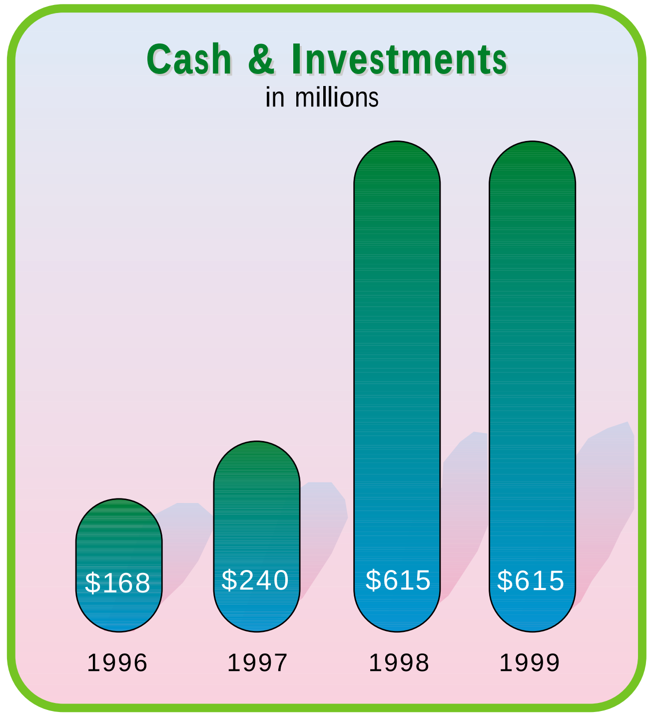


customer service centers from 21 to 3 resulting in savings that will approach $7 million. We expect to achieve another $10 million in savings by spring 2000 through reductions in headcount and other economies.

We are similarly committed to maintaining pricing discipline, as reflected in an average commercial rate increase of 10% in 1999 and an additional increase of 8-10% projected for 2000.

While cost reduction remains a major goal, we are vigilant that savings not be achieved at the expense of customer service or quality.

Services to customers and providers, in fact, were upgraded in many areas during the year, notably by speeding up claims payments and cutting the response time to telephone inquiries dramatically.



Acquisitions

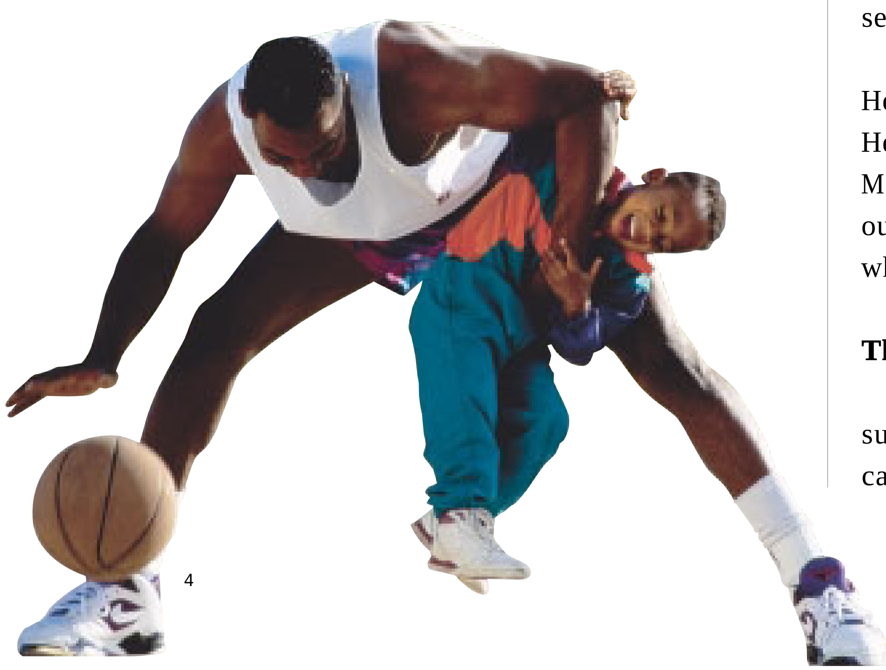
Our growth was also spurred by two acquisitions during the year.

In October, Coventry acquired Carelink Health Plans of Charleston, West Virginia, with membership of 58,000, making Coventry the largest such plan in the state.

In November, we vastly improved our position in Charlotte, North Carolina by acquiring the Kaiser Foundation Health Plan of North Carolina's commercial membership in that market. Besides adding its 25,000 members, the Kaiser membership acquisition opened the doors to larger employer accounts, significantly improved our operating leverage and competitive position in the market and should add operating income of $3 to $4 million in 2000.

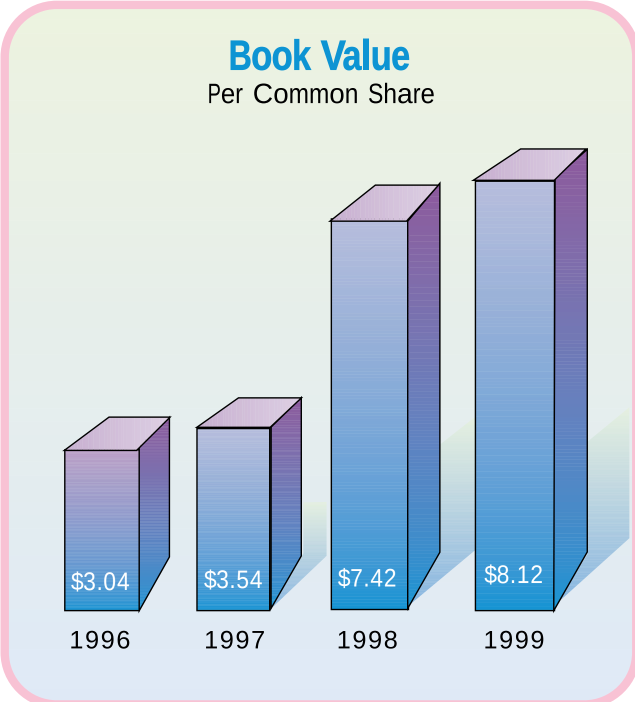
Also in 1999 we announced two transactions that have since been finalized. First, we further expanded our West Virginia presence by acquiring PrimeONE, adding another 18,000-members and expanding our West Virginia service area to cover the entire state.

The second transaction involved Prudential Health Care, a member company of Aetna U.S. Healthcare. We acquired their 11,800 member Medicaid business in St. Louis, strengthening our market leadership position in an area where we have proven to be successful.



The Managed Care Industry

While 1999 was a noteworthy and highly successful year for Coventry, the managed care industry continued to be the subject of



intense scrutiny by legislative bodies, by public interest groups and by the media. Class action litigation was instituted against several HMOs across the nation resulting in a great deal of publicity, much of it negative.

Questions were also raised in many quarters about patient rights, referral procedures, prescription drug availability, pricing and other concerns.

We take this criticism very seriously and recognize that some of the complaints are justified. Many others, however, are not, often arising from a lack of knowledge or a misinterpretation of the facts.

We find the accusation that managed care companies put profits before patients particularly distasteful. It is simply untrue and does a great disservice to the overwhelming majority of payors who, like Coventry, see the well-being of our members as our first and highest priority.

While we know our industry can do better, it is our firm conviction that managed care remains the best vehicle now available for delivering quality health care to the largest number of our citizens at costs they can afford.

Customer Service

One of the cornerstones on which the managed care industry was built is the simplification of the health care system, making such care easier to obtain and more affordable.

In the early days of health insurance coverage, patients had to pay for doctor visits out of their own pockets and then seek reimbursement from their insurance providers, often involving some kind of paperwork.

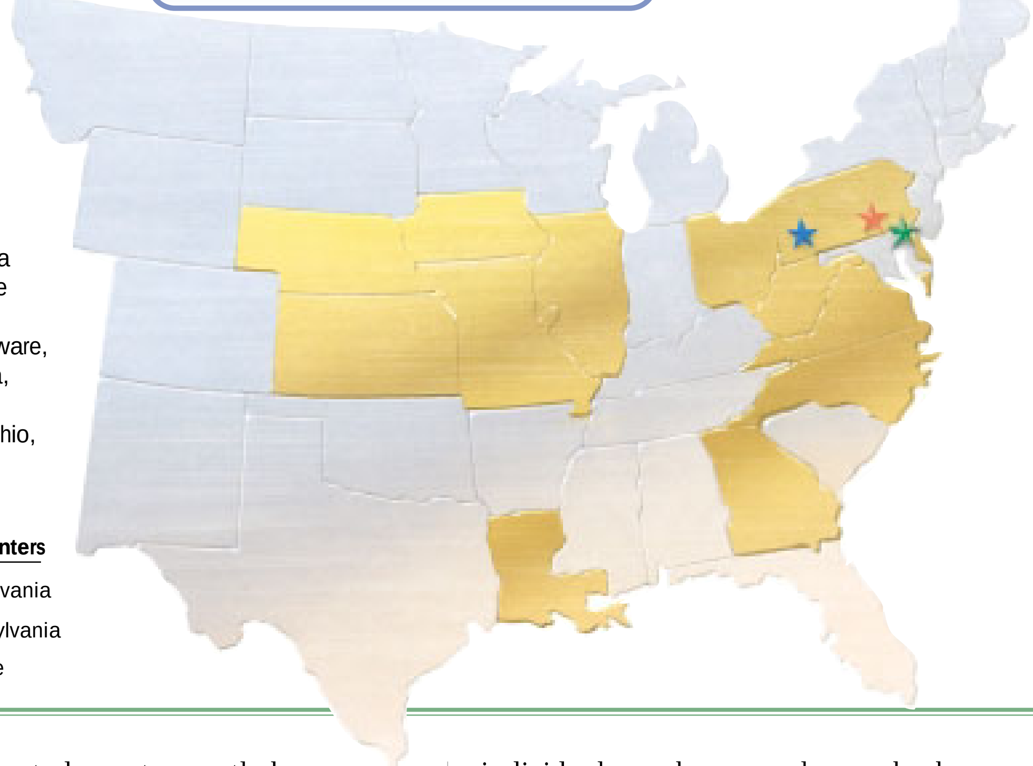
Managed care made that process infinitely simpler by establishing contracts with doctors, enabling patients to pay those doctors a token

amount, often as little as $5 or $10 for a visit, with the doctor's office, rather than the patient, undertaking to do the paperwork.

Since that first giant step forward in the delivery and financing of health care, the managed care industry has continued to add new services and improve access to quality care, with no payor being more innovative in this area than Coventry.

Coventry's achievements in providing quality care to our members have, in fact,

COVENTRY'S 13 STATE SERVICE AREA



Markets By State

Coventry's service area includes counties in the following states: North Carolina, Delaware, Georgia, Illinois, Iowa, Louisiana, Missouri, Nebraska, Kansas, Ohio, Pennsylvania, Virginia, and West Virginia

Customer Servive Centers

★ Pittsburgh, Pennsylvania

★ Harrisburg, Pennsylvania

★ Newark, Delaware

been well documented, most recently by ***Newsweek*** magazine. In its November 8, 1999 issue, the publication ranked HealthAmerica Pennsylvania, our largest health plan, as the best health plan in the state and *the sixth best health plan in the entire nation*.

Having always been committed to meeting the highest possible standards of quality in all our products and services, the vote of confidence represented by such external and impartial analysis is gratifying and will spur us on toward even greater accomplishment as we move forward.

This emphasis on service and quality is nothing more than sound business practice. By providing quality service to the individual members, employers, brokers, physicians and hospitals who constitute our customer base, we increase their level of satisfaction, bolster loyalty and foster the long-term relationships which are basic to success, now and in the future.

Evidence of Coventry's devotion to a high level of service, and the success it has engendered, is visible in every customer group we serve.

Member Service

Toward the midpoint of 1998, Coventry undertook a 24-month initiative aimed at streamlining its customer service. Among other things, this initiative involved consolidating various operations, setting new standards and incorporating the newest advances in technology.

Attesting to its success, claims today are paid 29% faster, and response time to telephone inquiries has been reduced by two thirds. At the same time, we have lowered the cost to process each claim significantly. To further improve service, in March, 2000, Coventry signed an agreement with GeoAccess to provide expanded online access and search capabilities to our provider directories.

Provider Service

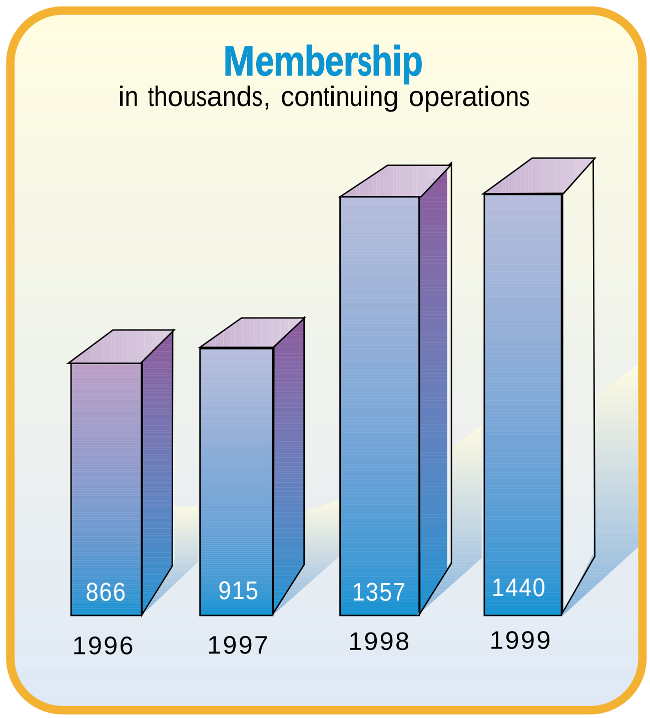
Bolstering our continuing progress in making it easier for doctors and other healthcare providers to work with us, Coventry set a new precedent early this year by initiating the processing of claims, and similar transactions, via the Internet.

In February, 2000, Coventry signed an agreement with Healtheon/WebMD, the first end-to-end Internet healthcare company connecting physicians and consumers to the healthcare industry.

The agreement, covering the next three years, will initially allow Coventry to use Healtheon/Web MD's Internet services to manage the electronic submission and processing of eligibility determination, referrals and authorizations, claims submission, claim status and reporting. Using this system, Coventry will ultimately be able to pay certain claims within 48 hours.

Under the agreement, our new partner's electronic transaction services will be rolled out in phases. When the rollout is completed, Healtheon/WebMD services will be available to the entire Coventry network of 20,000 primary care and 50,000 specialty physicians.

While undoubtedly a major step forward, this agreement is only the beginning of Coventry's venture into e-commerce and the eventual reconfiguration of our business as new technology becomes available.

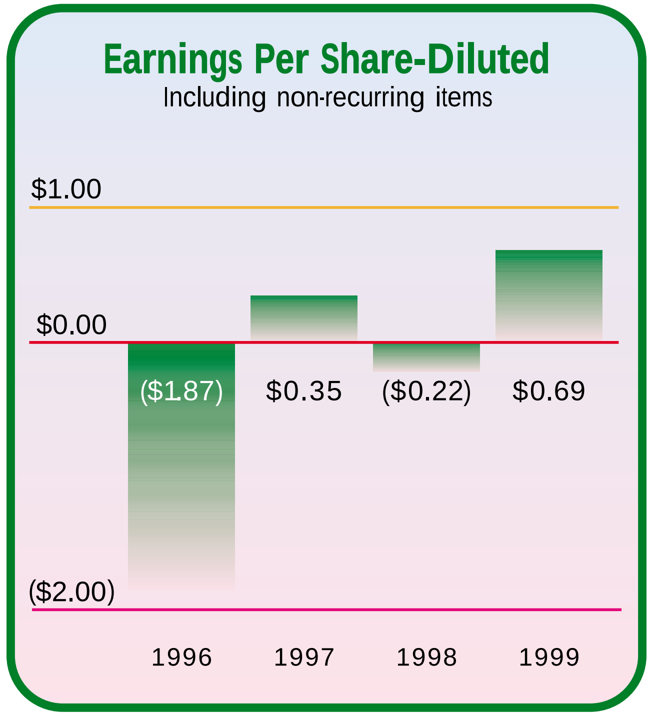


Employer and Broker Service

The small-group health insurance market, consisting of employers with 2 to 50 employees, is the fastest growing employer segment and a significant source of revenue for Coventry. The segment is primarily served through third party insurance brokers and agents. At present, Coventry provides managed care products and services to approximately 16,000 small group employers, representing 245,000 members.

To further improve our service to this important segment, Coventry, in February, 2000, signed a two-year agreement with Workscape, a leading application service provider, to offer an online Internet-based rate quoting system.

This new capability will make it possible to provide benefits information, generate customized proposals, register agents, complete medical questionnaires and applications, underwrite risk, calculate rates and enroll groups via the Internet.



Community Involvement

While our relationship with employers and members remains paramount, the relationship Coventry maintains with the communities in which we operate is nonetheless vital and will continue to be a major priority.

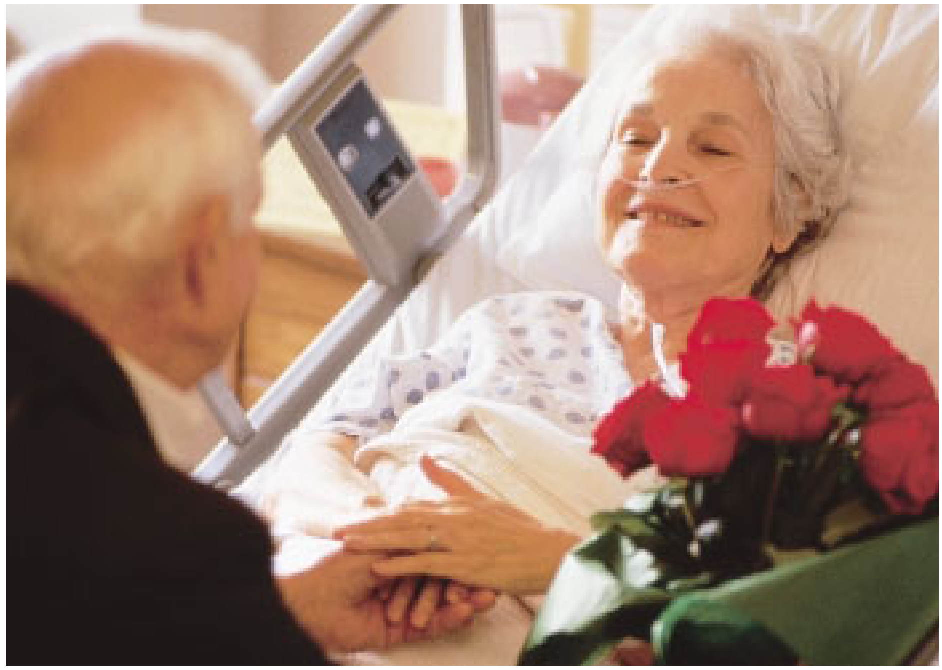
Community involvement for Coventry takes many forms.

Our Medicaid program, HealthCare USA, for example, uses a colorful mascot, Doc Bear, to reach out to children and teach them health habits that will contribute to a healthier and happier lifestyle as they grow into adulthood.

Group Health Plan in St. Louis set up a wide range of community activities including employer health fairs, a Juvenile Diabetes Walk, and a Fall Foot Drive as well as maintaining a Health Education Coordinator on staff to participate in employer health functions, provide blood pressure testing and offer nutrition counseling. In the Western and Central regions of Pennsylvania served by our HealthAmerica plan, employees have demonstrated their commitment to their communities by volunteering their time and energy for such worthwhile activities as the American Red Cross CPR Day, Big Brothers/Big Sisters, the Carlisle/YMCA Downtown Mile, the HealthAmerica Kid's Run to benefit an area hospital, and the United Way.

In addition, all of our plans routinely participate in employer health fairs, combining health testing, preventive care and general health information in a festive atmosphere.

Coventry also serves its local communities through its investment in research. One of these research



projects, Senior Life Management, has as its aim to seek out alternative, and more effective, means of delivering care to older citizens. Under this research program, a coordinated system is set up to manage the health of seniors by using comprehensive medical, educational and health improvement interventions for seniors, be they in good health or chronically ill.

It is hoped that this research, being conducted with 5000 Medicare members in our Pittsburgh market, will demonstrate the potential advantages of using non-traditional services such as transportation, telephone, social interactions and exercise as well as the advantages of increased drug com-

pliance and increased medical staff-to-patient ratios. If the results meet our expectations, we plan to expand the system to include all our Medicare members.

Looking to the Future

New concepts in financing, globalization and, most notably, technology, have all conspired to make the way business is done today seem very different from how business was transacted even a few years ago.

I have just indicated how the Internet, as one example, is impacting our relationship with providers and brokers. I have no doubt that, in the months to come, it will transform our relationship with members and other customers just as dramatically.

Despite this and other changes, I believe the basic truth of business success remains the same; the businesses that succeed are the businesses that are good at what they do.

On the business side, we are moving forward with a solid and talented management team. We are debt-free, growing with increasing quarterly profits and are showing excellent cash flow results.

We have embraced new technologies and will be introducing new products that will underscore our reputation as innovators and address some of the managed care concerns expressed by elements of our society.

In short, I see a company that is financially sound, well managed and poised for an exciting and rewarding future. I look forward to sharing that future with you.

Sincerely,

Allen F. Wise

Allen F. Wise
President and Chief Executive Officer

Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with the accompanying audited consolidated financial statements and notes thereto.

Results of Operations

The following table (in thousands, except percentages and membership data) is provided to facilitate a more meaningful discussion regarding the results of the Company's operations for each of the three years in the period ended December 31, 1999.

	1999			1998			1997	
	Amount	Percent of Operating Revenue	Percent Increase (Decrease)	Amount	Percent of Operating Revenue	Percent Increase (Decrease)	Amount	Percent of Operating Revenue
Operating revenues:								
Managed care premiums	$2,082,075	96.3%	2.4%	$2,033,372	96.4%	68.3%	$1,208,149	98.4%
Management services	80,297	3.7%	4.3%	77,011	3.6%	281.2%	20,202	1.6%
Total operating revenues	2,162,372	100.0%	2.5%	2,110,383	100.0%	71.8%	1,228,351	100.0%
Operating expenses:								
Health benefits (1)	1,792,652	82.9%	1.4%	1,767,374	83.7%	70.0%	1,039,860	84.7%
Selling, general and administrative	297,922	13.8%	2.1%	291,919	13.8%	71.7%	170,017	13.8%
Depreciation and amortization	28,205	1.3%	9.4%	25,793	1.2%	102.5%	12,735	1.0%
Plan shutdown expense	2,020	0.1%	-	-	-	-	-	-
AHERF charge	(6,282)	(0.3%)	(111.4%)	55,000	2.6%	-	-	-
Merger costs	-	-	-	6,492	0.3%	-	-	-
Operating earnings (loss)	47,855	2.2%	(232.2%)	(36,195)	(1.7%)	(730.7%)	5,739	0.5%
Other income, net	29,906	1.4%	9.7%	27,251	1.3%	9.5%	24,880	2.0%
Interest expense	(1,761)	(0.1%)	(79.4%)	(8,566)	(0.4%)	(16.6%)	(10,275)	(0.8)%
Earnings (loss) before income taxes and minority interest	76,000	3.5%	(534.0%)	(17,510)	(0.8%)	(186.1%)	20,344	1.7%
Net earnings (loss)	$43,435			$(11,741)			$11,903	
Membership at December 31:								
Commercial	1,010,282			1,000,699			622,942	
Governmental Programs	215,123			166,342			142,881	
Non-risk	237,968			218,273			148,910	
	1,463,373			1,385,314			914,733	

(1) The medical loss ratio (health benefits as a percentage of managed care premiums) was 86.1%, 86.9%, and 86.1% in 1999, 1998 and 1997, respectively.

General Overview

Coventry Health Care, Inc. (together with its subsidiaries, the "Company", "Coventry", "we", "our", or "us"), successor-in-interest to Coventry Corporation, is a managed health care company operating health plans under the names Coventry Health Care, HealthAmerica, HealthAssurance, HealthCare USA, Group Health Plan, Southern Health, SouthCare and Carelink Health Plans. The Company provides a full range of managed care products and services including health maintenance organization ("HMO"), point of service ("POS") and preferred provider organization ("PPO") products. The Company also administers self-insured plans for large employer groups. Coventry was incorporated under the laws of the state of Delaware on December 17, 1997.

During the three years ended December 31, 1999, the Company experienced substantial growth in operating revenues due primarily to membership increase. Much of the growth was in 1998 and was attributable to the acquisition of the Principal Health Care, Inc. ("PHC") plans effective April 1, 1998. Additional membership growth was achieved through marketing efforts, acquisitions, geographic expansion and increased product offerings.

The Company's commercial managed care premium revenues during the three years in the period ended December 31, 1999 were comprised of premiums from its commercial HMO products and flexible provider products, including PPO and POS products for which the Company assumes full underwriting risk. Premiums for such commercial PPO and POS products are typically lower than HMO premiums due to medical underwriting and higher deductibles and copayments that are required from the PPO and POS members. Premium rates for commercial HMO products are reviewed by various state agencies based on rate filings. While the Company has not had such filings modified, no assurance can be given that approvals for rate submissions will continue.

The public sector managed care premium revenues consists of premiums from the Company's Medicare risk, Medicare cost and Medicaid products. The Company provides comprehensive health benefits to members participating in government programs and receives premium payments from federal and state governments. Premium rates for the Medicaid and Medicare risk products are established by governmental regulatory agencies and may be reduced by regulatory action.

The Company's management services revenues result from operations in which the Company's health plans provide administrative and other services to self-insured employers and to employer group beneficiaries that have elected HMO coverage. The Company receives an administrative fee for these services, but does not assume underwriting risk. In addition, the Company offers a PPO product to other third party payors, under which it provides rental of and access to the Company's PPO network, claims repricing and utilization review, and does not assume underwriting risk. A significant portion of the Company's management services revenue in 1999 and 1998 was a result of the acquisition of certain PHC health plans from Principal Life Insurance Company, ("Principal Life"). The Company recognized revenue under a Marketing Services Agreement, Management Services Agreement and PPO access agreement with Principal Life. These agreements have either expired or have been terminated as of December 31, 1999.

As of December 31, 1999, Coventry had 1,202,304 members for whom it assumes underwriting risk ("risk members") and 237,635 members of self-insured employers for whom it provides management services but does not assume underwriting risk ("non-risk members") in continuing operations. The following tables show the total number of members in continuing operations as of December 31, 1999 and 1998:

	Commercial Risk		Governmental Risk			
	HMO	**PPO/POS**	**Medicare**	**Medicaid**	**Non-Risk**	**Total**
1999						
Pennsylvania	172,221	181,371	22,824	-	102,808	479,224
St. Louis	104,773	69,748	42,317	97,460	28,872	343,170
Delaware	35,529	139	-	21,032	59,978	116,678
West Virginia	44,937	19,291	990	13,750	13,636	92,604
Iowa	73,901	-	686	1,618	12,145	88,350
Kansas City	64,893	45	1,815	-	1,844	68,597
Richmond	37,650	7,268	-	8,415	14,345	67,678
Carolina	43,989	-	-	4,216	-	48,205
Wichita	39,177	-	-	-	299	39,476
Louisiana	37,837	-	-	-	57	37,894
Nebraska	26,927	-	-	-	3,651	30,578
Georgia	27,485	-	-	-	-	27,485
Total	709,319	277,862	68,632	146,491	237,635	1,439,939
1998						
Pennsylvania	200,688	175,919	25,571	-	88,785	490,963
St. Louis	138,031	62,615	38,028	81,505	23,029	343,208
Delaware	37,500	-	-	16,829	58,062	112,391
West Virginia	6,379	18,620	-	-	14,503	39,502
Iowa	77,912	-	-	1,394	10,778	90,084
Kansas City	51,993	-	-	-	5,526	57,519
Richmond	51,980	264	-	3,015	14,812	70,071
Carolina	21,575	-	-	-	-	21,575
Wichita	35,342	-	-	-	399	35,741
Louisiana	39,730	-	-	-	161	39,891
Nebraska	34,598	-	-	-	720	35,318
Georgia	20,273	-	-	-	748	21,021
Total	716,001	257,418	63,599	102,743	217,523	1,357,284

The Company experienced strong sales and renewals for January 2000, adding about 30,000 members, excluding Indiana membership, to December 1999 results. Commercial membership grew by about 12,000 members despite pricing increases in most markets. Medicare membership was essentially flat, even though the Company exited three counties in Pennsylvania and reduced benefits and increased premiums in remaining service areas. Medicaid membership increased by about 17,000 members mainly due to the increase of membership in the Delaware plan, as a result of another carrier exiting the Medicaid program effective December 31, 1999. The remaining 1,000 member increase was a result of modest growth in non-risk membership.

Coventry's operating expenses are primarily medical costs, including medical claims under contractual relationships with a wide variety of providers, and capitation payments. Medical claims expense also includes an estimate of claims incurred but not reported ("IBNR"). Coventry currently believes that the estimates for IBNR liabilities are adequate to satisfy its ultimate medical claims liability after all medical claims have been reported. In determining the Company's IBNR liabilities, Coventry employs plan by plan standard actuarial reserve methods (specific to the plan's membership, product characteristics, geographic territories and provider network) that consider utilization frequency and unit costs of inpatient, outpatient, pharmacy and other medical costs, as well as claim payment backlogs and the timing of provider reimbursements. Reserve estimates are reviewed by underwriting, finance and accounting, and other appropriate plan and corporate personnel and judgments are then made as to the necessity for reserves in addition to the estimated amounts. Changes in assumptions for medical costs caused by changes in actual experience, changes in the delivery system, changes in pricing due to ancillary capitation and fluctuations in the claims backlog could cause these estimates to change in the near term. Coventry periodically monitors and reviews its IBNR reserves, and as actual settlements are made or accruals adjusted, reflects these differences in current operations.

PHC Acquisitions and Dispositions

Effective April 1, 1998, Coventry completed its acquisition of certain health plans of PHC from Principal Mutual Life Insurance Company, now known as Principal Life, for a total purchase price of approximately $330.2 million including transaction costs of approximately $5.7 million. The acquisition was accounted for using the purchase method of accounting and, accordingly, the operating results of PHC have been included in Coventry's consolidated financial statements since the date of acquisition. The purchase price consisted of 25,043,704 shares of Coventry's common stock at an assigned value of $11.96 per share. In addition, a warrant valued at $25.0 million ("the Warrant") was issued that grants Principal Life the right to acquire additional shares of Coventry's common stock in the event that its ownership percentage of such common stock is diluted below 40%. The Warrant is included as a component of additional paid-in capital in the accompanying consolidated financial statements. Through April 2003, Principal Life is restricted from buying additional shares of Coventry's common stock to increase its ownership percentage above 40%. As of December 31, 1999, Principal Life had exercised the Warrant to purchase 12,250 shares of the Company's common stock.

Coincident with the closing of the transaction, Coventry entered into a Renewal Rights Agreement and a Coinsurance Agreement with Principal Life, to manage certain of Principal Life's indemnity health insurance policies in the markets where Coventry does business and, on December 31, 1999, to offer to renew such policies in force at that time. Effective June 1, 1999, Coventry amended these agreements with Principal Life and waived its rights to reinsure and renew Principal Life's health insurance indemnity business located in Coventry's service area. Coventry received $19.8 million in cash in exchange for waiving these rights. At the date of the amendment, the Renewal Rights and Coinsurance Agreements had a net book value of $19.7 million resulting in an after tax gain of $0.1 million.

At the closing, Coventry also entered into a License Agreement, which was amended effective June 1, 1999, a Marketing Services Agreement and a Management Services Agreement with Principal Life. All three agreements expired on December 31, 1999. Pursuant to the latter two agreements, Coventry recognized revenue of approximately $25.5 million and $23.0 million for the years ended December 31, 1999 and 1998, respectively. Coventry no longer receives revenue under these agreements. In anticipation of the loss of these fees, Coventry commenced reducing selling, general and administrative ("SG&A") costs through cost savings from service center consolidation, headcount reductions and across-the-board reductions in administrative expenses. In addition to SG&A reductions, Coventry plans to increase its gross margin through acquisitions and by implementing rate increases.

As a result of the acquisition, Coventry assumed an agreement with Principal Life, whereby Principal Life pays a fee for access to Coventry's PPO network based on a fixed rate per employee entitled to access the PPO network and a percentage of savings realized by Principal Life. Effective June 1, 1999, Coventry sold the Illinois portion of the PPO network back to Principal Life. Under this agreement, Coventry recognized revenue of approximately $8.0 million and $12.0 million for the years ended December 31, 1999 and 1998, respectively.

Effective November 30, 1998, Coventry sold its subsidiary, Principal Health Care of Illinois, Inc., for $4.3 million in cash. The Illinois health plan accounted for approximately 56,000 risk members and approximately 2,400 non-risk members as of November 30, 1998.

On December 31, 1998, Coventry sold its subsidiary, Principal Health Care of Florida, Inc., for $95.0 million in cash. The Florida health plan accounted for approximately 156,000 risk members and approximately 5,500 non-risk members as of December 31, 1998.

The proceeds from both sales were used to retire Coventry's credit facility, to assist in improving the capital position of its regulated subsidiaries, and for other general corporate purposes. Given the short time period between the respective acquisition and sale dates and the lack of events or other evidence which would indicate differing values, no gain or loss was recognized on the sales of the Florida and Illinois health plans, as the sale prices were considered by management to be equivalent to the fair values allocable to these plans at the date of their acquisition from Principal Life in April 1998.

In connection with the acquisition of certain PHC health plans and the sales of the Florida and Illinois plans, Coventry established reserves of approximately $33.0 million for the estimated transition costs of the PHC health plans. These reserves are primarily comprised of severance costs related to involuntary terminations of former PHC employees, relocation costs of former PHC personnel, lease termination costs and contract termination costs. Through December 31, 1999, Coventry has expended approximately $29.7 million related to these reserves and expects to make payments on the remaining reserves through July 2002.

In the fourth quarter of 1999, Coventry notified the Indiana Department of Insurance of its intention to close its subsidiary, Coventry Health Care of Indiana, Inc. As of December 31, 1999, the health plan had approximately 23,000 members throughout the state. As a result of the cost associated with exiting the Indiana market, Coventry recorded a reserve of $2.0 million in the fourth quarter of 1999. Coventry has expended approximately $0.4 million as of December 31, 1999 and expects to close the plan by the end of the fourth quarter 2000.

The Indiana health plan was not operating profitably or demonstrating good prospects for future growth. Although closing the plan will not have a substantial impact on consolidated earnings, it will allow Coventry to focus resources and management attention on its other markets. Coventry's transition plan gives employers and members ample time to obtain health care coverage through one of the many other companies operating in Indiana.

In the fourth quarter of 1999, the Company's PHC subsidiaries changed the word Principal in their names to Coventry. All aspects of the health plans' operations, such as member coverage and access, remain unchanged. After the merger on April 1, 1998, the PHC plans continued to use the Principal brand name under the terms of the License Agreement as amended, between the parties, even though the Plans were no longer subsidiaries of Principal Life.

Other Acquisitions

Effective October 1, 1999, the Company acquired Carelink Health Plans ("Carelink"), the managed care subsidiary of Camcare, Inc., for a total purchase price of approximately $8.3 million including transaction costs of approximately $0.3 million. The acquisition was accounted for using the purchase method of accounting, and accordingly the operating results of Carelink have been included in the Company's consolidated financial statements since October 1, 1999, the date of the acquisition. The purchase price for Carelink was allocated to the assets, including the identifiable intangible assets, and liabilities based on estimated fair values. The $4.7 million excess of purchase price over the net identified tangible assets acquired was allocated to goodwill, which is being amortized over a useful life of 25 years. The final purchase price may be adjusted subject to the results of the final determination of the balance sheet of Carelink as of

October 1, 1999. Carelink is the market leader and has a broad provider network in West Virginia with a service area covering the majority of the state's population.

On November 1, 1999, the Company's subsidiary, Coventry Health Care of the Carolinas, Inc., acquired Kaiser Foundation Health Plan of North Carolina, Inc.'s (KFHPNC) commercial membership in Charlotte, North Carolina. The total purchase price was approximately $1.8 million including transaction costs. The transaction more than doubles Coventry's membership in the Charlotte market.

Effective February 1, 2000, the Company completed its acquisition of The Anthem Company's West Virginia managed care subsidiary, PrimeONE, Inc., ("PrimeONE"), for the total purchase price of approximately $3.9 million including acquisition costs. The $1.5 million excess of purchase price over the net identifiable tangible assets acquired was allocated to goodwill. The acquisition expands Coventry's West Virginia service area and brings its total membership in the state to over 109,000 members. This transaction combined with the Carelink acquisition solidifies Coventry's market leadership position in West Virginia.

On February 3, 2000, Coventry completed the acquisition of Prudential Health Care Plan, Inc.'s 11,800-member Medicaid business in St. Louis, Missouri at approximately $100 per member. The acquisition brings Coventry's total Medicaid membership in St. Louis to more than 106,000 members, expanding Coventry's leading position in the market.

Medical Office Dispositions

Effective March 31, 1997, the Company completed the sale of the medical offices associated with HealthAmerica Pennsylvania, Inc., ("HealthAmerica"), in Pittsburgh, Pennsylvania, to a major health care provider organization. The sales price was $20.0 million, resulting in a pretax gain to the Company of approximately $6.0 million. Coincident with the sale, the Company entered into a long-term global capitation agreement with the purchaser which increased the Company's globally capitated membership in western Pennsylvania to approximately 250,000 members. Under the agreement, the provider organization received a fixed percentage of premiums to cover all of the medical treatment the globally capitated members received. The provider organization filed for bankruptcy protection on July 21, 1998 and, as a result, the Company is no longer operating under this agreement. See "Legal Proceedings – Settlement with AHERF Related Entities."

Effective May 1, 1997, the Company completed the sale of the medical offices associated with GHP, its health plan in St. Louis, Missouri, to a major health care provider organization. The sales price was $26.9 million, resulting in a pretax gain to the Company of approximately $9.6 million. Coincident with the sale, the Company entered into a long-term global capitation agreement with the purchaser covering approximately 83,000 members, pursuant to which the provider organization receives a fixed percentage of premiums to cover all of the medical treatment the globally capitated members receive.

In August 1997, the Company entered into agreements to sell certain remaining medical offices associated with HealthAmerica in Harrisburg, Pennsylvania. The sales price was $2.4 million, resulting in a pretax loss to the Company of $0.6 million. All gains or losses resulting from medical office sales are reflected in other income, net, in the accompanying Consolidated Statement of Operations for the year ended December 31, 1997.

Legal Proceedings

Settlement with AHERF Related Entities. The Company and certain affiliated hospitals of Allegheny Health, Education and Research Foundation (AHERF) were involved in litigation to determine if the Company had the financial responsibility for medical services provided to the Company's members by the hospitals as a consequence of the bankruptcy filed by AHERF on July 21, 1998. As a result of the bankruptcy, AHERF failed to pay for medical services under its global capitation agreement with the Company covering approximately 250,000 Company members in the western Pennsylvania market. Shortly after AHERF filed for bankruptcy protection, the Company filed a lawsuit against AHERF's non-debtor, affiliated hospitals seeking monetary damages and a declaratory judgment that the Company was not obligated to pay in excess of $21.5 million to the hospitals for medical services provided by them to the Company's members and the hospitals filed a counterclaim for payment of these services. As a result, the Company, which was ultimately responsible for medical costs delivered to its members, notwithstanding the global capitation agreement, recorded a charge of $55.0 million in the second quarter of 1998 to establish a reserve for, among other things, the medical costs incurred by its members under the AHERF global capitation agreement at the time of the bankruptcy filing. On July 22, 1999, the Company reached a settlement with the hospitals, including Allegheny General Hospital, formerly owned by AHERF, and its new owner, Western Pennsylvania Health Care System ("West Penn"), whereby the hospitals agreed that the Company would not be liable for the payment of certain medical services rendered by the hospitals to the Company's members prior to July 21, 1998, the date of AHERF's bankruptcy filing. Simultaneous with the settlement, the Company signed a new three-year provider contract with West Penn. The conditions to execute the settlement and the provider contract were finalized in October 1999 and, as a result, all liability issues surrounding AHERF's failure to fulfill its contractual obligations and Coventry's remaining obligations have been determined and all AHERF-related litigation has been concluded. As of December 31, 1999, approximately $35.4 million of the $55.0 million reserve had been paid for medical claims. As a result of the settlement, Coventry released $6.3 million from the reserve, which was reflected as a gain in the fourth quarter and year-end 1999 results. The balance of the reserve represents Coventry's remaining obligations under the settlement and will be expended through August 2007.

Unity Arbitration. Group Health Plan, Inc. ("GHP"), a health plan subsidiary of the Company, entered into an agreement, effective January 1, 1998, with Unity Health Network, L.L.C. ("Unity") for Unity's provider network to provide health care services to GHP's members in the southern and western areas of St. Louis County, Missouri. The agreement contained risk sharing provisions. Disputes arose under the agreement and the matter was submitted to arbitration before the American Arbitration Association ("AAA"). GHP demanded payment from Unity of $7.6 million and specific performance under the agreement. Unity demanded payment from GHP of $14.5 million, specific performance of certain provisions of the agreement and suspension of its payment obligations. On December 23, 1999, the AAA tribunal of arbitrators awarded GHP the sum of $1.1 million for deficiencies in risk fund pools for 1998 and awarded Unity the sum of $1.8 million as liquidated damages for GHP's failure to meet certain administrative performances standards, and held Unity contractually liable for funding any deficits in the risk fund pools for 1999. The only remaining issue pending is the readjudication of certain disputed claims submitted subsequent to June 30, 1999.

BJC. Effective May 1, 1997, the Company completed its sale of the medical offices associated with Group Health Plan, Inc., its health plan in St. Louis, Missouri, to BJC Health System ("BJC"), a major provider organization in the St. Louis market, for approximately $26.9 million. Upon the sale, the Company entered into a long-term global capitation agreement with BJC, since amended, that covered approximately 33.3% of the risk membership in St. Louis at December 31, 1998. Under the agreement, BJC receives a fixed percentage of premium to cover all of the medical treatment received by the globally capitated members. Global capitation agreements limit the Company's exposure to the risk of increasing medical costs, but expose the Company to risk as to the adequacy of the financial and medical care resources of the provider organization. To the extent that the respective provider organization faces financial difficulties or otherwise is unable to perform its obligations under the global capitation agreements, the Company, which is responsible for the coverage of its members pursuant to its customer agreements, will be required to perform such obligations, and may have to incur costs in doing so in excess of the amounts it would otherwise have to pay under the global capitation agreements. Various disputes alleging breaches have arisen under the BJC global capitation agreement concerning the accuracy and timeliness of claims payments, and the accuracy of membership reconciliations that would affect the amount of premiums paid to BJC to provide its services under the agreement. BJC contends that these alleged breaches entitles it to terminate the agreement. Although the parties are obligated to arbitrate their disputes under the terms of the agreement, the parties have agreed to attempt to negotiate a resolution of the various issues concurrent with arbitration. While the Company acknowledges certain claims payment inaccuracies, the Company denies the remaining allegations and vigorously disputes that any such claims constitute a material breach of the agreement. Management does not believe that the outcome of these disputes will have a material impact on the consolidated financial statements, although there can be no assurances in this regard.

Other Legal Actions. In the normal course of business, the Company has been named as a defendant in various legal actions seeking payments for claims denied by the Company, medical malpractice, and other monetary damages. The claims are in various stages of proceedings and some may ultimately be brought to trial. Incidents occurring through December 31, 1999 may result in the assertion of additional claims. With respect to medical malpractice, the Company carries professional malpractice and general liability insurance for each of its operations on a claims-made basis for which the Company maintains reserves. In the opinion of management, the outcome of these actions should not have a material adverse effect on the financial position or results of operations of the Company.

Other managed care companies have been sued recently in class action lawsuits claiming violations of the federal racketeering act (RICO) and federal employee benefits law (ERISA), and generally claiming that managed care companies overcharge consumers and misrepresent that they deliver quality health care. Although it is possible that the Company may be the target of a similar suit, the Company believes there is no valid basis for such a suit.

The Company's industry is heavily regulated and the laws and rules governing the industry and interpretations of those laws and rules are subject to frequent change. Existing or future laws could have significant impact on the Company's operations.

Comparison of 1999 to 1998

Managed care premiums increased $48.7 million in 1999, or 2.4%, over 1998. The increase is primarily attributable to the additional revenue associated with the acquisitions of Carelink and the KFHPNC membership in the fourth quarter of 1999 and also due to the increase in Medicare risk and Medicaid membership of 34,345, or 20.6%, in continuing markets. In addition to the increase in risk membership, premiums increased by an average of $9.0, or 6.3%, over 1998 on a per member per month ("PMPM") basis, to $150.8 PMPM, as a result of rate increases. The Medicare Risk and Medicaid programs continue to grow in existing markets through recently expanded programs. On a same store basis, the increase in Medicare risk and Medicaid membership was offset by a decrease in commercial membership of 57,321, or 5.7%. The decrease in commercial membership occurred primarily in the western Pennsylvania market, attributable to the disruption caused by the AHERF bankruptcy filing and the conversion of a large group from a commercial risk product to a self-funded product. Membership also decreased in other markets due to Coventry's efforts to adhere to a strict pricing discipline. Coventry will continue to be diligent in attempting to obtain adequate premium increases and expects premium rates to increase 8% to 10% for renewals in the first quarter of 2000.

Management services revenue increased $3.3 million in 1999, or 4.3%, from the prior year. The increase in management service revenue is primarily attributable to an increase in self-funded membership of 19,695, or 9.0%, including the conversion of a large group from a commercial risk product to a self-funded product.

Health benefits expense increased $25.3 million, or 1.4%, in 1999, compared to 1998 due primarily to the additional expenses associated with the acquisitions of Carelink and KFHPNC membership. Exclusive of the Carelink and KFHPNC transactions, health benefits expense decreased $4.0 million. Coventry's medical loss ratio decreased slightly to 86.1% from 86.9% in 1998 due to premium rate increases which were a result of Coventry's efforts to maintain a strict pricing discipline.

Medical claim liability accruals are periodically monitored and reviewed with differences for actual settlements from reserves reflected in current operations. In addition to the procedures for determining reserves as discussed above, the Company reviews the actual payout of claims relating to prior period accruals, which may take up to six months to fully develop. Medical costs are affected by a variety of factors, including the severity and frequency of claims, that are difficult to predict and may not be entirely within the Company's control. The Company continually refines its reserving practices to incorporate new cost events and trends.

SG&A expense increased $6.0 million, or 2.1%, from 1998. SG&A expense, as a percent of revenue, remained unchanged at 13.8% in 1999, compared to 1998. The increase in SG&A expense was primarily attributable to additional expense associated with the acquired Carelink health plan and Coventry's consolidation of eighteen service centers into three regional service centers. In an effort to control costs and improve customer service, Coventry is in the process of transferring certain of its operating activities (e.g., customer service, claims processing, billing and enrollment) to regional service centers. All activities are expected to be fully transferred by the end of the fourth quarter of 2000.

Depreciation and amortization increased $2.4 million, or 9.4%, compared to the prior year primarily as a result of the depreciation related to the net capital expenditures of $14.7 million in 1999 and the additional amortization related to the intangibles recorded as part of the acquisition of the PHC health plans in April 1998.

Other income, net of interest expense, increased $9.5 million, or 50.6%, in 1999 from 1998, primarily due to the reduction of interest expense from the reduction of debt and increased investment income resulting from the increase in invested assets subsequent to the acquisition of the PHC health plans.

Earnings from operations increased $84.1 million, or 232.2% in 1999, compared to 1998. Excluding charges related to AHERF, plan shutdown expense and the relocation of the corporate office, operating earnings increased $18.3 million, or 72.3%, attributable to the various factors described above.

Coventry's net income was $43.4 million in 1999 compared to a loss of $11.7 million in 1998. Net income per diluted share was $0.69 in 1999 compared to a net loss per diluted share of $0.22 in 1998. Excluding the AHERF charge, plan shutdown expense and merger costs, Coventry would have reported earnings per diluted share of $0.65 and $0.49 in 1999 and 1998, respectively. The weighted average common shares outstanding were approximately 64,159,000 and 52,477,000 on a diluted basis for the years ended December 31, 1999 and 1998, respectively.

Comparison of 1998 to 1997

Managed care premiums increased $825.2 million, or 68.3%, in 1998 compared to 1997. The PHC plans accounted for approximately $697.7 million, or 84.6%, of the increase. Exclusive of the PHC plans, the Medicare risk membership increased by 25,285 members, or 66.0%. Medicare risk membership has a significantly higher per member per month premium (approximately three times) when compared to commercial risk membership and represented an increase in premiums, exclusive of the PHC plans, of $117.9 million from $161.1 million in 1997 to $279.0 million in 1998. The increase in Medicare risk membership was offset by a 20,047 decrease in Medicaid risk membership primarily resulting from the Company's decision to exit the Medicaid market in Pennsylvania in the first quarter of 1998. In addition, revenues per member per month, exclusive of the PHC plans, increased by 3.3% for HMO members, 8.3% for PPO/POS members and 5.5% for Medicaid members in 1998 over 1997. Excluding Medicaid membership, risk membership grew by 25,885, or 3.9%. The Company implemented rate increases that averaged approximately 7.0% in the fourth quarter of 1998.

The Company has exited the Medicare program in several counties representing approximately 18,000 members as of December 31, 1998. Approximately 10,000 of those members were in the Illinois and Florida health plans that were sold effective November 30, 1998 and December 31, 1998, respectively.

Management services revenue increased $56.8 million for the year ended December 31, 1998, or 281.2%, from the prior year. Management services and marketing services agreements that were entered into coincident with the acquisition of the PHC plans accounted for approximately $23.0 million, or 40.5%, of the increase. Approximately $30.5 million, or 53.7%, of the increase is primarily attributable to the PHC Administrative Services Only ("ASO") operations and PPO access fees. Exclusive of the PHC plans and the related agreements with Principal Life, management services revenue increased approximately $3.3 million, or 5.8%, attributable to transition services related to global capitation agreements and rate increases to ASO customers.

Membership

	Commercial Risk		Governmental Risk			
	HMO	PPO/POS	Medicare	Medicaid	Non-Risk	Total
1998						
Pennsylvania (1)	207,067	194,539	25,571	-	103,288	530,465
St. Louis (2)	138,031	62,615	38,028	81,505	23,029	343,208
Richmond	51,980	264	-	3,015	14,812	70,071
Nebraska	34,598	-	-	-	720	35,318
Kansas City	51,993	-	-	-	5,526	57,519
Wichita	35,342	-	-	-	399	35,741
Louisiana	39,730	-	-	-	161	39,891
Delaware	37,500	-	-	16,829	58,062	112,391
Iowa	77,912	-	-	1,394	10,778	90,084
Indiana	27,280	-	-	-	750	28,030
Georgia	20,273	-	-	-	748	21,021
Carolina	21,575	-	-	-	-	21,575
Total	743,281	257,418	63,599	102,743	218,273	1,385,314
1997						
Pennsylvania (1)	238,122	174,157	12,141	23,683	111,087	559,190
St. Louis	103,456	52,932	26,173	78,323	21,281	282,165
Richmond	54,095	180	-	2,561	16,542	73,378
Total	395,673	227,269	38,314	104,567	148,910	914,733

(1) Pennsylvania includes West Virginia membership in 1998 and 1997.
(2) St. Louis includes PHC of St. Louis membership in 1998.

Health benefits expense increased $727.5 million for the year ended December 31, 1998, or 70.0%, compared to 1997. The PHC plans accounted for approximately $612.5 million, or 84.2%, of the increase. The Company's medical loss ratio increased slightly to 86.9% from 86.1% in the previous year, primarily as a result of increases in Medicare membership.

As previously discussed, in July 1998, AHERF, the global capitation provider organization in western Pennsylvania, filed for bankruptcy protection under Chapter 11. On July 22, 1999, the Company reached a settlement with the non debtor, affiliated hospitals, including Allegheny General Hospital ("AGH"), formerly owned by AHERF, and its new owner, Western Pennsylvania Health Care System ("West Penn"), whereby the hospitals agreed that the Company would not be liable for the payment of certain medical services rendered by the hospitals to the Company's members prior to July 21, 1998, the date of AHERF's bankruptcy filing. Simultaneous with the settlement, the Company signed a new three-year provider contract with West Penn. The conditions to execute the settlement and the provider contract were finalized in October 1999 and, as a result, all liability issues surrounding AHERF's failure to fulfill its contractual obligations and Coventry's remaining obligations have been determined and all AHERF-related litigation has been concluded.

SG&A expense for the year ended December 31, 1998 increased $121.9 million, or 71.7%, compared to 1997. The PHC plans accounted for approximately $92.8 million, or 76.1%, of the increase. The remainder of the increase in SG&A is primarily attributable to the increased costs relating to administrative processes, particularly in claims processing, associated with the growth of the Medicare product in certain markets. SG&A expense as a percent of revenue remained at 13.8% for the year ended 1998. In an effort to control costs and improve customer service, the Company started the process of migrating certain of its operating activities (e.g., customer service, claims processing, billing and enrollment) to regional service centers.

Depreciation and amortization for the year ended December 31, 1998 increased $13.1 million, or 102.5%, compared to 1997. Depreciation expense from the PHC plans accounted for approximately $2.3 million, or 17.6%, of the increase. The remainder of the increase is attributable to the amortization of intangibles and goodwill recorded in connection with the acquisition of the PHC plans.

Loss from operations was $36.2 million for the year ended December 31, 1998. Excluding the $61.5 million of charges associated with the AHERF bankruptcy and the relocation of the corporate headquarters and other merger related costs, operating earnings were $25.3 million for the year ended December 31, 1998 compared to $5.7 million for the corresponding period in 1997. The increase in the operating earnings, exclusive of the $61.5 million of charges in 1998, is attributable to various factors as previously described.

Other income, net of interest expense, increased $4.1 million for the year ended December 31, 1998, or 27.9%, from the corresponding period in the prior year. Other income, net of interest expense, related to the PHC plans accounted for approximately $10.1 million, or 246.3%, of the increase. Exclusive of the PHC plans, other income, net of interest expense, decreased by $6.0 million. This reduction was primarily attributable to a $15.0 million pre-tax gain related to the sale of medical offices that was recognized in the prior year, offset by increased investment income resulting from the increase in invested assets subsequent to the acquisition of the PHC plans.

The Company's net loss was $11.7 million for the year ended December 31, 1998. Net loss per common and common equivalent share was $0.22 for the year ended December 31, 1998 compared to earnings per common and common equivalent share of $0.35 for the corresponding period in 1997. Excluding the $61.5 million of charges associated with the AHERF bankruptcy and the relocation of the corporate headquarters and other merger related costs, the Company reported basic earnings per common and common equivalent share of $0.50 in 1998. The weighted average number of common shares outstanding were approximately 52,477,000 and 33,912,000 for the years ended December 31, 1998 and 1997, respectively. The increase in the weighted average number of shares outstanding in 1998 was primarily attributable to the shares issued in April 1998 related to the acquisition of the PHC plans. Effective in the fourth quarter of 1997, the Company adopted SFAS 128, "Earnings Per Share." Accordingly, prior periods have been restated.

Liquidity and Capital Resources

The Company's total cash and investments, excluding deposits of $24.8 million restricted under state regulations, decreased $8.5 million to $589.8 million at December 31, 1999 from $598.3 million at December 31, 1998. This decrease was primarily a result of approximately $55.6 million that was used to pay the amount of medical claims for Principal Health Care of Florida, Inc. and Principal Health Care of Illinois, Inc., the two plans that were sold effective December 31, 1998 and November 30, 1998, respectively. The decrease is also attributable to the Company's efforts to reduce medical claims inventory in 1999.

The Company's investment guidelines emphasize investment grade fixed income instruments in order to provide short-term liquidity and minimize the risk to principal. The Company believes that since its long-term investments are available-for-sale, the amount of such investments should be added to current assets when assessing the Company's working capital and liquidity; on such basis, current assets plus long-term investments available-for-sale less short-term liabilities increased to $246.7 million at December 31, 1999 from $187.8 million at December 31, 1998.

The Company's HMOs and its insurance company subsidiary, Coventry Health and Life Insurance Company ("CHLIC"), are required by state regulatory agencies to maintain minimum surplus balances, thereby limiting the dividends the Company may receive from its HMOs and its insurance company subsidiary. After giving effect to these statutory reserve requirements, the Company's HMO subsidiaries had surplus in excess of statutory requirements of approximately $102.6 million and $93.4 million at December 31, 1999 and December 31, 1998, respectively. CHLIC had surplus in excess of statutory requirements of approximately $15.0 million and $7.8 million at December 31, 1999 and 1998, respectively. Excluding funds held by entities subject to regulation, the Company had cash and investments of approximately $61.1 million and $96.8 million at December 31, 1999 and December 31, 1998, respectively, which are available to pay intercompany balances to regulated subsidiaries and for general corporate purposes. The Company also has entered into agreements with certain of its regulated subsidiaries to provide additional capital if necessary to prevent the subsidiary's insolvency.

On December 29, 1997, the Company entered into a credit agreement with a group of banks (the "Credit Facility"), which replaced a prior credit agreement. Using a portion of the proceeds received from the sale of its Florida health plan, the Company retired the Credit Facility and the $42.2 million balance then outstanding effective December 31, 1998. On December 31, 1998, the effective interest rate on the indebtedness retired was 7.0625%.

During the quarter ended June 30, 1997, the Company entered into a securities purchase agreement ("Warburg Agreement") with Warburg, Pincus Ventures, L.P. ("Warburg") and Franklin Capital Associates III, L.P. ("Franklin") for the purchase of $40.0 million of Coventry's 8.3% Convertible Exchangeable Senior Subordinated Notes ("Coventry Notes"), together with warrants to purchase 2.35 million shares of the Company's common stock for $42.35 million. The original amount of the Coventry Notes, $36.0 million held by Warburg and $4.0 million held by Franklin, were exchangeable at Coventry's or Warburg's option for shares of redeemable convertible preferred stock.

During the second and third quarters of 1999, Coventry converted all Coventry Notes held by Warburg and Franklin totaling $47.1 million, including interest, into 4,709,545 shares of Series A redeemable convertible preferred stock ("preferred stock") at a price of $10 per share. The preferred stock is subject to mandatory redemption at a price of $10 per share, plus accrued dividends, in the amount equal to one-third of the shares outstanding on May 15, 2002, 2003 and 2004. The stock is carried at its fair value, which equals both its redemption value and liquidation value as of December 31, 1999 and will accrue dividends only if the Board of Directors declares dividends on the common stock. The dividends (per share) on the preferred stock would be equal to the dividends on the common stock. The preferred stock may be converted at any time at the holder's option into shares of common stock at a conversion price equal to the closing market price of the Company's common stock on the date of conversion, if the closing market price is less than $10 per share. If the closing market price of the Company's common stock is greater than $10 per share, the preferred stock is converted into common stock on a share for share basis. The preferred stock is callable by the Company if the market price of the Company's common stock exceeds certain agreed upon targets.

Projected capital investments in 2000 of approximately $15.0 million consist primarily of computer hardware, software and related equipment costs associated with the development and implementation of improved operational and communications systems.

The Company believes that cash flows generated from operations, cash on hand and investments, and excess funds in certain of its regulated subsidiaries will be sufficient to fund continuing operations through December 31, 2000.

Share Repurchase Program

On December 20, 1999, the Company announced a program to purchase up to 5% of its outstanding common stock. Stock repurchases may be made from time to time at prevailing prices in the open market, by block purchase or in private transactions. Coventry had approximately 64.2 million diluted shares of common stock outstanding as of December 31, 1999.

As part of a program previously authorized by the Board of Directors, as of March 23, 2000, the Company purchased approximately 826,200, 55,396 and 439,560 shares of its common stock in 2000, 1999 and 1997, respectively, for the treasury at an aggregate cost of $6.4 million, $0.4 million and $5.0 million in 2000, 1999 and 1997, respectively.

Legislation and Regulation

Numerous proposals have been introduced in the United States Congress and various state legislatures relating to health care reform. Some proposals, if enacted, could among other things, restrict the Company's ability to raise prices and to contract independently with employers and providers. Certain reform proposals favor the growth of managed health care, while others would adversely affect managed care. Although the provisions of any legislation adopted at the state or federal level cannot be accurately predicted at this time, management of the Company believes that the ultimate outcome of currently proposed legislation would not have a material adverse effect on the Company and its results of operations in the short-term.

Litigation and Insurance

The Company may be subject to certain types of litigation, including medical malpractice claims, claim disputes pertaining to contracts and other arrangements with providers, employer groups and their employees and individual members, and disputes relating to HMO denials of coverage for certain types of medical procedures or treatments. In addition, the Company has contingent litigation risk in connection with certain discontinued operations. Such litigation may result in losses to the Company. The Company maintains insurance coverage in amounts it believes to be adequate, including professional liability (medical malpractice) and general liability insurance. Contracting physicians are required to maintain professional liability insurance. In addition, the Company carries “stop-loss” reinsurance to reimburse it for costs resulting from catastrophic injuries or illnesses to its members. Nonetheless, no assurance can be given as to the future availability or cost of such insurance and reinsurance or that litigation losses will not exceed the limits of the insurance coverage and reserves. In the opinion of management and based on the facts currently known, the outcome of these actions should not have a material adverse effect on the financial position or results of operations of the Company.

New Accounting Standards

The Financial Accounting Standards Board (“FASB”) has issued Statement of Financial Accounting Standards (“SFAS”) No. 128, “Earnings Per Share”, which became effective for both interim and annual reporting periods that ended after December 15, 1997. The Company adopted the new standard in its reporting for the quarter and the year ended December 31, 1997, including required restatement of prior periods. The adoption of this standard did not have a material impact on earnings per share.

The FASB has also issued SFAS No. 130, “Reporting Comprehensive Income,” which became effective for fiscal years that began after December 15, 1997. SFAS No. 130 requires that changes in the amounts of certain items, including unrealized gains and losses on certain securities, be reflected in the financial statements. The Company adopted SFAS 130 effective January 1, 1998. The adoption of this standard did not have a material effect on the Company’s consolidated financial statements.

The FASB has also issued SFAS No. 131, “Disclosures about Segments of an Enterprise and Related Information.” This standard requires that a public business enterprise report financial and descriptive information about its reportable operating segments. Operating segments are components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. SFAS No. 131 also requires that all public business enterprises report information about the revenues derived from the enterprise’s products or services (or groups of similar products and services), about the countries in which the enterprise earns revenues and holds assets and about major customers regardless of whether that information is used in making operating decisions. Effective December 31, 1998, the Company adopted SFAS 131.

In June 1998, the FASB issued SFAS No. 133, “Accounting for Derivative Instruments and Hedging Activities.” SFAS 133 requires companies to record derivatives on the balance sheet as assets or liabilities, measured at fair value. Gains or losses resulting from changes in the values of the derivatives would be accounted for depending on the use of the derivatives and whether they qualify for hedge accounting. In June 1999, the FASB also issued Statement of Financial Accounting Standards No. 137 (“SFAS 137”), which defers the effective date of SFAS 133 until fiscal years beginning after June 15, 2000. The Company does not believe that adoption of SFAS 133 (as amended by SFAS 137) will have a material effect on its future results of operations.

In March 1998, the American Institute of Certified Public Accountants (“AICPA”) issued Statement of Position 98-1 (“SOP 98-1”), “Accounting for the Costs of Computer Software Developed or Obtained for Internal Use.” SOP 98-1 provides authoritative guidance for the capitalization of certain costs related to computer software developed or obtained for internal applications, such as external direct costs of materials and services, payroll costs for employees and certain interest costs. Costs incurred during the preliminary project stage, as well as training and data conversion costs, are to be expensed as incurred. SOP 98-1 is effective for fiscal years that began after December 15, 1998. The Company adopted SOP 98-1 effective January 1, 1999. The adoption of SOP 98-1 did not have a material effect on the Company’s consolidated financial statements.

Inflation

Health care cost inflation has exceeded the general inflation rate and the Company has implemented cost control measures and risk sharing arrangements, which seek to reduce the effect of health care cost inflation. During 1999, the Company implemented increases in premium rates which exceeded inflationary cost increases while maintaining competitive rates within its markets.

Quarterly Results of Operations

The unaudited quarterly consolidated results of operations of the Company are summarized in Item 8, Footnote to the Financial Statements.

2000 Outlook

The Company's membership in January 2000 was approximately 1,485,000 members, an increase of 6.3% over January 1999. The increase was primarily attributable to the acquisitions in North Carolina and West Virginia. Of the January 2000 membership, approximately 1,246,000 were risk members and approximately 239,000 were non-risk members.

The Company operates in highly competitive markets, but generally believes that the pricing environment is improving in its existing markets, thus creating the opportunity for reasonable price increases. However, there is no assurance that the Company will be able to increase premiums at rates equal to or in excess of increases in its health care costs.

For 2000, the Company continues to pursue ways to improve its underwriting processes and oversight in both risk and management services products with the objective of increasing premium yields and profitable growth in its markets. The Company's migration of certain of its operating activities (e.g., customer service, claims processing, billing and enrollment) to regional service centers is expected to be completed by the end of the fourth quarter of 2000. The Company expects that the regional service centers will allow it to provide improved levels of service in a more cost effective manner. The integration of the PHC health plans has allowed the Company to strengthen its balance sheet and gain entry into additional markets. Management believes that existing markets have potential for growth for the Company's commercial and governmental products. Management believes that the foregoing should result in progressive improvements in 2000, although realization is dependent upon a variety of factors, some of which may be outside the control of the Company.

E-Commerce Initiatives

The Company is launching several e-commerce initiatives. Each initiative is intended to reach a segment of our core business customers: providers, brokers, employers and members, and will have a distinct e-commerce solution.

Provider Channel. In February 2000, the Company entered into a three-year agreement with Healtheon/WebMD, the first end-to-end Internet healthcare company connecting physicians and consumers to the entire healthcare industry. Initially, the Company will use Healtheon/WebMD's Internet services to manage the electronic submission and processing of eligibility determination, referrals and authorizations, claims submission, claim status, and reporting. Upon completion of the roll-out, Healtheon/WebMD will also provide administrative services to the providers in the Company's health plans' networks who have signed up for WebMD Practice. It is expected that this relationship will significantly improve service to our members and reduce administrative costs.

Broker/Employer Channel. In February 2000, the Company entered into a two-year agreement with Workscape, Inc. ("Workscape"), which specializes in the development of Internet solutions for the insurance industry. Workscape will focus on automating the full broker/small employer relationship, including enrolling customers, providing benefits information, generating customized proposals, registering agents, processing applications, underwriting risk, and calculating rates. The Company will initially implement this initiative in its Pittsburgh and Harrisburg, Pennsylvania markets, and then into its other markets.

Member Channel. In March 2000, the Company announced a one-year agreement with GeoAccess to implement GeoAccess' online healthcare directory technology. This technology makes information about health plan providers available to members. The online directories will be available in all the Company's health plans. ProviderLookup Online uses GeoAccess' proprietary distance-calculation technology, which provides precise results about the providers located closest to an individual's address. The Company's members will be able to search for providers by name, geographic proximity or specific criteria.

Year 2000

The Company has been aware of the "Year 2000" issue that has the potential to affect products and systems that were not designed to properly handle the transition between the twentieth and twenty-first centuries. The Company recognized the need to ensure that its business operations would not be adversely impacted by the year 2000, and it implemented a Year 2000 readiness program to facilitate the necessary readiness preparations. Through December 31, 1999, the Company incurred approximately $13.1 million in its Year 2000 assessment and remediation program, and it does not expect to incur significant further costs in this program. Prior to the end of 1999, the Company completed its readiness assessment and its implementation of all plans for handling anticipated readiness risks. The Company's transition from 1999 to 2000 occurred without any major business disruption. With the transition into the Year 2000 complete, the Year 2000 issue has not had, and the Company believes it will not have, a material impact on the Company's business, financial condition or results of operations.

Risk Factors

The risks described below are not the only ones that we face. Additional risks not presently known to us or that we currently deem immaterial may also impair our business operations.

Our business, financial condition or results of operations could be materially adversely affected by any of these risks. Further, the trading price of our common stock could decline due to any of these risks, and you may lose all or part of your investment.

Health care costs may rise faster than our ability to increase our premium rates, causing our profit margins to shrink which may in turn reduce our net income and adversely affect the value of your investment in Coventry.

In the future, the costs of health care services and supplies that we provide to our membership may rise faster than our ability to increase premium rates. If costs rise and we are unable to increase premium rates, our profit margins will shrink. Shrinking profit margins may reduce our net income and adversely affect the value of your investment in Coventry. Premium rates for managed care plans generally have increased in recent months, but we could experience unforeseen decreases or severely limited increases in future premium rates. Also, 27.5% of our premium revenues through February 29, 2000 were derived from governmental programs, including Medicare and Medicaid. The government generally fixes these premium rates and we cannot adjust them based on our anticipated costs. Recent legislation has limited Medicare premium rate increases substantially as compared to increases permitted in prior years. As a result, in the future the total costs of our government programs could exceed the total premiums that we receive from these programs.

If we are unable to increase our revenues and our profit margins shrink, our net income may decrease and the value of your investment in Coventry may decline.

In the future, we may not be able to increase or maintain our current revenues. Since we no longer receive revenues under our agreements with Principal Life, which expired on December 31, 1999, there is a risk that we may not be able to replace the revenues generated from these fees. We recognized revenues from these agreements of $25.5 million in 1999 and $23.0 million in 1998. We may also be unable to reduce our costs or increase our premium rates. If we are faced with shrinking profit margins and are unable to increase our revenues, we will have a decline in net income, which could adversely affect the value of your investment in Coventry.

Increases in our revenues will be generally dependent upon our ability to increase premiums and membership. In addition to the loss of revenues generated from the Principal Life fees, there are several factors that may affect our ability to maintain or increase revenues including:

- rising costs
- loss of membership to our competitors
- failure to attract new members
- inability to increase premiums due to regulatory restrictions
- loss of membership due to increased premium rates
- withdrawal from unprofitable markets
- consumer preferences for lower priced health care options
- price competition

Our failure to accurately estimate future health care costs may result in premiums that are not sufficient to cover medical costs, which may negatively affect our operating results and reduce the value of your investment in Coventry.

If we underestimate the costs of health care services and supplies that we provide to our members, we may set our premium rates too low. Low premiums may result in an inability to generate revenues that are sufficient to pay future health care costs. This shortfall could significantly change our results of operations, affect profitability and adversely affect the value of your investment in Coventry. While we attempt to base the premiums we charge, at least in part on our estimate of expected health care costs over the fixed premium period, other factors may limit our ability to fully base premiums on estimated costs and could cause actual health care costs to exceed estimated health care costs. These factors could include:

- the increased cost of individual health care services
- the type and number of individual health care services delivered exceeding our expectations
- the occurrence of catastrophes or epidemics
- seasonality and trends
- general inflation
- new mandated benefits or other regulatory changes that increase our costs
- operational issues
- insured population characteristics
- competitive pressures
- other unforeseen occurrences

Failure to obtain cost-effective agreements with a sufficient number of providers may result in higher medical costs and loss of membership, which could cause a decline in the value of your investment in Coventry.

We expect that substantially all of our members will be served by providers contracting with us to provide the requisite medical care. Our ability to contract successfully with a sufficiently large number of providers in a given geographic market will impact the relative attractiveness of managed care products in those markets. In addition, the terms of those provider contracts also have a material impact on our medical costs and our ability to control these costs.

We may not be able to reach cost-effective agreements with certain major market providers which could reduce Coventry's net income and cause a decline in the value of your investment in Coventry.

In some of our markets, there are provider systems that have a major presence. Our product offerings and profitability may be adversely affected if these provider systems refuse to contract with us, place us at a competitive disadvantage or use their market position to negotiate contracts that are unfavorable to us.

There is a risk that providers with whom we have capitation contracts may be financially unable or unwilling to fulfill their payment or medical care obligations under capitation agreements and that our members may prefer to utilize other providers with whom we do not have capitation contracts.

Among the medical cost control techniques we have utilized are capitation agreements with providers pursuant to which we pay providers a fixed dollar amount per member per month, with the provider obligated to provide all of a particular type of medical service required by the members, and global capitation agreements pursuant to which a single integrated hospital-physician provider system provides substantially all hospital and medical services to a large number of members for a fixed percentage of the premium we charge with respect to those members. While these systems may shift to the contracting provider system the risk that medical costs will exceed the amounts anticipated, we will be exposed to the risks that the provider systems are financially unable or unwilling to fulfill their payment or medical care obligations under the capitation agreements. In addition, it is possible that members may prefer other providers in the market with whom we do not have capitation agreements. If our members choose to utilize providers with whom we do not have capitation agreements, we may incur higher costs. These higher costs may reduce our net income and negatively impact the value of your investment in Coventry.

Principal Life and its affiliates' ability to exercise control over Coventry could adversely affect the value of your investment in Coventry.

As a result of our acquisition of the Principal Health Care plans, Principal Life owns approximately 40% of our common stock, on a fully diluted basis. Due to previously agreed upon limitations that are effective through April 2003, Principal Life may purchase additional shares of our common stock, but only to maintain its 40% ownership of our fully diluted common stock.

In addition to its ownership position, Principal Life has designated 4 members of our 10 member Board of Directors in correspondence with its percentage ownership of our common stock. As long as Principle Life owns at least 10% of our common stock, it can designate one member of our Board of Directors for each 6% ownership of our common stock. Accordingly, Principle Life has the right to designate up to six members of our Board.

Principal Life's ownership position and its representation on the Company's Board of Directors, allow it to exert significant influence over the direction and operations of Coventry. In some instances, this influence could be used in a manner that is contrary to the best interests of our other stockholders, and may accordingly decrease the value of your investment in Coventry.

It should be noted, however, that prior to April 2003, Principal Life has agreed to vote its shares in favor of any acquisition required to be approved by our shareholders, that a Special Committee of our Board of Directors has recommended, and that a majority of our shareholders, other than Principal Life, have approved. The Special Committee will consist of members of our Board of Directors that are neither management, nor designees of Principal Life.

Additionally, prior to April 2003, Principal Life has agreed to vote its shares for the election of directors nominated by the nominating committee of the Board of Directors, and not to oppose or seek removal of any person nominated by this nominating committee.

Once the previously agreed upon limitations imposed on Principal Life expire in April 2003, Principal Life may acquire additional shares of our common stock to the point that it exercises complete control over the Company. If Principal Life were to acquire over 50% of our common stock, it would have actual control over us, and would have a controlling vote in all actions involving a shareholder vote. As the majority shareholder, Principal Life could block transactions that were advantageous to our minority shareholders. Accordingly, the value of your investment in Coventry could decline as future investors may not consider our common stock to be an attractive stock due to the percentage of our common stock held by Principal Life.

Future and existing laws and rules governing Coventry may impact our business and negatively affect our profitability.

Coventry's industry is heavily regulated and the laws and rules governing the industry and interpretations of those laws and rules are subject to frequent change. Existing or future laws could force us to change how we do business and may restrict our revenue and/or enrollment growth and/or increase our health care and administrative costs. Regulatory approvals must be obtained and maintained to market many of our products and services. Delays in obtaining or failing to obtain or maintain such approvals could adversely affect our revenue or the number or our covered lives, or could increase our costs.

Our contracts with federal and state government agencies are subject to periodic audits that could have an adverse result that may lead to a decline in the value of your investment in Coventry.

Coventry contracts with various federal and state governmental agencies to provide managed health care services. These agencies include the United States Office of Personnel Management that contracts with us to provide managed health care services for federal employees under the Federal Employees Health Benefits Program; the U. S. Health Care Financing Administration that contracts with us to provide a Medicare product to eligible beneficiaries; and certain states that contract with us to provide a Medicaid product to eligible recipients. These contracts and applicable federal and state regulations, among other requirements, establish premium rating requirements or fixed premiums per member per month. These governmental agencies and states may periodically audit us to verify our compliance with their contracts and applicable federal and state laws and regulations. Such audits could result in material adjustments. An adverse audit of our contracts with governmental agencies could result in the loss of licensure, the loss of the right to participate in certain programs, the imposition of fines, penalties, and other sanctions and could negatively affect our reputation in various markets and make it more difficult for us to sell our products and services.

In the future, we may not be able to meet certain minimum capitalization limits that may be adopted by states in which we do business.

The National Association of Insurance Commissioners has proposed that states adopt risk-free capital standards that, if implemented, would generally require higher minimum capitalization limits for health care coverage provided by HMOs and other risk-bearing health care entities. To date, no state where Coventry has HMO operations has adopted those standards. We do not expect this legislation to have a material impact on our consolidated financial position in the near future. We believe that cash flows from operations will be sufficient to fund any additional regulatory risk-based capital.

Costs associated with litigation may result in losses to us that could negatively impact the value of your investment in Coventry.

We are susceptible to litigation and insurance risks, including medical malpractice liability, disputes relating to the denial of coverage and the adequacy of "stop-loss" reinsurance for costs resulting from catastrophic injuries or illness. Coventry has contingent litigation risk with certain discontinued operations. Such litigation may result in losses to us that could have material adverse effect on our operations, financial performance, cash flows or future prospects and adversely affect the value of your investment in Coventry.

Quantitative and Qualitative Disclosures of Market Risk

The Company's only material risk in investments in financial instruments is in its debt securities portfolio. The Company invests primarily in marketable state and municipal, U.S. Government and agencies, corporate, and mortgage-backed debt securities. As of December 31, 1999, the Company has not invested in financial instruments of a hedging or derivative nature.

The Company has established policies and procedures to manage its exposure to changes in the fair value of its investments. These policies include an emphasis on credit quality, management of portfolio duration, maintaining or increasing investment income through high coupon rates and actively managing profile and security mix depending upon market conditions. The Company has classified all of its investments as available-for-sale. The fair value of the Company's investments in debt securities at December 31, 1999 was $374.5 million. Debt securities at December 31, 1999 mature according to their contractual terms, as follows (actual maturities may differ because of call or prepayment rights):

1999	Amortized Cost	Fair Value
Maturities:		
Within 1 year	$102,126	$102,045
1 to 5 years	114,850	113,517
6 to 10 years	68,382	66,373
Over 10 years	93,726	92,592
Total short-term and long-term securities	$379,084	$374,527

The Company believes its investment portfolio is diversified and expects no material loss to result from the failure to perform by the issuer of the debt securities it holds. The mortgage-backed securities are insured by GNMA and FNMA.

The Company's projections of hypothetical net losses in fair value of the Company's market rate sensitive instruments, should potential changes in market rates occur, are presented below. While the Company believes that the potential market rate change is reasonably possible, actual results may differ.

Based on the Company's debt securities portfolio and interest rates at December 31, 1999, a 100 basis point increase in interest rates would result in a decrease of $7.9 million or 2.1%, in the fair value of the portfolio. Changes in interest rates may affect the fair value of the debt securities portfolio and may result in unrealized gains or losses. Gains or losses would be realized upon the sale of the investments.

Financial Statements and Supplementary Data

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Board of Directors of Coventry Health Care, Inc.:

We have audited the accompanying consolidated balance sheets of Coventry Health Care, Inc. (a Delaware corporation and successor-in-interest to Coventry Corporation) and subsidiaries as of December 31, 1999 and 1998, and the related consolidated statements of operations, stockholders' equity and cash flows for each of the three years in the period ended December 31, 1999. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Coventry Health Care, Inc. and subsidiaries as of December 31, 1999 and 1998, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1999 in conformity with accounting principles generally accepted in the United States.

Baltimore, Maryland
February 21, 2000

Arthur Andersen LLP

Coventry Health Care, Inc. and Subsidiaries
Consolidated Balance Sheets
(in thousands, except share data)

	December 31, 1999	December 31, 1998
ASSETS		
Cash and cash equivalents	$240,076	$405,323
Short-term investments	88,365	46,714
Accounts receivable, net of allowance of $5,548 and $12,023 as of December 31, 1999 and 1998, respectively	53,173	43,466
Other receivables, net	42,304	23,126
Deferred income taxes	56,157	65,583
Other current assets	3,330	6,993
Total current assets	483,405	591,205
Long-term investments	286,162	162,546
Property and equipment, net	37,863	35,780
Goodwill and intangible assets, net	268,289	295,966
Other assets	5,864	5,731
Total assets	$1,081,583	$1,091,228
LIABILITIES AND STOCKHOLDERS' EQUITY		
Medical claim liabilities	$308,095	$330,743
Other medical liabilities	54,691	73,079
Accounts payable and other accrued liabilities	110,186	115,716
Deferred revenue	49,914	46,414
Total current liabilities	522,886	565,952
Convertible exchangeable subordinated notes	-	45,538
Long-term debt	-	781
Other long-term liabilities	31,217	42,418
Total liabilities:	554,103	654,689
Redeemable convertible preferred stock, $.01 par value; Series A, convertible, 6,000,000 shares authorized; 4,709,545 shares issued and outstanding in 1999	47,095	-
Stockholders' equity:		
Common stock, $.01 par value; 200,000,000 shares authorized; 59,643,753 shares issued and 59,148,797 outstanding in 1999; and 59,274,370 shares issued and 58,834,810 outstanding in 1998	596	593
Additional paid-in capital	480,792	476,430
Accumulated other comprehensive (loss) income	(2,780)	794
Retained earnings (accumulated deficit)	7,157	(36,278)
Treasury stock, at cost, 494,956 and 439,560 shares as of December 31, 1999 and 1998, respectively	(5,380)	(5,000)
Total stockholders' equity	480,385	436,539
Total liabilities and stockholders' equity	$1,081,583	$1,091,228

See notes to consolidated financial statements.

Coventry Health Care, Inc. and Subsidiaries
Consolidated Statements of Operations
(in thousands, except per share data)

	Years Ended December 31,		
	1999	1998	1997
Operating revenues:			
Managed care premiums	$2,082,075	$2,033,372	$1,208,149
Management services	80,297	77,011	20,202
Total operating revenues	2,162,372	2,110,383	1,228,351
Operating expenses:			
Health benefits	1,792,652	1,767,374	1,039,860
Selling, general and administrative	297,922	291,919	170,017
Depreciation and amortization	28,205	25,793	12,735
Plan shutdown expense	2,020	-	-
AHERF charge	(6,282)	55,000	-
Merger costs	-	6,492	-
Total operating expenses	2,114,517	2,146,578	1,222,612
Operating earnings (loss)	47,855	(36,195)	5,739
Other income, net	29,906	27,251	24,880
Interest expense	(1,761)	(8,566)	(10,275)
Earnings (loss) before income taxes and minority interest	76,000	(17,510)	20,344
Provision for (benefit from) income taxes	32,565	(5,769)	8,422
Minority interest in earnings of consolidated subsidiary, net of income tax	-	-	19
Net earnings (loss)	$43,435	$(11,741)	$11,903
Net earnings (loss) per share:			
Basic	$ 0.74	$ (0.22)	$ 0.36
Diluted	$ 0.69	$ (0.22)	$ 0.35

See notes to consolidated financial statements.

Coventry Health Care, Inc. and Subsidiaries
Consolidated Statements of Stockholders' Equity
Years Ended December 31, 1999, 1998 and 1997 (in thousands)

	Common Stock	Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings (Accumulated Deficit)	Treasury Stock, at Cost	Total Stockholders' Equity
Balance, December 31, 1996	$330	$136,142	$395	$(36,440)	$-	$100,427
Comprehensive income:						
Net earnings				11,903		11,903
Unrealized gain on securities, net of reclassifications			197			197
Comprehensive income:						12,100
Issuance of common stock, including exercise of options and warrants	7	7,722			(5,000)	2,729
Issuance of warrants		2,353				2,353
Tax benefit of stock options exercised		209				209
Balance, December 31, 1997	$337	$146,426	$592	$(24,537)	$(5,000)	$117,818
Comprehensive (loss) income:						
Net loss				(11,741)		(11,741)
Unrealized gain on securities, net of reclassifications			202			202
Comprehensive loss:						(11,539)
Issuance of common stock, including exercise of options and warrants	256	304,888				305,144
Issuance of warrants		25,000				25,000
Tax benefit of stock options exercised		116				116
Balance, December 31, 1998	$593	$476,430	$794	$(36,278)	$(5,000)	$436,539
Comprehensive income (loss):						
Net earnings				43,435		43,435
Unrealized loss on securities, net of reclassifications			(3,574)			(3,574)
Comprehensive income:						39,861
Issuance of common stock, including exercise of options and warrants	3	3,931			(380)	3,554
Tax benefit of stock options exercised		431				431
Balance, December 31, 1999	$596	$480,792	$(2,780)	$7,157	$(5,380)	$ 480,385

See notes to consolidated financial statements.

Coventry Health Care, Inc. and Subsidiaries
Consolidated Statements of Cash Flows
(in thousands)

	Years Ended December 31,		
	1999	1998	1997
Cash flows from operating activities:			
Net earnings (loss)	$43,435	$(11,741)	$11,903
Adjustments to reconcile net earnings (loss) to cash provided by operating activities:			
Depreciation and amortization	28,205	25,793	12,735
Deferred income tax provision (benefit)	14,038	(19,439)	(11,701)
Loss/Gain on sales of medical offices & property disposals	287	(399)	(13,338)
Non-cash interest on convertible debt	1,557	3,496	2,042
Other	100	3,631	(383)
Changes in assets and liabilities, net of effects of the purchase of subsidiaries:			
Accounts receivable	(7,357)	14,163	(2,432)
Other receivables	(17,265)	12,677	715
Prepaid expenses and other current assets	388	(424)	2,013
Other assets	(133)	2,373	2,874
Medical claims liabilities	(41,982)	36,184	(28,060)
Other medical liabilities	(20,007)	73,079	-
Accounts payable and other accrued liabilities	(7,139)	(70,741)	26,000
Deferred revenue	3,012	516	24,205
Other long-term liabilities	(8,269)	(724)	(4,312)
Net cash (used in) provided by operating activities	(11,130)	68,444	22,261
Cash flows from investing activities:			
Capital expenditures, net	(14,717)	(3,196)	(7,218)
Sales of investments	253,489	122,871	37,329
Purchases of investments & other	(425,109)	(141,577)	(34,137)
Payments for acquisitions	(10,133)	-	-
Proceeds from sales of subsidiaries & medical offices	-	99,277	53,977
Proceeds from sale of Renewal Rights Agreement	19,850	-	-
Cash acquired in conjunction with acquisitions	19,730	148,600	-
Net cash (used in) provided by investing activities	(156,890)	225,975	49,951
Cash flows from financing activities:			
Proceeds from issuance of convertible exchangeable notes	-	-	40,000
Payments on long-term debt	(781)	(44,491)	(48,961)
Net proceeds from issuance of stock	3,554	1,416	2,729
Proceeds from issuance of stock warrants	-	-	2,353
Net cash provided by (used in) financing activities	2,773	(43,075)	(3,879)
Net (decrease) increase in cash and cash equivalents	(165,247)	251,344	68,333
Cash and cash equivalents at beginning of period	405,323	153,979	85,646
Cash and cash equivalents at end of period	$240,076	$405,323	$153,979
Supplemental disclosure of cash flow information:			
Cash paid for interest	$ -	$3,386	$7,572
Income taxes paid (refunded), net	$40,210	$9,487	$(4,456)

See notes to consolidated financial statements.

Coventry HealthCare, Inc. and Subsidiaries

Notes to Consolidated Financial Statements December 31, 1999, 1998 and 1997

A. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Coventry Health Care, Inc. (together with its subsidiaries, the “Company”, “we”, “our”, or “us”), successor-in-interest to Coventry Corporation, is a managed health care company operating health plans under the names Coventry Health Care, HealthAmerica, HealthAssurance, HealthCare USA, Group Health Plan, Southern Health, SouthCare and Carelink Health Plans. The Company provides a full range of managed care products and services including health maintenance organization (“HMO”), point of service (“POS”) and preferred provider organization (“PPO”) products. The Company also administers self-insured plans for large employer groups. The Company was incorporated under the laws of the state of Delaware on December 17, 1997.

The Company began operations in 1987 with the acquisition of the American Service Companies (“ASC”) entities, including the Coventry Health and Life Insurance Company (“CHLIC”). In 1988, the Company acquired HealthAmerica Pennsylvania, Inc. (“HAPA”), a Pennsylvania HMO. In 1990, the Company acquired Group Health Plan, Inc. (“GHP”), a St. Louis, Missouri HMO. Southern Health Services, Inc. (“SHS”), a Richmond, Virginia HMO, was acquired by the Company in 1994. In 1995, the Company acquired HealthCare USA, Inc. (“HCUSA”), a Jacksonville, Florida-based Medicaid managed care company. In 1998, the Company acquired certain assets of Principal Health Care, Inc. (“PHC”) from Principal Mutual Life Insurance Company, now known as Principal Life Insurance Company (“Principal Life”). On October 1, 1999, the Company acquired Carelink Health Plans (“Carelink”) from Camcare, Inc. On November 1, 1999, the Company’s subsidiary, Coventry Health Care of the Carolinas, Inc., acquired Kaiser Foundation Health Plan of North Carolina, Inc.’s commercial membership. See Notes B and C to consolidated financial statements.

Principles of Consolidation—The consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany transactions have been eliminated. Interests of other investors in the Company’s majority owned (or otherwise effectively-controlled) subsidiaries are accounted for as minority interests and are included in other long-term liabilities for financial reporting purposes.

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

Cash and Cash Equivalents—Cash and cash equivalents consist principally of overnight repurchase agreements, money market funds, commercial paper and certificates of deposit. The Company considers all highly liquid securities purchased with an original maturity of three months or less to be cash equivalents. The carrying amounts of cash and cash equivalents reported in the accompanying consolidated balance sheets approximate fair value.

Investments—The Company accounts for investments in accordance with Statement of Financial Accounting Standards No. 115 (“SFAS 115”), “Accounting for Certain Investments in Debt and Equity Securities.” The Company considers all of its investments as available-for-sale, and accordingly, records unrealized gains and losses, net of deferred income taxes, as a separate component of stockholders’ equity. Realized gains and losses on the sale of these investments are determined on a specific identification basis.

Investments with original maturities in excess of three months and less than one year are classified as short-term investments and generally consist of time deposits, U.S. Treasury Notes, and obligations of various states and municipalities. Long-term investments have original maturities in excess of one year and primarily consist of debt securities.

Other Receivables—Other receivables include interest receivable, reinsurance claims receivable, receivables from providers and suppliers and any other receivables that do not relate to premiums.

Property and Equipment—Property and equipment are recorded at cost. Depreciation is computed using the straight-line method over the estimated lives of the related assets or, if shorter, over the terms of the respective leases.

Long-Lived Assets—The Company has adopted Statement of Financial Accounting Standards No. 121 ("SFAS 121"), "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of." In accordance with SFAS 121, the Company evaluates long-lived assets to be held for events or changes in circumstances that would indicate that the carrying value may not be recoverable. In making that determination, the Company considers a number of factors, including undiscounted future cash flows, prior to interest expense. The Company measures an impairment loss by comparing the fair value of the assets to their carrying value. Fair values are determined by using market prices for similar assets, if available, or discounted future estimated cash flows, prior to interest expense. Assets held for sale are recorded at the lower of the carrying amount or fair value, less any cost of disposition.

Goodwill and Intangible Assets—Goodwill and intangible assets consist of costs in excess of the fair value of the net assets of subsidiaries or operations acquired. Goodwill is amortized using the straight-line method over periods ranging from 15 to 35 years. The remaining unamortized goodwill and intangible asset balances at December 31, 1999 are as follows (in thousands):

Description	Estimated Useful Life	Amount	Accumulated Amortization	Net Book Value
Customer Lists	5 years	$11,700	$8,450	$3,250
HMO Licenses	15-20 years	10,700	1,202	9,498
Goodwill	15-35 years	314,240	58,699	255,541
Total		$336,640	$68,351	$268,289

Amortization expense for the years ended December 31, 1999, 1998 and 1997 was approximately $14.6 million, $13.6 million and $3.8 million, respectively. In accordance with SFAS 121 and Accounting Principles Board ("APB") Opinion No.17, the Company periodically evaluates the realizability of goodwill and intangible assets and the reasonableness of the related lives in light of factors such as industry changes, individual market competitive conditions, and operating income.

Other Assets—Other assets consist of loan acquisition costs, assets related to the supplemental executive retirement plan (See Note P to consolidated financial statements), restricted assets, deferred charges and certain costs incurred to develop new service areas and new products prior to the initiation of revenues. Loan acquisition costs are amortized over the term of the related debt while the other assets are amortized over their expected periods of benefit, where applicable. Loan acquisition costs were fully amortized in 1999. The preoperational new service area and new product costs were amortized over their expected period of benefit up to eight years. Effective April 1, 1997, the Company adopted a one-year period for amortization of new service area and new product costs. $2.7 million of expense was included in selling, general and administrative expense due to this change. These costs were fully amortized at December 31, 1997. Accumulated amortization of other assets was approximately $3.5 million and $3.4 million at December 31, 1999 and 1998, respectively.

Medical Claims Liabilities—Medical claims liabilities consist of actual claims reported but not paid and estimates of health care services incurred but not reported. The estimated claims incurred but not reported are based on historical data, current enrollment, health service utilization statistics, and other related information. Although considerable variability is inherent in such estimates, management believes that the liability is adequate. The Company also establishes reserves, if required, for the probability that anticipated future health care costs and contract maintenance costs under the group of existing contracts will exceed anticipated future premiums and reinsurance recoveries on those contracts. These accruals are continually monitored and reviewed, and as settlements are made or accruals adjusted, differences are reflected in current operations. Changes in assumptions for medical costs caused by changes in actual experience could cause these estimates to change in the near term.

Revenue Recognition—Managed care premiums are recorded as revenue in the month in which members are entitled to service. Premiums collected in advance are recorded as deferred revenue. Employer contracts are typically on an annual basis, subject to cancellation by the employer group or the Company upon thirty days written notice. Management services revenues are recognized in the period in which the related services are performed. Premiums for services to federal employee groups are subject to audit and review by the Office of Personnel Management ("OPM") on a periodic basis. Such audits are usually a number of years in arrears. The Company provides reserves, on an estimated basis annually, based on the appropriate guidelines. Any differences between actual results and estimates are recorded in the year the audits are finalized.

Significant Customers—For the years ended 1999, 1998, and 1997, the Company received 16.0%, 15.2%, and 14.0%, respectively, of its revenue from the Federal Medicare program throughout the Company's various markets.

Reinsurance—Premiums paid to reinsurers are reported as health benefits expense and the related reinsurance recoveries are reported as deductions from health benefits expense.

Income Taxes—The Company files a consolidated tax return for the Company and its wholly owned consolidated subsidiaries. The Company accounts for income taxes in accordance with Statement of Financial Accounting Standards No. 109 ("SFAS 109"). The deferred tax assets and/or liabilities are determined by multiplying the differences between the financial reporting and tax reporting bases for assets and liabilities by the enacted tax rates expected to be in effect when such differences are recovered or settled. The effect on deferred taxes of a change in tax rates is recognized in income in the period that includes the enactment date. See Note I for disclosures related to income taxes.

Minority Interest—For 1997, the minority interest represents a joint venture interest of 51% in Pennsylvania HealthMate, Inc. ("HealthMate").

Stock-based Compensation—The Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 123 ("SFAS 123"), "Accounting for Stock-Based Compensation." As permitted by SFAS 123, the Company has elected to continue to account for stock-based compensation to employees under APB Opinion No. 25, and complies with the disclosure requirements for SFAS 123. See Note L for disclosures related to stock-based compensation.

Earnings per Share—In the fourth quarter of 1997, the Company adopted Statement of Financial Accounting Standards No. 128 ("SFAS 128"), "Earnings per Share." SFAS 128 establishes new standards for computing and presenting earnings per share ("EPS"), replacing primary EPS with "basic EPS." Basic EPS excludes dilution and is computed by dividing income available to common stockholders by the weighted-average number of common shares outstanding for the period. The adoption of SFAS 128 did not have a material effect on the Company's earnings per share. All prior periods were previously restated to comply with SFAS 128. See Note S for calculation of EPS.

Comprehensive Earnings—Effective January 1, 1998, the Company adopted Statement of Financial Accounting Standards No. 130 ("SFAS 130"), "Reporting Comprehensive Income." SFAS 130 requires that changes in the amounts of certain items, including unrealized gains and losses on certain securities, be shown in the financial statements as part of comprehensive earnings. The adoption of this standard did not have a material effect on the Company's consolidated financial statements.

Segment reporting—Effective December 31, 1998, the Company adopted Statement of Financial Accounting Standards No. 131 ("SFAS 131"), "Disclosures about Segments of an Enterprise and Related Information." This standard requires that a public business enterprise report financial and descriptive information about its reportable operating segments. Operating segments are components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. SFAS 131 also requires that all public business enterprises report information about the revenues derived from the enterprise's products or services (or groups of similar products and services), about the countries in which the enterprise earns revenues and holds assets and about major customers regardless of whether that information is used in making operating decisions. The Company has two reportable segments: Commercial products and Government products. The products are provided to a cross section of employer groups through the Company's health plans in the Midwest, Mid-Atlantic, and Southeastern United States.

Commercial products include HMO, PPO, and POS products. HMO products provide comprehensive health care benefits to enrollees through a primary care physician. PPO and POS products permit members to participate in managed care but allow them the flexibility to utilize out of network providers in exchange for an increase in out-of-pocket costs to the member.

Governmental products include Medicare Risk, Medicare Cost, and Medicaid. The Company provides comprehensive health benefits to members participating in government programs and receives premium payments from federal and state governments. The Company evaluates the performance of its operating segments and allocates resources based on gross margin. Assets are not allocated to specific products and, accordingly, cannot be reported by segment. See Note U for disclosures on segment reporting.

Derivative Instruments—In June 1998, the FASB issued Statement of Financial Accounting Standards No. 133 (“SFAS 133”), “Accounting for Derivative Instruments and Hedging Activities.” SFAS 133 requires companies to record derivatives on the balance sheet as assets or liabilities, measured at fair value. Gains or losses resulting from changes in the values of the derivatives would be accounted for depending on the use of the derivatives and whether they qualify for hedge accounting. In June 1999, the FASB also issued Statement of Financial Accounting Standards No. 137 (“SFAS 137”), which defers the effective date of SFAS 133 until fiscal years beginning after June 15, 2000. The Company does not believe that adoption of SFAS 133 (as amended by SFAS 137) will have a material effect on its future results of operations.

Computer Software—Effective January 1, 1999, the Company adopted Statement of Position 98-1 (“SOP 98-1”), “Accounting for the Cost of Computer Software Developed or Obtained for Internal Use” issued by the American Institute of Certified Public Accountants (“AICPA”). SOP 98-1 provides authoritative guidance for the capitalization of certain costs related to computer software developed or obtained for internal applications, such as external direct costs of materials and services, payroll costs for employees and certain interest costs. Costs incurred during the preliminary project stage, as well as training and data conversion costs, are to be expensed as incurred. The adoption of SOP 98-1 did not have a material effect on the Company’s consolidated financial statements.

Reclassifications—Certain 1997 and 1998 amounts have been reclassified to conform to the 1999 presentation.

B. PHC ACQUISITIONS AND DISPOSITIONS

Effective April 1, 1998, the Company completed its acquisition of certain PHC health plans from Principal Life for a total purchase price of approximately $330.2 million including transaction costs of approximately $5.7 million. The acquisition was accounted for using the purchase method of accounting and, accordingly, the operating results of PHC have been included in the Company’s consolidated financial statements since the date of acquisition. The purchase price consisted of 25,043,704 shares of the Company’s common stock at an assigned value of $11.96 per share. In addition, a warrant valued at $25.0 million (“the Warrant”) was issued that grants Principal Life the right to acquire additional shares of the Company’s common stock in the event that its ownership percentage of such common stock is diluted below 40%. The Warrant is included as a component of additional paid-in capital in the accompanying consolidated financial statements. Through April 2003, Principal Life is restricted from buying additional shares of the Company’s common stock to increase its ownership percentage above 40%.

Coincident with the closing of the transaction, the Company entered into a Renewal Rights Agreement and a Coinsurance Agreement with Principal Life, to manage certain of Principal Life’s indemnity health insurance policies in the markets where the Company does business and, on December 31, 1999, to offer to renew such policies in force at that time. Effective June 1, 1999, the Company amended these agreements with Principal Life and waived its rights to reinsure and renew Principal Life’s health insurance indemnity business located in the Company’s service area. The Company received $19.8 million in cash in exchange for waiving these rights. At the date of the amendment, the Renewal Rights and Coinsurance Agreements had a net book value of $19.7 million resulting in an after tax gain of $0.1 million.

At the closing, the Company also entered into a Marketing Services Agreement and a Management Services Agreement with Principal Life. Both agreements expired on December 31, 1999. Pursuant to the agreements, the Company recognized revenue of approximately $25.5 million and $23.0 million for the years ended December 31, 1999 and 1998, respectively.

As a result of the acquisition, the Company assumed an agreement with Principal Life, whereby Principal Life paid a fee for access to the Company's PPO network based on a fixed rate per employee entitled to access the PPO network and a percentage of savings realized by Principal Life. Effective June 1, 1999, Coventry sold the Illinois portion of the PPO network back to Principal Life. Under this agreement the Company recognized revenue of approximately $8.0 million and $12.0 million for the years ended December 31, 1999 and 1998, respectively.

Effective November 30, 1998, the Company sold its subsidiary, Principal Health Care of Illinois, Inc., for $4.3 million in cash. The Illinois health plan accounted for approximately 56,000 risk members and approximately 2,400 non-risk members as of November 30, 1998.

On December 31, 1998, the Company sold its subsidiary, Principal Health Care of Florida, Inc., for $95.0 million in cash. The Florida health plan accounted for approximately 156,000 risk members and approximately 5,500 non-risk members as of December 31, 1998.

The proceeds from both sales were used to retire the Company's credit facility, to assist in improving the capital position of its regulated subsidiaries, and for other general corporate purposes. Given the short time period between the respective acquisition and sale dates and the lack of events or other evidence which would indicate differing values, no gain or loss was recognized on the sales of the Florida and Illinois health plans, as the sale prices were considered by management to be equivalent to the fair values allocable to these plans at the date of their acquisition from Principal Life in April 1998.

In connection with the acquisition of certain PHC health plans and the sales of the Florida and Illinois plans, the Company established reserves of approximately $33.0 million for the estimated transition costs of the PHC health plans. These reserves are primarily comprised of severance costs related to involuntary terminations of former PHC employees, relocation costs of former PHC personnel, lease termination costs and contract termination costs. Through December 31, 1999, the Company has expended approximately $29.7 million related to these reserves and expects to make payments on the remaining reserves through July 2002.

In the fourth quarter of 1999, the Company notified the Indiana Department of Insurance of its intention to close its subsidiary, Coventry Health Care of Indiana, Inc. As of December 31, 1999, the health plan had approximately 23,000 members throughout the state. As a result of the cost associated with exiting the Indiana market, the Company recorded a reserve of $2.0 million in the fourth quarter of 1999. The Company plans to close the health plan by the end of the fourth quarter 2000 and has expended approximately $0.4 million as of December 31, 1999.

The purchase price for certain of the PHC plans, was allocated to the assets, including the identifiable intangible assets, and liabilities based on estimated fair values. The $174.0 million excess of purchase price over the net identified tangible assets acquired was allocated to identifiable intangible assets and goodwill. The allocated amounts, net of the Florida and Illinois health plans and net of the impact of waiving the Renewal Rights and Coinsurance Agreements and the expiration of The Marketing Services Agreement, Management Services Agreement and PPO access agreement, and their related useful lives are as follows:

Description	**Amount (in thousands)**	**Estimated Useful Life**
Customer Lists	7,233	5 years
HMO Licenses	10,000	20 years
Goodwill	156,795	35 years
Total	$174,028	

The following unaudited pro-forma condensed consolidated results of operations assumes the PHC acquisition and the sales of the Florida and Illinois health plans occurred on January 1, 1998 and 1997 and excludes the non-recurring charge to merger costs of $6.5 million, see Note F:

	December 31, 1998 (unaudited)	**December 31, 1997 (unaudited)**
Operating revenues	$2,021,580	$1,875,411
Net loss	(32,165)	(22,694)
Loss per share, basic	(0.55)	(0.39)

(in thousands, except per share data)

C. OTHER ACQUISTIONS

Effective October 1, 1999, the Company acquired Carelink Health Plans ("Carelink"), the managed care subsidiary of Camcare, Inc., for a total purchase price of approximately $8.3 million including transaction costs of approximately $0.3 million. The acquisition was accounted for using the purchase method of accounting, and, accordingly, the operating results of Carelink have been included in the Company's consolidated financial statements since the date of the acquisition. The purchase price for Carelink was allocated to the assets, including the identifiable intangible assets, and liabilities based on estimated fair values. The $4.7 million excess of purchase price over the net identified tangible assets acquired was allocated to goodwill which is amortized over a useful life of 25 years. The final purchase price may be adjusted subject to the results of the final determination of the balance sheet of Carelink as of October 1, 1999.

On November 1, 1999, the Company's subsidiary, Coventry Health Care of the Carolinas, Inc., acquired Kaiser Foundation Health Plan of North Carolina's ("KFHPNC") commercial membership in Charlotte, North Carolina. The total purchase price was approximately $1.8 million including transaction costs.

D. MEDICAL OFFICE DISPOSITIONS

Effective March 31, 1997, the Company completed its sale of the medical offices associated with HealthAmerica Pennsylvania, Inc., ("Health America"), in Pittsburgh, Pennsylvania, to a major health care provider organization. The sales price was $20.0 million resulting in a pretax gain of approximately $6.0 million. Coincident with the sale, the Company entered into a long-term global capitation agreement with the purchaser which increased the globally capitated membership in western Pennsylvania to approximately 250,000 members. Under the agreement, the provider organization receives a fixed percentage of premiums to cover all of the medical treatment the globally capitated members receive. The provider organization filed for bankruptcy protection on July 21, 1998 and, as a result, the Company is no longer operating under this agreement. See Note E for AHERF Charge.

Effective May 1, 1997, the Company completed its sale of the medical offices associated with GHP, its health plan in St. Louis, Missouri, to a major health care provider organization. The sales price was $26.9 million resulting in a pretax gain of approximately $9.6 million. Coincident with the sale, the Company entered into a long-term global capitation agreement with the purchaser covering approximately 83,000 members, pursuant to which the provider organization receives a fixed percentage of premiums to cover all of the medical treatment the globally capitated members receive.

In August 1997, the Company entered into agreements to sell certain remaining medical offices associated with HealthAmerica, in Harrisburg, Pennsylvania. The sales price was $2.4 million and the transaction resulted in a pretax loss of $0.6 million. All gains or losses resulting from medical office sales are reflected in other income, net in the accompanying Consolidated Statement of Operations for the year ended December 31, 1997.

E. AHERF CHARGE

The Company and certain affiliated hospitals of Allegheny Health, Education and Research Foundation ("AHERF") were involved in litigation to determine if the Company had the financial responsibility for medical services provided to the Company's members by the hospitals as a consequence of the bankruptcy filed by AHERF on July 21, 1998. As a result of the bankruptcy, AHERF failed to pay for medical services under its global capitation agreement with the Company covering approximately 250,000 Company members in the western Pennsylvania market.

Shortly after AHERF filed for bankruptcy protection, the Company filed a lawsuit against AHERF's non-debtor, affiliated hospitals seeking a declaratory judgment that the Company was not obligated to pay in excess of $21.5 million to the hospitals for medical services provided by them to the Company's members. The lawsuit also included additional claims for monetary damages. In response, the hospitals filed a counter-claim alleging that the Company's subsidiary, HealthAmerica Pennsylvania, Inc., was liable to the hospitals for payment of these medical services.

As a result, the Company, which is ultimately responsible for medical costs delivered to its members, notwithstanding the global capitation agreement, recorded a charge of $55.0 million in the second quarter of 1998 to establish a reserve for, among other things, the medical costs incurred by its members under the AHERF global capitation agreement at the time of the bankruptcy filing.

On July 22, 1999, the Company reached a settlement with the hospitals, including Allegheny General Hospital, formerly owned by AHERF, and its new owner, Western Pennsylvania Health Care System ("West Penn"), whereby the hospitals agreed that the Company would not be liable for the payment of the certain medical services rendered by the hospitals to the Company's members prior to July 21, 1998, the date of AHERF's bankruptcy filing. Simultaneous with the settlement, the Company signed a new three-year provider contract with West Penn. The conditions to execute the settlement and the provider contract were finalized in October 1999 and, as a result, all liability issues surrounding AHERF's failure to fulfill its contractual obligations and the Company's remaining obligations have been determined and all AHERF-related litigation has been concluded.

As of December 31, 1999, approximately $35.4 million of the $55.0 million reserve had been paid for medical claims. As a result of the settlement, the Company released $6.3 million of the reserve, which was reflected as a gain in the fourth quarter and year-end 1999 results. The balance of the reserve represents the Company's remaining obligations under the settlement and will be expended through August 2007.

F. MERGER COSTS

In connection with the acquisition of the PHC health plans, the Company relocated its corporate headquarters from Nashville, Tennessee to Bethesda, Maryland. As a result, the Company established a one-time reserve in 1998 of approximately $6.5 million for the incurred and anticipated costs related to the relocation of the corporate office and other direct merger related costs. The reserve is primarily comprised of severance costs related to involuntary terminations, relocation costs for management personnel, and lease costs, net of sublease income, related to the unused space remaining at the old headquarters location. As of December 31, 1999, the Company expended approximately $6.0 million and expects to make payments through March 2003 related to these charges.

G. PROPERTY AND EQUIPMENT

Property and equipment is comprised of the following (in thousands):

	December 31, 1999	December 31, 1998
Land	$350	$481
Buildings and leasehold improvements	14,310	11,922
Equipment	62,567	54,313
	77,227	66,716
Less accumulated depreciation and amortization	(39,364)	(30,936)
Property and equipment, net	$37,863	$35,780

Depreciation expense for the years ended December 31, 1999, 1998, and 1997 was approximately $13.6 million, $12.2 million, and $8.9 million, respectively.

H. INVESTMENTS IN DEBT SECURITIES

The Company considers all of its investments as available-for-sale securities and, accordingly, records unrealized gains and losses, as other comprehensive earnings, in the stockholders' equity section of its consolidated balance sheets. As of December 31, 1999 and 1998, stockholders' equity was decreased by approximately $5.9 million and increased by $0.3 million, respectively, netted by a deferred tax benefit of approximately $2.3 million and deferred tax cost of $0.1 million, respectively, to reflect the net unrealized investment loss/gain on securities.

The amortized cost, gross unrealized gain or loss and estimated fair value of short-term and long-term investments by security type were as follows at December 31, 1999 and 1998 (in thousands):

1999	Amortized Cost	Unrealized Gain	Unrealized Loss	Fair Value
State and municipal bonds	$107,821	$97	$(1,369)	$106,549
Asset-backed securities	16,383	6	(172)	16,217
Mortgage-backed securities	63,577	424	(1,021)	62,980
US Treasury & agencies securities	34,046	23	(1,148)	32,921
Other debt securities	157,257	128	(1,525)	155,860
	$379,084	$678	$(5,235)	$374,527

1998	Amortized Cost	Unrealized Gain	Unrealized Loss	Fair Value
State and municipal bonds	$55,355	$548	$(290)	$55,613
Asset-backed securities	10,728	71	(174)	10,625
Mortgage-backed securities	50,626	455	(141)	50,940
US Treasury & agencies securities	51,246	661	(316)	51,591
Other debt securities	40,003	529	(41)	40,491
	$207,958	$2,264	$(962)	$209,260

The amortized cost and estimated fair value of short-term and long-term investments by contractual maturity were as follows at December 31, 1999 and December 31, 1998 (in thousands):

1999	Amortized Cost	Fair Value
Maturities:		
Within 1 year	$102,126	$102,045
1 to 5 years	114,850	113,517
6 to 10 years	68,382	66,373
Over 10 years	93,726	92,592
Total short-term and long-term securities	$379,084	$374,527

1998	Amortized Cost	Fair Value
Maturities:		
Within 1 year	$50,773	$50,416
1 to 5 years	57,362	57,949
6 to 10 years	29,382	29,423
Over 10 years	70,441	71,472
Total short-term and long-term securities	$207,958	$209,260

Proceeds from the sale and maturities of investments were approximately $253.5 million and $122.9 million for the years ended December 31, 1999 and 1998, respectively. Gross investment gains of approximately $1.0 million and gross investment losses of approximately $1.2 million were realized on these sales for the year ended December 31, 1999 compared to gross investment gains of approximately $0.9 million and no gross investment losses on these sales for the year ended December 31, 1998.

I. INCOME TAXES

The provision (benefit) for income taxes consists of the following (in thousands):

	Year Ended December 31,		
	1999	**1998**	**1997**
Current provision:			
Federal	$15,606	$12,907	$16,439
State	2,921	763	3,684
Deferred provision (benefit):			
Federal	11,092	(14,695)	(9,943)
State	2,946	(4,744)	(1,758)
	$32,565	$(5,769)	$8,422

The expected tax provision based on the statutory rate of 35% differs from the Company's effective tax rate as a result of the following:

	Year Ended December 31,		
	1999	**1998**	**1997**
Statutory federal tax rate	35.00%	(35.00%)	35.00%
Effect of:			
State income taxes, net of federal benefit	4.00%	(4.04%)	6.15%
Amortization of goodwill	4.72%	18.60%	5.98%
Tax exempt interest income	(1.51%)	(13.77%)	(5.54%)
Other	0.64%	1.27%	(0.19%)
Income tax provision (benefit)	42.85%	(32.94%)	41.40%

The effect of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 1999 and 1998 are presented below (in thousands):

	December 31,1999	December 31,1998
Deferred tax assets:		
Deferred revenue	$3,005	$2,804
Medical liabilities	4,748	5,799
Accounts receivable	4,749	7,921
Deferred compensation	4,525	4,211
Other accrued liabilities	3,254	6,487
Other assets	8,363	8,419
Contingent liabilities	29,289	31,173
Net operating loss carry forward	3,769	3,769
Gross deferred tax assets	61,702	70,583
Less valuation allowance	(3,252)	(3,252)
Deferred tax asset	58,450	67,331
Deferred tax liabilities:		
Property and equipment	(5,000)	(982)
Intangibles	(2,650)	(12,562)
Other	-	(508)
Gross deferred tax liabilities	(7,650)	(14,052)
Net deferred tax asset	$50,800	$53,279

The valuation allowance for deferred tax assets as of December 31, 1999 and 1998 is $3.3 million due to the Company's belief that the realization of the deferred tax asset resulting from federal and state net operating loss carry forwards associated with certain acquisitions is doubtful.

J. CONVERTIBLE EXCHANGEABLE SUBORDINATED NOTES AND REDEEMABLE CONVERTIBLE PREFERRED STOCK

During the quarter ended June 30, 1997, the Company entered into a securities purchase agreement ("Warburg Agreement") with Warburg, Pincus Ventures, L.P. ("Warburg") and Franklin Capital Associates III, L.P. ("Franklin") for the purchase of $40 million of the Company's 8.3% Convertible Exchangeable Senior Subordinated Notes ("Coventry Notes"), together with warrants to purchase 2.35 million shares of the Company's common stock for $42.35 million. The original amount of the Coventry Notes, $36.0 million held by Warburg and $4.0 million held by Franklin, were exchangeable at the Company's or Warburg's option for shares of redeemable convertible preferred stock.

During the second and third quarters of 1999, the Company converted all Coventry Notes held by Warburg and Franklin totaling $47.1 million, including interest, into 4,709,545 shares of Series A redeemable convertible preferred stock ("preferred stock") at a price of $10 per share. The preferred stock is subject to mandatory redemption at a price of $10 per share, plus accrued dividends, in an amount equal to one-third of the shares outstanding on May 15, 2002, 2003 and 2004. The stock is carried at its fair value, which equals both its redemption value and liquidation value as of December 31, 1999 and will accrue dividends only if the Board of Directors declares dividends on common stock. The dividends (per share) on the preferred stock would be equal to the dividends on the common stock. The preferred stock may be converted at any time at the holders' option into shares of common stock at a conversion price equal to the closing market price of the Company's common stock on the date of conversion, if the closing market price is less than $10 per share. If the closing market price of the Company's common stock is greater than $10 per share, the preferred stock is convertible to common stock on a share for share basis. The preferred stock is callable by the Company if the market price of the Company's common stock exceeds certain agreed upon targets.

K. LONG-TERM DEBT

At December 31, 1998, long-term debt of $781,000, payable to the U. S. Department of Health and Human Services, represented obligations which were assumed in the acquisition of HAPA. Under the terms of the notes, principal was payable in various annual installments through June 30, 2000 with interest payable semi-annually at rates ranging from 7.75% to 9.125%. The notes were secured by certain assets of the Company. These notes were paid in full in May 1999.

Interest expense for the year ended December 31, 1999 was $1.6 million, substantially all of which related to the Coventry Notes.

The fair value of the Company's long-term borrowings is based on quoted market rates. The carrying amount of the Company's borrowings approximates fair value.

L. STOCK OPTIONS, WARRANTS AND EMPLOYEE STOCK PURCHASE PLAN

As of December 31, 1999, the Company had one stock incentive plan, the Amended and Restated 1998 Stock Incentive Plan (the "1998 Plan"), with an aggregate of 7 million shares of common stock authorized for issuance there under to officers, key employees, consultants and directors in the form of stock options, restricted stock and other stock-based awards. At April 1, 1998, the 1998 Plan assumed the obligations of six stock option plans of Coventry Corporation with total outstanding options representing 3,322,714 shares, and one stock option plan of Principal Health Care, Inc. with total outstanding options representing 750,000 shares, as a result of the acquisition of the PHC plans. Under the 1998 Plan, the terms and conditions of grants are established on an individual basis with the exercise price of the options being equal to not less than 100% of the market value of the underlying stock at the date of grant. Options generally become exercisable after one year in 20% to 25% increments per year and expire ten years from the date of grant. The 1998 Plan is authorized to grant either incentive stock options or nonqualified stock options at the discretion of the Compensation and Benefits Committee of the Board of Directors.

As of September 10, 1998, employees of the Company were offered an opportunity to exchange their existing options (issued at a higher exercise price) for a reduced number of new options (issued at a lower exercise price) equivalent to the same value as their existing options, based upon a Black-Scholes equal valuation model. Employees could choose to decline the offer of new options and keep their existing options. As a result, the Company canceled approximately 4,370,100 options, and reissued re-priced options equal to approximately 3,714,182 shares. The options canceled were at exercise prices ranging from a high of $22.750 to a low of $6.3750. The options were reissued in accordance with an exchange formula (using the Black-Scholes equal valuation model) that issued one-half of the new options at an exercise price of the then current market value ($5.00) and the remaining one-half at 150% of the then current market value ($7.50). The resulting value of the repriced options was the same as the exchanged options.

During 1997, the Company adopted the 1997 Stock Incentive Plan (the "1997 Plan"). Under the 1997 Plan, the Company may grant options and other rights with respect to the Company's common stock to officers, other key employees, consultants and outside directors of the Company. A total of 1,600,000 shares of common stock was reserved for this issuance.

The Company follows APB No. 25, under which no compensation cost has been recognized in connection with stock option grants. Had compensation cost for these plans been determined consistent with SFAS 123, the Company's net income and earnings per share would have been reduced to the following pro forma amounts (in thousands, except per share data):

		For the year ended December 31, 1999	1998	1997
Net income (loss):	As Reported	$43,435	$(11,741)	$11,903
	Pro Forma	40,098	(14,224)	8,790
EPS, basic	As Reported	0.74	$(0.22)	$0.36
EPS, diluted	As Reported	0.69	$(0.22)	$0.35
EPS, basic	Pro Forma	0.68	(0.27)	0.26
EPS, diluted	Pro Forma	0.64	(0.27)	0.26

Because the SFAS 123 method of accounting has not been applied to options granted prior to January 1, 1995, the resulting pro forma compensation cost may not be representative of that to be expected in future years.

Transactions with respect to the plans for the three years ended December 31, 1999 were as follows (shares in thousands):

	1999		1998		1997	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at beginning of year	5,441	$8	3,261	$13	2,858	$13
Granted	2,339	9	7,627	8	1,584	$15
Exercised	(344)	9	(110)	12	(166)	$12
Canceled	(1,259)	11	(5,337)	13	(1,015)	$14
Outstanding at end of year	6,177	$8	5,441	$8	3,261	$13
Exercisable at end of year	1,655	$8	837	$11	819	$13

The following table summarizes information about stock options outstanding at December 31, 1999 (shares in thousands):

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	**Number Outstanding at 12/31/99**	**Weighted Average Remaining Contractual Life**	**Weighted Average Exercise Prices**	**Number Exercisable at 12/31/99**	**Weighted Average Exercise Price**
\$5–\$7	2,910	8.6	\$6	752	\$5
\$7–\$8	1,247	7.4	8	530	8
\$8–\$11	1,449	9.4	10	43	9
\$11–\$21	567	7.5	14	326	14
\$21–\$25	4	5.0	25	4	25
\$5–\$25	6,177	8.4	\$8	1,655	\$8

The fair value of the stock options included in the pro forma amounts shown above was estimated as of the grant date using the Black-Scholes option-pricing model with the following weighted-average assumptions:

	1999	1998	1997
Dividend yield	0%	0%	0%
Expected volatility	74%	73%	64%
Risk-free interest rate	6%	5%	6%
Expected life	4 years	4 years	5 years

The weighted-average grant date fair values for options granted in 1999, 1998 and 1997 were \$5.29, \$4.53, and \$8.77, respectively.

At December 31, 1999, the Company had outstanding warrants granting holders the right to purchase 5,690,188 shares of common stock. In July 1995, 100,000 warrants were issued at a price of \$14.125 and expire in July 2000. During the first half of 1996, warrants for 170,000 shares were exercised at a price of \$6.75 per share.

On July 7, 1997, the Company finalized the sale of \$40 million of Coventry Convertible Exchangeable Subordinated Notes, together with warrants to purchase 2,352,941 shares at \$10.625 per share of common stock. The purchase price for the warrants was \$1.00 per share, valued by the Company and the purchaser. The warrants expire seven years from the purchase date.

On April 1, 1998, the Company issued a warrant to PHC (the “Principal Warrant”) to purchase that number of shares of common stock equal to 66-2/3% of the total number of shares of common stock actually issued upon the exercise or conversion of the Company’s employee stock options and warrants issued and outstanding at March 31, 1998, on the same terms and conditions as set forth in the respective options and warrants. The subsequent repricing of outstanding employee stock options on September 10, 1998 (see above) did not affect the Principal Warrant. Options and warrants that terminated or expired and are not exercised, are also canceled in the Principal Warrant. At March 31, 1998, the Company had options and warrants outstanding for 5,800,480 shares of common stock, representing the right to purchase 3,866,986 shares under the Principal Warrant. On May 21, 1999 and November 11, 1999, PHC exercised a portion of the Principal Warrant pursuant to exercises of the underlying options and purchased 1,335 and 10,915 shares of common stock, respectively. At December 31, 1999, the Principal Warrant represented the right to purchase 3,017,183 shares, taking into account exercises and cancellations.

On May 1, 1997, the Company issued warrants to certain providers to purchase a total of 24,825 shares of common stock at an exercise price of \$12.625 per share, expiring in 2002. On May 18, 1998, the Company issued warrants to four individual consultants to purchase a total of 40,000 shares of common stock at an exercise price of \$13.625 per share, expiring in 2003. On October 22, 1998, the Company issued warrants to certain providers to purchase a total of 10,000 shares of common stock at an exercise price of $7.625 per share, expiring in 2003. On December 21, 1998, the Company issued a warrant to an individual in connection with the acquisition of a health plan to purchase 85,239 shares of common stock at an exercise price of $8.32 per share, expiring in 2003. On December 21, 1998, the Company issued a warrant to an individual in connection with legal services to purchase 50,000 shares of common stock at an exercise price of $7.625 per share, expiring in 2009. On April 19, 1999, the Company issued a warrant to an individual in recognition of years served on the Company's Board of Directors to purchase 10,000 shares of common stock at an exercise price of $7.625 per share, expiring in 2004.

The Company implemented an Employee Stock Purchase Plan in 1994, which allows substantially all employees who meet length of service requirements to set aside a portion of their salary for the purchase of the Company's common stock. At the end of each plan year, the Company will issue the stock to participating employees at an issue price equal to 85% of the lower of the stock price at the end of the plan year or the average stock price, as defined. The Company has reserved 1.0 million shares of stock for this plan and has issued 11,416, 15,016, and 7,074, shares in 1999, 1998, and 1997 respectively.

M. REINSURANCE

Throughout 1997, 1998 and the first quarter of 1999, the Company had reinsurance agreements, through its subsidiary CHLIC, with American Continental Insurance Company and Continental Assurance Company for portions of the risk it has underwritten through its products. Beginning in April 1999, the Company entered into new reinsurance agreements with Continental Assurance Company and American Continental Insurance Company with greater coverages. Reinsurance premiums for the years ended December 31, 1999, 1998 and 1997, were approximately $9.9 million, $1.0 million and $0.7 million respectively. Reinsurance recoveries, including amounts receivable, for the same periods were approximately $5.9 million, $0.6 million and $0.4 million.

These reinsurance agreements do not release the Company from its primary obligations to its membership. The Company remains liable to its membership if the reinsurers are unable to meet their contractual obligations under the reinsurance agreements. All reinsurance agreements are subject to certain limits on hospital costs per patient-day. To minimize its exposure to significant losses from reinsurer insolvencies, the Company evaluates the financial condition of its reinsurers on an annual basis. American Continental Insurance Company and Continental Assurance Company are both currently A rated by the A.M. Best Company.

Medicaid risk exposures in Missouri are reinsured through the State of Missouri mandated program. Reinsurance recoveries for the years ended December 31, 1999, 1998 and 1997 were approximately $3.1 million, $2.1 million and $3.6 million, respectively.

N. COMMITMENTS

The Company operates primarily in leased facilities with original lease terms of up to ten years with options for renewal. The Company also leases computer equipment with lease terms of approximately three years. Leases that expire generally are expected to be renewed or replaced by other leases.

The minimum rental commitments payable and minimum sublease rentals to be received by the Company during each of the next five years ending December 31 and thereafter for noncancelable operating leases are as follows (in thousands):

Year	Rental Commitments	Sublease Income
2000	$15,314	$4,491
2001	14,342	4,367
2002	12,727	3,878
2003	9,902	3,252
2004	8,657	3,216
Thereafter	7,795	3,157
	$68,737	$22,361

Total rent expense was approximately $14.5 million, $14.6 million and $8.3 million for the years ended December 31, 1999, 1998 and 1997, respectively.

O. CONCENTRATIONS OF CREDIT RISK

Financial instruments which potentially subject the Company to concentrations of credit risk consist primarily of cash and cash equivalents, investments in marketable securities and accounts receivable. The Company invests its excess cash in interest bearing deposits with major banks, commercial paper, and money market funds. Investments in marketable securities are managed within guidelines established by the Board of Directors which emphasize investment-grade fixed income securities and limit the amount that may be invested in any one issuer. The fair value of the Company's financial instruments is substantially equivalent to their carrying value and, although there is some credit risk associated with these instruments, the Company believes this risk to be minimal.

As discussed in Notes D and E to the consolidated financial statements, the Company entered into long-term global capitation arrangements with two integrated provider organizations. Global capitation agreements limit the Company's exposure to the risk of increasing medical costs, but expose the Company to risk as to the adequacy of the financial and medical care resources of the provider organization. To the extent that the respective provider organization faces financial difficulties or otherwise is unable to perform its obligations under the global capitation agreements, the Company, which is responsible for the coverage of its members pursuant to its customer agreements, will be required to perform such obligations, and may have to incur costs in doing so in excess of the amounts it would otherwise have to pay under the global capitation agreements. To the extent that the Company becomes a party to global capitation agreements with a single provider organization serving substantial membership, the Company becomes exposed to credit risk with respect to such organizations. The Company may utilize the following to manage such risk: 1) contract with providers with significant net worth and cash reserves; 2) require letters of credit or cash to be reserved for claims payment and 3) monitor the providers' financial condition in regard to the Company membership.

Concentration of credit risk with respect to accounts receivable is limited due to the large number of customers comprising the Company's customer base and their breakdown among geographical locations. See Note A for additional information with respect to accounting policies for accounts receivable.

The Company believes the allowance for doubtful collections adequately provides for estimated losses as of December 31, 1999. The Company has a risk of incurring loss if such allowances are not adequate.

As discussed in Note M to consolidated financial statements, the Company has reinsurance agreements with major insurance companies. The Company monitors the insurance companies' financial ratings to determine compliance with standards set by state law. The Company has a credit risk associated with these reinsurance agreements to the extent the reinsurers are unable to pay valid reinsurance claims of the Company.

P. BENEFIT PLANS

On July 1, 1994, Coventry Corporation adopted an employee defined contribution retirement plan qualifying under IRC Section 401(k), the Coventry Corporation Retirement Savings Plan (the "Plan"), which covered substantially all employees of Coventry Corporation and its subsidiaries who meet certain requirements as to age and length of service and who elect to participate in the Plan. Similar retirement savings plans offered by (1) both HAPA and GHP and (2) both Coventry Healthcare Management Corporation ("CHMC") and HCUSA were merged into the Plan effective July 1, 1994 and January 1, 1996, respectively. Effective March 31, 1998, the Company was formed as the parent company of an affiliated group of companies that includes Coventry Corporation. The Company, with the approval of Coventry Corporation, adopted and became sponsor of the Plan effective April 1, 1998. On April 1, 1998, the Coventry Health Care, Inc. Retirement Savings Plan (the "New Plan") was adopted and any prior PHC and certain affiliated participant account balances included in the assets of the former PHC qualified retirement plan were rolled over into the New Plan at the election of the former PHC employees. Effective October 1, 1998, the Plan was merged with the New Plan. All employees that were participants under the Plan became participants in the New Plan. On October 1, 1998, the assets of the Plan were merged and transferred to: (1) Principal Life Insurance Company, as funding agent of the assets held under the terms of the Flexible Investment Annuity Contract with Coventry Health Care, Inc., (2) Delaware Charter Guarantee and Trust Company, as custodial trustee of the mutual funds and (3) Bankers Trust Company, as custodial trustee of the New Plan's participant loans and the Coventry Health Care, Inc. Common Stock. Effective October 1, 1999, pursuant to the merger of Coventry Health Plan of West Virginia, Inc. (CHC-WV), a wholly-owned subsidiary of the Company, and Carelink Health Plans, Inc. (Carelink) whereby Carelink was the surviving entity, Carelink became an adopting employer of the New Plan.

Prior to 1998, under the Plan, participants were able to defer up to 15% of their compensation, limited by the maximum compensation deferral amount permitted by applicable law. The Company made matching contributions equal to 100% of the participant's contribution on the first 3% of the participant's compensation deferral and equal to 50% of the participant's contribution on the second 3% of the participant's compensation deferral. Prior to 1998, participants vested in the Company's matching contributions in 20% increments annually over a period of 5 years, based on length of service with the Company and/or its subsidiaries. Effective January 1, 1998, under the Plan and the New Plan, participants may defer up to 15% of their compensation, limited by the maximum compensation deferral amount permitted by applicable law. The Company makes matching contributions in the Company's common stock equal to 100% of the participant's contribution on the first 3% of the participant's compensation deferral and equal to 50% of the participant's contribution on the second 3% of the participant's compensation deferral. Participants will vest in the Company's matching contributions in 50% increments annually over a period of 2 years, based on length of service with the Company and/or its subsidiaries. All costs of the Plan and the New Plan are funded by the Company and participants as they are incurred.

On July 1, 1994, Coventry Corporation adopted a supplemental executive retirement plan (the "SERP"), which covered employees of Coventry Corporation and its subsidiaries who (1) meet certain requirements as to age and management responsibilities and/or salary, (2) are designated as being eligible to participate in the SERP by the Compensation and Benefits Committee of the Board of Directors of the Company, and (3) elect to participate in the SERP and the Plan. A similar supplemental executive retirement plan offered by HAPA was merged into the SERP effective July 1, 1994. The Company, with the approval of Coventry Corporation, adopted and became sponsor of the SERP effective April 1, 1998. Effective April 1, 1998, the SERP Plan name changed to the Coventry Health Care, Inc. Supplemental Executive Retirement Plan. Under the SERP, participants may defer up to 15% of their base salary, and up to 100% of any bonus awarded, over and beyond the compensation deferral limits of the Plan. Effective January 1, 1999, the Company amended the SERP's definition of compensation to exclude income or proceeds from the Company's Stock Incentive Plan and relocation payments. The Company makes matching contributions equal to 100% of the participant's contribution on the first 3% of the participant's compensation deferral and 50% of the participant's contribution on the second 3% of the participant's compensation deferral. Prior to January 1, 1998, participants vested in the Company's matching contributions in 20% increments annually over a period of 5 years, based on length of service with the Company and/or its subsidiaries. Effective January 1, 1998, participants vest in the Company's matching contributions ratably over two years, based on length of service. All costs of the SERP are funded by the Company as they are incurred.

The cost, principally employer matching contributions, of the benefit plans charged to operations for 1999, 1998 and 1997 was approximately $3.6 million, $4.0 million and $1.8 million, respectively.

Q. STATUTORY INFORMATION

The Company's HMO subsidiaries are required by the respective domicile states to maintain minimum statutory capital and surplus in aggregate of approximately $80.7 million at December 31, 1999. Combined statutory capital and surplus of the Company's HMOs was approximately $159.8 million. The states in which the Company's HMOs operate require HMOs to maintain deposits with the Department of Insurance. These deposits totaled $24.8 million at December 31, 1999.

The National Association of Insurance Commissioners has proposed that states adopt risk-free capital standards that, if implemented, would generally require higher minimum capitalization limits for health care coverage provided by HMOs and other risk-bearing health care entities. To date, no state where Coventry has HMO operations has adopted those standards.

CHLIC's authorized control level risk-based capital is approximately $11.8 million. Total adjusted statutory capital and surplus of CHLIC as of December 31, 1999 was approximately $38.6 million. Statutory deposits for CHLIC as of December 31, 1999 totaled approximately $3.5 million.

R. OTHER INCOME

Other income for the years ended December 31, 1999, 1998, and 1997 includes investment income of approximately $30.3 million, $25.5 million, and $10.8 million, respectively. As described in Note D, other income includes $15.0 million in 1997 from the sale of medical offices.

S. EARNINGS PER SHARE

Basic earnings per share ("EPS") is based on the weighted average number of common shares outstanding during the year. Diluted EPS, when applicable, assumes the conversion of convertible notes and the exercise of all options, warrants and redeemable convertible preferred stock using the treasury stock method. Net earnings is increased for the assumed elimination of interest expense on the convertible notes. In all cases, however, losses are not diluted.

The following table summarizes the earnings and the average number of common shares used in the calculation of basic and diluted EPS (in thousands, except for per share amounts):

	1999		
	Earnings (Numerator)	**Shares (Denominator)**	**Per Share Amount**
Basic EPS	$43,435	59,025	$ 0.74
Effect of Dilutive Securities			
Options and warrants		498	
Convertible notes		2,997	
Redeemable convertible preferred stock		1,639	
Interest on convertible notes	$848		
Diluted EPS	$44,283	64,159	$0.69

	1998		
	Loss (Numerator)	**Shares (Denominator)**	**Per Share Amount**
Basic EPS	$(11,741)	52,477	$(0.22)
Effect of Dilutive Securities			
Options and warrants			
Convertible notes			
Diluted EPS	$(11,741)	52,477	$(0.22)

	1997		
	Earnings (Numerator)	**Shares (Denominator)**	**Per Share Amount**
Basic EPS	$11,903	33,210	$0.36
Effect of Dilutive Securities			
Options and warrants		702	
Convertible notes			
Diluted EPS	$11,903	33,912	$0.35

T. LEGAL PROCEEDINGS

In the normal course of business, the Company has been named as a defendant in various legal actions seeking payments for claims denied by the Company, medical malpractice, and other monetary damages. The claims are in various stages of proceedings and some may ultimately be brought to trial. Incidents occurring through December 31, 1999 may result in the assertion of additional claims. With respect to medical malpractice, the Company carries professional malpractice and general liability insurance for each of its operations on a claims made basis with varying deductibles for which the Company maintains reserves. In the opinion of management, the outcome of these actions should not have a material adverse effect on the financial position or results of operations of the Company.

Other managed care companies have been sued recently in class action lawsuits claiming violations of the federal racketeering act (RICO) and federal employee benefits law (ERISA), and generally claiming that managed care companies overcharge consumers and misrepresent that they deliver quality health care. Although it is possible that the Company may be the target of a similar suit, the Company believes there is no valid basis for such a suit.

The Company's industry is heavily regulated and the laws and rules governing the industry and interpretations of those laws and rules are subject to frequent change. Existing or future laws could have significant impact on the Company's operations.

Unity Arbitration. GHP, a health plan subsidiary of the Company, entered into an agreement, effective January 1, 1998, with Unity Health Network, L.L.C. ("Unity") for Unity's provider network to provide health care services to GHP's members in the southern and western areas of St. Louis County, Missouri. The agreement contained risk sharing provisions. Disputes arose under the agreement and the matter was submitted to arbitration before the American Arbitration Association ("AAA"). GHP demanded payment from Unity of $7.6 million and specific performance under the agreement. Unity demanded payment from GHP of $14.5 million, specific performance of certain provisions of the agreement and suspension of its payment obligations. On December 23, 1999, the AAA tribunal of arbitrators awarded GHP the sum of $1.1 million for deficiencies in risk fund pools for 1998 and awarded Unity the sum of $1.8 million as liquidated damages for GHP's failure to meet certain administrative performance standards, and held Unity contractually liable for funding any deficits in the risk fund pools for 1999. The only remaining issue pending is the readjudication of certain disputed claims submitted subsequent to June 30, 1999.

BJC. Effective May 1, 1997, the Company completed its sale of the medical offices associated with Group Health Plan, Inc., its health plan in St. Louis, Missouri, to BJC Health System ("BJC"), a major provider organization in the St. Louis market, for approximately $26.9 million. Upon the sale, the Company entered into a long-term global capitation agreement with BJC, since amended, that covered approximately 33.3% of the risk membership in St. Louis at December 31, 1998. Under the agreement, BJC receives a fixed percentage of premium to cover all of the medical treatment received by the globally capitated members. Various disputes alleging breaches have arisen under the BJC global capitation agreement concerning the accuracy and timeliness of claims payments, and the accuracy of membership reconciliations that would affect the amount of premiums paid to BJC to provide its services under the agreement. BJC contends that these alleged breaches entitles it to terminate the agreement. Although the parties are obligated to arbitrate their disputes under the terms of the agreement, the parties have agreed to attempt to negotiate a resolution of the various issues while concurrently proceeding with arbitration. While the Company acknowledges certain claims payment inaccuracies, the Company denies the remaining allegations and vigorously disputes that any such claims constitute a material breach of the agreement. Management does not believe that the outcome of these disputes will have a material impact on the consolidated financial statements, although there can be no assurance in this regard.

U. SEGMENT INFORMATION

	For the Year Ended December 31, 1999 (in $000s)		
	Commercial	Government Programs	Total
Revenues	$1,541,786	540,289	2,082,075
Gross Margin	235,084	60,621	295,705

	For the Year Ended December 31, 1998 (in $000s)		
	Commercial	Government Programs	Total
Revenues	$1,561,640	471,732	2,033,372
Gross Margin	165,299	45,699	210,998

	For the Year Ended December 31, 1997 (in $000s)		
	Commercial	Government Programs	Total
Revenues	$886,237	321,912	1,208,149
Gross Margin	132,340	35,949	168,289

Following are reconciliations of reportable segment information to financial statement amounts:

	For the Years Ended December 31,		
	1999	1998	1997
Revenues			
Reportable Segments	$2,082,075	$2,033,372	$1,208,149
Management services	80,297	77,011	20,202
Total revenues	$2,162,372	$2,110,383	$1,228,351
Earnings (Loss) Before Income Taxes:			
Gross margin from reportable segments	$295,705	$210,998	$168,289
Management services	80,297	77,011	20,202
Selling, general and administrative	(299,942)	(291,919)	(170,017)
Depreciation and amortization	(28,205)	(25,793)	(12,735)
Merger costs	-	(6,492)	-
Other income, net	29,906	27,251	24,880
Interest expense	(1,761)	(8,566)	(10,275)
Earnings (loss) before income taxes and minority interest	$76,000	$(17,510)	$20,344

V. QUARTERLY FINANCIAL DATA (unaudited)

The following is a summary of unaudited quarterly results of operations (in thousands, except per share data) for the years ended December 31, 1999 and 1998.

	Quarter Ended			
	March 31, 1999	June 30, 1999	September 30, 1999	December 31, 1999 (1)(2)
Operating revenues	$527,848	$531,831	$529,889	$572,804
Operating earnings	8,683	9,626	11,391	18,155
Net earnings	8,293	9,157	10,970	15,015
Net earnings per share – basic	0.14	0.16	0.19	0.25
Net earnings per share – diluted	0.14	0.15	0.17	0.24

	Quarter Ended			
	March 31, 1998	June 30, 1998 (3)(4)	September 30, 1998	December 31, 1998(5)
Operating revenues	$330,209	$583,804	$593,278	$603,092
Operating earnings (loss)	7,178	(51,238)	2,179	5,686
Net earnings (loss)	4,707	(27,756)	5,068	6,240
Net earnings (loss) per share – basic	0.14	(0.47)	0.09	0.11
Net earnings (loss) per share – diluted	0.13	(0.47)	0.09	0.11

(1) The Company will close its subsidiary, Coventry Health Care of Indiana, Inc., by the end of the fourth quarter 2000. As a result of the cost associated with exiting the Indiana market, the Company recorded a reserve for $2.0 million in the fourth quarter of 1999.

(2) In October 1999, the Company reached a settlement with AHERF. As a result of the settlement, the Company released $6.3 million of its AHERF reserve, which was reflected as a gain in the fourth quarter.

(3) Effective April 1, 1998, the Company completed its acquisition of certain assets of PHC from Principal Life. The acquisition was accounted for using the purchase method of accounting and, accordingly, the operations of PHC have been included in the Company's consolidated financial statements since the date of acquisition. As a result of the merger, an estimated reserve of $7.8 million was established for the costs related to the relocation of the corporate office from Nashville, Tennessee to Bethesda, Maryland and other merger related expenses.

(4) The second quarter 1998 operating results were affected by the establishment of a reserve as a result of the bankruptcy filing by AHERF. The establishment of the reserves resulted in a charge to earnings of $55.0 million.

(5) The merger costs were less than the reserve established in the second quarter of 1998, resulting in a credit to earnings of $1.3 million.

W. SUBSEQUENT EVENTS

Effective February 1, 2000, the Company completed its acquisition of The Anthem Company's West Virginia managed care subsidiary, PrimeONE, Inc. ("PrimeONE"), for the total purchase price of approximately $3.9 million including acquisition costs. The $1.5 million excess of purchase price over the net identifiable tangible assets acquired was allocated to goodwill. PrimeONE has approximately 18,000 commercial members and annual premium revenue of $32.0 million. The acquisition expands the Company's West Virginia service area and brings its total membership in the state to over 109,000 members.

On February 3, 2000, the Company completed the acquisition of Prudential Health Care Plan, Inc.'s 11,800-member Medicaid business in St. Louis, Missouri at approximately $100 per member. The acquisition brings the Company's total Medicaid membership in St. Louis to more than 106,000 members.

Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Directors and Executive Officers of the Registrant.

The information set forth under the captions "Directors and Executive Officers" and "Election of Directors" in the Company's Proxy Statement for its 2000 Annual Meeting of Shareholders, which the Company intends to file within 120 days after its fiscal year-end, is incorporated herein by reference.

Executive Compensation.

The information set forth under the caption "Executive Compensation" in the Company's Proxy Statement for its 2000 Annual Meeting of Shareholders, which the Company intends to file within 120 days after its fiscal year-end, is incorporated herein by reference.

Securities Ownership of Certain Beneficial Owners and Management.

The information set forth under the captions "Executive Compensation," "Voting Stock Outstanding and Shareholders," and "Voting Stock Ownership of Principal Shareholders and Management" in the Company's Proxy Statement for its 2000 Annual Meeting of Shareholders, which the Company intends to file within 120 days after its fiscal year-end, is incorporated by reference herein.

Certain Relationships and Related Transactions.

The information set forth under the caption "Certain Transactions" in the Company's Proxy Statement for its 2000 Annual Meeting of Shareholders, which the Company intends to file within 120 days after its fiscal year-end, is incorporated by reference herein.

DIRECTORS AND OFFICERS

Board of Directors

John H. Austin, M.D.
Chairman of Coventry Health Care
and Chairman and Chief Executive Officer of Arcadian
Management Services.

Allen F. Wise
President and Chief Executive Officer
Coventry Health Care

Thomas L. Blair
Former Chairman and Chief Executive Officer
United Payors and United Providers, Inc.

David J. Drury
Chairman and Chief Executive Officer
Principal Financial Group

Emerson D. Farley, Jr., M.D.
Private Medical Practice

Thomas J. Graf
Executive Vice President
Principal Financial Group

Joel Ackerman
Managing Director
E. M. Warburg, Pincus & Co., LLC

Lawrence N. Kugelman
Former President and Chief Executive Officer
Coventry Corporation

Rodman W. Moorhead, III
Senior Managing Director
E. M. Warburg, Pincus & Co., LLC

Elizabeth E. Tallett
President and Chief Executive Officer
Dioscor, Inc.

Officers

Allen F. Wise
President and Chief Executive Officer

Thomas P. McDonough
Executive Vice President and Chief Operating Officer

Dale B. Wolf
Executive Vice President,
Chief Financial Officer and Treasurer

Harvey C. DeMovick, Jr.
Senior Vice President, Government Programs,
Compliance, Information Systems
and Human Resources

Claudia Bjerre
Senior Vice President of Coventry Health Care
and Chief Executive Officer of HealthCare USA, Inc.

Ronald M. Chaffin
Senior Vice President of Coventry Health Care
and Chief Executive Officer of
Coventry Health Care of Delaware, Inc.

Thomas A. Davis
Senior Vice President of Coventy Health Care
and Chief Executive Officer of Coventry
Health Care of Georgia, Inc.

Davina C. Lane
Senior Vice President of Coventry
Health Care and Chief Executive Officer
of Group Health Plan, Inc.

J. Stewart Lavelle
Senior Vice President and Chief
Marketing and Sales Officer

Bernard J. Mansheim, M.D.
Senior Vice President and Chief Medical Officer

James E. McGarry
Senior Vice President, Customer Service

Shirley R. Smith
Senior Vice President, General Counsel
and Secretary

Francis S. Soistman, Jr.
Senior Vice President of Coventry Health Care
and Chief Executive Officer of HealthAmerica
Pennsylvania, Inc.

Janet M. Stallmeyer
Senior Vice President of Coventry Health Care
and Chief Executive Officer of Coventry
Health Care of Kansas, Inc.

Harry D. Fox
Vice President, Information Systems

Shawn M. Guertin
Vice President, Finance

James R. Hailey
Vice President, Specialty Markets

Jan H. Hodges
Vice President of Coventry Health Care
and Chief Financial Officer of
HealthAmerica Pennsylvania, Inc.

Harvey Pollak
Vice President, Network Development

John J. Ruhlmann
Vice President, Controller

John J. Stelben
Vice President, Business Development

CORPORATE DATA

Notice of Annual Meeting:
The annual meeting of shareholders will be held on June 8, 2000, at 9:30 a.m., Daylight Savings Time, at the offices of Epstein Becker & Green, P.C., 1227 25th Street NW, Washington, DC.

Independent Public Accountants
Arthur Andersen, L.L.P.
Baltimore, MD

Transfer Agent
ChaseMellon Shareholder Services, L.L.C.
P.O. Box 3315
South Hackensack, NJ 07606-1915
(800) 756-3353
www.chasemellon.com

Corporate Counsel
Epstein Becker & Green, P.C.
Washington, DC

Corporate Headquarters
Coventry Health Care, Inc.
6705 Rockledge Drive, Suite 900
Bethesda, MD 20817
(301) 581–0600

Form 10K
Coventry Health Care has filed an Annual Report on Form 10K for the year ended December 31, 1999 with the Securities and Exchange Commission. Shareholders may obtain a copy of this report, without charge, by writing:
Investor Relations Department, Coventry Health Care, 6705 Rockledge Drive, Suite 900, Bethesda, MD 20817

Common Stock
Coventry Health Care common stock is traded on The Nasdaq Stock Market® (National Market) under the symbol “CVTY”. The following tables show the quarterly range of high and low closing prices of the common stock during the calendar year indicated.

	1999		1998	
	High	Low	High	Low
1st Quarter	$11 3/8	$7 1/2	$19 1/4	$12 1/8
2nd Quarter	$14 7/8	$7 1/8	$19 1/8	$12 3/4
3rd Quarter	$11 1/2	$9 1/2	$16	$ 3 7/8
4th Quarter	$ 7 15/16	$5 1/8	$10 1/4	$ 4 5/8

As of March 17, 2000, Coventry Health Care had approximately 487 shareholders of record and approximately 4,500 persons or entities holding common stock in nominee name.

Dividend Policy
Coventry Health Care has not paid a dividend over the past two years. The Company’s ability to pay dividends is restricted as discussed in the Liquidity and Capital Resources section of Management’s Discussion and Analysis of Financial Condition and Results of Operations.

This annual report contains forward–looking information. The forward–looking statements are made paramount to the safe harbor provisions of the Private Securities Legation Reform Act of 1995. Forward–Looking statements may be significantly impacted by certain risks and uncertainties described herein and in the Company’s Annual Report on Form 10–K filed with the Securities and Exchange Commission for the year ended December 31, 1999.

Coventry Health Care, Inc. 6705 Rockledge Drive, Suite 900 Bethesda, MD 20817
www.cvty.com
CHCH 5085/00