Care1st Health Plan

Consolidated Financial Statements and Supplemental Consolidating Information

For the Years Ended December 31, 2013 and 2012

BDO

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BDO

Tel: 714-957-3200
Fax: 714-957-1080
www.bdo.com

3200 Bristol Street, 4th Floor
Costa Mesa, CA 92626

Independent Auditor's Report

The Board of Directors
Care1st Health Plan
Monterey Park, California

We have audited the accompanying consolidated financial statements of Care1st Health Plan and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 2013 and 2012, and the related consolidated statements of income and comprehensive income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Care1st Health Plan and its subsidiaries as of December 31, 2013 and 2012, and the consolidated results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1 to the consolidated financial statements, on January 1, 2013, the Company adopted an update to accounting standards, which permits the Company among other things, to amortize goodwill on a straight-line basis over a period of ten years. Accordingly, the Company's depreciation and amortization charge for the year ended December 31, 2013 includes the impact of this adoption. The adoption of this update to the accounting standards has not been retrospectively applied for the year ended December 31, 2012. Our opinion is not modified with respect to this matter.

BDO USA, LLP

March 31, 2014

Consolidated Financial Statements

Care1st Health Plan

Consolidated Balance Sheets

December 31,	2013	2012
Assets		
Current assets		
Cash and cash equivalents	**$ 156,050,000**	$ 130,363,000
Investments	**19,872,000**	29,360,000
Receivables, net	**82,564,000**	66,966,000
Prepaid expenses and other current assets	**7,695,000**	5,950,000
Income tax receivable	**-**	5,026,000
Deferred tax assets, net	**2,662,000**	1,857,000
Total current assets	**268,843,000**	239,522,000
Fixed assets, net	**28,655,000**	25,241,000
Restricted regulatory deposits	**11,902,000**	6,800,000
Intangible assets, net	**19,959,000**	23,067,000
Goodwill, net	**5,844,000**	6,493,000
Total assets	**$ 335,203,000**	$ 301,123,000

Care1st Health Plan

Consolidated Balance Sheets

December 31,	2013	2012
Liabilities and Stockholders' Equity		
Current liabilities		
Capitation and medical claims payable	$ 141,684,000	$ 117,725,000
Risk-sharing arrangements	7,129,000	2,270,000
Accounts payable	7,862,000	12,719,000
Accrued expenses	10,083,000	8,663,000
Current maturities of long-term debt	600,000	2,300,000
Income tax payable	3,144,000	-
Other current liabilities	11,219,000	16,314,000
Total current liabilities	181,721,000	159,991,000
Long-term debt, less current maturities	6,300,000	6,900,000
Deferred tax liabilities, net	3,892,000	3,843,000
Total liabilities	191,913,000	170,734,000
Commitments and contingencies		
Stockholders' equity		
Preferred stock:		
Series A, nonvoting; no par value; 1,000,000 shares authorized, 46,000 shares issued and outstanding, liquidation preference of $4,551,000	46,000	46,000
Series B, nonvoting; no par value; 1,000,000 shares authorized, 10,000 shares issued and outstanding, liquidation preference of $996,000	10,000	10,000
Common stock:		
Series A, no par value; 1,000,000 shares authorized, 3,000 shares issued and outstanding	3,000	3,000
Series B, no par value; 1,000,000 shares authorized, 3,000 shares issued and outstanding	3,000	3,000
Additional paid-in capital	33,940,000	33,940,000
Stockholder note receivable	(2,000,000)	(2,000,000)
Retained earnings	111,590,000	98,291,000
Accumulated other comprehensive (loss) income	(302,000)	96,000
Total stockholders' equity	143,290,000	130,389,000
Total liabilities and stockholders' equity	$ 335,203,000	$ 301,123,000

See independent auditor's report and accompanying notes to consolidated financial statements.

Care1st Health Plan

Consolidated Statements of Income and Comprehensive Income

For the years ended December 31,	2013	2012
Revenues		
Premium revenue	$ 1,122,016,000	$ 934,184,000
Interest income	838,000	1,194,000
Other revenue	9,667,000	2,421,000
Total revenues	1,132,521,000	937,799,000
Expenses		
Healthcare services	990,964,000	833,665,000
Selling, general and administrative expenses	113,491,000	95,498,000
Depreciation and amortization	6,324,000	4,754,000
Total expenses	1,110,779,000	933,917,000
Income from operations	21,742,000	3,882,000
Interest expense	(481,000)	(604,000)
Other income	2,000	1,016,000
Income before provision for income taxes	21,263,000	4,294,000
Provision for income taxes	7,964,000	1,829,000
Net income	13,299,000	2,465,000
Change in unrealized gains or losses on available-for-sale securities, net of related tax effects	(398,000)	131,000
Comprehensive income	$ 12,901,000	$ 2,596,000

See independent auditor's report accompanying notes to consolidated financial statements.

Care1st Health Plan

Consolidated Statements of Changes in Stockholders' Equity

	Preferred Stock				Common Stock				Additional Paid-In-Capital	Stockholder Note Receivable	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
	Series A		Series B		Series A		Series B						
	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount					
Balance, December 31, 2011	46,000	$ 46,000	10,000	$ 10,000	3,000	$ 3,000	3,000	$ 3,000	$ 33,940,000	$ -	$ 95,826,000	$ (35,000)	$ 129,793,000
Stockholder note receivable (See Note 14)	-	-	-	-	-	-	-	-	-	(2,000,000)	-	-	(2,000,000)
Unrealized holding gains on investments, net of tax	-	-	-	-	-	-	-	-	-	-	-	131,000	131,000
Net income	-	-	-	-	-	-	-	-	-	-	2,465,000	-	2,465,000
Balance, December 31, 2012	46,000	46,000	10,000	10,000	3,000	3,000	3,000	3,000	33,940,000	(2,000,000)	98,291,000	96,000	130,389,000
Stockholder note receivable (See Note 14)	-	-	-	-	-	-	-	-	-	-	-	-	-
Unrealized holding losses on investments, net of tax	-	-	-	-	-	-	-	-	-	-	-	(398,000)	(398,000)
Net income	-	-	-	-	-	-	-	-	-	-	13,299,000	-	13,299,000
Balance, December 31, 2013	46,000	$ 46,000	10,000	$ 10,000	3,000	$ 3,000	3,000	$ 3,000	$ 33,940,000	$ (2,000,000)	$ 111,590,000	$ (302,000)	$ 143,290,000

See independent auditor's report and accompanying notes to consolidated financial statements.

Care1st Health Plan

Consolidated Statements of Cash Flows

For the years ended December 31,	2013	2012
Cash flows from operating activities		
Net income	$ 13,299,000	$ 2,465,000
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	6,324,000	4,754,000
Allowance for reinsurance receivables	-	79,000
Deferred income taxes	(756,000)	220,000
Changes in assets and liabilities:		
Receivables	(15,598,000)	(20,889,000)
Prepaid expenses and other current assets	(1,745,000)	(2,705,000)
Income taxes	8,170,000	(1,803,000)
Capitation and medical claims payable	23,959,000	17,081,000
Risk-sharing arrangements	4,859,000	(17,471,000)
Accounts payable	(4,857,000)	4,669,000
Accrued expenses	1,420,000	(1,737,000)
Other current liabilities	(5,095,000)	(5,939,000)
Net cash provided by (used in) operating activities	29,980,000	(21,276,000)
Cash flows from investing activities		
Proceeds from sale of investments, net	9,090,000	8,195,000
Purchases of fixed assets	(5,981,000)	(4,945,000)
Increase in regulatory deposits	(5,102,000)	-
Net cash (used in) provided by in investing activities	(1,993,000)	3,250,000
Cash flows from financing activities		
Payments on long-term debt	(2,300,000)	(800,000)
Stockholder note receivable	-	(2,000,000)
Net cash used in financing activities	(2,300,000)	(2,800,000)
Net increase (decrease) in cash and cash equivalents	25,687,000	(20,826,000)
Cash and cash equivalents		
Beginning of year	130,363,000	151,189,000
End of year	$ 156,050,000	$ 130,363,000
Supplemental information		
Cash paid for income taxes	$ 7,550,000	$ 3,870,000
Cash paid for interest	$ 439,000	$ 510,000
Noncash investing transactions		
Change in unrealized (loss) gain on investments, net	$ (398,000)	$ 131,000

See independent auditors' report and accompanying notes to consolidated financial statements.

1. Organization and Significant Accounting Policies

Organization

Care1st Health Plan (the "Company") is a Health Maintenance Organization ("HMO") principally engaged in providing managed health care services to under-served communities. The Company was incorporated under the laws of the State of California on March 7, 1994 for the purpose of providing medical and hospital services to Medi-Cal beneficiaries residing in Los Angeles County. Since its incorporation, the Company has expanded into a full service health plan offering multiple health care options that include Medicare, Medi-Cal Health, Medi-Cal Dental, Healthy Families and commercial coverage throughout California.

The Company has maintained a California full service health plan license under the Knox-Keene Act since 1995 and is regulated by the Department of Managed Health Care (the "DMHC").

In 1995, the Company entered into an agreement with the Local Initiative Health Authority for Los Angeles County ("L.A. CARE") to provide health care services to eligible Medi-Cal beneficiaries, with enrollment not to exceed 250,000 members. The Company was able to obtain additional enrollment of Medi-Cal subscribers from L.A. CARE through the acquisition of the Plan Partner Contract between Maxicare Corporation and LA CARE in 2001 and the Medi-Cal program between WATTsHealth Foundation, Inc. dba UHP Healthcare ("UHP") and L.A. Care in 2006. As part of the 2006 UHP transaction, the Company also acquired UHP's Medicare Advantage program, Denti-Cal program, and commercial insurance programs (see Note 8).

The Company has maintained a contract with the California Managed Risk Medical Insurance Board to provide care to members who voluntarily enroll in the Healthy Families Program ("HFP") since 2000 and will continue to provide coverage to members when HFP transitions into Medi-Cal managed care plans in 2013. As of December 31, 2013, all members but 2 have transitioned to Medi-Cal managed care plans.

In October 2003, the Company formed a wholly-owned Arizona subsidiary, Care1st Health Plan Arizona, Inc. (the "Arizona Plan"), for the purpose of providing specified health services to Medicaid members pursuant to a contract with the Arizona Health Care Cost Containment System ("AHCCCS"). The Arizona Plan also participates in Arizona's Acute Care Program, Division of Developmental Disabilities Program ("DDD"), and Children's Health Insurance Program ("KidsCare"). The Arizona Plan subcontracts with hospitals, physicians and other medical providers within Arizona to care for eligible AHCCCS and KidsCare members in Maricopa County. In October 2013, Arizona's care for eligible AHCCCS and KidsCare members expanded to Pima County.

In March 2005, the Company formed a wholly-owned Arizona subsidiary, ONECare by Care1st Health Plan of Arizona, Inc. ("ONECare"), which commenced operations in October 2005 when the Company was granted the Medicare Advantage Prescription Drug Contracting ("MAPD") license by the Centers for Medicare & Medicaid Services ("CMS"). ONECare provides health care services to enrollees in Maricopa County eligible for Medicare coverage including the Part D Prescription Drug Benefit. Coverage for members in Pima County begins January 2014.

In June 2005, the Company was granted the Geographic Managed Care ("GMC") contract by the California Department of Health Care Services ("DHCS") to provide health care services to Medi-Cal beneficiaries in San Diego County.

From 2006 through 2011, the Company continued to expand its presence in California by obtaining licensure from CMS to be a Medicare Advantage plan provider in San Bernardino, Orange, Riverside, Santa Clara, San Joaquin, and Stanislaus counties in addition to Los Angeles. In 2012, the Company was selected by the DHCS to participate in the Dual Eligible Demonstration Pilot Project in San Diego County.

Basis of Presentation

The following significant accounting policies are in accordance with accounting principles generally accepted in the United States of America and have been consistently applied.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany transactions and accounts have been eliminated in consolidation.

Use of Estimates

The preparation of consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses for each reporting period. Significant items subject to such estimates and assumptions include the valuation of receivables, goodwill, intangible assets, long-lived assets, capitation and medical claims payable including incurred but not reported claims, income taxes, and risk-sharing arrangements. Estimates were made based on the Company's knowledge of current events and anticipated future events. Actual results could materially differ from those estimates. The Company evaluates and updates its assumptions and estimates on an ongoing basis.

Cash and Cash Equivalents

The Company considers all highly liquid investments that are readily convertible to cash, with original maturity dates of three months or less when purchased, to be cash and cash equivalents.

Restricted Regulatory Deposits

As a condition for licensure, the Company is required to maintain certain funds on deposit or pledged to various state agencies. The Company records these restricted regulatory deposits at fair value and classify the amounts as noncurrent assets regardless of the contractual maturity date of the securities held due to the nature of the states' requirements (see Note 6).

Investments

Investments as of December 31, 2013 and 2012 consist of certificates of deposits, fixed income debt securities with short-term maturities, mutual funds, and asset backed securities. Investments in certificates of deposits are those with maturity dates of more than three months when purchased. The Company classifies its investment securities as available-for-sale and reports them at fair value in the consolidated balance sheets. Unrealized holdings gains or losses, net of the

related tax effects, are excluded from earnings and are reported as a separate component in other comprehensive income. Realized gains and losses from the sale of available-for-sale securities are determined on a specific-identification basis. The Company does not invest in trading securities or held-to-maturity securities (see Note 2).

The Company evaluates an investment for impairment by considering the length of time and extent to which market value has been less than cost or amortized cost, the financial condition and near-term prospects of the issuer, the specific events or circumstances that may influence the operations of the issuer, and the Company's intent to sell the security or the likelihood that it will be required to sell the security before recovery of the entire amortized cost. As of December 31, 2013 and 2012, there were no unrealized losses that the Company believed to be other-than-temporary.

Fixed Assets

Fixed assets are stated at cost, net of depreciation. When fixed assets are retired, or otherwise disposed, the appropriate accounts are relieved of costs and accumulated depreciation, and any resulting gain or loss is reflected in the consolidated statement of operations for the related period. Depreciation is computed using the straight-line method over the following estimated useful lives of the assets:

	Estimated Lives
Buildings and improvements	10 - 39 years
Furniture and fixtures	5 - 10 years
Computer software	3 years
Computer and office equipment	3-5 years
Vehicles	5 years
Leasehold improvements	Lesser of lease term or 5 years

Goodwill

Goodwill represents the excess of purchase consideration paid over the fair value of net assets acquired in a business acquisition. Goodwill recorded at December 31, 2013 and 2012 is fully attributable to the asset acquisition of UHP in 2006. In 2012, goodwill was not amortized and was tested for impairment on an annual basis or more frequently whenever events or changes in circumstances indicate that goodwill may be impaired. As of December 31, 2013, the Company adopted an accounting standards update, which permits the Company, among other things, to amortize goodwill on a straight-line basis over a period of ten years. The adoption was effective as of January 1, 2013.

As a result of the adoption, the Company tests goodwill impairment whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. The carrying amount of goodwill is considered impaired when fair value of the reporting unit or on an entity-wide basis is less than its carrying value. No impairment was recorded during the years ended December 31, 2013 or 2012.

Other Intangible Assets

Other intangible assets consist primarily of Medi-Cal membership subscribers, Medicare subscribers and a Provider Network acquired in asset acquisitions. Acquired intangible assets with finite lives are amortized on a straight-line basis over their respective estimated useful lives. The Company tests intangible assets impairment whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. The carrying amount of a long-lived asset is considered impaired when anticipated undiscounted cash flows expected to result from the use of the asset and its eventual disposition are less than its carrying amount. No impairment was recorded during the years ended December 31, 2013 or 2012.

Comprehensive Income

Comprehensive income includes net earnings and unrealized net gains and losses on investment securities. Other comprehensive income is net of reclassification adjustments to adjust for items currently included in net earnings, such as realized gains and losses on investment securities. The Company recorded an unrealized loss relating to the available-for-sale securities of $503,000 ($398,000, net of tax), included in other comprehensive income for the year ended December 31, 2013 and an unrealized gain relating to the available-for-sale securities of $219,000 ($131,000, net of tax), included in other comprehensive income for the year ended December 31, 2012.

Recognition of Premium Revenue and Related Healthcare Services

Premium revenues are primarily derived from the Company's contracts with various state and Medicare programs where the premium is typically at a fixed rate based on membership category, and the Company assumes the economic risk of funding its customers' health care and related administrative costs. Membership and category eligibility are periodically reconciled with the various programs and such reconciliations could result in adjustments to revenue. Premium revenues are recognized in the period in which eligible individuals are entitled to receive health care benefits. Premium billings may be subsequently adjusted to reflect changes in membership as a result of retroactive terminations, additions or other changes. Health care premium payments received in advance for a service period are recorded as unearned revenues. The Company recognizes revenue on retroactive healthcare premium adjustments that result in a benefit, generally when the amounts are determinable and collectability is reasonably assured.

The Company's Medicare Advantage and Part D premium revenues are subject to periodic adjustment under CMS' risk adjustment payment methodology. The CMS risk adjustment model provides higher per member payments for enrollees diagnosed with certain conditions and lower payments for enrollees who are healthier. Health care providers collect, capture, and submit available diagnosis data to CMS within prescribed deadlines. CMS uses submitted diagnosis codes, demographic information, and special statuses to determine the risk score for most Medicare Advantage beneficiaries. CMS also retroactively adjusts risk scores during the year based on additional data. The Company estimates risk adjustment revenues based upon the data submitted and expected to be submitted to CMS. As a result of the variability of factors that determine such estimations, the actual amount of CMS' retroactive payments could be materially more or less than those estimates. Changes in revenue from CMS resulting from the periodic changes in risk adjustments scores for the Company's membership are recognized when the amounts become determinable and the collectability is reasonably assured. This is primarily upon cash receipt.

The Company arranges comprehensive healthcare services for its members principally through capitation, a fixed monthly payment made without regard to the frequency, extent or nature of the healthcare services actually furnished. Benefits are provided to enrolled members generally through the Company's contractual relationships with physician groups and hospitals. The Company's contracted providers may, in turn, contract with specialists or referral providers for specific services and the Company is responsible for any related payments to those referral providers. Such expenses are determined on a per-member-month basis and are included in health care services expense in the accompanying consolidated statements of income and comprehensive income.

The Company maintains a program that provides incentives to participating contracted primary care providers and hospitals through the use of risk-sharing agreements. Payments are made to contracted primary care providers and hospitals based on the risk-sharing agreements. Expenses related to the program are recorded as incurred based on contracted amounts.

Arizona AHCCCS Specific Revenue Recognition

Delivery supplemental payments are intended by AHCCCS to cover the costs of maternity care for deliveries during a prospective enrollment period. Such premiums are recognized in the month the delivery occurs.

Reinsurance revenues are recorded at estimated amounts due to the Arizona Plan pursuant to the AHCCCS contract net of estimated uncollectible amounts. Acute reinsurance revenue is recognized as a percentage of expenses incurred by members whose medical costs exceed a stated deductible per member per contract year. Catastrophic reinsurance revenue is recognized as the actual costs paid by the Arizona Plan. These revenues are included as an offset of other medical expenses.

Prior Period Coverage ("PPC") capitation premiums are payments received from AHCCCS for the period of time, prior to the member's enrollment, during which a member is eligible for covered services. Such premiums are recognized upon receipt.

Claims Payable and Related Expenses

The Company recognizes the cost of medical benefits in the period in which services are provided, including an estimate of the cost of medical benefits incurred but not reported ("IBNR"). Medical benefits expense includes direct medical expenses and certain medically-related administrative costs. The IBNR portion of medical claims payable is estimated based on past claims payment experience for member groups, enrollment data, utilization statistics, authorized healthcare services and other factors. Medical claims payable balances are continually monitored and reviewed. If it is determined that the Company's assumptions in estimating such liabilities are significantly different than actual results, the Company's consolidated results of operations and consolidated financial position could be impacted in future periods. Adjustments of prior period estimates may result in additional cost of care or a reduction of cost of care in the period an adjustment is made. Further, due to the considerable variability of healthcare costs, adjustments to claim liabilities occur each period and are sometimes significant as compared to the net income recorded in that period. As the liability is based upon estimates, the ultimate settlement of claims may be materially more or less than the amount included in the consolidated financial statements. While the ultimate amount of program expenses is dependent on future developments, the Company believes that the liability for claims payable is adequate to cover such expenses.

The following table presents the roll-forward of incurred but not reported medical claims reserves included in capitation and medical claims payable in the accompanying consolidated balance sheets as of December 31:

	2013	2012
Beginning Balance	$ 100,217,000	$ 81,786,000
Health care claim expenses incurred during the year	539,753,000	483,159,000
Health care claims paid during the year	(523,668,000)	(464,728,000)
Ending Balance	$ 116,302,000	$ 100,217,000

Premium Deficiency Reserve

The Company also periodically evaluates the need to establish premium deficiency reserves for the probability that anticipated future healthcare services expenses could exceed future premium payments under contracts and, where appropriate, records a premium deficiency reserve.

Advertising

Costs associated with advertising and promotions services are recorded as selling, general and administrative expense when incurred. Advertising expenses totaled approximately $4,222,000 and $5,881,000 for the years ended December 31, 2013 and 2012, respectively.

Income Taxes

Deferred tax assets and liabilities be recognized for temporary differences between the financial reporting basis and the tax basis of assets and liabilities. The Company records a valuation allowance when it is more likely than not that the deferred tax assets will not be realized. Each period, the Company evaluates the need for a valuation allowance for its deferred tax assets and adjusts the valuation allowance so that the Company records net deferred tax assets only to the extent that it has concluded it is more likely than not that these deferred tax assets will be realized.

The Company recognizes liabilities for uncertain tax positions based on a two-step process. To the extent a tax position does not meet a more-likely-than-not level of certainty, no benefit is recognized in the consolidated financial statements. If a position meets the more-likely-than-not level of certainty, it is recognized in the consolidated financial statements at the largest amount that has a greater than 50% likelihood of being realized upon ultimate settlement. Interest and penalties related to unrecognized tax benefits are recognized on liabilities recorded for uncertain tax positions and are recorded in the provision for income taxes. The actual liability for unrealized tax benefits may be materially different from the Company's estimates, which could result in the need to record additional liabilities for unrecognized tax benefits or potentially adjust previously-recorded liabilities for unrealized tax benefits, and may materially affect its operating results.

The Company's unrecognized tax benefits were immaterial at December 31, 2013 and 2012. The Company does not expect its unrecognized tax benefits to change significantly over the next 12 months. For the years ended December 31, 2013 and 2012, the Company did not record any interest and/or penalties expense related to unrecognized tax positions in the accompanying consolidated statements of income and comprehensive income.

The Company is subject to taxation in the United States and state jurisdictions. The Company's tax years for 2010 and forward are open for examination by the United States and 2009 and forward are subject to examination by state taxing authorities.

Concentration of Credit Risk

The Company maintains cash and cash equivalents in deposit accounts at financial institutions that, at times, may exceed federally insured limits. Historically, the Company has not experienced any losses related to such accounts. The Company's non-interest bearing cash balances at December 31, 2013 were insured up to $250,000 per depositor at each final institution.

The Company's operations are concentrated in a limited number of states, which could cause its revenues, profitability, or cash flow to change suddenly and unexpectedly as a result of significant premium rate reductions or payment delays, a loss of material a material contract, legislative actions, changes in Medicaid or Medicare eligibility methodologies, or an unexpected increase in utilization in those states.

The premium revenues related to the Medi-Cal Agreements represent approximately 51% and 54% of the Company's total consolidated premium revenue for the years ended December 31, 2013 and 2012, respectively.

The premium revenues related to the AHCCCS Agreement represent approximately 14% and 15% of the Company's total consolidated premium revenue for the years ended December 31, 2013 and 2012, respectively (see Note 12).

The premium revenues related to the Medicare Agreements represent approximately 34% and 30% of the Company's total consolidated premium revenue for the years ended December 31, 2013 and 2012, respectively.

The premium revenues related to other agreements represent approximately 0% and 1% of the Company's total consolidated premium revenue for the years ended December 31, 2013 and 2012, respectively.

Recently Issued Accounting Standards

In July 2011, the Financial Accounting Standards Board ("FASB") issued ASU 2011-06, "*Other Expenses - Fees Paid to the Federal Government by Health Insurers*." This update addresses accounting for the annual fees mandated by the Patient Protection and Affordable Care Act, as amended by the Health Care and Education Reconciliation Act ("2010 Acts"). The 2010 Acts impose an annual fee on health insurers, payable to the U.S. government, calculated on net premiums and third-party administrative agreement fees. The updated standard requires that the liability for the fee be estimated and accrued in full once the entity provides qualifying health insurance in the applicable calendar year in which the fee is payable with a corresponding deferred cost that is amortized to expense. The fees are initiated for calendar years beginning January 1, 2014, and the amendments provided by this update become effective for calendar years beginning after December 31, 2013. The Company is currently evaluating the potential impact that this provision will have on the consolidated financial statements.

Recently Adopted Accounting Standards

In February 2013, the FASB issued Accounting Standards Update 2013-02, "Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income". This update provides entities with two basic options for reporting the effect of significant reclassifications – either 1) on the face of the statement where net income is presented or 2) as a separate footnote disclosure. Public entities will report reclassifications in both annual and interim periods, while private entities are only required to report them in annual financial statements. The Company adopted this standard effective January 1, 2013, which did not have a material impact on the consolidated financial statements.

In January 2014, the FASB issued an Accounting Standards Update No. 2014-02, Intangibles—Goodwill and Other (Topic 350): Accounting for Goodwill, which permits a private company to subsequently amortize goodwill on a straight-line basis over a period of ten years, or less if the company demonstrates that another useful life is more appropriate. It also permits a private company to apply a simplified impairment model to goodwill. Goodwill is the residual asset recognized in a business combination after recognizing all other identifiable assets acquired and liabilities assumed. The Company adopted this standard effective January 1, 2013.

Subsequent events

Management has evaluated events that have occurred subsequent to December 31, 2013 through March 31, 2014, the date on which the consolidated financial statements were available to be issued and has determined there were no material events that require recognition or disclosure.

2. Investments

The following is a summary of available-for-sale securities:

	December 31, 2013		
	Amortized cost	Gross unrealized gain (loss)	Fair value (net carrying amount)
Fixed income debt securities	$ 12,924,000	$ 110,000	$ 13,034,000
Mutual funds	1,666,000	-	1,666,000
Asset backed debt securities	5,784,000	(612,000)	5,172,000
Total	$ 20,374,000	$ (502,000)	$ 19,872,000

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	December 31, 2012		
	Amortized cost	Gross unrealized gain	Fair value (net carrying amount)
Certificates of deposits	$ 2,646,000	$ -	$ 2,646,000
Fixed income debt securities	18,143,000	199,000	18,342,000
Mutual funds	288,000	-	288,000
Asset backed debt securities	7,981,000	103,000	8,084,000
Total	$ 29,058,000	$ 302,000	$ 29,360,000

The net carrying value and estimated fair value of debt and marketable equity securities at December 31, 2013 and 2012, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because the issuers of the securities may have the right to prepay obligations without penalties.

	December 31, 2013	
Available-for-sale debt securities	Amortized cost	Fair value
Due in one year or less	$ 4,480,000	$ 4,323,000
Due after one year through three years	8,444,000	8,513,000
Due after three years	5,784,000	5,370,000
	18,708,000	18,206,000
Mutual funds	1,666,000	1,666,000
	$ 20,374,000	$ 19,872,000

	December 31, 2012	
Available-for-sale debt securities	Amortized cost	Fair value
Due in one year or less	$ 10,629,000	$ 10,641,000
Due after one year through three years	9,958,000	10,115,000
Due after three years	8,184,000	8,316,000
	28,771,000	29,072,000
Mutual funds	288,000	288,000
	$ 29,059,000	$ 29,360,000

3. Fair Value Measurements

Accounting literature establishes a framework for measuring fair value and clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. Financial assets and liabilities that are remeasured and reported at fair value at each reporting period in are classified and disclosed in one of the following three levels:

Level 1 Quoted prices in active markets for identical assets or liabilities;

Level 2 Quoted prices in active markets for similar assets and liabilities and inputs that are observable for the asset or liability; or

Level 3 Unobservable inputs for the asset or liability, such as discounted cash flow models or valuations. The determination of where assets and liabilities fall within this hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

The Company's Level 1 assets include certain cash and cash equivalents (money market mutual funds) and investments, bonds issued by government-sponsored enterprises, such as the Federal Home Loan Bank, the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation, State and Municipal Bonds, and Corporate Debt.

The following table reflects the Company's assets required to be measured at fair value on a recurring basis on the consolidated balance sheets:

	December 31, 2013		
	Fair Value Measurement Using		
	Level 1	Level 2	Level 3
Assets			
Money market mutual funds	$ 51,714,000	$ -	$ -
Investments (available-for-sale)			
Fixed income debt securities	13,034,000	-	-
Mutual funds	1,666,000	-	-
Asset backed securities	5,172,000	-	-
	$ 71,586,000	$ -	$ -

	December 31, 2012		
	Fair Value Measurement Using		
	Level 1	Level 2	Level 3
Assets			
Money market mutual funds	$ 60,896,000	$ -	$ -
Investments (available-for-sale)			
Fixed income debt securities	18,342 000	-	-
Mutual funds	288,000	-	-
Asset backed securities	8,084,000	-	-
	$ 87,610,000	$ -	$ -

4. Receivables, net

Receivables consist of the following at December 31:

	2013	2012
Due from L.A. CARE	$ 67,057,000	$ 51,696,000
Due from AHCCCS, net of allowances of $211,000 and $164,000, respectively	3,163,000	2,174,000
Other	12,344,000	13,096,000
Total receivables, net	$ 82,564,000	$ 66,966,000

At December 31, 2013 and 2012, the Company recorded amounts owing by L.A. CARE of $67,057,000 and $51,696,000, respectively. These amounts due to the Company generally related to Medi-Cal enrollee capitation receivables under the local initiative including retroactive premiums due.

At December 31, 2013 and 2012, $2,394,000 and $1,781,000 of the AHCCCS receivables related to reinsurance receivables due to the Arizona Plan, net of allowances for uncollectability.

The remaining receivables at December 31, 2013 and 2012, due from AHCCCS in the amount of $769,000 and $393,000, respectively, related primarily to capitation due and other items. Other receivables largely relate to Medi-Cal enrollee capitation receivables under the GMC program for San Diego County, the Healthy Families and Denti-Cal programs.

5. Other Current Liabilities, Net

	2013	2012
Settlement payable due to AHCCCS, net	$ 7,607,000	$ 15,871,000
Other current liabilities	3,612,000	443,000
	$ 11,219,000	$ 16,314,000

Due to uncertainty regarding actual utilization, AHCCCS intends to limit its financial risk to its contractors. Accordingly, profits and losses by defined risk code groupings are annually reconciled as defined for each contract year ending in the month of September. In accordance with the reconciliation, profits and losses for the certain risk group members are generally limited to a percentage of the contractor's profit or loss for that risk group. Profits or losses in excess of the corridor are reimbursed to, or recovered from, AHCCCS by the contractor. Accordingly, at December 31, 2013 and 2012, the Arizona Plan recorded a net payable of $7,607,000 and $15,871,000, respectively. The payables are included in other current liabilities on the accompanying consolidated balance sheets. Generally, the final reconciliation and settlement is anticipated to take place no more than 15 months after the contract year-end.

6. Regulatory Requirements

The Company must meet certain minimum requirements under the Knox-Keene Health Care Service Plan Act of 1975, as amended (the "Knox-Keene" or the "Act"), to ensure that the Company can provide the medical benefits for which it has contracted. The Company is required by the Act to maintain a minimum deposit. Pursuant to these requirements, as of December 31, 2013 and 2012, $400,000 and $300,000 was invested in certificates of deposit, respectively, and is recorded as a restricted regulatory deposit in the accompanying consolidated balance sheets. In addition, the Company is required to maintain a minimum tangible net equity as defined by Section 1300.76 of the Act. As of December 31, 2013 and 2012, the Company was in compliance with the Act.

On a quarterly basis, AHCCCS will review the following ratios with the purpose of monitoring the financial health of the Arizona Plan: Current Ratio of at least 1.0; Equity per Member of $170 for Contractors with enrollment less than 100,000 and $115 for Contractors with enrollment greater than 100,000; Medical Expense Ratio of at least 85%; and the Administrative Cost Percentage no greater than 10%. The Arizona Plan is in compliance with the current ratio and equity per member requirement. The plan is not in compliance with medical expense ratio, due to reductions in its medical expense accrual in fiscal year 2013. The Arizona Plan is also not in compliance with the administrative expense ratio due to non-recurring expenses associated with the AHCCCS Request for Proposal and implementation expenses associated with the expansion into Pima County in advance of the October 1, 2013 contract effective date. The Arizona plan anticipates that it will be compliant with these ratios in fiscal year 2013. AHCCCS may elect to impose sanctions and penalties, the impact of which may be material to the consolidated financial statements if the plan does not meet these standards. However, as of March 31, 2014, no sanctions have been imposed against the Arizona Plan.

The Company maintains restricted regulatory deposits totaling $10,502,000 and $6,500,000 as security for the letters of credit and to meet the performance bond obligation as of December 31, 2013 and 2012, respectively (see Note 12). The letter of credit was extended through to November 2014. Total restricted regulatory deposits amounted to $11,902,000 and $6,800,000 (including the $400,000 and $300,000 required under Knox-Keene, respectively, and $1,000,000 and $0 required for the State of Texas), respectively, each at December 31, 2013 and 2012.

7. Fixed Assets, net

Fixed assets consist of the following:

December 31,	2013	2012
Land	$ 5,791,000	$ 5,591,000
Buildings and improvement	21,218,000	19,461,000
Furniture and fixtures	4,389,000	3,555,000
Purchased software	2,985,000	2,656,000
Computer equipment	7,830,000	5,340,000
Leasehold improvements	1,128,000	878,000
Motor vehicles	24,000	24,000
	43,365,000	37,505,000
Less accumulated depreciation	(14,710,000)	(12,264,000)
Total	$ 28,655,000	$ 25,241,000

Depreciation expense amounted to $2,567,000 and $1,651,000 for the years ended December 31, 2013 and 2012, respectively.

8. Intangible Assets and Goodwill, Net

The following table provides a summary of goodwill and intangible assets and the related accumulated amortization:

December 31	Amortization Period	2013	2012
Goodwill, net	10 years (*)	$ 5,844,000	$ 6,493,000
Licensing costs	20 years	$ 1,609,000	$ 1,609,000
Maxicare Medi-Cal subscribers and assignment	13 years	15,000,000	15,000,000
UHP intangible assets			
Medi-Cal subscribers	13 years	8,860,000	8,860,000
Medicare subscribers	12 years	6,040,000	6,040,000
Provider network	15 years	9,970,000	9,970,000
Non-compete agreement	5 years	70,000	70,000
Other	20 years	476,000	476,000
Total acquisition cost of intangible assets		42,025,000	42,025,000
Less accumulated amortization		(22,066,000)	(18,958,000)
Intangible assets, net		$ 19,959,000	$ 23,067,000

(*) Effective January 1, 2013, goodwill is amortized on a straight-line basis over a period of ten years.

The following table summarizes the changes in goodwill:

Goodwill (gross) at December 31, 2012 and 2011	$ 6,493,000
Amortization	(649,000)
Goodwill, net at December 31, 2013	$ 5,844,000

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The total estimated future amortization related to goodwill and intangible assets are as follows:

For the years ending December 31,	Total
2014	$ 3,757,000
2015	3,751,000
2016	3,676,000
2017	3,676,000
2018	3,510,000
Thereafter	7,433,000
Total	$ 25,803,000

The Company recorded amortization expense related to intangible assets of $3,108,000 and $3,103,000 for the years ended December 31, 2013 and 2012, respectively.

The Company recorded amortization expense related to goodwill of $649,000 for the year ended December 31, 2013. There was no goodwill amortization for the year ended December 31, 2012.

Licensing Costs

Licensing costs relate to fees incurred by the Company to obtain the necessary regulatory licenses.

9. Long-Term Debt

December 31,	2013	2012
Note payable to bank, original principal amount $12,000,000, entered into June 2005, bearing interest at a fixed rate of 5.86% per annum, with monthly repayments of principal of $50,000 plus interest accruing on the outstanding balance. Payments on the note are to be made through June 2015, when all remaining principal is due in full. The note is secured by buildings.	$ 6,900,000	$ 7,500,000
Note payable to bank, original principal $3,000,000, dated May 2006, bearing interest at a fixed rate of 6.93% per annum, with monthly repayments of principal of $16,667 plus interest accruing on the outstanding balance.	-	1,700,000
	6,900,000	9,200,000
Less current maturities	(600,000)	(2,300,000)
	$ 6,300,000	$ 6,900,000

The note payable to the bank has various financial and non-financial covenants. The most significant financial covenant is for the Company to maintain a debt service coverage ratio of at least 1.25 to 1 annually through the term of the notes. At December 31, 2013, the Company was in compliance with or had obtained a waiver for non-compliance of the financial covenants pursuant to the note payable agreement.

Maturities of long-term debt are as follows:

For the years ending December 31,	
2014	$ 600,000
2015	600,000
2016	600,000
2017	600,000
2018	600,000
Thereafter	3,900,000
	$ 6,900,000

10. Equity

At December 31, 2013 and 2012, in connection with preferred stock previously issued and outstanding, the following is applicable:

In the event of liquidation, dissolution, or winding-up of the Company, holders of Series A and B Preferred Stock (Series A Preferred Stock in preference to Series B Preferred Stock) are entitled to receive an amount equal to $100.00 per share of Series A and B Preferred Stock plus any accrued and unpaid dividends if declared. No dividends have been declared by the Company as of December 31, 2013 and 2012, respectively.

In August 2006, pursuant to the purchase of certain assets from UHP, the shareholders of the Company contributed additional capital in the amount of approximately $16,000,000 in cash. No additional shares were issued to the existing shareholders. The decision not to issue additional shares pursuant to this capital contribution was unanimously approved by the existing shareholders. Accordingly, the capital contribution was recorded as additional paid-in-capital.

11. Income Taxes

The provision for income taxes consists of the following:

For the years ended December 31,	2013	2012
Current		
Federal	$ 7,155,000	$ 1,276,000
State	1,565,000	333,000
	8,720,000	1,609,000
Deferred		
Federal	(681,000)	254,000
State	(75,000)	(34,000)
	(756,000)	220,000
Total	$ 7,964,000	$ 1,829,000

The provision for income taxes differs from the statutory rate of 35% due to the following:

December 31,	2013	2012
Federal income tax at statutory rate of 35%	$ 7,442,000	$ 1,503,000
State tax, net of federal tax benefit	942,000	183,000
Other, net	(420,000)	143,000
Total provision	$ 7,964,000	$ 1,829,000
Effective tax rate	37.5%	42.6%

The Company's deferred taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax assets and liabilities are as follows:

December 31,	2013	2012
Deferred tax assets		
State taxes	$ 548,000	$ 117,000
Vacation accrual	796,000	652,000
Other accruals and allowances	1,264,000	962,000
Other	491,000	560,000
Total deferred tax assets	3,099,000	2,291,000
Deferred tax liabilities		
Depreciation and amortization	(3,627,000)	(3,905,000)
Other	(702,000)	(372,000)
Total deferred tax liabilities	(4,329,000)	(4,277,000)
Total deferred tax liabilities, net	$ (1,230,000)	$ (1,986,000)

Deferred tax assets and liabilities are classified as follows:

December 31,	2013	2012
Deferred tax assets, net, current	$ 2,662,000	$ 1,857,000
Deferred tax liabilities, net, noncurrent	(3,892,000)	(3,843,000)
Total deferred tax liabilities, net	$ (1,230,000)	$ (1,986,000)

The Company pays premium tax on certain capitation and premiums. For the years ended December 31, 2013 and 2012, the premium taxes were approximately $2,788,000 and $4,075,000, respectively, and are included in selling, general and administrative expenses.

12. Commitments and Contingencies

Operating Leases

The Company leases various equipment, automobiles, and buildings under noncancellable operating leases.

Future minimum lease payments under operating lease obligations with an initial term of one year or more are as follows:

For the years ending December 31,	Operating Leases
2014	$ 1,561,000
2015	1,720,000
2016	1,689,000
2017	1,519,000
2018 and thereafter	1,341,000
	$ 7,830,000

The Company's operating lease obligations expire at various dates through April 2019.

Rent expense of approximately $1,692,000 and $1,505,000 was charged to operations for the years ended December 31, 2013 and 2012, respectively.

L.A. CARE Agreement

During 1996, the State of California Department of Health Services (the "SDHS") contracted with L.A. CARE Health Plan ("L.A. CARE") to be the locally created healthcare service plan for Los Angeles County. L.A. CARE commenced operations effective May 1, 1997, at which time the Company's contract with the SDHS terminated, and Medi-Cal enrollment was assigned by L.A. CARE to the Company, up to a maximum of 250,000 members. During 2012, the contract was amended to remove the 250,000 member enrollment limit. The Company has a current contract with L.A. CARE through September 30, 2015.

GMC SD Agreement

During 2005, the Company entered into a contract with the California Department of Health Care Services ("DHCS") as a Geographic Managed Care ("GMC") Plan to provide health care to Medi-Cal beneficiaries in San Diego County. The Company continues to operate in the San Diego GMC program and maintains a current contract through June 30, 2015.

AHCCCS Agreement

On March 22, 2013, the Company was notified that the Arizona Plan received a contract award from AHCCCS Acute Care Program effective October 1, 2013. The contract term is for three years, with two one year options for renewal. Under the contract, the Arizona Plan will provide services to eligible enrollees in Maricopa and Pima Counties.

Performance Bond

Pursuant to its contract with the State of Arizona, the Arizona Plan is required to provide either a performance bond or designated substitute to guarantee performance of the Plan's obligations under the contract. As of December 31, 2013, the Arizona plan has one letter of credit in the amount of $18,000,000. This letter of credit renews automatically unless cancelled. The Arizona Plan has $7,500,000 of funds on deposit with the Arizona Department of Insurance to meet the performance bond requirement of its Medicare operation and to supplement the letter of credit for its AHCCCS operation. The letter of credit is secured by a restricted deposit of $10,500,000 (see Note 6).

As of December 31, 2012, the Arizona Plan had two letters of credit in the amounts of $11,500,000 and $2,000,000, for a total of $13,500,000. These letters of credit were cancelled during 2013 at their expiration dates. The letters of credit were secured by a restricted deposit of $6,500,000 (See Note 6).

In accordance with AHCCCS regulations, the letter of credit amounts have been excluded from the consolidated balance sheets as of December 31, 2013 and 2012.

UHP Acquisition

Pursuant to the asset purchase agreement, within 30 days of the emergence of UHP from bankruptcy, the Company agreed to make charitable contributions to UHP of $100,000, as well as $100,000 for each of the four years thereafter, totaling $500,000. In 2012, UHP emerged from bankruptcy and the Company made a donation of $100,000 to UHP in May 2012. As of December 31, 2013, the Company pledged to make a donation of $100,000 to UHP and is recorded in accounts payable in the consolidated balance sheets.

General Matters and Litigation

The Company is subject to claims and legal proceedings which include the usual obligations incurred by a health plan. The Company purchases commercial Managed Care Errors and Omissions Insurance on a claims-made basis with a $50,000 deductible for each claim. The limits of liability are $5,000,000 for each claim and $10,000,000 per policy year in the aggregate. The Company is party to legal proceedings and claims that arise in the ordinary course of business. Based on currently available information, management does not believe that the outcome of the proceedings will have a material effect on the Company's consolidated financial statements.

AHCCCS Audit

AHCCCS periodically audits, among other things, the accuracy, timeliness and omission rates of encounters. Errors are subject to sanction. Additionally, the AHCCCS contract requires the plan to meet identified Minimum Performance Standards ("MPS") related to clinical quality measures. Should the Company fail to meet the MPS, the Company could be sanctioned. The Company must submit a corrective action plan to AHCCCS with 30 days following notification of a deficiency. Based on the results of the corrective action plan, AHCCCS may waive the sanctions and penalties. Should AHCCCS not waive them, the impact of the penalties and sanctions could be material to the overall consolidated financial position of the Company. The Company has received final audit results for the contract year ended September 30, 2012 and no material sanctions have occurred or are anticipated. Results have not yet been issued by AHCCCS for the contract year ended September 30, 2013.

13. Retirement Plan

The Company sponsors a 401(k) defined contribution retirement plan (the "Plan"), available to all employees meeting eligibility requirements. Employees' contributions are voluntary, with an annual maximum contribution of 20% of gross compensation, not to exceed the IRS limit. The employer's matching contribution is based on the Safe Harbor requirements under the 401(k) defined contribution retirement plan. The employee has a choice of investing in various investment funds, subject to Internal Revenue Service limits. Company contributions to the Plan totaled approximately $1,223,000 and $1,064,000 for the years ended December 31, 2013 and 2012, respectively.

14. Related Party Transactions

The Company has entered into various agreements with stockholders to provide medical care services to a significant number of the Company's members. The amounts due to stockholders include accrued capitation, and amounts related to their risk-sharing agreements with the Company in which funds remaining in the hospital and medical expense pools are paid according to the agreements. For the years ended December 31, 2013 and 2012, the Company had paid under its capitation and risk-sharing arrangements approximately $41,265,000 and $53,103,000, respectively, to related parties.

The Company also has made capitation, claims and risk pool settlement payments in the normal course of business to two related party IPAs, in the amount of approximately $23,172,000 and $23,414,000 for the years ended December 31, 2013 and 2012, respectively.

In March 2012, the Company extended a loan to a stockholder in the amount of $2,000,000 payable on March 22, 2013 at an interest rate of 1% per annum. The promissory note specified repayment of principal and interest on the maturity date or offset against future distributions by the Company. The Company reflected this note as a contra to stockholders' equity.