Management Discussion & Analysis

1. Introduction

Soundpath Health (SPH) was founded in 2007 by three local physician organizations who wished to deliver a better Medicare Advantage insurance option for their patients. Coverage for members began January 1, 2008, and enrollment has grown to over 11,000 members in 2011.

Soundpath's mission is to:

•Be the local industry leader in supporting health care delivery

•Promote members' health through local provider innovation

•Be responsible stewards of health care resources

•Be an active partner in improving the health of their communities

Soundpath's revenue comes from the Centers for Medicare and Medicaid Services (CMS) and from members. When a member joins Soundpath, they assign their Medicare benefits to Soundpath, so that they member may experience greater benefits, increased access and simpler administration than they would through original Medicare. Members receive services through Soundpath's extensive network of contracted physicians and health care providers.

Soundpath offers Medicare Advantage Plans through its contract with the Center for Medicare and Medicaid Services. Soundpath is subject to extensive federal and state health insurance regulations which govern many aspects of the company's business affairs, including licensure requirements, premium rate increases, financial condition cash and other reserve requirements.

2. Results of Operations

Soundpath ended the year with 11,745 members, or a 60% increase over December 31, 2010. The result from operations before Federal income taxes was a loss of $1.3 million compared to a gain of $7,000 in 2010. The loss before income tax was due to increases in Fee-for-Service medical claim expenses and an increase in new-member acquisition expenses. The medical expense increase was due to newly-eligible enrollment growth (turning 65 throughout the year) that is subject to a one year lag in the premium risk-factor adjustment. The result is increased medical costs without a related premium increase. The Company has adjusted its marketing strategy in 2012 to reduce acquisition expenses by over $500,000 and to slow the growth of newly-eligible (age 65) members. SPH believes this will result in a better mix of members who have the proper risk adjusted premium payments and improve profitability.

Direct premiums increased $29 million from $75 million in 2010 to $104 million in 2011. On a per-member per-month (pmpm) basis, the average premium was $759 compared with $879 in 2010. The 2011 average premium was lower due to a shift in member mix to lower priced

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plans and a reduction in average risk scores, which determines the amount of payment from CMS for each member.

Soundpath has entered in to a quota-share reinsurance agreement with Canada Life Assurance Company to assist the company in managing its premium growth. For 2011, the Company ceded $54.6 million compared to $22.6 million in 2010. Under this agreement, Soundpath cedes a pro-rata share of its medical premiums and claim expenses while receiving an administrative expense allowance. Net premiums, after reinsurance cession, were $48.8 million in 2011, compared with $51.3 million in 2010. Soundpath received a $1.3 million experience-based refund and rate credits under the quota share agreement in 2011 compared to $432,000 in 2010.

Soundpath had $87.6 million in direct claims expense, or an increased of $24.5 million and 39% over 2010. The average claim expense decreased 14% from $742 pmpm in 2010 to $639 pmpm in 2011. The majority of the decrease in the average claim expense was due a reduction in the average capitation payments, which are paid as a percent of premiums. The direct medical care ratio was 85.3% in 2011 compared to 84.0% in 2010. Under the quota-share reinsurance agreement, $46.9 million of claims were ceded in 2011, leaving net claim expenses of $40.7 million. This resulted in a net medical care ratio of 81.1%.

Administrative expenses were $10.9 million, an increase of $2.4 million, or 28% over 2010. The average administrative expense decreased 20% from $99.65 pmpm in 2010 to $79.72 pmpm in 2011. This decrease was due to spreading fixed administrative expenses over a greater number of members and the effect of quota share reinsurance expense allowance. Investment income increased $92k from $148k in 2010 to $240k in 2011 due to the increase in invested assets.

3. Prospective Information

A. Risk Adjustment Factor (RAF) Scores

Soundpath collects premiums from both CMS and plan members. The premium from CMS is adjusted for the health status of Soundpath's membership population. Soundpath submits claims and diagnosis data to CMS throughout the year to facilitate the assessment of our members' health status. Soundpath analyzes the response files from CMS and estimates the amount of retroactive premium payments. Due to changes in CMS methodology, Soundpath is unable to fully validate these calculations and there is a high degree of uncertainty determining these receivables. Soundpath will receive retroactive premium payments from CMS in mid

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2012. In accordance with the agreements in place, Soundpath will reimburse the capitated providers for their share of these premiums upon receipt.

B. Pharmacy Benefit Management (PBM) Rebates

Soundpath has an agreement with a PBM to provide a number of pharmacy services to our members. As part of this agreement, Soundpath is entitled to receive rebates. These rebates are estimated based on reports received from the PBM and booked as receivables. All rebates that are 90 days past due the date they are confirmed as due and receivable are non-admitted for statutory accounting purposes. Estimated rebates receivables are included in settlements owed to or due from CMS.

C. CMS Part D Cost Sharing Settlement

As part of CMS's Medicare Advantage Part D pharmacy program, the Company participates in a cost sharing arrangement on the profitability the Part D plans. If incurred costs are within +/- 5% of the target premiums, there is no settlement (the Company retains 100% of the gain/loss.) If the incurred gains or losses are in a corridor of within 5% to 10% of the targeted premiums, then CMS is responsible for 50% of those gains or losses. For incurred gains or losses that are greater than 10% of the targeted premiums, than CMS is responsible for 80% of these amounts. The cost sharing calculations take into consideration rebates and retroactive premium payments due to risk score adjustments. Currently, estimated rebates are used to determine the settlement with CMS. Should there be differences between the estimated and actual rebates collected, the Company would appeal cost sharing settlements with CMS.

D. Financial Estimates

Because of uncertainties in estimates of retrospective premiums receivable, final CMS cost sharing settlements can vary significantly from projections. The complexities and interdependency of cost sharing calculations can be very sensitive to small changes between estimated and final results. Due to the difficulties of estimating RAF scores, rebates, and CMS cost sharing settlements, future financial statements may be impacted based on the final determination of these amounts.

E. Health Care Reform

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With the passage of the Patient Protection and Affordable Care Act, Soundpath is subject to a number of regulatory changes. The Organization is actively monitoring the rule-making process and adjusting our business plans and strategies to address changes.

The Company makes these forward-looking representations in good faith and is intended to be used in such manner.

4. Material Changes

Assets

Admitted assets increased to $20.9 million as of December 31, 2010 from $18.8 million as of December 31, 2010, an increase of $1.9 million. Invested assets increased from $5.63 million to $12.3 million. Investments in bonds increase $5.5 million to $10.4 million due to positive cash flow and financing. In 2010 and 2011, the Company made investments in mutual funds to maintain liquidity and yield, while hedging against inflation risk. Total investments in mutual funds, which are classified as a common stock for SAP accounting purposes, was $1.2 million as of December 31, 2010 and December 31, 2011. The Company cash, cash equivalents, and short term investments on hand for operations were $563k and $799k as of December 31, 2011 and 2010 respectively. All of the Company's investments are in fixed income securities rated single A or better, mutual funds with an average security rating of A, and short term investments. The Company owns no stock, real estate, mortgage or mortgage back securities. Soundpath's investment policy limits debt and equity investments in a single entity to no more than 4% of statutory assets, except for United States Treasury obligations, or funds backed by US Treasury obligations. The Company's admitted Deferred Tax Asset (DTA) was $778,000 as of December 31, 2010 compared to $688,000 as of December 31, 2011. The decrease in DTA was due the limitation of the asset admitted under SSAP 10 R.

Reinsurance recoverable and receivable decreased from $9.7 million to $4.5 million as December 31, 2011 due to the reduction in the quota-share percentage. This amount was

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settled and offset against Reinsurance payable within 20 days after the end of the year. Retrospective premium accrued increased from $840,000 as of December 31, 2010 to $1.69 million as of December 31, 2011 due to increased enrollment and the lag in adjusting premium for risk-based experience. There were no amounts receivable relating to uninsured plans as the annual settlement with CMS for 2011 is a net payable. Healthcare and other receivables increased to $1.4 million as of December 31, 2011 compared to $129,000 for prior year driven by an increase in pharmacy rebates of $677,000 and provider risk pool receivable of $711,000.

Liabilities

Total liabilities increased $3.9 million to $16.9 million as of December 31, 2011. Claims unpaid increased $5.6 million to $7.2 million due to an increase in fee-for-service members exceeding the increase in capitated membership. Liability for Aggregate Health Policy reserve increase $476,000 due to the increase in CMS Part D cost sharing of $605,000. There was no gain-sharing earned or accrued as of December 31, 2011. General expense due and accrued increased $280,000 to $698,000 as of December 31, 2010 due to growth in business. Ceded reinsurance premium payable decreased from $9.8 million to $4.5 million as of December 31, 2011 due to the reduction in the quota-share agreement to 25% in the fourth quarter of 2011 compared to 70% as of December 31, 2010. In the fourth quarter, the Company entered into sale-leaseback agreement for certain tangible and intangible assets. These amounts were reported as debt of $3.1 million using the lease financing accounting method.

Other Items

Effective January 1, 2011, Soundpath entered into a contractual arrangement for CMS Part D services with a new pharmacy benefits manager (PBM). The current PBM contract provides for more transparency and guarantees certain rebate payments. The prior PBM contract provided no assurances regarding the collectability of reported pharmacy rebates. Therefore, as of December 31, 2010, the Company offset the prior PBM's invoices payable with the estimated rebates due, and reported the net amount due. For December 31, 2011, because of rebate guarantee with the new PBM, the rebates due and invoices payable are reported separately.

In 2009, the Company entered into a provider agreement which is subject to a risk sharing arrangement if certain terms of the agreement are met. Final annual risk sharing settlement, if any, are determined nine months after the end of the contract year under its terms and due to the length of time for CMS to determine the final risk adjusted premiums. Because of the length of time to settle a contract year, contract year risk pools balances are overlapping. To the extent that the two contract year risk pool balances offset each other, the Company determines the net balance due or owed prior to collecting or paying any settlement. In 2009, the provider did not meet the contract terms for any risk sharing settlement. In 2010, the provider met the terms of the risk sharing agreement and earned a $97,000 risk sharing gain. The 2010 risk sharing gain was finalized in August 2011 after CMS determined the final risk adjusted premium for members in this provider's risk pool. At that time, the provider's 2011 interim risk sharing pool was negative, offsetting the 2010 positive balance. Therefore, the 2010 risk pool balance was not paid out and was used to offset the 2011 negative risk sharing balance.

5. Liquidity and Capital Resources

Cash flow from operations increased from $216,000 in 2010 to $3.9 million in 2011. Cash and invested assets increased $5.64 million in 2011.

Soundpath is domiciled in the state of Washington and is therefore subject to the regulations issued by the Office of the Insurance Commissioner (OIC) of Washington and the Washington insurance laws. The regulations set forth minimum levels of capital and surplus. The minimum OIC required capital and surplus is $3 million. Soundpath's capital and surplus decreased by $1.3 million in 2011 and was $4.1 million as of December 31, 2011.

Additionally, the National Association of Insurance Commissioners prescribes the use of the Risk-Based Capital (RBC) Model. This model includes different action levels. Soundpath calculated its risked-based capital requirements and is in excess of the calculated RBC capital requirements as of December 31, 2011. Soundpath's RBC was at 257% of the company action level.

Due to the 2011 net operating loss and decline in surplus, the Company has initiated the following actions. The Company has reduce marketing and advertising during the so-called "age-in" period so as to save administrative expenses and to reduce the enrollment growth of age 65 members which do not have the proper risk adjusted premium payments and caused the Company to lose money in 2011. The Company has also made changes in medical management protocols to better contain the cost of providing medical care. The 2012 budget includes no increases in personnel expenses. For 2012, Soundpath budget projects an operating gain of over $1 million due to the increase in membership and a $500,000 reduction in

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advertising expense. This income will improve statutory surplus as well as meet current operating needs.

SPH is also developing a plan to raise additional capital in 2012. SPH has no current plans to transfer funds or pay dividends to the Shareholders.

6. Other Considerations

There are no off-balance sheet arrangements.

There is no participation in High Yield Financings, Highly Leverage Transactions or Non-Investment Grade Loans or Investments.

The Company's shareholders are exploring opportunities with other investors which may involve an acquisition or a change of control, which could impact the Company's long-term strategic plans.