MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL POSITION AND RESULTS OF OPERATIONS

For the Year Ended December 31, 2010

The following discussion highlights the principal factors affecting the statutory financial condition and financial results of the PreferredOne Community Health Plan (PCHP) for the year ended December 31, 2010. This analysis should be read in conjunction with the financial statements and notes contained in the 2010 Annual Statement and Report of Independent Auditors filed with the Department of Commerce of the State of Minnesota.

RESULTS OF OPERATIONS

PROFITABILITY

PCHP's 2010 statutory underwriting loss of $(1,173,000) decreased $2,663,000 from the 2009 statutory underwriting loss of $(3,836,000), resulting in an underwriting loss margin of (.8%) and (2.8%), respectively. Net premium income for 2010 of $289.10 PMPM increased by an average of 4.3% over the 2009 net premium income of $277.05 PMPM. Total medical costs of $252.13 PMPM in 2010 increased 3.1% over the 2009 total medical costs of $244.49 PMPM. The result was a 2010 medical loss ratio of 87.2%, which was a decrease over the 2009 medical loss ratio of 88.2%. Total administrative/claims adjustment expenses of $40.48 PMPM in 2010 increased .2% over the 2009 expenses of $40.37 PMPM. The result was a 2010 administrative expense ratio of 14.0%, which was a decrease over the 2009 expense ratio of 14.6%. PCHP's 2010 statutory net income of $424,000 increased $2,549,000 from the 2009 statutory net loss of $(2,125,000).

COMMERCIAL ENROLLMENT

PCHP's December 31, 2010 enrollment of 39,457 decreased 426 members or 1.0% over December 31, 2009 enrollment of 39,883. 2010 member months of 475,878 decreased 3.0% over 2009 member months of 491,084.

NET PREMIUM INCOME

Premium income, net of reinsurance premium ceded, was $137,574,000 in 2010 compared to $136,054,000 in 2009.

MANAGEMENT'S DISCUSSION AND ANALYSIS

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MEDICAL AND HOSPITAL EXPENSES

Medical and hospital expenses were $119,983,000 or $252.13 PMPM in 2010 compared to $120,067,000 or $244.49 PMPM in 2009 for an increase of 3.1% PMPM. These expenses as a percentage of net premium income were 87.2% and 88.3%, respectively.

CLAIMS ADJUSTMENT AND GENERAL ADMINISTRATIVE EXPENSES

Claims adjustment and general administrative expenses primarily include management fee, broker commissions, cost containment expenses, Minnesota Comprehensive Health Association (MCHA) assessments, premium taxes, and medical care surcharge. Cost containment expenses are costs incurred to reduce the number or cost of health services and include expenses such as disease management programs and network access costs. These combined expenses totaled $19,264,000 and $19,823,000 in 2010 and 2009, respectively. The 2010 total administrative expenses as a percentage of net premium income of 14.0% decreased over 2009 percentage of net premium of 14.6% by .6%.

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FINANCIAL POSITION AND LIQUIDITY

Total statutory assets as of December 31, 2010 were $30,411,000 compared to $27,933,000 at December 31, 2009. The cash, cash equivalents, and short-term investments at December 31, 2010 were $4,289,000 compared to $3,708,000 at December 31, 2009 for an increase of $581,000 or 15.6%. Investments in fixed income securities decreased by $934,000 and equity securities increased by $3,484,000 at December 31, 2010 from the balance at December 31, 2009.

At December 31, 2010 and 2009 equities represented 24.1% and 13.7%, respectively, of total cash and invested assets. The remaining investments are maintained primarily in fixed income securities and money market funds. This investment portfolio mix is in compliance with PCHP's primary investment objectives of safety of principal and liquidity. The fixed income securities are comprised of corporate debt, public utilities, U.S. Treasuries, U.S. Government Agencies and other mortgage backed securities. Investments are stated in compliance with the NAIC guidelines.

PCHP records an estimated claim liability based upon date of service. This claim liability includes an amount for incurred but not reported (IBNR) claims as well as amounts withhold under provider risk allowance arrangements. PCHP's claim liability is reviewed annually by an independent actuary. Management is satisfied that all necessary claim liabilities have been recorded.

The net increase in total capital and surplus (statutory net worth) during 2010 was $529,000. This increase consists of the current year statutory net income of $424,000, unrealized capital net gains of $7,000, and a decrease of $98,000 in non-admitted assets at December 31, 2010.

At December 31, 2010, PCHP's statutory net worth as defined by the Minnesota HMO statutes was $11,949,000. The statutory net worth at December 31, 2009 was $11,420,000. PCHP is subject to risk-based capital (RBC) requirements promulgated by the NAIC. The RBC standards establish uniform minimum capital requirements for insurance companies. The RBC formula applies various weighting factors to financial balances or various levels of activities based on the perceived degree of risk. At December 31, 2010 and 2009, PCHP's total adjusted capital and surplus on a statutory basis was $11,949,000 and $11,420,000, respectively. These amounts exceeded the minimum Company Action Level for both periods. In October 2005, PCHP obtained permission from the Department of Health

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allowing PCHP to return up to $6.0 million of the total $6.6 million of contributed capital made by the contributing members over a time period not shorter than three years and not longer than six years. PCHP returned $2.0 million in 2009 and $2.0 million in 2006 to the contributing members and intends to return the additional $2.0 million over the next year based upon PCHP's financial condition, subject to Board approval.

KNOWN TRENDS AND UNCERTAINTIES

In March 2010, the President signed into law the Patient Protection and Affordable Care Act and Health Care and Education Reconciliation Act of 2010 (collectively referred to as the "Healthcare Reform Legislation"), which considerably transforms the U.S. health care delivery system and increases regulations within the U.S. health insurance industry. The legislation is intended to expand the availability of health insurance coverage to millions of Americans. The Healthcare Reform Legislation contains provisions that take effect from 2010 through 2018, with most measures effective in 2014. The total impact of the Healthcare Reform Legislation is unknown, as many aspects of the legislation require additional guidance and clarification to be developed by the Department of Health and Human Services, the Department of Labor, the Department of Treasury, and the NAIC. Certain provisions of the new legislation are likely to have an impact on PCHP's future operations, including a fee assessed on companies in the insurance industry beginning in 2014, minimum medical loss ratios (MLR) beginning in 2011, guarantee issue and renewability of policies beginning in 2014 and state-based insurance exchanges for individual insurance and small groups beginning in 2014. The impact of the Healthcare Reform Legislation on the financial position and results of operations and changes in net assets of PCHP will continue to be evaluated.

The cost of health care continues to increase due to inflation, new technologies, advances in medical applications, diseases and other external factors. PCHP attempts to mitigate the impact of these changes by emphasizing preventative care, contracting with providers in a manner which encourages cost-effective, appropriate care, increased member financial responsibility under deductible plans, and purchaser awareness of provider unit costs using internet based tools. Despite such strategies, there is no assurance the rate of increase in health care costs will be reduced.