VISION.
CONNECTION.
SUCCESS.

SHARP COMMUNITY MEDICAL GROUP, THROUGH ITS NETWORKS OF AFFILIATED PHYSICIANS, IS THE MODEL OF CHOICE FOR PATIENTS TO RECEIVE CARE AND PHYSICIANS TO PRACTICE MEDICINE. WE FOSTER HIGH QUALITY, EFFICIENT, FINANCIALLY SUSTAINABLE PRACTICES THAT IMPROVE HEALTH AND DELIVER BETTER CARE FOR OUR POPULATION.

LET ME FIRST SAY THAT IT IS AN EXCITING TIME FOR SCMG

AND I AM PROUD TO BEGIN MY FIRST TERM AS PRESIDENT OF THE MEDICAL GROUP DURING THESE TIMES OF CHANGE AND CHALLENGE. THANK YOU FOR THAT OPPORTUNITY.

As I reflect back on each of our individual journeys as physicians, I realize that this is exactly what becoming a physician involves, an individual journey. We compete with the best of the best to get to the finest medical schools and residencies, and then begin our careers in one of the noblest of professions. We are committed to serving our patients, managing our offices and creating our success, again as individuals, relying on our own accomplishments and talents. Very few of us perhaps credit our success to others in a large way and so it is sometimes difficult to change our perspective and embrace or value the "larger good" of an organization like Sharp Community Medical Group.

In 1989, Sharp Community Medical Group was formed. It was and still is a physician led IPA created with the single goal of maintaining our patient base while preserving the autonomy to practice medicine in the model of our choosing. SCMG provided access to health plan contracts and therefore patients. Through our integrated network of primary and specialty physicians, we provided services focused on appropriate utilization, quality and cost management.

Since those days the landscape has changed markedly and continues to do so at an even faster rate. We are facing increasing pressures to control health care costs, demonstrate value and quality in the care provided to our patients, and compete in the market place with other highly performing, efficient medical groups. The bar continues to be raised in many ways.

Now more than ever before we must demonstrate that we provide high quality, cost efficient care, and we must measure this and prove it to our patients and health plans. SCMG must make significant gains in patient satisfaction, HCC coding, electronic connectivity and reach top quartile performance in our quality scores. Other Medical Groups are performing and outpacing us in these endeavors.

In order to be successful we must stop thinking just as individuals, but more as an organization. And yes, this is different from when we started practicing medicine many years ago. We need you to be a part of the team. Our success as a group depends upon your commitment to our vision. And now, more than ever before, your individual success will be tied to the success of SCMG.

The "call to action" will challenge our collective talents, abilities and commitment to outperform our competition. I look forward to your renewed commitment and look forward to the journey ahead!

KENNETH ROTH, M.D.
PRESIDENT AND CHAIR
SHARP COMMUNITY MEDICAL GROUP

JOHN JENRETTE, M.D.
CHIEF EXECUTIVE &
MEDICAL OFFICER

WHAT DO YOU SEE AS SCMG'S GREATEST STRENGTH?

Sharp Community Medical Group's strengths encompass three areas that have contributed to its success historically, as well as laying the ground work for the future.

- **Leadership –** This includes a strong and dedicated physician Board of Directors and Regional Council representation. The Executive Committee adds an additional level of expertise and decision making that supports innovation and responsiveness to our changing environment. Administratively, SCMG also has some of the best and most talented executives at the helm in the State, if not country.
- **Medical Skill –** This refers to the medical skill and dedication to providing excellent patient care to the SCMG population of our primary and specialty physicians. Since 1989, SCMG has been fortunate to attract the most talented physicians to our ranks, and continues to be an organization that is well respected by the health plans and patients.
- **County-Wide Presence –** Our large geographic footprint places SCMG in a particularly good position for health plan negotiations and the development of exclusive narrow networks. It is also an excellent network for participation in the California Health Insurance Exchanges in 2014.

ALTERNATIVELY, WHAT DO YOU SEE AS SCMG'S GREATEST THREATS?

While SCMG has been successful to date in attracting talented physicians to our group, the future presents a challenge. We have an aging workforce, and many young residents are looking for more work/life balance, which often leads them to employment opportunities with large multi-specialty groups or staff models, such as Kaiser. Our physicians also struggle financially because of low reimbursement rates in some lines of business such as PPO, Medicare and MediCal.

WHAT IS SCMG DOING TO ADDRESS THOSE CONCERNS?

SCMG is working diligently to improve PPO reimbursement through the development of commercial Accountable Care Organization (ACO) structures and programs. Even if successful with the new ACOs, SCMG will need to respond to the varying needs of the physicians by supporting all types of practice models. We will need to create new practice models for our physicians that fit their desired level of autonomy – from the ferociously" independent, to those who would prefer someone else operate the business aspects of their offices, even to physicians who want to be employed. Shareholders of SCMG will see efforts in all of these areas.

WITH JOHN JENRETTE, M.D.

DR. JOHN JENRETTE, CHIEF EXECUTIVE OFFICER FOR SHARP COMMUNITY MEDICAL GROUP, WAS RECENTLY ASKED HIS OPINION ON THE CHALLENGES THAT SCMG FACES, AND HOW THE ORGANIZATION IS RESPONDING TO HEALTHCARE REFORM. HERE'S WHAT HE HAD TO SAY.

HOW IS SCMG BEING IMPACTED BY HEALTHCARE REFORM AND WHAT ARE WE DOING TO RESPOND OR PREPARE?

SCMG is in an excellent position to succeed with the changes that have occurred and are coming with healthcare reform. We are a clinically integrated physician group that is perfectly structured as an Accountable Care Organization of the future. SCMG provides medical care for a population of patients, focusing on improving the health and care of our patients, while bringing value in controlling costs. Our long-term successes of providing efficient patient care, coordinated population and case management, and managing chronic disease and hospital services will continue to position us well. All of these efforts are what will be required to succeed in the Exchanges in 2014, where our network should be a strong choice for individuals and small groups choosing health insurance products.

WHAT STRATEGIES ARE IN MOTION OR BEING CONSIDERED FOR SCMG OVER THE NEXT THREE TO FIVE YEARS?

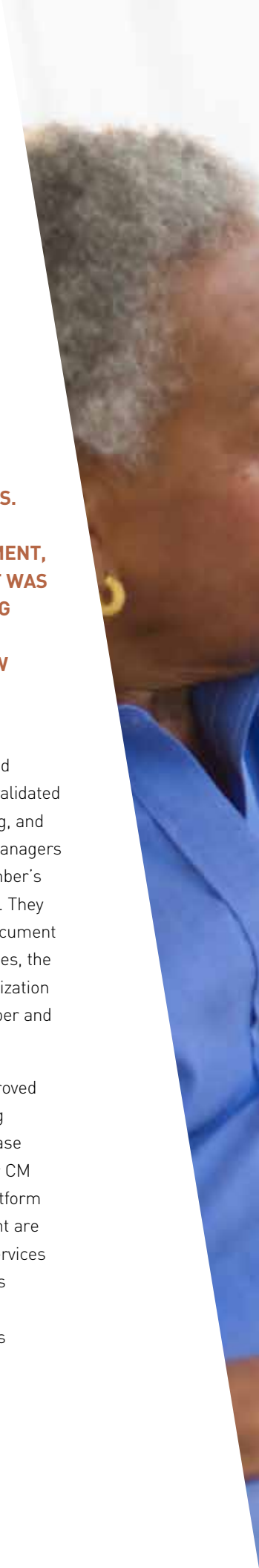
SCMG, through new and innovative delivery models, continues to position itself to be the organization of choice for physicians to practice medicine and patients to receive care. To this end we continue to leverage our strong physician network in the development of new products with the payers – including commercial ACOs and the Medicare Pioneer ACO. Additional opportunities may be in direct to employer contracts, health plan collaborative partnerships, and the opportunity to increase membership through dual eligible enrollment beginning in 2013.

SCMG has also branched out in the development of Partners Urgent Care Centers and the opening of its first supported model office, SmartCare^{MD}, which provides a turn-key operation for primary care physicians who no longer want to manage their own offices. Providing access for patients newly enrolling through the California Health Insurance Exchange is a key consideration to the development of these new projects.

DO YOU HAVE ANY FINAL THOUGHTS THAT YOU WOULD LIKE TO SHARE?

Our future success requires an even greater commitment to alignment of our physicians and health care delivery systems – to create standardization in our performance and processes of care. This elevates the critical nature of health information technology as a major initiative and priority for SCMG. It is only through sophisticated use of IT by connecting physicians together and providing "intelligent" clinical decision support that we can compete in the market place on service, quality and cost. Sharp Community Medical Group's strategies as outlined above will require continued strong physician leadership and shareholder support in order to succeed. In that we are well positioned.

HEALTH SERVICES



THE HEALTH SERVICES (HS) DIVISION OF SCMG CONTINUES TO STRIVE TO IMPROVE THE QUALITY OF SERVICES OFFERED TO OUR PHYSICIAN PARTNERS AND OUR MEMBERS. PAST YEARS' GOALS HAVE FOCUSED ON REFINING THE ROLE OF EACH DEPARTMENT WITHIN HEALTH SERVICES (I.E. UTILIZATION MANAGEMENT, HOSPITAL CASE MANAGEMENT, AMBULATORY CASE MANAGEMENT AND QUALITY MANAGEMENT). IN 2011, THE EFFORT WAS FOCUSED ON INTEGRATING ALL SERVICES, COORDINATING CARE, AND COMMUNICATING ACROSS THE CONTINUUM IN ORDER TO MEET OUR GOALS OF IMPROVED QUALITY AND INCREASED EFFICIENCIES. THIS COLLABORATION ACROSS ALL LEVELS OF CARE IS NOW REFERRED TO AS "INTEGRATED CASE MANAGEMENT" (ICM).

Integrated Case Management's goal is to provide member-centric, interdisciplinary care to members through the use of consistent processes.
Those processes include:

- Screening – using tools and processes to assist in identifying members who are at "high risk" and would benefit from Case Management
- Triage – a specialized Case Management (CM) team determines the appropriate level/type of services based on knowledge of member's physical, functional and environmental needs
- Communication – improved communication between all members of the interdisciplinary team through the use of information technology
- Outcome Measures – use of validated tools and measurements to ensure that ICM program meets the goal of providing high quality, cost efficient care to all members

SCMG Case Managers (CM) are experienced professionals who use a variety of methods to assist our physician partners in caring for their patients, and improving coordination in order to avoid fragmented care. Those methods include validated assessment tools, motivational interviewing, and use of evidenced based guidelines. Case Managers perform complex assessments of the member's clinical, functional and psychosocial status. They create member-specific care plans and document ongoing interventions. To measure outcomes, the teams continually assess the impact of utilization of services on total cost of care, and member and provider satisfaction.

Information technology has facilitated improved communication, coordination and reporting capabilities across the system. Essette® Case Management Software was adopted as our CM platform in the spring of 2011. This CM platform ensures that all levels of Case Management are knowledgeable, and that coordination of services can occur without interruption as members transition through multiple levels of care.
In addition, we support our SCMG providers through the use Allscripts™ Electronic Health Record.

SCMG CONNECT

FOR THE SCMG CONNECT TEAM, 2011 WAS A YEAR OF REBUILDING AND REFOCUSING. A NUMBER OF AREAS FOR IMPROVEMENT WERE IDENTIFIED, INCLUDING SYSTEM STABILITY AND PRACTICE IMPLEMENTATION STRATEGIES.

SYSTEM STABILITY – In order to provide more stability for the system, the team partnered with Dell to transition the software and data to all new hardware in its state-of-the-art data center in Plano, Texas. A thorough evaluation of the existing software system configuration was undertaken, and improvements have been methodically implemented. The team performed a number of software upgrades in order to ensure the most current versions are being used. Regular preventive maintenance work was scheduled to ensure the system continues to meet performance expectations. ReCONNECT, a backup chart viewer application, was created to ensure access to clinical information in the event of a system outage.

IMPLEMENTATION BEST PRACTICES – Standard processes were developed and implemented to ensure a consistently high quality outcome for each new practice. A more thorough practice assessment process was implemented to better prepare practices for the changes necessary in order to transition to an electronic office. Additional follow-up visits were scheduled to ensure providers have the assistance needed to genuinely adopt the system as an integral part of the practice.

PRACTICE ENGAGEMENT – The team changed its focus from software installation to partnering to build a solution. Staff members began to proactively visit with providers and practices to develop a deeper understanding of actual physician practice operations. Independent physician practice experience was added as a top priority in recruiting staff. The team defined and implemented the following:

- **A practice prioritization process**
- **Practice "Super User" program**
- **Standard practice communication process**
- **Physician user group**

The SCMG CONNECT team also began a concerted service recovery initiative to develop positive relationships and build trust (key focus areas include striving for quality, consistency, predictability, repeatability).

STAFFING – After an evaluation of the project needs and current staffing, twelve new positions were created and filled. Blending the new staff with the existing staff provided the team with a deeper set of skills and experience – with a balance between physician practice and information systems experience.

Once these improvements were made, the team resumed installing the system at additional practices. During the coming year, the plan is to move "full speed ahead," bringing the PM/EHR system to additional practices, and providing additional functionality for the practices already using the system.

SMART CARE[MD]
PRACTICE MANAGEMENT, LLC

NEW MODELS OF PRACTICE FOR PHYSICIANS

> WE HAVE PHYSICIANS ACROSS THE SPECTRUM – FROM THOSE WHO ARE FEROCIOUSLY INDEPENDENT, TO THOSE WHO WOULD PREFER TO DELEGATE THE BUSINESS ASPECTS OF THEIR PRACTICE TO AN EXPERIENCED MANAGEMENT COMPANY.

CHRISTOPHER MCGLONE,
Chief Operating Officer for SCMG & President of SmartCareMD Practice Management, LLC.

Anticipating the desire physicians have expressed to work in different practice models, SCMG formed SmartCare[MD] Practice Management, LLC (SmartCare[MD]) in 2011. On October 3, 2011, the first site, SmartCare[MD] Medical Group Point Loma, opened in Liberty Station.

SmartCare[MD] Practice Management provides comprehensive practice management services while still allowing physicians to maintain a sense of independence. "We have physicians across the spectrum – from those who are ferociously independent to those who prefer to delegate the business aspects of their practice to an experienced management company." says Christopher McGlone, Chief Operating Officer for SCMG and President of SmartCare[MD] Practice Management, LLC. "Under the SmartCare[MD] model, SCMG provides the office staff and manages the business practices, freeing the physician to focus primarily on patient care."

SmartCare[MD] Practice Management provides the following services: **lease negotiations and office build out, staff employment and human resources, compliance, office equipment and supply purchasing, office operations, billing, and all other business-related issues of a private practice.**

SmartCare[MD] Medical Group Point Loma brings together two SCMG solo practitioners into one supported practice environment – Dr. Elizabeth Saarni and Dr. Gerald Paul, who have each had very successful practices in the Point Loma area for many years. The practice will be expanding by bringing in a new physician in August 2012.

PARTNERS URGENT CARE

In 2011, Sharp Community Medical Group partnered with an organization in Orange County that has experience managing urgent care centers, to open four new urgent care centers in San Diego. Named Partners Urgent Care, the centers are strategically located throughout San Diego County.

SCMG entered into this venture in order to provide our physicians and patients with an enhanced level of service, specifically focused on their needs. The benefits include better communication and follow up with SCMG physicians, and more accessible services to patients, such as flu shot clinics, travel immunizations, and post-discharge appointments. Additional services are being developed.

Working together with Partners, SCMG is able to offer an enhanced level of service to physicians and patients, while providing new convenient locations where patients can receive a wide array of quality, cost-effective healthcare services.

Partners URGENT CARE

NEW MODELS OF CARE FOR PATIENTS

East Lake location

Partners Urgent Cares are located in the following San Diego communities:

EAST LAKE
2315 Otay Lakes Rd., Suite 306
Chula Vista, CA 91914

UTC
4085 Governor Dr.
San Diego, CA 92122

GROSSMONT
6136 Lake Murray Blvd.
La Mesa, CA 91942

RANCHO PEÑASQUITOS
9878 Carmel Mountain Rd., Suite B
San Diego, CA 92129

PATIENT SATISFACTION

PATIENT SATISFACTION IS ESSENTIAL TO SCMG BECAUSE IT LEADS TO IMPROVED PATIENT ADHERENCE OF TREATMENT PLANS, PATIENT SELF-MANAGEMENT OF CHRONIC CONDITIONS, AND BETTER CONTINUITY OF CARE ASSOCIATED WITH REDUCED HOSPITALIZATIONS.

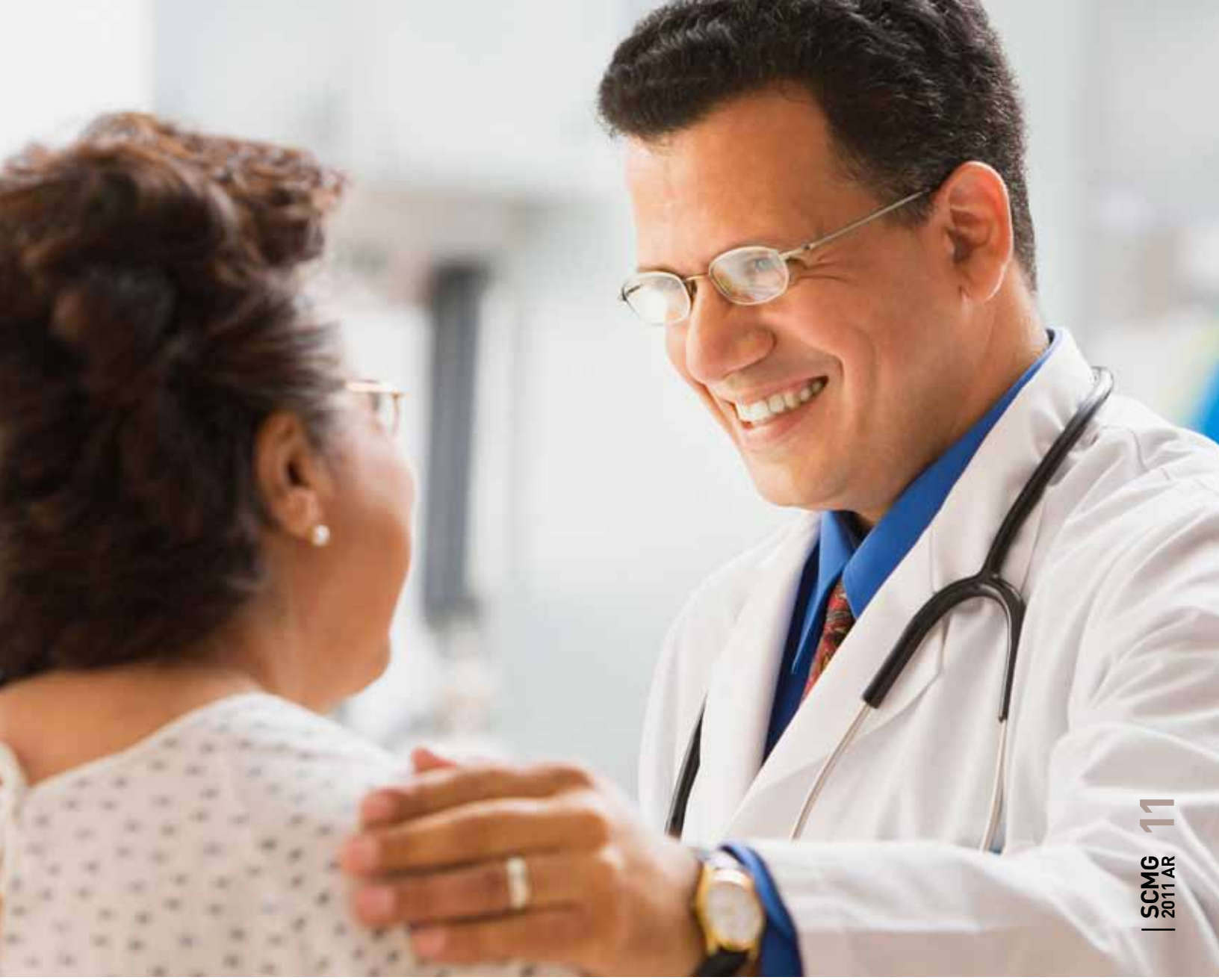
Enhanced communication and relationships among clinicians, staff, and patients are equally important. These factors foster confidence in and loyalty to the care provider team, and patients' likelihood to recommend that team.

Patient satisfaction drives revenue and profitability. Lower satisfaction has been shown to increase the chances of malpractice claims and inefficiencies, such as, excessive wait time, reduced access to care, missed appointments, inappropriate use of the Emergency Department for primary care, and abuse of referrals and diagnostic tests. Patient satisfaction is also important for increasing SCMG's prospect for selection into tiered health plans and narrow networks. Increased satisfaction also bolsters each provider's opportunity to earn greater Quality Incentive Service Recognition (QISR) and Pay for Performance (P4P) scores and rewards.

Over the years, SCMG physicians have become increasingly engaged in improving patient satisfaction. In 2011, a large portion of the clinicians who participated in the Improving Patient Experience (IPE) Collaborative, customarily an invitation-only program, were volunteers who had heard about the initiative from their peers. The IPE collaborative is an intense 8-month training series that engages clinicians and staff in enhancing communication and relationships with patients. Participants are exposed to more than 50 key techniques that are instrumental in improving patient and work satisfaction. The training workshops are coupled with personalized clinician and staff shadowing from a nationally renowned clinical psychologist and one-on-one coaching from trained SCMG staff. To date, 102 physicians (59 practices, 21 mid-level providers and more than 230 staff) have participated in the collaborative. Collectively, participants have recognized a 52 percent improvement in survey scores (10 percent above the organizational average).

In addition to the IPE collaborative, SCMG spearheaded several initiatives for improving patient satisfaction in 2011. These initiatives include one-on-one in-office action planning, scripting and brainstorming sessions, and on-site patient satisfaction training workshops customized to address specific issues in each practice. The SCMG Medical Directors and executives worked closely with regional and specialty advisory committee members and leaders to engage them in fostering patient satisfaction improvement efforts within their respective fields.

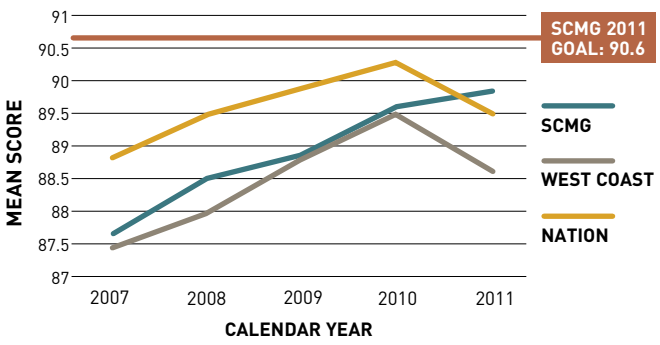
Despite SCMG's aggressive approach to improving patient satisfaction in 2011, there was a slight setback. Press Ganey, SCMG's survey vendor, and the industry's recognized leader in health care performance and improvement, updated their Medical Practice patient satisfaction survey during the first quarter of 2011. Press Ganey reported that many of their top performers had achieved a ceiling effect: their scores were in the top percentile ranks, leaving little room for further growth. Press Ganey's strategy in updating the survey was to lower the database distribution of mean scores by introducing questions that typically score lower (such as questions about wait time, team effort and updating patients about delays). By lowering the mean scores, all Press Ganey clients would have a greater opportunity to



reach higher. Shortly after the survey update, as Press Ganey predicted, most medical groups experienced a significant drop in scores (see Figure 1). Despite this decline, SCMG is proud to announce an improvement in mean score between 2010 (89.6, 26th percentile) and 2011 (89.9, 45th percentile).

As the Press Ganey national database stabilizes in 2012, SCMG anticipates recognizing further improvement by the end of 2012. SCMG has a vested interest in ensuring that all patients are satisfied with the delivery of care provided, and that all clinicians and staff enjoy their work. As we plow forward in this progressive medical market, SCMG is committed to continually enhancing patients' experiences and keeping patient satisfaction on the forefront. It is the right thing to do and patients expect it.

SCMG PATIENT SATISFACTION SCORE TREND



CFO PERSPECTIVE

SHARP COMMUNITY MEDICAL GROUP MAINTAINED ITS STRONG FINANCIAL PERFORMANCE IN 2011.

PAUL DURR
CHIEF FINANCIAL OFFICER

Bolstered by improved revenue for its commercial line of business, SCMG was able to continue to reward physicians with a Quality Incentive Service Recognition (QISR) of $7.6 million and an additional extraordinary distribution of $9.0 million for a total payment of $16.6 million. The Board also directed that $2.9 million be added to its tangible net equity balance to allow for future investment in the organization.

SCMG's financial success was the result of receiving an average 7.6% increase from its commercial health plans. The Board continues to balance the need for rate increases with remaining competitive in the commercial market. Commercial membership decreased 3.6% from the prior year in part due to employers making decisions to opt for less expensive healthcare coverage for employees, as well as limited economic growth in the county. Overall medical costs held steady compared to the prior year.

Recognizing the need to continue to adapt to the future changes in healthcare delivery, the Board made the decision to invest in urgent care centers and establish a new company called SmartCare[MD] Practice Management. SCMG owns 50% of four Partners Urgent Care Centers established throughout San Diego County. The urgent care centers will enable SCMG to offer a range of healthcare services to its enrolled members thereby creating more efficiency in the care continuum. SmartCare[MD] Practice Management, a wholly owned subsidiary of SCMG, was created to offer practice management services to physicians who are burdened by the ever increasing complexities of running a medical office. The combined losses for these investments were $1.2 million for 2011. In addition, SCMG expanded its investment in the electronic medical record by authorizing the expansion of staff needed to more quickly get providers on the system in 2012.

Ever mindful of the constant changes in healthcare, the Board has been prudent about insuring a solid financial foundation for the corporation. With continued pressure to become more efficient in the delivery of healthcare, the Board has created a fiscally sound corporation that will allow the corporation to continue to invest in various initiatives to ensure the success of the group into the future.

SEATED FRONT LEFT TO RIGHT:
Sergio Flores, M.D. *(Vice President)*
Kenneth Roth, M.D. *(President)*
David Bodkin, M.D. *(Secretary)*

MIDDLE ROW LEFT TO RIGHT:
Corey Marco, M.D.
Brian Meyerhoff, M.D.
Ada Marin, M.D.
Carlos Castro, M.D. *(Treasurer)*
Eva Leonard, M.D.
Alan Schoengold, M.D. *(ex-officio)*
Neil Tarzy, M.D.

BACK ROW LEFT TO RIGHT:
Barry Scher, M.D.
Eric Orr, M.D.
Gregory Czer, M.D.
Kenneth Warm, M.D.
Larry Pollack, M.D.
Franklin Martin, M.D.

REPORT ON CONSOLIDATED FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 20**11** AND 20**10**

J.H. COHN LLP
Accountants and Consultants since 1919

www.jhcohn.com • 888-542-6461 • fax 888-542-3291

Report of Independent Public Accountants

To the Board of Directors
Sharp Community Medical Group Incorporated

We have audited the accompanying consolidated balance sheets of Sharp Community Medical Group Incorporated as of December 31, 2011 and 2010, and the related consolidated statements of income, equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. 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 financial statements are free of material misstatements. 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Sharp Community Medical Group Incorporated as of December 31, 2011 and 2010, and its results of operations and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

J.H. Cohn LLP

San Diego, California
April 26, 2012

CONSOLIDATED BALANCE SHEETS

YEARS ENDED DECEMBER 31, 2011 AND 2010

ASSETS	2011	2010
Current assets:		
Cash and cash equivalents	$ 19,274,938	$ 18,552,193
Investments in available-for-sale securities	38,160,310	33,977,262
Investments – other	—	4,948,000
Accounts receivable	533,975	1,045,564
Accrued interest receivable	307,385	267,201
Inventories	—	32,434
Prepaid expenses	53,442	24,480
Income taxes receivable	—	1,071,524
Current portion of notes receivable from related parties	591,972	104,382
Deferred tax assets	622,504	351,474
Total current assets	59,544,526	60,374,514
Long-term assets:		
Long-term portion of notes receivable from related parties	3,493,523	271,617
Equipment, leasehold improvements and software, net	2,944,670	3,868,816
Total long-term assets	6,438,193	4,140,433
Totals	$ 65,982,719	$ 64,514,947
LIABILITIES AND EQUITY		
Current liabilities:		
Physician fees payable	$ 12,736,831	$ 14,938,472
Incurred but unreported claims	11,596,969	11,896,984
Professional fees payable	1,020,062	533,524
Deferred revenue	3,141,752	2,417,089
Physician quality incentive payable	15,202,121	15,201,465
Income taxes payable	281,978	—
Other current liabilities	3,356,676	5,197,165
Total current liabilities	47,336,389	50,184,699
Deferred tax liability	1,050,231	1,212,666
Interest in urgent care partnerships	987,298	—
Other liabilities	947,147	420,358
Total liabilities	50,321,065	51,817,723
Commitments and contingencies		
Equity:		
Sharp Community Medical Group, Inc.:		
Common stock	303,933	310,233
Retained earnings	14,973,195	12,096,559
Accumulated other comprehensive income	402,056	290,432
Total Sharp Community Medical Group, Inc.	15,679,184	12,697,224
Non-controlling interest—SmartCare MD	(17,530)	—
Total equity	15,661,654	12,697,224
Total liabilities and equity	$ 65,982,719	$ 64,514,947

CONSOLIDATED STATEMENTS OF INCOME

YEARS ENDED DECEMBER 31, 2011 AND 2010

	2011	2010
Revenue:		
Capitated fees	$ 262,388,844	$ 250,185,644
Incentive	1,554,625	1,569,983
Totals	263,943,469	251,755,627
Operating expenses:		
Capped fees:		
Primary care physicians	54,669,747	48,729,085
Specialty physicians	37,710,400	39,642,980
Fees for services – primary and specialty care physicians and ancillary providers	106,988,933	104,614,036
Physician quality incentive	16,603,049	16,206,271
Totals	215,972,129	209,192,372
Income from operations before general and administrative fees	47,971,340	42,563,255
General and administrative fees:		
Management fees	31,964,277	29,831,426
Professional and legal fees	8,908,639	6,137,040
Depreciation and amortization	803,620	855,123
Other	1,397,387	931,131
Totals	43,073,923	37,754,720
Income from operations	4,897,417	4,808,535
Other income (expense):		
Investment income	961,372	1,161,127
Loss on investments in urgent care partnerships	(987,298)	—
Interest expense	(25,754)	(47,281)
Income before income taxes and non-controlling interest	4,845,737	5,922,381
Provision for income taxes	1,989,131	2,412,888
Consolidated net income	2,856,606	3,509,493
Net loss attributable to non-controlling interest—SmartCareMD	(20,030)	—
Net income attributable to Sharp Community Medical Group, Inc.	$ 2,876,636	$ 3,509,493

CONSOLIDATED STATEMENTS OF EQUITY

YEARS ENDED DECEMBER 31, 2011 AND 2010

	Common Stock			Accumulated Other		
	Shares	Amount	Retained Earnings	Comprehensive Income	Non-Controlling Interest	Total
Balance at January 1, 2010	583.13	$ 324,833	$ 8,587,066	$ 312,412	$ —	$ 9,224,311
Net income			3,509,493			3,509,493
Unrealized loss on available-for-sale securities, net of deferred taxes of $14,552				(21,980)	—	(21,980)
Comprehensive income						3,487,513
Issuance of common stock	35.00	3,500				3,500
Shares repurchased and cancelled	(37.00)	(18,100)				(18,100)
Balance at December 31, 2010	581.13	310,233	12,096,559	290,432	—	12,697,224
Net income			**2,876,636**		**(20,030)**	**2,856,606**
Unrealized gain on available-for-sale securities, net of deferred taxes of $73,904				**111,624**		**111,624**
Comprehensive income						**2,968,230**
Issuance of common stock	**31.00**	**3,100**			**2,500**	**5,600**
Shares repurchased and cancelled	**(22.00)**	**(9,400)**				**(9,400)**
Balance at December 31, 2011	**590.13**	**$ 303,933**	**$ 14,973,195**	**$ 402,056**	**$ (17,530)**	**$ 15,661,654**

CONSOLIDATED STATEMENTS OF CASH FLOWS

YEARS ENDED DECEMBER 31, 2011 AND 2010

	2011	2010
Operating activities:		
Consolidated net income	$ 2,856,606	$ 3,509,493
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of premium	442,058	317,531
Realized gain on investments	(120,289)	(368,220)
Deferred income taxes	(507,369)	(200,822)
Depreciation and amortization	803,620	855,123
Loss on disposal of fixed assets	337,858	50,312
Loss from urgent care partnerships	987,298	—
Changes in operating assets and liabilities:		
Accounts receivable	511,589	(970,121)
Accrued interest receivable	(40,184)	(38,676)
Inventories	32,434	60,603
Prepaid expenses	(28,962)	42,191
Income taxes receivable	1,071,524	(585,661)
Physician fees payable	(2,201,641)	(2,448,464)
Incurred but unreported claims	(300,015)	(3,326,415)
Professional fees payable	486,538	(325,225)
Deferred revenue	724,663	28,808
Physician quality incentive payable	656	8,632,139
Income taxes payable	281,978	—
Other liabilities	(1,313,700)	(193,895)
Net cash provided by operating activities	4,024,662	5,038,701
Investing activities:		
Purchases of investments	(35,676,032)	(40,213,954)
Proceeds from sales of investments	36,304,743	24,923,639
(Increase) decrease in notes receivable from related parties	(3,709,496)	39,593
Acquisition of equipment and software	(217,332)	(18,225)
Net cash used in investing activities	(3,298,117)	(15,268,947)
Financing activities:		
Issuance of common stock	3,100	3,500
Repurchase and cancellation of common stock	(9,400)	(18,100)
Capital contribution from non-controlling interest	2,500	—
Net cash used in financing activities	(3,800)	(14,600)
Net increase (decrease) in cash and cash equivalents	722,745	(10,244,846)
Cash and cash equivalents, beginning of year	18,552,193	28,797,039
Cash and cash equivalents, end of year	$ 19,274,938	$ 18,552,193
Supplementary disclosure of cash flow data:		
Interest paid	$ 24,340	$ 47,281
Income taxes paid	$ 1,535,500	$ 3,510,000
Supplementary disclosure of noncash information:		
Discount for early payment of license fee payable	$ —	$ 329,486
Accrued fixed asset additions	$ —	$ 70,500

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - Organization and business:

Sharp Community Medical Group Incorporated (the "Company") is a California professional corporation of physicians, organized in 1989 and licensed to practice medicine in the State of California. The Company is an association of independent primary and specialty care physicians who practice in their local offices throughout San Diego County and southern Riverside County. The Company contracts with Health Maintenance Organizations ("HMOs") to provide physician and related health care services for the HMO enrollees. Effective January 1, 2011, the Company entered into two Accountable Care Organization ("ACO") contracts with the intent to coordinate patient care that will promote improvements in quality and efficiency of care delivered to Preferred Provider Organization ("PPO") enrollees.

In November 2000, the Company entered into a professional services agreement with Graybill Medical Group ("Graybill"), a professional medical corporation, which employs primary care and certain specialty care physicians. The agreement allows Graybill to access the Company's contracts with HMOs. Graybill assumes the risk for all specialty care and covered services for enrollees selecting a Graybill primary care physician.

Sharp Healthcare provides management advisory, consulting and administrative services to the Company. The Company entered into a purchase services agreement with Sharp Healthcare which was effective in 2006.

In May 2011, the Company established a subsidiary, SmartCare[MD] Practice Management, LLC ("SmartCare[MD]"), to manage physician offices thereby sustaining the Company's current model of private practice. The Company owns 90% of the LLC and Graybill owns 10%. The first office opened in Point Loma in October 2011.

Note 2 - Summary of significant accounting policies:

Use of estimates:

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Principles of consolidation:

The accompanying financial statements are consolidated and include the accounts of the Company and its SmartCare[MD] subsidiary as described above. All intercompany balances and transactions have been eliminated in consolidation.

SmartCare[MD] has assets totaling $227,000, liabilities of $402,000, contributed capital of $25,000, and losses of $200,000 at December 31, 2011.

Cash and cash equivalents:

The Company considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents.

Concentrations of credit risk:

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of cash and cash equivalents, investments and accounts receivable from HMOs. The Company maintains cash in certain money market investment accounts that are not covered by the Federal Deposit Insurance Corporation. The money market funds and investments consist of high quality debt securities including: U.S. Government obligations; certificates of deposit, time deposits and other obligations issued by domestic banks; commercial paper and corporate bonds. The Company has experienced insignificant losses in such accounts and does not believe it is exposed to any significant credit risk.

With respect to the accounts receivable from HMOs, credit risk is mitigated by the HMOs' concurrent payment of the contracted amount for services provided and government regulations (primarily covered by the State of California Knox-Keene Act) which require the HMOs to maintain adequate financial reserves for payment of medical services (see Note 10 for major payors).

Investments:

The Company classifies its investments in debt securities as available-for-sale. Accordingly, these investments are reported at fair value with unrealized holding gains and losses, net of tax, as a component of accumulated other comprehensive income (loss) until realized. The fair value of these securities is based on quoted market prices or quoted prices for similar assets. Realized gains and losses are determined on the specific identification method. It is the intent of the Company not to hold securities until maturity but instead to follow its investment policy regarding maturity guidelines, investment ratings, and investment concentrations.

Investments - other:

The Company classifies certificates of deposit held for investment that are not debt securities as "investments - other." All certificates of deposit having original maturities greater than three months and remaining maturities less than one year are classified as short-term investments.

Inventories:

Inventories primarily consist of diabetic supplies which are stated at the lower of cost or market. Cost is determined using the first-in, first-out method.

Equipment, leasehold improvements, and software:

Equipment and software are stated at cost. The majority of the equipment and software are related to the implementation of the electronic health record system and practice management project. In 2011, the Company purchased a case management platform as well as obtained assets necessary for the operation of SmartCare[MD]. Depreciation is calculated over the estimated useful life of each class of depreciable asset from five to seven years. The Company began depreciating the equipment and software related to the practice management project in October 2008, the equipment and software related to the electronic health record system in April 2009, and the software related to the case management platform in May 2011. All SmartCare[MD] assets were placed into service in October 2011.

Note 2 - Summary of significant accounting policies (continued):

Investments in partnerships:

Investments in partnerships in which the Company has the ability to exercise significant influence are recorded on the equity method at cost plus advances and equity in undistributed earnings or losses.

Revenue recognition:

The Company's contracts with various HMOs provide for a prepaid, monthly, fixed capitation payment on a per member basis by the HMOs to the Company. Capitation payments from HMOs are recognized as revenue during the period in which enrollees are entitled to receive services.

Under capitation contracts, the Company is financially responsible to provide the enrollee with necessary covered primary and specialty physician care. The Company is a party to shared risk (incentive) arrangements which generally reward the Company for the efficient utilization of certain inpatient and outpatient services. Under the shared risk arrangements, the Company shares any surplus above amounts pre-established by the HMO. Amounts received as surplus from the HMOs are recognized as revenue when received.

Incurred but unreported claims:

Incurred but unreported claims are estimated based on historical data of actual claims approved for a given date of service. These estimates may vary from actual results and the differences may be significant.

Income taxes:

The Company accounts for income taxes pursuant to the asset and liability method which requires deferred income tax assets and liabilities to be computed annually for temporary differences between the financial statement and tax bases of assets and liabilities that will result in taxable or deductible amounts in the future based on enacted laws and rates applicable to the periods in which the temporary differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce deferred tax assets to the amounts expected to be realized. The income tax provision or credit is the tax payable or refundable for the period plus or minus the change during the period in deferred tax assets and liabilities.

At December 31, 2011 and 2010, the total accrued interest and penalties associated with uncertain tax positions were $8,835 and $11,139, respectively.

The Company files income tax returns in the U.S. Federal jurisdiction and California. Federal and California tax returns prior to fiscal years 2008 and 2007, respectively, are closed. The Company's tax returns are not currently under examination.

The Company recognizes interest and penalties associated with tax matters as part of operating expenses and includes accrued interest and penalties with the related tax liability in the balance sheet.

Accounting for the impairment of long-lived assets:

The Company assesses potential impairments to its long-lived assets when there is evidence that events or changes in circumstances indicate that the carrying amount of an asset may not be recovered. An impairment loss

is recognized when the undiscounted cash flows expected to be generated by an asset (or group of assets) is less than its carrying amount. Any required impairment loss is measured as the amount by which the assets carrying value exceeds its fair value, and is recorded as a reduction in the carrying value of the related asset and a charge to operations. The Company has determined that there have been no such changes in circumstance as of December 31, 2011.

Note 3 - Investments and fair value measurement:

Accounting principles generally accepted in the United States of America provide a framework for measuring fair value, expands disclosures about fair value measurements and establishes a fair value hierarchy which prioritizes the inputs used in measuring fair value summarized as follows:

Level 1: Fair value determined based on quoted prices in active markets for identical assets.

Level 2: Fair value determined using quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar instruments in markets that are not active and model-derived valuations in which all significant inputs are observable in active markets.

Level 3: Fair value determined using significant unobservable inputs.

Following are the major categories of assets measured at fair value on a recurring basis as of December 31, 2011:

	Level 1	Level 2	Level 3	Total
U.S. Government agency securities	$ —	$ 15,518,393	$ —	$ 15,518,393
Corporate bonds				
AA+	—	3,164,579	—	3,164,579
AA	—	2,699,211	—	2,699,211
AA-	—	231,210	—	231,210
A+	—	2,773,003	—	2,773,003
A	—	4,481,630	—	4,481,630
A-	—	3,011,663	—	3,011,663
BBB+	—	759,412	—	759,412
BBB	—	965,356	—	965,356
Total corporate bonds		18,086,064		18,086,064
U.S. Treasury securities	4,555,853	—	—	4,555,853
Totals	$ 4,555,853	$ 33,604,457	$ —	$ 38,160,310

Note 3 - Investments and fair value measurement (continued):

Following are the major categories of assets measured at fair value on a recurring basis as of December 31, 2010:

	Level 1	Level 2	Level 3	Total
U.S. Government agency securities	$ —	$ 11,414,782	$ —	$ 11,414,782
Commercial paper				
A-1+	—	2,997,452	—	2,997,452
A-1	—	1,499,503	—	1,499,503
Total commercial paper	—	4,496,955	—	4,496,955
Corporate bonds				
AAA	—	2,583,220	—	2,583,220
AA+	—	1,954,373	—	1,954,373
AA	—	2,183,960	—	2,183,960
AA—	—	627,830	—	627,830
A+	—	1,681,580	—	1,681,580
A	—	3,446,906	—	3,446,906
A—	—	1,228,293	—	1,228,293
BBB+	—	466,376	—	466,376
BBB	—	587,682	—	587,682
BBB-	—	75,822	—	75,822
Total corporate bonds		14,836,042		14,836,042
U.S. Treasury securities	3,229,483	—	—	3,229,483
Totals	$ 3,229,483	$ 30,747,779	$ —	$ 33,977,262

The Company's investments in available-for-sale securities are valued based on the market approach valuation technique and are exposed to price fluctuations. The fair value measurements for the Company's Level 1 investment securities are valued based upon the quoted price in active markets multiplied by the number of securities owned, exclusive of any transaction costs and without any adjustments to reflect discounts that may be applied to selling a large block of securities at one time.

The Company's Level 2 investment securities are valued based on standard inputs listed in approximate order of priority for use when available that include benchmark yields, reported tables, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, reference data including market research publications, vendor traded platform data. The Company does not believe changes in the fair value of these assets will materially differ from the amount that could be realized upon settlement or that the changes in fair value will have a material effect on the Company's results of operations or financial position. However, the ultimate amount that could be realized upon sale or settlement is dependent on several factors including external market conditions, the terms and conditions of a sale agreement, the counterparty to a sale agreement, the investment's liquidity in capital markets and the length of time to liquidate an equity investment.

Available-for-sale securities at December 31, 2011 consist of the following:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Government agency securities	$ 15,188,396	$ 329,997	$ —	$ 15,518,393
Corporate bonds				
AA+	3,086,962	77,617	—	3,164,579
AA	2,606,743	92,468	—	2,699,211
AA-	229,019	2,196	(5)	231,210
A+	2,738,381	35,408	(786)	2,773,003
A	4,444,919	47,318	(10,607)	4,481,630
A-	2,999,279	35,835	(23,451)	3,011,663
BBB+	753,465	6,536	(589)	759,412
BBB	969,057	4,118	(7,819)	965,356
Total corporate bonds	17,827,825	301,496	(43,257)	18,086,064
U.S. Treasury securities	4,453,459	102,394	—	4,555,853
Total available-for-sale securities	$ 37,469,680	$ 733,887	$ (43,257)	$ 38,160,310

Available-for-sale securities at December 31, 2010 consist of the following:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Government agency securities	$ 11,103,854	$ 318,367	$ (7,439)	$ 11,414,782
Commercial paper				
A-1+	2,996,720	732	—	2,997,452
A-1	1,499,453	50	—	1,499,503
Total commercial paper	4,496,173	782	—	4,496,955
Corporate bonds				
AAA	2,527,481	55,739	—	2,583,220
AA+	1,932,266	29,455	(7,348)	1,954,373
AA	2,165,915	21,579	(3,534)	2,183,960
AA-	617,509	10,324	(3)	627,830
A+	1,671,594	23,442	(13,456)	1,681,580
A	3,450,279	29,397	(32,770)	3,446,906
A-	1,225,604	10,410	(7,721)	1,228,293
BBB+	471,004	362	(4,990)	466,376
BBB	598,685	—	(11,003)	587,682
BBB-	77,037	—	(1,215)	75,822
Total corporate bonds	14,737,374	180,708	(82,040)	14,836,042
U.S. Treasury securities	3,134,760	94,723	—	3,229,483
Total available-for-sale securities	$ 33,472,161	$ 594,580	$ (89,479)	$ 33,977,262

Note 3 - Investments and fair value measurement (concluded):

The amortized cost and estimated fair value of investments in debt securities at December 31, 2011 and 2010, by contractual maturity, were as follows:

	2011		2010	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Within one year	$ 4,365,028	$ 4,437,693	$ 5,313,421	$ 5,331,984
One to five years	33,104,652	33,722,617	28,158,739	28,645,278
Totals	$ 37,469,680	$ 38,160,310	$ 33,472,160	$ 33,977,262

Actual maturities may differ from contractual maturities because some issuers have the right to call or prepay obligations with or without call or prepayment penalties.

As of December 31, 2011 and 2010, the Company recorded unrealized gains of $185,528 and losses of $36,532, net of deferred income taxes of $73,904 and $14,552, respectively. As of December 31, 2011 and 2010, the Company recorded net realized gains of $120,289 and $368,220, respectively.

Note 4 - Equipment, leasehold improvements, and software:

Equipment, leasehold improvements, and software consist of the following:

	2011	2010
Equipment	$ 94,196	$ 805,664
Leasehold improvements	25,889	-
Software	4,855,275	4,758,027
	4,975,360	5,563,691
Less accumulated depreciation and amortization	2,030,690	1,694,875
Totals	$ 2,944,670	$ 3,868,816

Depreciation and amortization expense totaled $803,620 and $855,123 for the years ended December 31, 2011 and 2010, respectively.

Note 5 - Notes receivable:

The Company entered into a Center Development Agreement on June 15, 2010 for the development of four urgent care centers in San Diego County. Under this agreement, four partnerships were formed to develop and operate the centers. The Company has provided $3,600,000 of the $4,000,000 originally agreed upon for financing that is to be repaid over the period of eight years accruing interest at 2% above the prime rate. The Company may provide additional funding as necessary.

Note 6 - Interest in urgent care partnerships:

As a 50% owner of the four urgent care centers the Company has recognized its share of losses of $987,298 under the equity method of accounting for the period ending December 31, 2011. The Company will continue to fund the operating needs of the urgent care centers as needed.

Note 7 - Related party transactions and balances:

A substantial portion of the medical services provided on behalf of the Company is rendered by physicians who are also stockholders of the Company. During the years ended December 31, 2011 and 2010, approximately $121,969,000 and $109,141,000, respectively, of primary and specialty care physicians' fees, board fees, and committee fees related to physicians who were also stockholders. At December 31, 2011 and 2010, approximately $8,854,000 and $9,592,000, respectively, of such fees were included in physician fees payable and incurred but unreported claims.

At December 31, 2011 and 2010, substantially all of the physician quality incentive payable and expense related to physicians who were also shareholders. The physician quality incentive rewards physicians for various quality and service measures.

Note 8 - Income taxes:

The provision for income taxes for the years ended December 31, 2011 and 2010 consists of the following:

	2011	2010
Current:		
Federal	$ 1,983,700	$ 2,172,531
State	512,800	512,572
Deferred:		
Federal	(433,675)	(266,613)
State	(73,694)	(5,602)
Totals	$ 1,989,131	$ 2,412,888

For the years ended December 31, 2011 and 2010, the Company's effective tax rate differs from the Federal statutory rate due to the existence of state income taxes and nondeductible expenses of $570,000 and $675,000, respectively.

The components that comprise deferred tax assets and liabilities are as follows at December 31:

	2011	2010
Current deferred tax assets (liabilities):		
Current state taxes	$ 174,352	$ 181,356
Physician guaranteed payments reserve	380,617	52,245
Accrued liabilities	342,643	319,077
Unrealized gain on available-for-sale securities	(275,108)	(201,204)
Totals	622,504	351,474
Long-term deferred tax liability:		
Depreciation	(1,050,231)	(1,212,666)
Totals	$ (427,727)	$ (861,192)

Note 9 - Line of credit:

The $5,000,000 line of credit agreement that the Company had with a financial institution expired on September 4, 2011. The line of credit was secured by the investment securities. The interest rate was variable based on 2% plus the one-month LIBOR rate. The Company paid a loan facility fee equal to 0.50% per annum of the difference between the loan amount and the actual daily unpaid principal amount. There was no balance outstanding under the agreement at December 31, 2010.

Note 10- Major payors:

For the year ended December 31, 2011, capitation revenue from four HMOs individually comprised greater than 10% of the Company's capitation revenue. In 2011, the four HMOs comprised 32%, 14%, 14% and 12% for a total of 72% of capitation revenue. For the year ended December 31, 2010, capitation revenue from five HMOs individually comprised greater than 10% of the Company's capitation revenue. In 2010, the four HMOs comprised 34%, 15%, 12%, and 11% for a total of 72% of capitation revenue.

Note 11- Capital structure:

Pursuant to the amended Articles of Incorporation the Company is authorized to issue one class of shares of common stock. The capital structure is as follows:

December 31, 2011	Shares Authorized	Shares Outstanding	Amount
Common Stock	12,000	590.13	$ 303,933

December 31, 2010	Shares Authorized	Shares Outstanding	Amount
Common Stock	12,000	581.13	$ 310,233

Shares of common stock are owned by licensed primary care physicians and specialty care physicians who have entered into a provider services agreement with the Company. Prior to the amendment of the Articles of Incorporation in 2007, the shares were issued at $100 and $1,000 depending on the contribution at the time their provider services agreement was executed. Following the amendment, a single class of shares is issued at $100. All shares bought back by the Company are at the original share value.

Note 12- State of California solvency standards:

The California Department of Managed Health Care ("DMHC") promulgated regulations that establish certain financial and reporting requirements to which risk-bearing organizations, such as the Company, must adhere. These regulations require quarterly reporting to the DMHC of a financial survey report as well as statements to verify positive tangible net equity and positive working capital are maintained by the Company. The regulations also include compliance of claim payment timeliness and meeting a cash-to-claims ratio requirement. Currently, the Company believes that it meets all of the requirements of this regulation.

Note 13- Contingencies:

Litigation:

The Company, from time to time, is a defendant in actions arising in the ordinary course of business. In the opinion of management, such litigation will not have a material effect on the Company's financial condition, results of operations or cash flows.

Note 14- Commitments:

Hosting fees payable:

The Company entered into an agreement with a vendor in December 2006, which was subsequently amended in June 2011, for hosting services related to the electronic health record and practice management licenses. The Company plans to implement the licenses in its contracted physician offices by December 20, 2013. The Company agreed to pay the vendor $47,250 each month for 60 months for hosting fees which are included in professional fees expense in the statements of income. The Company capitalizes and amortizes all other costs associated with the purchase and implementation of the licenses in accordance with accounting principles generally accepted in the United States of America.

Operating leases:

The Company has directly guaranteed certain operating leases for SmartCare[MD] with aggregate guarantee of approximately $747,000 and has secondarily guaranteed the urgent care centers for office space as well as equipment. The leases have terms of between five and seven years.

Note 15- Subsequent events:

Subsequent events have been evaluated through April 26, 2012 the date the financial statements were available to be issued.

SHARP Community Medical Group

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