

PHYSICIANS' MEDICAL CENTER, LLC

FINANCIAL STATEMENTS

AND

SUPPLEMENTARY INFORMATION

DECEMBER 31, 2010 AND 2009

CPAs / ADVISORS



PHYSICIANS' MEDICAL CENTER, LLC

TABLE OF CONTENTS DECEMBER 31, 2010 AND 2009

	Page
Report of Independent Auditors	1
Financial Statements:	
Balance Sheets	2
Statements of Income	4
Statements of Changes in Members' Capital.....	5
Statements of Cash Flows	6
Notes to Financial Statements	8
Supplementary Information:	
Schedules of Operating Expenses.....	14



Blue & Co., LLC / 500 W. Jefferson Street, Suite 1600 / Louisville, KY 40202
main 502.584.1101 fax 502.584.4960 email blue@blueandco.com

REPORT OF INDEPENDENT AUDITORS

The Members of the Board
Physicians' Medical Center, LLC
New Albany, Indiana

We have audited the accompanying balance sheets of Physicians' Medical Center, LLC (the "Company") as of December 31, 2010 and 2009, and the related statements of income, changes in members' capital and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Physicians' Medical Center, LLC as of December 31, 2010 and 2009, and the results of its operations and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The schedules of operating expenses are presented for the purpose of additional analysis and are not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Blue & Co., LLC

May 16, 2011

PHYSICIANS' MEDICAL CENTER, LLC

BALANCE SHEETS DECEMBER 31, 2010 AND 2009

	<u>2010</u>	<u>2009</u>
ASSETS		
Current assets:		
Cash	\$ 192,389	\$ 139,239
Patient receivables, less allowance for contractuals and doubtful accounts	1,233,418	1,328,139
Other receivables	37,414	0
Inventories	366,350	390,776
Prepaid expenses	49,271	74,887
Total current assets	<u>1,878,842</u>	<u>1,933,041</u>
Property and equipment:		
Medical equipment and instruments	3,376,109	3,251,151
Other equipment	213,997	211,278
Furniture and furnishings	183,002	159,213
Software	84,631	84,631
Computer equipment	40,448	40,448
	<u>3,898,187</u>	<u>3,746,721</u>
Less accumulated depreciation	1,462,148	827,207
Property and equipment, net	<u>2,436,039</u>	<u>2,919,514</u>
Other assets:		
Due from related parties	964,056	1,720,453
Deferred loan costs, net of amortization of \$3,258 in 2010 and \$1,467 in 2009	5,241	6,532
Total other assets	<u>969,297</u>	<u>1,726,985</u>
Total assets	<u>\$ 5,284,178</u>	<u>\$ 6,579,540</u>

See accompanying notes to financial statements.

	<u>2010</u>	<u>2009</u>
LIABILITIES AND MEMBERS' CAPITAL		
Current liabilities:		
Accounts payable	\$ 438,195	\$ 782,848
Line of credit - bank	60,000	1,080,000
Obligation under capital lease	799,999	799,999
Notes payable	0	21,469
Notes payable - former members	21,174	0
Accrued personnel costs	166,028	131,580
Payroll taxes withheld	5,830	4,172
Accrued expenses	<u>281,901</u>	<u>286,823</u>
Total current liabilities	1,773,127	3,106,891
Long-term liabilities:		
Obligation under capital lease	1,733,331	2,533,330
Notes payable - former members	74,859	0
Notes payable	<u>0</u>	<u>13,910</u>
Total long-term liabilities	<u>1,808,190</u>	<u>2,547,240</u>
 Total liabilities	 3,581,317	 5,654,131
Commitments		
 Members' capital	 <u>1,702,861</u>	 <u>925,409</u>
 Total liabilities and members' capital	 <u>\$ 5,284,178</u>	 <u>\$ 6,579,540</u>

PHYSICIANS' MEDICAL CENTER, LLC

STATEMENTS OF INCOME YEARS ENDED DECEMBER 31, 2010 AND 2009

	<u>2010</u>		<u>2009</u>	
	<u>Amount</u>	<u>Percent</u>	<u>Amount</u>	<u>Percent</u>
Revenues, net				
of contractual adjustments of \$30,427,716 in 2010 and \$31,904,270 in 2009	\$ 11,076,053	100.00	\$ 10,790,551	100.00
Operating expenses	<u>9,848,627</u>	<u>88.92</u>	<u>9,440,422</u>	<u>87.49</u>
Income from operations	1,227,426	11.08	1,350,129	12.51
Other income (expense):				
Miscellaneous income	48,539	0.44	0	0.00
Interest income	0	0.00	514	0.00
Interest expense	<u>(85,622)</u>	<u>(0.77)</u>	<u>(123,655)</u>	<u>(1.14)</u>
Other income (expense), net	<u>(37,083)</u>	<u>(0.33)</u>	<u>(123,141)</u>	<u>(1.14)</u>
Net income	<u>\$ 1,190,343</u>	<u>10.75</u>	<u>\$ 1,226,988</u>	<u>11.37</u>

See accompanying notes to financial statements.

PHYSICIANS' MEDICAL CENTER, LLC

STATEMENTS OF CHANGES IN MEMBERS' CAPITAL
YEARS ENDED DECEMBER 31, 2010 AND 2009

	Capital Contributions	Members' Capital (Deficit)	Total
Balance - January 1, 2009	\$ 872,000	\$ (1,122,579)	\$ (250,579)
Redemption of equities	(2,000)	0	(2,000)
Distributions	0	(49,000)	(49,000)
Net income	0	1,226,988	1,226,988
	<u>(2,000)</u>	<u>1,177,988</u>	<u>1,175,988</u>
Balance - December 31, 2009	870,000	55,409	925,409
Redemption of equities	(90,000)	(26,291)	(116,291)
Capital contributions	30,000	0	30,000
Distributions	0	(326,600)	(326,600)
Net income	0	1,190,343	1,190,343
	<u>(60,000)</u>	<u>837,452</u>	<u>777,452</u>
Balance - December 31, 2010	\$ 810,000	\$ 892,861	\$ 1,702,861

See accompanying notes to financial statements.

PHYSICIANS' MEDICAL CENTER, LLC

STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, 2010 AND 2009

	2010	2009
Operating activities:		
Net income	\$ 1,190,343	\$ 1,226,988
Adjustments to reconcile net income to net cash flows from operating activities:		
Depreciation	635,090	602,967
Amortization	1,792	1,467
Bad debts	414,798	426,948
Changes in operating assets and liabilities:		
Patient receivables	(320,077)	(195,145)
Other receivables	(37,414)	143,327
Inventories	24,426	(108,247)
Prepaid expenses	25,616	(39,529)
Accounts payable	(344,653)	(34,562)
Accrued personnel costs	34,448	(33,843)
Payroll taxes withheld	1,658	(7,677)
Accrued expenses	(4,922)	215,990
Net cash flows from operating activities	1,621,105	2,198,684
Investing activities:		
Purchase of property and equipment	(151,615)	(238,239)
Advances to related parties	756,397	256,066
Net cash flows from investing activities	604,782	17,827
Financing activities:		
Net borrowings (payments) on line of credit	(1,020,000)	(1,519,970)
Principal payments on capital lease	(799,999)	(666,666)
Principal payments on notes payable	(35,379)	(4,637)
Payments of loan costs	(500)	(8,000)
Proceeds from issuance of member's units	30,000	0
Distributions to members	(326,600)	(49,000)
Payments on notes payable - former member	(7,259)	0
Redemption of members' units	(13,000)	(2,000)
Net cash flows from financing activities	(2,172,737)	(2,250,273)
Net change in cash	53,150	(33,762)
Cash, beginning of year	139,239	173,001
Cash, end of year	\$ 192,389	\$ 139,239

See accompanying notes to financial statements.

Supplemental disclosure of cash flow information:

Cash paid for interest	\$ 90,885	\$ 128,918
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Supplemental disclosure of noncash investing and financing activities:

Purchase of property and equipment by accounts payable	\$ 0	\$ 18,087
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Purchase of property and equipment by notes payable	\$ 0	\$ 40,016
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Redemption of members' units through notes payable	\$ 103,291	\$ 0
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PHYSICIANS' MEDICAL CENTER, LLC

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009

1. NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Physicians' Medical Center, LLC (the "Company") is a physician-owned hospital located in New Albany, Indiana. Services provided include both outpatient and inpatient healthcare services. The Company was organized as a limited liability company under the laws of the State of Indiana. As a limited liability company, each member's liability for the debts and obligations of the Company is limited under provisions of the IRS Code. There is only one class of membership interest. As a result, each membership interest shares equally in the rights, preferences, and privileges of members' equity. Net income or loss is apportioned among the members in accordance with membership interest percentage. The period of duration of the Company specified in its operating agreement is perpetual.

Management's Estimates

Management uses estimates and assumptions in preparing financial statements in accordance with accounting principles generally accepted in the United States of America. Those estimates and assumptions affect the reported amounts of assets and liabilities and the reported amounts of revenues and expenses. Actual results could vary from the estimates used.

Patient Receivables

Patient accounts receivable are based on gross charges less allowances for contractual adjustments and uncollectible accounts. An allowance for uncollectible accounts is established on an aggregate basis by using historical loss rate factors applied to unpaid accounts. Loss rate factors are based on historical loss experience and adjusted for other trends affecting the Company's ability to collect outstanding amounts. Uncollectible amounts are written off against the allowance for uncollectible accounts in the period they are deemed to be uncollectible.

Allowance for Uncollectible Patient Receivables

The Company estimates an allowance for uncollectible patient receivables based on an evaluation of the aging of the accounts, historical losses, current economic conditions, and other factors unique to their service area and the healthcare industry.

Inventories

Inventories consist of medical supplies and are stated at the lower of cost (using the first-in, first-out method) or market.

PHYSICIANS' MEDICAL CENTER, LLC

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009

Property and Equipment

Property and equipment are stated at cost. Depreciation is provided using the straight-line method over the estimated useful lives of the assets. Estimated useful lives range from 3 to 7 years.

Net Patient Service Revenue

Net patient service revenue is reported at the estimated net realizable amounts from patients, third party payors, and others for services rendered, including estimated retroactive adjustments arising under reimbursement agreements with third-party payors.

Advertising

The Company follows the policy of charging the costs of advertising to expense as incurred. Advertising expense was \$24,419 for 2010 and \$24,834 for 2009.

Income Taxes

No provision is made for federal and state income taxes since the members report their distributive share of Company taxable income or loss on their respective income tax returns. The Company has filed its federal and state income tax returns for periods through December 31, 2010. These income tax returns are generally open to examination by the relevant taxing authorities for a period of three years from the later of the date the return was filed or its due date (including approved extensions).

Professional Liability Insurance

The Company is insured against medical professional liability claims under an occurrence-based policy. The policy covers claims resulting from incidents that occur during the policy term, regardless of when the claims are reported to the insurance carrier. Under the terms of the policy, the Company bears the risk of the ultimate costs of any individual claim exceeding \$1,000,000 or aggregate claims exceeding \$3,000,000 for claims asserted in the policy year. In addition, the Company maintains for all classes of liability coverage an additional policy of \$250,000 for each occurrence and \$5,000,000 in the aggregate.

Date of Management's Review

The Company has evaluated the subsequent events through May 16, 2011, which is the date the financial statements were available to be issued.

PHYSICIANS' MEDICAL CENTER, LLC

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009

2. PATIENT RECEIVABLES

The detail of patient receivables is set forth below:

	<u>2010</u>	<u>2009</u>
Patient receivables	\$ 4,978,989	\$ 4,892,391
Less allowances for:		
Contractual adjustments	2,679,836	2,971,435
Uncollectible accounts	<u>1,065,735</u>	<u>592,817</u>
Net patient receivables	<u>\$ 1,233,418</u>	<u>\$ 1,328,139</u>

The Company grants credit without collateral to its patients, most of whom are local residents who are insured under third-party payor agreements. The mix of receivables from patients and third party payors at December 31, 2010 and 2009 is as follows:

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3. CAPITAL LEASE

The Company leases property from Fifth Third Bank under a capital lease. The economic substance of the capital lease is financing the acquisition of the assets through the lease. The capital lease was initially for \$3,999,995 with \$1,135,112 in assets transferred to a related party. The Company recognizes the entire obligation under the capital lease on its balance sheet. The assets transferred out are reflected in the balance shown as due from the related party.

The following is a summary of the property under the capital lease:

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Each member has personally guaranteed their pro rata share of the capital lease.

The following is a schedule by year of future minimum payments required under the lease as of December 31, 2010:

PHYSICIANS' MEDICAL CENTER, LLC

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009

Year Ending December 31:	
2011	\$ 799,999
2012	799,999
2013	799,999
2014	<u>133,333</u>
Total minimum lease payments	<u>\$ 2,533,330</u>

4. LINE OF CREDIT

The Company has a line of credit with a local bank. The line is for a maximum of \$2,000,000 with interest at a floating rate per annum equal to 1.80% in excess of the LIBOR rate (LIBOR rate was .26% at December 31, 2010). The line is subject to annual renewal and is collateralized by substantially all business assets. At December 31, 2010, the Company had \$60,000 drawn leaving \$1,940,000 available to draw on the line of credit.

5. NOTES PAYABLE – MEMBERS

During the year ended December 31, 2010, an agreement was made with a member for the redemption of his shares. The total value of his shares was calculated to be \$36,291. During the year, distributions were paid to the member of \$13,000 leaving \$26,291 payable to the member. Upon execution of the agreement, \$7,258 was paid to the member. The remaining balance is payable over the next 3 years.

During the year ending December 31, 2010, terminating events occurred with two other members causing the redemption of their shares as of December 31, 2010. An agreement has been executed with each member to redeem their shares for \$40,000.

6. RELATED PARTY TRANSACTIONS

The Company leases property on a triple net lease from Physicians' Surgical Properties, LLC. All of the Company's primary partners are also partners of Physicians' Surgical Properties, LLC. The lease is for ten years and has an option to renew under the same terms for four additional five-year terms. The rental payments will increase 3% after each 60 month period. Subsequent to year end, the lease was amended to include a 4% increase in the rent as of January 1, 2011. All other terms of the lease remained the same. Rental expense was \$859,512 for both 2010 and 2009.

At December 31, 2010 the minimum lease payments under the terms of all lease

PHYSICIANS' MEDICAL CENTER, LLC

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009

agreements were as follows:

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The Company had a balance due from Physicians' Surgical Properties, LLC of approximately \$965,000 at December 31, 2010 and \$1,720,000 at December 31, 2009.

The Company entered into a service agreement with one of its members, Prexus Health. Services provided under the agreement include but are not limited to billing, coding, consulting, management, and transcription. Fees are calculated using a percentage of net revenues, set fees per hour, or other methods as outlined in the agreement. The Company had a balance due to Prexus Health of approximately \$60,000 at December 31, 2010 and \$17,000 at December 31, 2009. The Company paid \$604,730 in 2010 and \$561,621 in 2009 for fees under the service agreement.

7. COMMITMENT

The Company entered into a reimbursement agreement with Physicians' Surgical Properties, LLC, a related party, to guarantee a bond issued by Physicians' Surgical Properties, LLC for the construction of the facility used by the Company. The Company and Physicians' Surgical Properties, LLC entered into and are jointly liable on an outstanding letter of credit with a local bank for \$4,869,302. All members also individually guaranteed the letter of credit. The Company also guarantees a term note held by Physicians' Surgical Properties, LLC. At December 31, 2010, the balance remaining on the term note was \$1,961,667.

The Company entered into an agreement with Metro Lithotripsy, LLC, for the use of a mobile extracorporeal shock wave lithotripter. The agreement is for a one-year period and unless terminated, will be automatically renewed for successive one-year terms. The Company had a balance due to Metro Lithotripsy, LLC of \$29,898 at December 31, 2010, and \$194,761 at December 31, 2009. The Company paid \$719,319 in 2010 and \$19,200 in 2009 under the agreement.

SUPPLEMENTARY INFORMATION

PHYSICIANS' MEDICAL CENTER, LLC

SCHEDULES OF OPERATING EXPENSES YEARS ENDED DECEMBER 31, 2010 AND 2009

	2010		2009	
	Amount	Percent to Sales	Amount	Percent to Sales
Salaries	\$ 2,830,243	25.55	\$ 2,620,768	24.29
Employee benefits	373,907	3.38	343,800	3.19
Payroll taxes	224,965	2.03	208,700	1.93
Other personnel expenses	37,757	0.34	25,685	0.24
Rent	896,093	8.09	924,792	8.57
Medical supplies	2,264,577	20.45	2,562,836	23.75
Depreciation	635,090	5.73	602,967	5.59
Amortization	1,792	0.02	1,467	0.01
Consulting fees	252,683	2.28	227,987	2.11
Utilities	172,897	1.56	169,145	1.57
Bad debts	414,798	3.74	426,948	3.96
Support services	115,277	1.04	151,232	1.40
Billing services	317,655	2.87	245,305	2.27
Coding services	76,066	0.69	47,961	0.44
Transcription services	18,213	0.16	18,179	0.17
Office supplies	70,272	0.63	57,424	0.53
Janitorial expense	85,465	0.77	81,564	0.76
Repairs	217,743	1.97	109,389	1.01
Taxes and licenses	226,910	2.05	10,218	0.09
Insurance	59,000	0.53	48,352	0.45
Bank charges	26,412	0.24	26,562	0.25
Travel	5,620	0.05	7,468	0.07
Computer support	40,498	0.37	34,060	0.32
Miscellaneous	42,132	0.38	42,866	0.40
Mileage reimbursement	7,796	0.07	9,339	0.09
Laundry, linen, and apparel	54,350	0.49	42,719	0.40
Telephone	14,644	0.13	17,907	0.17
Legal fees	2,815	0.03	(7,789)	(0.07)
Waste removal	8,819	0.08	6,446	0.06
Meals and entertainment	3,629	0.03	4,041	0.04
Dues and subscriptions	14,097	0.13	17,890	0.17
Accounting fees	42,238	0.38	37,471	0.35
Security	1,562	0.01	6,069	0.06
Other outside services	268,193	2.42	285,820	2.65
Advertising	24,419	0.22	24,834	0.23
Total operating expenses	\$ 9,848,627	88.92	\$ 9,440,422	87.49

See report of independent auditors on page 1.