

Report on Examination
of
Avalon Healthcare, Inc.

Tampa, Florida

as of

December 31, 2007

By The
State of Florida
Office of Insurance Regulation

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Tallahassee, Florida

October 29, 2008

Kevin M. McCarty, Commissioner
Florida Office of Insurance Regulation
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Virginia Bureau of Insurance
Chair, NAIC Financial Condition (E) Committee
P.O. Box 1157
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Dear Sirs:

Pursuant to your instructions, in compliance with Section 624.316, Florida Statutes (F.S.), and in accordance with the practices and procedures promulgated by the National Association of Insurance Commissioners (NAIC), we have conducted an examination as of December 31, 2007, of the financial condition and corporate affairs of:

Avalon Healthcare, Inc.
3030 N. Rocky Point Dr., Suite 800
Tampa, Florida 33607

hereinafter referred to as the "Company." Such report of examination is herewith respectfully submitted.

SCOPE OF EXAMINATION

This examination covered the period of January 1, 2007 through December 31, 2007. The Company was last examined by the Florida Office of Insurance Regulation (the "Office") as of December 31, 2006.

Planning for the current examination began on March 17, 2008. The fieldwork commenced on March 24, 2008 and concluded on July 24, 2008. The examination included any material transactions and/or events occurring subsequent to the examination date and noted during the course of this examination.

This was a statutory financial condition examination conducted in accordance with the *NAIC Financial Condition Examiners Handbook, Accounting Practices and Procedures Manual, and Annual Statement Instructions* as adopted by Rules 69O-137.001(4) and 69O-138.001, Florida Administrative Code (F.A.C.), with due regard to the requirements of the insurance laws and rules of the State of Florida.

In this examination, emphasis was directed to the quality, value, and integrity of the statement assets and the determination of liabilities, as they affect the Company's solvency.

The examination included a review of corporate and other selected records deemed pertinent to the Company's operations and practices. In addition, the NAIC Insurance Regulatory Information System (IRIS) ratio results and the Company's independent audit report were reviewed and utilized where applicable within the scope of this examination.

We valued and/or verified the Company's assets and liabilities as reported by the Company in its 2007 annual statement. Transactions subsequent to December 31, 2007 were reviewed where relevant and deemed significant to the Company's financial condition.

This report of examination is confined to financial statements and comments on matters that involve departures from laws, regulations or rules, or which require special explanation or description.

STATUS OF ADVERSE FINDINGS FROM PRIOR EXAMINATION

The following is a summary of a significant adverse finding contained in the Office's prior examination report as of December 31, 2006, along with resulting action taken by the Company in connection therewith.

Capital and Surplus

In its 2006 annual statement, the Company incorrectly reported that 10,000 of its common shares were issued and outstanding in the total amount of \$10,000, rather than 100 shares in the total amount of \$100. Resolution: The Company filed an amended annual statement correctly reporting the number of common shares issued and outstanding.

HISTORY

GENERAL

The Company was incorporated in Florida on July 8, 2005, and commenced business on September 22, 2005.

As of the date of this examination, the Company was authorized to transact accident and health insurance coverage in Florida, in accordance with Section 624.401, F.S.

CAPITAL STOCK

As of December 31, 2007, the Company's capitalization was as follows:

Number of authorized common capital shares	5,000,000
Number of shares issued and outstanding	1,500,000
Total common capital stock	\$1,500,000
Par value per share	\$1.00

The number of the Company's authorized common capital shares was increased to 5 million on December 31, 2007 and, as a result, amended articles of incorporation were filed with the Florida Department of State on July 10, 2008. At December 31, 2007, the Company was wholly-owned and controlled by Avalon Healthcare Holdings, Inc. An abbreviated organizational chart appears on page 8.

PROFITABILITY

For years 2005 – 2007, the Company reported the following:

(In '000s)	<u>2007</u>	<u>2006</u>	<u>2005</u>
Net premiums	\$3,588	\$660	\$0
Total revenues	\$3,604	\$668	\$0
Net income (loss)	\$78	(\$2,550)	(\$565)
Total capital and surplus	\$2,063	\$1,656	\$4,234

DIVIDENDS

The Company did not pay any shareholder dividends during the period of this examination.

MANAGEMENT

The annual shareholder meeting for the election of directors was held in accordance with Section 607.0701, F.S. Directors serving as of December 31, 2007 were:

Directors

<u>Name and Location</u>	<u>Principal Occupation</u>
Joseph Gauta, M.D. Naples, Florida	Physician Especially For Women Clinic
Richard W. Haydon Bellair, Florida	Vice President Avalon Healthcare, Inc.
Paul W. Kowalski St. Petersburg, Florida	Chief Sales Officer Avalon Healthcare, Inc.
Judith Lyons Clearwater, Florida	Vice President Avalon Healthcare, Inc.
Henry H. Neely Tampa, Florida	Vice President Avalon Healthcare, Inc.
Charles T. O'Neill Tampa, Florida	Chief Executive Officer Avalon Healthcare, Inc.

At December 31, 2007, members of the principal committees of the Board were:

<u>Executive Committee</u>	<u>Audit Committee</u>
Henry H. Neely	Joseph Gauta, M.D.
Charles T. O'Neill	Henry H. Neely
	Charles T. O'Neill

The following were the Company's senior officers as of December 31, 2007, as appointed by its board of directors in accordance with the Company's bylaws:

Senior Officers	
<u>Name</u>	<u>Title</u>
Charles T. O'Neill	President and Chief Executive Officer
Andrew B. Cassidy	Chief Financial Officer and Treasurer
Henry H. Neely	Vice President and Secretary

CONFLICT OF INTEREST PROCEDURE

The Company adopted a policy statement requiring annual disclosure of conflicts of interest in accordance with Section 607.0832, F.S. No exceptions were noted during this examination.

CORPORATE RECORDS

The recorded minutes of the shareholder and Board of Directors meetings were reviewed for the period examined. The recorded minutes of the Board adequately documented its meetings and approval of Company transactions in accordance with Section 607.1601, F.S. A review of the prior report of examination by the Office was documented in the minutes of the Board.

AFFILIATED COMPANIES

The Company was a member of an insurance holding company system as defined by Rule 69O-143.045(3), F.A.C. Its latest holding company registration statement was filed with the State of Florida, as required by Section 628.801, F.S., and Rule 69O-143.046, F.A.C., on March 6, 2008.

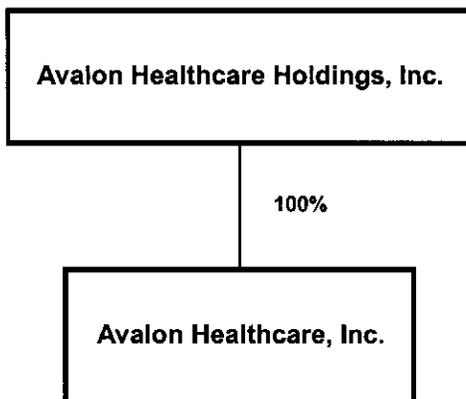
The following agreement was in force between the Company and an affiliate on December 31, 2007:

MANAGEMENT AGREEMENT

Avalon Healthcare Holdings, Inc. provided management services to the Company pursuant to a January 1, 2007 agreement in return for fees which amounted to \$1.8 million in 2007. Services provided included executive management and administration, marketing, accounting and financial support, claims processing and administration, claims analysis and statistical reporting, and utilization management services.

An abbreviated organizational chart as of December 31, 2007 reflecting the holding company system is shown below. Schedule Y of the Company's 2007 annual statement provided the names of all related companies in the holding company group.

**Avalon Healthcare, Inc.
Organizational Chart
December 31, 2007**



FIDELITY BOND AND OTHER INSURANCE

The Company maintained fidelity bond coverage of up to \$250,000 with a deductible of \$5,000 which adequately covered the suggested minimum amount of coverage for the Company as recommended by the NAIC of \$100,000.

PENSION, STOCK OWNERSHIP, AND INSURANCE PLANS

The Company offered to eligible employees participation in a Section 401(k) retirement plan.

STATUTORY DEPOSITS

The Company maintained a cash deposit of \$100,000 with the State of Florida as required by Section 624.411, F.S.

INSURANCE PRODUCTS AND RELATED PRACTICES

The Company marketed individual and group accident and health insurance products through licensed agents and brokers.

TERRITORY AND PLAN OF OPERATION

At December 31, 2007, the Company was authorized to transact insurance solely in the State of Florida.

TREATMENT OF POLICYHOLDERS

The Company established procedures for handling written complaints in accordance with Section 626.9541(1)(j), F.S., and maintained a claims procedure manual that included detailed procedures for handling each type of claim.

REINSURANCE

ASSUMED

The Company did not assume insurance during the period examined.

CEDED

The Company maintained reinsurance coverage with General Re Life Corporation on a loss occurring basis of up to \$5 million in losses on covered policies in excess of the first \$100,000 of medical expenses.

ACCOUNTS AND RECORDS

Pursuant to Section 624.424(8)(b), F.S., the Company was exempt from the general requirement to have conducted an annual audit by an independent certified public accountant for the year 2006. An independent CPA audited the Company's statutory-basis financial statements for the year ended December 31, 2007, pursuant to Section 624.424(8), F.S.

The Company's accounting records were maintained on a computerized system. Its balance sheet accounts were verified with the line items of its annual statement submitted to the Office.

The Company's main administrative office was located in Tampa, Florida, where this examination was conducted.

RISK-BASED CAPITAL

The Company reported its risk-based capital at an adequate level.

The following agreements were in effect between the Company and non-affiliates:

TPA AGREEMENT

Health Network America, Inc. provided third party administrator services to the Company pursuant to an April 1, 2007 agreement. Fees related to this agreement amounted to \$633,656 in 2007.

INDEPENDENT AUDITOR AGREEMENT

The Company contracted with Thomas Howell Ferguson P.A. to audit its statutory-basis financial statements. The fee related to this agreement was \$34,056 for 2007.

FINANCIAL STATEMENTS PER EXAMINATION

The following four pages contain statements of the Company's financial position at December 31, 2007, as determined by this examination, and the results of its operations for the year then ended as reported by the Company.

Avalon Healthcare, Inc.
Assets
December 31, 2007

	Per Company	Examination Adjustments	Per Examination
Cash, cash equivalents, and short-term investments	\$2,994,679	\$0	\$2,994,679
Investment income due and accrued	1,602	0	1,602
Health care and other amounts receivable	43,580	0	43,580
Total assets	<u>\$3,039,861</u>	<u>\$0</u>	<u>\$3,039,861</u>

Avalon Healthcare, Inc.
Liabilities, Capital and Surplus
December 31, 2007

Liabilities	Per Company	Examination Adjustments	Per Examination
Claims unpaid	\$34,525	\$0	\$34,525
Unpaid claims adjustment expenses	15,000	0	15,000
Aggregate health claim reserves	320,566	0	320,566
Premiums received in advance	246,440	0	246,440
General expenses due or accrued	28,826	0	28,826
Ceded reinsurance premiums payable	59,213	0	59,213
Amounts due to parent, subsidiaries and affiliates	272,486	0	272,486
Total liabilities	<u>977,056</u>	<u>0</u>	<u>977,056</u>
Capital and Surplus			
Common capital stock	1,500,000	0	1,500,000
Gross paid in and contributed surplus	3,600,000	0	3,600,000
Unassigned funds (deficit)	(3,037,195)	0	(3,037,195)
Total capital and surplus	<u>2,062,805</u>	<u>0</u>	<u>2,062,805</u>
Total liabilities, capital and surplus	<u>\$3,039,861</u>	<u>\$0</u>	<u>\$3,039,861</u>

Avalon Healthcare, Inc.
Statement of Revenue and Expenses
For The Year Ended December 31, 2007

Net premium income		\$3,588,022
Aggregate write-ins for other non-health revenues		<u>15,899</u>
Total revenues		3,603,921
Hospital and medical benefits	\$1,407,826	
Outside referrals	14,388	
Emergency room and out-of-area	63,431	
Prescription drugs	<u>136,530</u>	
Total hospital and medical expenses	1,622,175	
General administrative expenses	<u>2,011,449</u>	
Total underwriting deductions		<u>3,633,624</u>
Net underwriting gain (loss)		(29,703)
Net investment income earned		<u>107,458</u>
Net income		<u><u>\$77,755</u></u>

Avalon Healthcare, Inc.
Capital and Surplus Account
For The Year Ended December 31, 2007

Capital and surplus - December 31, 2006		\$1,655,702
Net income	\$77,755	
Change in nonadmitted assets	29,348	
Change in paid in capital	1,499,900	
Change in paid in surplus	(1,199,900)	
Examination adjustments	<u>0</u>	
		<u>407,103</u>
Capital and surplus - December 31, 2007		<u><u>\$2,062,805</u></u>

COMMENTS ON FINANCIAL STATEMENTS

Claims unpaid	\$34,525
Aggregate health claim reserves	\$320,566

The Company's appointed actuary rendered an opinion that the amounts carried in the Company's balance sheet as of December 31, 2007 reasonably provided for all unpaid loss and loss expense obligations of the Company under the terms of its policies and agreements. The Office actuary reviewed work papers provided by the Company and concurred with this opinion. Based on the results of the Office actuary's review and analysis of work papers and data provided by the Company, we concluded that the aggregate liability was not materially misstated.

Avalon Healthcare, Inc.
Comparative Analysis of Changes in Capital and Surplus
December 31, 2007

The following is a reconciliation of capital and surplus between that reported by the Company and as determined by the examination.

Capital and surplus, December 31, 2007 - per annual statement			\$2,062,805
	<u>Per Company</u>	<u>Per Exam</u>	<u>Increase (Decrease) In Capital & Surplus</u>
Total assets	\$3,039,861	\$3,039,861	\$0
Total liabilities	\$977,056	\$977,056	<u>\$0</u>
Net change in capital and surplus			<u>0</u>
Capital and surplus, December 31, 2007 - per examination			<u><u>\$2,062,805</u></u>

SUBSEQUENT EVENTS

On February 26, 2008, the Company filed amended articles of incorporation to change its name to "Avahealth, Inc." and registered the fictitious name "Avalon Healthcare, Inc." with the Florida Department of State.

The Company filed an amended 2007 annual statement with the Office on May 30, 2008.

SUMMARY OF FINDINGS

COMPLIANCE WITH PREVIOUS DIRECTIVES

The Company has taken the necessary actions to comply with the comments contained in the 2006 examination report.

CURRENT EXAMINATION COMMENTS AND CORRECTIVE ACTION

The current financial condition examination did not result in any material findings of non-compliance with statutes, rules, or other requirements on the part of the Company.

CONCLUSION

The customary insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of **Avalon Healthcare, Inc.** as of December 31, 2007, consistent with the insurance laws of the State of Florida.

Per examination findings, the Company's total capital and surplus was \$2,062,805, which was in compliance with Section 624.408, F.S. Its required minimum capital and surplus at December 31, 2007 was \$1.5 million.

In addition to the undersigned, the following participated in this examination: Tom Cook, Financial Examiner/Analyst; Cathy S. Jones, CPA, Financial Examiner/Analyst Supervisor; and Kerry A. Krantz, Actuary.

Respectfully submitted,

Russell K. Judge, Financial Examiner/Analyst
Florida Office of Insurance Regulation