Indiana Orthopaedic Hospital, LLC

Accountants’ Report and Consolidated Financial Statements

December 31, 2008 and 2007

Indiana Orthopaedic Hospital, LLC
December 31, 2008 and 2007

Contents

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Independent Accountants' Report

Board of Managers
Indiana Orthopaedic Hospital, LLC
Indianapolis, Indiana

We have audited the accompanying consolidated balance sheets of Indiana Orthopaedic Hospital, LLC (Hospital) as of December 31, 2008 and 2007, and the related consolidated statements of income, members' equity and cash flows for the years then ended. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based on our audits.

Except as discussed in the following paragraph, 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 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 accordance with the terms of the engagement, we did not audit the Hospital's investment in Southeast Surgery Center, LLC, a 50%-owned affiliate, for which the investment is stated at $2,927,074 and $2,811,203 at December 31, 2008 and 2007, respectively, and the equity in earnings is stated at $4,016,182 and $2,138,531, which is included in net income for the years then ended as described in Notes 10 and 11 to the consolidated financial statements.

As discussed in Note 10 to the consolidated financial statements, the Hospital acquired OI South, LLC in a business combination on July 1, 2007. The Hospital recorded the acquisition at the historical carrying value of the assets acquired, which in our opinion, is not in accordance with accounting principles generally accepted in the United States of America. The effects of this matter on the financial statements are not reasonably determinable.

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we performed the omitted auditing procedures described in the second preceding paragraph and of not accounting for the 2007 acquisition of OI South, LLC using the purchase method of accounting as discussed in the preceding paragraph, the consolidated financial statements referred to in the first paragraph above present fairly, in all material respects, the financial position of Indiana Orthopaedic Hospital, LLC as of December 31, 2008 and 2007, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

BKD, LLP

April 6, 2009

Indiana Orthopaedic Hospital, LLC

Consolidated Balance Sheets
December 31, 2008 and 2007

Assets

	2008	2007
Current Assets		
Cash and cash equivalents	$ 4,794,153	$ 6,107,078
Patient accounts receivable, net of allowance: 2008 - $725,000; 2007 - $500,000	12,161,096	10,221,068
Due from affiliate	82,201	25,049
Supplies	634,061	705,533
Prepaid expenses and other	862,010	927,086
Total current assets	18,533,521	17,985,814
Property and Equipment, At Cost		
Land and land improvements	6,091,997	778,901
Buildings and improvements	135,250	135,250
Equipment	18,167,652	13,310,586
	24,394,899	14,224,737
Less accumulated depreciation	11,557,849	9,169,396
	12,837,050	5,055,341
Other Assets		
Investment in affiliate	2,927,074	2,811,203
Other	100,008	233,225
	3,027,082	3,044,428
Total assets	$ 34,397,653	$ 26,085,583

Liabilities and Members' Equity

	2008	2007
Current Liabilities		
Accounts payable	$ 3,161,569	$ 3,073,805
Accrued expenses	2,393,002	1,099,872
Current maturities of capital leases payable	2,981,877	2,272,384
Line of credit	5,005,625	-
Estimated amounts due to third-party payers	525,269	378,690
Due to affiliate	326,215	648,407
Other	40,000	958,000
Total current liabilities	14,433,557	8,431,158
Long-Term Obligations		
Capital leases	1,576,656	1,969,829
Total liabilities	16,010,213	10,400,987
Members' Equity		
Contributed capital	8,370,807	6,302,764
Accumulated earnings	10,016,633	9,381,832
Total members' equity	18,387,440	15,684,596
Total liabilities and members' equity	$ 34,397,653	$ 26,085,583

Indiana Orthopaedic Hospital, LLC

Consolidated Statements of Income

Years Ended December 31, 2008 and 2007

	2008	2007
Operating Revenues		
Net patient service revenue	$ 85,168,847	$ 67,420,526
Other	529,222	522,511
Total operating revenues	85,698,069	67,943,037
Expenses and Losses		
Salaries and wages	16,462,895	13,635,647
Employee benefits	3,893,654	2,702,865
Purchased services and professional fees	4,715,199	3,489,284
Medical supplies	22,239,814	18,537,281
Facility expense	7,898,551	6,954,498
Depreciation and amortization	2,388,454	3,372,437
Interest	336,413	445,697
Provision for uncollectible accounts	517,603	720,172
Other expenses	2,678,050	1,823,044
Total operating expenses	61,130,633	51,680,925
Operating Income	24,567,436	16,262,112
Other Income		
Income from joint venture activities	4,016,182	2,138,531
Investment return	151,183	233,918
Other	-	5,000
	4,167,365	2,377,449
Net Income	$ 28,734,801	$ 18,639,561

Indiana Orthopaedic Hospital, LLC
Consolidated Statements of Members' Equity
Years Ended December 31, 2008 and 2007

	Contributed Capital	Accumulated Earnings	Total
Balance, January 1, 2007	$ 4,337,182	$ 9,765,912	$ 14,103,094
Net income		18,639,561	18,639,561
Membership units issued	1,965,582		1,965,582
Distributions to members		(19,023,641)	(19,023,641)
Balance, December 31, 2007	6,302,764	9,381,832	15,684,596
Net income		28,734,801	28,734,801
Membership units issued	2,068,043		2,068,043
Distributions to members		(28,100,000)	(28,100,000)
Balance, December 31, 2008	$ 8,370,807	$ 10,016,633	$ 18,387,440

Indiana Orthopaedic Hospital, LLC
Consolidated Statements of Cash Flows
Years Ended December 31, 2008 and 2007

	2008	2007
Operating Activities		
Net income	$ 28,734,801	$ 18,639,561
Items not requiring (providing) cash		
Depreciation and amortization	2,388,454	3,372,437
Undistributed earnings of joint venture	(115,871)	(1,468,531)
Provision for uncollectible accounts	517,603	720,172
Changes in		
Patient accounts receivable, net	(2,457,631)	(1,918,969)
Estimated amounts due from and to third-party payers	146,579	(21,310)
Accounts payable and accrued expenses	1,001,550	1,812,580
Other current assets and liabilities	(648,235)	940,003
Net cash provided by operating activities	29,567,250	22,075,943
Investing Activity - purchase of property and equipment	(6,787,987)	(239,074)
Financing Activities		
Net drawings under a letter-of-credit agreement	5,005,265	-
Principal payments under capital lease obligations	(3,065,496)	(3,095,653)
Issuance of membership units	2,068,043	622,911
Distributions to members	(28,100,000)	(19,023,641)
Net cash used in financing activities	(24,092,188)	(21,496,383)
Increase (Decrease) in Cash and Cash Equivalents	(1,312,925)	340,486
Cash and Cash Equivalents, Beginning of Year	6,107,078	5,766,592
Cash and Cash Equivalents, End of Year	$ 4,794,153	$ 6,107,078
Supplemental Cash Flows Information		
Interest paid	$ 336,131	$ 445,697
Capital lease obligation incurred for property and equipment	3,382,175	-
Non-cash portion of consideration of membership units issued	-	1,342,671

Note 1: Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations

Indiana Orthopaedic Hospital, LLC primarily earns revenues by providing inpatient and outpatient musculoskeletal and related surgical services to patients in the greater Indianapolis, Indiana area.

NNS, LLC was formed in 2008 in the state of Indiana for the purpose to own, manage, invest, develop, lease and otherwise deal in real property.

Principles of Consolidation

The consolidated financial statements include the accounts of Indiana Orthopaedic Hospital, LLC and NNS, LLC (collectively, "the Hospital"). All material inter-organization accounts and transactions have been eliminated in consolidation.

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 the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash Equivalents

The Hospital considers all liquid investments with original maturities of three months or less to be cash equivalents. At December 31, 2008 and 2007, cash equivalents consisted primarily of money market funds.

Investment Return

Investment return is comprised primarily of interest income earned on the operating cash accounts.

Patient Accounts Receivable

The Hospital reports patient accounts receivable for services rendered at net realizable amounts from third-party payers, patients and others. The Hospital provides an allowance for doubtful accounts based upon a review of outstanding receivables, historical collection information and existing economic conditions. As a service to the patient, the Hospital bills third-party payers directly and bills the patient when the patient's liability is determined. Patient accounts receivable are due in full when billed. Accounts are considered delinquent and subsequently written off as bad debts based on individual credit evaluation and specific circumstances of the account.

Supplies

The Hospital states supply inventories at the lower of cost, determined using the first-in, first-out method (FIFO) or market.

Property and Equipment

Property and equipment are depreciated on a straight-line basis over the estimated useful life of each asset. Assets under capital lease obligations and leasehold improvements are depreciated over the shorter of the lease term or their respective estimated useful lives.

Investment in Affiliate

Effective July 1, 2007, the Hospital entered into a joint venture agreement with an Indianapolis health care provider to jointly operate Southeast Surgery Center, LLC (d/b/a Indiana Orthopaedic Surgery Center), an ambulatory surgery center on the south side of Indianapolis. The Hospital’s investment in this joint venture is accounted for under the equity method of accounting with the associated earnings being reported as other income in the accompanying operating statement.

Net Patient Service Revenue

The Hospital has agreements with third-party payers that provide for payments to the Hospital at amounts different from its established rates. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payers and others for services rendered and includes estimated retroactive revenue adjustments. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered and such estimated amounts are revised in future periods as adjustments become known.

Charity Care

The Hospital provides charity care to patients who are unable to pay for services. The amount of charity care is included in net patient service revenue and is not separately classified from the provision for uncollectible accounts.

Estimated Malpractice Costs

Estimated malpractice costs, if any, include estimates of the ultimate costs for both reported claims and claims incurred but not reported.

Income Taxes

The Hospital is organized as a pass-through Limited Liability Corporation under the Internal Revenue Code. As such, the Hospital is not taxed at the entity level and income is passed through to the members of the Hospital at the individual level. Accordingly, the Hospital does not recognize income taxes in the accompanying consolidated financial statements.

Note 2: Net Patient Service Revenue

The Hospital has agreements with third-party payers that provide for payments to the Hospital at amounts different from its established rates. These payment arrangements include:

Medicare. Inpatient acute care services and substantially all outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. The Hospital is reimbursed for certain services at tentative rates with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicare fiscal intermediary.

Medicaid. Inpatient acute care services and substantially all outpatient services rendered to Medicaid program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors.

The Hospital has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations and preferred provider organizations. The basis for payment to the Hospital under these agreements includes prospectively determined rates per discharge, discounts from established charges and prospectively determined daily rates. Approximately 27% of the Hospital's receivables are due from a single commercial insurance carrier for the years ended December 31, 2008 and 2007.

The Medicare Modernization Act of 2003 contained an 18-month moratorium on the development of new physician-owned "specialty hospitals", as such hospitals are defined in the statute, the expansion of services by specialty hospitals and certain ownership changes in specialty hospitals. This moratorium expired during 2005. There is currently discussion regarding potential legislation that might impact specialty hospitals, ranging from disclosures to a new moratorium to prohibition of specialty hospitals. Management can not estimate the long-term impact of any future legislation on the Hospital given the uncertainty involved with the regulatory changes.

Note 3: Limited Liability Company

The Hospital is organized as an Indiana limited liability company and began operations in March 2005. Prior to July 1, 2007, the Hospital was owned by two LLC's that each shared in a combined and issued 100 member units. Effective July 1, 2007, these units were replaced with three classes of units and members, referred to as Classes A, B and C. A related discussion of the July 1, 2007 transaction is more fully described in Note 11.

The Hospital is governed by a seven-member board of managers. The board of managers is generally responsible for the direction and management of the Hospital. Only Class A members can serve on the governing board of managers.

Class A members control a total 11,388 units and generally receive a pro-rata percentage of operating profits from the Hospital as defined in the operating agreement. Class A members voting responsibilities include the election of members to serve on the board of managers. They vote on all matters subject to a membership vote and also retain certain reserved powers. The reserved powers limit certain decisions that can only be decided by Class A members and also limit when Class B members can vote on general membership voting matters.

Class B members provide up to a total of 711 total units and generally received a pro-rata percentage of operating profits from the Hospital, with certain limitations, as defined in the operating agreement. Their units allow them to vote on matters submitted to the membership; however, the Class A members reserved powers may limit the ability for Class B members to vote on certain matters.

Class C member controls 244 units and received profit distributions based upon its pro rata share of profits earned from the Hospital's interest in the Southeast Surgery Center, LLC. Class C units are non-voting units.

NNS, LLC (Company) was organized as a limited liability company and was formed in October 2008. Indiana Orthopaedic Hospital, LLC is the sole member of NNS, LLC for which complete authority, power and discretion to manage and control the business affairs and properties of the Company, to make all decisions regarding those matters and to perform any and all other acts or activities customary or incident to the management of NNS, LLC's business. The Hospital holds 100 units of the Company.

Note 4: Medical Malpractice Coverage and Claims

The Hospital purchases medical malpractice insurance under a claims-made policy on a fixed premium basis. Accounting principles generally accepted in the United States of America require a health care provider to accrue the expense of its share of malpractice claim costs, if any, for any reported and unreported incidents of potential improper professional service occurring during the year by estimating the probable ultimate costs of the incidents. Based upon the Hospital's claim experience, no such accrual has been made. It is reasonably possible that this estimate could change materially in the near term.

Note 5: Line of Credit

The Hospital is a party to a line of credit and equipment purchase line agreements with a bank providing up to $5,000,000 and $1,500,000 in borrowings, respectively. The line of credit and equipment purchase line agreements expire June 5, 2009 and July 5, 2014, respectively, and require interest only payments at prime minus 1% on any outstanding balance. The agreements are secured by the Hospital's accounts receivable and the Hospital had $5,005,625 outstanding owed to the bank at December 31, 2008.

Note 6: Long-Term Obligations

	2008	2007
Capital lease obligations (A)	$ 4,558,533	$ 4,242,213
Less current maturities	2,981,877	2,272,384
	$ 1,576,656	$ 1,969,829

(A) Capital lease obligations, payable in quarterly installments of $805,662 with an imputed interest rate of 7.5%. The leases are governed by a master lease agreement from a leasing company and all leases are generally secured by the leased equipment. The lease terms range from three to six years. Property and equipment include the following property under capital lease arrangements:

	2008	2007
Equipment	$ 11,632,320	$ 8,250,145
Less accumulated depreciation	7,433,676	5,584,855
	$ 4,198,644	$ 2,665,290

Aggregate annual payments on capital lease obligations at December 31, 2008, are:

	Capital Lease Obligations
2009	$ 3,222,649
2010	1,611,324
	4,833,973
Less amount representing interest	275,440
Present value of future minimum lease payments	4,558,533
Less current maturities	2,981,877
Noncurrent portion	$ 1,576,656

Note 7: Operating Leases

Noncancellable operating leases for the primary Hospital facility, several other facilities in the greater Indianapolis area and certain diagnostic equipment expire through 2016. The facility leases generally contain renewal options for periods ranging from five to ten years and require the Hospital to pay all executory costs (property taxes, maintenance and insurance). The leases are secured by certain assets, as defined in the lease agreements.

Future minimum lease payments at December 31, 2008, were:

2009	$ 5,215,276
2010	5,318,443
2011	5,411,368
2012	5,481,571
2013	5,533,106
Later years	20,123,315
Future minimum lease payments	$ 47,083,079

Total lease expense was $7,278,713 and $6,720,444 for 2008 and 2007, respectively.

Note 8: Related Party Transactions

The Hospital and Orthopaedics-Indianapolis, P.C. (Ortho Indy) are related parties through common ownership. The Hospital entered into a management services agreement with Ortho Indy to provide certain management, administrative and payroll related services for the Hospital. The management service agreement also provides leased employees and their benefits to the Hospital. The agreement includes renewal options, which allow the Hospital to extend the term for successive five year periods. Reimbursed expenses to Ortho Indy amounted to $5,347,079 and $4,445,788 for the years ended December 31, 2008 and 2007, respectively. Amounts due from and to Ortho Indy are reported in the accompanying balance sheets as due from and to affiliates.

The Hospital subleases certain facilities from Ortho Indy on the west side of Indianapolis. The lease expires on August 15, 2023 and provides annual rental payments approximately $675,000. Lease expense recognized in 2008 approximated $360,000.

Note 9: Pension Plans

In March 2007, the Hospital joined the post-retirement benefit plan of Ortho Indy. The plan provides for a matching component for up to 6% of the employees’ salary and also allows a discretionary profit-sharing contribution from the Hospital. Substantially all of the Hospital’s full-time employees are covered by the plan. Pension expense in 2008 and 2007 was $772,638 and $565,893, respectively. Prior to March 2007, the employees serving the Hospital were leased from Ortho Indy, and related costs were included in the management service agreement described in Note 8 above.

Note 10: Investment in Affiliate (Unaudited)

The investment in affiliate relates to a 50% ownership of the Southeast Surgery Center, LLC. The Hospital acquired an ownership in this entity on July 1, 2007. Financial position and results of operations of the investee at December 31 are summarized below:

	2008	2007
Current assets	$ 5,373,324	$ 4,695,558
Property and other long-term assets, net	573,592	882,490
Goodwill	-	1,412
Total assets	$ 5,946,916	$ 5,579,460
Accounts payable and accrued liabilities	$ 92,768	$ (42,946)
Total liabilities	92,768	(42,946)
Members' equity	5,854,148	5,622,406
Total liabilities and members' equity	$ 5,946,916	$ 5,579,460
Revenues	$ 16,055,081	$ 13,852,074
Excess of revenues over expenses	8,310,281	8,554,127

Note 11: Business Combinations

Effective July 1, 2007, the Hospital’s two LLC members merged into the Hospital, which resulted in a reverse acquisition. The merger did not result in a change in control of the Hospital. The two LLC members were holding companies with no business operations and the transaction resulted in the Hospital receiving approximately $500,000 of cash for the membership units issued.

Also on July 1, 2007, the Hospital acquired the assets of OI South, LLC in a business combination. OI South, LLC owned a 50% interest in the Southeast Surgery Center, LLC. The acquisition met the definition of a business combination under Financial Accounting Standards Board Statement No. 141, *Business Combinations* (FAS 141). FAS 141 requires the acquisition to be accounted for under the purchase method of accounting. Although the business combination was supported and accomplished by fair market value calculations, management elected to record the investment at the book value of the net assets received which is not in compliance with this standard. The Hospital issued approximately $1,343,000 of various classes of membership units in exchange for the outstanding member units of OI South, LLC. The Hospital’s interest in the operations of Southeast Surgery Center, LLC is accounted for under the equity method of accounting subsequent to the business combination.

Note 12: Commitments and Contingencies

Litigation

The Hospital is subject to claims and lawsuits that arise primarily in the ordinary course of its activities. It is the opinion of management that the disposition or ultimate resolution of such claims and lawsuits will not have a material adverse effect on the financial position, change in net assets and cash flows of the Hospital. As such, no accrual for such losses has been recognized in the accompanying consolidated financial statements. It is reasonably possible this estimate could change materially in the near term.

South Side Project

NNS, LLC, which is a wholly owned subsidiary of the Hospital, acquired property on the south side of Indianapolis in December 2008. The purpose of the land acquisition is to develop and operate an ambulatory surgery center. Neither NNS, LLC or the Hospital has entered into formal agreements to develop the property, however, the Board of Managers has given management the authority to negotiate the terms of development.

Capital Lease

The Hospital entered into a capital lease obligation on December 30, 2008 to acquire various equipment. The obligation provides for semi-annual payments of roughly $72,000 over a 4 year life. No amounts have been reflected in the consolidated balance sheet as no equipment was acquired prior to December 31, 2008.

Note 13: Significant Estimates and Concentrations

Accounting principles generally accepted in the United States of America require disclosure of certain significant estimates and current vulnerabilities due to certain concentrations. Those matters include the following:

Allowance for Net Patient Service Revenue Adjustments

Estimates of allowances for adjustments included in net patient service revenue are described in Notes 1 and 2.

Malpractice Claims

Estimates related to the accrual for medical malpractice claims are described in Notes 1 and 4.

Admitting Physicians

The Hospital is served by a group of admitting and surgical physicians that comprise nearly 100% of the Hospital's net patient service revenue. The physician group is a related party of the Hospital through common ownership as described in Note 7.

Self Insurance of Employee Health Claims

The Hospital pools its share of health insurance claims with Ortho Indy, a related party. Any such accrual is included in the related party accrual described in Note 7.

Note 14: Subsequent Event

On January 9, 2009, the Hospital entered into a partially-binding letter of intent to sell a 20% interest of the Hospital, among other provisions. The terms of the partially-binding letter of intent would require an amendment to the Hospital's operating agreement, which require approval of two-thirds of the Hospital's membership.

Note 15: Significant Estimates and Concentrations

Current Economic Conditions

The current economic environment presents hospitals with unprecedented circumstances and challenges, which in some cases have resulted in large declines in the fair value of investments and other assets, large declines in contributions, constraints on liquidity and difficulty obtaining financing. The financial statements have been prepared using values and information currently available to the Hospital.

Current economic conditions, including the rising unemployment rate, have made it difficult for certain of our patients to pay for services rendered. As employers make adjustments to health insurance plans or more patients become unemployed, services provided to self-pay and other payers may significantly impact net patient service revenue, which could have an adverse impact on the Hospital's future operating results. Further, the effect of economic conditions on the state may have an adverse effect on cash flows related to the Medicaid program.

Given the volatility of current economic conditions, the values of assets and liabilities recorded in the financial statements could change rapidly, resulting in material future adjustments in investment values (including defined benefit pension plan investments) and allowances for accounts and contributions receivable that could negatively impact the Hospital's ability to meet debt covenants or maintain sufficient liquidity.