



Jay M. Gellert

President and Chief Executive Officer

To our stockholders

Health Net's board of directors and management are pleased to report on a successful 2009 – a year of significant milestones, substantial operating progress and stronger financial results for the company. As a result of our hard work in 2009, we believe that Health Net today is a much stronger company, better prepared to succeed in a challenging environment.

Strategic Review Completed

At the end of 2008, at our board's direction, management undertook an extensive strategic review of our operations with particular emphasis on our Northeast and Arizona health plans. After a thorough process, we reached two conclusions – to sell our Northeast health plans and retain our Arizona plan.

On July 20, 2009, we announced the sale of the Northeast health plans to UnitedHealthcare (United). The transaction closed on December 11, 2009, and we received \$350 million at closing for a portion of tangible net equity payments and a minimum payment for expected membership transition to United. The transaction is currently valued at between \$490 million and \$610 million. The ultimate value depends on several factors – most importantly, the number of our former commercial members who transition to other United products at their renewal dates.

We will continue to provide administrative services to United in the Northeast during a transition period of approximately two years.

The Northeast sale unlocked the equity in the Northeast businesses. We've redeployed the equity in other areas and to support the growth of our Western health plans. The sale placed our Northeast plans in the hands of a leading company with substantial scale in the region.

With the completion of the Northeast sale, we are now a Western region health plan company with a substantial Government Contracts business. We believe these businesses present multiple growth opportunities for the future.

Last year was not simply a period of strategic changes. We also achieved significant operating improvements throughout the year.

Health Plan Focus

The greatest effect on the competitive climate for commercial health insurance in 2009 was the struggling U.S. economy. Many of our commercial customers, particularly employers in our Western health plan markets, continued to ask for products that can enhance affordability.

We addressed this renewed need for affordability with new lower-cost, narrow network products. These plans provide comprehensive coverage with low out-of-pocket costs and access to a wide range of physicians and hospitals. They are narrow network because they exclude the most expensive providers outside the employer's immediate geographic region.

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Membership in these products rose by approximately 13 percent in 2009, bucking the tide of commercial membership declines in the industry. These products now account for approximately 40 percent of our California small group and individual membership and approximately 20 percent of our total commercial membership.

Despite the growth in these affordable products, Health Net's commercial enrollment declined 10.4 percent in our Western health plans in 2009.

Commercial membership decreases came largely from existing accounts as employers trimmed their workforces. Our 2009 new commercial account sales were approximately equal to the number of accounts that left our plans, a testament to our sales strategies.

Our success with affordable products strengthened our position as one of the leading commercial network-model health plans in California. We believe we gained market share in 2009 and, with these new products continuing to gain favor, we believe we can achieve further market share gains in the years ahead.

Medicare Turnaround

Our 2009 Medicare goals focused on improving performance in both the Medicare Advantage programs and in the Medicare prescription drug benefit plan, known as Medicare Part D. We achieved these goals and took several key steps to promote continued success in both programs.

With our planned exit from the Medicare Private Fee-for-Service business and the Northeast sale, we can now concentrate on Western Medicare network-model markets where Medicare Advantage has been part of the health care fabric for more than 20 years. With rate pressure expected as the federal government takes steps to reduce Medicare costs, we believe these long-standing Western markets will continue to provide opportunities for us.

For example, in 2009 we introduced a Medicare Advantage plan for California's burgeoning senior Latino population. This plan is based on our commercial product for Latinos called *Salud con Health Net*.

For 2009, we substantially reworked our Part D offerings to improve our performance. As a result, we saw our membership decline by 5.5 percent to approximately 460,000 at the end of 2009. This refinement allowed us to concentrate on markets where we had the best competitive profiles.

Our Medicaid program, known as Medi-Cal in California, and Healthy Families program, California's program for low-income children, saw significant membership increases and expanded market share in 2009. We believe these increases were the result of the continuing tough economy combined with our recognized high service levels. Health Net of California's Medi-Cal program is the highest-ranked Medicaid plan in the state according to *U.S. News/NCQA America's Best Health Insurance Plans* for 2009–2010.

Steady TRICARE Performance and Award Protest

We continued our exemplary service to more than 3 million TRICARE beneficiaries in the North Region in 2009. Our program consistently earns some of the highest customer satisfaction ratings in the United States. We are very proud of our record of serving the families of active duty personnel and military retirees for more than 20 years.

With a new North Region contract up for bid in 2009, we worked hard to produce a competitive bid that met the government's needs. On July 13, 2009, however, the Department of Defense (DoD) announced that it had awarded the new North Region contract to another bidder.

Health Net protested the award, believing there were serious issues that the bid assessment process did not adequately address. The Government Accountability Office, an independent investigative arm of the U.S. Congress, agreed and directed the DoD to conduct a further review of the bids based on the issues raised in the protest. On March 9, 2010, the DoD exercised additional option periods that extend our current contract through March 31, 2011.

Operating Efficiencies

Our operating team made major strides in the company's Operations Strategy in 2009. This effort is designed to make our administrative operations more efficient and less costly.

The Operations Strategy included streamlining and consolidating processes, IT application and

infrastructure outsourcing, and outsourcing of some non-customer-facing business processes.

While our headcount has been reduced by approximately 1,300 since the start of the Operations Strategy, many of these Health Net associates are now employed by our business partners such as IBM and Cognizant. We have retained significant institutional knowledge, achieved vital efficiencies, and tapped into the broad knowledge and experience of our partners.

The Operations Strategy has reduced our administrative costs by more than \$125 million on an annual run-rate basis. Equally important are the efficiency improvements that we believe bring better service to our members and make us more competitive in the market.

Health Care Reform

Health care reform took center stage in Washington this year. While the debate continues, there are many parts of reform that are consistent with Health Net's strategy. All of the reform proposals build on the current employer-based system, expand Medicaid eligibility, and guarantee affordable coverage for everyone. This includes coverage for those with pre-existing conditions and a requirement that everyone participate in the system. However, there remains much more work to be done on lowering the overall cost trend for health care services. We have pledged to do our part, but it requires the efforts of all involved to be successful.

2009 Highlights

- A challenging environment
- Completed Northeast sale
- Western health plan focus on affordability
- Operations Strategy yielding savings
- Steady Government Contracts performance
- Solid financial performance in 2009

No matter the outcome of this debate, health care reform and the current economic environment present both challenges and opportunities for the future. We believe we are well-positioned for success today and also in a post-reform environment.

Financial Summary

In 2009, revenue climbed by 2.2 percent to \$15.7 billion. The company recorded a net loss of \$0.47 per diluted share in 2009 compared with net income of \$0.88 per diluted share in 2008. The 2009 loss was the direct result of charges for the Northeast sale and for investments that reduce general and administrative costs. These were necessary expenses that represent investments in the company's Operations Strategy.

Our balance sheet is solid, with cash and investments of \$2.1 billion and debt-to-total capital at 26.2 percent at the end of 2009. The \$350 million we received at the closing of the Northeast sale allowed us to contribute additional capital to our regulated subsidiaries, pay down debt and resume our share repurchase program.

From its resumption on December 14, 2009, through January 29, 2010, the company repurchased more than 2.7 million shares at an average price of \$24.74 per share, spending approximately \$67.3 million. Management believes that share repurchase is currently the best use of our capital.

Conclusion

We are very proud of our operational and strategic success in 2009. We accomplished much, but we know we have more work to do to ensure continued future growth. The challenges are substantial, but we believe that 2009 will prove to be a positive sign for the future.

On behalf of the board of directors and our entire management team, let me again thank our associates who rose to 2009's challenges with dedication, focus and determination.

To our stockholders, we remain committed to taking the steps necessary to enhance stockholder value through better products, greater efficiencies and appropriate capital deployment. Thank you again for your support.

Regards,



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