
# Dear Stockholders:

## We are pleased to report on a very strong 2011. We continued our progress, building on a solid 2010. We believe this progress positions us well for the future opportunities we see.

In 2011, these achievements stood out:

→ We successfully transitioned to the new TRICARE North Region contract that was effective April 1, 2011.

→ Enrollment in our commercial tailored network products continued to grow.

→ Membership in our California state health plans increased as we supported the state's efforts to transition Seniors and Persons with Disabilities (SPDs) into managed care beginning in the second quarter.

→ We repurchased 13.6 million shares for approximately $374 million — that's more than 14 percent of the outstanding common stock as of the end of 2010.

### Financial Highlights

GAAP net income was $72.1 million, or $0.80 per diluted share, for 2011 compared with GAAP net income of $204.2 million, or $2.06 per diluted share, in 2010. The decline was primarily attributable to a legal judgment recorded in the first quarter of 2011.

Key operating and financial metrics for the combined Western Region Operations (Western Region) and Government Contracts segments, however, showed marked improvement compared with 2010 and, in many cases, exceeded our expectations.

Net income for these combined segments was $278.4 million, or $3.09 per diluted share, in 2011 compared with net income of $258.4 million, or $2.60 per diluted share, for the combined segments in 2010.

One of our primary goals is to produce consistent margin improvement. While the GAAP pretax margin was 1.5 percent in 2011, the pretax margin for our combined Western Region and Government Contracts segments was 3.8 percent. This represents a 60 basis point gain year-over-year.

Operating cash flow was on target at $103.4 million, approximately equal to GAAP net income plus depreciation and amortization. We absorbed the cash impact of the legal judgment yet still had substantial capital resources to fund operations and our share repurchases throughout the year.

"At the end of 2011, our tailored network products accounted for 31 percent of our total commercial enrollment compared with 23 percent at the end of 2010."

### Commercial Health Plans

In our commercial health plans in Arizona, California, Oregon and Washington, two trends continued from 2010. Commercial enrollment growth is challenging while health care cost increases remain low.

While overall enrollment was down slightly, membership in our tailored network products grew by 35 percent in 2011. At the end of 2011, they accounted for 31 percent of our total commercial enrollment compared with 23 percent at the end of 2010.

These tailored network products use networks of providers who share our commitment to quality health care combined with affordability for our members. These products also incorporate benefit levels that ensure our members have access to all the care they need.

The popularity of our tailored network products affirms that our customers are looking for sensible economic solutions that preserve access and quality for their employees. In addition, these lower-cost products help contribute to our financial performance. They are a key factor in our improved margins.

We also aim to achieve a positive spread between health care premiums and costs. Such positive spreads keep us financially strong and allow us to continue to innovate to meet emerging customer needs.

In 2011, commercial premiums per member per month (PMPM) rose by 5.1 percent while health care costs PMPM rose by 4.0 percent.

In addition to the growth in our tailored network products, disciplined pricing, favorable geographic mix shifts and low health care utilization contributed to the positive spread performance.

Commercial health care cost increases are currently low. We are experiencing low hospital utilization and lower unit cost increases across our commercial provider networks — an encouraging development. Also, the use of generic medications continues to expand, allowing our members access to a broad range of effective drugs at reasonable costs.

Our solid commercial profile is in large part the result of the tireless efforts of our associates. Thanks to their work, we are today a stronger competitor in our commercial markets. Our products are popular by meeting customer needs for affordability. We are a leader in culturally targeted health plans, such as our Latino products. We believe that brokers and general agents increasingly appreciate our discipline and predictability.

We believe this is a recipe for continued profitable growth in our commercial markets.

### Medicaid

Our California state health programs business exceeded its annual enrollment goal as membership rose 12 percent in 2011. The economy remains an important factor in the growth of the basic Medi-Cal program.

In addition, we began to enroll members from the SPD program on June 1, 2011. At December 31, 2011, we had enrolled approximately 52,000 new SPD members. We expect to continue to enroll SPD members through May 2012.

These members have special needs for a broad range of health care services. We expect that through better coordination of care, an increased focus on individual needs and overall efficiencies, we will improve their quality of life and access to needed services and, at the same time, reduce costs.

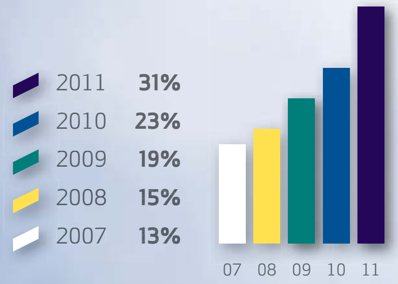
Our overall Medicaid medical care ratio (MCR), at 85.5 percent for 2011, primarily reflected the low utilization levels we also experienced in our commercial business.

We have been able to maintain stable financial performance in our state health programs over several years. We work closely with the state of California to achieve the most cost-effective services possible. Because of California's ongoing budget challenges, this is vitally important.

The state included in its fiscal 2012-13 budget a plan to move dual-eligible beneficiaries into managed care plans beginning in January 2013. Dual eligibles are beneficiaries eligible for both Medicare and Medicaid.

**TAILORED NETWORK PLANS ENROLLMENT**

% of Total Western Region Operations Membership (As of December 31)




These patients require a great deal of attention and a very high level of services. We responded to the state's Request for Solutions regarding the dual eligibles. We hope that we can work with the state within the counties we serve to help create new solutions that will provide these beneficiaries with the care they need in a more efficient and effective fashion — just as we've been doing for the Medicaid population for many years.

### Medicare

Our Medicare Advantage (MA) plans performed in line with expectations in 2011. Enrollment declined as we were unable to add new members due to sanctions imposed by the Centers for Medicare & Medicaid Services (CMS).

We worked hard in 2011 to address CMS' concerns, and the sanctions were lifted in August 2011. With the sanctions lifted, we prepared for active marketing for the 2012 annual enrollment period to seniors in our service areas in Arizona, California and Oregon.

This ambitious marketing effort in the fourth quarter of 2011 restored momentum in our MA markets and, as a result, MA enrollment in 2012 has rebounded by at least 10 percent.

Our Medicare stand-alone Prescription Drug Plan (Medicare PDP) business met expectations in 2011. During the course of 2011, we determined that Health Net did not possess the necessary scale to be successful over the long-term in its Medicare PDP markets. Therefore, we decided to sell our Medicare PDP business to CVS/Caremark. The transaction was announced in January of 2012 and is expected to close in the second quarter of 2012.

### Government Contracts

The Government Contracts segment had a solid 2011. In addition to the transition to the new TRICARE contract, we also continued our important work in the Military & Family Life Consultant (MFLC) program.

The vital behavioral services under the MFLC contract help returning active duty uniformed personnel and their families. We hope to continue this work in the years ahead.

We also added to our work for the Department of Veterans Affairs (VA). Our partnership with the VA is based on the same principle as the rest of our government work — work hard to sustain access and quality and do so in the most cost-effective way possible.

### General and Administrative Expenses (G&A)

Our G&A performance in 2011 was on target at 8.9 percent. We achieved this while supporting increased Medicare and commercial marketing efforts.

We are constantly looking for ways to further reduce G&A in the years ahead. It is our goal to achieve cost savings that rival those of our larger competitors. We believe we can do this by further outsourcing and achieving other operational efficiencies, especially in the use of information technology.

### Outlook

In closing, we believe that Health Net is well positioned today to succeed with its existing businesses. The progress we made in 2011 clearly demonstrates this. Our diverse book of commercial and government businesses is a real strength.

For the future, we have many opportunities. Commercial customers are increasingly looking for affordable solutions, and we offer them. Our various government customers are all seeking ways to curb cost increases in a number of programs — from dual eligibles to the numerous programs financed by the Department of Defense and others.

We are gratified that 2011 exceeded expectations in so many areas and are prepared to meet the challenges of the future.

Thanks to you, our stockholders, for your steadfast support and encouragement.

Regards,

Jay Gellert

**Jay M. Gellert**
President and Chief Executive Officer

April 6, 2012