
**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2019

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File Number: 001-35628

PERFORMANT FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

20-0484934
(I.R.S. Employer
Identification No.)

Performant Financial Corporation
333 North Canyons Parkway
Livermore, CA 94551
(925) 960-4800

(Address, including zip code and telephone number, including area code of registrant's principal executive offices)

Indicate by check mark whether the registrant (1) has filed all reports required by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	<input type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input checked="" type="checkbox"/>
		Emerging growth company	<input type="checkbox"/>

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

Securities registered pursuant to Section 12(b) of the Act:

<u>Title of each class</u>	<u>Trading Symbol(s)</u>	<u>Name of exchange on which registered</u>
Common Stock, par value \$.0001 per share	PFMT	The Nasdaq Stock Market LLC

The number of shares of Common Stock outstanding as of May 13, 2019 was 53,148,566.

PERFORMANT FINANCIAL CORPORATION
QUARTERLY REPORT ON FORM 10-Q
FOR THE QUARTER ENDED MARCH 31, 2019
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PERFORMANT FINANCIAL CORPORATION AND SUBSIDIARIES
Consolidated Balance Sheets
(In thousands)

	March 31, 2019	December 31, 2018
	(Unaudited)	
Assets		
Current assets:		
Cash and cash equivalents	\$ 4,364	\$ 5,462
Restricted cash	1,659	1,813
Trade accounts receivable, net of allowance for doubtful accounts of \$130 and \$22, respectively	17,877	20,879
Prepaid expenses and other current assets	3,792	3,420
Income tax receivable	14	179
Total current assets	27,706	31,753
Property, equipment, and leasehold improvements, net	21,488	22,255
Identifiable intangible assets, net	1,101	1,160
Goodwill	81,572	81,572
ROU assets	9,714	—
Other assets	1,019	1,019
Total assets	\$ 142,600	\$ 137,759
Liabilities and Stockholders' Equity		
Current liabilities:		
Current maturities of notes payable, net of unamortized debt issuance costs of \$144 and \$126, respectively	\$ 2,806	\$ 2,224
Accrued salaries and benefits	7,364	5,759
Accounts payable	1,989	1,402
Other current liabilities	4,317	3,414
Deferred revenue	658	1,078
Estimated liability for appeals	255	210
Earnout payable	410	—
Lease liabilities	2,882	—
Total current liabilities	20,681	14,087
Notes payable, net of current portion and unamortized debt issuance costs of \$2,095 and \$2,345, respectively	40,755	41,105
Deferred income taxes	53	22
Earnout payable	1,802	1,936
Lease liabilities	8,028	—
Other liabilities	2,167	3,383
Total liabilities	73,486	60,533
Commitments and contingencies		
Stockholders' equity:		
Common stock, \$0.0001 par value. Authorized, 500,000 shares at March 31, 2019 and December 31, 2018 respectively; issued and outstanding 53,146 and 52,999 shares at March 31, 2019 and December 31, 2018, respectively	5	5
Additional paid-in capital	77,747	77,370
(Accumulated deficit)	(8,638)	(149)
Total stockholders' equity	69,114	77,226
Total liabilities and stockholders' equity	\$ 142,600	\$ 137,759

See accompanying notes to consolidated financial statements.

PERFORMANT FINANCIAL CORPORATION AND SUBSIDIARIES

Consolidated Statements of Operations
(In thousands, except per share amounts)
(Unaudited)

	Three Months Ended March 31,	
	2019	2018
Revenues	\$ 34,876	\$ 57,021
Operating expenses:		
Salaries and benefits	29,116	21,781
Other operating expenses	12,953	23,020
Total operating expenses	42,069	44,801
(Loss) income from operations	(7,193)	12,220
Interest expense	(1,136)	(1,270)
Interest income	11	6
(Loss) income before provision for income taxes	(8,318)	10,956
Provision for income taxes	171	2,501
Net (loss) income	\$ (8,489)	\$ 8,455
Net (loss) income per share		
Basic	\$ (0.16)	\$ 0.16
Diluted	\$ (0.16)	\$ 0.16
Weighted average shares		
Basic	53,059	51,320
Diluted	53,059	53,455

See accompanying notes to consolidated financial statements.

PERFORMANT FINANCIAL CORPORATION AND SUBSIDIARIES
Consolidated Statements of Comprehensive Income (Loss)
(In thousands)
(Unaudited)

	Three Months Ended March 31,	
	2019	2018
Net (loss) income	\$ (8,489)	\$ 8,455
Other comprehensive (loss) income:		
Foreign currency translation adjustment	—	1
Comprehensive (loss) income	<u>\$ (8,489)</u>	<u>\$ 8,456</u>

See accompanying notes to consolidated financial statements.

PERFORMANT FINANCIAL CORPORATION AND SUBSIDIARIES
Consolidated Statements of Cash Flows
(In thousands)
(Unaudited)

	Three Months Ended March 31,	
	2019	2018
Cash flows from operating activities:		
Net (loss) income	\$ (8,489)	\$ 8,455
Adjustments to reconcile net (loss) income to net cash provided by (used in) operating activities:		
Release of net payable to client related to contract termination	—	(9,860)
Release of estimated liability for appeals due to termination of contract	—	(17,932)
Derecognition of subcontractor receivable for appeals due to termination of contract	—	5,535
Derecognition of subcontractor receivable for overturned claims	—	1,536
Provision for doubtful accounts for subcontractor receivable	—	1,868
Depreciation and amortization	2,312	2,576
Deferred income taxes	31	283
Stock-based compensation	499	639
Interest expense from debt issuance costs	232	331
Earnout mark-to-market	276	—
ROU assets amortization	660	—
Changes in operating assets and liabilities:		
Trade accounts receivable	3,002	(5,905)
Prepaid expenses and other current assets	(372)	(82)
Income tax receivable	165	2,316
Other assets	—	41
Accrued salaries and benefits	1,605	1,417
Accounts payable	587	(80)
Deferred revenue and other current liabilities	483	1,571
Estimated liability for appeals	45	—
Net payable to client	—	(2,940)
Lease liabilities	(723)	—
Other liabilities	43	395
Net cash provided by (used in) operating activities	356	(9,836)
Cash flows from investing activities:		
Purchase of property, equipment, and leasehold improvements	(1,486)	(2,500)
Net cash used in investing activities	(1,486)	(2,500)
Cash flows from financing activities:		
Repayment of notes payable	—	(550)
Taxes paid related to net share settlement of stock awards	(156)	(299)
Proceeds from exercise of stock options	34	116
Net cash used in financing activities	(122)	(733)
Effect of foreign currency exchange rate changes on cash	—	1
Net decrease in cash, cash equivalents and restricted cash	(1,252)	(13,068)
Cash, cash equivalents and restricted cash at beginning of period	7,275	23,519
Cash, cash equivalents and restricted cash at end of period	\$ 6,023	\$ 10,451
Supplemental disclosures of cash flow information:		
Cash received for income taxes	\$ (54)	\$ (299)
Cash paid for interest	\$ —	\$ 939

PERFORMANT FINANCIAL CORPORATION AND SUBSIDIARIES
Consolidated Statements of Cash Flows
(In thousands)
(Unaudited)

Reconciliation of the Consolidated Statements of Cash Flows to the Consolidated Balance Sheets:

Cash and cash equivalents	\$	4,364	\$	8,663
Restricted cash	\$	1,659	\$	1,788
Total cash, cash equivalents and restricted cash at end of period	\$	<u>6,023</u>	\$	<u>10,451</u>

See accompanying notes to consolidated financial statements.

PERFORMANT FINANCIAL CORPORATION AND SUBSIDIARIES

Notes To Consolidated Financial Statements
For the Three Months Ended March 31, 2019 and 2018
(Unaudited)

1. Organization and Description of Business

(a) Basis of Presentation and Organization

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America, or U.S. GAAP, for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by U.S. GAAP for complete financial statements. In the opinion of management, the unaudited interim financial statements furnished herein include all adjustments necessary (consisting only of normal recurring adjustments) for a fair presentation of our and our subsidiaries' financial position at March 31, 2019, and the results of our operations and cash flows for the three months ended March 31, 2019 and 2018 and cash flows for the three months ended March 31, 2019 and 2018. Interim financial statements are prepared on a basis consistent with our annual consolidated financial statements. The interim financial statements included herein should be read in conjunction with the consolidated financial statements and related notes included in our annual report on Form 10-K for the year ended December 31, 2018.

Performant Financial Corporation (the "Company" or "we") is a leading provider of technology-enabled recovery and analytics services in the United States. The Company's services help identify, restructure and recover delinquent or defaulted assets and improper payments for both government and private clients in a broad range of markets. Clients of the Company typically operate in complex and regulated environments and contract for their recovery needs in order to reduce losses on defaulted student loans, improper healthcare payments and delinquent state tax and federal treasury receivables. The Company generally provides services on an outsourced basis; handling many or all aspects of the clients' recovery processes.

The Company's consolidated financial statements include the operations of Performant Financial Corporation (Performant), its wholly-owned subsidiaries Premiere Credit of North America, LLC (Premiere) and Performant Business Services, Inc., (PBS), and PBS's wholly-owned subsidiaries Performant Recovery, Inc. (Recovery), Performant Technologies, LLC., and Performant Europe Ltd. Performant is a Delaware corporation headquartered in California and was formed in 2003. Premiere is an Indiana limited liability company acquired by Performant on August 31, 2018. Performant Business Services, Inc. is a Nevada corporation founded in 1997. Recovery is a California corporation founded in 1976. PBS is a California corporation that was formed in 2004. All significant intercompany balances and transactions have been eliminated in consolidation.

The Company is managed and operated as one business, with a single management team that reports to the Chief Executive Officer.

The preparation of the consolidated financial statements in conformity with U.S. GAAP requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities, primarily accounts receivable, intangible assets, goodwill, estimated liability for appeals, earnout payable, other liabilities, deferred income taxes and income tax expense and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. Our actual results could differ from those estimates.

(b) Revenues, Accounts Receivable, and Estimated Liability for Appeals

The Company derives its revenues primarily from providing recovery services. Revenues are recognized when control of these services is transferred to its customers, in an amount that reflects the consideration the Company expects to be entitled to in exchange for those services.

The Company determines revenue recognition through the following steps:

- Identification of the contract with a customer
- Identification of the performance obligations in the contract
- Determination of the transaction price
- Allocation of the transaction price to the performance obligations in the contract
- Recognition of revenue when, or as, the performance obligations are satisfied

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The Company accounts for a contract when it has approval and commitment from both parties, the rights of the parties are identified, payment terms are identified, the contract has commercial substance and collectability of consideration is probable.

The Company's contracts generally contain a single performance obligation, delivered over time as a series of services that are substantially the same and have the same pattern of transfer to the client, as the promise to transfer the individual services is not separately identifiable from other promises in the contracts and, therefore, not distinct. For contracts with multiple performance obligations, the Company would allocate the contract's transaction price to each performance obligation using its best estimate of the standalone selling price of each distinct service in the contract. The Company determines the standalone selling prices by taking into consideration the value of the services being provided, the client type and how similar services are priced in other contracts on a standalone basis.

The Company's contracts are composed primarily of variable consideration. Fees earned under the Company's recovery service contracts consist primarily of contingency fees based on a specified percentage of the amount the Company enables its clients to recover. The contingency fee percentage for a particular recovery depends on the type of recovery or claim facilitated. In certain contracts the Company can earn additional performance-based consideration determined based on its performance relative to the client's other contractors providing similar services.

Revenue from contingency fees earned upon recovery of funds is generally recognized as amounts are invoiced based on either the 'as-invoiced' practical expedient when such amounts reflect the value of the services completed to-date, or an output measure based on milestones which is used to measure progress of the satisfaction of its performance obligation. The Company estimates any performance-based variable consideration and recognizes such revenue over the performance period only if it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur. Under certain contracts, consideration can include periodic performance-based bonuses which can be awarded based on the Company's performance under the specific contract. These performance-based awards are considered variable and may be constrained by the Company until there is not a risk of a material reversal.

For contracts that contain a refund right, these amounts are considered variable consideration and the Company estimates its refund liability for each claim and recognizes revenue net of such estimate.

The following table presents revenue disaggregated by category (in thousands) for the three months ended March 31, 2019 and 2018:

	Three Months Ended March 31,	
	2019	2018
	(in thousands)	
Student Lending	\$ 12,855	\$ 19,105
Healthcare ⁽¹⁾	10,173	31,314
Other ⁽²⁾	11,848	6,602
Total Revenues	<u>\$ 34,876</u>	<u>\$ 57,021</u>

(1) Includes \$27.8 million related to the termination of the 2009 CMS Region A contract for the three months ended March 31, 2018.

(2) Represents outsourced call center services, tax and IRS.

The Company generally either applies the as-invoiced practical expedient where its right to consideration corresponds directly to its right to invoice its clients, or the variable consideration allocation exception where the variable consideration is attributable to one or more, but not all, of the services promised in a series of distinct services that form part of a single performance obligation. As such the Company has elected the optional exemptions related to the as-invoiced practical expedient and the variable consideration allocation exception whereby the disclosure of the amount of transaction price allocated to the remaining performance obligations is not required.

The Company has applied the as-invoiced practical expedient or the variable allocation exception to contracts with performance obligations that have an average remaining duration of less than a year.

Revenue is recognized upon the collection of defaulted loan and debt payments. Loan rehabilitation revenue is recognized when the rehabilitated loans are sold (funded) by clients. Incentive revenue is recognized upon receipt of official notification of incentive award from customers.

Under the Company's Medicare Secondary Payer (MSP) Commercial Payment Center (CPC) with Centers for Medicare and Medicaid Services (CMS), the Company recognizes revenues when insurance companies or other responsible parties remit payment to reimburse CMS for claims for which they are responsible, and the remittance has been applied in the CMS database. Under the Company's Medicare Recovery Audit Contractor (RAC) contract with CMS, the Company recognizes revenues when the healthcare provider has paid CMS for a given claim or has agreed to an offset against other claims by the provider.

Under other healthcare contracts, the Company may recognize revenue upon delivering the results of claims audits, when sufficient reliable information is available to the Company for estimating the variable consideration earned, as it is a reasonable measure of the Company's progress toward complete satisfaction of our performance obligation.

Healthcare providers have the right to appeal a claim and may pursue additional appeals if the initial appeal is found in favor of the healthcare client. Total estimated liability for appeals was \$0.3 million and \$0.2 million as of March 31, 2019 and December 31, 2018, respectively. This represents the Company's best estimate of the amount probable of being refunded to the Company's healthcare clients following successful appeals of claims for which commissions were previously collected.

The Company determines the allowance for doubtful accounts by specific identification. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is consider remote. The allowance for doubtful account was \$130 thousand and \$22 thousand at March 31, 2019 and December 31, 2018, respectively.

The Company determined that it does not have any costs related to obtaining or fulfilling a contract that are recoverable and as such, these contract costs are expensed as incurred.

The Company has contract assets of \$6.6 million and \$3.0 million as of March 31, 2019 and December 31, 2018, respectively. The contract assets relate to the Company's rights to consideration for services completed during the three months ended March 31, 2019 and year ended December 31, 2018, but not invoiced at the reporting date. The increase in contract assets is primarily due to timing of invoices issued and increased volume of work. Contract assets are recorded to accounts receivable when the rights become unconditional and amounts are invoiced. Contract assets are included in trade accounts receivable in the consolidated balance sheets.

The Company has contract liabilities of \$0.7 million as of March 31, 2019 and \$1.1 million as of December 31, 2018, which are included in deferred revenue in the consolidated balance sheets. The Company's contract liability relates to an advance recovery commission payment received from a customer during the first quarter of 2018, for which the Company anticipates revenue to be recognized as services are delivered.

(c) Prepaid Expenses and Other Current Assets

At March 31, 2019, prepaid expenses and other current assets were \$3.8 million and included approximately \$2.5 million related to prepaid software licenses and maintenance agreements and \$0.5 million for prepaid insurance.

(d) Impairment of Goodwill and Long-Lived Assets

Goodwill and long-lived assets are evaluated for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets or intangibles may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of the assets to future undiscounted net cash flows expected to be generated by the assets. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. The balance of goodwill was \$81.6 million as of March 31, 2019 and December 31, 2018. There was no impairment expense for goodwill or long-lived assets for the three months ended March 31, 2019.

(e) Other Current Liabilities

At March 31, 2019, other current liabilities included \$2.4 million for services received for which we have not received an invoice, \$0.9 million for accrued subcontractor fees, \$0.8 million in accrued interest expense, and \$0.2 million for estimated workers' compensation claims incurred but not reported. At December 31, 2018 other current liabilities included \$2.7 million for services received for which we have not received an invoice, \$0.4 million for accrued subcontractor fees, and \$0.2 million for estimated workers' compensation claims incurred but not reported.

(f) New Accounting Pronouncements

Recently Adopted Accounting Standards

In February 2016, the FASB issued ASU 2016-02, "Leases", which requires the recognition of lease assets and lease liabilities on the balance sheet by lessees for those leases currently classified as operating leases under ASC Topic 840 Leases. The guidance is effective for our fiscal year beginning January 1, 2019 and should be applied using a modified retrospective approach. In July 2018, the FASB issued ASU No. 2018-11, *Targeted Improvements*, which provide the option to apply the new leasing standard to all open leases as of the adoption date. The Company elected to adopt this pronouncement on January 1, 2019 using the optional transition method under ASU 2018-11 and elected the package of practical expedients permitted under the transition guidance, which permits the Company not to reassess under the new standard prior conclusions about lease identification, lease classification and initial direct costs. The Company also elected to combine lease and non-lease components, and to apply the short-term lease exception.

As a result of implementing this guidance, the Company recognized \$10.4 million of right of use (ROU) assets and \$11.6 million of lease liabilities for its operating leases, including a reclassification of deferred rent of \$1.2 million, on its consolidated balance sheet as of January 1, 2019.

The adoption did not impact the consolidated statements of operations, nor will it have a notable impact on the Company's liquidity. The standard will also have no impact on the Company's debt-covenant compliance under its current agreement. Results and disclosure requirements for reporting periods beginning after January 1, 2019 are presented under Topic 842, while prior period amounts have not been adjusted and continue to be reported in accordance with historical accounting under Topic 840.

Under Topic 842, ROU assets represent the Company's right to use an underlying asset for the lease term, and lease liabilities represent the Company's obligation to make lease payments arising from the lease. We determine if an arrangement is a lease at inception. ROU assets and liabilities are recognized at commencement date based on the present value of remaining lease payments over the lease term. As the implied discount rate in most of our leases is indeterminable, we use our incremental borrowing rate based on the information available at commencement date in determining the present value of lease payments. Our incremental borrowing rate is a hypothetical rate based on our understanding of what our credit rating would be. The ROU asset also includes any lease payments made prior to commencement and is recorded net of any lease incentives received. Our lease terms may include options to extend or terminate the lease when it is reasonably certain that we will exercise such options.

2. Property, Equipment, and Leasehold Improvements

Property, equipment, and leasehold improvements consist of the following at March 31, 2019 and December 31, 2018 (in thousands):

	March 31, 2019	December 31, 2018
Land	\$ 1,943	\$ 1,943
Building and leasehold improvements	8,082	8,076
Furniture and equipment	6,480	6,248
Computer hardware and software	78,656	78,743
	95,161	95,010
Less accumulated depreciation and amortization	(73,673)	(72,755)
Property, equipment and leasehold improvements, net	\$ 21,488	\$ 22,255

Depreciation expense of property, equipment and leasehold improvements was \$2.3 million and \$2.4 million for the three months ended March 31, 2019 and 2018, respectively.

3. Credit Agreement

On August 7, 2017, we, through our wholly-owned subsidiary Performant Business Services, Inc. (the "Borrower"), entered into a credit agreement with ECMC Group, Inc. (as amended, the "Credit Agreement"). Before the amendment described below, the Credit Agreement provided for a term loan facility in the initial amount of \$44 million (the "Initial Term Loan") and for up to \$15 million of additional term loans ("Additional Term Loans"; and together with the Initial Term Loan, the "Loans") which original Additional Term Loans were initially able to be drawn until the second anniversary of the funding of the Initial Term Loans, subject to the satisfaction of customary conditions. On August 11, 2017, the Initial Term Loan was advanced (the "Closing Date") and the proceeds were applied to repay all outstanding amounts under our prior credit agreement with Madison Capital Funding LLC as administrative agent ("the Prior Credit Agreement"). On August 31, 2018, we entered into Amendment No. 2 to the Credit Agreement to among other things (i) extend the maturity date of the Initial Term Loan and any Additional Term Loans by one year to August 2021, (ii) expand the Additional Term Loans commitment from \$15 million to \$25 million, (iii) extend the period during which Additional Term Loans can be borrowed by one year to August 2020, and (iv) relieve the Borrower from its obligation to comply with the financial covenants in the Credit Agreement during the six fiscal quarters following the Premiere acquisition. On October 15, 2018, the Company borrowed \$4 million of the \$25 million available as Additional Term Loans under the Credit Agreement. On March 21, 2019, we entered into Amendment No. 3 to the Credit Agreement to among other things relieve the Borrower from its obligation to comply with the financial covenants in the Credit Agreement until the quarter ending June 30, 2020.

As of March 31, 2019, \$45.8 million was outstanding under the Credit Agreement.

We have the option to extend the maturity of the Loans for two additional one-year periods, subject to the satisfaction of customary conditions. The Loans bear interest at the one-month LIBOR rate (subject to a 1% per annum floor) plus a margin which may vary from 5.5% per annum to 10.0% per annum based on our total debt to EBITDA ratio. Our annual interest rate at March 31, 2019 was 8.0% and 8.0% at December 31, 2018. We are required to pay 5% of the original principal balance of the Loans annually in quarterly installments and to make mandatory prepayments of the Loans with a percentage of our excess cash flow which may vary between 75% and 0% depending on our total debt to EBITDA ratio and from the net cash proceeds of certain asset dispositions and debt not otherwise permitted under the Credit Agreement, in each case, subject to the lender's right to decline to receive such payments. The Loans may be voluntarily prepaid at any time, together with a prepayment premium of 1% for all voluntary prepayments prior to August 11, 2019.

The Credit Agreement contains certain restrictive financial covenants which are not effective until the quarter ending June 30, 2020, at which point, we will be required to (1) achieve a minimum fixed charge coverage ratio of 1.0 to 1.0 through December 31, 2020 and 1.25 to 1.0 through June 30, 2022 if the maturity date of the Loans is extended until the fifth anniversary of the Closing Date and (2) maintain a maximum total debt to EBITDA ratio of 6.00 to 1.00. The Credit Agreement also contains covenants that restrict the Company's and its subsidiaries' ability to incur certain types or amounts of indebtedness, incur liens on certain assets, make material changes in corporate structure or the nature of its business, dispose of material assets, engage in a change in control transaction, make certain foreign investments, enter into certain restrictive agreements, or engage in certain transactions with affiliates. The Credit Agreement also contains various customary events of default, including with respect to change of control of the Company or its ownership of the Borrower.

The obligations under the Credit Agreement are secured by substantially all of our United States domestic subsidiaries' assets and are guaranteed by the Company and its United States domestic subsidiaries, other than the Borrower.

In consideration for, and concurrently with, the origination of the Initial Term Loan in accordance with the terms of the Credit Agreement, we issued a warrant to the lender to purchase up to an aggregate of 3,863,326 shares of the Company's common stock (representing approximately up to 7.5% of our diluted common stock as calculated using the "treasury stock" method as defined under U.S. GAAP for the three month period ended June 30, 2017) with an exercise price of \$1.92 per share (the "Exercise Price"). In connection with the October 15, 2018 Additional Term Loan borrowing of \$4 million, we were required to, and did, issue a warrant to the lender to purchase an aggregate of 309,066 shares of the Company's common stock at the same Exercise Price of \$1.92 per share. Upon any further borrowing of the Additional Term Loans, we will be required to issue additional warrants at the same Exercise Price to purchase up to an aggregate of 77,267 additional shares of common stock (which represents approximately 0.15% of our diluted common stock calculated using the "treasury stock" method as defined under U.S. GAAP for the fiscal quarter ended June 30, 2017) for each \$1.0 million of such Additional Term Loans. Similarly, upon our election to extend the maturity of the loans for two additional one year periods, we will be required to issue additional warrants at the same Exercise Price to purchase up to an aggregate of 515,110 additional shares of common stock for the first year, and to purchase up to an aggregate of 772,665 additional shares of common stock for the second year (which represent approximately 1.0% and 1.5% of our diluted common stock for the first and second years, respectively, calculated using the "treasury stock" method as defined under U.S. GAAP for the fiscal quarter ended June 30, 2017).

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The Company has accounted for these warrants as equity instruments since the warrants are indexed to the Company's common shares and meet the criteria for classification in shareholders' equity. The relative fair value of the warrants on August 11, 2017 and October 15, 2018, were approximately \$3.3 million and \$0.2 million, respectively and were treated as a discount to the associated debt. These amounts are being amortized to interest expense under the effective interest method over the life of the Term Loan and Additional Term Loans, respectively, which is a period of 48 months. The Company estimated the value of the warrants using the Black-Scholes model. The key assumptions used to value the warrants are as follows:

	August 2017 Issuance	October 2018 Issuance
Exercise price	\$1.92	\$1.92
Share price on date of issuance	\$1.85	\$1.93
Volatility	50.0%	55.0%
Risk-free interest rate	1.83%	3.01%
Expected dividend yield	—%	—%
Contractual term (in years)	5	5

In addition, at the closing of the Initial Term Loan, the Company paid transaction costs of \$0.6 million, which were recorded as a discount on the debt and are being amortized to interest expense using the effective interest method over the life of the Initial Term Loan, which is a period of 36 months.

Outstanding debt obligations are as follows (in thousands):

	March 31, 2019
Principal amount	\$ 45,800
Less: unamortized discount and debt issuance costs	(2,239)
Loan payable less unamortized discount and debt issuance costs	43,561
Less: current maturities	(2,806)
Long-term loan payable, net of current maturities	\$ 40,755

4. Leases

The Company has entered into various non-cancelable operating lease agreements for office facilities and equipment with original lease periods expiring between 2020 and 2025. Certain of these arrangements have free rent periods and /or escalating rent payment provisions. As such, we recognize rent expense under such arrangements on a straight-line basis in accordance with U.S. GAAP. Some leases include options to renew. We do not assume renewals in our determination of the lease term unless the renewals are deemed to be reasonably assured at lease commencement. Our lease agreements do not contain any material residual value guarantees or material restrictive covenants. Leases with an initial term of twelve months or less are not recorded on the balance sheet.

Supplemental balance sheet information related to operating leases as of March 31, 2019 are as follows (in thousands):

Weighted Average Remaining Lease Term	4.5 years
Weighted Average Discount Rate	6.4%

Cash paid for amounts included in the measurement of operating lease liabilities were \$0.9 million for the three months ended March 31, 2019, included in operating cash flows.

The following is a schedule, by years, of maturities of lease liabilities as of March 31, 2019 (in thousands):

Year Ending December 31,	Amount
Remainder of 2019	2,614
2020	3,397
2021	2,517
2022	1,902
2023	800
Thereafter	1,390
Total undiscounted cash flows	\$ 12,620
Less imputed interest	\$ (1,710)
Present value of lease liabilities	<u>\$ 10,910</u>

Disclosures related to periods prior to adoption of the new lease standard

Future minimum rental commitments under non-cancelable leases as of March 31, 2018 are as follows (in thousands):

Year Ending December 31,	Amount
Remainder of 2018	2,007
2019	3,070
2020	3,033
2021	2,139
2022	1,710
Thereafter	2,190
Total	<u>\$ 14,149</u>

Operating lease expense was \$0.9 million for the three months ended March 31, 2018.

5. Stock-based Compensation

(a) Stock Options

Total stock-based compensation expense charged as salaries and benefits expense in the consolidated statements of operations was \$0.5 million and \$0.6 million for the three months ended March 31, 2019 and 2018. The following table shows stock option activity for the three months ended March 31, 2019:

	Outstanding Options	Weighted average exercise price per share	Weighted average remaining contractual life (Years)	Aggregate Intrinsic Value (in thousands)
Outstanding at December 31, 2018	2,459,102	\$ 8.97	3.25	\$ 273
Granted	—	—		
Forfeited	(239,047)	7.20		
Exercised	(19,478)	1.74		
Outstanding at March 31, 2019	<u>2,200,577</u>	<u>\$ 9.23</u>	<u>3.37</u>	<u>\$ 207</u>
Vested, exercisable, expected to vest ⁽¹⁾ at March 31, 2019	<u>2,200,462</u>	<u>\$ 9.23</u>	<u>3.37</u>	<u>\$ 207</u>
Exercisable at March 31, 2019	<u>2,198,285</u>	<u>\$ 9.23</u>	<u>3.37</u>	<u>\$ 207</u>

(1) Options expected to vest reflect an estimated forfeiture rate.

The Company recognizes share-based compensation costs as expense on a straight-line basis over the option vesting period, which generally is four years.

(b) Restricted Stock Units and Performance Stock Units

The following table summarizes restricted stock unit and performance stock unit activity for the three months ended March 31, 2019:

	Number of Awards	Weighted average grant date fair value per share
Outstanding at December 31, 2018	2,933,236	\$ 2.50
Granted	30,000	2.16
Forfeited	(94,075)	2.50
Vested and converted to shares, net of units withheld for taxes	(127,864)	1.75
Units withheld for taxes	(74,261)	1.75
Outstanding at March 31, 2019	2,667,036	\$ 2.55
Expected to vest at March 31, 2019	2,534,184	\$ 2.55

Restricted stock units and performance stock units granted under the Performant Financial Corporation Amended and Restated 2012 Stock Incentive Plan generally vest over periods ranging from one to four years.

6. Income Taxes

Our effective income tax rate changed to (2.1)% for the three months ended March 31, 2019 from 22.8% for the three months ended March 31, 2018. The change in the effective tax rate is primarily driven by the overall losses from operations for the three months ended March 31, 2019 for which no benefit is recognized due to valuation allowance.

We file income tax returns with the U.S. federal government and various state jurisdictions. We operate in a number of state and local jurisdictions, most of which have never audited our records. Accordingly, we are subject to state and local income tax examinations based upon the various statutes of limitations in each jurisdiction. For tax years before 2015, the Company is no longer subject to Federal and certain other state tax examinations. We are currently being examined by the Franchise Tax Board of California for tax years 2011 through 2014.

7. Earnings (Loss) per Share

For the three months ended March 31, 2019 and 2018, basic earnings (loss) per share is calculated by dividing net income (loss) by the sum of the weighted average number of shares of common stock outstanding during the period. Diluted earnings per share is calculated by dividing net income by the weighted average number of shares of common stock and dilutive common share equivalents outstanding during the period. Common share equivalents consist of stock options, restricted stock units, performance stock units, and warrants. When there is a loss in the period, dilutive common share equivalents are excluded from the calculation of diluted earnings per share, as their effect would be anti-dilutive. For example, for the three months ended March 31, 2019, dilutive common share equivalents have been excluded, and diluted weighted average shares outstanding are the same as basic average shares outstanding. When there is net income in the period, the Company excludes stock options, restricted stock units, performance stock units and warrants from the calculation of diluted earnings per share when their combined exercise price and unamortized fair value exceeds the average market price of the Company's common stock because their effect would be anti-dilutive. For the three months ended March 31, 2018, the Company excluded 2,346,711 options from the calculation of diluted earnings per share because their effect would be anti-dilutive. The following table reconciles the basic to diluted weighted average shares outstanding using the treasury stock method (shares in thousands):

	Three Months Ended March 31,	
	2019	2018
Weighted average shares outstanding – basic	53,059	51,320
Dilutive effect of stock options	—	2,135
Weighted average shares outstanding – diluted	53,059	53,455

8. Subsequent Events

On April 5, 2019, the Company borrowed \$5 million of the \$21 million available as Additional Term Loans under the Credit Agreement as amended. In connection with this borrowing, we issued a warrant to the lender to purchase an aggregate of 386,333 shares of the Company's common stock (representing approximately 0.75% of our diluted common stock calculated using the "treasury stock" method as defined under U.S. GAAP for the fiscal quarter ended June 30, 2017) with an exercise price of \$1.92 per share.

We have evaluated subsequent events through the date these consolidated financial statements were issued and there are no other events that have occurred that would require adjustments or disclosures to our consolidated financial statements.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

You should read the following discussion in conjunction with our consolidated financial statements (unaudited) and related notes included elsewhere in this report. This report on Form 10-Q contains forward-looking statements that involve risks and uncertainties. The words "believe," "may," "will," "estimate," "continue," "anticipate," "design," "intend," "expect" and similar expressions are intended to identify forward-looking statements. We have based these forward-looking statements largely on our current expectations and projections about future events and trends that we believe may affect our financial condition, results of operations, strategy, short-term and long-term business operations and objectives, and financial needs. These forward-looking statements are subject to a number of risks, uncertainties and assumptions, including those described in "Risk Factors" under Item 1A of Part II of this report. In light of these risks, uncertainties and assumptions, the forward-looking events and trends discussed in this report may not occur, and actual results could differ materially and adversely from those anticipated or implied in the forward-looking statements. Forward-looking statements include, but are not limited to, statements about our: opportunities and expectations for growth in the student lending, healthcare and other markets; anticipated trends and challenges in our business and competition in the markets in which we operate; our client relationships and our ability to maintain such client relationships; our ability to maintain compliance with the covenants in our debt agreements; the adaptability of our technology platform to new markets and processes; our ability to invest in and utilize our data and analytics capabilities to expand our capabilities; the sufficiency of our appeals reserve; our growth strategy of expanding in our existing markets and considering strategic alliances or acquisitions; our ability to meet our liquidity and working capital needs; maintaining, protecting and enhancing our intellectual property; our expectations regarding future expenses; expected future financial performance; and our ability to comply with and adapt to industry regulations and compliance demands. The forward-looking statements in this report speak only as of the date hereof. We expressly disclaim any obligation or undertaking to release publicly any updates or revisions to any forward-looking statements contained herein to reflect any change in our expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

Overview

We provide technology-enabled audit, recovery, outsource services and related analytics services in the United States. Our services help identify improper payments, and in some markets, restructure and recover delinquent or defaulted assets and improper payments for both government and private clients in a broad range of markets. Our clients typically operate in complex and regulated environments and outsource their recovery needs in order to reduce losses on billions of dollars of defaulted student loans, improper healthcare payments and delinquent state and federal tax and federal treasury and other receivables. We also provide complex outsource services for clients across our various markets, where we handle many or all aspects of our clients' various processes.

Our revenue model is generally success-based as we earn fees on the aggregate correct audits and/or amount of funds that we enable our clients to recover. Our services do not require any significant upfront investments by our clients and offer our clients the opportunity to recover significant funds otherwise lost. Because our model is based upon the success of our efforts, our business objectives are aligned with those of our clients and we are generally not reliant on their spending budgets. Furthermore, our business model does not require significant capital as we do not purchase loans or obligations.

Sources of Revenues

We derive our revenues from services for clients in a variety of different markets. These markets include our two largest markets, healthcare and student lending, as well as our other markets which include but are not limited to outsourced call center services, delinquent state and federal taxes and federal treasury and other receivables.

	Three Months Ended March 31,	
	2019	2018
	(in thousands)	
Student Lending	\$ 12,855	\$ 19,105
Healthcare ⁽¹⁾	10,173	31,314
Other ⁽²⁾	11,848	6,602
Total Revenues	<u>\$ 34,876</u>	<u>\$ 57,021</u>

(1) Includes one-time release of a \$27.8 million appeals reserve related to the termination of the 2009 CMS Region A contract which took place during the three months ended March 31, 2018.

(2) Represents outsourced call center services, tax and IRS.

Healthcare

We derive revenues from both commercial and government clients in the healthcare market. Revenues earned under these contracts are driven by auditing, identifying, and sometimes recovering improperly paid claims through both automated and manual review of such claims. We are paid contingency fees by our clients based on a percentage of the dollar amount of improper claims recovered as a result of our efforts. The revenues we recognize are net of our estimate of claims that we believe will be overturned by appeal following payment by the provider.

On October 5, 2017, we announced that we were awarded the MSP CRC contract by the CMS. Under this agreement, we are responsible for identifying and recovering payments in situations where Medicare should not be the primary payer of healthcare claims because a beneficiary has other forms of insurance coverage, such as through an employer group health plan or certain other payers.

On October 26, 2016, CMS awarded new RAC contracts and we received RAC contracts for audit Regions 1 and 5. The RAC contract award for Region 1 allows us to continue our audit of payments under Medicare's Part A and Part B for all provider types other than DMEPOS and home health and hospice within an 11 state region in the Northeast and Midwest. The Region 5 RAC contract provides for the post-payment review of DMEPOS and home health and hospice claims nationally. While audit and recovery activity under the new contracts commenced in April 2017, the scope of audit permitted by CMS under the new RAC contracts has been limited to 0.5% of claims. We do not expect to recognize significant revenues from the newly awarded RAC contracts until the percentage of claims we are able to audit increases from the current 0.5% of the claims.

Healthcare providers have the right to appeal a claim and may pursue additional appeals if the initial appeal is found in favor of the healthcare insurer. Total estimated liability for appeals was \$0.3 million and \$0.2 million as of March 31, 2019 and December 31, 2018, respectively. This represents our best estimate of the amount probable of being refunded to our healthcare clients following successful appeals of claims for which commissions were previously collected.

For our commercial healthcare business, our business strategy is focused on utilizing our technology-enabled services platform to provide audit, recovery and analytical services for private healthcare payers. We have entered into contracts with several private payers, although these contracts are in the early stage of implementation. Revenues from our commercial healthcare clients were \$4.3 million for the quarter ended March 31, 2019 compared to revenues of \$2.2 million that we earned from our commercial healthcare clients during the quarter ended March 31, 2018.

Student Lending

Our revenues from the student lending market are contract-based and consist primarily of contingency fees based on a specified percentage of the amount we enable our clients to recover. Our contingency fee percentage for a particular recovery depends on the type of recovery facilitated. Our clients in the student loan recovery market mainly consist of several of the largest guaranty agencies, or GAs. We believe the size and the composition of our student loan inventory at any point provides us with a significant degree of revenue visibility for our student loan revenues. Based on data compiled from over two decades of experience with the recovery of defaulted student loans, at the time we receive a placement of student loans, we are able to make a reasonably accurate estimate of the recovery outcomes likely to be derived from such placement and the revenues we are likely able to generate based on the anticipated recovery outcomes.

An important metric in evaluating our student lending business is Placement Volume. Our Placement Volume represents the dollar volume of defaulted student loans first placed with us during the specified period by public and private clients for recovery. Placement Volume allows us to measure and track trends in the amount of inventory our clients in the student lending market are placing with us during any period. The revenues associated with the recovery of a portion of these loans may be recognized in subsequent accounting periods, which assists management in estimating future revenues and in allocating resources necessary to address current Placement Volumes. As a result of the Department of Education’s termination of our January 2018 contract and its last procurement in its entirety, all of our Placement Volume is currently coming from Guaranty Agencies.

	Three Months Ended March 31,	
	2019	2018
	(in thousands)	
Total Student Lending Placement Volume	\$ 1,070,125	\$ 913,657

There are five potential outcomes to the student loan recovery process from which we generate revenues. These outcomes include: full repayment, recurring payments, rehabilitation, loan restructuring and wage garnishment. Of these five potential outcomes, our ability to rehabilitate defaulted student loans is the most significant component of our revenues in this market. Generally, a loan is considered successfully rehabilitated after the student loan borrower has made nine consecutive qualifying monthly payments and our client has notified us that it is recalling the loan. Once we have structured and implemented a repayment program for a defaulted borrower, we (i) earn a percentage of each periodic payment collected up to and including the final periodic payment prior to the loan being considered “rehabilitated” by our clients, and (ii) if the loan is “rehabilitated,” then we are paid a one-time percentage of the total amount of the remaining unpaid balance for each rehabilitated loan. The fees we are paid vary by recovery outcome as well as by contract. For non-government-supported student loans we are generally only paid contingency fees on two outcomes: full repayment or recurring repayments. The table below describes our typical fee structure for each of these five outcomes.

Student Loan Recovery Outcomes				
Full Repayment	Recurring Payments	Rehabilitation	Loan Restructuring	Wage Garnishment
<ul style="list-style-type: none"> • Repayment in full of the loan • We are paid a percentage of the full payment that is made 	<ul style="list-style-type: none"> • Regular structured payments, typically according to a renegotiated payment plan • We are paid a percentage of each payment 	<ul style="list-style-type: none"> • After a defaulted borrower has made nine consecutive recurring payments, the loan is eligible for rehabilitation • We are paid based on a percentage of the overall value of the rehabilitated loan 	<ul style="list-style-type: none"> • Restructure and consolidate a number of outstanding loans into a single loan, typically with one monthly payment and an extended maturity • We are paid based on a percentage of overall value of the restructured loan 	<ul style="list-style-type: none"> • If we are unable to obtain voluntary repayment, payments may be obtained through wage garnishment after certain administrative requirements are met • We are paid a percentage of each payment

Other

We also derive revenues from the recovery of delinquent state and federal taxes, and federal treasury and other receivables, default aversion and/or first party call center services for certain clients and the licensing of hosted technology solutions to certain clients. For our hosted technology services, we license our system and integrate our technology into our clients’ operations, for which we are paid a licensing fee. Our revenues for these services include contingency fees, fees based on dedicated headcount to our clients and hosted technology licensing fees.

Costs and Expenses

We generally report two categories of operating expenses: salaries and benefits and other operating expense. Salaries and benefits expenses consist primarily of salaries and performance incentives paid and benefits provided to our employees. Other operating expense includes expenses related to our use of subcontractors, other production related expenses, including costs associated with data processing, retrieval of medical records, printing and mailing services, amortization and other outside services, as well as general corporate and administrative expenses.

Factors Affecting Our Operating Results

Our results of operations are influenced by a number of factors, including allocation of placement volume, claim recovery volume, contingency fees, regulatory matters, client retention and macroeconomic factors.

Allocation of Placement Volume

Our clients have the right to unilaterally set and increase or reduce the volume of defaulted student loans or other receivables that we service at any given time. In addition, many of our recovery contracts for student loans and other receivables are not exclusive, with our clients retaining multiple service providers to service portions of their portfolios. Accordingly, the number of delinquent student loans or other receivables that are placed with us may vary from time to time, which may have a significant effect on the amount and timing of our revenues. We believe the major factors that influence the number of placements we receive from our clients in the student loan market include our performance under our existing contracts and our ability to perform well against competitors for a particular client. To the extent that we perform well under our existing contracts and differentiate our services from those of our competitors, we may receive a relatively greater number of placements under these existing contracts and may improve our ability to obtain future contracts from these clients and other potential clients. Further, delays in placement volume, as well as acceleration of placement volume, from any of our large clients may cause our revenues and operating results to vary from quarter to quarter.

Typically, we are able to anticipate with reasonable accuracy the timing and volume of placements of defaulted student loans and other receivables based on historical patterns and regular communication with our clients. Occasionally, however, placements are delayed due to factors outside of our control.

Contingency Fees

Our revenues consist primarily of contract-based contingency fees. The contingency fee percentages that we earn are set by our clients or agreed upon during the bid process and may change from time to time either under the terms of existing contracts or pursuant to the terms of contract renewals.

Regulatory Matters

Each of the markets which we serve is highly regulated. Accordingly, changes in regulations that affect the types of loans, receivables and claims that we are able to service or the manner in which any such delinquent loans, receivables and claims can be recovered will affect our revenues and results of operations. For example, the passage of the Student Aid and Fiscal Responsibility Act, or SAFRA, in 2010 had the effect of transferring the origination of all government-supported student loans to the Department of Education, thereby ending all student loan originations guaranteed by the GAs. Loans guaranteed by the GAs represented approximately 70% of government-supported student loans originated in 2009. While the GAs will continue to service existing outstanding student loans for years to come, this legislation means that there will be no further growth in student loans held by GAs. Further, we are seeing a larger amount of defaulted student loans in our GA clients' portfolios that have been previously rehabilitated and by regulation are not subject to rehabilitation for a second time. In addition, our entry into the healthcare market was facilitated by passage of the Tax Relief and Health Care Act of 2006, which mandated CMS to contract with private firms to audit Medicare claims in an effort to increase the recovery of improper Medicare payments. Any changes to the regulations that affect the student loan industry or the recovery of defaulted student loans or the Medicare program generally or the audit and recovery of Medicare claims could have a significant impact on our revenues and results of operations.

Client Contract Cancellation

Substantially all of our contracts entitle our clients to unilaterally terminate their contractual relationship with us at any time without penalty. If we lose one of our significant clients, including if one of our significant clients is acquired by an entity that does not use our services, if the terms of compensation for our services change or if there is a reduction in the level of placements provided by any of these clients, our revenues could decline.

Macroeconomic Factors

Certain macroeconomic factors influence our business and results of operations. These include the increasing volume of student loan originations in the U.S. as a result of increased tuition costs and student enrollment, the default rate of student loan borrowers, the growth in Medicare expenditures resulting from increasing healthcare costs, as well as the fiscal budget tightening of federal, state and local governments as a result of general economic weakness and lower tax revenues.

Critical Accounting Policies

Our consolidated financial statements are prepared in accordance with generally accepted accounting principles in the United States, or U.S. GAAP. The preparation of these consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, costs and expenses and related disclosures. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. In many instances, we could have reasonably used different accounting estimates, and in other instances changes in the accounting estimates are reasonably likely to occur from period-to-period. Accordingly, actual results could differ significantly from the estimates made by our management. To the extent that there are material differences between these estimates and actual results, our future financial statement presentation, financial condition, results of operations and cash flows will be affected. We believe that the accounting policies discussed below are critical to understanding our historical and future performance, as these policies relate to the more significant areas involving management's judgments and estimates.

Revenue Recognition

We derive our revenues primarily from providing recovery services. Revenues are recognized when control of these services is transferred to our customers, in an amount that reflects the consideration expect to be entitled to in exchange for those services.

We determine revenue recognition through the following steps:

- Identification of the contract with a customer
- Identification of the performance obligations in the contract
- Determination of the transaction price
- Allocation of the transaction price to the performance obligations in the contract
- Recognition of revenue when, or as, the performance obligations are satisfied

We account for a contract when it has approval and commitment from both parties, the rights of the parties are identified, payment terms are identified, the contract has commercial substance and collectability of consideration is probable.

Our contracts generally contain a single performance obligation, delivered over time as a series of services that are substantially the same and have the same pattern of transfer to a client, as the promise to transfer the individual services is not separately identifiable from other promises in the contracts and, therefore, not distinct. For contracts with multiple performance obligations, we allocate the contract's transaction price to each performance obligation using our best estimate of the standalone selling price of each distinct service in the contract. We determine the standalone selling prices by taking into consideration the value of the services being provided, the client type and how similar services are priced in other contracts on a standalone basis.

Our contracts are composed primarily of variable consideration. Fees earned under our recovery service contracts consist primarily of contingency fees based on a specified percentage of the amount we enable our clients to recover. The contingency fee percentage for a particular recovery depends on the type of recovery or claim facilitated. In certain contracts we can earn additional performance-based consideration determined based on its performance relative to a client's other contractors providing similar services.

Revenue from contingency fees earned upon recovery of funds is generally recognized as amounts are invoiced based on either the 'as-invoiced' practical expedient when such amounts reflect the value of the services completed to-date, or an output measure based on milestones which is used to measure progress of the satisfaction of its performance obligation. We estimate any performance-based variable consideration and recognizes such revenue over the performance period only if it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur. Under certain contracts, consideration can include periodic performance-based bonuses which can be awarded based on our performance under the specific contract. These performance-based awards are considered variable and may be constrained by us until there is not a risk of a material reversal.

For contracts that contain a refund right, these amounts are considered variable consideration, and we estimate our refund liability for each claim and recognizes revenue net of such estimate.

We generally either apply the as-invoiced practical expedient where our right to consideration corresponds directly to our right to invoice our clients, or the variable consideration allocation exception where the variable consideration is attributable to one or more, but not all, of the services promised in a series of distinct services that form part of a single performance obligation. As such, we have elected the optional exemptions related to the as-invoiced practical expedient and the variable consideration allocation exception whereby the disclosure of the amount of transaction price allocated to the remaining performance obligations is not required.

We have applied the as-invoiced practical expedient and the variable consideration allocation exception to contracts with performance obligations that have an average remaining duration of less than a year.

Revenue is recognized upon the collection of defaulted loan and debt payments. Loan rehabilitation revenue is recognized when the rehabilitated loans are sold (funded) by clients. Incentive revenue is recognized upon receipt of official notification of incentive award from customers. Under our MSP CRC contract with CMS, we recognize revenues when insurance companies or other responsible parties remit payment to reimburse CMS for claims for which they are responsible, and the remittance has been applied in the CMS database. Under our RAC contracts with CMS, we recognize revenues when the healthcare provider has paid CMS for a claim or has agreed to an offset against other claims by the provider. Under other healthcare contracts, we may recognize revenue upon delivering the results of claims audits, when sufficient reliable information is available to us for estimating the variable consideration earned, as it is a reasonable measure of our progress toward complete satisfaction of our performance obligation.

Healthcare providers have the right to appeal a claim and may pursue additional appeals if the initial appeal is found in favor of the healthcare client. Total estimated liability for appeals was \$0.3 million and \$0.2 million as of March 31, 2019 and December 31, 2018, respectively. This represents our best estimate of the amount probable of being refunded to our healthcare clients following successful appeals of claims for which commissions were previously collected.

We determined that we do not have any costs related to obtaining or fulfilling a contract that are recoverable and as such, these contract costs are expensed as incurred.

Recent Accounting Pronouncements

See "New Accounting Pronouncements" in Note 1(f) of the Consolidated Financial Statements included in Part I - Item 1 of this report.

Results of Operations

Three Months Ended March 31, 2019 compared to the Three Months Ended March 31, 2018

The following table represents our historical operating results for the periods presented:

	Three Months Ended March 31,			
	2019	2018	\$ Change	% Change
(in thousands)				
Consolidated Statement of Operations Data:				
Revenues	\$ 34,876	\$ 57,021	\$ (22,145)	(39)%
Operating expenses:				
Salaries and benefits	29,116	21,781	7,335	34 %
Other operating expenses	12,953	23,020	(10,067)	(44)%
Total operating expenses	42,069	44,801	(2,732)	(6)%
(Loss) income from operations	(7,193)	12,220	19,413	(159)%
Interest expense	(1,136)	(1,270)	(134)	(11)%
Interest income	11	6	5	45 %
(Loss) income before provision for income taxes	(8,318)	10,956	19,274	(176)%
Provision for income taxes	171	2,501	2,330	93 %
Net (loss) income	\$ (8,489)	\$ 8,455	\$ 16,944	(200)%

Revenues

Revenues were \$34.9 million for the three months ended March 31, 2019, a decrease of approximately 39%, compared to revenues of \$57.0 million for the three months ended March 31, 2018.

Student lending revenues were \$12.9 million for the three months ended March 31, 2019, representing a decrease of \$6.2 million, or 32%, compared to the three months ended March 31, 2018. The decrease was primarily the result of reduced revenues from Great Lakes Higher Education Guaranty Corporation, which had revenues of \$1.2 million in the first quarter of 2019, compared to \$10.0 million in the prior year period, partially offset by a \$2.6 million increase in revenues from other guaranty agencies.

Healthcare revenues were \$10.2 million for the three months ended March 31, 2019, representing a decrease of \$21.1 million, or 67%, compared to the three months ended March 31, 2018. This decrease was due primarily to the one-time release of a \$27.8 million appeals reserve in connection with the termination of our 2009 CMS Region A contract in the first quarter of 2018. Excluding the \$27.8 million impact of the termination of the 2009 CMS Region A contract, healthcare revenues in the first quarter of 2019 increased \$6.7 million, or 191%, when compared to \$3.5 million in the prior year period.

Other revenues were \$11.8 million for the three months ended March 31, 2019, representing an increase of \$5.2 million, or 79%, compared to the three months ended March 31, 2018. This increase was primarily due to revenues from Premiere, which was acquired on August 31, 2018.

Salaries and Benefits

Salaries and benefits expense was \$29.1 million for the three months ended March 31, 2019, an increase of \$7.3 million, or 34%, compared to salaries and benefits expense of \$21.8 million for the three months ended March 31, 2018. The increase in salaries and benefits expense was primarily due to an increase in headcount as a result of the acquisition of Premiere, and increased headcount in anticipation of ramp up activity related to new clients and contracts.

Other Operating Expenses

Other operating expenses were \$13.0 million for the three months ended March 31, 2019, a decrease of \$10.1 million, or 44%, compared to other operating expenses of \$23.0 million for the three months ended March 31, 2018. The decrease in other operating expenses was primarily due to a \$7.1 million derecognition of subcontractor receivable associated with the termination of the 2009 CMS Region A contract and a \$1.9 million allowance for doubtful accounts against subcontractor receivable, both of which occurred in the first quarter of 2018.

Loss (income) from Operations

Loss from operations was \$7.2 million for the three months ended March 31, 2019, compared to income from operations of \$12.2 million for the three months ended March 31, 2018. The decrease was primarily the result of the one-time release of a \$27.8 million appeals reserve in connection with the termination of the 2009 CMS Region A contract in the first quarter of 2018 discussed above, and increased salaries and benefits partially offset by lower other operating expenses in the first quarter of 2019.

Interest Expense

Interest expense was \$1.1 million for the three months ended March 31, 2019, compared to \$1.3 million for the three months ended March 31, 2018. Interest expense decreased by approximately \$0.1 million or 11% due to lower outstanding balance and lower interest rate in 2019 compared to 2018.

Income Taxes

We recognized an income tax expense of \$0.2 million for the three months ended March 31, 2019, compared to an income tax expense of \$2.5 million for the three months ended March 31, 2018. Our effective income tax rate decreased to (2)% for the three months ended March 31, 2019, from 23% for the three months ended March 31, 2018. The change in the effective tax rate is primarily driven by the overall losses from operations for the three months ended March 31, 2019 for which no benefit is recognized due to valuation allowance.

Net Loss

As a result of the factors described above, net loss was \$8.5 million for the three months ended March 31, 2019, which represented an increase of \$16.9 million, or 200% compared to net income of \$8.5 million for the three months ended March 31, 2018.

Adjusted EBITDA and Adjusted Net Income

To provide investors with additional information regarding our financial results, we have disclosed in the table below adjusted EBITDA and adjusted net income, both of which are non-U.S. GAAP financial measures. We have provided a reconciliation below of adjusted EBITDA to net income and adjusted net income to net income, the most directly comparable U.S. GAAP financial measure to these non-U.S. GAAP financial measures.

We have included adjusted EBITDA and adjusted net income in this report because they are key measures used by our management and board of directors to understand and evaluate our core operating performance and trends and to prepare and approve our annual budget. Accordingly, we believe that adjusted EBITDA and adjusted net income provide useful information to investors and analysts in understanding and evaluating our operating results in the same manner as our management and board of directors.

Our use of adjusted EBITDA and adjusted net income has limitations as an analytical tool, and you should not consider it in isolation or as a substitute for analysis of our results as reported under U.S. GAAP. Some of these limitations are:

- although depreciation and amortization are non-cash charges, the assets being depreciated and amortized may have to be replaced in the future, and adjusted EBITDA does not reflect cash capital expenditure requirements for such replacements or for new capital expenditure requirements;
- adjusted EBITDA does not reflect interest expense on our indebtedness;
- adjusted EBITDA does not reflect changes in, or cash requirements for, our working capital needs;
- adjusted EBITDA does not reflect tax payments;
- adjusted EBITDA and adjusted net income do not reflect the potentially dilutive impact of equity-based compensation;
- adjusted EBITDA and adjusted net income do not reflect the impact of certain non-operating expenses resulting from matters we do not consider to be indicative of our core operating performance; and
- other companies may calculate adjusted EBITDA and adjusted net income differently than we do, which reduces its usefulness as a comparative measure.

Because of these limitations, you should consider adjusted EBITDA and adjusted net income alongside other financial performance measures, including net income and our other U.S. GAAP results. The following tables present a reconciliation of adjusted EBITDA and adjusted net income for each of the periods indicated:

	Three Months Ended March 31,	
	2019	2018
	(in thousands)	
Adjusted EBITDA:		
Net (loss) income	\$ (8,489)	\$ 8,455
Provision for income taxes	171	2,501
Interest expense ⁽¹⁾	1,136	1,270
Interest income	(11)	(6)
Depreciation and amortization	2,312	2,576
CMS Region A contract termination ⁽⁵⁾	—	(18,816)
Stock-based compensation	499	639
Adjusted EBITDA	<u>\$ (4,382)</u>	<u>\$ (3,381)</u>

	Three Months Ended March 31,	
	2019	2018
	(in thousands)	
Adjusted Net Loss:		
Net loss (income)	\$ (8,489)	\$ 8,455
Stock-based compensation	499	639
Amortization of intangibles ⁽²⁾	59	203
Deferred financing amortization costs ⁽³⁾	232	331
CMS Region A contract termination ⁽⁵⁾	—	(18,816)
Tax adjustments ⁽⁴⁾	(217)	4,852
Adjusted Net Loss	<u>\$ (7,916)</u>	<u>\$ (4,336)</u>

- (1) Represents interest expense and amortization of issuance costs related to the refinancing of our indebtedness.
- (2) Represents amortization of capitalized expenses related to the acquisition of Performant by an affiliate of Parthenon Capital Partners in 2004.
- (3) Represents amortization of capitalized financing costs related to our Credit Agreement for 2018.
- (4) Represents tax adjustments assuming a marginal tax rate of 27.5%.
- (5) Represents the net impact of the termination of our 2009 CMS Region A contract during the first quarter of 2018, comprised of release of an aggregate of \$27.8 million of the estimated liability for appeals and the net payable to client balances into revenue, net of derecognition of \$9.0 million of prepaid expenses and other current assets, with a charge to other operating expenses, reflecting accrued receivables associated with amounts due from subcontractors for decided and yet-to-be decided appeals.

Liquidity and Capital Resources

Our primary sources of liquidity are cash on hand, cash flows from operations and the availability of up to \$16 million in additional term loans under the Credit Agreement discussed below. Cash and cash equivalents, which includes restricted cash and consists primarily of cash on deposit with banks, totaled \$6.0 million as of March 31, 2019, compared to \$7.3 million as of December 31, 2018. Due to our existing cash and cash equivalents, availability under the Credit Agreement and our ability to restructure both our variable and fixed expenses, we believe that we have the ability to meet our working capital and capital expenditure needs for the foreseeable future.

The \$1.3 million decrease in the balance of our cash and cash equivalents from December 31, 2018, was primarily due to \$1.5 million negative cash flows from investing activities discussed below.

Cash flows from operating activities

Cash provided by operating activities was \$0.4 million for the three months ended March 31, 2019, compared to negative cash used in operating activities of \$9.8 million for the same period in 2018. The increase in cash flows from operating activities is due primarily to our cash provided of trade accounts receivable of \$3.0 million, accrued salaries and benefits of \$1.6 million and accounts payable of \$0.6 million, which was partially offset by our net loss of (\$8.5) million and non-cash adjustments of \$4.0 million.

Cash flows from investing activities

Cash used in investing activities of \$1.5 million for the three months ended March 31, 2019 was mainly for capital expenditures related to information technology, data storage, hardware, telecommunication systems and security enhancements to our information technology systems. Cash used in investing activities in the three months ended March 31, 2018 was \$2.5 million.

Cash flows from financing activities

Cash used in financing activities of \$0.1 million for the three months ended March 31, 2019 was primarily attributable to taxes paid related to net share settlement of stock awards. Cash used in financing activities in the three months ended March 31, 2018 was \$0.7 million primarily attributable to repayments of principal of \$0.6 million on long-term debt.

Restricted Cash

As of March 31, 2019, restricted cash included in current assets on our consolidated balance sheet was \$1.7 million.

Long-term Debt

On August 7, 2017, we, through our wholly-owned subsidiary Performant Business Services, Inc. (the "Borrower"), entered into a credit agreement with ECMC Group, Inc. (as amended, the "Credit Agreement"). Before the amendment described below, the Credit Agreement provided for a term loan facility in the initial amount of \$44 million (the "Initial Term Loan") and for up to \$15 million of additional term loans ("Additional Term Loans"; and together with the Initial Term Loan, the "Loans") which original Additional Term Loans were initially able to be drawn until the second anniversary of the funding of the Initial Term Loans, subject to the satisfaction of customary conditions. On August 11, 2017, the Initial Term Loan was advanced (the "Closing Date") and the proceeds were applied to repay all outstanding amounts under our prior credit agreement with Madison Capital Funding LLC as administrative agent ("the Prior Credit Agreement"). On August 31, 2018, we entered into Amendment No. 2 to the Credit Agreement to among other things (i) extend the maturity date of the Initial Term Loan and any Additional Term Loans by one year to August 2021, (ii) expand the Additional Term Loans commitment from \$15 million to \$25 million, (iii) extend the period during which the Additional Term Loans can be borrowed by one year to August 2020, and (iv) relieve the Borrower from its obligation to comply with the financial covenants in the Credit Agreement during the six fiscal quarters following the Premiere acquisition. On October 15, 2018, the Company borrowed \$4 million of the \$25 million available as Additional Term Loans under the Credit Agreement. On March 21, 2019, we entered into Amendment No. 3 to the Credit Agreement to among other things relieve the Borrower from its obligation to comply with the financial covenants in the Credit Agreement until the quarter ending June 30, 2020.

As of March 31, 2019, \$45.8 million was outstanding under the Credit Agreement.

We have the option to extend the maturity of the Loans for two additional one year periods, subject to the satisfaction of customary conditions. The Loans bear interest at the one-month LIBOR rate (subject to a 1% per annum floor) plus a margin which may vary from 5.5% per annum to 10.0% per annum based on our total debt to EBITDA ratio. Our annual interest rate at March 31, 2019, was 8.0%, and at December 31, 2018 was 8.0%. We are required to pay 5% of the original principal balance of the Loans annually in quarterly installments and to make mandatory prepayments of the Loans with a percentage of our excess cash flow which may vary between 75% and 0% depending on our total debt to EBITDA ratio and from the net cash proceeds of certain asset dispositions and debt not otherwise permitted under the Credit Agreement, in each case, subject to the lender's right to decline to receive such payments. The Loans may be voluntarily prepaid at any time, together with a prepayment premium of 1% for all voluntary prepayments prior to August 11, 2019.

The Credit Agreement contains certain restrictive financial covenants which are not effective until the quarter ending June 30, 2020, at which point, we will be required to (1) achieve a minimum fixed charge coverage ratio of 1.0 to 1.0 through December 31, 2020, 1.25 to 1.0 through June 30, 2021, and 1.25 to 1.0 through June 30, 2022 if the maturity date of the Loans is extended until the fifth anniversary of the Closing Date and (2) maintain a maximum total debt to EBITDA ratio of 6.00 to 1.00. The Credit Agreement also contains covenants that restrict the Company and its subsidiaries' ability to incur certain types or amounts of indebtedness, incur liens on certain assets, make material changes in corporate structure or the nature of its business, dispose of material assets, engage in a change in control transaction, make certain foreign investments, enter into certain restrictive agreements, or engage in certain transactions with affiliates. The Credit Agreement also contains various customary events of default, including with respect to change of control of the Company or its ownership of the Borrower. The obligations under the Credit Agreement are secured by substantially all of our United States domestic subsidiaries' assets and are guaranteed by the Company and its United States domestic subsidiaries, other than the Borrower.

In consideration for, and concurrently with, the extension of the Initial Term Loan in accordance with the terms of the Credit Agreement, we issued a warrant to the lender to purchase up to an aggregate of 3,863,326 shares of the Company's common stock (representing approximately up to 7.5% of our diluted common stock as calculated using the "treasury stock" method as defined under U.S. GAAP for the most recent fiscal quarter, with an exercise price of \$1.92 per share (the "Exercise Price")). In connection with the October 15, 2018 Additional Term Loan borrowing of \$4 million, we were required to, and did, issue a warrant to the lender to purchase an aggregate of 309,066 shares of the Company's common stock at the same Exercise Price of \$1.92 per share. Upon any further borrowing of the Additional Term Loans, we will be required to issue additional warrants at the same Exercise Price to purchase up to an aggregate of 77,267 additional shares of common stock (which represents approximately 0.15% of our diluted common stock calculated using the "treasury stock" method as defined under U.S. GAAP for the fiscal quarter ended June 30, 2017) for each \$1.0 million of such Additional Term Loans. Similarly, upon our election to extend the maturity of the Loans for additional one year periods, we will be required to issue additional warrants at the same Exercise Price to purchase up to an aggregate of 515,110 additional shares of common stock for the first year's extension, and to purchase up to an aggregate of 772,665 additional shares of common stock for the second year's extension (which represent approximately 1.0% and 1.5% of our diluted common stock for the first and second years, respectively, calculated using the "treasury stock" method as defined under U.S. GAAP for the fiscal quarter ended June 30, 2017).

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We do not hold or issue financial instruments for trading purposes. We conduct all of our business in U.S. currency and therefore do not have any material direct foreign currency risk. We do have exposure to changes in interest rates with respect to the borrowings under our senior secured credit facility, which bear interest at a variable rate based on LIBOR. For example, if the interest rate on our borrowings increased 100 basis points (1%) from the credit facility floor of 1.0%, our annual interest expense would increase by approximately \$0.4 million.

While we currently hold our excess cash in an operating account, in the future we may invest all or a portion of our excess cash in short-term investments, including money market accounts, where returns may reflect current interest rates. As a result, market interest rate changes impact our interest expense and interest income. This impact will depend on variables such as the magnitude of interest rate changes and the level of our borrowings under our credit facility or excess cash balances.

ITEM 4. DISCLOSURE CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

We maintain a system of disclosure controls and procedures that are designed to ensure that information required to be disclosed in the Company's reports under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to management, including our Chief Executive Officer and the Chief Accounting Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives.

Management, with the participation of our Chief Executive Officer and our Chief Accounting Officer, has evaluated the effectiveness of our disclosure controls and procedures, as defined in Rule 13a-15(e) under the Exchange Act, as of the fiscal quarter covered by this Quarterly Report on Form 10-Q. Based on that evaluation, our Chief Executive Officer and Chief Accounting Officer concluded that our disclosure controls and procedures were functioning effectively at the reasonable assurance level as of March 31, 2019.

Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting during the quarter ended March 31, 2019, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are involved in various legal proceedings that arise from our normal business operations. These actions generally derive from our student loan recovery services, and generally assert claims for violations of the Fair Debt Collection Practices Act or similar federal and state consumer credit laws. While litigation is inherently unpredictable, we believe that none of these legal proceedings, individually or collectively, will have a material adverse effect on our financial condition or our results of operations.

ITEM 1A. RISK FACTORS

Our business, financial condition, results of operations and liquidity are subject to various risks and uncertainties, including those described below, and as a result, the trading price of our common stock could decline.

Risks Related to Our Business

Revenues generated from our three largest clients represented 61% of our revenues in 2018 and 63% of our revenues in 2017. Our relationships with one of these clients, Great Lakes Higher Education Guaranty Corporation, was terminated in 2017. Any termination of or deterioration in our relationship with any of our other significant clients would result in a further decline in our revenues.

We have derived a substantial majority of our revenues from a limited number of clients. Revenues from our three largest clients represented 61% of our revenues for the year ended December 31, 2018 and 63% of our revenues for the year ended December 31, 2017. We have had relationships with numerous GAs in the U.S. including Pennsylvania Higher Education Assistance Authority and Great Lakes, which were responsible for 17% and 17%, respectively, of our revenues for the year ended December 31, 2018. On June 15, 2017, we received a 30-day termination notice with respect to our contract with Great Lakes, based on Great Lakes' decision to bundle with a single third-party vendor its student loan servicing work, a service that we currently do not provide, along with its student loan recovery work. While we subsequently obtained a subcontract for student loan recovery work from Navient, the new provider of servicing and defaulted portfolio management to Great Lakes, this contract has no set term or volume, and Navient has the right to terminate the contract at will. Because the Department of Education terminated our January 2018 contract and the current procurement in its entirety, we now will become even more dependent on our business relationships with our remaining GA clients for our student loan revenues. In that regard, we believe that the portfolios of our GA clients will continue to decrease over time due to (i) the effect of federal legislation in 2010 that requires all student loan originations to come from the Department of Education (which means that there will be no further growth in student loans held by GAs), and (ii) because we are seeing a larger amount of defaulted student loans in our GA client portfolios that have been previously rehabilitated and by regulation are not subject to rehabilitation for a second time. All of our contracts with our significant clients are subject to periodic renewal and re-bidding processes and if we lose one of these clients or if the terms of our relationships with any of these clients become less favorable to us, our revenues would decline, which would harm our business, financial condition and results of operations.

Many of our contracts with our clients for the recovery of student loans and other receivables are not exclusive and do not commit our clients to provide specified volumes of business. In addition, the terms of these contracts may be changed unilaterally and on short notice by our clients. As a consequence, there is no assurance that we will be able to maintain our revenues and operating results.

Substantially all of our existing contracts for the recovery of student loans and other receivables, which represented approximately 64% of our revenues for the year ended December 31, 2018 and 92% of our revenues in the year ended December 31, 2017, enable our clients to unilaterally terminate their contractual relationship with us at any time without penalty, potentially leading to loss of business or renegotiation of terms. Further, most of our contracts in these markets allow our clients to unilaterally change the volume of loans and other receivables that are placed with us or the payment terms at any given time. In addition, most of our contracts are not exclusive, with our clients retaining multiple service providers with whom we must compete for placements of loans or other obligations. Therefore, despite our contractual relationships with our clients, our contracts do not provide assurance that we will generate a minimum amount of revenues or that we will receive a specific volume of placements. Our revenues and operating results would be negatively affected if our student loan and receivables clients reduce the volume of student loan placements provided to us, modify the terms of service, including the success fees we are able to earn upon recovery of defaulted student loans, or any of these clients establish more favorable relationships with our competitors.

We typically face a long period to implement a new contract which may cause us to incur expenses before we receive revenues from new client relationships.

If we are successful in obtaining an engagement with a new client or a new contract with an existing client, we typically have a subsequent long implementation period in which the services are planned in detail and we integrate our technology, processes and resources with the client's operations. If we enter into a contract with a new client, we typically will not receive revenues until implementation is completed and work under the contract actually begins. Our clients may also experience delays in obtaining approvals or managing protests from unsuccessful bidders, or delays associated with technology or system implementations, such as the delays experienced with the implementation of our first RAC contract with CMS. Because we generally begin to hire new employees to provide services to a new client once a contract is signed, we may incur significant expenses associated with these additional hires before we receive corresponding revenues under any such new contract. If we are not successful in maintaining contractual commitments after the expenses we incur during our typically long implementation cycle, our cash flows and results of operations could be adversely affected.

We may not have sufficient cash flows from operations and availability of funds under our credit agreement to fund our ongoing operations and our other liquidity needs, which could adversely affect our business and financial condition.

Our ability to fund our business plans, capital expenditures and to fund our other liquidity needs depends on our financial and operating performance, which is subject to prevailing economic and competitive conditions and to certain financial, business and other factors beyond our control. We cannot make assurances that we will maintain a level of cash flows from operating activities sufficient to permit us to fund our ongoing and planned business operations and to fund our other liquidity needs. If our cash flows and capital resources are insufficient to fund our planned business operations or to fund our other liquidity needs, we may be forced to reduce or delay capital expenditures, alter our business plans, sell assets or operations, seek additional capital or restructure or refinance our indebtedness, any of which could have an adverse effect on our financial condition and results of operations.

Our indebtedness could adversely affect our business and financial condition and reduce the funds available to us for other purposes, and our failure to comply with the covenants contained in our Credit Agreement could result in an event of default that could adversely affect our results of operations.

Our ability to make scheduled payments under our credit agreement and to fund our other liquidity needs depends on our financial and operating performance, which is subject to prevailing economic and competitive conditions and to certain financial, business and other factors beyond our control. We cannot make assurances that we will maintain a level of cash flows from operating activities sufficient to permit us to pay the principal and interest on our indebtedness and to fund our other liquidity needs. If our cash flows and capital resources are insufficient to fund our debt service obligations and allow us to maintain compliance with the covenants under our Credit Agreement or to fund our other liquidity needs, we may be forced to reduce or delay capital expenditures, sell assets or operations, seek additional capital or restructure or refinance our indebtedness. We cannot ensure that we would be able to take any of these actions, that these actions would be successful and permit us to meet our scheduled debt service obligations or that these actions would be permitted under the terms of our existing or future debt agreements, including our Credit Agreement with ECMC. If we cannot make scheduled payments on our debt, we will be in default and, as a result, our debt holders could declare all outstanding principal and interest to be due and payable, the lenders under our Credit Agreement could terminate their commitments to lend us money and foreclose against the assets securing our borrowings and we could be forced into bankruptcy or liquidation.

Our debt agreement contains, and any agreements to refinance our debt likely will contain, certain financial and restrictive covenants that limit our ability to incur additional debt, including to finance future operations or other capital needs, and to engage in other activities that we may believe are in our long-term best interests, including to dispose of or acquire assets. Our failure to comply with these covenants may result in an event of default, which, if not cured or waived, could accelerate the maturity of our indebtedness or result in modifications to our credit terms. If our indebtedness is accelerated, we may not have sufficient cash resources to satisfy our debt obligations and we may not be able to continue our operations as planned.

Our ability to derive revenues under our new RAC contracts will depend in part on the number and types of potentially improper claims that we are allowed to pursue by CMS, and our results of operations may be harmed if the scope of claims that we are allowed to pursue and be compensated for is limited.

Under CMS's Medicare recovery audit program, RAC contractors have not been permitted to seek the recovery of an improper claim unless that particular type of claim has been pre-approved by CMS to ensure compliance with applicable Medicare payment policies, as well as national and local coverage determinations. As work under the first RAC contract progressed, CMS placed increasing restrictions on the scope of audits permitted by RAC contractors and these restrictions have not been relaxed under the newly awarded RAC contracts. Accordingly, the long-term growth of the revenues we derive under our two newly awarded RAC contracts will depend in significant part on the scope of potentially improper claims that we are allowed to pursue. Revenues from our RAC contracts with CMS during the year ended December 31, 2018 were \$1.7 million (excluding the effects of the release of the \$28.4 million appeal reserve in connection with the termination of our first CMS RAC contract).

In particular, in September 2013, CMS implemented rules that prevent RAC contractors from being able to review and audit (i) whether inpatient care delivered to patients with hospital stays lasting less than two midnights was medically necessary and therefore deserving of the higher reimbursement levels under Medicare Part A or (ii) whether inpatient treatment was medically necessary for admissions spanning more than two midnights. In connection with these restrictions, hospitals cannot bill CMS for outpatient services on hospital stays lasting less than two midnights during such period. Fees associated with recoveries initiated by us based upon improper claims for inpatient reimbursement of these short stays had represented a substantial portion of the revenues we had earned under our prior RAC contract. The continued suspension of this type of review activity has had and may continue to have a material adverse effect on our future healthcare revenues and operating results, depending on a variety of factors including, among other things, CMS's evaluation of provider compliance with the new rules, the rules ultimately adopted by CMS with respect to medical necessity reviews of Medicare reimbursement claims associated with short stay inpatient admissions and, more generally, the scope of improper claims that CMS allows us to pursue and our ability to successfully identify improper claims within the permitted scope.

We may not be able to manage our potential growth effectively and our results of operations could be negatively affected.

Our newly awarded RAC contracts, MSP CRC contract, and other commercial healthcare contracts provide the potential opportunity to restore the growth in our recovery businesses. However, our focus on growth and the expansion of our business may place additional demands on our management, operations and financial resources and will require us to incur additional expenses. We cannot be sure that we will be able to manage our performance under any significant new contracts effectively. In order to successfully perform under any significant new contracts, our expenses will increase to recruit, train and manage additional qualified employees and subcontractors and to expand and enhance our administrative infrastructure and continue to improve our management, financial and information systems and controls. If we cannot manage our growth effectively, our expenses may increase and our results of operations could be negatively affected.

We face significant competition in connection with obtaining, retaining and performing under our client contracts, and an inability to compete effectively in the future could harm our relationships with our clients, which would impact our ability to maintain our revenues and operating results.

We operate in very competitive markets. In providing our services to the student loan and other receivables markets, we face competition from many other companies. Initially, we compete with these companies to be one of typically several firms engaged to provide recovery services to a particular client and, if we are successful in being engaged, we then face continuing competition from the client's other retained firms based on the client's benchmarking of the recovery rates of its several vendors. In addition, those recovery vendors who produce the highest recovery rates from a client often will be allocated additional placements and in some cases additional success fees. Accordingly, maintaining high levels of recovery performance, and doing so in a cost-effective manner, are important factors in our ability to maintain and grow our revenues and net income and the failure to achieve these objectives could harm our business, financial condition and results of operations. Some of our current and potential competitors in the markets in which we operate may have greater financial, marketing, technological or other resources than we do. The ability of any of our competitors and potential competitors to adopt new and effective technology to better serve our markets may allow them to gain market strength. Increasing levels of competition in the future may result in lower recovery fees, lower volumes of contracted recovery services or higher costs for resources. Any inability to compete effectively in the markets that we serve could adversely affect our business, financial condition and results of operations.

The U.S. federal government accounts for a significant portion of our revenues, and any loss of business from, or change in our relationship with, the U.S. federal government would result in a significant decrease in our revenues and operating results.

We have historically derived and are likely to continue to derive a significant portion of our revenues from the U.S. federal government. For the year ended December 31, 2018, revenues under contracts with the U.S. federal government accounted for approximately 35% of our total revenues. The continuation and exercise of renewal options on government contracts and any new government contracts are, among other things, contingent upon the availability of adequate funding for the applicable federal government agency. Changes in federal government spending could directly affect our financial performance.

For example, although the Department of Education announced in January 2018 that we were selected as one of two recovery contractors under its award for new student loan recovery contracts, we were notified on May 3, 2018 that the Department of Education has decided to cancel the current procurement in its entirety, and as a result terminated our contract award. Protests have been filed by certain of the unsuccessful bidders of the procurement of the new contracts from the Department of Education, and at this time, we cannot speculate on the outcome of any such protest or when work will begin under our new contract award. The loss of business from the U.S. federal government, or significant policy changes or financial pressures within the agencies of the U.S. federal government that we serve would result in a significant decrease in our revenues, which would adversely affect our business, financial condition and results of operations.

Future legislative or regulatory changes affecting the markets in which we operate could impair our business and operations.

The two principal markets in which we provide our recovery services, government-supported student loans and the Medicare program, are a subject of significant legislative and regulatory focus and we cannot anticipate how future changes in government policy may affect our business and operations. For example, Student Aid and Fiscal Responsibility Act, (SAFRA) significantly changed the structure of the government-supported student loan market by assigning responsibility for all new government-supported student loan originations to the Department of Education, rather than originations by private institutions and backed by one of the remaining 25 government-supported GAs. Any future changes in the legislation and regulations that govern these markets, may require us to adapt our business to the new circumstances and we may be unable to do so in a manner that does not adversely affect our business and operations.

The reduction in the number of government-supported student loans originated by our GA clients may result in a lower amount of student loans that we are able to rehabilitate, and may result in the consolidation among the GAs, either of which would decrease our revenues.

As a result of SAFRA, which terminated the ability of the GAs to originate government-supported student loans, the overall number of defaulted student loans that we are able to service on behalf of our GA clients has begun to decline. Further, we are seeing a larger amount of defaulted student loans within our GA client portfolios that have previously been rehabilitated, which, according to current regulations, prevents us from rehabilitating any such student loan for a second time. This overall reduction in the number of defaulted student loans in our GA client portfolios, and the larger percentage of defaulted student loans that have been previously rehabilitated, may result in a decrease in revenues from our GA clients, which could negatively impact our business, financial condition and results of operations.

Further, some have speculated that there may be consolidation among the remaining GAs. This speculation has heightened as a result of the reduction of fees that the GAs will receive for rehabilitating student loans as a result of the Bipartisan Budget Act of 2013. If GAs that are our clients are combined with GAs with whom we do not have a relationship, we could suffer a loss of business. Two of our GA clients: Great Lakes and Pennsylvania Higher Education Assistance Authority were responsible for 17% and 17%, respectively, of revenues for the year ended December 31, 2018. The consolidation of our GA clients with others and the failure to provide recovery services to the consolidated entity could decrease our revenues, which could negatively impact our business, financial condition and results of operations.

Our results of operations may fluctuate on a quarterly or annual basis and cause volatility in the price of our stock.

Our revenues and operating results could vary significantly from period-to-period and may fail to match our past performance because of a variety of factors, some of which are outside of our control. Any of these factors could cause the price of our common stock to fluctuate. Factors that could contribute to the variability of our operating results include:

- the amount of defaulted student loans and other receivables that our clients place with us for recovery;

- the timing of placements of student loans and other receivables which are entirely in the discretion of our clients;
- the schedules of government agencies for awarding contracts;
- our ability to maintain contractual commitments after the expenses we incur during our typically long implementation cycle for new customer contracts;
- our ability to successfully identify improper Medicare claims and the number and type of potentially improper claims that CMS authorizes us to pursue under our RAC contact;
- our ability to continue to generate revenues under our private healthcare contracts;
- the loss or gain of significant clients or changes in the contingency fee rates or other significant terms of our business arrangements with our significant clients;
- technological and operational issues that may affect our clients and regulatory changes in the markets we service;
and
- general industry and macroeconomic conditions.

Downturns in domestic or global economic conditions and other macroeconomic factors could harm our business and results of operations.

Various macroeconomic factors influence our business and results of operations. These include the volume of student loan originations in the United States, together with tuition costs and student enrollment rates, the default rate of student loan borrowers, which is impacted by domestic and global economic conditions, rates of unemployment and similar factors, and the growth in Medicare expenditures resulting from changes in healthcare costs. For example, during the global financial crisis beginning in 2008, the market for securitized student loan portfolios was disrupted, resulting in delays in the ability of some GA clients to resell rehabilitated student loans and, as a result, delays our ability to recognize revenues from these rehabilitated loans. Changes in the overall economy could lead to a reduction in overall recovery rates by our clients, which in turn could adversely affect our business, financial condition and results of operations.

A failure of our operating systems or technology infrastructure, or those of our third-party vendors and subcontractors, could disrupt the operation of our business.

A failure of our operating systems or technology infrastructure, or those of our third-party vendors and subcontractors, could disrupt our operations. Our operating systems and technology infrastructure are susceptible to damage or interruption from various causes, including acts of God and other natural disasters, power losses, computer systems failures, Internet and telecommunications or data network failures, operator error, computer viruses, losses of and corruption of data and similar events. The occurrence of any of these events could result in interruptions, delays or cessations in service to our clients, reduce the attractiveness of our recovery services to current or potential clients and adversely impact our financial condition and results of operations. While we have backup systems in many of our operating facilities, an extended outage of utility or network services may harm our ability to operate our business. Further, the situations we plan for and the amount of insurance coverage we maintain for losses as result of failures of our operating systems and infrastructure may not be adequate in any particular case.

If our security measures are breached or fail and unauthorized access is obtained to our clients' confidential data, our services may be perceived as insecure, the attractiveness of our recovery services to current or potential clients may be reduced, and we may incur significant liabilities.

Our recovery services involve the storage and transmission of confidential information relating to our clients and their customers, including health, financial, credit, payment and other personal or confidential information. Although our data security procedures are designed to protect against unauthorized access to confidential information, our computer systems, software and networks may be vulnerable to unauthorized access and disclosure of our clients' confidential information. Further, we may not effectively adapt our security measures to evolving security risks, address the security and privacy concerns of existing or potential clients as they change over time, or be compliant with federal, state, and local laws and regulations with respect to securing confidential information. Unauthorized access to confidential information relating to our clients and their customers could lead to reputational damage which could deter our clients and potential clients from selecting

our recovery services, or result in termination of contracts with those clients affected by any such breach, regulatory action, and claims against us.

In the event of any unauthorized access to personal or other confidential information, we may be required to expend significant resources to investigate and remediate vulnerabilities in our security procedures, and we may be subject to fines, penalties, litigation costs, and financial losses that are either not insured against or not fully covered through any insurance maintained by us. If one or more of such failures in our security and privacy measures were to occur, our business, financial condition and results of operations could suffer.

Our business may be harmed if we lose members of our management team or other key employees.

We are highly dependent on members of our management team and other key employees and our future success depends in part on our ability to retain these people. Our inability to continue to attract and retain members of our management team and other key employees could adversely affect our business, financial condition and results of operations.

The growth of our healthcare business will require us to hire and retain employees with specialized skills and failure to do so could harm our ability to grow our business.

The growth of our healthcare business will depend in part on our ability to recruit, train and manage additional qualified employees. Our healthcare-related operations require us to hire registered nurses and experts in Medicare coding. Finding, attracting and retaining employees with these skills is a critical component of providing our healthcare-related recovery and audit services, and our inability to staff these operations appropriately represents a risk to our healthcare service offering and associated revenues. An inability to hire qualified personnel, particularly to serve our healthcare clients, may restrain the growth of our business.

We rely on subcontractors to provide services to our clients and the failure of subcontractors to perform as expected could harm our business operations and our relationships with our clients.

We engage subcontractors to provide certain services to our clients. These subcontractors participate to varying degrees in our recovery activities with regards to all of the services we provide. While we believe that we perform appropriate due diligence before we hire subcontractors, our subcontractors may not provide adequate service or otherwise comply with the terms set forth in their agreements. In the event a subcontractor provides deficient performance to one or more of our clients, any such client may reduce the volume of services we are providing under an existing contract or may terminate the relevant contract entirely and we may face claims for breach of contract. Any such disruption in our relations with our clients as a result of services provided by any of our subcontractors could adversely affect our revenues and operating results.

If our software vendors or utility and network providers fail to deliver or perform as expected our business operations could be adversely affected.

Our recovery services depend in part on third-party providers, including software vendors and utility and network providers. Our ability to service our clients depends on these third-party providers meeting our expectations and contractual obligations in a timely and effective manner. Our business could be materially and adversely affected, and we might incur significant additional liabilities, if the services provided by these third-party providers do not meet our expectations or if they terminate or refuse to renew their relationships with us on similar contractual terms.

We are subject to extensive regulations regarding the use and disclosure of confidential personal information and failure to comply with these regulations could cause us to incur liabilities and expenses.

We are subject to a wide array of federal and state laws and regulations regarding the use and disclosure of confidential personal information and security. For example, the federal Health Insurance Portability and Accountability Act of 1996 (HIPAA), as amended, and related state laws subject us to substantial restrictions and requirements with respect to the use and disclosure of the personal health information that we obtain in connection with our contracts with CMS and we must establish administrative, physical and technical safeguards to protect the confidentiality of this information. Similar protections extend to the type of personal financial and other information we acquire from our student loan, state tax and federal receivables clients. We are required to notify affected individuals and government agencies of data security breaches involving protected health and certain personally identifiable information. These laws and regulations also require that we develop, implement and maintain written, comprehensive information security programs containing safeguards that are appropriate to protect personally identifiable information or health information against unauthorized access, misuse, destruction or modification. Federal law generally does not preempt state law in the area of protection of personal information, and as a result

we must also comply with state laws and regulations. Regulation of privacy, data use and security require that we incur significant expenses, which could increase in the future as a result of additional regulations, all of which adversely affects our results of operations. Failure to comply with these laws and regulations can result in penalties and in some cases expose us to civil lawsuits.

Our student loan recovery business is subject to extensive regulation and consumer protection laws and our failure to comply with these regulations and laws may subject us to liability and result in significant costs.

Our student loan recovery business is subject to regulation and oversight by various state and federal agencies, particularly in the area of consumer protection. The Fair Debt Collection Practices Act(FDCPA), and related state laws provide specific guidelines that we must follow in communicating with holders of student loans and regulates the manner in which we can recover defaulted student loans. Some state attorney generals have been active in this area of consumer protection regulation. We are subject, and may be subject in the future, to inquiries and audits from state and federal regulators, as well as frequent litigation from private plaintiffs regarding compliance under the FDCPA and related state regulations. We are also subject to the Fair Credit Reporting Act(FCRA), which regulates consumer credit reporting and may impose liability on us to the extent adverse credit information reported to a credit bureau is false or inaccurate. Our compliance with the FDCPA, FCRA and other federal and state regulations that affect our student loan recovery business may result in significant costs, including litigation costs. We may also become subject to regulations promulgated by the United States Consumer Financial Protection Bureau(CFPB), which was established in July 2011 as part of the Dodd-Frank Act to, among other things, establish regulations regarding consumer financial protection laws. In addition, the CFPB has investigatory and enforcement authority with respect to whether persons are engaged in unlawful acts or practices in connection with the collection of consumer debts.

Litigation may result in substantial costs of defense, damages or settlement, any of which could subject us to significant costs and expenses.

We are party to lawsuits in the normal course of business, particularly in connection with our student loan recovery services. For example, we are regularly subject to claims that we have violated the guidelines and procedures that must be followed under federal and state laws in communicating with consumer debtors. We may not ultimately prevail or otherwise be able to satisfactorily resolve any pending or future litigation, which may result in substantial costs of defense, damages or settlement. In the future, we may be required to alter our business practices or pay substantial damages or settlement costs as a result of litigation proceedings, which could adversely affect our business operations and results of operations.

If we are unable to adequately protect our proprietary technology, our competitive position could be harmed, or we could be required to incur significant costs to enforce our rights.

The success of our business depends in part upon our proprietary technology platform. We rely on a combination of copyright, patent, trademark, and trade secret laws, as well as on confidentiality procedures and non-compete agreements, to establish and protect our proprietary technology rights. The steps we have taken to deter misappropriation of our proprietary technology may be insufficient to protect our proprietary information. In particular, we may not be able to protect our trade secrets, know how and other proprietary information adequately. Although we use reasonable efforts to protect this proprietary information and technology, our employees, consultants and other parties may unintentionally or willfully disclose our information or technology to competitors. Enforcing a claim that a third party illegally obtained and is using any of our proprietary information or technology is expensive and time consuming, and the outcome is unpredictable. We rely, in part, on nondisclosure, confidentiality and invention assignment agreements with our employees, consultants and other parties to protect our trade secrets, know how and other intellectual property and proprietary information. These agreements may not be self executing, or they may be breached and we may not have adequate remedies for such breach. Moreover, third parties may independently develop similar or equivalent proprietary information or otherwise gain access to our trade secrets, know how and other proprietary information. Any infringement, misappropriation or other violation of our patents, trademarks, copyrights, trade secrets, or other intellectual property rights could adversely affect any competitive advantage we currently derive or may derive from our proprietary technology platform and we may incur significant costs associated with litigation that may be necessary to enforce our intellectual property rights.

Claims by others that we infringe their intellectual property could force us to incur significant costs or revise the way we conduct our business.

Our competitors protect their proprietary rights by means of patents, trade secrets, copyrights, trademarks and other intellectual property. Any party asserting that we infringe, misappropriate or violate their intellectual property rights may force us to defend ourselves, and potentially our clients, against the alleged claim. These claims and any resulting lawsuit, if successful, could be time-consuming and expensive to defend, subject us to significant liability for damages or invalidation of

our proprietary rights, prevent us from operating all or a portion of our business or force us to redesign our services or technology platform or cause an interruption or cessation of our business operations, any of which could adversely affect our business and operating results. In addition, any litigation relating to the infringement of intellectual property rights could harm our relationships with current and prospective clients. The risk of such claims and lawsuits could increase if we increase the size and scope of our services in our existing markets or expand into new markets.

We may make acquisitions that prove unsuccessful, strain or divert our resources and harm our results of operations and stock price.

We may consider acquisitions of other companies in our industry or in new markets. We may not be able to successfully complete any such acquisition and, if completed, any such acquisition may fail to achieve the intended financial results. We may not be able to successfully integrate any acquired businesses with our own and we may be unable to maintain our standards, controls and policies. Further, acquisitions may place additional constraints on our resources by diverting the attention of our management from other business concerns. Moreover, any acquisition may result in a potentially dilutive issuance of equity securities, the incurrence of additional debt and amortization of expenses related to intangible assets, all of which could adversely affect our results of operations and stock price.

The price of our common stock could be volatile, and you may not be able to sell your shares at or above the public offering price.

Since our initial public offering in August 2012, the price of our common stock, as reported by NASDAQ Global Select Market, has ranged from a low sales price of \$1.25 on November 16, 2018 to a high sales price of \$14.09 on March 4, 2013. The trading price of our common stock may be significantly affected by various factors, including: quarterly fluctuations in our operating results; the financial projections we may provide to the public, any changes in those projections or our failure to meet those projections; changes in investors' and analysts' perception of the business risks and conditions of our business; our ability to meet the earnings estimates and other performance expectations of financial analysts or investors; unfavorable commentary or downgrades of our stock by equity research analysts; changes in our capital structure, such as future issuances of debt or equity securities; our success or failure to obtain new contract awards; lawsuits threatened or filed against us; strategic actions by us or our competitors, such as acquisitions or restructurings; new legislation or regulatory actions; changes in our relationship with any of our significant clients; fluctuations in the stock prices of our peer companies or in stock markets in general; and general economic conditions.

Our significant stockholders have the ability to influence significant corporate activities and our significant stockholders' interests may not coincide with yours.

Parthenon Capital Partners and Invesco Ltd. beneficially owned approximately 25.5% and 19.3% of our common stock, respectively, as of December 31, 2018. As a result of their ownership, Parthenon Capital Partners and Invesco Ltd. have the ability to influence the outcome of matters submitted to a vote of stockholders and, through our board of directors, the ability to influence decision making with respect to our business direction and policies. Parthenon Capital Partners and Invesco Ltd. may have interests different from our other stockholders' interests and may vote in a manner adverse to those interests. Matters over which Parthenon Capital Partners and Invesco Ltd. can, directly or indirectly, exercise influence include:

- mergers and other business combination transactions, including proposed transactions that would result in our stockholders receiving a premium price for their shares;
- other acquisitions or dispositions of businesses or assets;
- incurrence of indebtedness and the issuance of equity securities;
- repurchase of stock and payment of dividends; and
- the issuance of shares to management under our equity incentive plans.

In addition, Parthenon Capital Partners has a contractual right to designate a number of directors proportionate to its stock ownership. Further, under our amended and restated certificate of incorporation, Parthenon Capital Partners does not have any obligation to present to us, and Parthenon Capital Partners may separately pursue, corporate opportunities of which it becomes aware, even if those opportunities are ones that we would have pursued if granted the opportunity.

Anti-takeover provisions contained in our certificate of incorporation and bylaws could impair a takeover attempt that our stockholders may find beneficial.

Our amended and restated certificate of incorporation and amended and restated bylaws contain provisions that could have the effect of rendering more difficult or discouraging an acquisition deemed undesirable by our board of directors. Our corporate governance documents include the following provisions: establishing a classified board of directors so that not all members of our board are elected at one time; providing that directors may be removed by stockholders only for cause; authorizing blank check preferred stock, which could be issued with voting, liquidation, dividend and other rights superior to our common stock; limiting the ability of our stockholders to call and bring business before special meetings and to take action by written consent in lieu of a meeting; limiting our ability to engage in certain business combinations with any “interested stockholder,” other than Parthenon Capital Partners, for a three-year period following the time that the stockholder became an interested stockholder; requiring advance notice of stockholder proposals for business to be conducted at meetings of our stockholders and for nominations of candidates for election to our board of directors; requiring a super majority vote for certain amendments to our amended and restated certificate of incorporation and amended and restated bylaws; and limiting the determination of the number of directors on our board of directors and the filling of vacancies or newly created seats on the board, to our board of directors then in office. These provisions, alone or together, could have the effect of delaying or deterring a change in control, could limit the opportunity for our stockholders to receive a premium for their shares of our common stock, and could also affect the price that some investors are willing to pay for our common stock.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

(A) Exhibits:

Exhibit No.	Description
31.1	Certification of the Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a)
31.2	Certification of the Principal Financial Officer pursuant to Rule 13a-14(a)/15d-14(a)
32.1 ⁽¹⁾	Certification of the Chief Executive Officer pursuant to 18 USC Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2 ⁽¹⁾	Certification of the Principal Financial Officer pursuant to 18 USC Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS ⁽²⁾	XBRL Instance Document
101.SCH ⁽²⁾	XBRL Taxonomy Extension Scheme
101.CAL ⁽²⁾	XBRL Taxonomy Extension Calculation Linkbase
101.DEF ⁽²⁾	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB ⁽²⁾	XBRL Taxonomy Extension Label Linkbase
101.PRE ⁽²⁾	XBRL Taxonomy Extension Presentation Linkbase

- (1) The material contained in Exhibit 32.1 and Exhibit 32.2 is not deemed “filed” with the Securities and Exchange Commission and is not to be incorporated by reference into any filing of the Company under the Securities Act of 1933 or the Securities Exchange Act of 1934, whether made before or after the date hereof and irrespective of any general incorporation language contained in such filing, except to the extent that the registrant specifically incorporates it by reference.
- (2) In accordance with Rule 406T of Regulation S-T, the information furnished in these exhibits will not be deemed “filed” for purposes of Section 18 of the Exchange Act. Such exhibits will not be deemed to be incorporated by reference into any filing under the Securities Act or Exchange Act.

SIGNATURES

Pursuant to the requirement of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: May 14, 2019

PERFORMANT FINANCIAL CORPORATION

By: /s/ Lisa Im

Lisa Im

Chief Executive Officer (Principal Executive Officer)

By: /s/ Ian Johnston

Ian Johnston

Vice President and Chief Accounting Officer

**CERTIFICATION OF THE CHIEF EXECUTIVE OFFICER PURSUANT TO
SECURITIES EXCHANGE ACT RULES 13A-14(A) AND 15D-14(A)**

I, Lisa Im, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Performant Financial Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 14, 2019

/s/ Lisa Im

Lisa Im

Chief Executive Officer

CERTIFICATION

I, Ian Johnston, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Performant Financial Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 14, 2019

/s/ Ian Johnston

Ian Johnston

Vice President and Chief Accounting Officer (Principal Financial Officer)

