

# PERFORMANT FINANCIAL CORP

## FORM 10-Q (Quarterly Report)

Filed 11/08/16 for the Period Ending 09/30/16

Address	333 North Cayons Parkway Livermore, CA 94551
Telephone	925-960-4800
CIK	0001550695
Symbol	PFMT
SIC Code	7380 - Miscellaneous Business Services
Industry	Business Support Services
Sector	Industrials

---

---

**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 September 30, 2016

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 or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act). (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

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

The number of shares of Common Stock outstanding as of November 8, 2016 was 50,226,376.

---

---

---

**PERFORMANT FINANCIAL CORPORATION**  
**QUARTERLY REPORT ON FORM 10-Q**  
**FOR THE QUARTER ENDED SEPTEMBER 30, 2016**  
**INDEX**

	<u>Page</u>
<b><u>PART I—Financial Information</u></b>	
<u>Item 1.</u>	
<u>Consolidated Financial Statements</u>	
<u>Consolidated Balance Sheets September 30, 2016 (unaudited) and December 31, 2015</u>	<u>1</u>
<u>Consolidated Statements of Operations Three and Nine Months Ended September 30, 2016 and 2015 (unaudited)</u>	<u>2</u>
<u>Consolidated Statements of Comprehensive Income Three and Nine Months Ended September 30, 2016 and 2015 (unaudited)</u>	<u>3</u>
<u>Consolidated Statements of Cash Flows Nine Months Ended September 30, 2016 and 2015 (unaudited)</u>	<u>4</u>
<u>Notes to Consolidated Financial Statements Three and Nine Months Ended September 30, 2016 and 2015 (unaudited)</u>	<u>5</u>
<u>Item 2.</u>	<u>13</u>
<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	
<u>Item 3.</u>	<u>28</u>
<u>Quantitative and Qualitative Disclosures about Market Risk</u>	
<u>Item 4.</u>	<u>28</u>
<u>Disclosure Controls and Procedures</u>	
 <b><u>PART II—Other Information</u></b>	
<u>Item 1.</u>	<u>29</u>
<u>Legal Proceedings</u>	
<u>Item 1A.</u>	<u>29</u>
<u>Risk Factors</u>	
<u>Item 2.</u>	<u>39</u>
<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	
<u>Item 6.</u>	<u>40</u>
<u>Exhibits</u>	
<u>Signatures</u>	<u>41</u>
<u>Exhibit Index</u>	<u>42</u>

**PERFORMANT FINANCIAL CORPORATION AND SUBSIDIARIES**

Consolidated Balance Sheets  
(In thousands, except per share amounts)

	September 30, 2016	December 31, 2015
	(Unaudited)	
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 48,302	\$ 71,182
Restricted cash	7,507	—
Trade accounts receivable, net of allowance for doubtful accounts of \$224 and \$386, respectively	10,309	17,965
Deferred income taxes	7,734	7,170
Prepaid expenses and other current assets	12,878	12,933
Income tax receivable	658	—
Total current assets	87,388	109,250
Property, equipment, and leasehold improvements, net	23,740	25,515
Identifiable intangible assets, net	22,268	25,074
Goodwill	82,522	82,522
Other assets	157	179
Total assets	\$ 216,075	\$ 242,540
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities:		
Current maturities of notes payable, net of unamortized debt issuance costs of \$1,102 and \$1,078, respectively	\$ 12,422	\$ 7,998
Accrued salaries and benefits	8,518	4,761
Accounts payable	1,081	929
Other current liabilities	2,979	5,615
Income Tax Payable	—	895
Estimated liability for appeals	19,556	19,118
Net payable to client	13,419	14,400
Total current liabilities	57,975	53,716
Notes payable, net of current portion and unamortized debt issuance costs of \$472 and \$1,038, respectively	50,955	84,144
Deferred income taxes	8,028	8,818
Other liabilities	1,776	2,006
Total liabilities	118,734	148,684
Commitments and contingencies		
Stockholders' equity:		
Common stock, \$0.0001 par value. Authorized, 500,000 shares at September 30, 2016 and December 31, 2015; issued and outstanding 50,226 and 49,479 shares at September 30, 2016 and December 31, 2015, respectively	5	5
Additional paid-in capital	64,451	61,808
Retained earnings	32,885	32,043
Total stockholders' equity	97,341	93,856
Total liabilities and stockholders' equity	\$ 216,075	\$ 242,540

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 September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Revenues	\$ 31,195	\$ 38,506	\$ 107,548	\$ 118,327
Operating expenses:				
Salaries and benefits	18,710	21,729	60,107	67,595
Other operating expenses	12,311	14,096	40,401	48,801
Total operating expenses	31,021	35,825	100,508	116,396
Income from operations	174	2,681	7,040	1,931
Interest expense	(1,863)	(2,137)	(6,136)	(6,800)
Income (loss) before provision for (benefit from) income taxes	(1,689)	544	904	(4,869)
Provision for (benefit from) income taxes	(974)	858	62	(879)
Net income (loss)	\$ (715)	\$ (314)	\$ 842	\$ (3,990)
Net income (loss) per share				
Basic	\$ (0.01)	\$ (0.01)	\$ 0.02	\$ (0.08)
Diluted	\$ (0.01)	\$ (0.01)	\$ 0.02	\$ (0.08)
Weighted average shares				
Basic	50,200	49,436	49,974	49,394
Diluted	50,200	49,436	50,401	49,394

*See accompanying notes to consolidated financial statements.*

**PERFORMANT FINANCIAL CORPORATION AND SUBSIDIARIES**

## Consolidated Statements of Comprehensive Income

(In thousands)

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net income (loss)	\$ (715)	\$ (314)	\$ 842	\$ (3,990)
Other comprehensive income:				
Foreign currency translation adjustment	(1)	—	24	—
Comprehensive income (loss)	\$ (716)	\$ (314)	\$ 866	\$ (3,990)

See accompanying notes to consolidated financial statements.

## PERFORMANT FINANCIAL CORPORATION AND SUBSIDIARIES

## Consolidated Statements of Cash Flows

(In thousands)

(Unaudited)

	Nine Months Ended September 30,	
	2016	2015
<b>Cash flows from operating activities:</b>		
Net income (loss)	\$ 842	\$ (3,990)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
(Gain) loss on disposal of asset	12	(594)
Depreciation and amortization	10,098	10,094
Deferred income taxes	(2,455)	(1,320)
Stock-based compensation	3,546	3,398
Interest expense from debt issuance costs and amortization of discount note payable	874	957
Write-off unamortized debt issuance costs	468	—
Changes in operating assets and liabilities:		
Trade accounts receivable	7,656	1,254
Prepaid expenses and other current assets	55	515
Income tax receivable	(658)	3,837
Other assets	22	163
Accrued salaries and benefits	3,757	2,311
Accounts payable	152	1,138
Other current liabilities	(2,210)	(2,439)
Income taxes payable	(895)	—
Estimated liability for appeals	438	318
Net payable to client	(981)	2,579
Other liabilities	(230)	792
Net cash provided by operating activities	20,491	19,013
<b>Cash flows from investing activities:</b>		
Proceeds from sale of property, equipment, and leasehold improvements	—	1,272
Purchase of property, equipment, and leasehold improvements	(5,529)	(5,635)
Net cash used in investing activities	(5,529)	(4,363)
<b>Cash flows from financing activities:</b>		
Repayment of notes payable	(29,307)	(15,268)
Restricted cash for repayment of notes payable	(7,507)	—
Debt issuance costs paid	(800)	—
Taxes paid related to net share settlement of stock awards	(261)	(90)
Proceeds from exercise of stock options	333	26
Income tax benefit (shortfall) from employee stock options	103	(370)
Payment of purchase obligation	(427)	(969)
Net cash used in financing activities	(37,866)	(16,671)
Effect of foreign currency exchange rate changes on cash	24	—
Net decrease in cash and cash equivalents	(22,880)	(2,021)
Cash and cash equivalents at beginning of period	71,182	80,298
Cash and cash equivalents at end of period	\$ 48,302	\$ 78,277
<b>Supplemental disclosures of cash flow information:</b>		
Cash paid (received) for income taxes	\$ 3,976	\$ (3,242)
Cash paid for interest	\$ 4,797	\$ 5,846

See accompanying notes to consolidated financial statements.

**PERFORMANT FINANCIAL CORPORATION AND SUBSIDIARIES**

Notes To Consolidated Financial Statements  
For the Three and Nine Months Ended September 30, 2016 and 2015  
(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 U.S. Generally Accepted Accounting Principles, 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 September 30, 2016, the results of our operations for the three and nine months ended September 30, 2016 and 2015 and cash flows for the nine months ended September 30, 2016 and 2015. 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 years ended December 31, 2015, 2014, and 2013.

The Company 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. Company 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 tax and federal treasury receivables. The Company generally provides services on an outsourced basis, where we handle many or all aspects of the clients' recovery processes.

The Company's consolidated financial statements include the operations of Performant Financial Corporation (PFC), its wholly owned subsidiary Performant Business Services, Inc., and its wholly owned subsidiaries Performant Recovery, Inc. (Recovery) and Performant Technologies, Inc. PFC is a Delaware corporation headquartered in California and was formed in 2003. Performant Business Services, Inc. is a Nevada corporation founded in 1997. Recovery is a California corporation founded in 1976. Performant Technologies, Inc. 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, accrued expenses, 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***

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 Recovery Audit Contractor, or RAC, contract with Centers for Medicare and Medicaid Services, or 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. Providers have the right to appeal a claim and may pursue additional appeals if the initial appeal is found in favor of CMS. The Company accrues an estimated liability for appeals at the time revenue is recognized based on the Company's estimate of the amount of revenue probable of being refunded to CMS following successful appeal. In addition, if the Company's estimate of the liability for appeals with respect to revenues recognized during a prior period changes, the Company increases or decreases current period accruals based on such change in estimated liability. At September 30, 2016 a total of \$19.2 million was presented as an allowance against revenue, representing the Company's estimate of claims audited under the CMS contract that may be overturned. Of this, an immaterial amount was related to accounts receivable and \$19.2 million was related to commissions which had already been received. The zero allowance against accounts receivable at September 30, 2016 is due to the fact that the receivable from CMS is netted against an offsetting payable for overturned audits, and at September 30, 2016, the amount of the payable exceeded the amount of the receivable as discussed in note 1(c). In addition to the \$19.2 million related to the RAC contract with CMS, the Company



has accrued \$0.4 million of additional estimated liability for appeals related to other healthcare contracts. The total accrued liability for appeals of \$19.6 million has been presented in the caption estimated liability for appeals at September 30, 2016 . At December 31, 2015, the total appeals-related liability was \$19.1 million . The \$19.6 million balance at September 30, 2016 and \$19.1 million balance at December 31, 2015, represent the Company's best estimate of the probable amount of losses related to appeals of claims for which commissions were previously collected. In addition to the \$19.6 million amount accrued at September 30, 2016 , the Company estimates that it is reasonably possible that it could be required to pay an additional amount up to approximately \$5.4 million as a result of potentially successful appeals. To the extent that required payments by the Company exceed the amount accrued, revenues in the applicable period would be reduced by the amount of the excess.

***(c) Net Payable to Client***

The Company nets outstanding accounts receivable invoices from an audit and recovery contract against payables for overturned audits. The overturned audits are netted against current fees due on the invoice to the client when they are processed by the client's system. The "Net payable to client" balance of \$13.4 million represents the excess of payables for overturned audits at September 30, 2016 . At December 31, 2015, the net of the "Net payable to client" balance of \$14.4 million was comprised of payables of \$15.4 million for overturned audits offset by outstanding receivables of \$1.0 million . The Company expects that the net payable-to-client balance will be paid to the client within the next twelve months.

***(d) Prepaid Expenses and Other Current Assets***

At September 30, 2016 , prepaid expenses and other current assets includes \$5.7 million of amounts estimated to become due from subcontractors. The Company employs subcontractors to audit claims as part of an audit & recovery contract, and to the extent that audits by these subcontractors are overturned on appeal, the fees associated with such claims are contractually refundable to the Company. At September 30, 2016 , the receivable associated with estimated future overturns of subcontractor audits was \$5.7 million . In addition, at September 30, 2016 , prepaid expenses and other current assets includes a net receivable of \$3.9 million for subcontractor fees for already overturned audits refundable to the Company once the Company refunds its fees to the client as prime contractor. By comparison, at December 31, 2015, prepaid expenses and other current assets included \$5.7 million of estimated future overturns of subcontractor audits, as well as a net receivable of \$3.8 million for subcontractor fees for already overturned audits refundable to the Company once the Company refunds its fees to the client as prime contractor.

***(e) Impairment of Long-Lived Assets***

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. There was no impairment expense for long-lived assets for the nine months ended September 30, 2016. For the nine months ended September 30, 2015, an impairment expense of \$0.2 million was recognized to account for the loss of a client and it has been included in other operating expenses in the consolidated statements of operations.

***(f) Restricted Cash***

At September 30, 2016, restricted cash included in current assets on our consolidated balance sheet was \$7.5 million . As discussed in Note 3, in February 2016 the Company deposited \$7.5 million into a segregated deposit account in connection with the Fourth Amendment to our credit agreement. The cash in this segregated deposit account is restricted because it is subject to the exclusive control of the administrative agent as set forth in our credit agreement.

***(g) Recent Accounting Pronouncements***

*Recently Issued Accounting Standards*

In May 2014, FASB issued an ASU that amends the FASB ASC by creating a new Topic 606, Revenue from Contracts with Customers. The new guidance will supersede the revenue recognition requirements in Topic 605, Revenue Recognition, and most industry-specific guidance on revenue recognition throughout the Industry Topics of the Codification. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve that core principle, an entity should apply the following steps:

- Step 1: Identify the contract(s) with a customer.
- Step 2: Identify the performance obligations in the contract.
- Step 3: Determine the transaction price.
- Step 4: Allocate the transaction price to the performance obligations in the contract.
- Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation.

In addition, an entity should disclose sufficient qualitative and quantitative information to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. Early adoption is not permitted. This amendment is to be either retrospectively adopted to each prior reporting period presented or retrospectively with the cumulative effect of initially applying this ASU recognized at the date of initial application. On July 9, 2015, the FASB decided to defer the effective date by one year, to annual reporting periods beginning on or after December 15, 2017, including interim periods within that reporting period. The FASB also voted to permit early adoption of the guidance but no earlier than the original effective date. The Company is currently evaluating the impact of the adoption of this guidance on its consolidated financial statements.

In August 2014, the FASB issued Accounting Standards Update No. 2014-15, "Presentation of Financial Statements - Going Concern", which addresses management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures. Management's evaluation should be based on relevant conditions and events that are known, and reasonably knowable, at the date that the financial statements are issued. This new guidance will be effective for the first interim period within annual reporting periods beginning after December 31, 2016 with early adoption permitted. We have not adopted this guidance early and are currently evaluating the effect on our consolidated financial statements.

In November 2015, the FASB issued ASU 2015-17, "Income Taxes: Balance Sheet Classification of Deferred Taxes" which simplifies the current presentation of separately classifying deferred tax assets and deferred tax liabilities as current and noncurrent in a classified balance sheet by requiring companies to present them as noncurrent. This new guidance is effective for annual reporting periods beginning after December 15, 2016, including interim periods within such annual reporting periods with early adoption permitted. We have not adopted this guidance early and are currently evaluating the effect on our consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, "Leases", which, for operating leases, requires a lessee to recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, in its balance sheet. The standard also requires a lessee to recognize a single lease cost, calculated so that the cost of the lease is allocated over the lease term, on a generally straight-line basis. This new guidance is effective for annual reporting periods beginning after December 15, 2018 with early adoption permitted. We have not adopted this guidance early and are currently evaluating the effect on our consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, "Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting". The standard is intended to simplify several areas of accounting for share-based compensation arrangements, including the income tax impact, classification on the statement of cash flows and forfeitures. This new guidance is effective for annual reporting periods, and interim periods within those years, beginning after December 15, 2016, and early adoption is permitted. We have not adopted this guidance early and are currently evaluating the effect on our consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, "Statement of Cash Flows: Classification of Certain Cash Receipts and Cash Payments" which provides guidance on the presentation of certain cash receipts and cash payments in the statement of cash flows in order to reduce diversity in existing practice. This new guidance is effective for annual reporting periods, and interim periods within those years, beginning after December 15, 2017, and early adoption is permitted. This new standard requires retrospective adoption, with a provision for impracticability. We have not adopted this guidance early and are currently evaluating the effect on our consolidated financial statements.

## 2. Property, Equipment, and Leasehold Improvements

Property, equipment, and leasehold improvements consist of the following at September 30, 2016 and December 31, 2015 (in thousands):

	September 30, 2016	December 31, 2015
Land	\$ 1,122	\$ 1,122
Building and leasehold improvements	6,093	6,053
Furniture and equipment	5,569	5,390
Computer hardware and software	66,063	67,353
	78,847	79,918
Less accumulated depreciation and amortization	(55,107)	(54,403)
Property, equipment and leasehold improvements, net	\$ 23,740	\$ 25,515

Depreciation expense of property, equipment and leasehold improvements was \$2.4 million and \$2.3 million for the three months ended September 30, 2016 and 2015, respectively, and \$7.3 million and \$7.0 million for the nine months ended September 30, 2016 and 2015, respectively.

## 3. Credit Agreement

On July 26, 2016, Performant Business Services, Inc., which is a wholly-owned subsidiary of Performant Financial Corporation (the "Company") and is the borrower under that certain Credit Agreement dated as March 19, 2012 with Madison Capital Funding LLC, as agent (the "Agent") and the lenders party thereto from time to time (as amended, the "Credit Agreement"), entered into Amendment No. 5 to the Credit Agreement (the "Fifth Amendment"). The Company and certain other of its subsidiaries are guarantors of the obligations under the Credit Agreement. Pursuant to the Fifth Amendment, our financial covenants were modified as follows:

- The total debt to EBITDA ratio of 3.25 to 1.0, which was in effect for the computation period ending as of September 30, 2017, has been revised under the Fifth Amendment to be 4.75 to 1.0 for that period.
- The interest coverage ratio, which was not in effect for the computation period ending as of September 30, 2017, has been revised under the Fifth Amendment to be 1.75 to 1.0 for that period.
- The fixed charge coverage ratio of 1.20 to 1.0, which was in effect for the computation period ending as of September 30, 2017, has been revised under the Fifth Amendment to no longer apply to that period.

Our obligation to apply, on an annual basis, a percentage, which may fluctuate between 25% and 75% (determined based upon our total debt to EBITDA ratio), of our annual excess cash flow as a mandatory prepayment of the loans under the Credit Agreement has also been modified. Pursuant to the Fifth Amendment, we will be required to apply 75% of our excess cash flow each quarter as a mandatory prepayment of the loans under the Credit Agreement. In addition, without the consent of the Agent and lenders holding more than 50% of the revolving loan commitments under the Credit Agreement, we will no longer be permitted to request revolving loans; however, this will not affect our ability to utilize the letter of credit sub-facility under Credit Agreement.

In connection with the Fourth Amendment, we deposited \$7.5 million into a deposit account which is subject to the exclusive control of the Agent, and voluntarily prepaid \$22.5 million under the Credit Agreement. Pursuant to the Fifth Amendment, the date on which these funds will be remitted to the Agent for application to the term loans or other obligations, as applicable, under the Credit Agreement was extended by one month, to October 31, 2016. On October 27, 2016, the Company entered into Amendment No. 6 to its Credit Agreement (Sixth Amendment) in which certain financial covenants were further amended and additional financial covenants were added. Please see footnote 8 - "Subsequent Events" below. Pursuant to the Sixth Amendment, the date on which these funds will be remitted to the Agent for application to the term loans or other obligations, as applicable, under the Credit Agreement has been extended by four months, to February 28, 2017 (or such later date not more than thirty days ( 30 ) days thereafter as may be agreed by the Agent in its sole discretion). However, all or a portion of these funds may also be returned to us if the Agent and the requisite lenders under the Credit Agreement elect otherwise in their sole discretion.

Scheduled payments under the Agreement for the next five years and thereafter are as follows (in thousands):

<u>Year Ending December 31,</u>	<u>Amount</u>
Remainder of 2016	\$ 9,769
2017	3,959
2018	51,223
2019	—
2020	—
Thereafter	—
<b>Total</b>	<b>\$ 64,951</b>

Due to delays in the award of the new contracts by CMS and the Department of Education, significant limitations on our audit and recovery activity during the CMS contract transition period, suspension of student loan placements to us from the Department of Education during the contract transition period and recovery fee reductions in the student lending market, we have been actively restructuring both our variable and fixed expenses consistent with our reduced operations and in order to maintain compliance with our debt covenants under our credit agreement. As mentioned below, and as discussed in footnote 8, in October 2016, the Company entered into Amendment No. 6 to its Credit Agreement, and our current financial projections show that we expect to be able to maintain compliance with these covenants through the fourth quarter of 2017. However, the factors noted above have had and, until resolved, will continue to have a significant negative effect on our revenues and earnings and our ability to continue to comply with these covenants. Accordingly, we expect to seek further modifications to the covenants from our lenders or refinance our indebtedness. Our inability to maintain long-term compliance with our debt covenants, or to refinance or restructure the terms of our indebtedness on commercially reasonable terms or at all, would have an adverse effect, which could be material on our business, financial condition and results of operations, as well as our ability to satisfy our debt obligations.

In addition, due to the delays in the award of the new contracts from the Department of Education and CMS, we implemented cost and expense reductions during 2015 that included a significant reduction in personnel. To the extent we are able to secure new contracts with the Department of Education or CMS, we will incur significant expenses to hire additional personnel that will be required to provide services under any such new contract that may require us to obtain additional financing. There can be no assurance that we will be able to obtain such financing on favorable terms, or at all.

On October 27, 2016, the Company entered into Amendment No. 6 to its Credit Agreement, or the Sixth Amendment, in which certain financial covenants were further amended and additional financial covenants were added. Please see footnote 8 - "Subsequent Events" below.

#### 4. Commitments and Contingencies

We have entered into various non-cancelable operating lease agreements for certain of our office facilities and equipment with original lease periods expiring between 2016 and 2021. Certain of these arrangements have free rent periods and /or escalating rent payment provisions, and we recognize rent expense under such arrangements on a straight-line basis.

Future minimum rental commitments under non-cancelable leases as of September 30, 2016 are as follows (in thousands):

<u>Year Ending December 31,</u>	<u>Amount</u>
Remainder of 2016	\$ 558
2017	1,794
2018	964
2019	890
2020	847
Thereafter	310
<b>Total</b>	<b>\$ 5,363</b>

Operating lease expense was \$ 0.7 million and \$0.7 million for the three months ended September 30, 2016 and 2015 , respectively, and was \$2.1 million and \$2.2 million for the nine months ended September 30, 2016 and 2015 , respectively.

## 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 \$1.2 million and \$1.2 million for the three months ended September 30, 2016 and 2015 , respectively, and \$3.5 million and \$3.4 million for the nine months ended September 30, 2016 and 2015 , respectively.

The following table shows stock option activity for the nine months ended September 30, 2016 :

	Outstanding Options	Weighted average exercise price per share	Weighted average remaining contractual life (Years)	Aggregate Intrinsic Value (in thousands)
Outstanding at December 31, 2015	4,117,123	\$ 6.92	5.64	\$ 1,211
Granted	115,000	1.74		
Forfeited	(322,061)	8.29		
Exercised	(395,767)	0.84		
Outstanding at September 30, 2016	3,514,295	\$ 7.31	5.30	\$ 1,936
Vested, exercisable, expected to vest <sup>(1)</sup> at September 30, 2016	3,477,028	\$ 7.31	5.28	\$ 1,929
Exercisable at September 30, 2016	2,742,055	\$ 7.21	4.74	\$ 1,797

(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 to five years .

### (b) Restricted Stock Units and Performance Stock Units

The following table summarizes restricted stock unit and performance stock unit activity for the nine months ended September 30, 2016 :

	Number of Awards	Weighted average grant date fair value per share
Outstanding at December 31, 2015	1,229,274	\$ 4.67
Granted	1,465,154	1.73
Forfeited	(130,050)	4.28
Vested and converted to shares, net of units withheld for taxes	(352,072)	4.31
Units withheld for taxes	(146,850)	4.31
Outstanding at September 30, 2016	2,065,456	\$ 2.69
Expected to vest at September 30, 2016	1,962,182	\$ 2.69

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

## 6. Income Taxes

Our effective income tax rate changed to 7% for the nine months ended September 30, 2016 from 18% for the nine months ended September 30, 2015 . The decrease in the effective tax rate is primarily due to the income from operations generated for

the nine months ended September 30, 2016 compared to the loss from operations for the nine months ended September 30, 2015 and the resulting impact that the state taxes have on the forecasted rate applied to year to date income for the nine months ended September 30, 2016 offset by the impact of the Work Opportunity Tax Credit on the effective tax rate.

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 2011, the Company is no longer subject to California, Texas and certain state tax examinations. For tax years before 2013, 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 and 2012.

## 7. Earnings per Share

For the three and nine months ended September 30, 2016 and 2015, basic income per share is calculated by dividing net income by the sum of the weighted average number of shares of Common Stock outstanding during the period. Diluted income 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, and performance stock units. 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 September 30, 2016 and 2015, and nine months ended September 30, 2015, 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, and performance stock units from the calculation of diluted earnings per share when the combined exercise price, unamortized fair value and excess tax benefits of the options exceed the average market price of the Company's common stock because their effect would be anti-dilutive. For the nine months ended September 30, 2016, the Company excluded 4,559,511 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 September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Weighted average shares outstanding – basic	50,200	49,436	49,974	49,394
Dilutive effect of stock options	—	—	427	—
Weighted average shares outstanding – diluted	50,200	49,436	50,401	49,394

## 8. Subsequent Events

On October 27, 2016, Performant Business Services, Inc., which is a wholly-owned subsidiary of Performant Financial Corporation (the “Company”) and is the borrower under that certain Credit Agreement dated as March 19, 2012 with Madison Capital Funding LLC, as agent (the “Agent”) and the lenders party thereto from time to time (as amended, the “Credit Agreement”), entered into Amendment No. 6 to the Credit Agreement (the “Sixth Amendment”). The Company and certain other of its subsidiaries are guarantors of the obligations under the Credit Agreement. Pursuant to the Sixth Amendment, the Company’s financial covenants were modified as follows:

- The total debt to EBITDA ratio of 3.25 to 1.0, which was in effect for the computation period ending as of December 31, 2017, has been revised under the Sixth Amendment to be 4.75 to 1.0 for that period.
- The interest coverage ratio, which was not in effect for the computation period ending as of December 31, 2017, has been revised under the Sixth Amendment to be 1.75 to 1.0 for that period.
- The fixed charge coverage ratio of 1.20 to 1.0, which was in effect for the computation period ending as of December 31, 2017, has been revised under the Sixth Amendment to no longer apply to that period.

In connection with Amendment No. 4 to the Credit Agreement dated as of February 19, 2016, the Company deposited \$7.5 million into a deposit account which is subject to the exclusive control of the Agent. Pursuant to the Sixth Amendment, the date

on which these funds will be remitted to the Agent for application to the term loans or other obligations, as applicable, under the Credit Agreement has been extended by approximately four months, to February 28, 2017 (or such later date not more than thirty ( 30 ) days thereafter as may be agreed by Agent in its sole discretion); however, all or a portion of these funds may also be returned to the Company if the Agent and the requisite lenders under the Credit Agreement elect otherwise in their sole discretion. These funds may also be remitted to the Agent in accordance with the foregoing sentence prior to February 28, 2017 if an event of default has occurred and is continuing under the Credit Agreement. Also in connection with the Sixth Amendment, the Company voluntarily prepaid \$7.5 million under the Credit Agreement, which was applied ratably to the Term A loan and the Term B loan.

On October 26, 2016, CMS awarded the next round of Medicare-Fee-For-Service Audit Contractor contracts, or RAC contracts. The Company was awarded 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 Durable Medical Equipment, Prosthetics, Orthotics, and Supplies (DMEPOS) and Home Health and Hospice within the Northeast Region. The Region 5 RAC contract provides for the post-payment review of DMEPOS and Home Health and Hospice claims nationally. While the new RAC contracts have been awarded, the Company is uncertain when audit and recovery services under the new contracts will begin, as well as the potential scope of audit permitted by the new RAC contracts.

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

*You should read the following discussion in conjunction with our condensed 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 recovery and related analytics services in the United States. Our services help identify 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 tax and federal treasury and other receivables. We generally provide our services on an outsourced basis, where we handle many or all aspects of our clients' recovery processes.

Our revenue model is generally success-based as we earn fees on the aggregate 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 and the dollars we enable our clients to recover, 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 expenditures and 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, student lending and healthcare, as well as our other markets which include, but are not limited to, delinquent state taxes and federal Treasury and other receivables.



	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(in thousands)		(in thousands)	
<b>Student Lending:</b>				
Department of Education	\$ 3,906	\$ 6,025	\$ 18,243	\$ 28,227
Guaranty Agencies and Other	19,891	22,513	63,964	58,323
Total of Student Lending	23,797	28,538	82,207	86,550
<b>Healthcare:</b>				
CMS RAC	1,717	3,497	5,180	9,727
Commercial	1,262	1,586	3,878	5,887
Total of Healthcare	2,979	5,083	9,058	15,614
Other:	4,419	4,885	16,283	16,163
Total Revenues	\$ 31,195	\$ 38,506	\$ 107,548	\$ 118,327

**Student Lending**

We derive the majority of our revenues from the recovery of student loans. These revenues 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. With respect to the recovery services we have historically performed for the Department of Education and certain of our guaranty agency clients, we have also received incremental performance incentives based upon our performance as compared to other contractors, which incentives consist of additional inventory allocation volumes and incentive fees. We are currently subject to a competitive rebidding process for the next contract with the Department of Education. While five other recovery service providers had their contracts extended by the Department of Education past the original April 2015 expiration date, we did not receive such an extension from the Department of Education. We submitted our proposal for a new contract to the Department of Education in February 2016, but it is uncertain when any new contracts will be awarded. We do not anticipate receiving any new loan placements from the Department of Education until the new contracts are awarded. Due to the nine month rehabilitation process for loans placed with us by the Department of Education, there was minimal impact on our revenues in 2015 as a result of not receiving an extension of our current contract. However, the absence of placements of new student loans from the Department of Education since the expiration of our prior contract in April 2015 resulted in our revenues from the Department of Education falling from \$28.2 million in the first nine months of 2015 to \$18.2 million in the first nine months of 2016. We expect our revenues from the Department of Education will continue to be significantly lower during the fourth quarter of 2016 and at least the first half of 2017.

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.

Our key 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.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(in thousands)		(in thousands)	
<b>Student Lending Placement Volume:</b>				
Department of Education	\$ —	\$ 6,741	\$ 5,082	\$ 1,538,979
Guaranty Agencies and Other	678,910	541,012	2,539,998	2,845,977
<b>Total Student Lending Placement Volume</b>	<b>\$ 678,910</b>	<b>\$ 547,753</b>	<b>\$ 2,545,080</b>	<b>\$ 4,384,956</b>

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, except that beginning in July 2015, our contract with the Department of Education has provided for a fixed fee of \$1,710 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"> <li>Repayment in full of the loan</li> <li>We are paid a percentage of the full payment that is made</li> </ul>	<ul style="list-style-type: none"> <li>Regular structured payments, typically according to a renegotiated payment plan</li> <li>We are paid a percentage of each payment</li> </ul>	<ul style="list-style-type: none"> <li>After a defaulted borrower has made nine consecutive recurring payments, the loan is eligible for rehabilitation</li> <li>We are paid based on a percentage of the overall value of the rehabilitated loan or for the Department of Education, a fixed fee</li> </ul>	<ul style="list-style-type: none"> <li>Restructure and consolidate a number of outstanding loans into a single loan, typically with one monthly payment and an extended maturity</li> <li>We are paid based on a percentage of overall value of the restructured loan</li> </ul>	<ul style="list-style-type: none"> <li>If we are unable to obtain voluntary repayment, payments may be obtained through wage garnishment after certain administrative requirements are met</li> <li>We are paid a percentage of each payment</li> </ul>

For certain guaranty agency, or GA, clients, we have entered into Master Service Agreements, or MSAs. Under these agreements, clients provide their entire inventory of outsourced loans or receivables to us for recovery on an exclusive basis, in contrast with traditional contracts that are split among various service providers. In certain circumstances, we engage subcontractors to assist in the recovery of a portion of the client’s portfolio. We also receive success fees for the recovery of loans under MSAs and our revenues under MSA arrangements include fees earned by the activities of our subcontractors. As of September 30, 2016, we had three MSA clients in the student loan market.

In October 2014, the Department of Education announced a change in the structure for the payment of fees to recovery contractors upon rehabilitation of student loans under the existing recovery contract. The new fee structure provides for a fixed fee of \$1,710 for each loan that is rehabilitated. Previously, the fee had been based on a percentage of the principal amount of the rehabilitated loan. The change to the fee structure became effective for student loans rehabilitated on or following July 1, 2015.

Further, the Bipartisan Budget Act of 2013 reduced the compensation paid to GAs for the rehabilitation of student loans, effective July 1, 2014. This “revenue enhancement” measure reduced the amount that GAs can charge borrowers from 18.5% to 16.0% of the outstanding loan balance, when a rehabilitated loan is sold by the GA and eliminated entirely the GAs retention of 18.5% of the outstanding loan balance as a fee for rehabilitation services. The reduction in compensation the GAs receive resulted in a decrease in the contingency fee percentage that we receive from the GAs for assisting in the rehabilitation of defaulted student loans.

## **Healthcare**

We derive revenues from the healthcare market from our RAC contract, under which we are the prime contractor responsible for detecting improperly paid Part A and Part B Medicare claims in 12 states in the Northeastern United States. Revenues earned under the RAC contract are driven by the identification of improperly paid Medicare claims through both automated and manual review of such claims. We are paid contingency fees by CMS based on a percentage of the dollar amount of claims recovered by CMS as a result of our efforts. We recognize revenue when the provider pays CMS or incurs an offset against future Medicare claims. The revenues we recognize are net of our estimate of claims that will be overturned by appeal following payment by the provider.

Our first RAC contract was wound down and then terminated in 2016 in connection with CMS' plan to award new contracts. On October 26, 2016, CMS awarded new RAC contracts and the Company 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 Durable Medical Equipment, Prosthetics, Orthotics, and Supplies (DMEPOS) and Home Health and Hospice within the Northeast Region. The Region 5 RAC contract provides for the post-payment review of DMEPOS and Home Health and Hospice claims nationally. While the new RAC contracts have been awarded, the Company is uncertain when audit and recovery services under the new contracts will begin, as well as the potential scope of audit permitted by the new RAC contracts. In connection with the wind down of the prior RAC contract, CMS adopted a series of contract transition procedures, beginning in 2013, that restricted our ability to request medical records for audit and has otherwise suspended our ability to perform any audit services for certain periods of time, thus adversely affecting our revenues under this contract. In addition, CMS's contract transition rules have limited scope of our permitted audit activities as CMS has generally not permitted audits of periodic interim payment, or PIP, providers and has also placed additional restrictions on the types of claims we are permitted to audit and number of medical records we are permitted to request. In May 2016, CMS announced that the recovery audit contractors would not be able to request documents from providers for audit after May 16, 2016 and would not be able to submit claims for improper payments after July 29, 2016, effectively terminating additional revenue generating activity under our previous RAC contract. It is unclear when we will be permitted to begin work under the newly awarded RAC contracts and whether and to what extent audit restrictions implemented by CMS during the contract transition will be replaced. Revenues for the quarter ending September 30, 2016 from the RAC contract were \$1.7 million, compared with \$3.5 million for the same period last year, and we expect that our revenues from the RAC contract will remain at low levels for the last quarter of 2016. We do not expect to recognize significant revenue from the newly awarded RAC contracts for four to six months after we are permitted to begin performing recovery services under the new RAC contracts.

In connection with the previous RAC contract, CMS has announced a settlement offer to pay hospitals 68% of what they have billed Medicare to settle a backlog of pending appeals challenging Medicare's denials of reimbursement for certain types of short-term care. The implication of this settlement offer related to claims for which fees have already been paid to recovery auditors under the prior RAC contracts is unclear at this time, but we may be obligated to repay certain amounts that we previously received from CMS depending on the final terms of any such settlement. We accrue an estimated liability for appeals based on the amount of commissions received which are subject to appeal and which we estimate are probable of being returned to providers following successful appeal. The \$19.2 million balance as of September 30, 2016, represents our best estimate of the probable amount we may be required to refund related to appeals of claims for which commissions were previously collected. We estimate that it is reasonably possible that we could be required to pay an additional amount up to approximately \$5.4 million as a result of potentially successful appeals in excess of the amount we accrued as of September 30, 2016.

In connection with the award of our initial RAC contract, we outsourced certain aspects of our healthcare recovery process to three different subcontractors. Two of these subcontractors provided a specific service to us in connection with our claims recovery process, with the third subcontractor, whose services were terminated in December 2015, formerly providing all of the audit and recovery services for claims within a portion of our region. We recognize all of the revenues generated by the claims recovered through our subcontractor relationships, and we recognize the fees that we pay to these subcontractors in our expenses. We expect that we will outsource certain claims recovery processes under the newly awarded RAC contracts.

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 payors. We have entered into contracts with several private payors, although these contracts are in the early stage of implementation. Revenues from our commercial healthcare clients were \$1.3 million for the quarter ended September 30, 2016, compared to revenues of \$1.6 million that we earned from our commercial healthcare clients for the same period last year.

## ***Other***

We also derive revenues from the recovery of delinquent state taxes, as well as federal Treasury and other receivables, default aversion services for certain clients including financial institutions and the licensing of hosted technology solutions to certain clients. In September 2016, the Company, and three other service providers, were awarded contracts to collect overdue federal tax debts under a new federal law enacted in December 2015. The Company and other private collectors will work to recover delinquent taxes that the IRS is no longer actively pursuing. The IRS has stated that it expects the new program to begin in the spring of 2017. 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. The fees that we earn under our contractual arrangement with the Department of Education have been subject to unilateral change by the Department of Education. For example, in connection with the implementation of the IBR program, the Department of Education initially reduced the contingency fee rate that we receive for rehabilitating student loans by approximately 13% effective March 1, 2013.

Further, the Department of Education changed its fee structure to a fixed recovery fee of \$1,710 for each rehabilitated loan, effective as of July 1, 2015. The fixed recovery fee is payable for each loan that is rehabilitated and replaces a recovery fee structure that historically had been based on a percentage of the balance of the rehabilitated loan.

### ***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 will over time shift the portfolio of outstanding student loans toward the Department of Education, which, as noted above, is currently in a contract procurement process, the outcome of which is material to our business. 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 Retention***

Our revenues from the student loan market depend on our ability to maintain our contracts with some of the largest providers of student loans. For the nine months ended September 30, 2016, three providers of student loans each accounted for more than 10% of our revenues and they collectively accounted for approximately 55% of our total revenues during this period. The Department of Education was responsible for approximately 17% of our revenues for the nine months ended September 30, 2016. We have a relationship with numerous GAs in the U.S. including Great Lakes Higher Education Guaranty Corporation and Pennsylvania Higher Education Assistance Authority, which were responsible for 23% and 16%, respectively, of revenues for the nine months ended September 30, 2016. Our contract with the Department of Education, which generated approximately 13% of our revenues in the third quarter of 2016, is currently the subject to a competitive bidding process. Our contracts with these clients entitle them 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 consolidated 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.

Our contract with CMS for the recovery of improper Medicare payments represented approximately 5% of our total revenues for the nine months ended September 30, 2016, compared to approximately 15% in 2014 and 26% in 2013. Our audit work under our initial RAC contract is almost entirely wound down and CMS has now awarded new RAC contracts. We do not expect to recognize significant revenue under our newly awarded RAC contracts for four to six months after we are permitted to begin performing recovery services under the new RAC contracts.

### ***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 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***

The majority of our contracts are contingency fee based. We recognize revenues on these contingency fee based contracts when third-party payors remit payments to our clients or remit payments to us on behalf of our clients, and, consequently, the contingency is deemed to have been satisfied. Under our RAC contract 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. Healthcare providers have the right to appeal a claim and may pursue additional level of appeals if the initial appeal is found in favor of CMS. We accrue an estimated liability for appeals at the time revenue is recognized based on our estimate of the amount of revenue probable of being returned to CMS following successful appeal based on historical data and other trends relating to such appeals. In addition, if our estimate of liability for appeals with respect to revenues recognized during a prior period changes, we increase or decrease the estimated liability for appeals in the current period.

This estimated liability for appeals is an offset to revenues on our income statement. Resolution of appeals can take a very long time to resolve and there is a significant backlog in the system for resolving appeals, as over the course of our first RAC contract, healthcare providers have increased their pursuit of appeals beyond the first and second levels of appeals to the third level of appeal, where cases are heard by administrative law judges, or ALJs. In our experience, decisions at the third level of appeal are the least favorable as ALJs exercise greater discretion and there is less predictability in the ALJ decisions as compared to appeals at the first or second levels. This increase of ALJ appeals and backlog of claims at the third level of appeal is the primary reason our total estimated liability for appeals (consisting of the estimated liability for appeals plus the contra-accounts-receivable estimated allowance for appeals) has grown from a balance of \$16.4 million at December 31, 2013, to \$18.6 million as of December 31, 2014, to \$19.0 million at December 31, 2015, and increased to \$19.2 million as of September 30, 2016. In addition to the \$19.2 million related to the RAC contract with CMS, the Company has accrued \$0.4 million of additional estimated liability for appeals related to other healthcare contracts. The total accrued liability for appeals is therefore \$19.6 million at September 30, 2016.

The \$19.6 million balance as of September 30, 2016, represents our best estimate of the probable amount of losses related to appeals of claims for which commissions were previously collected. We estimate that it is reasonably possible that we could be required to pay up to an additional approximately \$5.4 million as a result of potentially successful appeals. To the extent that required payments by us related to successful appeals exceed the amount accrued, revenues in the applicable period would be reduced by the amount of the excess.

### ***Goodwill***

We periodically review the carrying value of intangible assets not subject to amortization, including goodwill, to determine whether an impairment may exist. GAAP requires that goodwill and certain intangible assets not subject to amortization be assessed annually for impairment using fair value measurement techniques.

We assess goodwill for impairment on an annual basis as of November 30 of each year or more frequently if an event occurs or changes in circumstances would more likely than not reduce the fair value of a reporting unit below its carrying amount. We have the option to perform a qualitative assessment to determine if an impairment is more likely than not to have occurred. If we can support the conclusion that it is more likely than not that the fair value of a reporting unit is greater than its carrying amount, then we would not need to perform the two-step impairment test. If we cannot support such a conclusion, or we do not elect to perform the qualitative assessment, then the first step of the goodwill impairment test is used to identify potential impairment by comparing the fair value of a reporting unit with its carrying amount, including goodwill. The Company performed a Step 1 impairment assessment as of November 30, 2015 and concluded that it was not necessary to perform a Step 2 impairment assessment. The Company performed a qualitative assessment of whether it is more likely than not that goodwill value is less than its carrying amount as of September 30, 2016 and concluded that there was no need to perform an impairment test. There was no impairment expense for goodwill for the nine months ended September 30, 2016 or 2015.

### ***Impairments of Depreciable Intangible Assets***

The balance of depreciable intangible assets was \$22.3 million as of September 30, 2016. We evaluate depreciable intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. Depreciable intangible assets consist of client contracts and related relationships, and are being amortized over their estimated useful life, which is generally 20 years. We evaluate the client contracts intangible at the individual contract level. The recoverability of such assets 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 the 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. There was no impairment expense for depreciable intangible assets for the nine months ended September 30, 2016. For the year ended December 31, 2015, an impairment expense of \$0.2 million was recognized to account for the loss of a client and it has been included in other operating expenses in the consolidated statements of operations.

**Recent Accounting Pronouncements**

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

**Results of Operations**

**Three Months Ended September 30, 2016 compared to the Three Months Ended September 30, 2015**

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

	Three Months Ended September 30,			
	2016	2015	\$ Change	% Change
(in thousands)				
<b>Consolidated Statement of Operations Data:</b>				
Revenues	\$ 31,195	\$ 38,506	\$ (7,311)	(19)%
Operating expenses:				
Salaries and benefits	18,710	21,729	(3,019)	(14)%
Other operating expenses	12,311	14,096	(1,785)	(13)%
Total operating expenses	31,021	35,825	(4,804)	(13)%
Income from operations	174	2,681	(2,507)	(94)%
Interest expense	(1,863)	(2,137)	(274)	(13)%
Income before provision for (benefit from) income taxes	(1,689)	544	(2,233)	(410)%
Provision for (benefit from) income taxes	(974)	858	(1,832)	(214)%
Net loss	\$ (715)	\$ (314)	\$ (401)	128 %

**Revenues**

Revenues were \$31.2 million for the three months ended September 30, 2016 , a decrease of approximately 19% , compared to revenues of \$38.5 million for the three months ended September 30, 2015 .

Student lending revenues were \$23.8 million for the three months ended September 30, 2016 , representing a decrease of \$4.7 million , or 17% , compared to the three months ended September 30, 2015 . The decrease was primarily a result of the reduction of revenues from the Department of Education as we have not received new placements of student loans from the Department of Education since our contact expired in April 2015.

Healthcare revenues were \$3.0 million for the three months ended September 30, 2016 , representing a decrease of \$2.1 million , or 41% , compared to the three months ended September 30, 2015 . This decrease was due primarily to the wind down of our first RAC contract and a \$0.3 million reduction in revenue from commercial healthcare customers.

**Salaries and Benefits**

Salaries and benefits expense was \$18.7 million for the three months ended September 30, 2016 , a decrease of \$3.0 million , or 14% , compared to salaries and benefits expense of \$21.7 million for the three months ended September 30, 2015 . The decrease in salaries and benefits expense was primarily due to a decrease in employee headcount as we have reduced expenses in concert with lower business volumes.

**Other Operating Expenses**

Other operating expenses were \$12.3 million for the three months ended September 30, 2016 , a decrease of \$1.8 million , or 13% , compared to other operating expenses of \$14.1 million for the three months ended September 30, 2015 . The



decrease in other operating expenses was primarily due to lower outside services and lower communication and postage expenses related to the wind down of our first RAC contract.

**Income from Operations**

Income from operations was \$0.2 million for the three months ended September 30, 2016 , compared to income from operations of \$2.7 million for the three months ended September 30, 2015 , representing a decrease of \$2.5 million or 94% . The decrease was primarily the result of lower revenues, which was partially offset by a reduction in salaries and benefits and other operating expenses.

**Interest Expense**

Interest expense was \$1.9 million for the three months ended September 30, 2016 , compared to \$2.1 million for the three months ended September 30, 2015 . Interest expense decreased by approximately \$0.2 million or 13% due to repayments of principal under our credit agreement, resulting in a lower outstanding balance.

**Income Taxes**

Income tax benefit was \$1.0 million for the three months ended September 30, 2016 , compared to an income tax expense of \$0.9 million for the three months ended September 30, 2015 . Our effective income tax rate decreased to 58% for the three months ended September 30, 2016 , from 158% for the three months ended September 30, 2015 . The decrease in the effective tax rate is primarily due to an increase in forecasted income for the three months ended September 30, 2015 that increased the tax rate at September 30, 2015, offset by an increase in the tax rate for the three months ended September 30, 2016 related to the impact of discrete items on the effective tax rate.

**Net Loss**

As a result of the factors described above, net loss was \$0.7 million for the three months ended September 30, 2016 , which represented an increase of \$0.4 million , or 128% compared to net loss of \$0.3 million for the three months ended September 30, 2015 .

**Nine Months Ended September 30, 2016 compared to the Nine Months Ended September 30, 2015**

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

	Nine Months Ended September 30,			
	2016	2015	\$ Change	% Change
(in thousands)				
<b>Consolidated Statement of Operations Data:</b>				
Revenues	\$ 107,548	\$ 118,327	\$ (10,779)	(9)%
Operating expenses:				
Salaries and benefits	60,107	67,595	(7,488)	(11)%
Other operating expenses	40,401	48,801	(8,400)	(17)%
Total operating expenses	100,508	116,396	(15,888)	(14)%
Income from operations	7,040	1,931	5,109	265 %
Interest expense	(6,136)	(6,800)	(664)	(10)%
Income before provision for (benefit from) income taxes	904	(4,869)	5,773	119 %
Provision for (benefit from) income taxes	62	(879)	941	107 %
Net income (loss)	\$ 842	\$ (3,990)	\$ 4,832	121 %

**Revenues**

Revenues were \$107.5 million for the nine months ended September 30, 2016 , a decrease of approximately 9% , compared to revenues of \$118.3 million for the nine months ended September 30, 2015 .



Student lending revenues were \$82.2 million for the nine months ended September 30, 2016 , representing a decrease of \$4.4 million , or 5% , compared to the nine months ended September 30, 2015 . The decrease was primarily a result of the reduction of revenues from the Department of Education due to the lack of placements of new student loans from the Department of Education since our contract expired in April 2015, which was partially offset by an increase in the number of borrowers that are participating in the rehabilitation programs with our Guaranty Agency clients.

Healthcare revenues were \$9.1 million for the nine months ended September 30, 2016 , representing a decrease of \$6.5 million , or 42% , compared to the nine months ended September 30, 2015 . This decrease was due primarily to reduced levels of permitted healthcare audit and recovery activities under our first CMS RAC contract and an approximately \$2.0 million reduction in revenues from commercial healthcare customers.

#### ***Salaries and Benefits***

Salaries and benefits expense was \$60.1 million for the nine months ended September 30, 2016 , a decrease of \$7.5 million , or 11% , compared to salaries and benefits expense of \$67.6 million for the nine months ended September 30, 2015 . This decrease in salaries and benefits expense was primarily due to a decrease in employee headcount .

#### ***Other Operating Expenses***

Other operating expenses were \$40.4 million for the nine months ended September 30, 2016 , a decrease of \$8.4 million , or 17% , compared to other operating expenses of \$48.8 million for the nine months ended September 30, 2015 . The decrease in other operating expenses was primarily due to the absence of transaction expenses associated with a potential acquisition in the first quarter of 2015, lower communication and postage expenses and lower outside services.

#### ***Income from Operations***

Income from operations was \$7.0 million for the nine months ended September 30, 2016 , compared to income from operations of \$1.9 million for the nine months ended September 30, 2015 , representing an increase of \$5.1 million .

#### ***Interest Expense***

Interest expense was \$6.1 million for the nine months ended September 30, 2016 , compared to \$6.8 million for the nine months ended September 30, 2015 . Interest expense decreased \$0.7 million due to repayments of principal under our credit agreement, resulting in a lower outstanding balance.

#### ***Income Taxes***

We recognized an income tax expense of \$0.1 million for the nine months ended September 30, 2016 , compared to an income tax benefit of \$0.9 million for the nine months ended September 30, 2015 . Our effective income tax increased to 7% for the nine months ended September 30, 2016 , from 18% for the nine months ended September 30, 2015 . The decrease in the effective tax rate is primarily due to the income from operations generated for the nine months ended September 30, 2016 compared to the loss from operations for the nine months ended September 30, 2015 and the resulting impact that the state taxes have on the forecasted rate applied to year to date income for the nine months ended September 30, 2016 offset by the impact of the Work Opportunity Tax Credit on the effective tax rate.

#### ***Net Income (Loss)***

As a result of the factors described above, net income was \$0.8 million for the nine months ended September 30, 2016 , which represented an increase of \$4.8 million , or 121% compared to net loss of \$4.0 million for the nine months ended September 30, 2015 .

#### **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-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 GAAP financial measure to these non-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 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; 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 GAAP results. The following tables present a reconciliation of adjusted EBITDA and adjusted net income for each of the periods indicated:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(in thousands)		(in thousands)	
<b>Adjusted EBITDA:</b>				
Net income (loss)	\$ (715)	\$ (314)	\$ 842	\$ (3,990)
Provision for (benefit from) income taxes	(974)	858	62	(879)
Gain on sale of land <sup>(6)</sup>	—	(636)	—	(636)
Interest expense	1,863	2,137	6,136	6,800
Transaction expenses <sup>(1)</sup>	—	—	—	3,270
Restructuring and other expenses <sup>(4)</sup>	26	—	309	930
Depreciation and amortization	3,292	3,242	10,098	10,094
Stock-based compensation	1,206	1,231	3,546	3,398
Adjusted EBITDA	\$ 4,698	\$ 6,518	\$ 20,993	\$ 18,987

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(in thousands)		(in thousands)	
<b>Adjusted Net Income:</b>				
Net income (loss)	\$ (715)	\$ (314)	\$ 842	\$ (3,990)
Gain on sale of land <sup>(6)</sup>	—	(636)	—	(636)
Transaction expenses <sup>(1)</sup>	—	—	—	3,270
Stock-based compensation	1,206	1,231	3,546	3,398
Amortization of intangibles <sup>(2)</sup>	931	943	2,800	3,081
Deferred financing amortization costs <sup>(3)</sup>	324	290	1,342	906
Restructuring and other expenses <sup>(4)</sup>	26	—	309	930
Tax adjustments <sup>(5)</sup>	(995)	(731)	(3,199)	(4,379)
Adjusted Net Income	\$ 777	\$ 783	\$ 5,640	\$ 2,580

- (1) Represents direct and incremental costs associated with expenses incurred in 2015 for a potential acquisition and related financing.
- (2) Represents amortization of capitalized expenses related to the acquisition of Performant by an affiliate of Parthenon Capital Partners in 2004, and also an acquisition in the first quarter of 2012 to enhance our analytics capabilities.
- (3) Represents amortization of capitalized financing costs related to financing conducted in 2012 and costs related to the amendment of the terms of the note payable in 2014 and 2016.
- (4) Represents restructuring costs and severance and termination expenses incurred in connection with termination of employees and consultants.
- (5) Represents tax adjustments assuming a marginal tax rate of 40%.
- (6) Represents gain on the sale of land in San Angelo, TX in 2015.

## Liquidity and Capital Resources

Our primary source of liquidity is cash on hand and cash flows from operations. Cash and cash equivalents, which excludes restricted cash, totaled \$48.3 million as of September 30, 2016, and consists primarily of cash on deposit with banks. Due to our operating cash flows and our existing cash and cash equivalents 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 through the fourth quarter of 2017. See "Long-term Debt" below.

The \$22.9 million decrease in the balance of our cash and cash equivalents from December 31, 2015, was primarily due to principal repayments of \$29.3 million on our long-term debt, and a \$7.5 million restricted cash deposit, both of which were made in connection with the amendment to our credit agreement completed on February 19, 2016, and \$5.5 million of capital expenditures partially offset by cash generated from operations of \$20.5 million. In October 2016, the Company prepaid an additional \$7.5 million in connection with a further amendment to our Credit Agreement.

#### ***Cash flows from operating activities***

Cash provided by operating activities was \$20.5 million for the nine months ended September 30, 2016, and included net income of \$0.8 million, a decrease in trade accounts receivable of \$7.7 million, and an increase in accrued salaries and benefits of \$3.8 million. Cash provided by operating activities in the nine months ended September 30, 2015 was \$19.0 million.

#### ***Cash flows from investing activities***

Cash used in investing activities of \$5.5 million for the nine months ended September 30, 2016 was mainly for capital expenditures related to information technology, data storage, hardware, telecommunication systems and security enhancements to our proprietary software. Cash used in investing activities in the nine months ended September 30, 2015 was \$4.4 million.

#### ***Cash flows from financing activities***

Cash used in financing activities of \$37.9 million for the nine months ended September 30, 2016 was primarily attributable to repayments of principal of \$29.3 million on long-term debt and a \$7.5 million deposit in restricted cash in connection with the amendment to the Company's credit agreement in February 2016. Cash used in financing activities in the nine months ended September 30, 2015 was \$16.7 million.

#### ***Restricted Cash***

As of September 30, 2016, restricted cash included in current assets on our consolidated balance sheet was \$7.5 million. As discussed below, on February 19, 2016 the Company deposited \$7.5 million into a segregated deposit account in connection with the Fourth Amendment to our credit agreement. The cash in this segregated deposit account is restricted because it is subject to the exclusive control of the Agent.

#### ***Estimated liability for appeals and net payable to client***

The September 30, 2016 balances of \$19.6 million and \$13.4 million for the estimated liability for appeals and the net payable to client, respectively, represent obligations that we expect to pay in the near term, although it is difficult to predict the precise timing of the associated cash outflows as they are dependent on the processing and resolution of audit appeals.

#### ***Long-term Debt***

On March 19, 2012, we, through our wholly owned subsidiary, entered into a \$147.5 million credit agreement, as amended and restated, with Madison Capital Funding LLC as administrative agent, ING Capital LLC as syndication agent, and other lenders party thereto. The senior credit facility consists of (i) a \$57.0 million term A loan that matures in March 2017, (ii) a \$79.5 million term B loan that matures in March 2018, and (iii) a \$11.0 million revolving credit facility that expires in March 2017. On June 28, 2012, we amended the credit agreement to increase the amount of our borrowings under our term B loan by \$19.5 million. On each of November 4, 2014, January 28, 2015, February 19, 2016, July 27, 2016, and October 27, 2016, we further amended the credit agreement to modify a number of existing covenants and add certain new covenants.

All borrowings under the credit agreement bear interest at a rate per annum equal to an applicable margin plus, at our option, either (i) a base rate determined by reference to the highest of (a) the prime rate published in the Wall Street Journal or another national publication, (b) the federal funds rate plus 0.5%, (c) the sum of (A) the 1-month LIBOR rate and (B) the difference between the then effective applicable margins for LIBOR loans and base rate loans and (d) 2.5% or (ii) a LIBOR rate determined by reference to the highest of (a) a LIBOR rate published in Reuters or another national publication and (b) 1.5%. The term A loan and the revolving credit facility have an applicable margin of 5.75% for base rate loans and 6.75% for LIBOR rate loans. The term B loan (including the incremental term B loan) has an applicable margin of 6.25% for base rate loans and 7.25% for LIBOR rate loans. Interest is due at the end of each month for base rate loans and at the end of each LIBOR period for LIBOR rate loans unless the LIBOR period is greater than 3 months, in which case interest is due at the last day of each 3-month interval of such LIBOR period.

The credit agreement requires us to prepay the two term loans on a prorated basis and then to prepay the revolving credit facility under certain circumstances: (i) with 100% of the net cash proceeds of any asset sale or other disposition of assets by us or our subsidiaries where the net cash proceeds exceed \$1 million and (ii) with a percentage of our annual excess cash flow each year where such percentage ranges from 25%-75% depending on our total debt to EBITDA ratio reduced by any voluntary prepayments that are made on our term loans during the same period, unless we elect to apply voluntary prepayments in the inverse order of maturity, in which case only voluntary prepayments in excess of \$10 million shall reduce the amount of excess cash flow we are required to prepay. With respect to (ii) above, in May 2015 and May 2014, the Company made payments of \$7.0 million and \$11.5 million, respectively, to the lenders. In addition, the Company made a prepayment of \$1.3 million to the lenders in July 2015 for the sale of land in San Angelo, TX. The terms of the prepayment provisions in the credit agreement have been modified with the signing of the October 27, 2016 Amendment No. 6 discussed below.

We have to abide by certain negative covenants for our credit agreement, which limit the ability for our subsidiaries and us to:

- incur additional indebtedness;
- create or permit liens;
- pay dividends or other distributions to our equity holders;
- purchase or redeem certain equity interests of our equity holders, including any warrants, options and other security rights;
- pay management fees or similar fees to any of our equity holders;
- make any redemption, prepayment, defeasance, repurchase or any other payment with respect to any subordinated debt;
- consolidate, merge or make any acquisitions;
- sell assets, including the capital stock of our subsidiaries;
- enter into transactions with our affiliates;
- enter into different business lines;
- permit the aggregate amount of capital expenditures to exceed a certain amount; and
- make investments.

The credit agreement also requires us to meet certain financial covenants, including maintaining (i) a fixed charge coverage ratio, (ii) a total debt to EBITDA ratio, (iii) an interest coverage ratio, (iv) a minimum EBITDA amount, (v) a minimum required adjusted cash amount, and (vi) maximum capital expenditures, as such terms are defined in our credit agreement. These financial covenants are tested at the end of each year, quarter or month, as applicable. The table below further describes these financial covenants, as well as our current status under these covenants as of September 30, 2016 .

Financial Covenant	Covenant Requirement	Actual Ratio at September 30, 2016
Fixed charge coverage ratio (minimum) <sup>1</sup>	N/A	N/A
Total debt to EBITDA ratio (maximum) <sup>2</sup>	4.75 to 1.0	1.85
Interest coverage ratio (minimum) <sup>3</sup>	2.5 to 1.0	4.69
EBITDA (minimum) <sup>4</sup>	\$20,000,000	N/A
Required Adjusted Cash Amount (minimum) <sup>6</sup>	\$10,000,000	\$27,861,000
Capital Expenditures <sup>5</sup>	\$8,000,000	N/A

(1) The fixed charge coverage ratio will no longer apply to any future computation periods.

(2) The total debt to EBITDA ratio will apply to computation periods ending December 31, 2017.

(3) The interest coverage ratio will apply to computation periods ending December 31, 2017.

(4) This requirement was effective through June 30, 2016.

(5) This requirement is an annual limitation and adjusted to \$8,000,000 for the years ending December 31, 2016 and December 31, 2017.

(6) This requirement is effective through September 30, 2016.

On February 19, 2016, we entered into the Fourth Amendment to our Credit Agreement, on July 27, 2016, we entered into the Fifth Amendment to our Credit Agreement, and on October 27, 2016 we entered into the Sixth Amendment to our Credit Agreement. Pursuant to these amendments, our financial covenants were modified as follows:

- The annual capital expenditure limitation of \$12.5 million, which was in effect for the year ending December 31, 2016, has been revised to be \$8 million for the years ending December 31, 2016 and December 31, 2017.
- The total debt to EBITDA ratio of 3.25 to 1.0, which was in effect for the computation periods ending as of March 31, 2017, June 30, 2017, September 30, 2017, and December 31, 2017, has been revised to be 4.75 to 1.0 for those periods.
- The interest coverage ratio of 2.5 to 1.0 in effect for the computation period ending September 30, 2016, and 2.0 to 1.0 in effect for the computation period ending December 31, 2016, and 1.75 to 1.0 in effect for the computation periods ending as of March 31, 2017, June 30, 2017, September 30, 2017 has been revised to include December 31, 2017.
- The fixed charge coverage ratio of 1.20 to 1.0, which was in effect for the computation period ending as of December 31, 2017, has been revised to no longer apply to that period.
- The required minimum adjusted cash balance of \$30.0 million, which was in effect from March 31, 2016 through December 31, 2016, has been revised to be \$10.0 million from March 31, 2016 through September 30, 2016.
- The minimum trailing twelve month EBITDA of \$20.0 million, which was in effect from March 31, 2016 through December 31, 2016, has been revised by shortening such period to extend until June 30, 2016.

Our obligation to apply, on an annual basis, a percentage, which may fluctuate between 25% and 75% (determined based upon the Company's total debt to EBITDA ratio), of our annual excess cash flow as a mandatory prepayment of the loans under the Credit Agreement has also been modified. Pursuant to the Fifth Amendment, we will be required to apply 75% of our excess cash flow each quarter as a mandatory prepayment of the loans under the Credit Agreement. In addition, without the consent of the Agent and lenders holding more than 50% of the revolving loan commitments under the Credit Agreement, we will no longer be permitted to request revolving loans; however, this will not affect our ability to utilize the letter of credit sub-facility under the Credit Agreement.

In connection with the Fourth Amendment to our Credit Agreement, we deposited \$7.5 million into a deposit account which is subject to the exclusive control of the Agent, and voluntarily prepaid \$22.5 million under the Credit Agreement, which was ratably applied to the Term A loan and the Term B loan. Pursuant to the Fifth Amendment, the date on which these funds will be remitted to the Agent for application to the term loans or other obligations, as applicable, under the Credit Agreement was extended by one month, to October 31, 2016. Pursuant to the Sixth Amendment, the date on which these funds will be remitted to the Agent for application to the term loans or other obligations, as applicable, under the Credit Agreement has been extended by four months, to February 28, 2017 (or such later date not more than thirty (30) days thereafter as may be agreed by Agent in its sole discretion). However, all or a portion of these funds may also be returned to us if the Agent and the requisite lenders under the Credit Agreement elect otherwise in their sole discretion. These funds may also be remitted in accordance with the foregoing sentence prior to February 28, 2017 if an event of default has occurred and is continuing under the Credit Agreement. In connection with the Sixth Amendment, the Company voluntarily made a prepayment of \$7.5 million to the lenders on October 27, 2016.

Due to delays in the award of the new contracts by CMS and the Department of Education, significant limitations on our audit and recovery activity during the CMS contract transition period, suspension of student loan placements to us from the Department of Education during the contract transition period and recovery fee reductions in the student lending market, we have been actively restructuring both our variable and fixed expenses consistent with our reduced operations and in order to maintain compliance with our debt covenants. Our current financial projections show that we expect to be able to maintain compliance with our covenants through the fourth quarter of 2017. However, the factors noted above have had and, until resolved, will continue to have a significant negative effect on our revenues and earnings and our ability to continue to comply with our covenants. Accordingly, we expect that we will need to seek further modifications to the covenants from our lenders or refinance our indebtedness. Our inability to maintain long-term compliance with our debt covenants, or to refinance or restructure the terms of our indebtedness on commercially reasonable terms or at all, would have an adverse effect, which could be material on our business, financial condition and results of operations, as well as our ability to satisfy our debt obligations.

In addition, due to the delays in the award of the new contracts from the Department of Education and CMS, we implemented cost and expense reductions during 2015 that included a significant reduction in personnel. To the extent we are able to secure new contracts with the Department of Education or CMS and depending on the business volumes associated with any such new contract awards, we may incur significant expenses to hire additional personnel necessary to perform under any such new contract that may. We may need to obtain additional financing to fund such expenses and there can be no assurance that we will be able to obtain such financing on favorable terms, or at all.

### **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 the prime rate or LIBOR. For example, if the interest rate on our borrowings increased 100 basis points (1%) from the credit facility floor of 1.5%, our annual interest expense would increase by approximately \$0.6 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 “disclosure controls and procedures,” as such term is defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, or the Exchange Act, that are designed to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to our management, including our principal executive officer (our Chief Executive Officer) and our principal financial officer (our Chief Financial Officer), as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, management recognized that disclosure controls and procedures, no matter how well conceived 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 Financial 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 Financial Officer concluded that our disclosure controls and procedures were functioning effectively at the reasonable assurance level as of September 30, 2016 .

#### **Changes in Internal Control over Financial Reporting**

There was no change in our internal control over financial reporting during the quarter ended September 30, 2016 , 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

***Our agreement with the Department of Education, historically one of our most significant customers, is currently subject to a rebidding process, and our failure to renew this agreement or a renewal on less favorable terms would have a significant negative impact on our revenues and results of operations.***

Our existing contract with the Department of Education is currently subject to a rebidding process. The Department of Education was responsible for approximately 12.5% of our revenues for the quarter ended September 30, 2016, and 23.8% of our revenues for the year ended December 31, 2015.

While five other recovery service providers had their contracts extended by the Department of Education past the original April 2015 expiration date, we did not receive such an extension from the Department of Education. We submitted our proposal for a new contract to the Department of Education in February 2016, but it is uncertain as to when any new contracts will be awarded. We do not anticipate receiving any new loan placements from the Department of Education until after the new contracts are awarded. Due to the timing of the rehabilitation process for loans placed with us by the Department of Education, there was a minimal impact on our revenues in 2015 as a result of not receiving an extension of our current contract. However, the absence of placements of new student loans from the Department of Education since the expiration of our prior contract in April 2015 has had a significant negative impact on our revenues in the first six months of 2016 and resumption of a significant revenue stream from the Department of Education would not occur until a minimum of nine months after a successful award of a new contract in 2016 and beyond.

In addition, due to the delays in the award of the new contract from the Department of Education, we implemented cost and expense reductions during 2015 that included a significant reduction in personnel. To the extent we are able to secure a new contract with the Department of Education, we will incur significant expenses to hire additional personnel that will be required to provide services under any such new contract and those expenses may require us to obtain additional financing. There can be no assurance that we will be able to obtain such financing on favorable terms, or at all. Further, if we obtain a new contract from the Department of Education, we expect there will be delays until we start to recognize revenues after such award is made.

***Our current or future 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 senior secured credit facility could result in an event of default that could jeopardize our financial condition.***

As of September 30, 2016, our total debt was \$65.0 million. In February 2016 and October 2016, in connection with the Fourth Amendment and Sixth Amendment to our credit agreement, we voluntarily prepaid \$22.5 million and \$7.5 million, respectively, of the outstanding principal under our credit agreement. For the quarter ended September 30, 2016 our consolidated interest expense was \$1.9 million. Our ability to make scheduled payments or to refinance our debt obligations and to fund our other liquidity needs depends on our financial and operating performance. Due to factors such as our still unresolved contractual relationships with the Department of Education and the limited nature of the audit savings we can provide under our new RAC contracts, 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 financial covenants and other covenants under our senior secured credit facility 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, or that these actions would be successful and permit us to meet our scheduled debt service obligations. 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, our lenders could foreclose against the assets securing our borrowings and we could be forced into bankruptcy or liquidation.

Due to delays in the award of the new contracts by CMS and the Department of Education, significant limitations on our audit and recovery activity during the CMS contract transition period, suspension of student loan placements to us from the Department of Education during the contract transition period, recovery fee reductions in the student lending market and the limited nature of the audit savings we can provide under our new RAC contracts, we have been actively restructuring both our variable and fixed expenses consistent with our reduced operations and in order to maintain compliance with our debt covenants. In 2016, we have also obtained three amendments to the covenants in our credit agreement as a result of our reduced operations. Our current financial projections show that we expect to be able to maintain compliance with our amended covenants through the fourth quarter of 2017. However, the factors noted above have had and, until resolved, will continue to have a significant negative effect on our revenues and earnings and our ability to continue to comply with our covenants. Accordingly, we expect that it will be necessary to seek further modifications to the covenants from our lenders or refinance our indebtedness. To the extent we are not able to maintain compliance with our covenants, relations with both our existing and future customers could be adversely affected. Our inability to maintain long-term compliance with our debt covenants, or to refinance or restructure the terms of our indebtedness on commercially reasonable terms or at all, would have a material adverse effect on our business, financial condition and results of operations, as well as our ability to satisfy our debt obligations.

***Over the course of our first RAC contract, there has been an increase in the number of appeals by healthcare providers to the third, or ALJ, level of appeal relating to claims we have audited, and there can be no assurance that our estimated liability for such appeals will be adequate.***

Under our RAC contract 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. Healthcare providers have the right to appeal a claim and may pursue additional levels of appeal if the initial appeal is found in favor of CMS. We accrue an estimated liability for appeals at the time revenue is recognized based on our estimate of the amount of revenue probable of being refunded to CMS following successful appeal based on historical data and other trends relating to such appeals. In addition, if our estimate of liability for appeals with respect to revenues recognized during a prior period changes, we increase or decrease the estimated liability reserve in the current period. Over the course of our first RAC contract, healthcare providers have increased their pursuit of appeals beyond the first and second levels of appeal to the third level of appeal, where cases are heard by administrative law judges, or ALJs. In our experience, decisions at the third level of appeal are the least favorable as ALJs exercise greater discretion and there is less predictability in the ALJ decisions as compared to appeals at the first or second levels. The pursuit of third level appeals by healthcare providers has also resulted in a backlog of claims at that level of appeal. This increase of ALJ appeals and backlog of claims at the third level of appeal is the primary reason our total estimated liability for appeals (consisting of the estimated liability for appeals plus the contra-accounts-receivable estimated allowance for appeals) has grown from a balance of \$16.4 million at December 31, 2013 to \$18.6 million as of December 31, 2014 to \$19.0 million as of December 31, 2015, and increased to \$19.2 million as of September 30, 2016. Our estimates for our appeal reserve are subject to uncertainties, and accordingly we may underestimate the number of successful appeals or the financial impact of successful appeals in a given year or period. To the extent that the amount of commissions that we are required to return to CMS as a result of successful appeals exceeds our estimated appeals reserve, our revenues in the applicable period will be reduced by the amount of such excess. If we underestimate the amount of commissions that are subject to successful appeal, our revenues in future periods could be adversely affected. In addition, each of the subcontractors we engaged to assist in the recovery services under our RAC contract are similarly obligated to refund fees that they received from claims that are later overturned on appeal. To the extent any of our subcontractors fail to refund amounts that are due upon an appeals relating to claim that they were responsible for, we may be obligated to pay such amounts directly to CMS, which could have a material impact on our financial position.

Further, in August 2014 CMS offered to pay hospitals 68% of what they have billed Medicare to settle a backlog of pending appeals challenging Medicare's denials of reimbursement for certain types of short-term care. The implication of this settlement offer related to claims for which recovery auditors have already been paid under the first RAC contracts remains uncertain at this time. Any payments we are required to make to CMS under our first RAC contract in connection with such settlement offer may be significant and in excess of the amount we have reserved for appeals, which could have a material negative impact our financial position and liquidity.

***The transition rules implemented by CMS in connection with the award of the new RAC contracts and the delays associated with the award of the new RAC contract will have an adverse impact on our revenues.***

Our ability to make claims under the first RAC contract was limited by contract transition rules announced by CMS. During 2015 and 2016, our audit and recovery activities under our prior RAC contract were entirely suspended or subject to significant restrictions. Such restrictions involve limitations on the types of claims and the amount of medical records requests that we may make, and CMS has generally maintained a long-running prohibition on requesting medical records from PIP providers. These transition rules had a material adverse effect on our revenues during the nine months ended September 30, 2016. Our revenues from CMS during the nine months ended September 30, 2016 were \$5.2 million compared to \$9.7 million during the same period in 2015. While we were recently awarded two new RAC contracts, we are uncertain about the scope of permitted audit recovery and we expect there will be an approximate four to six month period from the date that we are permitted to start performing recovery services until we start to recognize revenue under our new RAC contracts. Further, the limitations on audit activities that were implemented by CMS during the contract transition period remain in effect under our new RAC contracts, which will continue to limit the revenues we may earn under the two new RAC contracts.

***Revenues generated from our three largest clients represented 55% of our revenues for the quarter ended September 30, 2016, and 55% of our revenues for the year ended December 31, 2015, and any termination of or deterioration in our relationship with any of these clients would result in a decline in our revenues.***

We derive a substantial majority of our revenues from a limited number of clients, including the Department of Education, and several GAs. Revenues from our three largest clients represented 55% of our revenues for the quarter ended September 30, 2016 and 55% of our revenues for the year ended December 31, 2015. The Department of Education was responsible for approximately 13% of our revenues for the nine months ended September 30, 2016. We have a relationship with numerous GAs in the U.S. including Great Lakes Higher Education Guaranty Corporation and Pennsylvania Higher Education Assistance Authority, which were responsible for 23% and 16%, respectively, of revenues for the nine months ended September 30, 2016. All of our contracts with these 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 92% of our revenues for the nine months ended September 30, 2016 and 88% of our revenues in the year ended December 31, 2015, 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, which include four of our five largest clients in 2015 and our five largest clients through the third quarter of 2016, 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. For example, in 2013 in connection with the Department of Education's decision to have its recovery vendors promote income-based repayment, or IBR, to defaulted student loans, the Department of Education unilaterally reduced the contingency fee rate that we receive for rehabilitating student loans by approximately 13%. Further, effective July 1, 2015, the Department of Education implemented a fixed fee of \$1,710 payable for each loan that is rehabilitated in place of a recovery fee that historically had been based on a percentage of the balance of the rehabilitated loan.

***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. Further, in connection with the transition procedures implemented by CMS during the long-delayed rebidding process, CMS has placed significant restrictions on the scope of audits permitted by RAC contractors. Accordingly, the long-term growth of the revenues we derive under our two newly awarded RAC contracts will also depend in part on the scope of potentially improper claims that we are allowed to pursue.

In addition, CMS has 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 represented a substantial portion of the revenues we have earned under our RAC contract. The continued suspension of this type of review activity could have a material adverse effect on our future healthcare revenues and operating results in the event we are successful in obtaining a second RAC contract, 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. In connection with the award of the new RAC contract, CMS has indicated that it is reviewing certain aspects of the RAC contract including the amount of medical records that RAC vendors may request and the timeframes for review and communications between RAC vendors and providers.

***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 quarter ended September 30, 2016, revenues under contracts with the U.S. federal government accounted for approximately 23% of our total revenues, compared to 35% for the year ended December 31, 2015. In addition, if we are awarded a new recovery contract by the Department of Education, fees payable by the U.S. federal government could become a larger percentage of our total revenues over the next several years as a result of legislation that has transferred responsibility for all new student loan origination to the Department of Education. 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, the Bipartisan Budget Act of 2013 reduced the compensation paid to GAs for the rehabilitation of student loans, effective July 1, 2014. This “revenue enhancement” measure reduced from 18.5% to 16.0% of the outstanding loan balance, the amount that GAs can charge borrowers when a rehabilitated loan is sold by the GA and eliminated entirely the GAs retention of 18.5% of the outstanding loan balance as a fee for rehabilitation services. The reduction in compensation the GAs receive resulted in a decrease of approximately 25.0% in the contingency fee percentage that we receive from the GAs for assisting in the rehabilitation of defaulted student loans. Further, on July 1, 2015, the Department of Education implemented a new fee structure for rehabilitated loans, providing a fixed fee of \$1,710 payable for each loan that is rehabilitated in place of a recovery fee that historically had been based as a percentage of the balance of the rehabilitated loan. Any additional decrease in the student loan contingency fees would result in a further decrease of our revenues. Further, any amounts that we may be obligated to pay CMS under our first RAC contract as a result of CMS’s offer to pay hospitals 68% of what they have billed Medicare to settle a backlog of pending appeals challenging Medicare’s denials of reimbursement for certain types of short-term care could have a material negative impact our financial position and liquidity. 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, 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 30 government-supported GAs. This legislation, and 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.

***Our business relationship with the Department of Education has accounted for a significant portion of our revenues and will take on increasing importance to our business as a result of SAFRA. Our failure to maintain this relationship would significantly decrease our revenues.***

While the majority of our historical revenues from the student loan market have come from our relationships with the GAs, as a result of SAFRA, the Department of Education will ultimately become the sole source of revenues in this market, although the GAs will continue to service their existing student loan portfolios for many years to come. As a result, over time, and assuming we are successful in entering into a new contract with the Department of Education under the current rebidding process, defaults on student loans originated by the Department of Education will predominate and our ability to maintain the revenues we had previously received from a number of GA clients will depend on our relationship with a single client, the Department of Education. While we have 25 years of experience in performing student loan recovery services for the Department of Education, we were one of 17 unrestricted recovery service providers on the prior Department of Education contract. We are currently subject to a competitive rebidding process for the next contract with the Department of Education. While five other recovery service providers have had their contracts extended by the Department of Education past the original April 2015 expiration date, we did not receive such an extension from the Department of Education. We do not anticipate receiving any new loan placements from the Department of Education until the new contracts are awarded. If our relationship with the Department of Education terminates or deteriorates or if the Department of Education, ultimately as the sole holder of defaulted student loans, requires its contractors to agree to less favorable terms, our revenues would significantly decrease, and our business, financial condition and results of operations would be harmed.

***We could lose clients as a result of consolidation among the GAs, which would decrease our revenues.***

As a result of SAFRA, which terminated the ability of the GAs to originate government-supported student loans, 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 were each responsible for more than 10% of our total revenues in the nine months ended September 30, 2016: Great Lakes Higher Education Guaranty Corporation and Pennsylvania Higher Education Assistance Authority were

responsible for 23% and 16%, respectively, of revenues for the nine months ended September 30, 2016. 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 including the impact of any protests filed in connection with the award of any such 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 contract;
- 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.

***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 and the possibility that we will receive a new contract from the Department of Education provide the potential opportunity to restore the growth in our business. 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 growth 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.

***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, as amended, or HIPAA, 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 audit and recovery services under our contract 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 requires 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, or 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, or 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, or 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.

***Failure to achieve and maintain effective internal controls in accordance with Section 404 of Sarbanes-Oxley would impair our ability to produce accurate and reliable financial statements, which would harm our stock price.***

We are subject to reporting obligations under Section 404 of the Sarbanes-Oxley Act that require us to include a management report on our internal control over financial reporting in our annual report, which contains management's assessment of the effectiveness of our internal control over financial reporting. These requirements first applied to our annual report on Form 10-K for the year ended December 31, 2013 and complying with these requirements can be difficult.

Our management may conclude that our internal control over our financial reporting is not effective. We have limited accounting personnel and other resources with which to address our internal controls and procedures. If we fail to timely achieve and maintain the adequacy of our internal control over financial reporting, we may not be able to produce reliable financial reports or help prevent fraud. Our failure to achieve and maintain effective internal control over financial reporting could prevent us from filing our periodic reports on a timely basis, which could result in the loss of investor confidence in the reliability of our financial statements, harm our business and negatively impact the trading price of our common stock.

We are required to disclose changes made in our internal controls and procedures on a quarterly basis. However, our independent registered public accounting firm is not required to formally attest to the effectiveness of our internal control over financial reporting pursuant to Section 404 until such time that we are no longer an "emerging growth company" as defined in the JOBS Act, if we continue to take advantage of the exemptions contained in the JOBS Act. At such time, our independent

registered public accounting firm may issue a report that is adverse in the event it is not satisfied with the level at which our controls are documented, designed or operating. Our remediation efforts may not enable us to avoid a material weakness in the future.

***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.

***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 delays associated with technology or system implementations, such as the delays experienced with the implementation of our first RAC contract with CMS due to an appeal by competitors who were unsuccessful in bidding on the contract. 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 results of operations could be adversely affected.

***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 non-disclosure, 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 \$1.51 on July 7, 2016 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; 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 26.9% and 19.1% of our common stock, respectively, as of September 30, 2016. 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**

### ***Sale of Unregistered Securities***

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 Chief 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 Chief 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.

PERFORMANT FINANCIAL CORPORATION

Date: November 8, 2016

By: /s/ Lisa Im  
\_\_\_\_\_  
Lisa Im  
*Chief Executive Officer (Principal Executive Officer) and Director*

By: /s/ Hakan Orvell  
\_\_\_\_\_  
Hakan Orvell  
*Chief Financial Officer (Principal Financial and Accounting Officer)*

**EXHIBIT INDEX**

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 Chief 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 Chief 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.



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

I, Hakan Orvell, 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: November 8, 2016

/s/ **Hakan Orvell**

---

**Hakan Orvell**  
**Chief Financial Officer**





