Performant Financial Corp
Form 10-Q
August 10, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2018
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	20-0484934
(State or other jurisdiction of incorporation or organization)	(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 x 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 x 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 x

Indicate by check mark whether the registrant is an emerging growth company as defined in Rule 405 of the Securities Act of 1933 (§ 230.405 of this chapter) or Rule 12b-2 of the Securities Exchange Act of 1934 (§ 240.12b-2 of this chapter).

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o Emerging growth company
o If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x
The number of shares of Common Stock outstanding as of August 8, 2018 was 51,943,714.

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QUARTERLY REPORT ON FORM 10-Q
FOR THE QUARTER ENDED JUNE 30, 2018
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PERFORMANT FINANCIAL CORPORATION AND SUBSIDIARIES
Consolidated Balance Sheets
(In thousands)

	June 30, 2018 (Unaudited)	December 31, 2017
Assets		
Current assets:		
Cash and cash equivalents	$ 7,977	$ 21,731
Restricted cash	1,788	1,788
Trade accounts receivable, net of allowance for doubtful accounts of $0 and $35, respectively	15,592	12,494
Prepaid expenses and other current assets	3,218	12,678
Income tax receivable	5,602	6,839
Total current assets	34,177	55,530
Property, equipment, and leasehold improvements, net	20,667	20,944
Identifiable intangible assets, net	4,458	4,864
Goodwill	81,572	81,572
Deferred income taxes	815	468
Other assets	1,013	1,058
Total assets	$ 142,702	$ 164,436
Liabilities and Stockholders' Equity		
Current liabilities:		
Current maturities of notes payable, net of unamortized debt issuance costs of $141 and $171, respectively	$ 2,059	$ 2,029
Accrued salaries and benefits	4,670	4,569
Accounts payable	1,634	1,518
Other current liabilities	4,051	3,347
Deferred revenue	1,440	—
Estimated liability for appeals	873	18,817
Net payable to client	—	12,800
Total current liabilities	14,727	43,080
Notes payable, net of current portion and unamortized debt issuance costs of $2,611 and $3,245, respectively	38,089	38,555
Deferred income taxes	396	—
Other liabilities	3,118	2,476
Total liabilities	56,330	84,111
Commitments and contingencies		
Stockholders' equity:		
Common stock, $0.0001 par value. Authorized, 500,000 shares at June 30, 2018 and December 31, 2017; issued and outstanding 51,920 and 51,085 shares at June 30, 2018 and December 31, 2017, respectively	5	5
Additional paid-in capital	73,642	72,459
Retained earnings	12,725	7,861
Total stockholders' equity	86,372	80,325

Total liabilities and stockholders' equity	$ 142,702	$ 164,436

See accompanying notes to consolidated financial statements.

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PERFORMANT FINANCIAL CORPORATION AND SUBSIDIARIES
Consolidated Statements of Operations
(In thousands, except per share amounts)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Revenues	$31,336	$35,907	$88,357	$69,016
Operating expenses:				
Salaries and benefits	22,305	20,450	44,086	41,146
Other operating expenses	12,399	16,082	35,419	29,523
Total operating expenses	34,704	36,532	79,505	70,669
(Loss) income from operations	(3,368)	(625)	8,852	(1,653)
Interest expense	(1,141)	(1,618)	(2,411)	(3,224)
Interest income	7	—	13	—
(Loss) income before (benefit from) provision for income taxes	(4,502)	(2,243)	6,454	(4,877)
(Benefit from) provision for income taxes	(911)	197	1,590	522
Net (loss) income	$(3,591)	$(2,440)	$4,864	$(5,399)
Net (loss) income per share				
Basic	$(0.07)	$(0.05)	$0.09	$(0.11)
Diluted	$(0.07)	$(0.05)	$0.09	$(0.11)
Weighted average shares				
Basic	51,643	50,579	51,483	50,443
Diluted	51,643	50,579	53,501	50,443

See accompanying notes to consolidated financial statements.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Net (loss) income	$(3,591)	$(2,440)	$4,864	$(5,399)
Other comprehensive income:				
Foreign currency translation adjustment	(1)	(2)	—	(5)
Comprehensive (loss) income	$(3,592)	$(2,442)	$4,864	$(5,404)

See accompanying notes to consolidated financial statements.

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

	Six Months Ended June 30,	
	2018	2017
Cash flows from operating activities:		
Net income (loss)	$4,864	$(5,399)
Adjustments to reconcile net income (loss) to net cash (used in) provided by operating activities:		
Loss on disposal of assets	43	10
Impairment of goodwill and intangible assets	—	1,081
Release of net payable to client related to contract termination	(9,860)	—
Release of estimated liability for appeals due to termination of contract	(17,932)	—
Derecognition of subcontractor receivable for appeals due to termination of contract	5,535	—
Derecognition of subcontractor receivable for overturned claims	1,536	—
Allowance for doubtful accounts for subcontractor receivable	1,868	—
Depreciation and amortization	5,113	5,668
Deferred income taxes	49	667
Stock-based compensation	1,589	2,290
Interest expense from debt issuance costs	664	696
Interest expense paid in kind	—	217
Changes in operating assets and liabilities:		
Trade accounts receivable	(3,098)	217
Prepaid expenses and other current assets	521	(1,806)
Income tax receivable	1,237	(610)
Other assets	45	(1)
Accrued salaries and benefits	101	194
Accounts payable	116	87
Deferred revenue and other current liabilities	2,144	(221)
Estimated liability for appeals	(12)	(126)
Net payable to client	(2,940)	30
Other liabilities	641	(71)
Net cash (used in) provided by operating activities	(7,776)	2,923
Cash flows from investing activities:		
Purchase of property, equipment, and leasehold improvements	(4,473)	(4,253)
Net cash used in investing activities	(4,473)	(4,253)
Cash flows from financing activities:		
Repayment of notes payable	(1,100)	(11,285)
Debt issuance costs paid	—	(296)
Taxes paid related to net share settlement of stock awards	(591)	(339)
Proceeds from exercise of stock options	186	31
Net cash used in financing activities	(1,505)	(11,889)
Effect of foreign currency exchange rate changes on cash	—	(5)
Net decrease in cash, cash equivalents and restricted cash	(13,754)	(13,224)
Cash, cash equivalents and restricted cash at beginning of period	23,519	40,484
Cash, cash equivalents and restricted cash at end of period	$9,765	$27,260

Supplemental disclosures of cash flow information:		
Cash paid for income taxes	$82	$439
Cash paid for interest	$1,748	$2,328

See accompanying notes to consolidated financial statements.

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PERFORMANT FINANCIAL CORPORATION AND SUBSIDIARIES
Notes To Consolidated Financial Statements
For the Three and Six Months Ended June 30, 2018 and 2017
(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 June 30, 2018, the results of our operations for the three and six months ended June 30, 2018 and 2017 and cash flows for the six months ended June 30, 2018 and 2017. 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, 2017, 2016, and 2015.

The Company is a leading provider of technology-enabled audit, recovery, and analytics services in the United States. The Company's services help identify improper payments, and in some markets, restructure and recover delinquent or defaulted assets and improper payments for both government and private clients across different markets. The Company's 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' various 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), Performant Technologies, Inc., and Performant Europe Ltd. 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

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

The Company determines revenue recognition through the following steps:

- Identification of the contract with a customer
- Identification of the performance obligations in the contract
- Determination of the transaction price
- Allocation of the transaction price to the performance obligations in the contract

- Recognition of revenue when, or as, the performance obligations are satisfied

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

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

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

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

The following table presents revenue disaggregated by category (in thousands) for the three and six months ended June 30, 2018 and 2017:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
	(in thousands)		(in thousands)	
Student Lending:				
Great Lakes Higher Education Guaranty Corporation	$7,611	$15,210	$17,650	$24,655
All Other Guaranty Agencies	9,917	12,249	18,983	27,353
Total of Student Lending	17,528	27,459	36,633	52,008
Healthcare:				
CMS RAC and MSP	3,496	66	32,600	148
Commercial	2,599	2,022	4,809	3,587
Total of Healthcare	6,095	2,088	37,409	3,735
Other:	7,713	6,360	14,315	13,273
Total Revenues	$31,336	$35,907	$88,357	$69,016

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

The Company has applied the as-invoiced practical expedient and the variable allocation exception to have an average remaining duration of less than a year.

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The Company determined that it does not have any costs related to obtaining or fulfilling a contract that are recoverable and as such, these contract costs are expensed as incurred.
The Company has contract assets of $1.4 million and $1.6 million as of June 30, 2018 and December 31, 2017, respectively. The contract assets relate to the Company's rights to consideration for services completed during the six months ended June 30, 2018 but not invoiced at the reporting date. Contract assets are recorded to accounts receivable when the rights become unconditional and amounts are invoiced. Contract assets are included in Trade accounts receivable in the consolidated balance sheets.

The Company has contract liabilities of $1.4 million as of June 30, 2018 and none as of December 31, 2017. The Company's contract liability relates to an advance recovery commission payment received from a customer during the first quarter of 2018, for which the Company anticipates revenue to be recognized as services are delivered. Contract liabilities are included in Deferred revenue in the consolidated balance sheets.

Revenue is recognized upon the collection of defaulted loan and debt payments. Loan rehabilitation revenue is recognized when the rehabilitated loans are sold (funded) by clients. Incentive revenue is recognized upon receipt of official notification of incentive award from customers. Under the Company's Medicare Secondary Payer, or MSP, contract with Centers for Medicare and Medicaid Services, or CMS, the Company recognizes revenues when insurance companies or other responsible parties remit payment to reimburse CMS for claims for which they are responsible, and the remittance has been applied in the CMS database. Under the Company's Medicare Recovery Audit Contractor, or RAC, contract with CMS, the Company recognizes revenues when the healthcare provider has paid CMS for a given claim or has agreed to an offset against other claims by the provider. 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 June 30, 2018, a total of $0.6 million was presented as an allowance against revenue, representing the Company's estimate of claims audited under the CMS contract that may be overturned. In addition to the $0.6 million related to the RAC contract with CMS, the Company has accrued $0.3 million of additional estimated liability for appeals related to other healthcare contracts. The total accrued liability for appeals of $0.9 million has been presented in the caption estimated liability for appeals at June 30, 2018. At December 31, 2017, the total appeals-related liability was $18.8 million. The $0.9 million balance at June 30, 2018 and $18.8 million at December 31, 2017, represent the Company's best estimate of the probable amount of losses related to appeals of claims for which commissions were previously collected. 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. The company determines the allowance for doubtful accounts by specific identification. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is consider remote. The allowance for doubtful account was $0 thousand and $35 thousand at June 30, 2018 and December 31, 2017, respectively.
(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. As a result of the 2009 CMS Region A contract termination on January 31, 2018, the "Net payable to client" balance was $0.0 million as of June 30, 2018. The "Net payable to client" balance of $12.8 million at December 31, 2017 represents the excess of payables for overturned audits.
(d) Prepaid Expenses and Other Current Assets
At June 30, 2018, prepaid expenses and other current assets includes $0.0 million of amounts due from subcontractors which consists of gross receivable of $1.7 million offset by $1.7 million allowance for doubtful accounts. 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 June 30, 2018, the receivable associated with estimated future overturns of subcontractor audits was $0.0 million as a result of the 2009 CMS Region A contract termination on January 31, 2018 and net receivable from subcontractor fees for already overturned audits was $0.0 million. By comparison, at December 31, 2017, prepaid expenses and other current assets included $5.6 million of estimated future overturns of subcontractor audits, as well as a net receivable of $3.7 million for subcontractor fees for already overturned audits refundable to the Company once the Company refunds its fees to the client as prime contractor.

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(e) Impairment of Goodwill and Long-Lived Assets

Goodwill and long-lived assets are evaluated for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets or intangibles may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of the assets to future undiscounted net cash flows expected to be generated by the assets. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. The balance of goodwill was $81.6 million as of June 30, 2018 and December 31, 2017. For the six months ended June 30, 2017, an impairment expense of $1.1 million was recognized to account for the write-off of goodwill and intangible assets in one of our subsidiaries, Performant Europe Ltd., due to the Company's decision to wind down activity in this business. The expense has been included in other operating expenses in the consolidated statements of operations. There was no impairment expense for goodwill and long-lived assets for the six months ended June 30, 2018.

(f) Restricted Cash

At June 30, 2018 and at December 31, 2017, restricted cash included in current assets on our consolidated balance sheet was $1.8 million and $1.8 million, respectively.

(g) New Accounting Pronouncements

Recently Adopted Accounting Standards

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. The Company adopted this guidance and it did not have any impact on our consolidated financial statements.

In May 2014, the FASB issued an ASU that amends the FASB ASC by creating a new Topic 606, "Revenue from Contracts with Customers". The new guidance supersedes 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 a five-step model for recognizing and measuring revenue from contracts with customers. 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.

The Company adopted Topic 606 as of January 1, 2018, utilizing the full retrospective method of transition. The Company applied Topic 606 retrospectively for all reporting periods presented before January 1, 2018, the date of the initial application. There was no impact of adopting Topic 606 on the Company’s 2017 and 2016 consolidated financial statements.

Recently Issued Accounting Standards

In February 2016, the FASB issued ASU 2016-02, “Leases”, which requires the recognition of lease assets and lease liabilities on the balance sheet by lessees for those leases currently classified as operating leases under Accounting Standards Codification Topic 840 Leases. The guidance is effective for our fiscal year beginning January 1, 2019 and should be applied using a modified retrospective approach. Early adoption is permitted. The Company plans to adopt this new standard in the first quarter of our fiscal 2019. The Company continues to evaluate the effect of adopting this guidance on the consolidated financial statements and related disclosures. Upon adoption, the Company will recognize right-of-use assets and operating lease liabilities on the consolidated balance sheets, which will increase the total assets and total liabilities. However, in July 2018 the FASB issued ASU No. 2018-11, Targeted Improvements, which provides us with the option to apply the new leasing standard to all open leases as of the adoption date. The Company has not adopted this guidance early and continues to evaluate the accounting, transition, and disclosure requirements of this standard.

In January 2017, the FASB issued ASU 2017-04, "Simplifying the Test for Goodwill Impairment" to simplify the goodwill impairment testing process. The new standard eliminates Step 2 of the goodwill impairment test. If a

company determines in Step 1 of the goodwill impairment test that the carrying value of goodwill is less than the fair value, an impairment in that

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amount should be recorded to the income statement, rather than proceeding to Step 2. This new guidance is effective for annual reporting periods, and interim periods with goodwill impairment tests within those years, beginning after December 15, 2019, and early adoption is permitted for testing periods after January 1, 2017. 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 June 30, 2018 and December 31, 2017 (in thousands):

	June 30, 2018	December 31, 2017
Land	$1,122	$ 1,122
Building and leasehold improvements	6,618	6,410
Furniture and equipment	5,791	5,763
Computer hardware and software	75,899	72,044
	89,430	85,339
Less accumulated depreciation and amortization	(68,763)	(64,395)
Property, equipment and leasehold improvements, net	$20,667	$ 20,944

Depreciation expense of property, equipment and leasehold improvements was $2.3 million and $2.7 million for the three months ended June 30, 2018 and 2017, respectively, $4.7 million and $5.2 million for the six months ended June 30, 2018 and 2017, respectively.

3. Credit Agreement

On August 7, 2017, we, through our wholly-owned subsidiary Performant Business Services, Inc. (the "Borrower"), entered into a credit agreement with ECMC Group, Inc. (the “Credit Agreement”). The Credit Agreement provides for a term loan facility in the initial amount of $44 million (the “Initial Term Loan”) and for up to $15 million of additional term loans (“Additional Term Loans”; and together with the Initial Term Loan, the “Loans”) which Additional Term Loans may be drawn until the second anniversary of the funding of the Initial Term Loans, subject to the satisfaction of customary conditions. On August 11, 2017, the Initial Term Loan was advanced (the "Closing Date") and the proceeds were applied to repay all outstanding amounts under our prior credit agreement with Madison Capital Funding LLC as administrative agent (the "Prior Credit Agreement"). On September 29, 2017, we entered into Amendment No. 1 to the Credit Agreement to extend the initial interest payment due date to December 31, 2017.

The Loans will mature on the third anniversary of the Closing Date, however we will have the option to extend the maturity of the Loans for two additional one year periods, subject to the satisfaction of customary conditions. The Loans will bear interest at the one-month LIBOR rate (subject to a 1% per annum floor) plus a margin which may vary from 5.5% per annum to 10.0% per annum based on our total debt to EBITDA ratio. The Initial Term Loans will initially bear interest at LIBOR plus 7.0% per annum. Our annual interest rate at June 30, 2018 was 7.6%. We will be required to pay 5% of the original principal balance of the Loans annually in quarterly installments beginning March 31, 2018, and to offer to make mandatory prepayments of the Loans with a percentage of our excess cash flow which may vary between 75% and 0% depending on our total debt to EBITDA ratio. In addition to mandatory prepayments for excess cash flow, we will also be required to offer to prepay the Loans with the net cash proceeds of certain asset dispositions and with the issuance of debt not otherwise permitted under the Credit Agreement. Except in connection with a change of control and the payment of a 1% premium, we will not be permitted to voluntarily prepay the Loans until after the first anniversary of the Closing Date. We will be permitted to prepay the Loans during the second year after the Closing Date if accompanied by a prepayment premium of 1%. Thereafter, we will be permitted to prepay the Loans without any prepayment premium.

The Credit Agreement contains certain restrictive financial covenants which became effective on the Closing Date. Such covenants require, among other things, that we meet a minimum fixed charge coverage ratio of 0.5 to 1.0 through December 31, 2019, 1.0 to 1.0 through June 30, 2020 (or until December 31, 2020 if the maturity date of the Loans is extended until the fourth anniversary of the Closing Date), 1.25 to 1.0 through June 30, 2021 if the maturity date of the Loans is extended until the fourth anniversary of the Closing Date and 1.25 to 1.0 through June 30, 2022 if the maturity date of the Loans is extended until the fifth anniversary of the Closing Date. In addition, we will be

required to maintain, a maximum total debt to EBITDA ratio

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of 6.00 to 1.00. The Credit Agreement also contains covenants that will restrict the Company and its subsidiaries' ability to incur certain types or amounts of indebtedness, incur liens on certain assets, make material changes in corporate structure or the nature of its business, dispose of material assets, engage in a change in control transaction, make certain foreign investments, enter into certain restrictive agreements, or engage in certain transactions with affiliates.

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

As a result of our entry into our Credit Agreement, and the repayment of all amounts owed under the Prior Credit Agreement, we wrote off debt issuance costs related to the Prior Credit Agreement of approximately $1.0 million in August 2017.

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

Year Ending December 31,	Amount
Remainder of 2018	$1,100
2019	2,200
2020	39,600
2021	—
2022	—
Thereafter	—
Total	$42,900

The Company made principal payments of $0.6 million and $1.1 million for the quarter and six months ending June 30, 2018, respectively.

In consideration for, and concurrently with, the extension of the Initial Term Loan in accordance with the terms of the Credit Agreement, we issued a warrant to the lender to purchase up to an aggregate of 3,863,326 shares of the Company's common stock (representing approximately up to 7.5% of our diluted common stock as calculated using the "treasury stock" method as defined under GAAP for the most recent fiscal quarter) with an exercise price of $1.92 per share. Upon our election to borrow any of the Additional Term Loans, we will be required to issue additional warrants at the same exercise price to purchase up to an aggregate of 77,267 additional shares of common stock (which represents approximately 0.15% of our diluted common stock calculated using the "treasury stock" method as defined under GAAP for the most recent fiscal quarter) for each $1,000,000 of such Additional Term Loans.

The Company has accounted for this warrant as an equity instrument since the Warrant is indexed to the Company's common shares and meets the criteria for classification in shareholders' equity. The relative fair value of the Warrant on the date of issuance was approximately $3.3 million and is treated as a discount to the debt. This amount is being amortized to interest expense under the effective interest method over the life of the Term Loan, which is a period of 36 months. The Company estimated the value of the Warrant using the Black-Scholes model. The key assumptions used to value the Warrant are as follows:

Exercise price	$1.92
Share price on date of issuance	$1.85
Volatility	50.0 %
Risk-free interest rate	1.83 %
Expected dividend yield	— %
Contractual term (in years)	5

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

Outstanding debt obligations are as follows (in thousands):

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	June 30, 2018
Principal amount	$42,900
Less: unamortized discount and debt issuance costs	(2,752)
Loan payable less unamortized discount and debt issuance costs	40,148
Less: current maturities	(2,059)
Long-term loan payable, net of current maturities	$38,089

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 2018 and 2025. 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 June 30, 2018 are as follows (in thousands):

Year Ending December 31,	Amount
Remainder of 2018	$1,411
2019	3,072
2020	3,035
2021	2,141
2022	1,710
Thereafter	2,190
Total	$13,559

Operating lease expense was $0.9 million and $0.7 million for the three months ended June 30, 2018 and 2017, respectively, and was $1.8 million and $1.4 million for the six months ended June 30, 2018 and 2017, 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 $1.0 million and $1.2 million for the three months ended June 30, 2018 and 2017, respectively, and was $1.6 million and $2.3 million for the six months ended June 30, 2018 and 2017, respectively.

The following table shows stock option activity for the six months ended June 30, 2018:

	Outstanding Options	Weighted average exercise price per share	Weighted average remaining contractual life (Years)	Aggregate Intrinsic Value (in thousands)
Outstanding at December 31, 2017	2,936,198	$ 8.21	4.48	$ 360
Granted	—	—		
Forfeited	(142,644)	10.35		
Exercised	(268,750)	0.69		
Outstanding at June 30, 2018	2,524,804	$ 8.89	4.39	$ 252
Vested, exercisable, expected to vest [1] at June 30, 2018	2,521,127	$ 8.90	4.39	$ 252
Exercisable at June 30, 2018	2,451,252	$ 9.06	4.32	$ 240

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

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

(b) Restricted Stock Units and Performance Stock Units

The following table summarizes restricted stock unit and performance stock unit activity for the six months ended June 30, 2018:

	Number of Awards	Weighted average grant date fair value per share
Outstanding at December 31, 2017	2,591,587	$ 2.39
Granted	1,773,536	2.80
Forfeited	(122,950)	2.37
Vested and converted to shares, net of units withheld for taxes	(566,383)	2.37
Units withheld for taxes	(213,684)	2.37
Outstanding at June 30, 2018	3,462,106	$ 2.61
Expected to vest at June 30, 2018	3,289,001	$ 2.61

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

6. Income Taxes

Our effective income tax rate changed to 24.6% for the six months ended June 30, 2018 from (10.7)% for the six months ended June 30, 2017. The increase in the effective tax rate is primarily due to the increase in forecasted net deferred tax liability after valuation allowance for which an income tax expense was recorded and the resulting impact that the separate state taxes have on the forecasted rate applied to year to date income for the six months ended June 30, 2018 compared to the loss from operations for the six months ended June 30, 2017 for which no benefit was recognized.

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 2014, the Company is no longer subject to Federal and certain other state tax examinations. We are currently being examined by the Franchise Tax Board of California for tax years 2011 through 2014 and reviewed by the Minnesota Department of Revenue for the tax years 2014 through 2016.

7. Earnings per Share

For the three and six months ended June 30, 2018 and 2017, 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 June 30, 2018, and the three and six months ended June 30, 2017, dilutive common share equivalents have been excluded, and diluted weighted average shares outstanding are the same as basic average shares outstanding. When there is net income in the period, the Company excludes stock options, restricted stock units, performance stock units and warrants from the calculation of diluted earnings per share when 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 six months ended June 30, 2018, the Company excluded 3,011,546 options from the calculation of diluted earnings per share because their effect would be anti-dilutive.

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The following table reconciles the basic to diluted weighted average shares outstanding using the treasury stock method (shares in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Weighted average shares outstanding – basic	51,643	50,579	51,483	50,443
Dilutive effect of stock options	—	—	2,018	—
Weighted average shares outstanding – diluted	51,643	50,579	53,501	50,443

8. Subsequent Events

On August 9, 2018, the Company and ECMC Holdings Corporation ("ECMC Holdings") entered into an Agreement for Purchase of LLC Membership Interests (the "Purchase Agreement"), pursuant to which the Company has agreed to acquire from ECMC Holdings all of the outstanding membership interests in Premiere Credit of North America, LLC ("Premiere"), a provider of asset recovery services to clients in the student loan, government, healthcare and commercial markets. As consideration for the purchase, at closing the Company will issue to ECMC Holdings 1,000,000 shares of its common stock and will be obligated to issue to ECMC Holdings additional shares of common stock over the five year period following the closing (not to exceed 2,591,824 shares in the aggregate) based on revenues associated with the Premiere business in each year. The Company estimates that it would issue approximately an additional 1,000,000 shares over the five year period if eligible revenues in each year are at the target level. The closing of the Premiere acquisition is subject to the satisfaction or waiver of customary closing conditions.

At the closing of the Premiere acquisition, the Company's subsidiary, Performant Recovery, Inc., will also enter into an amended collection services agreement with Educational Credit Management Corporation, an affiliate of ECMC Holdings, to be its primary student loan recovery vendor. Educational Credit Management Corporation, a Guaranty Agency and existing client of the Company, holds one of the largest student loan portfolios. The Company's subsidiary, Performant Business Services, Inc. (the "Borrower") will also amend its existing Credit Agreement, dated August 7, 2017, with ECMC Group, Inc., another affiliate of ECMC Holdings, to, among other things (i) extend the maturity date of the initial term loan and any additional term loans by one year to August 2021, (ii) expand the delayed draw term loan commitment from $15 million to $25 million, (iii) extend the period during which delayed draw term loans can be borrowed by one year to August 2020, and (iv) relieve the Borrower from its obligation to comply with the financial covenants in the Credit Agreement during the six fiscal quarters following the Premiere acquisition.

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

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

Overview

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

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

Sources of Revenues

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

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	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
	(in thousands)		(in thousands)	
Student Lending:				
Great Lakes Higher Education Guaranty Corporation	$7,611	$15,210	$17,650	$24,655
All Other Guaranty Agencies	9,917	12,249	18,983	27,353
Total of Student Lending	17,528	27,459	36,633	52,008
Healthcare:				
CMS RAC and MSP	3,496	66	32,600	148
Commercial	2,599	2,022	4,809	3,587
Total of Healthcare	6,095	2,088	37,409	3,735
Other:	7,713	6,360	14,315	13,273
Total Revenues	$31,336	$35,907	$88,357	$69,016

Student Lending

Our revenues from the student lending market are contract-based and consist primarily of contingency fees based on a specified percentage of the amount we enable our clients to recover. Our contingency fee percentage for a particular recovery depends on the type of recovery facilitated. Our clients in the student loan recovery market mainly consist of several of the largest guaranty agencies, or GAs.

We also have a long history of providing student loan recovery services to the Department of Education. Our previous contract with the Department of Education expired in April 2015, although we continued to work on loans placed with us prior the expiration of the contract. After an extended contract award process that included a successful protest of the initial award decision, the Department of Education announced on January 11, 2018 that we and another company had been awarded contracts to provide debt-collection services on defaulted Federal student loans. Those contract awards were the subject of another round of protests by unsuccessful bidders at the U.S. Court of Federal Claims. On May 3, 2018, the Department of Justice, on the Department of Education's behalf, notified the U.S. Court of Federal Claims that the Department of Education has decided to cancel this procurement and, as a result, will terminate for convenience the contracts awarded to us and the second awardee, the performance of which has been stayed since award due to the protests. The notice states that the Department of Education has decided to cancel the current procurement as part of its plan to make substantial changes in the collection and administrative resolution of defaulted Federal student loans, which the Department of Education concluded would eliminate the need for this procurement. Accordingly, at this time, we are not doing any student loan recovery work for the Department of Education other than as a subcontractor for a small business contractor, which generated revenues to us of $1.4 million in the second quarter of 2018 and $2.6 million in the first half of 2018.

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. The following table shows our Placement Volume for the three and six months ended June 30, 2018, showing separately the Placement Volume associated with student loans held by Great Lakes Higher Education Guaranty Corporation ("Great Lakes"), for

which we served as the primary recovery contractor until September 2017 and since that time as a subcontractor to the primary servicer of the Great Lakes portfolio.

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	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
	(in thousands)		(in thousands)	
Student Lending Placement Volume:				
Great Lakes Higher Education Guaranty Corporation	$468	$255,832	$1,274	$550,013
All Other Guaranty Agencies	475,881	635,555	1,388,732	1,024,647
Total Student Lending Placement Volume	$476,349	$891,387	$1,390,006	$1,574,660

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

Student Loan Recovery Outcomes

Full Repayment	Recurring Payments	Rehabilitation	Loan Restructuring	Wage Garnishment
• Repayment in full of the loan	• Regular structured payments, typically according to a renegotiated payment plan	• After a defaulted borrower has made nine consecutive recurring payments, the loan is eligible for rehabilitation	• Restructure and consolidate a number of outstanding loans into a single loan, typically with one monthly payment and an extended maturity	• If we are unable to obtain voluntary repayment, payments may be obtained through wage garnishment after certain administrative requirements are met
• We are paid a percentage of the full payment that is made	• We are paid a percentage of each payment	• We are paid based on a percentage of the overall value of the rehabilitated loan	• We are paid based on a percentage of overall value of the restructured loan	• We are paid a percentage of each payment

Our revenues from student lending were approximately 28% lower in the first half of 2018 compared to the same period in 2017 primarily as a result of the change in our relationship with Great Lakes, for which we acted as the primary recovery contractor until September 2017 and as a subcontractor on a portion of the overall portfolio since that time.

Healthcare

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

On October 5, 2017, we announced that we were awarded the Medicare Secondary Payer (MSP) CRC contract by the CMS. Under this agreement, we are responsible for identifying and recovering payments in situations where Medicare should not be the primary payer of healthcare claims because a beneficiary has other forms of insurance coverage,

such as through an employer group health plan or certain other payers.

On October 26, 2016, CMS awarded new RAC contracts and we received RAC contracts for audit Regions 1 and 5. The RAC contract award for Region 1 allows us to continue our audit of payments under Medicare's Part A and Part B for all

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provider types other than DMEPOS and home health and hospice within an 11 state region in the Northeast and Midwest. The Region 5 RAC contract provides for the post-payment review of DMEPOS and home health and hospice claims nationally. While audit and recovery activity under the new contracts commenced in April 2017, the scope of audit permitted by CMS under the new RAC contracts has been limited to 0.5% of claims. We do not expect to recognize significant revenues from the newly awarded RAC contracts until the percentage of claims we are able to audit increases from the current 0.5% of the claims.

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 $18.5 million balance as of December 31, 2017, represented our best estimate of the probable amount that we may be required to refund related to appeals of claims for which commissions were previously collected. The term of our first Medicare Recovery Audit Contract with CMS, for Region A, expired on January 31, 2018. During the term of this contract, we accrued an estimated liability for fees we may be required to return in connection with successful appeals by providers. Our estimates for this appeals liability are based on our historical experience with the Medicare RAC appeal process. As the term of the original contract expired, CMS issued a letter to us on January 2, 2018, stating that Performant will no longer be obligated to support the appeals process or maintain an appeal reserve after the January 31, 2018 contract termination date. In addition to the estimated liability for appeals, we also maintained a separate Net payable to client liability for appeals decisions which had been decided, but not yet refunded to CMS. On January 31, 2018, CMS issued to us their final Letter of Demand which reconciled all outstanding payables to CMS for the old Region A contract. Accordingly, during the first quarter 2018, we released an aggregate of approximately $27.8 million of the estimated liability for appeals and the Net payable to client balances. This increased first quarter 2018 revenue by $27.8 million. In conjunction with the release, we also derecognized approximately $9.0 million of prepaid expenses and other current assets, with a charge to other operating expenses, reflecting accrued receivables associated with amounts due to us from our subcontractors for decided and yet-to-be decided appeals. The estimated liability for appeals as of June 30, 2018 of $0.6 million represents our best estimate of the remaining liability for refunds and appeals overturned prior to the expiration of the contract term. In addition to the $0.6 million related to the RAC contract with CMS, we have accrued $0.3 million of additional estimated liability for appeals related to other healthcare contracts. The total accrued liability for appeals is therefore $0.9 million at June 30, 2018.

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 $4.8 million for the six months ended June 30, 2018, compared to revenues of $3.6 million that we earned from our commercial healthcare clients in the six months ended June 30, 2017.

Other

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

Costs and Expenses

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

Factors Affecting Our Operating Results

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

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Allocation of Placement Volume

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

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

Contingency Fees

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

Regulatory Matters

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

Client 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. Revenues from our three largest clients in the student loan market represented 63% of our revenues for the year ended December 31, 2017 and 55% of our revenues for the year ended December 31, 2016. The Department of Education was responsible for approximately 4% and 16% of our revenues for the years ended December 31, 2017 and December 31, 2016, respectively. Although the Department of Education announced in January 2018 that we were selected as one of two contractors under its award for new student loan recovery contracts, we were notified on May 3, 2018 that the Department of Education has decided to cancel the current procurement in its entirety, and as a result terminated our contract award. Our contracts with our other large clients entitle them to unilaterally terminate their contractual relationship with us at any time without penalty. On June 15, 2017, we received a 30-day termination notice, with respect to our contract with Great Lakes. The termination of this contract was based on Great Lakes’ decision to bundle its student loan servicing work, a service that we currently do not provide, along with its student loan recovery work to a single third-party vendor. While we subsequently obtained a

subcontract for recovery services from Navient, the new provider of servicing and defaulted portfolio management to Great Lakes, this contract has no set term or volume, and Navient has the right to terminate the contract at will. If we lose one of our other 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.

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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

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

We determine revenue recognition through the following steps:

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

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

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

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

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

awarded based on our performance under the

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specific contract. These performance-based awards are considered variable and may be constrained by us until there is not a risk of a material reversal.

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

Revenue is recognized upon the collection of defaulted loan and debt payments. Loan rehabilitation revenue is recognized when the rehabilitated loans are sold (funded) by clients. Incentive revenue is recognized upon receipt of official notification of incentive award from customers. Under our MSP, contract with CMS, we recognize revenues when insurance companies or other responsible parties remit payment to reimburse CMS for claims for which they are responsible, and the remittance has been applied in the CMS database. Under our RAC contracts with CMS, we recognize revenues when the healthcare provider has paid CMS for a claim or has agreed to an offset against other claims by the provider. 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 existing 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. 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 historically remained at a consistent level despite decreasing revenue from CMS. On January 31, 2018, CMS issued to us their final Letter of Demand which reconciled all outstanding payables to CMS for the old Region A contract. Accordingly, during the first quarter 2018, we released approximately $27.8 million of the estimated liability for appeals. The balance of the estimated liability for appeals was $0.6 million as of June 30, 2018. In addition to the $0.6 million related to the RAC contract with CMS, the Company has accrued $0.3 million of additional estimated liability for appeals related to other healthcare contracts. The total accrued liability for appeals is therefore $0.9 million at June 30, 2018.

The $0.9 million balance as of June 30, 2018, represents our best estimate of the probable amount of losses related to appeals of claims for which commissions were previously collected. 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.

In May 2014, the Financial Accounting Standards Board (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 a five-step model for recognizing and measuring revenue from contracts with customers. 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. The new revenue recognition guidance, including subsequent amendments, is effective for annual reporting periods beginning on or after December 15, 2017, including interim periods within that reporting period.

We adopted Topic 606 as of January 1, 2018, utilizing the full retrospective method of transition. We applied Topic 606 retrospectively for all reporting periods presented before January 1, 2018, the date of the initial application. There

was no impact of adopting Topic 606 on our 2017 and 2016 consolidated financial statements.

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

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

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

Recent Accounting Pronouncements

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

Results of Operations

Three Months Ended June 30, 2018 compared to the Three Months Ended June 30, 2017

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

	Three Months Ended June 30,			
	2018	2017	$ Change	% Change
	(in thousands)			
Consolidated Statement of Operations Data:				
Revenues	$31,336	$35,907	$(4,571)	(13)%
Operating expenses:				
Salaries and benefits	22,305	20,450	1,855	9 %
Other operating expenses	12,399	16,082	(3,683)	(23)%
Total operating expenses	34,704	36,532	(1,828)	(5)%
Loss from operations	(3,368)	(625)	2,743	439 %
Interest expense	(1,141)	(1,618)	(477)	(29)%
Interest income	7	—	7	100 %
Loss before (benefit from) provision for income taxes	(4,502)	(2,243)	2,259	101 %
(Benefit from) provision for income taxes	(911)	197	(1,108)	(562)%
Net loss	$(3,591)	$(2,440)	$1,151	47 %

Revenues

Revenues were $31.3 million for the three months ended June 30, 2018, a decrease of approximately 13%, compared to revenues of $35.9 million for the three months ended June 30, 2017.

Student lending revenues were $17.5 million for the three months ended June 30, 2018, representing a decrease of $10.0 million, or 36%, compared to the three months ended June 30, 2017. The decrease was due primarily to a $7.6 million decrease in revenues associated with the Great Lakes portfolio. We served as the primary recovery contractor for Great Lakes until September 2017 and since that time we have received a significantly reduced level of Placement Volume as a subcontractor to the primary servicer of the Great Lakes portfolio.

Healthcare revenues were $6.1 million for the three months ended June 30, 2018, representing an increase of $4.0 million, or 190%, compared to the three months ended June 30, 2017. This increase was due primarily to a new contract ramping up.

Salaries and Benefits

Salaries and benefits expense was $22.3 million for the three months ended June 30, 2018, an increase of $1.9 million, or 9%, compared to salaries and benefits expense of $20.5 million for the three months ended June 30, 2017. The increase in salaries and benefits expense was primarily due to increased headcount required in connection with the ramp up of several new contracts.

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Other Operating Expenses

Other operating expenses were $12.4 million for the three months ended June 30, 2018, a decrease of $3.7 million, or 23%, compared to other operating expenses of $16.1 million for the three months ended June 30, 2017. The decrease in other operating expenses was primarily due to goodwill and intangible impairment charges related to the closure of our European subsidiary, Performant Europe Ltd., in the second quarter of 2017 and lower third-party collection fees in the second quarter of 2018.

Loss from Operations

Loss from operations was $3.4 million for the three months ended June 30, 2018, compared to loss from operations of $0.6 million for the three months ended June 30, 2017. The increase was primarily the result of lower revenues and increased salaries and benefits partially offset by lower other operating expenses.

Interest Expense

Interest expense was $1.1 million for the three months ended June 30, 2018, compared to $1.6 million for the three months ended June 30, 2017. Interest expense decreased by approximately $0.5 million or 29% due to higher interest rates in the second quarter of 2017.

Income Taxes

We recognized an income tax benefit of $0.9 million for the three months ended June 30, 2018, compared to an income tax expense of $0.2 million for the three months ended June 30, 2017. Our effective income tax rate increased to 20% for the three months ended June 30, 2018, from (9)% for the three months ended June 30, 2017. The increase in the effective tax rate is primarily due to the benefit recognized on the loss for the three months ended June 30, 2018 compared to the loss from operations for the three months ended June 30, 2017 for which no benefit was recognized.

Net Loss

As a result of the factors described above, net loss was $3.6 million for the three months ended June 30, 2018, which represented an increase of $1.2 million, or 47% compared to net loss of $2.4 million for the three months ended June 30, 2017.

Six Months Ended June 30, 2018 compared to the Six Months Ended June 30, 2017

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

	Six Months Ended June 30,			
	2018	2017	$ Change	% Change
	(in thousands)			
Consolidated Statement of Operations Data:				
Revenues	$88,357	$69,016	$19,341	28 %
Operating expenses:				
Salaries and benefits	44,086	41,146	2,940	7 %
Other operating expenses	35,419	29,523	5,896	20 %
Total operating expenses	79,505	70,669	8,836	13 %
Income (loss) from operations	8,852	(1,653)	10,505	636 %
Interest expense	(2,411)	(3,224)	(813)	(25)%
Interest income	13	—	13	100 %
Income (loss) before provision for income taxes	6,454	(4,877)	11,331	232 %
Provision for income taxes	1,590	522	1,068	205 %
Net income (loss)	$4,864	$(5,399)	$10,263	190 %

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Revenues

Revenues were $88.4 million for the six months ended June 30, 2018, an increase of approximately 28%, compared to revenues of $69.0 million for the six months ended June 30, 2017.

Healthcare revenues were $37.4 million for the six months ended June 30, 2018, representing an increase of $33.7 million, or 911%, compared to the six months ended June 30, 2017. This increase was due primarily to revenues of $27.8 million related to the release of the appeals reserve in connection with the termination of our 2009 CMS Region A contract in the first quarter of 2018. Excluding revenues associated with the termination of this contract, healthcare revenues were $9.6 million for the six months ended June 30, 2018, representing an increase of $5.9 million, or 159%, compared to the six months ended June 30, 2017.

Student lending revenues were $36.6 million for the six months ended June 30, 2018, representing a decrease of $15.4 million, or 30%, compared to the six months ended June 30, 2017. The decrease was due primarily to a $7.0 million decrease in revenues associated with the Great Lakes portfolio.

Salaries and Benefits

Salaries and benefits expense was $44.1 million for the six months ended June 30, 2018, an increase of $2.9 million, or 7%, compared to salaries and benefits expense of $41.1 million for the six months ended June 30, 2017. The increase in salaries and benefits expense was primarily due to increased headcount required in connection with the ramp up of several new contracts.

Other Operating Expenses

Other operating expenses were $35.4 million for the six months ended June 30, 2018, an increase of $5.9 million, or 20%, compared to other operating expenses of $29.5 million for the six months ended June 30, 2017. The increase in other operating expenses was primarily due to a $7.1 million derecognition of subcontractor receivable associated with the termination of the 2009 CMS Region A contract in the first quarter of 2018.

Income (loss) from Operations

Income from operations was $8.9 million for the six months ended June 30, 2018, compared to a loss from operations of $1.7 million for the six months ended June 30, 2017. The increase was primarily the result of higher revenues driven primarily by release of an aggregate of $27.8 million of the estimated liability for appeals and the net payable to client balances into revenue, net of derecognition of $9.0 million of prepaid expenses and other current assets, with a $1.9 million charge to other operating expenses, reflecting accrued receivables associated with amounts due from subcontractors for decided and yet-to-be decided appeals and increased salaries and benefits.

Interest Expense

Interest expense was $2.4 million for the six months ended June 30, 2018, compared to $3.2 million for the six months ended June 30, 2017. Interest expense decreased by approximately $0.8 million or 25% due to lower interest rates and lower outstanding balance in 2018 and interest expense paid in kind in 2017.

Income Taxes

We recognized an income tax expense of $1.6 million for the six months ended June 30, 2018, compared to an income tax expense of $0.5 million for the six months ended June 30, 2017. Our effective income tax rate increased to 25% for the six months ended June 30, 2018, from (11)% for the six months ended June 30, 2017. The increase in the effective tax rate is primarily due to the increase in forecasted net deferred tax liability after valuation allowance for which an income tax expense was recorded and the resulting impact that the separate state taxes have on the forecasted rate applied to year to date income for the six months ended June 30, 2018 compared to the loss from operations for the six months ended June 30, 2017 for which no benefit was recognized.

Net Income (Loss)

As a result of the factors described above, net income was $4.9 million for the six months ended June 30, 2018, which represented an increase of $10.3 million, or 190% compared to net loss of $5.4 million for the six months ended June 30, 2017.

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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;
- adjusted EBITDA and adjusted net income do not reflect the impact of certain non-operating expenses resulting from matters we do not consider to be indicative of our core operating performance; and
- other companies may calculate adjusted EBITDA and adjusted net income differently than we do, which reduces its usefulness as a comparative measure.

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

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	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
	(in thousands)		(in thousands)	
Adjusted EBITDA:				
Net (loss) income	$(3,591)	$(2,440)	$4,864	$(5,399)
(Benefit from) provision for income taxes	(911)	197	1,590	522
Interest expense [1]	1,141	1,618	2,411	3,224
Interest income	(7)	—	(13)	—
Transaction expenses [7]	—	444	—	444
Depreciation and amortization	2,537	2,894	5,113	5,668
Impairment of goodwill and customer relationship [6]	—	1,081	—	1,081
CMS Region A contract termination [5]	—	—	(18,816)	—
Stock-based compensation	950	1,187	1,589	2,290
Adjusted EBITDA	$119	$4,981	$(3,262)	$7,830

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
	(in thousands)		(in thousands)	
Adjusted Net Income (Loss):				
Net (loss) income	$(3,591)	$(2,440)	$4,864	$(5,399)
Transaction expenses [7]	—	444	—	444
Stock-based compensation	950	1,187	1,589	2,290
Amortization of intangibles [2]	202	217	405	488
Impairment of goodwill and customer relationship [6]	—	1,081	—	1,081
Deferred financing amortization costs [3]	333	330	664	696
CMS Region A contract termination [5]	—	—	(18,816)	—
Tax adjustments [4]	(409)	(1,304)	4,443	(2,000)
Adjusted Net Loss	$(2,515)	$(485)	$(6,851)	$(2,400)

(1) Represents interest expense and amortization of issuance costs related to the refinancing of our indebtedness.

(2) Represents amortization of capitalized expenses related to the acquisition of Performant by an affiliate of Parthenon Capital Partners in 2004, and also an acquisition in the first quarter of 2012 to enhance our analytics capabilities.

(3) Represents amortization of capitalized financing costs related to our Credit Agreement for 2018, and amortization of capitalized financing costs related to our Prior Credit Agreement for 2017.

(4) Represents tax adjustments assuming a marginal tax rate of 40% for 2017 and 27.5% for 2018.

(5) Represents the net impact of the termination of our 2009 CMS Region A contract during the first quarter of 2018, comprised of release of an aggregate of $27.8 million of the estimated liability for appeals and the net payable to client balances into revenue, net of derecognition of $9.0 million of prepaid expenses and other current assets, with a charge to other operating expenses, reflecting accrued receivables associated with amounts due from subcontractors for decided and yet-to-be decided appeals.

(6) Represents goodwill and impairment charges related to our Performant Europe Ltd. subsidiary.

(7) Represents costs and expenses related to the refinancing of our indebtedness.

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Liquidity and Capital Resources

Our primary sources of liquidity are cash on hand, cash flows from operations and the availability of up to $15 million in additional term loans under the Credit Agreement discussed below. Cash and cash equivalents, which includes restricted cash and consists primarily of cash on deposit with banks, totaled $9.8 million as of June 30, 2018, compared to $23.5 million as of December 31, 2017. Due to our existing cash and cash equivalents, availability under the Credit Agreement and our ability to restructure both our variable and fixed expenses, we believe that we have the ability to meet our working capital and capital expenditure needs for the foreseeable future.

The $13.8 million decrease in the balance of our cash and cash equivalents from December 31, 2017, was primarily due to $7.8 million negative cash flows from operating activities discussed below.

Cash flows from operating activities

Cash used in operating activities was $7.8 million for the six months ended June 30, 2018, compared to positive cash provided by operating activities of $2.9 million for the same period in 2017. The reduction in cash flows from operating activities is due primarily to an increase in trade accounts receivable of $3.1 million related to increase in activity from certain new customers, and payment of $3.0 million related to the termination of the 2009 CMS Region A contract, partially offset by an increase in deferred revenue of $1.4 million.

Cash flows from investing activities

Cash used in investing activities of $4.5 million for the six months ended June 30, 2018 was mainly for capital expenditures related to information technology, data storage, hardware, telecommunication systems and security enhancements to our information technology systems. Cash used in investing activities in the six months ended June 30, 2017 was $4.3 million.

Cash flows from financing activities

Cash used in financing activities of $1.5 million for the six months ended June 30, 2018 was primarily attributable to repayments of principal of $1.1 million on long-term debt. Cash used in financing activities in the six months ended June 30, 2017 was $11.9 million primarily attributable to repayments of principal of $11.3 million on long-term debt.

Restricted Cash

As of June 30, 2018, restricted cash included in current assets on our consolidated balance sheet was $1.8 million. In November 2017, the Company deposited $1.8 million in restricted cash as collateral for new letters of credit issued to replace letters of credit terminated under our Prior Credit Agreement.

Long-term Debt

On August 7, 2017, we, through our wholly-owned subsidiary Performant Business Services, Inc. (the “Borrower”), entered into a credit agreement with ECMC Group, Inc. (the “Credit Agreement”). The Credit Agreement provides for a term loan facility in the initial amount of $44 million (the “Initial Term Loan”) and for up to $15 million of additional term loans (“Additional Term Loans”; and together with the Initial Term Loan, the “Loans”) which Additional Term Loans may be drawn until the second anniversary of the funding of the Initial Term Loans, subject to the satisfaction of customary conditions. On August 11, 2017, the Initial Term Loan was advanced (the “Closing Date”) and the proceeds were applied to repay all outstanding amounts under our Prior Credit Agreement. On September 29, 2017, we entered into Amendment No. 1 to the Credit Agreement to extend the initial interest payment due date to December 31, 2017.

The Loans will mature on the third anniversary of the Closing Date, however we will have the option to extend the maturity of the Loans for two additional one year periods, subject to the satisfaction of customary conditions. The Loans will bear interest at the one-month LIBOR rate (subject to a 1% per annum floor) plus a margin which may vary from 5.5% per annum to 10.0% per annum based on our total debt to EBITDA ratio. The Initial Term Loans will initially bear interest at LIBOR plus 7.0% per annum. We will be required to pay 5% of the original principal balance of the Loans annually in quarterly installments and to offer to make mandatory prepayments of the Loans with a percentage of our excess cash flow which may vary between 75% and 0% depending on our total debt to EBITDA ratio. In addition to mandatory prepayments for excess cash flow, we will also be required to offer to prepay the Loans with the net cash proceeds of certain asset dispositions and with the issuance of debt not otherwise permitted under the Credit Agreement. Except in connection with a change of

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control and the payment of a 1% premium, we will not be permitted to voluntarily prepay the Loans until after the first anniversary of the Closing Date. We will be permitted to prepay the Loans during the second year after the Closing Date if accompanied by a prepayment premium of 1%. Thereafter, we will be permitted to prepay the Loans without any prepayment premium.

The Credit Agreement contains certain restrictive financial covenants which became effective on the Closing Date. Such covenants, will require, among other things, that we meet a minimum fixed charge coverage ratio of 0.5 to 1.0 through December 31, 2019, 1.0 to 1.0 through June 30, 2020 (or until December 31, 2020 if the maturity date of the Loans is extended until the fourth anniversary of the Closing Date), 1.25 to 1.0 through June 30, 2021 if the maturity date of the Loans is extended until the fourth anniversary of the Closing Date and 1.25 to 1.0 through June 30, 2022 if the maturity date of the Loans is extended until the fifth anniversary of the Closing Date. In addition, we will be required to maintain a maximum total debt to EBITDA ratio of 6.00 to 1.00. The Credit Agreement also contains covenants that will restrict our and our subsidiaries' ability to incur certain types or amounts of indebtedness, incur liens on certain assets, make material changes in corporate structure or the nature of its business, dispose of material assets, engage in a change in control transaction, make certain foreign investments, enter into certain restrictive agreements, or engage in certain transactions with affiliates.

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

As a result of our entry into our Credit Agreement, and the repayment of all amounts owed under the Prior Credit Agreement, we wrote off debt issuance costs related to the Prior Credit Agreement of approximately $1.0 million in August 2017.

In consideration for, and concurrently with, the extension of the Initial Term Loan in accordance with the terms of the Credit Agreement, we issued a warrant to the lender to purchase up to an aggregate of 3,863,326 shares of the Company's common stock (representing approximately up to 7.5% of our diluted common stock as calculated using the "treasury stock" method as defined under GAAP for the most recent fiscal quarter) with an exercise price of $1.92 per share. Upon our election to borrow any of the Additional Term Loans, we will be required to issue additional warrants at the same exercise price to purchase up to an aggregate of 77,267 additional shares of common stock (which represents approximately 0.15% of our diluted common stock calculated using the "treasury stock" method as defined under GAAP for the most recent fiscal quarter) for each $1,000,000 of such Additional Term Loans.

The Credit Agreement also requires us to meet certain financial covenants, including maintaining a total debt to EBITDA ratio and a fixed charge coverage ratio, as such terms are defined in our credit agreement. These financial covenants are tested at the end of each quarter as applicable. The table below further describes these financial covenants, as well as our current status under these covenants as of June 30, 2018.

Financial Covenant	Covenant Requirement	Actual Ratio at June 30, 2018
Total debt to EBITDA ratio (maximum) [(1)]	6.00 to 1.00	1.71
Fixed charge coverage ratio (minimum) [(2)]	0.5 to 1.0	2.89

(1) The total debt to EBITDA ratio will apply to computation periods through August 11, 2020.

(2) The fixed charge coverage ratio of 0.5 to 1.0 is in effect through December 31, 2019, 1.0 to 1.0 will be in effect through June 30, 2020 (or until December 31, 2020 if the maturity date of the Loans is extended until the fourth anniversary of the Closing Date), 1.25 to 1.0 will be in effect through June 30, 2021 if the maturity date of the Loans is extended until the fourth anniversary of the Closing Date and 1.25 to 1.0 will be in effect through June 30, 2022 if the maturity date of the Loans is extended until the fifth anniversary of the Closing Date.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

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

ITEM 4. DISCLOSURE CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

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

Management, with the participation of our Chief Executive Officer and our Chief Accounting Officer, has evaluated the effectiveness of our disclosure controls and procedures, as defined in Rule 13a-15(e) under the Exchange Act, as of the fiscal quarter covered by this Quarterly Report on Form 10-Q. Based on that evaluation, our Chief Executive Officer and Chief Accounting Officer concluded that our disclosure controls and procedures were functioning effectively at the reasonable assurance level as of June 30, 2018.

Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting during the quarter ended June 30, 2018, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

ITEM 1A. RISK FACTORS

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

Risks Related to Our Business

Revenues generated from our three largest clients represented 63% of our revenues in 2017 and 55% of our revenues in 2016 and our relationships with two of these clients, Great Lakes Higher Education Guaranty Corporation and the Department of Education, have been terminated or substantially reduced in scope. Any termination of or deterioration in our relationship with any of our other significant clients would result in a further decline in our revenues.

We have derived a substantial majority of our revenues from a limited number of clients, including the Department of Education, and several Guaranty Agencies. Revenues from our three largest clients represented 63% of our revenues for the year ended December 31, 2017 and 55% of our revenues for the year ended December 31, 2016. The Department of Education was responsible for approximately 4% and 16% of our revenues for the years ended December 31, 2017 and December 31, 2016, respectively but has historically been one of our largest clients, accounting for 15.5%, 23.8%, and 27.2% of our revenues in 2016, 2015 and 2014, respectively. Although the Department of Education announced in January 2018 that we were selected as one of two recovery contractors under its award for new student loan recovery contracts, we were notified on May 3, 2018 that the Department of Education has decided to cancel the current procurement in its entirety, and as a result terminated our contract award. We have had relationships with numerous GAs in the U.S. including Great Lakes and Pennsylvania Higher Education Assistance Authority, which were responsible for 33% and 21%, respectively, of our revenues for the year ended December 31, 2017. On June 15, 2017, we received a 30-day termination notice, with respect to our contract with Great Lakes was terminated of this contract was based on Great Lakes' decision to bundle with a single third-party vendor its student loan servicing work, a service that we currently do not provide, along with its student loan recovery work. While we subsequently obtained a subcontract for student loan recovery work from Navient, the new provider of servicing and defaulted portfolio management to Great Lakes, this contract has no set term or volume, and Navient has the right to terminate the contract at will. Because the Department of Education has decided to terminate our January 2018 contract and the current procurement in its entirety, we now will become even more dependent on our business relationships with our remaining GA clients for our student loan revenues. In that regard, we believe that the portfolios of our GA clients will decrease over time due to (i) the effect of Federal legislation in 2010 that requires all student loan originations to come from the Department of Education (which means that there will be no further growth in student loans held by GAs), and (ii) because we are seeing a larger amount of defaulted student loans in our GA client portfolios that have been previously rehabilitated and by regulation are not subject to rehabilitation for a second time. All of our contracts with our significant clients are subject to periodic renewal and re-bidding processes and if we lose one of these clients or if the terms of our relationships with any of these clients become less favorable to us, our revenues would decline, which would harm our business, financial condition and results of operations.

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

Substantially all of our existing contracts for the recovery of student loans and other receivables, which represented approximately 84% of our revenues for the six months ended June 30, 2018 (excluding revenues from the release of the CMS appeals reserve) and 92% of our revenues in the year ended December 31, 2017, enable our clients to unilaterally terminate their contractual relationship with us at any time without penalty, potentially leading to loss of

business or renegotiation of terms. Further, most of our contracts in these markets allow our clients to unilaterally change the volume of loans and other receivables that are placed with us or the payment terms at any given time. In addition, most of our contracts are not exclusive,

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with our clients retaining multiple service providers with whom we must compete for placements of loans or other obligations. Therefore, despite our contractual relationships with our clients, our contracts do not provide assurance that we will generate a minimum amount of revenues or that we will receive a specific volume of placements.

Our revenues and operating results would be negatively affected if our student loan and receivables clients reduce the volume of student loan placements provided to us, modify the terms of service, including the success fees we are able to earn upon recovery of defaulted student loans, or any of these clients establish more favorable relationships with our competitors.

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

Under CMS's Medicare recovery audit program, RAC contractors have not been permitted to seek the recovery of an improper claim unless that particular type of claim has been pre-approved by CMS to ensure compliance with applicable Medicare payment policies, as well as national and local coverage determinations. As work under the first RAC contract progressed, CMS placed increasing restrictions on the scope of audits permitted by RAC contractors and these restrictions have not been relaxed under the newly awarded RAC contracts. Accordingly, the long-term growth of the revenues we derive under our two newly awarded RAC contracts will depend in significant part on the scope of potentially improper claims that we are allowed to pursue. Revenues from our RAC contracts with CMS during the six months ended June 30, 2018 were $0.8 million (excluding the effects of the release of the $27.8 million appeal reserve in connection with the termination of our first CMS RAC contract).

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

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

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

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

We operate in very competitive markets. In providing our services to the student loan and other receivables markets, we face competition from many other companies. Initially, we compete with these companies to be one of typically several firms engaged to provide recovery services to a particular client and, if we are successful in being engaged, we

then face continuing competition from the client's other retained firms based on the client's benchmarking of the recovery rates of its several vendors. In addition, those recovery vendors who produce the highest recovery rates from a client often will be allocated additional placements and in some cases additional success fees. Accordingly, maintaining high levels of recovery performance, and doing so in a cost-effective manner, are important factors in our ability to maintain and grow our revenues and net income and the failure to achieve these objectives could harm our business, financial condition and results of operations. Some of our current and potential competitors in the markets in which we operate may have greater financial,

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marketing, technological or other resources than we do. The ability of any of our competitors and potential competitors to adopt new and effective technology to better serve our markets may allow them to gain market strength. Increasing levels of competition in the future may result in lower recovery fees, lower volumes of contracted recovery services or higher costs for resources. Any inability to compete effectively in the markets that we serve could adversely affect our business, financial condition and results of operations.

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

We have historically derived and are likely to continue to derive a significant portion of our revenues from the U.S. federal government. For the year ended December 31, 2017, revenues under contracts with the U.S. federal government accounted for approximately 11% of our total revenues. The continuation and exercise of renewal options on government contracts and any new government contracts are, among other things, contingent upon the availability of adequate funding for the applicable federal government agency. Changes in federal government spending could directly affect our financial performance.

For example, 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. The loss of business from the U.S. federal government, or significant policy changes or financial pressures within the agencies of the U.S. federal government that we serve would result in a significant decrease in our revenues, which would adversely affect our business, financial condition and results of operations.

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

The two principal markets in which we provide our recovery services, government-supported student loans and the Medicare program, are a subject of significant legislative and regulatory focus and we cannot anticipate how future changes in government policy may affect our business and operations. For example, Student Aid and Fiscal Responsibility Act, or 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. 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.

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

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

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

As a result of SAFRA, which terminated the ability of the GAs to originate government-supported student loans, the overall number of defaulted student loans that we are able to service on behalf of our GA clients has begun to decline. Further, we are seeing a larger amount of defaulted student loans within our GA client portfolios that have previously been rehabilitated,

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which, according to current regulations, prevents us from rehabilitating any such student loan for a second time. This overall reduction in the number of defaulted student loans in our GA client portfolios, and the larger percentage of defaulted student loans that have been previously rehabilitated, may result in a decrease in revenues from our GA clients, which could negatively impact our business, financial condition and results of operations.

Further, some have speculated that there may be consolidation among the remaining GAs. This speculation has heightened as a result of the reduction of fees that the GAs will receive for rehabilitating student loans as a result of the Bipartisan Budget Act of 2013. If GAs that are our clients are combined with GAs with whom we do not have a relationship, we could suffer a loss of business. Two of our GA clients were each responsible for more than 10% of our total revenues in the year ended December 31, 2017: Great Lakes Higher Education Guaranty Corporation and Pennsylvania Higher Education Assistance Authority were responsible for 33% and 21%, respectively, of revenues for the year ended December 31, 2017. The consolidation of our GA clients with others and the failure to provide recovery services to the consolidated entity could decrease our revenues, which could negatively impact our business, financial condition and results of operations.

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

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

- the amount of defaulted student loans and other receivables that our clients place with us for recovery;
- the timing of placements of student loans and other receivables which are entirely in the discretion of our clients;
- the schedules of government agencies for awarding contracts;
- our ability to successfully identify improper Medicare claims and the number and type of potentially improper claims that CMS authorizes us to pursue under our RAC contact;
- 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.

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

Our ability to make scheduled payments and to fund our other liquidity needs depends on our financial and operating performance, which is subject to prevailing economic and competitive conditions and to certain financial, business and other factors beyond our control. We cannot make assurances that we will maintain a level of cash flows from operating activities sufficient to permit us to pay the principal and interest on our indebtedness and to fund our other liquidity needs. If our cash flows and capital resources are insufficient to fund our debt service obligations and allow us to maintain compliance with the covenants under our credit agreement or to fund our other liquidity needs, we may be forced to reduce or delay capital expenditures, sell assets or operations, seek additional capital or restructure or refinance our indebtedness. We cannot ensure that we would be able to take any of these actions, that these actions

would be successful and permit us to meet our scheduled debt service obligations or that these actions would be permitted under the terms of our existing or future debt agreements,

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including our credit agreement. If we cannot make scheduled payments on our debt, we will be in default and, as a result, our debt holders could declare all outstanding principal and interest to be due and payable, the lenders under our credit agreement could terminate their commitments to lend us money and foreclose against the assets securing our borrowings and we could be forced into bankruptcy or liquidation.

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

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.

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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 contracts with CMS and we must establish administrative, physical and technical safeguards to protect the confidentiality of this information. Similar protections extend to the type of personal financial and other information we acquire from our student loan, state tax and federal receivables clients. We are required to notify affected individuals and government agencies of data security breaches involving protected health and certain personally identifiable information. These laws and regulations also require that we develop, implement and maintain written, comprehensive information security programs containing safeguards that are appropriate to protect personally identifiable information or health information against unauthorized access, misuse, destruction or modification. Federal law generally does not preempt state law in the area of protection of personal information, and as a result we must also comply with state laws and regulations. Regulation of privacy, data use and security require that we incur significant expenses, which could increase in the future as a result of additional regulations, all of which adversely affects our results of operations. Failure to comply with these laws and regulations can result in penalties and in some cases expose us to civil lawsuits.

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

Our student loan recovery business is subject to regulation and oversight by various state and federal agencies, particularly in the area of consumer protection. The Fair Debt Collection Practices Act, 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

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enforcement authority with respect to whether persons are engaged in unlawful acts or practices in connection with the collection of consumer debts.

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

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

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

The success of our business depends in part upon our proprietary technology platform. We rely on a combination of copyright, patent, trademark, and trade secret laws, as well as on confidentiality procedures and non-compete agreements, to establish and protect our proprietary technology rights. The steps we have taken to deter misappropriation of our proprietary technology may be insufficient to protect our proprietary information. In particular, we may not be able to protect our trade secrets, know how and other proprietary information adequately. Although we use reasonable efforts to protect this proprietary information and technology, our employees, consultants and other parties may unintentionally or willfully disclose our information or technology to competitors. Enforcing a claim that a third party illegally obtained and is using any of our proprietary information or technology is expensive and time consuming, and the outcome is unpredictable. We rely, in part, on 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.

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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 $1.50 on March 16, 2017 to a high sales price of $14.09 on March 4, 2013. The trading price of our common stock may be significantly affected by various factors, including: quarterly fluctuations in our operating results; the financial projections we may provide to the public, any changes in those projections or our failure to meet those projections; changes in investors' and analysts' perception of the business risks and conditions of our business; our ability to meet the earnings estimates and other performance expectations of financial analysts or investors; unfavorable commentary or downgrades of our stock by equity research analysts; changes in our capital structure, such as future issuances of debt or equity securities; our success or failure to obtain new contract awards; lawsuits threatened or filed against us; strategic actions by us or our competitors, such as acquisitions or restructurings; new legislation or regulatory actions; changes in our relationship with any of our significant clients; fluctuations in the stock prices of our peer companies or in stock markets in general; and general economic conditions.

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

Parthenon Capital Partners and Invesco Ltd. beneficially owned approximately 26.0% and 19.5% of our common stock, respectively, as of June 30, 2018. As a result of their ownership, Parthenon Capital Partners and Invesco Ltd. have the ability to influence the outcome of matters submitted to a vote of stockholders and, through our board of directors, the ability to influence decision making with respect to our business direction and policies. Parthenon Capital Partners and Invesco Ltd. may have interests different from our other stockholders' interests and may vote in a manner adverse to those interests. Matters over which Parthenon Capital Partners and Invesco Ltd. can, directly or indirectly, exercise influence include:

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

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

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

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

our board of directors then in office. These provisions, alone or together, could have the effect of delaying or deterring a change in control, could limit the opportunity for our stockholders to receive a premium for their shares of our common stock, and could also affect the price that some investors are willing to pay for our common stock.

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ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS
Sale of Unregistered Securities
None.
ITEM 3. DEFAULTS UPON SENIOR SECURITIES
None.
ITEM 4. MINE SAFETY DISCLOSURES
None
ITEM 5. OTHER INFORMATION
Entry into Material Definitive Agreement

On August 9, 2018, the Company, through its wholly-owned subsidiary Performant Business Services, Inc. (the "Borrower"), agreed to enter into an amendment (the "Amendment") to its Credit Agreement, dated as of August 7, 2017 (the "Credit Agreement"), with ECMC Group, Inc. (the "Lender"). Prior to the Amendment, the Credit Agreement provided for a term loan facility in the initial amount of $44 million (the "Initial Term Loan") and for up to $15 million of additional term loans ("Additional Term Loans"; and together with the Initial Term Loan, the "Loans") which Additional Term Loans could be drawn until the second anniversary of the funding of the Initial Term Loans, subject to the satisfaction of customary conditions. The Loans were scheduled to mature in August 2020, although the Company had the option to extend the maturity of the Loans for two additional one year periods, subject to the satisfaction of customary conditions. The Amendment (i) extends the maturity date of the Loans by one year to August 2021 and retains the two additional one year options to extend the maturity, (ii) expands the loan commitment for Additional Term Loans from $15 million to $25 million, (iii) extends the period during which Additional Term Loans can be borrowed by one year to August 2020, and (iv) relieves the Borrower from its obligation to comply with its financial covenants (minimum fixed charge coverage ratio and maximum total debt to EBITDA ratio) in the Credit Agreement for the six fiscal quarters following the date when the Amendment becomes effective. The Company will enter into the Amendment concurrently with the closing under the Agreement for Purchase of LLC Membership Interests, dated as of August 9, 2018 (the "Purchase Agreement"), between the Company and ECMC Holdings Corporation, an affiliate of the Lender ("ECMC Holdings"), pursuant to which the Company has agreed to acquire from ECMC Holdings all of the outstanding membership interests in Premiere Credit of North America, LLC ("Premiere"), a provider of asset recovery services to clients in the student loan, government, healthcare and commercial markets. The closing of the Premiere acquisition is subject to the satisfaction or waiver of customary closing conditions contained in the Purchase Agreement.

The foregoing description of the Amendment is qualified in its entirety by reference to the full text of the Amendment, which is included as Exhibit 10.1 hereto and incorporated herein by reference.

Unregistered Sale of Equity Securities

As consideration for the purchase of Premiere under the Purchase Agreement described above, at closing the Company will issue to ECMC Holdings 1,000,000 shares of its common stock and will be obligated to issue to ECMC Holdings additional shares of common stock over the five year period following the closing (not to exceed 2,591,824 shares in the aggregate) based on revenues associated with the Premiere business in each year. The Company estimates that it would issue approximately an additional 1,000,000 shares over the five year period if eligible revenues in each year are at the target level. The closing of the Premiere acquisition is subject to the satisfaction or waiver of customary closing conditions. The shares of common stock of the Company described to be issued as described above were offered and sold in reliance upon exemptions from registration pursuant to Section 4(a)(2) of the Securities Act of 1933, as amended (the "Securities Act"), and Rule 506 of Regulation D thereunder. The Purchase Agreement contains representations and warranties to support our reasonable belief that ECMC Holdings had access to information concerning its operations and financial condition, that ECMC Holdings is acquiring such shares of common stock for its own account and not with a view to the distribution thereof, and that ECMC Holdings is an

“accredited investor” as defined by Rule 501 promulgated under the Securities Act.

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ITEM 6. EXHIBITS
(A) Exhibits:

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

(1) The material contained in Exhibit 32.1 and Exhibit 32.2 is not deemed “filed” with the Securities and Exchange Commission and is not to be incorporated by reference into any filing of the Company under the Securities Act of 1933 or the Securities Exchange Act of 1934, whether made before or after the date hereof and irrespective of any general incorporation language contained in such filing, except to the extent that the registrant specifically incorporates it by reference.

(2) In accordance with Rule 406T of Regulation S-T, the information furnished in these exhibits will not be deemed “filed” for purposes of Section 18 of the Exchange Act. Such exhibits will not be deemed to be incorporated by reference into any filing under the Securities Act or Exchange Act.

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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: August 10, 2018

By: /s/ Lisa Im
Lisa Im

Chief Executive Officer (Principal Executive Officer)

By: /s/ Ian Johnston
Ian Johnston

Vice President and Chief Accounting Officer