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Performant Financial Corp
Form 10-Q
November 10, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2014

or

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

For the transition period from _____ to _____

Commission File Number: 001-35628

PERFORMANT FINANCIAL CORPORATION
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)
Performant Financial Corporation
333 North Canyons Parkway
Livermore, CA 94551
(925) 960-4800

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

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

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

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

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

Large accelerated filer ☐ Accelerated filer ☒

Non-accelerated filer ☐ Smaller reporting company ☐

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

The number of shares of Common Stock outstanding as of November 7, 2014 was 49,323,567

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FOR THE QUARTER ENDED SEPTEMBER 30, 2014
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PERFORMANT FINANCIAL CORPORATION AND SUBSIDIARIES

Consolidated Balance Sheets

(In thousands, except per share amounts)

| | September 30, 2014 (Unaudited) | December 31, 2013 |
|---|--------------------------------------|----------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$84,970 | \$81,909 |
| Trade accounts receivable, net of allowance for doubtful accounts of \$32 and \$32, respectively and estimated allowance for appeals of \$0 and \$1,160, respectively | 16,654 | 19,649 |
| Deferred income taxes | 7,186 | 6,847 |
| Prepaid expenses and other current assets | 12,262 | 4,400 |
| Income tax receivable | 3,056 | — |
| Debt issuance costs, current portion | 1,004 | 1,055 |
| Total current assets | 125,132 | 113,860 |
| Property, equipment, and leasehold improvements, net | 26,681 | 26,247 |
| Identifiable intangible assets, net | 29,715 | 32,513 |
| Goodwill | 81,572 | 81,572 |
| Debt issuance costs, net | 2,045 | 2,789 |
| Other assets | 233 | 279 |
| Total assets | \$265,378 | \$257,260 |
| Liabilities and Stockholders' Equity | | |
| Current liabilities: | | |
| Current maturities of notes payable | \$8,939 | \$10,763 |
| Accrued salaries and benefits | 6,883 | 11,826 |
| Accounts payable | 2,442 | 2,383 |
| Other current liabilities | 5,167 | 5,311 |
| Income taxes payable | — | 103 |
| Estimated liability for appeals | 17,216 | 15,283 |
| Net payable to client | 13,987 | — |
| Total current liabilities | 54,634 | 45,669 |
| Notes payable, net of current portion | 105,311 | 122,541 |
| Deferred income taxes | 10,976 | 12,612 |
| Other liabilities | 2,139 | 2,204 |
| Total liabilities | 173,060 | 183,026 |
| Commitments and contingencies | | |
| Stockholders' equity: | | |
| Common stock, \$0.0001 par value. Authorized, 500,000 shares at September 30, 2014 and December 31, 2013; issued and outstanding 49,324 and 48,316 shares at September 30, 2014 and December 31, 2013, respectively | 5 | 5 |
| Additional paid-in capital | 56,096 | 49,791 |
| Retained earnings | 36,217 | 24,438 |
| Total stockholders' equity | 92,318 | 74,234 |
| Total liabilities and stockholders' equity | \$265,378 | \$257,260 |
| 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 September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|------------|------------------------------------|-----------|
| | 2014 | 2013 | 2014 | 2013 |
| Revenues | \$39,640 | \$76,808 | \$155,683 | \$195,326 |
| Operating expenses: | | | | |
| Salaries and benefits | 22,180 | 25,060 | 71,236 | 72,942 |
| Other operating expenses | 15,658 | 23,563 | 56,304 | 65,314 |
| Total operating expenses | 37,838 | 48,623 | 127,540 | 138,256 |
| Income from operations | 1,802 | 28,185 | 28,143 | 57,070 |
| Interest expense | (2,456) |) (2,863 |) (7,765 |) (8,752 |
| Income (loss) before provision for income taxes | (654) |) 25,322 | 20,378 | 48,318 |
| Provision for income taxes | (175) |) 9,868 | 8,599 | 19,848 |
| Net income (loss) | \$(479) |) \$15,454 | \$11,779 | \$28,470 |
| Net income (loss) per share | | | | |
| Basic | \$(0.01) |) \$0.32 | \$0.24 | \$0.60 |
| Diluted | \$(0.01) |) \$0.31 | \$0.24 | \$0.58 |
| Weighted average shares | | | | |
| Basic | 49,004 | 48,050 | 48,641 | 47,247 |
| Diluted | 49,004 | 49,556 | 49,758 | 49,315 |
| See accompanying notes to consolidated financial statements. | | | | |

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PERFORMANT FINANCIAL CORPORATION AND SUBSIDIARIES

Consolidated Statement of Changes in Stockholders' Equity

For the Nine Months Ended September 30, 2014

(In thousands)

(Unaudited)

| | Common Stock | | Additional | Retained | |
|--|--------------|--------|--------------------|----------|----------|
| | Shares | Amount | Paid-In Capital | Earnings | Total |
| Balance at December 31, 2013 | 48,316 | \$5 | \$49,791 | \$24,438 | \$74,234 |
| Exercise of stock options | 1,008 | — | 606 | — | 606 |
| Stock-based compensation expense | — | — | 2,621 | — | 2,621 |
| Income tax benefit from employee stock options | — | — | 3,078 | — | 3,078 |
| Net income | — | — | — | 11,779 | 11,779 |
| Balance at September 30, 2014 | 49,324 | \$5 | \$56,096 | \$36,217 | \$92,318 |

See accompanying notes to consolidated financial statements.

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PERFORMANT FINANCIAL CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cash Flows

(In thousands)

(Unaudited)

| | Nine Months Ended September 30, | |
|---|------------------------------------|----------|
| | 2014 | 2013 |
| Cash flows from operating activities: | | |
| Net income | \$11,779 | \$28,470 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Loss on disposal of asset | 29 | 1 |
| Depreciation and amortization | 9,058 | 7,840 |
| Deferred income taxes | (1,975) | (1,144) |
| Stock-based compensation | 2,621 | 2,196 |
| Interest expense from debt issuance costs and amortization of discount note payable | 887 | 939 |
| Changes in operating assets and liabilities: | | |
| Trade accounts receivable | 2,995 | (7,549) |
| Prepaid expenses and other current assets | (7,862) | 120 |
| Income tax receivable | (3,056) | — |
| Other assets | 46 | 117 |
| Accrued salaries and benefits | (4,943) | 1,249 |
| Accounts payable | 59 | 396 |
| Other current liabilities | (144) | (1,791) |
| Income taxes payable | (103) | 5,799 |
| Deferred revenue | — | (2,187) |
| Estimated liability for appeals | 1,933 | 8,319 |
| Net payable to client | 13,987 | — |
| Other liabilities | 594 | (137) |
| Net cash provided by operating activities | 25,905 | 42,638 |
| Cash flows from investing activities: | | |
| Purchase of property, equipment, and leasehold improvements | (6,724) | (8,697) |
| Net cash used in investing activities | (6,724) | (8,697) |
| Cash flows from financing activities: | | |
| Repayment of notes payable | (19,054) | (11,774) |
| Proceeds from exercise of stock options | 606 | 1,653 |
| Income tax benefit from employee stock options | 3,078 | 8,641 |
| Payment of purchase obligation | (750) | (750) |
| Net cash used in financing activities | (16,120) | (2,230) |
| Net increase in cash and cash equivalents | 3,061 | 31,711 |
| Cash and cash equivalents at beginning of period | 81,909 | 37,843 |
| Cash and cash equivalents at end of period | \$84,970 | \$69,554 |
| Supplemental disclosures of cash flow information: | | |
| Cash paid for income taxes | \$10,331 | \$6,552 |
| Cash paid for interest | \$6,863 | \$7,796 |

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 Nine Months Ended September 30, 2014 and 2013

(Unaudited)

1. Organization and Description of Business

(a) Basis of Presentation and Organization

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. Generally Accepted Accounting Principles, or U.S. GAAP, for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by U.S. GAAP for complete financial statements. In the opinion of management, the unaudited interim financial statements furnished herein include all adjustments necessary (consisting only of normal recurring adjustments) for a fair presentation of our and our subsidiaries' financial position at September 30, 2014, the results of our operations for the three and nine months ended September 30, 2014 and 2013 and cash flows for the nine months ended September 30, 2014 and 2013. 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, 2013, 2012 and 2011.

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

The Company's consolidated financial statements include the operations of Performant Financial Corporation (PFC), its wholly owned subsidiary Performant Business Services, Inc., and its wholly owned subsidiaries Performant Recovery, Inc. (Recovery) and Performant Technologies, Inc. PFC is a Delaware corporation headquartered in California and was formed in 2003. Performant Business Services, Inc. is a Nevada corporation founded in 1997. Recovery is a California corporation founded in 1976. Performant Technologies, Inc. is a California corporation that was formed in 2004. All significant intercompany balances and transactions have been eliminated in consolidation. The Company is managed and operated as one business, with a single management team that reports to the Chief Executive Officer.

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

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

Revenue is recognized upon the collection of defaulted loan and debt payments. Loan rehabilitation revenue is recognized when the rehabilitated loans are sold (funded) by clients. Incentive revenue is recognized upon receipt of official notification of incentive award from customers. Under the Company's Medicare Recovery Audit Contractor, or RAC, contract with Centers for Medicare and Medicaid Services, or CMS, the Company recognizes revenues when the healthcare provider has paid CMS for a given claim or offset. 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 based on the amount of commissions received which are subject to appeal and which the Company

estimates are probable of being returned to providers following successful appeal. At September 30, 2014, a total of \$17.2 million was presented as an allowance against revenue, representing the Company's estimate of claims that may be overturned. Of this amount, \$0.0 million was related to amounts in accounts receivable and \$17.2 million was related to commissions which had already been received. The \$17.2 million balance at September 30, 2014, and the \$15.3 million balance as of December 31, 2013, represents the Company's best estimate of the probable amount of losses related to appeals of claims for which commissions were previously collected. In addition to the \$17.2 million amount accrued at September 30, 2014, the Company estimates that it is reasonably possible that it could be required to pay an additional amount up to approximately \$5.4 million as a result of potentially successful appeals. To the extent that required payments by the Company exceed the amount accrued, revenues in the applicable period would be reduced by the amount of the excess.

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(c) Net Payable to Client

The Company nets outstanding accounts receivable invoices from an audit & recovery contract against payables for overturned audits. The overturned audits are netted against current fees due on the invoice to the client when they are processed by the client's system. The "Net payable to client" balance of \$14.0 million represents the excess of payables of \$14.2 million for overturned audits offset by outstanding accounts receivable of \$0.2 million at September 30, 2014. At December 31, 2013, the net of the outstanding accounts receivable invoices of \$12.8 million was offset against a payable for overturned audits of \$5.9 million for a net receivable of \$6.9 million, presented in Accounts receivable. The Company expects that the net payable-to-client balance will be paid to the client within the next twelve months.

(d) Prepaid Expenses and Other Current Assets

At September 30, 2014, Prepaid expenses and other current assets includes \$5.3 million of amounts estimated to become due from subcontractors. The Company employs subcontractors to audit claims as part of an audit & recovery contract, and to the extent that audits by these subcontractors are overturned on appeal, the fees associated with such claims are contractually refundable to the Company. At September 30, 2014, the receivable associated with estimated future overturns of subcontractor audits was \$5.3 million. In addition, at September 30, 2014, Prepaid expenses and other current assets includes a net receivable of \$3.4 million for subcontractor fees for already overturned audits refundable to the Company once the Company refunds its fees to the client as prime contractor. By comparison, at December 31, 2013, there was a net subcontractor payable under this contract of \$3.7 million that was offset by a subcontractor receivable for estimated future overturns of subcontractor audits of \$5.2 million, with the net asset of \$1.5 million included in Other liabilities.

(e) Recent Accounting Pronouncements

In May 2014, the FASB issued Accounting Standards Update No. 2014-09 (ASU 2014-09) "Revenue from Contracts with Customers." ASU 2014-09 supersedes the revenue recognition requirements in "Revenue Recognition (Topic 605)", and requires entities to recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Early adoption is not permitted. We are currently in the process of evaluating the impact of the adoption of ASU 2014-09 on our consolidated financial statements.

2. Property, Equipment, and Leasehold Improvements

Property, equipment, and leasehold improvements consist of the following at September 30, 2014 and December 31, 2013 (in thousands):

| | September 30, 2014 | December 31, 2013 |
|---|-----------------------|----------------------|
| Land | \$1,767 | \$1,767 |
| Building and leasehold improvements | 5,943 | 5,773 |
| Furniture and equipment | 5,113 | 4,932 |
| Computer hardware and software | 56,958 | 52,021 |
| | 69,781 | 64,493 |
| Less accumulated depreciation and amortization | (43,100) | (38,246) |
| Property, equipment and leasehold improvements, net | \$26,681 | \$26,247 |

Depreciation expense of property, equipment and leasehold improvements was \$2.1 million and \$1.8 million for the three months ended September 30, 2014 and 2013, respectively, and \$6.2 million and \$5.1 million for the nine months ended September 30, 2014 and 2013, respectively.

3. Credit Agreement

On March 19, 2012, the Company recapitalized by entering into a credit agreement (the Agreement) consisting of a Term A Loan of \$57.0 million, a Term B Loan of \$79.5 million, and a revolving credit facility of \$11.0 million. On June 28, 2012, the Agreement was amended to increase the Term B Loan to \$99.0 million. On November 4, 2014, the Agreement was further amended to, among other things, modify a number of existing covenants and add new covenants requiring the Company to maintain a minimum cash balance, comply with an interest coverage ratio and achieve minimum EBITDA levels. See Footnote

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8. Subsequent Events, for additional information regarding the November 4, 2014 amendment. Scheduled payments under the Agreement for the next five years and thereafter are as follows (in thousands):

| Year Ending December 31, | Amount |
|--------------------------|-----------|
| Remainder of 2014 | \$2,455 |
| 2015 | 9,820 |
| 2016 | 9,820 |
| 2017 | 9,119 |
| 2018 | 83,036 |
| Thereafter | — |
| Total | \$114,250 |

The Term A Loan is charged interest either at Prime (subject to a 2.50% floor) +4.25% or LIBOR (subject to a 1.50% floor) +5.25%, which was 6.75% at September 30, 2014. The Term A loan requires quarterly payments of \$2.2 million, with the remaining outstanding principal balance due March 19, 2017. As of September 30, 2014, the Term A loan ending balance, including the current portion was \$28.4 million.

The Term B loan is charged interest at Prime +4.75% (subject to a 2.50% floor) or LIBOR (subject to a 1.50% floor) +5.75% which was 7.25% at September 30, 2014. The Term B loan requires quarterly payments of \$0.2 million, with the outstanding principal balance due March 19, 2018. As of September 30, 2014, the Term B loan ending balance, including the current portion was \$85.9 million.

The Company has a line of credit under the Agreement which allows for borrowings of up to \$11.0 million.

Borrowings accrue interest at Prime +4.25% or LIBOR +5.25%, which was 6.75% as of September 30, 2014. Both the Prime and the LIBOR alternatives are subject to minimum rate floors. In addition, a facility fee of 0.5% is assessed on the commitment amount. There were no outstanding borrowings under this line of credit at September 30, 2014, other than letters of credit outstanding in the amount of \$1.6 million, leaving remaining borrowing capacity under the line of credit of \$9.4 million at September 30, 2014. The line of credit expires on March 19, 2017.

The Agreement contains a prepayment provision which requires the Company to perform an annual excess cash flow computation based on earnings before interest, taxes, depreciation and amortization compared to changes in working capital. Based on the results of this computation, in May 2014, the Company made a payment of \$11.5 million to the lenders.

The Agreement contains certain restrictive financial covenants, which require, among other things, that we meet a minimum fixed charge coverage ratio of 1.20, a maximum total debt to EBITDA ratio of 3.25. Additionally, these covenants 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. We were in compliance with all such covenants at September 30, 2014.

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 2014 and 2021. Certain of these arrangements have free rent periods and /or escalating rent payment provisions, and we recognize rent expense under such arrangements on a straight-line basis.

Future minimum rental commitments under non-cancelable leases as of September 30, 2014 are as follows (in thousands):

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| | |
|--------------------------|---------|
| Year Ending December 31, | Amount |
| Remainder of 2014 | \$574 |
| 2015 | 2,278 |
| 2016 | 1,945 |
| 2017 | 1,477 |
| 2018 | 660 |
| Thereafter | 1,416 |
| Total | \$8,350 |

Operating lease expense was \$0.8 million and \$0.7 million for the three months ended September 30, 2014 and 2013, respectively, and was \$2.2 million and \$1.9 million for the nine months ended September 30, 2014 and 2013, 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 \$0.8 million and \$0.8 million for the three months ended September 30, 2014 and 2013, respectively, and \$2.6 million and \$2.2 million for the nine months ended September 30, 2014 and 2013, respectively.

The following table shows stock option activity for the nine months ended September 30, 2014:

| | Outstanding Options | Weighted average exercise price per share | Weighted average remaining contractual life (Years) | Aggregate Intrinsic Value (in thousands) |
|---|------------------------|--|---|--|
| Outstanding at December 31, 2013 | 5,212,821 | \$6.03 | 6.62 | \$23,466 |
| Granted | 254,000 | 9.69 | | |
| Forfeited | (239,093) | 10.45 | | |
| Exercised | (1,007,856) | 0.61 | | |
| Outstanding at September 30, 2014 | 4,219,872 | \$7.29 | 6.50 | \$10,013 |
| Vested, exercisable, and expected to vest ⁽¹⁾ at September 30, 2014 | 4,133,236 | \$7.24 | 6.46 | \$9,986 |
| Exercisable at September 30, 2014 | 2,456,023 | \$5.24 | 5.35 | \$9,629 |

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

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

(b) Restricted Stock Units

The following table summarizes restricted stock unit activity for the nine months ended September 30, 2014:

| | Number of Awards | Weighted average grant date fair value per share |
|--|---------------------|--|
| Outstanding at December 31, 2013 | 5,263 | \$10.59 |
| Granted | 481,545 | 9.27 |
| Outstanding at September 30, 2014 | 486,808 | \$9.28 |
| Expected to vest at September 30, 2014 | 462,468 | \$9.28 |

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

6. Income Taxes

Our effective income tax rate changed to 42.2% for the nine months ended September 30, 2014 from 41.1% for the nine months ended September 30, 2013. The increase in the effective tax rate is primarily due to the decrease in earnings for the nine months ended September 30, 2014 compared to the nine months ended September 30, 2013 and the resulting impact of permanent difference on the effective tax rate.

We file income tax returns with the U.S. federal government and various state jurisdictions. We operate in a number of state and local jurisdictions, most of which have never audited our records. Accordingly, we are subject to state and local income tax examinations based upon the various statutes of limitations in each jurisdiction. For tax years before 2011, the Company is no longer subject to Federal and certain state tax examinations. For tax years before 2010, the Company is no longer subject to certain other state tax examinations. We are currently being examined by the Franchise Tax Board of California for tax years 2011 and 2012.

7. Earnings per Share

For the three and nine months ended September 30, 2014 and 2013, 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 and restricted stock units. When there is a loss in the period, dilutive common share equivalents are excluded from the calculation of diluted earnings per share, as their effect would be anti-dilutive. For example, for the three months ended September 30, 2014, dilutive common share equivalents have been excluded, and diluted weighted average shares outstanding are the same as basic average shares outstanding. The Company excludes options from the calculation of diluted earnings per share when the combined exercise price, unamortized fair value and excess tax benefits of the options exceed the average market price of the Company's common stock because their effect would be anti-dilutive. For the nine months ended September 30, 2014, the Company excluded 2,834,079 options from the calculation of diluted earnings per share because their effect would be anti-dilutive. For the three and nine months ended September 30, 2013, the Company excluded 2,623,314 options and 2,574,709 options from the calculation of diluted earnings per share because their effect would be anti-dilutive.

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|--------|------------------------------------|--------|
| | 2014 | 2013 | 2014 | 2013 |
| Weighted average shares outstanding – basic | 49,004 | 48,050 | 48,641 | 47,247 |
| Dilutive effect of stock options | — | 1,506 | 1,117 | 2,068 |
| Weighted average shares outstanding – diluted | 49,004 | 49,556 | 49,758 | 49,315 |

8. Subsequent Events

On November 4, 2014, the Company entered into Amendment No. 2 to its Credit Agreement (Second Amendment) in which certain financial covenants were amended and additional financial covenants were added. Under the Second Amendment, the total debt to EBITDA ratio, which required the Company to maintain a ratio of 3.25 to 1.0 as of September 30, 2014 was revised as follows:

for the computation periods ending December 31, 2014, March 31, 2015, June 30, 2015, September 30, 2015 and December 31, 2015, the Company must maintain a total debt to EBITDA ratio of 5.00 to 1.0

for the computation periods ending March 31, 2016, June 30, 2016, September 30, 2016 and December 31, 2016, the Company must maintain a total debt to EBITDA ratio of 4.75 to 1.0; and

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for each computation period ending March 31, 2017 and thereafter, the Company must maintain a total debt to EBITDA ratio of 3.25 to 1.0

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In addition, the fixed charge coverage ratio of 1.20 to 1.0, which was in effect for every computation period under the Credit Agreement as of September 30, 2014, has been revised under the Second Amendment to apply only to the computation periods ending September 30, 2014, March 31, 2017, and each computation period thereafter.

The Second Amendment also added an interest coverage ratio, defined as the ratio of EBITDA compared to interest expense paid in cash for the computation period. Under this new financial covenant, the Company is required to maintain:

- an interest coverage ratio of not to be less than 2.25 to 1.0 for the computation periods ending December 31, 2014, March 31, 2015, June 30, 2015, September 30, 2015, and December 31, 2015; and

• an interest coverage ratio not to be less than of 2.50 to 1.0 for the computation period ending March 31, 2016, June 30, 2016, September 30, 2016 and December 31, 2016.

In addition, among other things, under the Second Amendment, the Company is now required to maintain minimum adjusted cash balances of \$35.0 million from November 4, 2014 through December 31, 2015, and minimum adjusted cash balances of \$30.0 million from January 1, 2016 through December 31, 2016. Further, under the Second Amendment, the Company must maintain EBITDA for any trailing twelve month period of not less than \$20.0 million beginning with the month ending November 30, 2014 through the month ending December 31, 2016. Also, pursuant to the terms of the Second Amendment, the lenders are not required to make new loans or issue new letters of credit under the Company's line of credit when the total debt to EBITDA ratio exceeds 3.25 to 1.0. Lastly, under the Second Amendment, capital expenditures of the Company in the years ending December 31, 2014, December 31, 2015, and December 31, 2016, are not permitted to exceed \$12.5 million.

Interest charged under the Credit Agreement as revised by the Second Amendment is a function of the total debt to EBITDA ratio, adjusted quarterly. When the total debt to EBITDA ratio is greater than 4.0 to 1.00, the Term A loan is charged interest either at Prime + 4.75% or LIBOR + 5.75%, while the Term B loan is charged interest either at Prime + 5.25% or LIBOR + 6.25%. When the total debt to EBITDA ratio is equal to or less than 4.0 to 1.00, the Term A loan is charged interest either at Prime + 4.25% or LIBOR + 5.25%, while the Term B loan is charged interest either at Prime + 4.75% or LIBOR + 5.75%.

Fees for the Second Amendment of \$518,000 were paid to the agent and lenders on November 4, 2014.

Table of Contents**ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.**

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

Overview

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

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

Sources of Revenues

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

| | Three Months Ended | | Nine Months Ended | |
|-----------------|--------------------|----------|-------------------|-----------|
| | September 30, | | September 30, | |
| | 2014 | 2013 | 2014 | 2013 |
| | (in thousands) | | (in thousands) | |
| Student Lending | \$28,083 | \$43,416 | \$107,588 | \$121,672 |
| Healthcare | 5,205 | 28,331 | 30,112 | 56,613 |
| Other | 6,352 | 5,061 | 17,983 | 17,041 |
| Total Revenues | \$39,640 | \$76,808 | \$155,683 | \$195,326 |

Student Lending

We derive the majority of our revenues from the recovery of student loans. These revenues are contract-based and consist primarily of contingency fees based on a specified percentage of the amount we enable our clients to recover. Our

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contingency fee percentage for a particular recovery depends on the type of recovery facilitated. We also receive incremental performance incentives based upon our performance as compared to other contractors with the Department of Education, which are comprised of additional inventory allocation volumes and incentive fees. We are currently subject to a competitive rebidding process for the next contract with the Department of Education. The bidding process has been changed on two occasions and the Department of Education has now extended the current contract to April 2015, when we expect the new contract awards to become effective. The bidding process is not expected to have an impact on our 2014 revenues because we continue to operate under the existing contract. In October 2014, the Department of Education announced a change in the structure for the payment of fees to recovery contractors upon rehabilitation of student loans under the existing recovery contract. The new fee structure provides for a fixed fee of \$1,710 for each loan that is rehabilitated. Previously, the fee had been based on a percentage of the principal amount of the rehabilitated loan. The change to the fee structure will be effective to student loans that are rehabilitated on or following April 22, 2015. Although this change to a fixed fee structure will not take place until April 2015, had the new fixed fee structure been in place for 2014, we estimate that our overall student lending revenues would have decreased by approximately 13% for the nine months ended September 30, 2014 and by approximately \$2.4 million in the third quarter of 2014, assuming no variation in our student loan placement during the periods.

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.

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. As stated above, effective April 2015, our contract with the Department of education will provide for a fixed fee of \$1,710 for each rehabilitated loan. The fees we are paid vary by recovery outcome as well as by contract. For non-government-supported student loans we are generally only paid contingency fees on two outcomes: full repayment or recurring repayments. The table below describes our typical fee structure for each of these five outcomes.

Student Loan Recovery Outcomes

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

For certain guaranty agency, or GA, clients, we have entered into Master Service Agreements, or MSAs. Under these agreements, clients provide their entire inventory of outsourced loans or receivables to us for recovery on an exclusive basis, rather than just a portion, as with traditional contracts that are split among various service providers. In certain circumstances, we engage subcontractors to assist in the recovery of a portion of the client's portfolio. We also receive success fees for the recovery of loans under MSAs and our revenues under MSA arrangements include fees earned by the activities of our subcontractors. As of September 30, 2014, we had three MSA clients in the student loan market.

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Healthcare

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

We are currently involved in a competitive rebidding process for the next RAC contract with CMS. The timing of new RAC contract awards remains uncertain. The bidding process has been delayed, at least in part, by pre-award protests and, following the denial of those protests, by ongoing litigation. The litigation involves a request for injunction against award of the new RAC contracts and elimination of payment terms under the proposed new RAC contracts that would prohibit RACs from being compensated for improper claims until a second level of appeal has been exhausted. A decision in favor of CMS is currently on appeal, and injunction bars award of three of the five new RAC contracts pending the appeal.

In connection with our RAC contract, CMS has announced a settlement offer to pay hospitals 68% of what they have billed Medicare to settle a backlog of pending appeals challenging Medicare's denials of reimbursement for certain types of short-term care. The implication of this settlement offer related to claims for which fees have already been paid to recovery auditors under existing RAC contracts is unclear at this time, but we may be obligated to repay certain amounts that we previously received from CMS depending on the final terms of any such settlement. We accrue an estimated liability for appeals based on the amount of commissions received which are subject to appeal and which we estimate are probable of being returned to providers following successful appeal. The \$17.2 million balance as of September 30, 2014, represents our best estimate of the probable amount of we may be required to refund related to appeals of claims for which commissions were previously collected. We estimate that it is reasonably possible that we could be required to pay an additional amount up to approximately \$5.4 million as a result of potentially successful appeals in excess of the amount we accrued as of September 30, 2014.

In anticipation of the award of new RAC contracts, beginning in 2013 CMS has adopted a series of contract transition procedures that have restricted our ability to request medical records for audit, thus adversely affected our revenues under this contract. No records requests were permitted in July 2013 and then from November 15, 2013 through year end. In January 2014, records requests were again permitted through February 21, 2014 and claim activity was permitted through June 1, 2014, when work under the contract stopped. In addition to these periods of suspended activity, the contract transition rules have limited scope of our permitted audit activities as CMS has generally not permitted audits of PIP providers and has also placed additional restrictions on the types of claims we are permitted to audit and number of medical records we are permitted to request. CMS began to permit claim reviews again in August 2014 for an unspecified period, but has restricted reviews to a limited number of types of claims.

To accelerate our ability to provide Medicare audit and recovery services across our region following our award of our initial RAC contract, we outsourced certain aspects of our healthcare recovery process to three different subcontractors. Two of these subcontractors provide a specific service to us in connection with our claims recovery process, and one subcontractor is engaged to provide all of the audit and recovery services for claims within a portion of our region. We recognize all of the revenues generated by the claims recovered through these subcontractor relationships, and we recognize the fees that we pay to these subcontractors in our expenses.

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 and are not expected to generate material revenues until 2015.

Other

We also derive revenues from the recovery of delinquent state 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.

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Operating Metrics

We monitor a number of operating metrics in order to evaluate our business and make decisions regarding our corporate strategy. These key metrics include Placement Volume, Placement Revenue as a Percentage of Placement Volume, Net Claim Recovery Volume and Claim Recovery Fee Rate.

| | Three Months Ended September 30, 2014 | | 2013 | | Nine Months Ended September 30, 2014 | | 2013 | |
|---|---|---|-------------|---|--|---|-------------|---|
| | (dollars in thousands) | | | | (dollars in thousands) | | | |
| Student Lending: | | | | | | | | |
| Placement Volume | \$1,678,374 | | \$2,138,751 | | \$4,982,354 | | \$5,142,296 | |
| Placement Revenue as a Percentage of Placement Volume | 1.67 | % | 2.03 | % | 2.16 | % | 2.37 | % |
| Healthcare: | | | | | | | | |
| Net Claim Recovery Volume | \$46,089 | | \$251,290 | | \$266,632 | | \$501,526 | |
| Claim Recovery Fee Rate | 11.29 | % | 11.27 | % | 11.29 | % | 11.29 | % |

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.

Placement Revenue as a Percentage of Placement Volume. Placement Revenue as a Percentage of Placement Volume is calculated by dividing revenues recognized during the specified period by Placement Volume first placed with us during that same period. This metric is subject to some level of variation from period to period based upon certain timing differences including, but not limited to, the timing of placements received by us within a period and the fact that a significant portion of revenues recognized in a current period is often generated from the Placement Volume received in prior periods. However, we believe that this metric provides a useful indication of the revenues we are generating from Placement Volumes on an ongoing basis and provides management with an indication of the relative efficiency of our recovery operations from period to period.

Net Claim Recovery Volume. Our Net Claim Recovery Volume measures the dollar volume of improper Medicare claims that we have recovered for CMS during the applicable period net of any amount that we have reserved to cover appeals by healthcare providers. We are paid recovery fees as a percentage of this recovered claim volume. We calculate this metric by dividing our claim recovery revenues by our Claim Recovery Fee Rate. This metric shows trends in the volume of improper payments within our region and allows management to measure our success in finding these improper payments, over time.

Claim Recovery Fee Rate. Our Claim Recovery Fee Rate represents the weighted-average percentage of our fees compared to amounts recovered by CMS. This percentage primarily depends on the method of recovery and, in some cases, the type of improper payment that we identify. This metric helps management measure the amount of revenues we generate from Net Claim Recovery Volume.

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. We expect a significant portion of our expenses to increase as we grow our business. However, we expect certain expenses, including our corporate and general administrative expenses, to grow at a slower rate than our revenues. As a result, and over the long term, we expect our overall expenses to modestly decline as a percentage of revenues.

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, effects of client concentration and macroeconomic factors.

Allocation of Placement Volume

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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. For example, a technology system upgrade at the Department of Education significantly decreased the volume of student loan placements by the Department of Education to all recovery vendors, including us. While we and the other recovery vendors have received substantially larger placement volume in the fourth quarter of 2012 as a result of the completion of this technology system upgrade, the majority of the revenues from these placements were not recognized until the third quarter of 2013 because we do not begin to earn rehabilitation revenues from a given placement until at least nine months after receipt of a placement. In addition, for approximately twelve months beginning in September 2011, the Department of Education was not able to process a portion of rehabilitated student loans and accordingly we were not able to recognize certain revenues associated with rehabilitation of loans for this client. However, the Department of Education continued to pay us based on invoices submitted and we recorded these cash receipts as deferred revenues on our balance sheet.

Claim Recovery Volume

While we are entitled to review Medicare records for all Part A and Part B claims in our region, we are not permitted to identify 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. The growth of our revenues is determined primarily by the aggregate volume of Medicare claims in our region and our ability to identify improper payments within these claims. However, the long-term growth of these revenues will also be affected by the scope of the issues pre-approved by CMS.

CMS has made changes to the permitted audit scope during the course of the RAC contract that have had a significant effect on our revenues. For example, in September 2013, CMS announced that beginning October 1, 2013, we and the other RAC contractors would not be 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 inpatient services on hospital stays lasting less than two midnights. 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 existing RAC contract. The continued suspension of this type of review activity or restrictions on other types of review activities could have a material adverse effect on our healthcare revenues and operating results.

In addition, in planning for the award of the next RAC contracts, CMS has implemented transition procedures that have significantly affected our operations during the transition period by placing restrictions on the types of claims and the amount of certain medical records requests that we may make during the transition period, and by suspending records requests during other periods.

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. For example, the fees that we earn under our contractual arrangement with the Department of Education have been subject to unilateral change by the Department of Education as a result of the Department of Education's decision to have its recovery vendors promote IBR to defaulted student loans. The IBR program provides flexibility on the required monthly payment for student loan borrowers at an amount intended to be affordable based on a borrower's income and family size. As a result of the increased application of the IBR program to defaulted student loans, we expect that there will be an increase in the number of loans that become eligible for rehabilitation because more defaulted

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student loan borrowers will be able to make qualifying payments. In connection with the implementation of the IBR program, the Department of Education initially reduced the contingency fee rate that we receive for rehabilitating student loans by approximately 13% effective March 1, 2013. Further, in October 2014, the Department of Education announced a change to a fixed fee of \$1,710 payable for each loan that is rehabilitated in place of a recovery fee that historically had been based on a percentage of the balance of the rehabilitated loan. Although this change to a fixed fee structure will not take place until April 2015, had the new fixed fee structure been in place for 2014, we estimate that our overall student lending revenues would have decreased by approximately 13% for the nine months ended September 30, 2014 and by approximately \$2.4 million in the third quarter of 2014, assuming no variation in our student loan placement during the periods.

In addition, the Bipartisan Budget Act of 2013, which was signed into law by President Obama on December 26, 2013, reduced the compensation paid to GAs for the rehabilitation of student loans, effective July 1, 2014. This "revenue enhancement" measure reduced the amount that GAs can charge borrowers when a rehabilitated loan is sold from 18.5% to 16% of the outstanding loan balance, 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% in the contingency fee percentage that we receive from GAs for assisting in the rehabilitation of student loans.

Regulatory Matters

Each of the markets which we serve is highly regulated. Accordingly, changes in regulations that affect the types of loans, receivables and claims that we are able to service or the manner in which any such delinquent loans, receivables and claims can be recovered will affect our revenues and results of operations. For example, the passage of the Student Aid and Fiscal Responsibility Act, or SAFRA, in 2010 had the effect of transferring the origination of all government-supported student loans to the Department of Education, thereby ending all student loan originations guaranteed by the GAs. Loans guaranteed by the GAs represented approximately 70% of government-supported student loans originated in 2009. While the GAs will continue to service existing outstanding student loans for years to come, this legislation will over time shift the portfolio of student loans that we manage toward the Department of Education, and further concentrate our sources of revenues and increase our reliance on our relationship with the Department of Education. 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 Concentration

Our revenues from the student loan market depend on our ability to maintain our contracts with some of the largest providers of student loans. For the nine months ended September 30, 2014 and in 2013, three providers of student loans each accounted for more than 10% of our revenues and they collectively accounted for 53.7% and 48.8% of our total revenues during these respective periods. Our contracts with these clients entitle them to unilaterally terminate their contractual relationship with us at any time without penalty. If we lose one of our significant clients, including if one of our significant clients is consolidated by an entity that does not use our services, if the terms of compensation for our services change or if there is a reduction in the level of placements provided by any of these clients, our revenues could decline.

Our contract with CMS for the recovery of improper Medicare payments began generating significant revenues during 2011 and represented 17.8% and 26.2% of our total revenues for the nine months ended September 30, 2014 and for the year ended December 31, 2013, respectively. Our audit work under our existing RAC contract expired in June 2014, but we have been permitted to resume audit work with respect to a limited number of claims in August 2014. We are currently participating in a competitive bidding process for the next RAC contract. The award of the new RAC contracts has been delayed due in part to a bid protest followed by a lawsuit and a subsequent appeal process which is still underway. Pending a decision on appeal, the contract award process has been enjoined. While we believe our performance under the existing agreement and the experience we have gained in performing this contract position us well to renew the agreement, failure to renew the agreement or renewal on substantially less favorable terms could

significantly harm our revenues and results of operations.

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.

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Critical Accounting Policies

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

Revenue Recognition

The majority of our contracts are contingency fee based. We recognize revenues on these contingency fee based contracts when third-party payors remit payments to our clients or remit payments to us on behalf of our clients, and, consequently, the contingency is deemed to have been satisfied. Under our RAC contract with CMS, we recognize revenues when the healthcare provider has paid CMS for a given claim or incurs an offset against future Medicare claims. Providers have the right to appeal a claim and may pursue additional appeals if the initial appeal is found in favor of CMS. 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. This estimated liability for appeals is an offset to revenues on our income statement. Our estimates are based on our historical experience with appeals activity under our CMS contract since January 2010. The \$17.2 million balance as of September 30, 2014, represents our best estimate of the probable amount of losses related to appeals of claims for which commissions were previously collected and recognized as revenues. We estimate that it is reasonably possible that we could be required to pay an additional amount up to approximately \$5.4 million as a result of potentially successful appeals in excess of the amount we reserved as of September 30, 2014. 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. Our inability to correctly estimate the estimated liabilities and allowance against accounts receivable could adversely affect our revenues in future periods.

Goodwill

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

Specifically, goodwill impairment is determined using a two-step test. The first step of the goodwill impairment test is used to identify potential impairment by comparing the fair value of a reporting unit with its book value, including goodwill. If the fair value of the reporting unit exceeds its book value, goodwill is considered not impaired and the second step of the impairment test is unnecessary. If the book value of the reporting unit exceeds its fair value, the second step of the goodwill impairment test is performed to measure the amount of impairment loss, if any. The second step of the goodwill impairment test compares the implied fair value of the reporting unit's goodwill with the book value of that goodwill. If the book value of the reporting unit's goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. The implied fair value of goodwill is determined in the same manner as the amount of goodwill recognized in a business combination. That is, the fair value of the reporting unit is allocated to all of the assets and liabilities of that unit as if the reporting unit had been acquired in a business combination and the fair value of the reporting unit was the purchase price paid to acquire the reporting unit. There was no impairment expense for goodwill for the three and nine months ended September 30, 2014.

Impairments of Depreciable Intangible Assets

We evaluate depreciable intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. Depreciable intangible assets consist of client contracts and related relationships, and are being amortized over their estimated useful life, which is generally 20 years. We

evaluate the client contracts intangible at the individual contract level. The recoverability of such assets is measured by a comparison of the carrying amount of the assets to future undiscounted net cash flows expected to be generated by the assets. If the assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. There was no impairment expense for depreciable intangible assets for the three and nine months ended September 30, 2014.

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Recent Accounting Pronouncements

In May 2014, the FASB issued Accounting Standards Update No. 2014-09 (ASU 2014-09) "Revenue from Contracts with Customers." ASU 2014-09 supersedes the revenue recognition requirements in "Revenue Recognition (Topic 605)", and requires entities to recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Early adoption is not permitted. We are currently in the process of evaluating the impact of the adoption of ASU 2014-09 on our consolidated financial statements.

Results of Operations

Three Months Ended September 30, 2014 compared to the Three Months Ended September 30, 2013

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

| | Three Months Ended September 30, | | | | |
|---|----------------------------------|------------|-----------|----------|----|
| | 2014 | 2013 | \$ Change | % Change | |
| | (in thousands) | | | | |
| Consolidated Statement of Operations Data: | | | | | |
| Revenues | \$39,640 | \$76,808 | \$(37,168 |) (48 |)% |
| Operating expenses: | | | | | |
| Salaries and benefits | 22,180 | 25,060 | (2,880 |) (11 |)% |
| Other operating expenses | 15,658 | 23,563 | (7,905 |) (34 |)% |
| Total operating expenses | 37,838 | 48,623 | (10,785 |) (22 |)% |
| Income from operations | 1,802 | 28,185 | (26,383 |) (94 |)% |
| Interest expense | (2,456 |) (2,863 |) 407 | (14 |)% |
| Income (loss) before provision for income taxes | (654 |) 25,322 | (25,976 |) (103 |)% |
| Provision for income taxes | (175 |) 9,868 | (10,043 |) (102 |)% |
| Net income (loss) | \$(479 |) \$15,454 | \$(15,933 |) (103 |)% |

Revenues

Revenues were \$39.6 million for the three months ended September 30, 2014, a decrease of approximately 48%, compared to total revenues of \$76.8 million for the three months ended September 30, 2013.

Student lending revenues were \$28.1 million for the three months ended September 30, 2014, representing a decrease of \$15.3 million, or 35%, compared to the three months ended September 30, 2013. Approximately \$4.0 million of this decrease was a result of lower rehabilitation fees paid to us by our guaranty agency clients a result of the reduction that guaranty agencies can charge borrowers due to the Federal budget act that became effective July 1, 2014. The remainder of the decrease was primarily attributable to new documentation requirements imposed by our guaranty agency clients as they implemented income based repayment programs. The new documentation requirements require additional time and interaction with borrowers, which delayed some loans from qualifying for rehabilitation prior to the end of the quarter.

Healthcare revenues were \$5.2 million for the three months ended September 30, 2014, representing a decrease of \$23.1 million, or 82%, compared to the three months ended September 30, 2013. This decrease was due primarily to the wind-down of our current CMS RAC contract, resulting in substantially reduced levels of permitted healthcare audit and recovery activities.

Salaries and Benefits

Salaries and benefits expense was \$22.2 million for the three months ended September 30, 2014, a decrease of \$2.9 million, or 11%, compared to salaries and benefits expense of \$25.1 million for the three months ended September 30, 2013. The decrease in salaries and benefits expense was primarily due to lower bonus expense.

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Other Operating Expenses

Other operating expenses were \$15.7 million for the three months ended September 30, 2014, a decrease of \$7.9 million, or 34%, compared to other operating expenses of \$23.6 million for the three months ended September 30, 2013. The decrease in other operating expenses was primarily due to the wind-down of our current CMS RAC contract, resulting in lower levels of healthcare audit and recovery activities during the period.

Income from Operations

Income from operations was \$1.8 million for the three months ended September 30, 2014, compared to \$28.2 million for the three months ended September 30, 2013, representing a decrease of \$26.4 million, or 94%. The decrease is primarily the result of a decrease in Healthcare revenue during the three months ended September 30, 2014, as a result of the wind-down of our current CMS RAC contract.

Interest Expense

Interest expense was \$2.5 million for the three months ended September 30, 2014, compared to \$2.9 million for the three months ended September 30, 2013. Interest expense decreased \$0.4 million, or 14%, due to repayments of principal under our credit agreement, resulting in a lower outstanding balance.

Income Taxes

Income tax expense was a benefit of \$0.2 million for the three months ended September 30, 2014, compared to a \$9.9 million expense for the three months ended September 30, 2013. Our effective income tax decreased to 26.8% for the three months ended September 30, 2014, from 39% for the three months ended September 30, 2013. The decrease in our effective tax rate is primarily due to the decrease in earnings for the three months ended September 30, 2014 compared to the three months ended September 30, 2013 and the resulting impact of permanent difference on the effective tax rate.

Net Income (loss)

As a result of the factors described above, net loss was \$0.5 million for the three months ended September 30, 2014, which represented a decrease of \$15.9 million, or 103% compared to net income of \$15.5 million for the three months ended September 30, 2013.

Nine Months Ended September 30, 2014 compared to the Nine Months Ended September 30, 2013

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

| | Nine Months Ended September 30, | | | | |
|--|---------------------------------|------------|-----------|----------|----|
| | 2014 | 2013 | \$ Change | % Change | |
| | (in thousands) | | | | |
| Consolidated Statement of Operations Data: | | | | | |
| Revenues | \$ 155,683 | \$ 195,326 | \$(39,643 |) (20 |)% |
| Operating expenses: | | | | | |
| Salaries and benefits | 71,236 | 72,942 | (1,706 |) (2 |)% |
| Other operating expenses | 56,304 | 65,314 | (9,010 |) (14 |)% |
| Total operating expenses | 127,540 | 138,256 | (10,716 |) (8 |)% |
| Income from operations | 28,143 | 57,070 | (28,927 |) (51 |)% |
| Interest expense | (7,765 |) (8,752 |) 987 | (11 |)% |
| Income before provision for income taxes | 20,378 | 48,318 | (27,940 |) (58 |)% |
| Provision for income taxes | 8,599 | 19,848 | (11,249 |) (57 |)% |
| Net income | \$ 11,779 | \$ 28,470 | \$(16,691 |) (59 |)% |

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Revenues

Revenues were \$155.7 million for the nine months ended September 30, 2014, a decrease of approximately 20%, compared to revenues of \$195.3 million for the nine months ended September 30, 2013.

Student lending revenues were 107.6 million for the nine months ended September 30, 2014, representing a decrease of \$14.1 million, or 12%, compared to the nine months ended September 30, 2013. This decrease was primarily due to lower rehabilitation revenues. Approximately \$4.0 million of this decrease was a result of lower rehabilitation fees paid to us by our guaranty agency clients a result of the reduction that guaranty agencies can charge borrowers due to the Federal budget act that became effective July 1, 2014. The remainder of the decrease was primarily attributable to new documentation requirements imposed by our guaranty agency clients as they implemented income based repayment programs. The new documentation requirements require additional time and interaction with borrowers, which delayed some loans from qualifying for rehabilitation during the period.

Healthcare revenues were \$30.1 million for the nine months ended September 30, 2014, representing a decrease of \$26.5 million, or 47%, compared to the nine months ended September 30, 2013. The decrease was due primarily to reduced audit activity in the 2014 period as the result of the wind-down of our CMS RAC contract, resulting in substantially reduced levels of permitted healthcare audit and recovery activities.

Salaries and Benefits

Salaries and benefits expense was \$71.2 million for the nine months ended September 30, 2014, an increase of \$1.7 million, or 2%, compared to salaries and benefits expense of \$72.9 million for the nine months ended September 30, 2013. This decrease in salaries and benefits expense was primarily due to lower bonus expense.

Other Operating Expenses

Other operating expenses were \$56.3 million for the nine months ended September 30, 2014, a decrease of \$9.0 million, or 14%, compared to other operating expenses of \$65.3 million for the nine months ended September 30, 2013. The decrease in other operating expenses was primarily due to lower third party collection fees, communication and postage resulting from the wind-down of our current CMS RAC contract.

Income from Operations

Income from operations was \$28.1 million for the nine months ended September 30, 2014, compared to \$57.1 million for the nine months ended September 30, 2013, representing a decrease of \$28.9 million, or 51%. The decrease is primarily the result of a decline in our CMS audit and recovery activities as described above.

Interest Expense

Interest expense was \$7.8 million for the nine months ended September 30, 2014, compared to \$8.8 million for the nine months ended September 30, 2013. Interest expense decreased \$1.0 million due to repayments of principal under our credit agreement, resulting in a lower outstanding balance.

Income Taxes

Income tax expense was \$8.6 million for the nine months ended September 30, 2014, compared to \$19.8 million for the nine months ended September 30, 2013. Our effective income tax increased to 42.2% for the nine months ended September 30, 2014, from 41.1% for the nine months ended September 30, 2013. The increase in the effective tax rate is primarily due to the decrease in earnings for the nine months ended September 30, 2014 compared to the nine months ended September 30, 2013 and the resulting impact of permanent difference on the effective tax rate.

Net Income

As a result of the factors described above, net income was \$11.8 million for the nine months ended September 30, 2014, which represented a decrease of \$16.7 million, or 59%, compared to net income of \$28.4 million for the nine months ended September 30, 2013.

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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; and

other companies may calculate adjusted EBITDA and adjusted net income differently than we do, which reduces its usefulness as a comparative measure.

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|------------|------------------------------------|----------|
| | 2014 | 2013 | 2014 | 2013 |
| Adjusted EBITDA: | | | | |
| Net income (loss) | \$(479 |) \$15,454 | \$11,779 | \$28,470 |
| Provision for income taxes | (175 |) 9,868 | 8,599 | 19,848 |
| Interest expense | 2,456 | 2,863 | 7,765 | 8,752 |
| Secondary offering expense ⁽¹⁾ | — | — | — | 2,893 |
| Depreciation and amortization | 3,067 | 2,702 | 9,058 | 7,840 |
| Stock-based compensation | 839 | 774 | 2,621 | 2,196 |
| Adjusted EBITDA | \$5,708 | \$31,661 | \$39,822 | \$69,999 |
| | | | | |
| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
| | 2014 | 2013 | 2014 | 2013 |
| Adjusted Net Income: | | | | |
| Net income (loss) | \$(479 |) \$15,454 | \$11,779 | \$28,470 |
| Secondary offering expense ⁽¹⁾ | — | — | — | 2,893 |
| Stock-based compensation | 839 | 774 | 2,621 | 2,196 |
| Amortization of intangibles ⁽²⁾ | 933 | 933 | 2,799 | 2,799 |
| Deferred financing amortization costs ⁽³⁾ | 264 | 281 | 796 | 848 |
| Tax adjustments ⁽⁴⁾ | (814 |) (795 |) (2,486 |) (3,494 |
| Adjusted Net Income | \$743 | \$16,647 | \$15,509 | \$33,712 |

(1) Represents direct and incremental costs associated with the Company's secondary offerings in February and April 2013.

Represents amortization of capitalized expenses related to the acquisition of Performant by an affiliate of

(2) 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 debt offerings conducted in 2012.

(4) Represents tax adjustments assuming a marginal tax rate of 40%.

Liquidity and Capital Resources

Our primary sources of liquidity are cash flows from operations and our credit agreement. Cash and cash equivalents, which totaled \$85.0 million as of September 30, 2014, consist primarily of cash on deposit with banks. We expect that operating cash flows will continue to be a primary source of liquidity for our operating needs. There are currently no borrowings outstanding under our revolving credit facility other than \$1.6 million letters of credit. Due to our operating cash flows and our existing cash and cash equivalents, we believe that we have the ability to meet our working capital and capital expenditure needs for the foreseeable future.

The \$3.1 million increase in the balance of our cash and cash equivalents compared with the end of the fourth quarter of 2013 was primarily due to cash generated from operations of \$25.9 million during the first nine months of 2014, offset by principal repayments of \$19.1 million on our long-term debt and \$6.7 million of capital expenditures.

Cash flows from operating activities

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Cash provided by operating activities for the nine months ended September 30, 2014 was primarily due to net income of \$11.8 million, an increase in net payable to client of \$14.0 million, a decrease in trade accounts receivable of \$3.0 million, an increase in estimated liability for appeals of \$2.2, partially offset by an increase in prepaid expenses and other current assets of \$7.9 million, decrease in accrued salaries and benefits of \$4.9 million and increase in income tax receivable of \$3.1 million.

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Cash flows from investing activities

Cash used in investing activities for the nine months ended September 30, 2014 was due to capital expenditures of \$6.7 million related to information technology, data storage, hardware, telecommunication systems and security enhancements to our proprietary software.

Cash flows from financing activities

Cash used in financing activities for the nine months ended September 30, 2014 was primarily attributable to repayments of principal of \$19.1 million on long-term debt.

Estimated liability for appeals and Net payable to client

The September 30, 2014 balances of \$17.2 million and \$14.0 million for the Estimated liability for appeals and the Net payable to client, respectively, represent obligations that we expect to pay in the near term, although it is difficult to predict the precise timing of the associated cash outflows as they are dependent on the processing and resolution of audit appeals.

Long-term Debt

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

All borrowings under the credit agreement bear interest at a rate per annum equal to an applicable margin corresponding to our total debt to EBITDA ratio, plus, at our option, either (i) a base rate determined by reference to the highest of (a) the prime rate published in the Wall Street Journal or another national publication, (b) the federal funds rate plus 0.5%, (c) the sum of (A) the 1-month LIBOR rate and (B) the difference between the then effective applicable margins for LIBOR loans and base rate loans and (d) 2.5% or (ii) a LIBOR rate determined by reference to the highest of (a) a LIBOR rate published in Reuters or another national publication and (b) 1.5%. The term A loan and the revolving credit facility currently have an applicable margin of 4.25% for base rate loans and 5.25% for LIBOR rate loans, in each case based on a total debt to EBITDA ratio of less than 4.00 to 1.00. The term B loan (including the incremental term B loan) currently has an applicable margin of 4.75% for base rate loans and 5.75% for LIBOR rate loans, in each case based on a total debt to EBITDA ratio of less than 4.00 to 1.00. The minimum per annum interest rate that we are required to pay is 6.75% for the term A loan and revolving credit facility and 7.25% for the term B loan. Interest is due at the end of each month for base rate loans and at the end of each LIBOR period for LIBOR rate loans unless the LIBOR period is greater than 3 months, in which case interest is due at the last day of each 3-month interval of such LIBOR period.

The credit agreement requires us to prepay the two term loans on a prorated basis and then to prepay the revolving credit facility under certain circumstances: (i) with 100% of the net cash proceeds of any asset sale or other disposition of assets by us or our subsidiaries where the net cash proceeds exceed \$1 million, (ii) with a percentage of our annual excess cash flow each year where such percentage ranges from 25%-75% depending on our total debt to EBITDA ratio reduced by any voluntary prepayments that are made on our term loans during the same period, unless we elect to apply voluntary prepayments in the inverse order of maturity, in which case only voluntary prepayments in excess of \$10 million shall reduce the amount of excess cash flow we are required to prepay and (iii) with any net cash proceeds from a qualified initial public offering by us, less net proceeds applied to redeem any outstanding preferred equity or convertible debt, to pay a common shareholder dividend not to exceed \$20 million or, if we comply with an adjusted EBITDA ratio set forth in the agreement, to our cash balances in an amount not to exceed \$75 million. With respect to (ii) above, the Company made a pro rata prepayment of approximately \$11.5 million to the lenders in May 2014.

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

• incur additional indebtedness;

• create or permit liens;
• pay dividends or other distributions to our equity holders;
• purchase or redeem certain equity interests of our equity holders, including any warrants, options and other security rights;

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pay management fees or similar fees to any of our equity holders;
 make any redemption, prepayment, defeasance, repurchase or any other payment with respect to any subordinated debt;
 consolidate, merge or make any acquisitions;
 sell assets, including the capital stock of our subsidiaries;
 enter into transactions with our affiliates;
 enter into different business lines;
 permit the aggregate amount of capital expenditures to exceed a certain amount; and
 make investments.

The credit agreement also requires us to meet certain financial covenants, including maintaining (i) a fixed charge coverage ratio, (ii) a total debt to EBITDA ratio, (iii) an interest coverage ratio, (iv) a minimum EBITDA amount and (v) a minimum required adjusted cash amount, as such terms are defined in our credit agreement. These financial covenants are tested at the end of each quarter or month, as applicable. The table below further describes these financial covenants, as well as our current status under these covenants as of September 30, 2014.

| Financial Covenant | Covenant Requirement | Actual Ratio at September 30, 2014 |
|--|----------------------|------------------------------------|
| Fixed charge coverage ratio (minimum)* | 1.20 to 1.0 | 1.37 |
| Total debt to EBITDA ratio (maximum)* | 3.25 to 1.0 | 1.91 |
| Interest coverage ratio (minimum)** | 2.25 to 1.0 | 6.41 |
| EBITDA (minimum)** | \$20,000,000 | \$59,964,000 |
| Required Adjusted Cash Amount (minimum)*** | \$35,000,000 | \$59,527,000 |

* Covenant requirement as of September 30, 2014. These covenant requirements adjust in future period.

** These requirements will become effective December 2014, and will adjust in future periods

*** This requirement became effective November 4, 2014.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We do not hold or issue financial instruments for trading purposes. We conduct all of our business in U.S. currency and therefore do not have any material direct foreign currency risk. We do have exposure to changes in interest rates with respect to the borrowings under our senior secured credit facility, which bear interest at a variable rate based on the prime rate or LIBOR. For example, if the interest rate on our borrowings increased 100 basis points (1%) from the credit facility floor of 1.5%, our annual interest expense would increase by approximately \$1.2 million.

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

ITEM 4. DISCLOSURE CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

We maintain “disclosure controls and procedures,” as such term is defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, or the Exchange Act, that are designed to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to our management, including our principal executive officer (our Chief Executive Officer) and our principal financial officer (our Chief Financial Officer), as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, management recognized that disclosure controls and

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procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the disclosure controls and procedures are met. Our disclosure controls and procedures have been designed to meet reasonable assurance standards. Additionally, in designing disclosure controls and procedures, our management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures. The design of any disclosure controls and procedures also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

Based on their evaluation as of the end of the period covered by this Quarterly Report on Form 10-Q, our Chief Executive Officer and Chief Financial Officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting during the quarter ended September 30, 2014, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

ITEM 1A. RISK FACTORS

If any of the following risks actually occurs, our business, financial condition and results of operations could be harmed. In that case, the trading price of our common stock could decline and you might lose all or part of your investment in our common stock. The risks and uncertainties described below are not the only ones we face. You should also refer to the other information set forth in this Form 10-Q, including under “Managements’ Discussion and Analysis of Financial Condition and Results of Operations”. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also impair our business operations.

Risks Related to Our Business

Our agreements with the Department of Education and CMS, two of our largest customers, are currently subject to rebidding processes, and our failure to renew these agreements or a renewal on less favorable terms would have a significant negative impact on our revenues and results of operations.

Our existing contracts with the Department of Education and CMS are currently subject to rebidding processes. The Department of Education and CMS were responsible for approximately 25% and 18% of our revenues for the nine months ended September 30, 2014, respectively, and 20% and 26% of our revenues for the year ended December 31, 2013, respectively. The Department of Education has announced that it expects to award contracts in April 2015.

We are currently participating in a competitive bidding process for the next RAC contract, but this process has been and may continue to be delayed, including by ongoing litigation related to the bidding process, protests following the award of contracts or other factors. While we believe our performance under existing contracts with the Department of Education and CMS and the experience we have gained in performing under these contracts position us well to renew both of these agreements, continued delays in the award of the new contracts, failure to retain either of these agreements or a significant adverse change in the terms of either of these agreements upon any renewal would seriously harm our revenues and our operating results.

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

Our ability to make claims under our existing RAC contract continues to be limited by contract transition rules announced by CMS. In this regard, CMS suspended our ability to request medical records for audit during a significant portion of the fourth quarter of 2013 and all of 2014 other than a brief period in January and February 2014, beginning again in August 2014 through year end. In addition, even during periods of permitted audit activity,

CMS has placed restrictions on the types of claims and the amount of certain medical records requests that we may make during the transition period, and CMS has generally maintained a long-running prohibition on requesting medical records from PIP providers. These transition rules have had a material adverse effect on our revenues during the nine months ended September 30, 2014. Our revenues from CMS during the quarter ended September 30, 2014 were \$4.0 million, compared to \$28.2 million in the same quarter of 2013. Our revenues under this contract will be further diminished during the remainder of 2014 and into 2015. In addition, a federal appeals court is reviewing a lower court decision denying a protest involving the new RAC contract, which has resulted in continuing delays in the award of the new RAC contract. As a result of the delays in the award of the new RAC contract and the restrictions on our audit activities under the existing contract, we expect the reduction in healthcare revenues will have a material adverse effect on our revenues for the remainder of 2014 and into 2015. In addition, if we are successful in obtaining a new RAC contract with CMS, we expect there will be an approximate four to six month period until we start to recognize revenue after the award is made.

Revenues generated from our four largest clients represented 72% of our revenues for the nine months ended September 30, 2014 and 75% of our revenues for the year ended December 31, 2013, and any termination of or deterioration in our relationship with any of these clients would result in a decline in our revenues.

We derive a substantial majority of our revenues from a limited number of clients, including the Department of Education, CMS and two GAs. Revenues from our four largest clients represented 72% of our revenues for the nine month

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ended September 30, 2014 and 75% of our revenues for the year ended December 31, 2013. All of our contracts with these clients are subject to periodic renewal and re-bidding processes and if we lose one of these clients or if the terms of our relationships with any of these clients become less favorable to us, our revenues would decline, which would harm our business, financial condition and results of operations.

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

Substantially all of our existing contracts for the recovery of student loans and other receivables, which represented approximately 81% of our revenues for the nine months ended September 30, 2014 and 74% of our revenues in the year ended December 31, 2013, enable our clients to unilaterally terminate their contractual relationship with us at any time without penalty, potentially leading to loss of business or renegotiation of terms. Further, most of our contracts in these markets allow our clients to unilaterally change the volume of loans and other receivables that are placed with us or the payment terms at any given time. In addition, most of our contracts are not exclusive, with our clients retaining multiple service providers with whom we must compete for placements of loans or other obligations. Therefore, despite our contractual relationships with our clients, our contracts do not provide assurance that we will generate a minimum amount of revenues or that we will receive a specific volume of placements.

Our revenues and operating results would be negatively affected if our student loan and receivables clients, which include four of our five largest clients for the nine months ended September 30, 2014 and 2013, reduce the volume of student loan placements provided to us, modify the terms of service, including the success fees we are able to earn upon recovery of defaulted student loans, or any of these clients establish more favorable relationships with our competitors. For example, in 2013 in connection with the Department of Education's decision to have its recovery vendors promote income-based repayment, or IBR, to defaulted student loans, the Department of Education unilaterally reduced the contingency fee rate that we receive for rehabilitating student loans by approximately 13%. Further, in October 2014, the Department of Education announced a change to a fixed fee of \$1,710 payable for each loan that is rehabilitated in place of a recovery fee that historically had been based on a percentage of the balance of the rehabilitated loan. Although this change to a fixed fee structure will not take place until April 2015, had the new fixed fee structure been in place for 2014, we estimate that our overall student lending revenues would have decreased by approximately 13% for the nine months ended September 30, 2014 and by approximately \$2.4 million in the third quarter of 2014, assuming no variation in our student loan placement during the periods.

Further, CMS recently offered to pay hospitals 68% of what they have billed Medicare to settle a backlog of pending appeals challenging Medicare's denials of reimbursement for certain types of short-term care. The implication of this settlement offer related to claims for which recovery auditors have already been paid under existing RAC contracts is uncertain unclear at this time. 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 \$17.2 million balance as of September 30, 2014, represents our best estimate of the probable amount of we may be required to refund related to appeals of claims for which commissions were previously collected. We estimate that it is reasonably possible that we could be required to pay an additional amount up to approximately \$5.4 million as a result of potentially successful appeals in excess of the amount we accrued as of September 30, 2014. Any such payment that may be required back to CMS under our existing RAC contract in connection with such settlement offer may be significant, and could have a material negative impact our financial position and liquidity.

Any other changes in the contingency fee percentages or other compensation terms that we are paid under existing and future contracts could have a significant impact on our revenues and operating results.

Our ability to derive revenues under our RAC contract 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 our existing RAC contract with CMS and any new RAC contract that we enter into upon completion of the current rebidding process with CMS, we are not permitted to and may not 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. Accordingly, the long-term growth of the revenues we derive under a RAC contract will also depend in part on CMS expanding the scope of potentially improper claims that we are allowed to pursue. If we are unable to continue to identify improper claims within the types of claims that we are permitted to pursue from time to time or if CMS does not expand the scope of potentially improper claims that we are allowed to pursue, our results of operations could be adversely affected.

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

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

As of September 30, 2014, our total debt was \$114.3 million. For the nine months ended September 30, 2014 our consolidated interest expense was \$2.5 million. Our ability to make scheduled payments or to refinance our debt obligations and to fund our other liquidity needs depends on our financial and operating performance, which is subject to factors specific to our business, such as maintaining our agreements with our key clients, as well as prevailing economic and competitive conditions and to certain financial, business and other factors beyond our control. We cannot make assurances that we will maintain a level of cash flows from operating activities sufficient to permit us to pay the principal and interest on our indebtedness and to fund our other liquidity needs. If our cash flows and capital resources are insufficient to fund our debt service obligations and allow us to maintain compliance with the covenants under our credit agreement or to fund our other liquidity needs, we may be forced to reduce or delay capital expenditures, sell assets or operations, seek additional capital or restructure or refinance our indebtedness. We cannot ensure that we would be able to take any of these actions, that these actions would be successful and permit us to meet our scheduled debt service obligations or that these actions would be permitted under the terms of our existing or future debt agreements, including our credit agreement. 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 agreements contain, and any agreements to refinance our debt likely will contain, 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. We recently entered into an agreement amending the terms of our credit agreement, particularly in light of the delays in awarding new RAC contracts. See "Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources - Long Term Debt" in Item 2 above for a more detailed discussion of our financial covenants as well as our current status under these covenants. 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. We face significant competition in connection with obtaining, retaining and performing under our existing client contracts, including our contracts with the Department of Education and CMS, 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

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

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

We have historically derived and are likely to continue to derive a significant portion of our revenues from the U.S. federal government. For the nine months ended September 30, 2014, revenues under contracts with the U.S. federal government accounted for approximately 47% of our total revenues, compared to 48% for the year ended December 31, 2013. In addition, fees payable by the U.S. federal government are expected to become a larger percentage of our total revenues over the next several years as a result of legislation that has transferred responsibility for all new student loan origination to the Department of Education. The continuation and exercise of renewal options on existing 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, which was signed into law by President Obama on December 26, 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% 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% in the contingency fee percentage that we receive from the GAs for assisting in the rehabilitation of defaulted student loans. Further, in October 2014, the Department of Education announced a new fee structure with respect to payment for rehabilitated loans to provide a fixed fee of \$1,710 payable for each loan that is rehabilitated in place of a recovery fee that historically had been based as a percentage of the balance of the rehabilitated loan. Although this change to a fixed fee structure will not take place until April 2015, had the new fixed fee structure been in place for 2014, we estimate that our overall student lending revenue would have decreased by approximately 13% for the nine months ended September 30, 2014 and by approximately \$2.4 million in the third quarter of 2014, assuming no variation in our student loan placement volume in the periods. Any additional decrease in the student loan contingency fees would result in a further decrease of our revenues. Further, any amounts that we may be obligated to pay CMS under existing RAC contract as a result of CMS's recent offer to pay hospitals 68% of what they have billed Medicare to settle a backlog of pending appeals challenging Medicare's denials of reimbursement for certain types of short-term care could have a material negative impact our financial position and liquidity. The loss of business from the U.S. federal government, or significant policy changes or financial pressures within the agencies of the U.S. federal government that we serve would result in a significant decrease in our revenues, which would adversely affect our business, financial condition and results of operations. Future legislative or regulatory changes affecting the markets in which we operate could impair our business and operations.

The two principal markets in which we provide our recovery services, government-supported student loans and the Medicare program, are a subject of significant legislative and regulatory focus and we cannot anticipate how future changes in government policy may affect our business and operations. For example, SAFRA significantly changed the structure of the government-supported student loan market by assigning responsibility for all new government-supported student loan originations to the Department of Education, rather than originations by private institutions and backed by one of 30 government-supported GAs. This legislation, and any future changes in the legislation and regulations that govern these markets, may require us to adapt our business to the new circumstances and we may be unable to do so in a manner that does not adversely affect our business and operations.

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

While the majority of our historical revenues from the student loan market have come from our relationships with the GAs, as a result of SAFRA, the Department of Education will ultimately become the sole source of revenues in this market, although the GAs will continue to service their existing student loan portfolios for many years to come. As a result, over time, and assuming we are successful in entering into a new contract with the Department of Education under the current rebidding

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process, defaults on student loans originated by the Department of Education will predominate and our ability to maintain the revenues we had previously received from a number of GA clients will depend on our relationship with a single client, the Department of Education. While we have 23 years of experience in performing student loan recovery services for the Department of Education, we are one of 17 unrestricted recovery service providers on the current Department of Education contract. If we are successful in entering into a new contract with the Department of Education, there may be more than the current 17 recovery service providers, which could lead to greater competition among the selected service providers. If our relationship with the Department of Education terminates or deteriorates or if the Department of Education, ultimately as the sole holder of defaulted student loans, requires its contractors to agree to less favorable terms, our revenues would significantly decrease, and our business, financial condition and results of operations would be harmed.

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

As a result of SAFRA, which terminated the ability of the GAs to originate government-supported student loans, some have speculated that there may be consolidation among the 30 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. We currently have relationships with 11 of the 30 GAs and two of our GA clients were each responsible for more than 10% of our total revenues for the nine months ended September 30, 2014 and 2013. The consolidation of our GA clients with others and the failure to provide recovery services to the consolidated entity could decrease our revenues, which could negatively impact our business, financial condition and results of operations.

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

- the amount of defaulted student loans and other receivables that our clients place with us for recovery;
- the timing of placements of student loans and other receivables which are entirely in the discretion of our clients;
- the schedules of government agencies for awarding contracts including the impact of any protests or lawsuits filed in connection with the award of any such contracts;
- our ability to successfully identify improper Medicare claims and the number and type of potentially improper claims that CMS authorizes us to pursue under our RAC contract;
- the loss or gain of significant clients or changes in the contingency fee rates or other significant terms of our business arrangements with our significant clients;
- technological and operational issues that may affect our clients and regulatory changes in the markets we service; and
- general industry and macroeconomic conditions.

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

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

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

Our business has expanded significantly, especially in recent years with the expansion of our services in the healthcare market, and we intend to maintain our focus on growth. However, our continued 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

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additional expenses. We cannot be sure that we will be able to manage our growth effectively. In order to successfully manage our growth, our expenses will increase to recruit, train and manage additional qualified employees and subcontractors and to expand and enhance our administrative infrastructure and continue to improve our management, financial and information systems and controls. If we cannot manage our growth effectively, our expenses may increase and our results of operations could be negatively affected.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

We are subject to a wide array of federal and state laws and regulations regarding the use and disclosure of confidential personal information and security. For example, the federal Health Insurance Portability and Accountability Act of 1996, as amended, or HIPAA, and related state laws subject us to substantial restrictions and requirements with respect to the use and disclosure of the personal health information that we obtain in connection with our audit and recovery services under our contract with CMS and we must establish administrative, physical and technical safeguards to protect the confidentiality of this information. Similar protections extend to the type of personal financial and other information we acquire from our student loan, state tax and federal receivables clients. We are required to notify affected individuals and government agencies of data security breaches involving protected health and certain personally identifiable information. These laws and regulations also require that we develop, implement and maintain written, comprehensive information security programs containing safeguards that are appropriate to protect personally identifiable information or health information against unauthorized access, misuse, destruction or modification. Federal law generally does not preempt state law in the area of protection of personal information, and as a result we must also comply with state laws and regulations. Regulation of privacy, data use and security requires that we incur significant expenses, which could increase in the future as a result of additional regulations, all of which adversely affects our results of operations. Failure to comply with these laws and regulations can result in penalties and in some cases expose us to civil lawsuits.

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

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

regarding consumer financial protection laws. In addition, the CFPB has investigatory and enforcement authority with respect to whether persons are engaged in unlawful acts or practices in connection with the collection of consumer debts. On April 12, 2013, we received a Civil Investigative Demand, or a CID, from the CFPB requesting production of documents and answers to questions generally related to the Company's debt collection practices and procedures. The CFPB has not alleged a violation by us of any law or regulation. We responded to the CID, but have not been examined by the CFPB. In light of the possibility that the CFPB may issue interpretative regulations for the FDCPA, the issuance of such regulations could adversely affect our business and results of operations if we are not able to adapt our services and client relationships to meet any new regulatory structure that might be required.

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In addition, changing laws, regulations and standards relating to corporate governance and public disclosure are creating uncertainty for public companies, increasing legal and financial compliance costs and making some activities more time consuming. These laws, regulations and standards are subject to varying interpretations, in many cases due to their lack of specificity, and, as a result, their application in practice may evolve over time as new guidance is provided by regulatory and governing bodies. This could result in continuing uncertainty regarding compliance matters and higher costs necessitated by ongoing revisions to disclosure and governance practices. We will continue to invest resources to comply with evolving laws, regulations and standards, and this investment may result in increased general and administrative expenses and a diversion of management's time and attention from revenue-generating activities to compliance activities. If our efforts to comply with new laws, regulations and standards differ from the activities intended by regulatory or governing bodies due to ambiguities related to their application and practice, regulatory authorities may initiate legal proceedings against us and our business may be adversely affected.

However, for as long as we remain an "emerging growth company" as defined in the Jumpstart Our Business Startups Act of 2012, or the JOBS Act, we may take advantage of certain exemptions from various reporting requirements that are applicable to other public companies that are not "emerging growth companies," including, but not limited to, not being required to comply with the auditor attestation requirements of Section 404 of the Sarbanes-Oxley Act, reduced disclosure obligations regarding executive compensation in our periodic reports and proxy statements, and exemptions from the requirements of holding a nonbinding advisory vote on executive compensation and shareholder approval of any golden parachute payments not previously approved. We may take advantage of these reporting exemptions until we are no longer an "emerging growth company."

We will remain an "emerging growth company" for up to five years following our initial public offering in August 2012, although if the market value of our common stock that is held by non-affiliates exceeds \$700 million as of any June 30 before that time, our revenues exceed \$1 billion, or we issue more than \$1 billion in non-convertible debt in a three-year period, we would cease to be an "emerging growth company" as of the following December 31.

As a result of disclosure of information as a public company, our business and financial condition have become more visible, which we believe may result in threatened or actual litigation, including by competitors and other third parties. If such claims are successful, our business operations and financial results could be adversely affected, and even if the claims do not result in litigation or are resolved in our favor, these claims, and the time and resources necessary to resolve them, could divert the resources of our management and adversely affect our business operations and financial results. These factors could also make it more difficult for us to attract and retain qualified employees, executive officers and members of our board of directors.

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

We are subject to reporting obligations under Section 404 of the Sarbanes-Oxley Act that require us to include a management report on our internal control over financial reporting in our annual report, which contains management's assessment of the effectiveness of our internal control over financial reporting. These requirements first applied to our annual report on Form 10-K for the year ended December 31, 2013 and complying with these requirements can be difficult. For example, in June 2012, we determined that we had incorrectly accounted for our mandatorily redeemable preferred stock, which required audit adjusting entries for the three-year period ended December 31, 2011. Our failure to detect this error was deemed to be a deficiency in internal control and this deficiency was considered to be a material weakness. To address this situation, our independent registered public accounting firm recommended that the Company emphasize the importance of thoroughly researching all new accounting policies and revisiting accounting policies set for existing transactions when changes in the business or reporting requirements occur or are expected to occur. To prevent issues like these in the future, we have bolstered our technical accounting expertise and, where appropriate, engaged outside consultants with specialized knowledge.

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

loss of investor confidence in the reliability of our financial statements, harm our business and negatively impact the trading price of our common stock.

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

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

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

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

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

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

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

The success of our business depends in part upon our proprietary technology platform. We rely on a combination of copyright, patent, trademark, and trade secret laws, as well as on confidentiality procedures and non-compete agreements, to establish and protect our proprietary technology rights. The steps we have taken to deter misappropriation of our proprietary technology may be insufficient to protect our proprietary information. Any infringement or misappropriation of our patents, trademarks, 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

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issuance of equity securities, the incurrence of additional debt and amortization of expenses related to intangible assets, all of which could adversely affect our results of operations and stock price.

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

Since our initial public offering in August 2012, the price of our common stock, as reported by NASDAQ, has ranged from a low sales price of \$7.04 on November 7, 2014 to a high sales price of \$14.09 on March 4, 2013. The trading price of our common stock may be significantly affected by various factors, including: quarterly fluctuations in our operating results; the financial projections we may provide to the public, any changes in those projections or our failure to meet those projections; changes in investors' and analysts' perception of the business risks and conditions of our business; our ability to meet the earnings estimates and other performance expectations of financial analysts or investors; unfavorable commentary or downgrades of our stock by equity research analysts; changes in our capital structure, such as future issuances of debt or equity securities; lawsuits threatened or filed against us; strategic actions by us or our competitors, such as acquisitions or restructurings; new legislation or regulatory actions; changes in our relationship with any of our significant clients; fluctuations in the stock prices of our peer companies or in stock markets in general; and general economic conditions.

Our significant stockholder has the ability to influence significant corporate activities and our significant stockholder's interests may not coincide with yours.

Parthenon Capital Partners beneficially owns approximately 27.4% of our common stock as of November 7, 2014. As a result of its ownership, Parthenon Capital Partners has 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 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 can, directly or indirectly, exercise influence include: the election of our board of directors and the appointment and removal of our officers;

- 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.

If securities analysts do not publish research or if securities analysts or other third parties publish inaccurate or unfavorable research about us, the price of our common stock could decline.

The trading market for our common stock relies in part on the research and reports that securities analysts and other third parties choose to publish about us. We do not control these analysts or other third parties. The price of our common stock could decline if one or more securities analysts downgrade our common stock or if one or more securities analysts or other third parties publish inaccurate or unfavorable research about us or cease publishing reports about us.

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

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stockholders and for nominations of candidates for election to our board of directors; requiring a super majority vote for certain amendments to our amended and restated certificate of incorporation and amended and restated bylaws; and limiting the determination of the number of directors on our board of directors and the filling of vacancies or newly created seats on the board, to our board of directors then in office. These provisions, alone or together, could have the effect of delaying or deterring a change in control, could limit the opportunity for our stockholders to receive a premium for their shares of our common stock, and could also affect the price that some investors are willing to pay for our common stock.

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

Sale of Unregistered Securities

None.

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ITEM 5. OTHER INFORMATION

Amendment to Credit Agreement

On November 4, 2014, the Company entered into Amendment No. 2 to its Credit Agreement (Second Amendment) in which certain financial covenants were amended and additional financial covenants were added. Under the Second Amendment, the total debt to EBITDA ratio, which required the Company to maintain a ratio of 3.25 to 1.0 as of September 30, 2014 was revised as follows:

for the computation periods ending December 31, 2014, March 31, 2015, June 30, 2015, September 30, 2015 and December 31, 2015, the Company must maintain a total debt to EBITDA ratio of 5.00 to 1.0

for the computation periods ending March 31, 2016, June 30, 2016, September 30, 2016 and December 31, 2016, the Company must maintain a total debt to EBITDA ratio of 4.75 to 1.0; and

for each computation period ending March 31, 2017 and thereafter, the Company must maintain a total debt to EBITDA ratio of 3.25 to 1.0

In addition, the fixed charge coverage ratio of 1.20 to 1.0, which was in effect for every computation period under the Credit Agreement as of September 30, 2014, has been revised under the Second Amendment to apply only to the computation periods ending September 30, 2014, March 31, 2017, and each computation period thereafter.

The Second Amendment also added an interest coverage ratio, defined as the ratio of EBITDA compared to interest expense paid in cash for the computation period. Under this new financial covenant, the Company is required to maintain:

- an interest coverage ratio of not to be less than 2.25 to 1.0 for the computation periods ending December 31, 2014, March 31, 2015, June 30, 2015, September 30, 2015, and December 31, 2015; and

an interest coverage ratio not to be less than of 2.50 to 1.0 for the computation period ending March 31, 2016, June 30, 2016, September 30, 2016 and December 31, 2016.

In addition, among other things, under the Second Amendment, the Company is now required to maintain minimum adjusted cash balances of \$35.0 million from November 4, 2014 through December 31, 2015, and minimum adjusted cash balances of \$30.0 million from January 1, 2016 through December 31, 2016. Further, under the Second Amendment, the Company must maintain EBITDA for any trailing twelve month period of not less than \$20.0 million beginning with the month ending November 30, 2014 through the month ending December 31, 2016. Also, pursuant to the terms of the Second Amendment, the lenders are not required to make new loans or issue new letters of credit under the Company's line of credit when the total debt to EBITDA ratio exceeds 3.25 to 1.0. Lastly under the Second Amendment, capital expenditures of the Company in the years ending December 31, 2014, December 31, 2015, and December 31, 2016, are not permitted to exceed \$12.5 million.

Interest charged under the Credit Agreement as revised by the Second Amendment is a function of the total debt to EBITDA ratio, adjusted quarterly. When the total debt to EBITDA ratio is greater than 4.0 to 1.00, the Term A loan is charged interest either at Prime + 4.75% or LIBOR + 5.75%, while the Term B loan is charged interest either at Prime + 5.25% or LIBOR + 6.25%. When the total debt to EBITDA ratio is equal to or less than 4.0 to 1.00, the Term A loan is charged interest either at Prime + 4.25% or LIBOR + 5.25%, while the Term B loan is charged interest either at Prime + 4.75% or LIBOR + 5.75%.

Fees for the Second Amendment of \$518,000 were paid to the agent and lenders on November 4, 2014.

ITEM 6. EXHIBITS

(A) Exhibits:

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Exhibit No. Description

| | |
|------------|--|
| 10.1 | Amendment No. 2 to Credit Agreement, dated as of November 4, 2014, by and among Performant Business Services, Inc., the Lenders party hereto, and Madison Capital Funding LLC. |
| 31.1 | Certification of the Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a). |
| 31.2 | Certification of the Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a). |
| 32.1(1) | Certification of the Chief Executive Officer pursuant to 18 USC Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 32.2(1) | Certification of the Chief Financial Officer pursuant to 18 USC Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 101.INS(2) | XBRL Instance Document |
| 101.SCH(2) | XBRL Taxonomy Extension Scheme |
| 101.CAL(2) | XBRL Taxonomy Extension Calculation Linkbase |
| 101.DEF(2) | XBRL Taxonomy Extension Definition Linkbase Document |
| 101.LAB(2) | XBRL Taxonomy Extension Label Linkbase |
| 101.PRE(2) | XBRL Taxonomy Extension Presentation Linkbase |

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 (1) 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

In accordance with Rule 406T of Regulation S-T, the information furnished in these exhibits will not be deemed (2) “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: November 10, 2014

By: /s/ Lisa Im

Lisa Im

Chief Executive Officer (Principal Executive Officer) and
Director

By: /s/ Hakan Orvell
Hakan Orvell

Chief Financial Officer (Principal Financial and Accounting
Officer)

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