Evolent Health, Inc.
Form 10-Q
August 07, 2017

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 June 30, 2017
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: 001-37415

Evolent Health, Inc.
(Exact name of registrant as specified in its charter)

Delaware	32-0454912
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
800 N. Glebe Road, Suite 500, Arlington, Virginia	22203
(Address of principal executive offices)	(Zip Code)

(571) 389-6000
(Registrant's telephone number, including area code)

Not Applicable
(Former name, former address and former fiscal year, if changed since last report.)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed 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, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer (Do not check if a smaller reporting company)
Smaller reporting company Emerging growth company
If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13 (a) of the Exchange Act.

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

As of August 2, 2017, there were 65,822,144 shares of the registrant's Class A common stock outstanding and 2,653,544 shares of the registrant's Class B common stock outstanding.

Evolent Health, Inc.
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Explanatory Note

In this Quarterly Report on Form 10-Q, unless the context otherwise requires, "Evolent," the "Company," "we," "our" and "us" refer to (1) prior to the completion of the Offering Reorganization described in "Part I - Item 1. Business - Initial Public Offering, Organizational Transactions, 2016 Secondary Offering and Other Equity Transactions - Organizational Transactions" in our Annual Report on Form 10-K for the year ended December 31, 2016 (the "2016 Form 10-K"), Evolent Health Holdings, Inc., our predecessor, (including its operating subsidiary, Evolent Health LLC), and (2) after giving effect to such reorganization, Evolent Health, Inc. and its consolidated subsidiaries. Evolent Health LLC, a subsidiary of Evolent Health, Inc. through which we conduct our operations, has owned all of our operating assets and substantially all of our business since inception. Evolent Health, Inc. is a holding company and its principal asset is all of the Class A common units of Evolent Health LLC.

For more information about the Offering Reorganization, refer to "Part I - Item 1. Business - Initial Public Offering, Organizational Transactions, 2016 Secondary Offering and Other Equity Transactions - Organizational Transactions" in our 2016 Form 10-K.

FORWARD-LOOKING STATEMENTS - CAUTIONARY LANGUAGE

Certain statements made in this report and in other written or oral statements made by us or on our behalf are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995 ("PSLRA"). A forward-looking statement is a statement that is not a historical fact and, without limitation, includes any statement that may predict, forecast, indicate or imply future results, performance or achievements, and may contain words like: "believe," "anticipate," "expect," "estimate," "aim," "predict," "potential," "continue," "plan," "project," "will," "should," "might" and other words or phrases with similar meaning in connection with a discussion of future operating or financial performance. In particular, these include statements relating to future actions, trends in our businesses, prospective services, future performance or financial results and the outcome of contingencies, such as legal proceedings. We claim the protection afforded by the safe harbor for forward-looking statements provided by the PSLRA.

These statements are only predictions based on our current expectations and projections about future events. Forward-looking statements involve risks and uncertainties that may cause actual results, level of activity, performance or achievements to differ materially from the results contained in the forward-looking statements. Risks and uncertainties that may cause actual results to vary materially, some of which are described within the forward-looking statements, include, among others:

- the structural change in the market for health care in the United States;
- uncertainty in the health care regulatory framework;
- the uncertain impact the results of the 2016 presidential and congressional elections may have on health care laws and regulations;
- our ability to effectively manage our growth;
- the significant portion of revenue we derive from our largest partners, and the potential loss, termination or renegotiation of customer contracts;
- our ability to offer new and innovative products and services;
- risks related to completed and future acquisitions, investments and alliances, including the acquisitions of Valence Health, Inc., excluding Cicerone Health Solutions, Inc. ("Valence Health") and Aldera Holdings, Inc. ("Aldera"), which may be difficult to integrate, divert management resources, result in unanticipated costs or dilute our stockholders;
- certain risks and uncertainties associated with the acquisition of Valence Health, including future revenues of Valence Health may be less than expected, the timing and extent of new lives expected to come onto the platform may not occur as expected and the expected results of Evolent may not be impacted as anticipated;
- the growth and success of our partners, which is difficult to predict and is subject to factors outside of our control, including premium pricing reductions and the ability to control and, if necessary, reduce health care costs;

- our ability to attract new partners;
- the increasing number of risk-sharing arrangements we enter into with our partners;
- our ability to recover the significant upfront costs in our partner relationships;
- our ability to estimate the size of our target market;
- our ability to maintain and enhance our reputation and brand recognition;
- consolidation in the health care industry;
- competition which could limit our ability to maintain or expand market share within our industry;
- our ability to partner with providers due to exclusivity provisions in our contracts;
- restrictions and penalties as a result of privacy and data protection laws;
- adequate protection of our intellectual property, including trademarks;
- any alleged infringement, misappropriation or violation of third-party proprietary rights;
- our use of "open source" software;
- our ability to protect the confidentiality of our trade secrets, know-how and other proprietary information;
- our reliance on third parties and licensed technologies;
- our ability to use, disclose, de-identify or license data and to integrate third-party technologies;
- data loss or corruption due to failures or errors in our systems and service disruptions at our data centers;
- online security risks and breaches or failures of our security measures;

- our reliance on Internet infrastructure, bandwidth providers, data center providers, other third parties and our own systems for providing services to our users;
- our reliance on third-party vendors to host and maintain our technology platform;
- our dependency on our key personnel, and our ability to attract, hire, integrate and retain key personnel;
- the risk of potential future goodwill impairment on our results of operations;
- our indebtedness and our ability to obtain additional financing;
- our ability to achieve profitability in the future;
- the requirements of being a public company;
- our adjusted results may not be representative of our future performance;
- the risk of potential future litigation;
- our holding company structure and dependence on distributions from Evolent Health LLC;
- our obligations to make payments to certain of our pre-IPO investors for certain tax benefits we may claim in the future;
- our ability to utilize benefits under the tax receivables agreement described herein;
- our ability to realize all or a portion of the tax benefits that we currently expect to result from past and future exchanges of Class B common units of Evolent Health LLC for our Class A common stock, and to utilize certain tax attributes of Evolent Health Holdings and an affiliate of TPG;
- distributions that Evolent Health LLC will be required to make to us and to the other members of Evolent Health LLC;
- our obligations to make payments under the tax receivables agreement that may be accelerated or may exceed the tax benefits we realize;
- different interests among our pre-IPO investors, or between us and our pre-IPO investors;
- the terms of agreements between us and certain of our pre-IPO investors;
- the potential volatility of our Class A common stock price;
- the potential decline of our Class A common stock price if a substantial number of shares become available for sale or if a large number of Class B common units are exchanged for shares of Class A common stock;
- provisions in our amended and restated certificate of incorporation and amended and restated by-laws and provisions of Delaware law that discourage or prevent strategic transactions, including a takeover of us;
- the ability of certain of our investors to compete with us without restrictions;
- provisions in our amended and restated certificate of incorporation which could limit our stockholders' ability to obtain a favorable judicial forum for disputes with us or our directors, officers or employees;
- our intention not to pay cash dividends on our Class A common stock;
- our ability to remediate the material weakness in our internal control over financial reporting;
- our status as an "emerging growth company"; and
- our lack of public company operating experience.

The risks included here are not exhaustive. Although we believe the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, level of activity, performance or achievements. This Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2017, and other documents filed with the SEC include additional factors that could affect our businesses and financial performance. Moreover, we operate in a rapidly changing and competitive environment. New risk factors emerge from time to time, and it is not possible for management to predict all such risk factors.

Further, it is not possible to assess the effect of all risk factors on our businesses or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements. Given these risks and uncertainties, investors should not place undue reliance on forward-looking statements as a prediction of actual results. In addition, we disclaim any obligation to update any forward-looking statements to reflect events or circumstances that occur after the date of this report.

PART I – FINANCIAL INFORMATION
Item 1. Financial Statements
EVOLENT HEALTH, INC.
CONSOLIDATED BALANCE SHEETS
(unaudited, in thousands, except share data)

	As of June 30, 2017	As of December 31, 2016
ASSETS		
Current assets:		
Cash and cash equivalents	$99,975	$134,563
Restricted cash and restricted investments	10,258	34,416
Accounts receivable, net (amounts related to affiliates: 2017 - $4,204; 2016 - $8,258)	45,804	40,635
Prepaid expenses and other current assets (amounts related to affiliates: 2017 - $53; 2016 - $4,507)	12,556	11,011
Investments, at amortized cost	24,027	44,341
Total current assets	192,620	264,966
Restricted cash and restricted investments	11,861	6,000
Investments in and advances to affiliates	1,081	2,159
Property and equipment, net	40,194	31,179
Prepaid expenses and other non-current assets	9,483	10,043
Intangible assets, net	254,460	258,923
Goodwill	628,653	626,569
Total assets	$1,138,352	$1,199,839
LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT)		
Liabilities		
Current liabilities:		
Accounts payable (amounts related to affiliates: 2017 - $7,814; 2016 - $13,480)	$26,280	$43,892
Accrued liabilities (amounts related to affiliates: 2017 - $1,284; 2016 - $3,211)	25,919	29,160
Accrued compensation and employee benefits	21,787	38,408
Deferred revenue	27,774	20,481
Total current liabilities	101,760	131,941
Long-term debt, net of discount	120,935	120,283
Other long-term liabilities	10,024	14,655
Deferred tax liabilities, net	11,184	20,846
Total liabilities	243,903	287,725
Commitments and Contingencies (See Note 9)		
Shareholders' Equity (Deficit)		
Class A common stock - $0.01 par value; 750,000,000 shares authorized; 65,765,584 and 52,586,899 shares issued and outstanding as of June 30, 2017, and December 31, 2016, respectively	658	506
Class B common stock - $0.01 par value; 100,000,000 shares authorized; 2,653,544 and 15,346,981 shares issued and outstanding as of June 30, 2017, and December 31, 2016, respectively	27	153

Additional paid-in-capital	747,385	555,250
Retained earnings (accumulated deficit)	111,699	146,617
Total shareholders' equity (deficit) attributable to Evolent Health, Inc.	859,769	702,526
Non-controlling interests	34,680	209,588
Total shareholders' equity (deficit)	894,449	912,114
Total liabilities and shareholders' equity (deficit)	$1,138,352	$1,199,839

See accompanying Notes to Consolidated Financial Statements
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EVOLENT HEALTH, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited, in thousands, except per share data)

	For the Three Months Ended June 30, 2017	For the Three Months Ended June 30, 2016	For the Six Months Ended June 30, 2017	For the Six Months Ended June 30, 2016
Revenue				
Transformation [1]	$5,361	$10,388	$15,596	$18,502
Platform and operations [1]	101,710	46,130	197,714	87,465
Total revenue	107,071	56,518	213,310	105,967
Expenses				
Cost of revenue (exclusive of depreciation and amortization expenses presented separately below) [1]	67,994	32,779	135,523	61,390
Selling, general and administrative expenses [1]	51,090	32,756	104,641	64,702
Depreciation and amortization expenses	6,904	3,612	13,519	6,983
Goodwill impairment	—	—	—	160,600
Loss on change in fair value of contingent consideration	200	—	200	—
Total operating expenses	126,188	69,147	253,883	293,675
Operating income (loss)	(19,117)	(12,629)	(40,573)	(187,708)
Interest income	218	272	403	551
Interest expense	(947)	—	(1,901)	—
Income (loss) from affiliates	(555)	(14)	(1,077)	(14)
Other income (expense), net	3	1	5	2
Income (loss) before income taxes and non-controlling interests	(20,398)	(12,370)	(43,143)	(187,169)
Provision (benefit) for income taxes	(700)	(371)	(295)	(1,359)
Net income (loss)	(19,698)	(11,999)	(42,848)	(185,810)
Net income (loss) attributable to non-controlling interests	(2,793)	(3,612)	(7,930)	(54,683)
Net income (loss) attributable to Evolent Health, Inc.	$(16,905)	$(8,387)	$(34,918)	$(131,127)
Earnings (Loss) Available for Common Shareholders				
Basic	$(16,905)	$(8,387)	$(34,918)	$(131,127)
Diluted	(16,905)	(8,387)	(34,918)	(131,127)
Earnings (Loss) per Common Share				
Basic	$(0.28)	$(0.20)	$(0.62)	$(3.09)
Diluted	(0.28)	(0.20)	(0.62)	(3.09)
Weighted-Average Common Shares Outstanding				
Basic	59,478	42,594	56,057	42,390
Diluted	59,478	42,594	56,057	42,390

[1] Amounts related to affiliates included above are as follows (see Note 16):

Revenue				
Transformation	$ 48	$ 58	$ 245	$ 102
Platform and operations	8,575	8,704	15,353	15,706
Expenses				

Cost of revenue (exclusive of depreciation and amortization expenses)	5,739	5,358	12,083	10,486
Selling, general and administrative expenses	119	384	524	767

See accompanying Notes to Consolidated Financial Statements

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EVOLENT HEALTH, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited, in thousands)

	For the Six Months Ended June 30, 2017	2016
Cash Flows from Operating Activities		
Net income (loss)	$(42,848)	$(185,810)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Loss on change in fair value of contingent consideration	200	—
Impact of lease termination	(496)	—
Loss from affiliates	1,077	14
Depreciation and amortization expenses	13,519	6,983
Goodwill impairment	—	160,600
Stock-based compensation expense	10,464	9,045
Deferred tax provision (benefit)	(280)	(1,360)
Amortization of deferred financing costs	456	—
Accretion of bond premium (discount)	105	—
Other	291	276
Changes in assets and liabilities, net of acquisitions:		
Accounts receivables, net	(5,247)	(9,956)
Prepaid expenses and other current assets	(1,412)	(429)
Accounts payable, net of change in restricted cash and restricted investments	(2,514)	(2,975)
Accrued liabilities	(3,621)	2,524
Accrued compensation and employee benefits	(16,630)	(4,934)
Deferred revenue	6,719	4,013
Other long-term liabilities	(4,495)	91
Net cash provided by (used in) operating activities	(44,712)	(21,918)
Cash Flows from Investing Activities		
Cash paid for asset acquisition or business combination	(3,241)	(14,500)
Maturities and sales of investments	20,210	2,100
Purchases of property and equipment	(12,430)	(7,260)
Change in restricted cash and restricted investments	3,200	1,194
Net cash provided by (used in) investing activities	7,739	(18,466)
Cash Flows from Financing Activities		
Proceeds from stock option exercises	3,560	114
Taxes withheld and paid for vesting of restricted stock units	(1,175)	(318)
Net cash provided by (used in) financing activities	2,385	(204)
Net increase (decrease) in cash and cash equivalents	(34,588)	(40,588)
Cash and cash equivalents as of beginning-of-period	134,563	145,726
Cash and cash equivalents as of end-of-period	$99,975	$105,138
Supplemental Disclosure of		

Non-cash Investing and Financing Activities		
Accrued property and equipment purchases	$ 291	$ 98
Class A common stock issued in connection with business combinations	—	10,534
Measurement period adjustments related to business combinations	2,078	—
Change in accrued financing costs related to 2021 Notes	196	—
Effects of the 2017 Secondary Offerings		
Decrease in non-controlling interests as a result of Class B Exchanges	168,883	—

See accompanying Notes to Consolidated Financial Statements

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EVOLENT HEALTH, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (DEFICIT)
(unaudited, in thousands)

	Class A Common Stock Shares	Class A Common Stock Amount	Class B Common Stock Shares	Class B Common Stock Amount	Additional Paid-in Capital	Retained Earnings (Accum-ulated Deficit)	Non-controlling Interests	Total Equity (Deficit)
Balance as of December 31, 2015	41,491	$ 415	17,525	$ 175	$342,063	$306,688	$285,238	$934,579
Cumulative-effect adjustment from adoption of new accounting principle	—	—	—	—	468	(329)	(139)	—
Stock-based compensation expense	—	—	—	—	16,147	—	—	16,147
Acceleration of unvested equity awards for Valence Health employees	162	2	—	—	3,897	—	—	3,899
Exercise of stock options	221	—	—	—	1,259	—	—	1,259
Restricted stock units vested, net of shares withheld for taxes	84	—	—	—	2,193	—	—	2,193
Exchange of Class B common stock	2,178	22	(2,178)	(22)	28,220	—	(28,220)	—
Tax impact of Class B common stock exchange	—	—	—	—	1,606	—	—	1,606
Issuance of Class A common stock for business combinations	8,451	67	—	—	177,715	—	—	177,782
Tax impact of Class A common stock issued for business combinations	—	—	—	—	1,427	—	—	1,427
Reclassification of non-controlling interests	—	—	—	—	(19,745)	—	19,745	—
Net income (loss)	—	—	—	—	—	(159,742)	(67,036)	(226,778)
Balance as of December 31, 2016	52,587	506	15,347	153	555,250	146,617	209,588	912,114
Stock-based compensation expense	—	—	—	—	10,464	—	—	10,464
Exercise of stock options	690	27	—	—	3,533	—	—	3,560
Restricted stock units vested, net of shares withheld for taxes	105	2	—	—	(1,177)	—	—	(1,175)
Shares retired upon release from Valence Health escrow	(310)	(3)	—	—	911	—	—	908
Exchange of Class B common stock	12,693	126	(12,693)	(126)	168,883	—	(168,883)	—
Tax impact of Class B common stock exchange	—	—	—	—	11,426	—	—	11,426
Reclassification of non-controlling interests	—	—	—	—	(1,905)	—	1,905	—

Net income (loss)	—	—	—	—	—	(34,918)	(7,930)	(42,848)
Balance as of June 30, 2017	65,765	$ 658	2,654	$ 27	$ 747,385	$ 111,699	$ 34,680	$ 894,449

See accompanying Notes to Consolidated Financial Statements
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EVOLENT HEALTH, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Organization

Evolent Health, Inc. was incorporated in December 2014 in the state of Delaware, and is a managed services firm that supports leading health systems and physician organizations in their migration toward value-based care and population health management. The Company's services include providing our customers, who we refer to as partners, with a population management platform, integrated data and analytics capabilities, pharmacy benefit management ("PBM") services and comprehensive health plan administration services. Together these services enable health systems to manage patient health in a more cost-effective manner. The Company's contracts are structured as a combination of advisory fees, monthly member service fees, percentage of plan premiums and shared medical savings arrangements. The Company's headquarters is located in Arlington, Virginia.

Our predecessor, Evolent Health Holdings, Inc. ("Evolent Health Holdings"), merged with and into Evolent Health, Inc. in connection with the Offering Reorganization, as defined and discussed in our 2016 Form 10-K.

Prior to our initial public offering ("IPO") in June 2015 and the offering reorganization we undertook in connection therewith, Evolent Health Holdings did not control Evolent Health LLC, our operating subsidiary company due to certain participating rights granted to our investor, TPG Global, LLC and certain of its affiliates ("TPG"). However, Evolent Health Holdings was able to exert significant influence on Evolent Health LLC and, accordingly, accounted for its investment in Evolent Health LLC using the equity method of accounting through June 3, 2015. Subsequent to the offering reorganization which occurred on June 4, 2015, (the "Offering Reorganization"), the financial results of Evolent Health LLC have been consolidated in the financial statements of Evolent Health, Inc. As of June 30, 2017, the Company owned 96.1% of the economic interests and 100% of the voting rights in Evolent Health LLC, and is the sole managing member of Evolent Health LLC.

Since its inception, the Company has incurred losses from operations. As of June 30, 2017, the Company had cash and cash equivalents of $100.0 million. The Company believes it has sufficient liquidity for the next twelve months as of the date the financial statements were available to be issued.

2. Basis of Presentation, Summary of Significant Accounting Policies and Change in Accounting Principle

Basis of Presentation

In our opinion, the accompanying unaudited interim consolidated financial statements include all adjustments, consisting of normal recurring adjustments, which are necessary to fairly state our financial position, results of operations, and cash flows. The Consolidated Balance Sheet at December 31, 2016, has been derived from audited financial statements as of that date. The interim consolidated results of operations are not necessarily indicative of the results that may occur for the full fiscal year. Certain footnote disclosures normally included in financial statements prepared in accordance with United States of America generally accepted accounting principles ("GAAP") have been omitted pursuant to instructions, rules, and regulations prescribed by the United States Securities and Exchange Commission ("SEC"). The disclosures provided herein should be read in conjunction with the audited financial statements and notes thereto included in our 2016 Form 10-K.

Summary of Significant Accounting Policies

Certain GAAP policies that significantly affect the determination of our financial position, results of operations and cash flows, are summarized below. See “Part II - Item 8. Financial Statements and Supplementary Data - Note 2” in our 2016 Form 10-K for a complete summary of our significant accounting policies.

Accounting Estimates and Assumptions

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions affecting the reported amounts of assets and liabilities and the disclosures of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenue and expenses for the reporting period. Those estimates are inherently subject to change and actual results could differ from those estimates. In the accompanying consolidated financial statements, estimates are used for, but not limited to, the valuation of assets, liabilities, consideration related to business combinations and asset acquisitions, revenue recognition including discounts and credits, estimated selling prices for deliverables in multiple element arrangements, contingent payments, allowance for doubtful accounts, depreciable lives of assets, impairment of long lived assets (including equity method investments), stock-based compensation, deferred income taxes and valuation allowance, contingent liabilities, valuation of intangible assets (including goodwill) and the useful lives of intangible assets.

Principles of Consolidation

The consolidated financial statements include the accounts of Evolent Health, Inc. and its subsidiaries. All inter-company accounts and transactions are eliminated in consolidation.

Operating Segments

Operating segments are defined as components of a business that earn revenue and incur expenses for which discrete financial information is available that is evaluated, on a regular basis, by the chief operating decision maker ("CODM") to decide how to allocate resources and assess performance. The Company's CODM, the Chief Executive Officer, allocates resources at a consolidated level and therefore the Company views its operations and manages its business as one operating segment. All of the Company's revenue is generated in the United States and all assets are located in the United States.

Restricted Cash and Restricted Investments

Restricted cash and restricted investments include cash and investments used to collateralize various contractual obligations (in thousands) as follows:

	As of June 30, 2017	As of December 31, 2016
Collateral for letters of credit for facility leases [(1)]	$3,928	$4,852
Collateral with financial institutions [(2)]	8,150	4,950
Pharmacy benefit management and claims processing services [(3)]	8,618	30,555
Other	1,423	59
Total restricted cash and restricted investments	22,119	40,416
Non-current restricted investments [(2)]	8,150	4,950
Non-current restricted cash [(1)]	3,711	1,050
Total non-current restricted cash and restricted investments	11,861	6,000
Current restricted cash and restricted investments	$10,258	$34,416

[(1)] Represents restricted cash related to collateral for letters of credit required in conjunction with lease agreements. See Note 9 for further discussion of our lease commitments.
[(2)] Represents collateral for letters of credit held with financial institutions for risk-sharing arrangements. The collateral amount is invested in restricted certificates of deposit with original maturities in excess of 12 months. The restricted investments are classified as held-to-maturity and stated at amortized cost. Fair value of the certificates of deposit is determined using Level 2 inputs and approximates amortized cost as of June 30, 2017. See Note 9 for further discussion of our risk-sharing arrangements.
[(3)] Represents cash held on behalf of partners to process PBM and other claims.

Goodwill

We recognize the excess of the purchase price, plus the fair value of any non-controlling interests in the acquiree, over the fair value of identifiable net assets acquired as goodwill. Goodwill is not amortized, but is reviewed at least annually for indications of impairment, with consideration given to financial performance and other relevant factors. We perform impairment tests of goodwill at our single reporting unit level, which is consistent with the way management evaluates our business. Acquisitions to date have been complementary to the Company's core business, and therefore goodwill is assigned to our single reporting unit to reflect the synergies arising from each business combination.

As discussed in Note 3, we adopted Accounting Standards Update ("ASU") 2017-04, Intangibles-Goodwill and Other - Simplifying the Test for Goodwill Impairment, effective January 1, 2017. The adoption resulted in an update to our accounting policy for goodwill impairment. Under the updated policy, we perform a one-step test in our evaluation of the carrying value of goodwill, if qualitative factors determine it is necessary to complete a goodwill impairment test. In the evaluation, the fair value of the relevant reporting unit is determined and compared to the carrying value. If the fair value is greater than the carrying value, then the carrying value is deemed to be recoverable, and no further action is required. If the fair value estimate is less than the carrying value, goodwill is considered impaired for the amount by which the carrying amount exceeds the reporting unit's fair value and a charge is reported in impairment of goodwill on our Consolidated Statements of Operations. See Note 7 for additional discussion regarding goodwill impairment tests.

Change in Accounting Principle

In March 2016, the Financial Accounting Standards Board ("FASB") issued ASU 2016-09, which simplifies several aspects of the accounting for employee share-based payment transactions, including accounting for income taxes, forfeitures and statutory tax withholding requirements, as well as classification in the statement of cash flows. During the second quarter of 2016, we elected to early adopt ASU 2016-09 effective January 1, 2016.

Adoption of ASU 2016-09 resulted in a cumulative effect reduction to beginning retaining earnings of $0.5 million as of January 1, 2016, and an increase in net income (loss) of approximately $0.1 million for the three months ended March 31, 2016. The increase was due to our policy election to recognize share-based award forfeitures as they occur, as opposed to applying an estimated forfeiture rate. As we adopted the new guidance during the second quarter of 2016, the revised results of operations were not reflected in our Form 10-Q for the three months ended March 31, 2016, filed with the SEC on May 16, 2016. The results of operations for the three months ended March 31, 2016, were previously adjusted due to the adoption during the second quarter of 2016 and recasted in the footnotes to the financial statements in our Form 10-Q for the quarter ended June 30, 2016. However, that disclosure reflected a $0.5 million cumulative effect impact of adoption as an expense during the first quarter of 2016 rather than a reduction to beginning retained earnings. The disclosure was corrected in our Form 10-Q for the quarter ended September 30, 2016 and in our 2016 Form 10-K. Management has concluded that the impact of the error is not material to any of the periods presented. There is no impact related to this error to any other period. See "Part II - Item 8. Financial Statements and Supplementary Data - Note 18" in our 2016 Form 10-K for further information about the impact of the adoption.

3. Recently Issued Accounting Standards

Adoption of New Accounting Standards

In May 2017, the FASB issued ASU 2017-09, Compensation-Stock Compensation - Scope of Modification Accounting. The purpose of the ASU is to limit the circumstances in which an entity applies modification accounting to share-based awards by setting criteria whereby an entity would be precluded from applying modification accounting guidance in Topic 718. The ASU also removes guidance in Topic 718 stating that modification accounting is not required when an entity adds an anti-dilution provision if that modification is not made in contemplation of an equity restructuring. The amendments are effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. Early adoption is permitted, including adoption in any interim periods. The amendments should be applied prospectively to an award modified on or after the adoption date. We adopted this standard, effective June 1, 2017. The adoption of this ASU may have an impact if we have a modification to our share-based awards at a future date. There was no impact of the adoption for the three and six months ended June 30, 2017.

In January 2017, the FASB issued ASU 2017-01, Business Combinations - Clarifying the Definition of a Business. The purpose of the ASU is to add guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The ASU provides a screen to determine when an integrated set of assets and activities is not a business. The ASU also provides a framework to assist entities in evaluating whether both an input and a substantive process are present. The amendments are effective for annual periods beginning after December 15, 2017, including interim periods within those periods. The amendments should be applied prospectively on or after the effective date. Early adoption is permitted for transactions for which the acquisition date occurs before the issuance date or effective date of the amendments, only when the transaction has not been reported in financial statements that have been issued or made available for issuance. We adopted this standard during June 2017, in conjunction with the acquisition of Accordion Health, Inc. (see Note 4). The adoption had an impact on our financial statements with respect to the accounting for the Accordion Health, Inc. acquisition, and we anticipate it will have an impact if we engage in future business combinations or asset acquisitions.

In January 2017, the FASB issued ASU 2017-04, Intangibles-Goodwill and Other - Simplifying the Test for Goodwill Impairment. The purpose of the ASU is to simplify the subsequent measurement of goodwill. The ASU eliminates Step 2 from the goodwill impairment test. An entity no longer will determine goodwill impairment by calculating the implied fair value of goodwill by assigning the fair value of a reporting unit to all of its assets and liabilities as if that reporting unit had been acquired in a business combination. This update is effective for annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. We believe this newly adopted principle is preferable as it reduces the complexity of performing a goodwill impairment test. As a result, we adopted this standard effective January 1, 2017. Our updated accounting policy for goodwill impairment is described in Note 2. While the adoption of this ASU may have a material impact in determining the results of future goodwill impairment tests and thus impact our consolidated financial statements in the future, there was no impact of the adoption during the three and six months ended June 30, 2017.

In March 2016, the FASB issued ASU 2016-07, Investments-Equity Method and Joint Ventures - Simplifying the Transition to the Equity Method of Accounting. The purpose of this ASU is to eliminate the requirement to retroactively adopt the equity method of accounting when an investment qualifies for the equity method as a result of an increase in the level of ownership interest or degree of influence. The amendments require that the equity method investor add the cost of acquiring the additional interest in the investee to the current basis of the investor’s previously held interest and adopt the equity method of accounting as of the date the investment becomes qualified for equity method accounting. Therefore, upon qualifying for the equity method of accounting, no retroactive adjustment of the investment is required. The amendments in this ASU are effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. We adopted this standard effective January 1, 2017. The adoption did not have a material impact on our financial statements for the three and six months ended June 30, 2017.

In March 2016, the FASB issued ASU 2016-06, Derivatives and Hedging - Contingent Put and Call Options in Debt Instruments. The purpose of this ASU is to clarify the requirements for assessing whether contingent call (put) options that can accelerate the payment of principal on debt instruments are clearly and closely rated to their debt hosts. An entity performing the assessment under the amendments in the ASU is required to assess the embedded call (put) options solely in accordance with the four-step decision sequence. For public business entities, the amendments in this ASU are effective for financial statements issued for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years. We adopted this standard effective January 1, 2017. The adoption did not have a material impact on our financial statements for the three and six months ended June 30, 2017.

Future Adoption of New Accounting Standards

In November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows: Restricted Cash. The purpose of the ASU is to reduce diversity in practice regarding the classification and presentation of changes in restricted cash on the statement of cash flows. The amendments in the ASU require that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. The amendments are effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. The amendments in this ASU should be applied using a retrospective transition method to each period presented. We intend to adopt the requirements of this standard effective January 1, 2018, and are currently evaluating the impact of the adoption on our Consolidated Statements of Cash Flows.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows - Classification of Certain Cash Receipts and Cash Payments. This ASU provides updated guidance on eight specific cash flow issues to reduce diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows.

The amendments are effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. We intend to adopt the requirements of this standard effective January 1, 2018, and are currently evaluating the impact of the adoption on our Consolidated Statements of Cash Flows.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments - Credit Losses: Measurement of Credit Losses on Financial Instruments. With respect to assets measured at amortized cost, such as held-to-maturity assets, the update requires presentation of the amortized cost net of a credit loss allowance. The update eliminates the probable initial recognition threshold that was previously required prior to recognizing a credit loss on financial instruments. The credit loss estimate can now reflect an entity’s current estimate of all future expected credit losses as opposed to the previous standard, when an entity only considered past events and current conditions. With respect to available for sale debt securities, the update requires that credit losses be presented as an allowance rather than as a write-down. The update is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted as of the fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. We intend to adopt the requirements of this standard effective January 1, 2020, and are currently evaluating the impact of the adoption on our financial condition and results of operations.

In February 2016, the FASB issued ASU 2016-02, Leases, in order to establish the principles to report transparent and economically neutral information about the assets and liabilities that arise from leases. This update introduces a new standard on accounting for leases, including a lessee model that brings most leases on the balance sheet. The new standard also aligns many of the underlying principles of the new lessor model with those in ASC 606, the FASB's new revenue recognition standard (e.g., those related to evaluating when profit can be recognized). The standard also requires lessors to increase the transparency of their exposure to changes in value of their residual assets and how they manage that exposure. The ASU is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application is permitted. We intend to adopt the requirements of this standard effective January 1, 2019, and are currently evaluating the impact of the adoption on our financial condition and results of operations.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers, in order to clarify the principles of recognizing revenue. This standard establishes the core principle of recognizing revenue to depict the transfer of promised goods or services in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The FASB defines a five-step process that systematically identifies the various components of the revenue recognition process, culminating with the recognition of revenue upon satisfaction of an entity's performance obligations. By completing all five steps of the process, the core principles of revenue recognition will be achieved. In March 2016, the FASB issued an update to the new revenue standard (ASU 2014-09) in the form of ASU 2016-08, which amended the principal-versus-agent implementation guidance and illustrations in the new revenue guidance. The update clarifies that an entity should evaluate whether it is the principal or the agent for each specified good or service promised in a contract with a customer. In April 2016, the FASB issued another update to the new revenue standard in the form of ASU 2016-10, which amended the guidance on identifying performance obligations and the implementation guidance on licensing. These ASUs were followed by two further updates issued during May 2016: ASU 2016-11, which rescinds certain SEC guidance, such as the adoption of ASUs 2014-09 and 2014-16, including accounting for consideration given by a vendor to a customer, and ASU 2016-12, which is intended to clarify the objective of the collectability criterion while identifying the contract(s) with a customer. The new revenue standard (including updates) will be effective for annual and interim reporting periods beginning after December 15, 2017, with early adoption permitted only as of annual reporting periods beginning after December 15, 2016. The guidance permits two methods of adoption: i) the full retrospective method applying the standard to each prior reporting period presented, or ii) the modified retrospective method with a cumulative effect of initially applying the guidance recognized at the date of initial application. The standard also allows entities to apply certain practical expedients at their discretion. We intend to adopt this standard effective January 1, 2018. Preliminarily, we anticipate adopting the standard using the modified retrospective method with a cumulative catch up adjustment and providing additional disclosures comparing results to previous rules. We intend to complete the process during 2017. In our efforts to adopt this ASU, we have formulated an implementation team that is currently engaged in the evaluation process. We are continuing the review of our contracts with customers to identify potential differences that could result from applying the new guidance. As we complete our overall assessment, we are also identifying any needed changes to our accounting policies and practices, business processes, systems and controls to support the new revenue recognition and disclosure requirements. At this point, there is no clear indication regarding overall impact to our consolidated financial statements.

We have evaluated all other issued and unadopted ASUs and believe the adoption of these standards will not have a material impact on our results of operations, financial position, or cash flows.

4. Transactions

Business Combinations

Aldera

On November 1, 2016, the Company completed the acquisition of Aldera, including 100% of the voting equity interests. The acquisition provides control over Aldera, a key vendor and the primary software provider for the Valence Health third-party administration ("TPA") platform. The merger consideration, net of certain closing and post-closing adjustments was $34.3 million based on the closing price of the Company's Class A common stock on the New York Stock Exchange (the "NYSE") on November 1, 2016, and consisted of approximately 0.5 million shares of the Company's Class A common stock, $17.5 million in cash and $7.0 million related to the settlement of a prepaid software license. As a result of the Class A common stock issued for the Aldera transaction, the Company's ownership of Evolent Health LLC increased from 77.2% to 77.4%, immediately after the acquisition, as the Company was issued Class A membership units in Evolent Health LLC in exchange for the contribution of Aldera to Evolent Health LLC post-acquisition.

Prior to the acquisition of Aldera, Evolent entered into a perpetual license agreement for development rights and use of Aldera proprietary software for $7.0 million. Upon closing the acquisition of Aldera, the Company concluded that the $7.0 million prepaid asset recorded by Evolent and the deferred revenue balance recorded by Aldera for the perpetual software license should be assessed as a prepayment for a software license that was effectively settled upon acquisition and was eliminated in the post-combination consolidated financial statements. No gain or loss was recognized on settlement as management determined the $7.0 million license fee to be priced at fair value and the license agreement did not include a settlement provision. The Company increased the consideration transferred for the acquisition of Aldera by $7.0 million for the effective settlement of the prepaid software license at the recorded amount, which brought the total consideration paid for the acquisition to $34.3 million.

The Company incurred approximately $0.2 million in transaction costs related to the Aldera acquisition, which were recorded within “Selling, general and administrative expenses” on our Consolidated Statements of Operations for the year ended December 31, 2016. The Company incurred approximately $0.5 million in transaction costs related to the Aldera acquisition during the six months ended June 30, 2017, which were recorded within “Selling, general and administrative expenses” on our Consolidated Statements of Operations. The Company accounted for the transaction as a business combination using purchase accounting.

During the six months ended June 30, 2017, the Company recorded measurement period adjustments of approximately $0.3 million. The purchase price allocation, as previously determined, the measurement period adjustments and the purchase price allocation, as revised, are as follows (in thousands):

	As Previously Determined	Measurement Period Adjustments	As Revised
Purchase consideration:			
Fair value of Class A common stock issued	$ 9,864	$ —	$ 9,864
Cash for settlement of software license	7,000	—	7,000
Cash	17,481	—	17,481
Total consideration	$ 34,345		$ 34,345
Tangible assets acquired:			
Receivables	$ 624	$ (78)	$ 546
Prepaid expenses and other current assets	272	—	272
Property and equipment	1,065	—	1,065
Other non-current assets	9	—	9
Identifiable intangible assets acquired:			
Customer relationships	7,000	—	7,000
Technology	2,500	—	2,500
Liabilities assumed:			
Accounts payable	429	—	429
Accrued liabilities	1,204	205	1,409
Accrued compensation and employee benefits	605	—	605
Deferred revenue	44	—	44
Goodwill	25,157	283	25,440
Net assets acquired	$ 34,345		$ 34,345

The fair value of the receivables acquired, as shown in the table above, approximates the gross contractual amounts deemed receivable by management. Identifiable intangible assets associated with technology and customer relationships will be amortized on a straight-line basis over their estimated useful lives of 5 and 15 years, respectively. The technology is related to source code for licensed software used to support the third party administration platform offered to Aldera's clients. The fair value of the intangible assets was primarily determined using the income approach. The income approach estimates fair value for an asset based on the present value of cash flows projected to be generated by the asset. Projected cash flows are discounted at a required rate of return that reflects the relative risk of achieving the cash flows and the time value of money. Goodwill is calculated as the difference between the acquisition date fair value of the total consideration and the fair value of the net assets acquired, and represents the future economic benefits that we expect to achieve as a result of the acquisition. The goodwill is attributable primarily to the acquired assembled workforce and expected cost and revenue synergies. Goodwill is considered an indefinite lived asset. The transaction was a taxable business combination for the Company and the amount of goodwill determined for tax purposes is deductible upon the beginning of the amortization period for tax purposes.

The amounts above reflect management's preliminary estimate of the fair value of the tangible and intangible assets acquired and liabilities assumed based on a valuation performed using currently available information, inclusive of the measurement period adjustments. During the six months ended June 30, 2017, the Company recorded certain measurement period adjustments that primarily impacted receivables, accrued liabilities and goodwill. These adjustments resulted in a net $0.3 million increase to goodwill, as reflected in the purchase price allocation table above. Any remaining adjustments are expected to be finalized within one year of the acquisition date.

Valence Health

On October 3, 2016, the Company completed its acquisition of Valence Health, including 100% of the voting equity interests. Valence Health, based in Chicago, Illinois, was founded in 1996 and provides value-based administration, population health and advisory services. In its 20 year history, Valence Health developed particular expertise in the Medicaid and pediatric markets. The addition of Valence Health strengthens the Company's operational capabilities and provides increased scale and client diversification.

The merger consideration, net of certain closing and post-closing adjustments was $217.9 million based on the closing price of the Company's Class A common stock on the NYSE on October 3, 2016, and consisted of 6.8 million shares of the Company's Class A common stock and $54.8 million in cash. The shares issued to Valence Health stockholders represented approximately 10.5% of the Company's issued and outstanding Class A common stock and Class B common stock immediately following the transaction. As a result of the Class A common stock issued for the Valence Health transaction, the Company's ownership in Evolent Health LLC increased from 74.6% to 77.2%, immediately after the acquisition, as the Company was issued Class A membership units in Evolent Health LLC in exchange for the contribution of Valence Health to Evolent Health LLC post acquisition. The transaction also included an earn-out of up to $12.4 million, fair valued at $2.6 million as of October 3, 2016, payable by January 30, 2017, in the Company's Class A common stock, tied to new business activity contracted on or before December 31, 2016. The fair value was determined by assigning probabilities to potential business activity in the pipeline as of the acquisition date. As of December 31, 2016, Valence Health had not contracted sufficient business to be eligible for payment of the earn-out consideration. As a result, the Company recorded a gain of $2.6 million in accordance with the release of the contingent liability for the year ended December 31, 2016, which is recorded within "(Gain) loss on change in value of contingent consideration" on our Consolidated Statements of Operations. The Company incurred approximately $2.7 million of transaction costs related to the Valence Health acquisition for the year ended December 31, 2016. Approximately $2.6 million of the transaction costs are recorded within "Selling, general and administrative expenses" and less than $0.1 million are recorded within "Cost of revenue" on our Consolidated Statements of Operations. The Company incurred approximately $4.1 million of transaction costs related to the Valence Health acquisition for the six months ended June 30, 2017. Approximately $1.5 million of these transaction costs are recorded within "Selling, general and administrative expenses" and approximately $2.6 million are recorded within "Cost of revenue" on our Consolidated Statements of Operations. The Company accounted for the transaction as a business combination using purchase accounting.

The purchase price was allocated to the assets acquired and liabilities assumed based on their estimated fair values as of October 3, 2016. During the six months ended June 30, 2017, the Company recorded measurement period adjustments of approximately $1.8 million. The purchase price allocation, as previously determined, the measurement period adjustments and the purchase price allocation, as revised, are as follows (in thousands):

	As Previously Determined	Measurement Period Adjustments	As Revised
Purchase consideration:			
Fair value of Class A common stock issued	$159,614	$ 911	$160,525
Fair value of contingent consideration	2,620	—	2,620
Cash	54,799	—	54,799
Total consideration	$217,033		$217,944
Tangible assets acquired:			
Restricted cash	$1,829	$ —	$1,829
Accounts Receivable	8,587	(129)	8,458
Prepaid expenses and other current assets	3,465	—	3,465
Property and equipment	6,241	—	6,241
Other non-current assets	313	—	313
Favorable leases assumed (net of unfavorable leases)	4,323	(126)	4,197
Identifiable intangible assets acquired:			
Customer relationships	69,000	—	69,000
Technology	18,000	—	18,000
Liabilities assumed:			
Accounts payable	5,703	—	5,703
Accrued liabilities	3,865	—	3,865
Accrued compensation and employee benefits	9,200	—	9,200
Deferred revenue	2,022	640	2,662
Other long-term liabilities	2,328	—	2,328
Net deferred tax liabilities	13,316	—	13,316
Goodwill	141,709	1,806	143,515
Net assets acquired	$217,033		$217,944

The fair value of the receivables acquired, as shown in the table above, approximates the gross contractual amounts due under contracts of $9.1 million, of which $0.6 million is expected to be uncollectible. Identifiable intangible assets associated with customer relationships and technology will be amortized on a straight-line basis over their preliminary estimated useful lives of 20 and 5 years, respectively. The customer relationships are primarily attributable to long-term existing contracts with current customers. The technology is an existing platform Valence Health uses to provide services to customers. The fair value of the intangible assets was primarily determined using the income approach. The income approach estimates fair value for an asset based on the present value of cash flows projected to be generated by the asset. Projected cash flows are discounted at a required rate of return that reflects the relative risk of achieving the cash flows and the time value of money. Goodwill is calculated as the difference between the acquisition date fair value of the total consideration and the fair value of the net assets acquired, and represents the future economic benefits that we expect to achieve as a result of the acquisition. The goodwill is attributable primarily to the acquired assembled workforce and expected cost and revenue synergies. Goodwill is considered an indefinite lived asset. The merger was structured as a tax-free reorganization and, therefore, the Company received carryover basis in the assets and liabilities acquired; accordingly, the Company recognized net deferred tax liabilities associated with the difference between the book basis and the tax basis for the assets and liabilities acquired, as well as the Valence Health net operating loss tax carryforward received in the merger, in the amount of $13.3 million, resulting in additional goodwill. The purchased and additional goodwill created due to the increase in the deferred tax liability were not deductible for tax purposes. The Company contributed the acquired assets and liabilities of Valence Health to Evolent Health LLC, resulting in a taxable gain of $52.7 million for the Company, not recognized for financial reporting purposes.

The amounts above reflect management's preliminary estimate of the fair value of the tangible and intangible assets acquired and liabilities assumed based on a valuation performed using currently available information, inclusive of measurement period adjustments. The Company recorded various measurement period adjustments that resulted in a $1.8 million net increase to goodwill during the six months ended June 30, 2017, including an adjustment to increase deferred revenue and goodwill by approximately $0.6 million during the six months ended June 30, 2017. Approximately $0.2 million of this adjustment was recorded as revenue during the three months ended March 31, 2017, with the remainder recorded as revenue during the second quarter of 2017. In addition, during the second quarter of 2017, the Company reached an agreement to finalize the net working capital ("NWC") settlement related to the Valence Health transaction. Per the executed settlement agreement, the Company received 0.2 million shares of its Class A Common Stock previously held in escrow. The fair value of the NWC settlement was approximately $0.9 million less than the Company's previously recorded estimate and, accordingly, the Company recorded a measurement period adjustment to increase purchase price and goodwill by approximately $0.9 million. The Company also recorded adjustments to accounts receivable and intangible assets, which resulted in a $0.3 million increase to goodwill. Any remaining necessary adjustments are expected to be finalized within one year from the date of acquisition.

Our results for the year ended December 31, 2016, included approximately $3.9 million in stock compensation expense related to the acceleration of unvested Valence Health equity awards that vested upon the close of the Valence Health acquisition. The expense was related to Valence Health employees that remained with the Company following the close of the acquisition.

As previously discussed in "Part II - Item 8. Financial Statements and Supplementary Data - Note 4" of our 2016 Form 10-K, immediately following the Valence Health acquisition, the Company decided to abandon and sublet its rented space at 540 W. Madison Street, Suite 1400, Chicago, Illinois (the "14th Floor Space"). Therefore, our results from operations for the year ended December 31, 2016, included a lease abandonment expense of approximately $6.5 million in conjunction with a rental space acquired as part of the Valence Health acquisition, based on remaining lease payments and expected future sublease income. During the second quarter of 2017, the Company reached an agreement to terminate the lease for the 14th Floor Space, effective September 2017. The Company will continue making rent payments until September 1, 2017, at which point it will pay a one-time lease cancellation and related brokerage fee. Remaining cash outflows related to the 14th Floor Space are estimated to be approximately $4.8 million as of June 30, 2017, while the remaining balance of the initial $6.5 million lease abandonment liability recorded after the Valence Health acquisition was approximately $5.3 million as of June 30, 2017, prior to adjustments pertaining to the lease cancellation fees. As such, the Company recorded a one-time adjustment of $0.5 million to reduce the lease abandonment liability, from $5.3 million to $4.8 million, as of June 30, 2017. The adjustment was recorded as a reduction to our rent expense within "Selling, general and administrative expenses" on our Consolidated Statements of Operations for the three and six months ended June 30, 2017.

In conjunction with our acquisition of Valence Health on October 3, 2016, we also signed a Master Service Agreement (the "MSA"), as well as a Transition Service Agreement (the "TSA") with Cicerone Health Solutions, Inc., the surviving Valence Health, Inc. state insurance cooperative business not acquired by Evolent ("CHS"). The MSA and the TSA are at market rates and, therefore, there is no allocation of purchase price to these arrangements.

The terms of the MSA stipulate that the Company will provide service information technology, system configuration and medical management services to CHS's state insurance cooperative clients until December 31, 2018. Based on management's analysis, the terms of the MSA are at fair market value.

Under the terms of the TSA, the Company will provide back office information technology support to CHS and CHS will provide back office finance and human resources support to Evolent until December 31, 2017. Additionally, employees of both entities will have mutual employee health care claims administration through a self-funded plan. Based on management's analysis, the terms of the TSA are at fair market value.

Passport

On February 1, 2016, the Company entered into a strategic alliance with University Health Care, Inc. d/b/a Passport Health Plan ("Passport"), a nonprofit community-based and provider-sponsored health plan administering Kentucky Medicaid and federal Medicare Advantage benefits to approximately 0.3 million Kentucky Medicaid and Medicare Advantage beneficiaries. As part of the transaction, we issued 1.1 million Class A common shares to acquire capabilities and assets from Passport to enable us to build out a Medicaid Center of Excellence based in Louisville, Kentucky. Additional equity consideration of up to $10.0 million may be earned by Passport should we obtain new third party Medicaid businesses in future periods. This transaction also includes a 10-year arrangement under which we will provide various health plan management and managed care services to Passport. The Company incurred approximately $0.2 million in transaction costs related to the Passport acquisition for the year ended December 31, 2016. The transaction costs were recorded within "Selling, general and administrative expenses" on our Consolidated Statements of Operations. The Company has accounted for the transactions with Passport as a business combination using purchase accounting.

The fair value of the total consideration transferred in connection with the close of the transaction was $18.2 million, of which the Class A common shares were valued at $10.5 million and the contingent equity consideration was initially valued at $7.8 million. The fair value of the shares issued was determined based on the closing price of the Company's Class A common stock on the NYSE as of February 1, 2016, and the quantity of shares issued was determined under a pricing collar set forth in the purchase agreement. The contingent consideration of $8.5 million and $8.3 million is a mark-to-market liability recorded within "Other long-term liabilities" on our Consolidated Balance Sheets as of June 30, 2017, and December 31, 2016. We recorded a re-measurement loss of approximately $0.2 million during the six months ended June 30, 2017, and $0.5 million during the fourth quarter of 2016, based on changes in the underlying assumptions of the fair value calculation. The fair value of the contingent equity consideration was estimated based on the real options approach, a form of the income approach, which estimated the probability of the Company achieving future revenues under the agreement. Key assumptions include the discount rate and the probability-adjusted recurring revenue forecast. A further discussion of the fair value measurement of the contingent consideration is provided in Note 15.

The purchase price was allocated to the assets acquired based on their fair values as of February 1, 2016, as follows (in thousands):

Purchase Consideration	
Fair value of Class A common stock issued	$10,450
Fair value of contingent consideration	7,750
Total consideration	$18,200
Tangible assets acquired	
Prepaid asset	$6,900
Goodwill	11,300
Net assets acquired	$18,200

The prepaid asset is related to an acquired facility license agreement as the Company was provided with leased facilities which house the acquired Passport employees at no future cost to the Company. The fair value of the acquired facility license agreement was determined by comparing the current market value of similar lease spaces to the facilities occupied by the acquired Passport personnel to obtain a market value of the occupied space, with the present value of the determined market value of the occupied space classified as the acquired facility license agreement prepaid asset. The goodwill is attributable partially to the acquired assembled workforce. The transaction was a taxable business combination for the Company and the amount of goodwill determined for tax purposes is deductible upon the beginning of the amortization period for tax purposes.

Pro Forma Financial Information (Unaudited)

The unaudited pro forma Consolidated Statements of Operations presented below gives effect to (1) the Aldera transaction as if it had occurred on January 1, 2015, (2) the Valence Health transaction as if it had occurred on January 1, 2015, and (3) the Passport transaction as if it had occurred on January 1, 2015. The following pro forma information includes adjustments to:

- remove transaction costs related to the Passport transaction of $0.3 million recorded during the six months ended June 30, 2016, and reclassify said amounts to the six months ended June 30, 2015;
- record amortization expenses related to intangible assets beginning January 1, 2015, for intangible assets related to Valence Health and Aldera;
- record revenue and expenses related to the Valence Health MSA and TSA agreements for the six months ended June 30, 2016; and

- record rent expense related to Passport prepaid lease beginning January 1, 2015.

This pro forma data is presented for informational purposes only and does not purport to be indicative of the results of future operations or of the results that would have occurred had the transactions described above occurred in the specified prior periods. The pro forma adjustments are based on available information and assumptions that the Company believes are reasonable to reflect the impact of these transactions on the Company's historical financial information on a pro forma basis (in thousands, except per share data).

	For the Three Months Ended June 30, 2016	For the Six Months Ended June 30, 2016
Revenue	$88,971	$170,297
Net income (loss)	(11,616)	(189,236)
Net income (loss) attributable to non-controlling interests	(3,005)	(49,012)
Net income (loss) attributable to Evolent Health, Inc.	(8,611)	(140,224)
Net income (loss) available to common shareholders:		
Basic	(0.17)	(2.80)
Diluted	(0.17)	(2.80)

Securities Offerings

Certain affiliates of TPG ("TPG"), The Advisory Board Company ("The Advisory Board"), UPMC and Ptolemy Capital, LLC ("Ptolemy Capital") (together, the "Investor Stockholders") have an existing exchange right that allows receipt of newly-issued shares of the Company's Class A common stock in exchange (a "Class B Exchange") for an equal number of shares of the Company's Class B common stock (which are subsequently canceled) and an equal number of Evolent Health LLC's Class B common units ("Class B units"). Class B units received by the Company from relevant Investor Stockholders are simultaneously exchanged for an equivalent number of Class A units of Evolent Health LLC, and Evolent Health LLC cancels the Class B units it receives in the Class B Exchange. The cancellation of the Class B units results in an increase in the Company's economic interest in Evolent Health LLC. The Company did not receive any proceeds from Class B exchanges or the sale of Class A common stock in the secondary offerings described below.

The Investor Stockholders initiated several Class B Exchanges as part of various secondary offerings during 2017 and 2016, thus increasing the Company's economic interest in Evolent Health LLC, as discussed below.

June 2017 Secondary Offering

In June 2017, the Company completed a secondary offering of 4.5 million shares of its Class A common stock at a price to the underwriters of $25.87 per share (the "June 2017 Secondary").

The shares sold in the June 2017 Secondary consisted of 0.7 million existing shares of the Company's Class A common stock owned and held by certain Investor Stockholders and 3.8 million newly-issued shares of the Company's Class A common stock received by certain Investor Stockholders pursuant to Class B Exchanges.

As a result of these Class B Exchanges and Evolent Health LLC's cancellation of the Class B units during the June 2017 Secondary, the Company's economic interest in Evolent Health LLC increased from 90.5% to 96.1%

immediately following the June 2017 Secondary, and, accordingly, we reclassified a portion of our non-controlling interests into shareholders' equity attributable to Evolent Health, Inc.

May 2017 Secondary Offering

In May 2017, the Company completed a secondary offering of 7.0 million shares of its Class A common stock at a price to the underwriters of $24.30 per share (the "May 2017 Secondary"). The shares were sold by the Investor Stockholders and certain management selling stockholders (together with the Investor Stockholders, the "Selling Stockholders").

The shares sold in the May 2017 Secondary consisted of 3.1 million existing shares of the Company's Class A common stock owned and held by the Selling Stockholders, 3.8 million newly-issued shares of the Company's Class A common stock received by certain

Investor Stockholders pursuant to Class B Exchanges and 0.1 million shares issued upon the exercise of options by certain management selling stockholders.

As a result of these Class B Exchanges and Evolent Health LLC's cancellation of the Class B units during the May 2017 Secondary, the Company's economic interest in Evolent Health LLC increased from 84.9% to 90.5% immediately following the May 2017 Secondary, and, accordingly, we reclassified a portion of our non-controlling interests into shareholders' equity attributable to Evolent Health, Inc.

March 2017 Secondary Offering

In March 2017, the Company completed a secondary offering of 7.5 million shares of its Class A common stock at a price to the underwriters of $19.53 per share (the "March 2017 Secondary").

The shares sold in the March 2017 Secondary consisted of 3.1 million existing shares of the Company's Class A common stock owned and held by the Investor Stockholders and 4.4 million newly-issued shares of the Company's Class A common stock received by certain Investor Stockholders pursuant to Class B Exchanges.

As a result of these Class B Exchanges and Evolent Health LLC's cancellation of the Class B units during the March 2017 Secondary, the Company's economic interest in Evolent Health LLC increased from 77.4% to 83.9% immediately following the March 2017 Secondary, and, accordingly, we reclassified a portion of our non-controlling interests into shareholders' equity attributable to Evolent Health, Inc.

In connection with the March 2017 Secondary, the underwriters exercised, in full, their option to purchase an additional 1.1 million shares of Class A common stock (the "March 2017 Option to Purchase Additional Shares") from the Investor Stockholders at a price of $19.53 per share. The March 2017 Option to Purchase Additional Shares closed in May 2017.

The shares sold in the March 2017 Option to Purchase Additional Shares consisted of 0.5 million existing shares of the Company's Class A common stock owned and held by certain Investor Stockholders. It also included 0.6 million newly-issued shares of the Company's Class A common stock received by certain Investor Stockholders pursuant to Class B Exchanges.

As a result of the Class B Exchanges and Evolent Health LLC's cancellation of the Class B units during the March 2017 Option to Purchase Additional Shares, the Company's economic interest in Evolent Health LLC increased from 83.9% to 84.9% immediately following the March 2017 Option to Purchase Additional Shares, and, accordingly, we reclassified a portion of our non-controlling interests into shareholders' equity attributable to Evolent Health, Inc.

The June 2017 Secondary, May 2017 Secondary, March 2017 Secondary and March 2017 Option to Purchase Additional Shares are collectively referred to as the "2017 Secondary Offerings."

September 2016 Secondary

In September 2016, the Company completed a secondary offering of 8.6 million shares of its Class A common stock at a price to the public of $22.50 per share, including the exercise in full by the underwriters of their option to purchase additional shares (the "September 2016 Secondary").

The shares sold in the September 2016 Secondary consisted of 6.4 million existing shares of the Company's Class A common stock owned and held by the Selling Stockholders and 2.2 million newly-issued shares of the Company's Class A common stock received by certain Investor Stockholders pursuant to Class B Exchanges.

As a result of these Class B Exchanges and Evolent Health LLC's cancellation of the Class B units during the September 2016 Secondary, the Company's economic interest in Evolent Health LLC increased from 71.0% to 74.6% immediately following the September 2016 Secondary, and, accordingly, we reclassified a portion of our non-controlling interests into shareholders' equity attributable to Evolent Health, Inc.

The Company's economic interest in Evolent Health LLC will increase if further Class B Exchanges occur.

Asset Acquisitions

Accordion Health, Inc.

On June 8, 2017, the Company entered into an agreement to acquire Accordion Health, Inc. (“Accordion”) for $3.2 million (the “Accordion Purchase Agreement”). Accordion provides technology that the Company believes enhances its risk-adjustment factor (“RAF”) services to its partners. In addition to technology assets, the software development team from Accordion joined Evolent as full-time employees. Under the terms of the Accordion Purchase Agreement, members of the software development team will be eligible for an additional $0.8 million earn-out, contingent upon the completion of specified software development targets.

We accounted for the transaction as an asset acquisition as substantially all of the fair value of the gross assets acquired was concentrated in a single identified asset, thus satisfying the requirements of the screen test introduced in ASU 2017-01. The assets acquired in the transaction were measured based on the amount of cash paid to Accordion, including transaction costs, as the fair value of the assets given was more readily determinable than the fair value of the assets received. We classified and designated the identifiable assets acquired as a $3.3 million technology intangible asset, inclusive of approximately $0.1 million of capitalized transaction costs. We also assessed and determined the useful life of the acquired intangible assets to be five years, subject to amortization. The Company will account for the contingent earn-out as a post-acquisition expense as the specified software development targets are achieved. The transaction was a taxable asset purchase and the Company recognized deferred tax liability of $2.0 million related to the book-tax basis difference in the acquired asset, which resulted in a $2.0 million increase in the value of the intangible asset. The additional deferred tax liability represents a future source of taxable income that enables the Company to release some of its previously established valuation allowance, the reduction of which is accounted for outside of acquisition accounting, resulting in income tax benefit.

Vestica

On March 1, 2016, the Company entered into an Asset Purchase Agreement between Vestica Healthcare, LLC (“Vestica”) and Evolent Health LLC. As part of the transaction, the Company paid $7.5 million to acquire certain assets from Vestica to further align our interests with one of our existing partners. Vestica can earn an additional $4.0 million in consideration, which is being held in escrow, based on certain future events. This transaction also includes an arrangement under which Vestica will continue to perform certain services on our behalf related to the acquired assets.

We accounted for the transaction as an asset acquisition where the assets acquired were measured based on the amount of cash paid to Vestica as well as transaction costs incurred as the fair value of the assets given was more readily determinable than the fair value of the assets received. We classified and designated identifiable assets acquired and we assessed and determined the useful lives of the acquired intangible assets subject to amortization. As a result, we recorded a $7.5 million customer relationship intangible asset with a useful life of thirteen years. The transaction was a taxable asset purchase.

5. Investments

Our investments are classified as held-to-maturity as we have both the intent and ability to hold the investments until their individual maturities. The amortized cost, gross unrealized gains and losses, and fair value of our investments as measured using Level 2 inputs (in thousands) were as follows:

	As of June 30, 2017			
		Gross	Gross	
	Amortized	Unrealized	Unrealized	Fair

	Costs	Gains	Losses	Value
U.S. Treasury bills	$24,027	$ 114	$ 16	$24,125

	As of December 31, 2016			
		Gross	Gross	
	Amortized	Unrealized	Unrealized	Fair
	Costs	Gains	Losses	Value
U.S. Treasury bills	$28,119	$ 116	$ 27	$28,208
Corporate bonds	16,222	81	8	16,295
Total investments	$44,341	$ 197	$ 35	$44,503

The amortized cost and fair value of our investments by contractual maturities (in thousands) were as follows:

	As of June 30, 2017		As of December 31, 2016	
	Amortized Costs	Fair Value	Amortized Costs	Fair Value
Due in one year or less	$24,027	$24,125	$ 44,341	$44,503

We did not have any held-to-maturity securities in an unrealized loss position as of June 30, 2017. The following table summarizes our held-to-maturity securities that had been in a continuous unrealized loss position for less than twelve months as of December 31, 2016 (in thousands, except number of securities):

	Number of Securities	Fair Value	Unrealized Losses
U.S. Treasury bills	1	$4,002	$ 1

We did not hold any securities in a continuous unrealized loss position for twelve months or longer as of December 31, 2016.

When a held-to-maturity investment is in an unrealized loss position, we assess whether or not we expect to recover the entire cost basis of security, based on our best estimate of the present value of cash flows expected to be collected from the debt security. Factors considered in our analysis include the reasons for the unrealized loss position, the severity and duration of the unrealized loss position, credit worthiness and forecasted performance of the investee. In cases where the estimated present value of future cash flows is less than our cost basis, we recognize an other than temporary impairment and write the investment down to its fair value. The new cost basis would not be changed for subsequent recoveries in fair value. No investments were written down during the three and six months ended June 30, 2017.

6. Property and Equipment, Net

The following summarizes our property and equipment (in thousands):

	As of June 30, 2017	As of December 31, 2016
Computer hardware	$5,026	$4,474
Furniture and equipment	2,448	2,448
Internal-use software development costs	33,466	21,385
Leasehold improvements	8,199	8,108
Total property and equipment	49,139	36,415
Accumulated depreciation and amortization	(8,945)	(5,236)
Total property and equipment, net	$40,194	$31,179

The Company capitalized $6.2 million and $12.0 million of internal-use software development costs for the three and six months ended June 30, 2017, respectively, and $3.7 million and $7.1 million for the three and six months ended June 30, 2016, respectively. The net book value of capitalized internal-use software development costs was $30.4 million and $19.9 million as of June 30, 2017, and December 31, 2016, respectively.

Depreciation expense related to property and equipment was $1.9 million and $3.7 million for the three and six months ended June 30, 2017, respectively, of which amortization expense related to capitalized internal-use software development costs was $0.9 million and $1.6 million, respectively. Depreciation expense related to property and equipment was $0.8 million and $1.5 million for the three and six months ended June 30, 2016, respectively, of which amortization expense related to capitalized internal-use software development costs was $0.3 million and $0.5 million, respectively.

7. Goodwill and Intangible Assets, Net

Goodwill

Goodwill has an estimated indefinite life and is not amortized; rather, it is reviewed for impairment at least annually or whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable.

Our annual goodwill impairment review occurs during the fourth quarter of each fiscal year. We performed our 2016 evaluation on October 31, 2016, as further described in our 2016 Form 10-K. Our qualitative assessment did not identify sufficient indicators of impairment to require a Step 1 evaluation.

In interim periods between annual goodwill reviews, we also evaluate qualitative factors that could cause us to believe our estimated fair value of our single reporting unit may be lower than the carrying value and trigger a Step 1 test including, but not limited to (i) macroeconomic conditions, (ii) industry and market considerations, (iii) our overall financial performance including an analysis of our current and projected cash flows, revenue and earnings, (iv) a sustained decrease in share price and (v) other relevant entity-specific events including changes in strategy, partners, or litigation.

We did not identify any qualitative factors that would trigger a Step 1 test during the six months ended June 30, 2017. As discussed in Notes 2 and 3, we adopted ASU 2017-04 effective January 1, 2017, thus changing our policy with regard to goodwill impairment testing. Following the adoption, we will perform a one-step test for goodwill impairment. The discussion below of our goodwill impairment testing during the first quarter of 2016 was performed using a two-step method under our previous policy.

During the three months ended March 31, 2016, our common stock traded between $8.48 and $12.32, or an average common stock price of $10.33, compared to an average common stock price of $19.51 and $14.73 during the three month periods ended September 30, 2015, and December 31, 2015, respectively. A sustained decline in our common stock price and the resulting impact on our market capitalization is one of several qualitative factors we consider each quarter when evaluating whether events or changes in circumstances indicate it is more likely than not that a potential goodwill impairment exists. We concluded that the decline in common stock price observed during the first quarter of 2016 did represent a sustained decline and, as such, we performed a Step 1 impairment test of our goodwill as of March 31, 2016.

Step 1 Results

To determine the implied fair value for our single reporting unit, we used both a market multiple valuation approach (“market approach”) and a discounted cash flow valuation approach (“income approach”). In determining the estimated fair value, we considered the level of our Class A common stock price and assumptions that we believed market participants would make in valuing our reporting unit, including a control premium, as well as discounted cash flow calculations of management’s estimates of future financial performance and management’s long-term plans. This analysis also required us to make judgments about revenues, expenses, fixed asset and working capital requirements, the timing of exchanges of our Class B common shares, capital market assumptions and discount rates.

In our March 31, 2016, Step 1 test, our most sensitive assumption for purposes of the market approach was our estimate of the control premium, and the most sensitive assumption related to the income approach, other than our cash flows, was the discount rate. As of March 31, 2016, our single reporting unit failed the Step 1 analysis as we determined that its implied fair value was less than its carrying value based on the weighting of the fair values determined under both the market and income approaches. As fair value was less than carrying value, we performed a Step 2 test to determine the implied fair value of our goodwill.

Step 2 Results

In our March 31, 2016, Step 2 test, the fair value of all assets and liabilities were estimated, including our tangible assets (corporate trade name, customer relationships and technology) for the purpose of deriving an estimate of the implied fair value of goodwill. The implied fair value of goodwill was then compared to the carrying amount of goodwill resulting in an impairment charge of $160.6 million on our Consolidated Statements of Operations.

The impairment was driven primarily by the sustained decline in our share price as our estimates of our future cash flows and the control premium have remained consistent, combined with an increase in the discount rate period over period. As noted above, our determination of fair value used a weighting of the fair values determined under both the market and income approaches, with the market approach driving the significant reduction in overall firm value and related impairment of goodwill.

The following table summarizes the changes in the carrying amount of goodwill (in thousands):

	For the Six Months Ended June 30, 2017	For the Year Ended December 31, 2016
Balance as of beginning-of-period	$626,569	$608,903
Goodwill Acquired [1]	—	178,266
Measurement period adjustments [2]	2,084	—
Goodwill Impairment	—	(160,600)
Balance as of end-of-period	$628,653	$626,569

[1] Represents goodwill acquired as a result of the Passport, Valence Health and Aldera transactions, as discussed in Note 4.
[2] Represents measurement period adjustments related to Valence Health and Aldera, as discussed in Note 4.

Intangible Assets, Net

As part of the Offering Reorganization, intangible assets of $169.0 million were recorded on our Consolidated Balance Sheets. We recorded additional intangible assets of $108.3 million related to our acquisitions in 2016, as discussed in Note 4.

Details of our intangible assets (in thousands) are presented below:

	As of June 30, 2017			
	Weighted-Average Remaining Useful Life	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value
Corporate trade name	17.9	$19,000	$ 1,979	$17,021
Customer relationships	21.0	203,500	13,665	189,835
Technology	4.7	55,823	12,046	43,777
Below market lease, net	8.7	4,197	370	3,827
Total		$282,520	$ 28,060	$254,460

	As of December 31, 2016			
	Weighted-Average Remaining Useful Life	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value
Corporate trade name	18.4	$19,000	$ 1,505	$17,495
Customer relationships	21.5	203,500	9,018	194,482
Technology	5.2	50,500	7,753	42,747
Below market lease, net	9.4	4,323	124	4,199
Total		$277,323	$ 18,400	$258,923

Amortization expense related to intangible assets was $4.9 million and $9.7 million for the three and six months ended June 30, 2017, respectively, and $2.6 million and $5.2 million for the three and six months ended June 30, 2016, respectively.

Intangible assets are reviewed for impairment if circumstances indicate the Company may not be able to recover the asset's carrying value. As discussed above, during the first quarter of 2016, our single reporting unit failed the Step 1 test for goodwill impairment, thus triggering an impairment analysis of the carrying value of our intangible asset group. In conjunction with the impairment testing of the carrying value of our goodwill in 2016, we performed an analysis to determine whether the carrying amount of our intangible asset group was recoverable. We performed a Step 1 test, which required management to compare the total undiscounted future cash flows of the intangible asset group to the current carrying amount. The total undiscounted cash flows included only the future cash flows that are directly associated with and that were expected to arise as a result of the use and eventual disposal of the asset group.

Based on our Step 1 test, we concluded the carrying amount of our intangible asset group was recoverable given the pre-tax, undiscounted cash flows exceeded the carrying value of the intangible asset group.

8. Long-term Debt

In December 2016, the Company issued $125.0 million aggregate principal amount of its 2.00% Convertible Senior Notes due 2021 (the “2021 Notes”) in a private placement to qualified institutional buyers within the meaning of Rule 144A under the Securities Act of 1933, as amended. The 2021 Notes were issued at par for net proceeds of $120.4 million. We incurred $4.6 million of debt issuance costs in connection with the 2021 Notes, which we are amortizing to non-cash interest expense using the straight line method over the contractual term of the 2021 Notes, since this method was not materially different from the effective interest method. The closing of the private placement of the 2021 Notes occurred on December 5, 2016.

Holders of the 2021 Notes are entitled to cash interest payments, which are payable semiannually in arrears on June 1 and December 1 of each year, beginning on June 1, 2017, at a rate equal to 2.00% per annum. The 2021 Notes will mature on December 1, 2021, unless earlier repurchased or converted in accordance with their terms prior to such date. In addition, holders of the 2021 Notes may require the Company to repurchase their 2021 Notes upon the occurrence of a fundamental change at a price equal to 100.00% of the principal amount of the 2021 Notes being repurchased, plus any accrued and unpaid interest. Upon maturity, and at the option of the holders of the 2021 Notes, the principal amount of the notes may be settled via shares of the Company’s Class A common stock. For the three and six months ended June 30, 2017, the Company recorded approximately $0.6 million and $1.2 million in interest expense and $0.2 million and $0.5 million in non-cash interest expense related to the amortization of deferred financing costs.

The 2021 Notes are convertible into shares of the Company’s Class A common stock, based on an initial conversion rate of 41.6082 shares of Class A common stock per $1,000 principal amount of the 2021 Notes, which is equivalent to an initial conversion price of approximately $24.03 per share of the Company’s Class A common stock. In the aggregate, the 2021 Notes are initially convertible into 5.2 million shares of the Company’s Class A common stock (excluding any shares issuable by the Company upon a conversion in connection with a make-whole provision upon a fundamental change under the indenture between Evolent Health, Inc. and U.S. Bank National Association, as trustee, related to the 2.00% convertible senior notes due 2021, dated as of December 5, 2016).

The 2021 Notes are convertible, in multiples of $1,000 principal amount, at the option of the holders at any time prior to the close of business on the business day immediately preceding the maturity date. Upon conversion, we will deliver for each $1,000 principal amount of notes converted a number of shares of our Class A common stock equal to the applicable conversion rate (together with a cash payment in lieu of delivering any fractional share) on the third business day following the relevant conversion date.

Convertible Senior Notes Carrying Value

While the 2021 Notes are recorded on our accompanying unaudited interim consolidated balance sheets at their net carrying value of $120.9 million as of June 30, 2017, the 2021 Notes are privately traded by qualified institutional buyers (within the meaning of Rule 144A under the Securities Act of 1933, as amended) and their fair value was $162.2 million, based on a traded price on June 30, 2017, a Level 2 input. As of December 31, 2016, the estimated fair value of the 2021 Notes was $125.0 million, which approximated cost as there were no significant movements in interest rates between the issuance date and December 31, 2016. The 2021 Notes also have embedded conversion options and contingent interest provisions.

The following table summarizes the carrying value of the long-term debt (in thousands):

	As of June 30, 2017	As of December 31, 2016
Carrying value	$120,935	$120,283
Unamortized discount	4,065	4,717
Principal amount	$125,000	$125,000
Remaining amortization period (years)	4.4	4.9

9. Commitments and Contingencies

UPMC Reseller Agreement

The Company and UPMC are parties to a reseller, services and non-competition agreement, dated August 31, 2011, which was amended and restated by the parties on June 27, 2013 (as amended through the date hereof, the "UPMC Reseller Agreement"). Under the terms of the UPMC Reseller Agreement, UPMC has appointed the Company as a non-exclusive reseller of certain services, subject to certain conditions and limitations specified in the UPMC Reseller Agreement. In consideration for the Company's obligations under the UPMC Reseller Agreement and subject to certain conditions described therein, UPMC has agreed not to sell certain products and services directly to the Company's customers and top prospects.

The Advisory Board Reseller Agreement

The Company and The Advisory Board are parties to a services, reseller, and non-competition agreement, dated August 31, 2011, which was amended and restated by the parties on June 27, 2013, and May 1, 2015 (as so amended, "The Advisory Board Reseller Agreement"). Under the terms of The Advisory Board Reseller Agreement, The Advisory Board provides certain services to the Company on an as-requested basis. In addition, The Advisory Board has a right of first offer to provide certain specified services during the term of the Agreement and has the right to collect certain fees for specified referrals. Pursuant to the Advisory Board Reseller Agreement, Evolent entered into a services agreement with The Advisory Board in October 2016 whereby The Advisory Board will provide certain services to the Company in conjunction with risk adjustment services provided to one of our customers.

Contingencies

Tax Receivables Agreement

In connection with the Offering Reorganization, the Company entered into the TRA with certain of its investors, which provides for the payment by the Company to these investors of 85% of the amount of the tax benefits, if any, that the Company is deemed to realize as a result of increases in our tax basis related to exchanges of Class B common units as well as tax benefits attributable to the future utilization of pre-IPO NOLs. These payment obligations are obligations of the Company. For purposes of the TRA, the benefit deemed realized by the Company will be computed by comparing its actual income tax liability to the amount of such taxes that the Company would have been required to pay had there been no increase to the tax basis of the assets of the Company as a result of the exchanges or had the Company had no NOL carryforward balance. The actual amount and timing of any payments under the TRA will vary depending upon a number of factors, including:

- the timing of the exchanges and the price of the Class A shares at the time of the transaction, triggering a tax basis increase in the Company's asset and a corresponding benefit to be realized under the TRA; and
- the amount and timing of our taxable income - the Company will be required to pay 85% of the tax savings as and when realized, if any. If the Company does not have taxable income, it will not be required to make payments under the TRA for that taxable year because no tax savings were actually realized.

Due to the items noted above, and the fact that the Company is in a full valuation allowance position such that the deferred tax assets related to the Company's historical pre-IPO losses and tax basis increase benefit from exchanges have not been realized, the Company has not recorded a liability pursuant to the TRA.

Litigation Matters

We are engaged from time to time in certain legal disputes arising in the ordinary course of business, including employment claims. When the likelihood of a loss contingency becomes probable and the amount of the loss can be reasonably estimated, we accrue a liability for the loss contingency. In connection with the Valence Health acquisition, the Company acquired certain in-process litigation; however, the Company is indemnified by the Valence Health sellers for certain matters and therefore has no potential material exposure. We continue to review accruals and adjust them to reflect ongoing negotiations, settlements, rulings, advice of legal counsel, and other relevant information. To the extent new information is obtained, and our views on the probable outcomes of claims, suits, assessments, investigations, or legal proceedings change, changes in our accrued liabilities would be recorded in the period in which such determination is made. The Company is not aware of any legal proceedings or claims as of June 30, 2017, or December 31, 2016, that the Company believes will have, individually or in the aggregate, a material adverse effect on the Company’s financial position or result of operations.

Commitments

Lease Commitments

The Company has entered into lease agreements for its office locations in Arlington, Virginia, Chicago, Illinois, Lisle, Illinois and San Francisco, California. In addition, certain leases acquired as part of the Valence Health transaction included existing sublease agreements for office locations in Chicago, Illinois. Total rental expense, net of sublease income, on operating leases was $2.4 million and $5.0 million for the three and six months ended June 30, 2017, respectively, and $1.1 million and $2.2 million for the three and six months ended June 30, 2016, respectively.

In connection with various lease agreements, the Company is required to maintain $3.9 million in letters of credit and, as such, held $3.9 million in restricted cash and restricted investments as collateral for the letters of credit as of June 30, 2017.

As previously discussed in “Part II - Item 8. Financial Statements and Supplementary Data - Note 4” of our 2016 Form 10-K, immediately following the Valence Health acquisition, the Company decided to abandon and sublet its rented space at 540 W. Madison Street, Suite 1400, Chicago, Illinois. Therefore, our results from operations for the year ended December 31, 2016, included a lease abandonment expense of approximately $6.5 million in conjunction with a rental space acquired as part of the Valence Health acquisition, based on remaining lease payments and expected future sublease income. During the second quarter of 2017, the Company reached an agreement to terminate the lease for the 14th Floor Space, effective September 2017. The Company will continue making rent payments until September 1, 2017, at which point it will pay a one-time lease cancellation and related brokerage fee. Remaining cash outflows related to the 14th Floor Space are estimated to be approximately $4.8 million as of June 30, 2017, while the remaining balance of the initial $6.5 million lease abandonment liability recorded after the Valence Health acquisition was approximately $5.3 million as of June 30, 2017, excluding adjustments pertaining to the lease cancellation fees. As such, the Company recorded a one-time adjustment of $0.5 million to reduce the lease abandonment liability, from $5.3 million to $4.8 million, as of June 30, 2017. The adjustment was recorded as a reduction to our rent expense within “Selling, general and administrative expenses” on our Consolidated Statements of Operations for the three and six months ended June 30, 2017.

The following table presents a roll forward of the lease abandonment liability (in thousands):

	For the Six Months Ended June 30, 2017	For the Year Ended December 31, 2016
Accrual as of beginning-of-period	$6,100	$—
Abandonment expense	—	6,460
Impact of lease termination	(496)	—
Abandonment amortization	(765)	(360)
Accrual as of end-of-period	$4,839	$6,100

Indemnifications

The Company’s customer agreements generally include a provision by which the Company agrees to defend its partners against third party claims (a) for death, bodily injury, or damage to personal property caused by Company negligence or willful misconduct, (b) by former or current Company employees arising from such managed service agreements, (c) for intellectual property infringement under specified conditions and (d) for Company violation of applicable laws, and to indemnify them against any damages and costs awarded in connection with such claims. To date, the Company has not incurred any material costs as a result of such indemnities and has not accrued any liabilities related to such obligations in the accompanying consolidated financial statements.

Registration rights agreement

We entered into a registration rights agreement with The Advisory Board, UPMC, TPG and another investor to register for sale under the Securities Act, shares of our Class A common stock, including those delivered in exchange for Class B common stock and Class B common units. Subject to certain conditions and limitations, this agreement provides these investors with certain demand, piggyback and shelf registration rights. The registration rights granted under the registration rights agreement will terminate upon the date the holders of shares that are a party thereto no longer hold any such shares that are entitled to registration rights. Pursuant to our contractual obligations under this agreement, we filed a registration statement on Form S-3 with the SEC on July 28, 2016, which was declared effective on August 12, 2016.

Pursuant to certain terms of the registration rights agreement, the Investor Stockholders sold 19.7 million shares of the Company's Class A common stock during the 2017 Secondary Offerings, as discussed in Note 4. Pursuant to the terms of the registration rights agreement, we incurred $1.0 million and $1.3 million in expenses related to the 2017 Secondary Offerings for the three and six months ended June 30, 2017, which were recorded within "Selling, general and administrative expenses" on our Consolidated Statement of Operations.

We will continue to pay all expenses relating to any demand, piggyback or shelf registration, other than underwriting discounts and commissions and any transfer taxes, subject to specified conditions and limitations. The registration rights agreement includes customary indemnification provisions, including indemnification of the participating holders of shares of Class A common stock and their directors, officers and employees by us for any losses, claims, damages or liabilities in respect thereof and expenses to which such holders may become subject under the Securities Act, state law or otherwise.

Guarantees

As part of our strategy to support certain of our partners in the Next Generation Accountable Care Program, we entered into upside and downside risk sharing arrangements. Our downside risk-sharing arrangements are limited to our fees and are executed through our wholly-owned captive insurance company. To satisfy the capital requirements of our insurance entity as well as state insurance regulators, Evolent entered into letters of credit of $8.2 million to secure potential losses related to insurance services. This amount is in excess of our actuarial assessment of loss.

Credit and Concentration Risk

The Company is subject to significant concentrations of credit risk related to cash and cash equivalents and accounts receivable. As of June 30, 2017, approximately 39.7% of our $113.9 million of cash and cash equivalents (including restricted cash) were held in bank deposits with FDIC participating banks and approximately 60.3% were held in money market funds. While the Company maintains its cash and cash equivalents with financial institutions with high credit ratings, it often maintains these deposits in federally insured financial institutions in excess of federally insured limits. The Company has not experienced any realized losses on cash and cash equivalents to date.

The following table summarizes those partners who represented at least 10.0% of our trade accounts receivable for the periods presented:

	As of June 30, 2017	As of December 31, 2016
Customer B	12.5%	*
Customer C	17.8%	*

Customer E	11.6%	14.3 %

* Represents less than 10.0% of the respective balance

In addition, the Company is subject to significant concentration of revenue risk as a substantial portion of our revenue is derived from a small number of contractual relationships with our operating partners.

The following table summarizes those partners who represented at least 10.0% of our revenue for the periods presented:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2017	2016	2017	2016
Customer A	19.2%	17.1%	18.2%	15.1%
Customer B	10.7%	16.2%	*	17.2%
Customer C	10.4%	*	10.8%	*
Customer D	*	15.5%	*	14.9%

* Represents less than 10.0% of the respective balance

10. Earnings (Loss) Per Common Share

The following table sets forth the computation of basic and diluted earnings per share available for common stockholders (in thousands, except per share data):

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2017	2016	2017	2016
Net income (loss)	$(19,698)	$(11,999)	$(42,848)	$(185,810)
Less:				
Net income (loss) attributable to non-controlling interests	(2,793)	(3,612)	(7,930)	(54,683)
Net income (loss) available for common shareholders (1) (2)	$(16,905)	$(8,387)	$(34,918)	$(131,127)
Weighted-average common shares outstanding (2) (3)	59,478	42,594	56,057	42,390
Earnings (Loss) per Common Share				
Basic	$(0.28)	$(0.20)	$(0.62)	$(3.09)
Diluted	(0.28)	(0.20)	(0.62)	(3.09)

(1) For periods of net loss, net income (loss) available for common shareholders is the same for both basic and diluted purposes.

(2) Each Class B common unit of Evolent Health LLC can be exchanged (together with a corresponding number of shares of our Class B common stock) for one share of our Class A common stock. As holders exchange their Class B common shares for Class A common shares, our interest in Evolent Health LLC will increase. Therefore, shares of our Class B common stock are not considered dilutive shares for the purposes of calculating our diluted earnings (loss) per common share as related adjustment to net income (loss) available for common shareholders would equally offset the additional shares, resulting in the same earnings (loss) per common share.

(3) For periods of net loss, shares used in the earnings (loss) per common share calculation represent basic shares as using diluted shares would be anti-dilutive.

Anti-dilutive shares (in thousands) excluded from the calculation of weighted-average common shares presented above are presented below:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2017	2016	2017	2016
Exchangeable Class B common stock	8,677	17,525	11,994	17,525
Restricted stock units ("RSUs")	607	158	546	85
Stock options and performance-based stock options	3,201	1,353	3,059	904
Convertible senior notes	5,201	—	5,201	—
Total	17,686	19,036	20,800	18,514

11. Stock-based Compensation

Total compensation expense by award type and line item in our consolidated financial statements were as follows (in thousands):

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2017	2016	2017	2016
Award Type				
Stock options	$4,108	$3,921	$8,161	$7,740
Performance-based stock options	112	123	222	148
RSUs	1,140	665	2,081	1,157
Total	$5,360	$4,709	$10,464	$9,045
Line Item				
Cost of revenue	$391	$406	$742	$850
Selling, general and administrative expenses	4,969	4,303	9,722	8,195
Total	$5,360	$4,709	$10,464	$9,045

No stock-based compensation in the totals above was capitalized as software development costs for the three and six months ended June 30, 2017 and 2016, respectively.

Stock-based awards granted were as follows:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2017	2016	2017	2016
Stock options	10,215	42,870	877,064	900,000
Performance-based stock options	—	—	—	267,770
RSUs	36,536	27,618	424,133	413,331

As discussed in Note 2, the Company adopted ASU 2016-09 with an effective date of January 1, 2016, and elected to recognize share-based award forfeitures as they occur. The adoption of ASU 2016-09 had an immaterial impact to our financial condition and results of operations as of and for the three and six months ended June 30, 2016.

In addition, the adoption of ASU 2016-09 changed how the Company recognizes excess tax benefits (“windfalls”) or deficiencies (“shortfalls”) related to share-based compensation. Prior to the adoption of ASU 2016-09, these windfalls and shortfalls were credited or charged, respectively, to additional paid-in capital in the Company’s Consolidated Balance Sheets when the amount of cash taxes paid was impacted by the windfalls and shortfalls. Under the revised standard, these windfalls and shortfalls are recognized prospectively as discrete tax benefit or discrete tax expense, respectively, in the Company’s Consolidated Statements of Operations without regard to the impact on cash taxes paid. For the three and six months ended June 30, 2017 and 2016, the Company recognized an immaterial discrete tax benefit related to net windfall tax benefits from share-based compensation, which increased the net operating loss ("NOL") deferred tax asset and our valuation allowance.

12. Income Taxes

For interim periods, we recognize an income tax provision (benefit) based on our estimated annual effective tax rate expected for the full year.

The Company recorded $0.7 million and $0.3 million in income tax benefit for the three and six months ended June 30, 2017, which resulted in effective tax rates of 3.4% and 0.7%, respectively. The Company recorded $0.4 million and $1.4 million in income tax benefit for the three and six months ended June 30, 2016, which resulted in effective tax rates of 3.0% and 0.7%, respectively. The income tax benefit recorded during the three months ended June 30, 2017, relates primarily to the release of valuation allowance as a result of the Accordion acquisition and the change in indefinite lived components and components expected to reverse outside of the net operating loss carryover period as part of the outside basis difference in our partnership interest in Evolent Health LLC. Neither of the components are considered a source of future taxable income for realizing the deferred tax assets, and with the exception of these components, the Company continues to record a valuation allowance against the net deferred tax assets.

As a result of the increase in our ownership of Evolent Health LLC following the 2017 Secondary Offerings discussed in Note 4 above, the Company reduced the indefinite portion of the deferred tax liability related to the book basis compared to the tax basis in our partnership interest in Evolent Health LLC by $8.6 million and $11.4 million for the three and six months ended June 30, 2017. The effect of this change in the deferred tax liability was recorded as additional paid-in capital.

As of each applicable period-end, the Company has not recognized any uncertain tax positions, penalties or interest as we have concluded that no such positions exist. The Company is not currently subject to income tax audits in any U.S. or state jurisdictions for any tax year.

Tax Receivables Agreement

In connection with the Offering Reorganization, the Company entered into the TRA with certain of its investors, which provides for the payment by the Company to these investors of 85% of the amount of the tax benefits, if any, that the Company is deemed to realize as a result of increases in our tax basis related to exchanges of Class B common units as well as tax benefits attributable to the future utilization of pre-IPO NOLs. See Note 9 above and "Part II - Item 8. Financial Statements and Supplementary Data - Note 12" in our 2016 Form 10-K for discussion of our TRA.

13. Investments In and Advances to Affiliates

Georgia Physicians for Accountable Care LLC

During the second quarter of 2016, the Company acquired 21,429 Class B Units of Georgia Physicians for Accountable Care, LLC ("GPAC") for $3.0 million in cash. The investment represented a 27% economic interest and a 28% voting interest in GPAC at the date of the transaction. As of June 30, 2017, the Company owned a 26% economic interest and a 28% voting interest in GPAC. The Company has determined it has significant influence but that it does not have control over GPAC. Accordingly, the investment is accounted for under the equity method of accounting and the Company will be allocated its proportional share of GPAC's profits and losses for each reporting period. Evolent Health, Inc.'s proportional share of the losses of GPAC was approximately $0.6 million and $1.1 million for the three and six months ended June 30, 2017, respectively, and less than $0.1 million for the three and six months ended June 30, 2016.

Concurrently, the Company also signed a long-term services agreement with GPAC to provide certain management, operational and support services to help GPAC manage elements of its service offerings. Revenue related to the long-term services agreement was approximately $0.2 million and $0.3 million for the three and six months ended June 30, 2017, respectively, and less than $0.1 million for the three and six months ended June 30, 2016.

14. Non-controlling Interests

In connection with the closing of the IPO, we used the net proceeds of the IPO to purchase 13.2 million newly-issued Class A common units in Evolent Health LLC. Additionally we acquired 2.1 million Class A common units in Evolent Health LLC, at $17.00 per unit, as a result of the merger of the TPG affiliate with and into Evolent Health, Inc. as described in our 2016 Form 10-K. Immediately following the Offering Reorganization and IPO, the Company owned 70.3% of Evolent Health LLC.

During the year ended December 31, 2016, the Company issued shares of its Class A common stock to acquire Passport, Valence Health and Aldera. For each share of Class A common stock issued by the Company, we received a reciprocal number of Class A units from Evolent Health LLC in exchange for contributing the acquired entities to Evolent Health LLC. As a result, our economic interest in Evolent Health LLC increased during the year from 70.3% to 70.8% due to Class A common shares issued for the acquisition of Passport and from 74.6% to 77.4% as a result of Class A common shares issued for the acquisitions of Valence Health and Aldera. In order to account for the change in our ownership interest in Evolent Health LLC, we reclassified a portion of our non-controlling interests into shareholders' equity attributable to Evolent Health, Inc.

In addition, the Company completed a secondary offering of 8.6 million shares of its Class A common stock at a price to the public of $22.50 per share in September 2016. The shares sold in the September 2016 Secondary consisted of 6.4 million existing shares of the Company's Class A common stock owned and held by the Selling Stockholders and 2.2 million newly-issued shares of the Company's Class A common stock received by certain Investor Stockholders pursuant to Class B Exchanges. As a result of these Class B Exchanges and Evolent Health LLC's cancellation of the Class B units during the September 2016 Secondary, the Company's economic interest in Evolent Health LLC increased from 71.0% to 74.6% as of September 22, 2016, and, accordingly, we reclassified a portion of our non-controlling interests into shareholders' equity attributable to Evolent Health, Inc.

Further, the Company completed the 2017 Secondary Offerings during the six months ended June 30, 2017. The shares sold in the 2017 Secondary Offerings consisted of 20.1 million shares of the Company's Class A common stock, consisting of 7.4 million existing shares of the Company's Class A common stock owned and held by certain Selling Stockholders, 12.6 million newly-issued shares of the Company's Class A common stock received by certain Investor Stockholders pursuant to Class B Exchanges and 0.1 million shares issued upon the exercise of options by certain management selling stockholders. As a result of these Class B Exchanges and Evolent Health LLC's cancellation of the Class B units during the 2017 Secondary Offerings, the Company's economic interest in Evolent Health LLC increased from 77.4% to 96.1% immediately following the June 2017 Secondary, and, accordingly, we reclassified a portion of our non-controlling interests into shareholders' equity attributable to Evolent Health, Inc.

As of June 30, 2017, and December 31, 2016, we owned 96.1% and 77.4% of the economic interests in Evolent Health LLC, respectively. See Note 4 for further discussion of our 2017 Secondary Offerings.

Changes in non-controlling interests (in thousands) for the periods presented were as follows:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2017	2016	2017	2016
Non-controlling interests as of beginning-of-period	$146,269	$234,028	$209,588	$285,238
Cumulative-effect adjustment from adoption of new accounting principle	—	—	—	(139)
Decrease in non-controlling interests as a result of Class B Exchanges	(109,298)	—	(168,883)	—
Reclassification of non-controlling interests	502	—	1,905	—
Net income (loss) attributable to non-controlling interests	(2,793)	(3,612)	(7,930)	(54,683)
Non-controlling interests as of end-of-period	$34,680	$230,416	$34,680	$230,416

15. Fair Value Measurement

GAAP defines fair value as the price that would be received from the sale of an asset or paid to transfer a liability (an exit price) assuming an orderly transaction in the most advantageous market at the measurement date. GAAP also establishes a hierarchical disclosure framework which prioritizes and ranks the level of observability of inputs used in measuring fair value. These tiers include:

- Level 1 - inputs to the valuation methodology are quoted prices available in active markets for identical instruments as of the reporting date;
- Level 2 - inputs to the valuation methodology are other than quoted prices in active markets, which are either directly or indirectly observable as of the reporting date and the fair value can be determined through the use of models or other valuation methodologies; and
- Level 3 - inputs to the valuation methodology are unobservable inputs in situations where there is little or no market activity for the asset or liability.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. Our assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the particular asset or liability being measured.

Recurring Fair Value Measurements

In accordance with GAAP, certain assets and liabilities are required to be recorded at fair value on a recurring basis. The following table summarizes the Company's assets and liabilities measured at fair value on a recurring basis (in thousands):

	As of June 30, 2017			
	Level 1	Level 2	Level 3	Total
Assets				
Cash and cash equivalents (1)	$68,653	$ —	$ —	$68,653
Liabilities				
Contingent consideration (2)	—	—	8,500	8,500

	As of December 31, 2016			
	Level 1	Level 2	Level 3	Total
Assets				
Cash and cash equivalents (1)	$1,128	$ —	$ —	$1,128
Liabilities				
Contingent consideration (2)	—	—	8,300	8,300

(1) Represents the cash and cash equivalents that were held in a money market fund as of June 30, 2017, and December 31, 2016, as presented in the tables above.
(2) Represents the contingent earn-out consideration related to the Passport acquisition as described further in Note 4.

The Company recognizes any transfers between levels within the hierarchy as of the beginning of the reporting period. There were no transfers between fair value levels for the three and six month periods ended June 30, 2017 and 2016, respectively.

In the absence of observable market prices, the fair value is based on the best information available and involves a significant degree of judgment, taking into consideration a combination of internal and external factors, including the appropriate risk adjustments for non-performance and liquidity risks.

As discussed in Note 4, the strategic alliance with Passport includes a provision for additional equity consideration contingent upon the Company obtaining new third party Medicaid business in future periods. The significant unobservable inputs used in the fair value measurement of the Passport contingent consideration are the five-year risk-adjusted recurring revenue compound annual growth rate ("CAGR") and the applicable discount rate. A significant increase in the assumed five-year risk-adjusted recurring revenue CAGR projection or decrease in discount rate in isolation would result in a significantly higher fair value of the contingent consideration.

The changes in our contingent consideration, measured at fair value, for which the Company uses Level 3 inputs to determine fair value are as follows (in thousands):

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2017	2016	2017	2016

Balance as of beginning-of-period	$8,300	$7,750	$8,300	$—
Additions	—	—	—	7,750
Realized and unrealized (gains) losses, net	200	—	200	—
Balance as of end-of-period	$8,500	$7,750	$8,500	$7,750

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The following table summarizes the fair value (in thousands), valuation techniques and significant unobservable inputs of our Level 3 fair value measurements as of the periods presented:

	As of June 30, 2017				
	Fair Value	Valuation Technique	Significant Unobservable Inputs	Assumption or Input Ranges	
Contingent consideration [1]	$8,500	Real options approach	Risk-adjusted recurring revenue CAGR	92.5	% [2]
			Discount rate/time value	2.7% - 4.0%	

[1] Related to additional Passport earn-out consideration as described further in Note 4.
[2] The risk-adjusted recurring revenue CAGR is calculated over the five-year period 2017-2021. Given that there was no recurring revenue in 2016 and 2017, the calculation of the 2017 and 2018 growth rate is based on a theoretical 2016 and 2017 recurring revenue of $1.0 million, resulting in a higher growth rate. The risk-adjusted recurring revenue CAGR over the period 2019-2021 is 19.2%.

	As of December 31, 2016				
	Fair Value	Valuation Technique	Significant Unobservable Inputs	Assumption or Input Ranges	
Contingent consideration [1]	$8,300	Real options approach	Risk-adjusted recurring revenue CAGR	97.0	% [2]
			Discount rate/time value	2.5% - 4.5%	

[1] Related to additional Passport earn-out consideration as described further in Note 4.
[2] The risk-adjusted recurring revenue CAGR is calculated over the five-year period 2017-2021. Given that there was no recurring revenue in 2016, the calculation of the 2017 growth rate was based on a theoretical 2016 recurring revenue of $1.0 million, resulting in a higher growth rate. The risk-adjusted recurring revenue CAGR over the period 2018-2021 was 50.8%.

Nonrecurring Fair Value Measurements

In addition to the assets and liabilities that are recorded at fair value on a recurring basis, the Company records certain assets and liabilities at fair value on a nonrecurring basis as required by GAAP. Generally, assets are recorded at fair value on a nonrecurring basis as a result of impairment charges. This includes goodwill, intangible assets, property, plant and equipment, held-to-maturity investments and equity method investments. While not carried at fair value on a recurring basis, these items are continually monitored for indicators of impairment that would indicate current carrying value is greater than fair value. In those situations, the assets are considered impaired and written down to current fair value. Refer to Notes 4, 5, 6, 7 and 13 for further discussion of assets measured at fair value on a nonrecurring basis.

Other Fair Value Disclosures

The carrying amounts of cash and cash equivalents (those not held in a money market fund), restricted cash, receivables, prepaid expenses, accrued liabilities and accrued compensation approximate their fair values because of the relatively short-term maturities of these items and financial instruments.

Refer to Note 8 for information regarding the fair value of the 2021 Notes.

16. Related Parties

As discussed in Note 13, Evolent owned a 26% economic interest in GPAC as of June 30, 2017, and is considered to have significant influence. As a result, the Company accounts for the investment under the equity method of accounting and is allocated its proportional share of GPAC's profits and losses for each reporting period. In addition, the Company signed a long-term services agreement with GPAC to provide certain management, operational and support services to help GPAC manage elements of its service offerings.

The Company also works closely with both of its founding investors, The Advisory Board and UPMC. The relationship with The Advisory Board is centered on providing certain specified services and making valuable connections with CEOs of health systems that could become partners. The Company's relationship with UPMC is a subcontractor relationship where UPMC has agreed to execute certain tasks (primarily TPA services) relating to certain customer commitments. We also conduct business with a company in which UPMC holds a significant equity interest. Our founding investors and their related businesses are considered related parties and the balances and/or transactions with them were reported on our consolidated financial statements.

Additionally, we issued shares of our stock to certain of our partners while concurrently entering into revenue contracts with those partners. Those partners are considered related parties and the balances and/or transactions with them were reported on our consolidated financial statements for the periods in which they held a significant equity interest in Evolent Health, Inc.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") is intended to help the reader understand the Company's financial condition and results of operations. The MD&A is provided as a supplement to, and should be read in conjunction with, our consolidated financial statements and the accompanying notes to consolidated financial statements ("Notes") presented in "Item 1. Financial Statements"; our 2016 Form 10-K, including the sections entitled "Risk Factors" and "Management's Discussion and Analysis of Financial Condition and Results of Operations"; and our current reports on Form 8-K filed in 2017.

INTRODUCTION

Background and Recent Events

Evolent Health, Inc. is a holding company whose principal asset is all of the Class A common units it holds in Evolent Health LLC, and its only business is to act as sole managing member of Evolent Health LLC. Substantially all of our operations are conducted through Evolent Health LLC and its consolidated subsidiaries. The financial results of Evolent Health LLC are consolidated in the financial statements of Evolent Health, Inc.

Securities Offerings

Certain affiliates of TPG ("TPG"), The Advisory Board Company ("The Advisory Board"), UPMC and Ptolemy Capital, LLC ("Ptolemy Capital") (together, the "Investor Stockholders") have an existing exchange right that allows receipt of newly-issued shares of the Company's Class A common stock in exchange (a "Class B Exchange") for an equal number of shares of the Company's Class B common stock (which are subsequently canceled) and an equal number of Evolent Health LLC's Class B common units ("Class B units"). Class B units received by the Company from relevant Investor Stockholders are simultaneously exchanged for an equivalent number of Class A units of Evolent Health LLC, and Evolent Health LLC cancels the Class B units it receives in the Class B Exchange. The cancellation of the Class B units results in an increase in the Company's economic interest in Evolent Health LLC. The Company did not receive any proceeds from Class B exchanges or the sale of Class A common stock in the secondary offerings described below.

The Investor Stockholders initiated several Class B Exchanges as part of various secondary offerings during 2017, thus increasing the Company's economic interest in Evolent Health LLC, as discussed below.

June 2017 Secondary Offering

In June 2017, the Company completed a secondary offering of 4.5 million shares of its Class A common stock at a price to the underwriters of $25.87 per share (the "June 2017 Secondary").

The shares sold in the June 2017 Secondary consisted of 0.7 million existing shares of the Company's Class A common stock owned and held by certain Investor Stockholders and 3.8 million newly-issued shares of the Company's Class A common stock received by certain Investor Stockholders pursuant to Class B Exchanges.

As a result of these Class B Exchanges and Evolent Health LLC's cancellation of the Class B units during the June 2017 Secondary, the Company's economic interest in Evolent Health LLC increased from 90.5% to 96.1% immediately following the June 2017 Secondary, and, accordingly, we reclassified a portion of our non-controlling interests into shareholders' equity attributable to Evolent Health, Inc.

May 2017 Secondary Offering

In May 2017, the Company completed a secondary offering of 7.0 million shares of its Class A common stock at a price to the underwriters of $24.30 per share (the “May 2017 Secondary”). The shares were sold by the Investor Stockholders and certain management selling stockholders (together with the Investor Stockholders, the “Selling Stockholders”).

The shares sold in the May 2017 Secondary consisted of 3.1 million existing shares of the Company’s Class A common stock owned and held by the Selling Stockholders, 3.8 million newly-issued shares of the Company’s Class A common stock received by certain Investor Stockholders pursuant to Class B Exchanges and 0.1 million shares issued upon the exercise of options by certain management selling stockholders.

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As a result of these Class B Exchanges and Evolent Health LLC's cancellation of the Class B units during the May 2017 Secondary, the Company's economic interest in Evolent Health LLC increased from 84.9% to 90.5% immediately following the May 2017 Secondary, and, accordingly, we reclassified a portion of our non-controlling interests into shareholders' equity attributable to Evolent Health, Inc.

March 2017 Secondary Offering

In March 2017, the Company completed a secondary offering of 7.5 million shares of its Class A common stock at a price to the underwriters of $19.53 per share (the "March 2017 Secondary").

The shares sold in the March 2017 Secondary consisted of 3.1 million existing shares of the Company's Class A common stock owned and held by the Investor Stockholders and 4.4 million newly-issued shares of the Company's Class A common stock received by certain Investor Stockholders pursuant to Class B Exchanges.

As a result of these Class B Exchanges and Evolent Health LLC's cancellation of the Class B units during the March 2017 Secondary, the Company's economic interest in Evolent Health LLC increased from 77.4% to 83.9% immediately following the March 2017 Secondary, and, accordingly, we reclassified a portion of our non-controlling interests into shareholders' equity attributable to Evolent Health, Inc.

In connection with the March 2017 Secondary, the underwriters exercised, in full, their option to purchase an additional 1.1 million shares of Class A common stock (the "March 2017 Option to Purchase Additional Shares") from the Investor Stockholders at a price of $19.53 per share. The March 2017 Option to Purchase Additional Shares closed in May 2017.

The shares sold in the March 2017 Option to Purchase Additional Shares consisted of 0.5 million existing shares of the Company's Class A common stock owned and held by certain Investor Stockholders. It also included 0.6 million newly-issued shares of the Company's Class A common stock received by certain Investor Stockholders pursuant to Class B Exchanges.

As a result of the Class B Exchanges and Evolent Health LLC's cancellation of the Class B units during the March 2017 Option to Purchase Additional Shares, the Company's economic interest in Evolent Health LLC increased from 83.9% to 84.9% immediately following the March 2017 Option to Purchase Additional Shares, and, accordingly, we reclassified a portion of our non-controlling interests into shareholders' equity attributable to Evolent Health, Inc.

The June 2017 Secondary, May 2017 Secondary, March 2017 Secondary and March 2017 Option to Purchase Additional Shares are collectively referred to as the "2017 Secondary Offerings."

The Company's economic interest in Evolent Health LLC will increase if further Class B Exchanges occur.

Asset Acquisitions

Accordion Health, Inc.

On June 8, 2017, the Company entered into an agreement to acquire Accordion Health, Inc. ("Accordion") for $3.2 million (the "Accordion Purchase Agreement"). Accordion provides technology that the Company believes enhances its risk-adjustment factor ("RAF") services to its partners. In addition to technology assets, the software development team from Accordion joined Evolent as full-time employees. Under the terms of the Accordion Purchase Agreement, members of the software development team will be eligible for an additional $0.8 million earn-out, contingent upon the completion of specified software development targets.

We accounted for the transaction as an asset acquisition as substantially all of the fair value of the gross assets acquired was concentrated in a single identified asset, thus satisfying the requirements of the screen test introduced in ASU 2017-01. The assets acquired in the transaction were measured based on the amount of cash paid to Accordion, including transaction costs, as the fair value of the assets given was more readily determinable than the fair value of the assets received. We classified and designated the identifiable assets acquired as a $3.3 million technology intangible asset, inclusive of approximately $0.1 million of capitalized transaction costs. We also assessed and determined the useful live of the acquired intangible assets to be five years, subject to amortization. The Company will account for the contingent earn-out as a post-acquisition expense as the specified software development targets are achieved. The transaction was a taxable asset purchase and the Company recognized deferred tax liability of approximately $2.0 million related to the book-tax basis difference in the acquired asset, which resulted in an income tax benefit related to the reduction in the Company’s previously established valuation allowance (the reduction of which is accounted for outside of acquisition accounting). This amount was recorded as an intangible asset.

Business Overview

We are a market leader and a pioneer in the new era of health care delivery and payment, in which leading providers are taking on increasing clinical and financial responsibility for the populations they serve. Our purpose-built platform, powered by our technology, proprietary processes and integrated services, enables providers to migrate their economic orientation from fee-for-service (“FFS”) reimbursement to value-based payment models. By partnering with providers to accelerate their path to value-based care, we enable our provider partners to expand their market opportunity, diversify their revenue streams, grow market share and improve the quality of the care they provide.

We consider value-based care to be the necessary convergence of health care payment and delivery. We believe the pace of this convergence is accelerating, driven by price pressure in traditional FFS health care, a market environment that is incentivizing value-based care models and innovation in data and technology. We believe providers are positioned to lead this transition to value-based care because of their control over large portions of health care delivery costs, their primary position with consumers and their strong local brand.

We market and sell our services primarily to major providers throughout the United States. We typically work with our partners in two phases. In the transformation phase, we initially work with our partners to develop a strategic plan for their transition to a value-based care model which includes sizing the market opportunity for our partner and creating a blueprint for executing that opportunity. During the second portion of the transformation phase, which typically lasts twelve to fifteen months, we generally work with our partner to implement the blueprint by establishing the resources necessary to launch its strategy and capitalize on the opportunity. During the transformation phase, we seek to enter into service agreements which we call the platform and operations phase and for which we deliver a wide range of services that support our partner in the execution of its new strategy. Certain contracts in the platform and operations phase can range from three to ten years in length, while others are shorter in duration, depending on the nature of the services. In the platform and operations phase, we establish a local market presence and embed our resources alongside our partners. Revenue from these long-term contracts is not guaranteed because certain of these contracts are terminable for convenience or other reasons by our partners after a notice period has passed, though certain partners would be required to pay us a termination fee in certain circumstances. In addition, at times our contracts may be renegotiated or amended to change the nature and price of the services and/or the time period over which they are provided.

As of June 30, 2017, we had over 25 operating partners, and a significant portion of our revenue is concentrated with several partners. Our two largest partners, Passport and MDWise, Inc., comprised 18.2% and 10.8%, respectively, of our revenue for the six months ended June 30, 2017, or 29.0% in the aggregate.

We have incurred operating losses since our inception, as we have invested heavily in resources to support our growth. We intend to continue to invest aggressively in the success of our partners, expand our geographic footprint and further develop our capabilities. We may continue to incur operating losses for the foreseeable future and may need to raise additional capital through equity and debt financings in order to fund our operations. Additional funds may not be available on terms favorable to us or at all. If we are unable to achieve our revenue growth and cost management objectives, we may not be able to achieve profitability. As of the date the financial statements were available to be issued, we believe we have sufficient liquidity for the next twelve months.

We manage our operations and allocate resources as a single reportable segment. All of our revenue is recognized in the United States and all of our long-lived assets are located in the United States.

Critical Accounting Policies and Estimates

The MD&A included in our 2016 Form 10-K contains a detailed discussion of our critical accounting policies and estimates. There have been no material changes to our critical accounting policies and estimates since our 2016 Form

10-K, except as discussed below. See “Item 1. Financial Statements - Note 2” in this Form 10-Q for a summary of our significant accounting policies and see “Item 1. Financial Statements - Note 3” in this Form 10-Q for information regarding the Company’s adoption of new accounting standards.

The Company adopted Accounting Standards Update (“ASU”) 2017-04, Intangibles-Goodwill and Other - Simplifying the Test for Goodwill Impairment, effective January 1, 2017. The adoption resulted in an update to our accounting policy for goodwill impairment. Under the updated policy, we perform a one-step test in our evaluation of the carrying value of goodwill, if qualitative factors determine it is necessary to complete a goodwill impairment test. In the evaluation, the fair value of the relevant reporting unit is determined and compared to the carrying value. If the fair value is greater than the carrying value, then the carrying value is deemed to be recoverable, and no further action is required. If the fair value estimate is less than the carrying value, goodwill is considered impaired for the amount by which the carrying amount exceeds the reporting unit’s fair value and a charge is reported in impairment of goodwill on our Consolidated Statements of Operations.

RESULTS OF OPERATIONS

Evolent Health, Inc. is a holding company and its principal asset is all of the Class A common units in Evolent Health LLC, which has owned all of our operating assets and substantially all of our business since inception. The financial results of Evolent Health LLC are consolidated in the financial statements of Evolent Health, Inc.

Key Components of our Results of Operations

Revenue

We derive our revenue from two sources: transformation and platform and operations services. We collect a fixed fee from our partners during the transformation phase and revenue is recognized based upon proportionate performance over the life of the engagement. Transformation revenue can fluctuate based on the timing of when contracts are executed with partners, the scope of the delivery and the timing of work being performed. During the platform and operations phase, our revenue structure shifts to a primarily variable fee structure which typically includes a monthly payment that is calculated based on a specified rate, or per member per month, multiplied by the number of members that our partners are managing under a value-based care arrangement or a percentage of plan premiums. The platform and operations agreements often include contingent fees such as service level agreements, shared medical savings arrangements and other performance measures which are recognized when the amount is estimable and there is evidence to support meeting the criteria. In some cases, we recognize revenue when the cash is received as we have limited data to support our estimate. Our platform and operations revenue may vary based on the nature of the population, the timing of new populations transitioning to our platform and the type of services being utilized by our partners. After a specified period, certain of our platform and operations contracts are terminable for convenience by our partners after a notice period has passed and the partner has paid a termination fee, or may be terminated or renegotiated in other circumstances. We also have arrangements with multiple deliverables (including both transformation and platform and operations components) and we evaluate the deliverables to determine whether they represent a separate unit of accounting. Revenue is then allocated to the units of accounting based on each unit's relative selling price.

Cost of revenue (exclusive of depreciation and amortization)

Our cost of revenue includes direct expenses and shared resources that perform services in direct support of clients. Costs consist primarily of employee-related expenses (including compensation, benefits and stock-based compensation), expenses for TPA support and other services, as well as other professional fees.

Selling, general and administrative expenses

Our selling, general and administrative expenses consist of employee-related expenses (including compensation, benefits and stock-based compensation) for selling and marketing, corporate development, finance, legal, human resources, corporate information technology, professional fees and other corporate expenses associated with these functional areas. Selling, general and administrative expenses also include costs associated with our centralized infrastructure and research and development activities to support our network development capabilities, PBM administration, technology infrastructure, clinical program development and data analytics.

Depreciation and amortization expense

Depreciation and amortization expenses consist of the amortization of intangible assets associated with the step-up in fair value of Evolent Health LLC's assets and liabilities for the Offering Reorganization, amortization of intangible assets recorded as part of the Vestica, Valence Health, Aldera and Accordion transactions and depreciation of property and equipment, including the amortization of capitalized software.

Evolent Health, Inc. Results

(in thousands)	For the Three Months Ended June 30, 2017	2016	Change Over Prior Period $	%	For the Six Months Ended June 30, 2017	2016	Change Over Prior Period $	%
Revenue								
Transformation	$5,361	$10,388	$(5,027)	(48.4)%	$15,596	$18,502	$(2,906)	(15.7)%
Platform and operations	101,710	46,130	55,580	120.5%	197,714	87,465	110,249	126.0%
Total revenue	107,071	56,518	50,553	89.4%	213,310	105,967	107,343	101.3%
Expenses								
Cost of revenue (exclusive of depreciation and amortization expenses presented separately below)	67,994	32,779	35,215	107.4%	135,523	61,390	74,133	120.8%
Selling, general and administrative expenses	51,090	32,756	18,334	56.0%	104,641	64,702	39,939	61.7%
Depreciation and amortization expenses	6,904	3,612	3,292	91.1%	13,519	6,983	6,536	93.6%
Goodwill impairment	—	—	—	—%	—	160,600	(160,600)	—%
Loss on change in fair value of contingent consideration	200	—	200	—%	200	—	200	—%
Total operating expenses	126,188	69,147	57,041	82.5%	253,883	293,675	(39,792)	(13.5)%
Operating income (loss)	$(19,117)	$(12,629)	$(6,488)	(51.4)%	$(40,573)	$(187,708)	$147,135	78.4%
Transformation revenue as a % of total revenue	5.0 %	18.4 %			7.3 %	17.5 %		
Platform and operations revenue as a % of total revenue	95.0 %	81.6 %			92.7 %	82.5 %		
Cost of revenue as a % of total revenue	63.5 %	58.0 %			63.5 %	57.9 %		
Selling, general and administrative expenses as a % of total revenue	47.7 %	58.0 %			49.1 %	61.1 %		

Comparison of the Results for the Three Months Ended June 30, 2017 to 2016

Revenue

Total revenue increased by $50.6 million, or 89.4%, to $107.1 million for the three months ended June 30, 2017, as compared to the same period in 2016.

Transformation revenue decreased by $5.0 million, or 48.4%, to $5.4 million for the three months ended June 30, 2017, as compared to the same period in 2016, due primarily to the timing of work being performed on existing contracts and timing of new contracts executed with new and existing partners. Transformation revenue accounted for 5.0% and 18.4% of our total revenue for the three months ended June 30, 2017, and 2016, respectively. Over time, we expect transformation revenue to continue to decrease as a percentage of total revenue.

Platform and operations revenue accounted for 95.0% and 81.6% of our total revenue for the three months ended June 30, 2017 and 2016, respectively. Platform and operations revenue increased by $55.6 million, or 120.5%, to $101.7 million for the three months ended June 30, 2017, as compared to the same period in 2016, primarily as a result of additional revenue from business combinations and aggregate enrollment growth of 98.2% from approximately 1.4 million lives on our platform as of June 30, 2016, to approximately 2.8 million lives on our platform as of June 30, 2017. We ended the quarter with over 25 revenue-producing partners compared to 13 as of June 30, 2016.

Cost of Revenue

Cost of revenue increased by $35.2 million, or 107.4%, to $68.0 million for the three months ended June 30, 2017, as compared to the same period in 2016. Cost of revenue increased period over period as a result of our business combinations during the fourth quarter of 2016. We incurred additional personnel costs and professional fees of $23.0 million and $6.7 million, respectively, to support our growing customer base and service offerings. Approximately $0.4 million of total personnel costs was attributable to stock-based compensation expense for the three months ended June 30, 2017 and 2016. Additionally, our technology services, TPA fees and other costs increased by $5.5 million period over period. The increase is attributable to costs to support our growth. Cost of revenue represented 63.5% and 58.0% of total revenue for the three months ended June 30, 2017 and 2016, respectively. Our cost of revenue increased as a percentage of our total revenue as we integrated new businesses acquired during the fourth quarter of 2016; however, we expect our cost of revenue to decrease as a percentage of total revenue going forward.

Selling, General and Administrative Expenses

Selling, general, and administrative expenses increased by $18.3 million, or 56.0%, to $51.1 million for the three months ended June 30, 2017, as compared to the same period in 2016. During the three months ended June 30, 2017, we incurred additional selling, general, and administrative expenses due partially to growth in our business resulting from our business combinations during the fourth quarter of 2016. Our selling, general and administrative expenses period over period also increased as a result of additional personnel costs, including investments in business development, research and development and general overhead, of $9.5 million. Approximately $5.0 million and $4.3 million of total personnel costs were attributable to stock-based compensation expense for the three months ended June 30, 2017 and 2016, respectively. Additionally, our professional fees, technology costs, lease costs and other costs related to our growth increased $3.0 million, $1.7 million, $1.1 million and $3.0 million, respectively, period over period, as a result of the growing customer base and service offerings and the 2016 business combinations mentioned above. Transaction and other acquisition-related costs accounted for approximately $1.4 million and $0.2 million of total selling, general, and administrative expenses for the three months ended June 30, 2017 and 2016, respectively. Selling, general and administrative expenses represented 47.7% and 58.0% of total revenue for the three months ended June 30, 2017 and 2016, respectively. While our selling, general and administrative expenses are expected to grow as our business grows, we expect them to decrease as a percentage of our total revenue over the long term.

Depreciation and Amortization Expenses

Depreciation and amortization expenses increased $3.3 million, or 91.1%, to $6.9 million for the three months ended June 30, 2017, as compared to the same period in 2016. The increase was due primarily to additional depreciation and amortization expenses related to assets acquired through business combinations and asset acquisitions subsequent to the second quarter of 2016 and the continued capitalization of internal-use software. We expect depreciation and amortization expenses to increase in future periods as we continue to capitalize internal-use software and amortize intangible assets resulting from asset acquisitions and business combinations (including possible future transactions).

Loss on change in fair value of contingent consideration

Loss on change in fair value of contingent consideration was $0.2 million for the three months ended June 30, 2017, as compared to zero for the same period in 2016. This increase was the result of changes in value of mark-to-market contingent liabilities acquired through business combinations during 2016. See “Item 1. Financial Statements - Note 15” for further details regarding the fair value of our mark-to-market contingent liabilities.

Comparison of the Results for the Six Months Ended June 30, 2017 to 2016

Revenue

Total revenue increased by $107.3 million, or 101.3%, to $213.3 million for the six months ended June 30, 2017, as compared to the same period in 2016.

Transformation revenue decreased by $2.9 million, or 15.7%, to $15.6 million for the six months ended June 30, 2017, as compared to the same period in 2016, due primarily to the timing of work being performed on existing contracts and timing of new contracts executed with new and existing partners. Transformation revenue accounted for 7.3% and 17.5% of our total revenue for the six months ended June 30, 2017, and 2016, respectively. Over time, we expect transformation revenue to continue to decrease as a percentage of total revenue.

Platform and operations revenue accounted for 92.7% and 82.5% of our total revenue for the six months ended June 30, 2017 and 2016, respectively. Platform and operations revenue increased by $110.2 million, or 126.0%, to $197.7 million for the six months ended June 30, 2017, as compared to the same period in 2016, primarily as a result of additional revenue from business combinations and aggregate enrollment growth of 98.2% from approximately 1.4 million lives on our platform as of June 30, 2016, to approximately 2.8 million lives on our platform as of June 30, 2017. We ended the quarter with over 25 revenue-producing partners compared to 13 as of June 30, 2016.

Cost of Revenue

Cost of revenue increased by $74.1 million, or 120.8%, to $135.5 million for the six months ended June 30, 2017, as compared to the same period in 2016. Cost of revenue increased period over period as a result of our business combinations during the fourth quarter of 2016. We incurred additional personnel costs and professional fees of $47.5 million and $13.9 million, respectively, to support our growing customer base and service offerings. Approximately $0.7 million and $0.9 million of total personnel costs was attributable to stock-based compensation expense for the six months ended June 30, 2017 and 2016, respectively. Additionally, our technology services, TPA fees and other costs increased by $12.8 million period over period. The increase is attributable to costs to support our growth. Cost of revenue represented 63.5% and 57.9% of total revenue for the six months ended June 30, 2017 and 2016, respectively. Our cost of revenue increased as a percentage of our total revenue as we integrated the new businesses acquired during the fourth quarter of 2016; however, we expect our cost of revenue to decrease as a percentage of total revenue going forward.

Selling, General and Administrative Expenses

Selling, general, and administrative expenses increased by $39.9 million, or 61.7%, to $104.6 million for the six months ended June 30, 2017, as compared to the same period in 2016. During the six months ended June 30, 2017, we incurred additional selling, general, and administrative expenses due primarily to growth in our business resulting from our business combinations during the fourth quarter of 2016. Our selling, general and administrative expenses period over period also increased as a result of additional personnel costs, including investments in business development, research and development and general overhead, of $21.8 million. Approximately $9.7 million and $8.2 million of total personnel costs were attributable to stock-based compensation expense for the six months ended June 30, 2017 and 2016, respectively. Additionally, our professional fees, technology costs, lease costs and other costs related to our growth increased $6.6 million, $3.2 million, $2.7 million and $5.7 million, respectively, period over period, primarily as a result of the 2016 business combinations mentioned above. Transaction and other acquisition-related costs accounted for approximately $5.2 million and $0.2 million of total selling, general, and administrative expenses for the six months ended June 30, 2017 and 2016, respectively. Selling, general and administrative expenses represented 49.1% and 61.1% of total revenue for the six months ended June 30, 2017 and 2016, respectively. While our selling, general and administrative expenses are expected to grow as our business grows, we expect them to decrease as a percentage of our total revenue over the long term.

Depreciation and Amortization Expenses

Depreciation and amortization expenses increased $6.5 million, or 93.6%, to $13.5 million for the six months ended June 30, 2017, as compared to the same period in 2016. The increase was due primarily to additional depreciation and amortization expenses related to assets acquired through business combinations and asset acquisitions subsequent to the second quarter of 2016 and the continued capitalization of internal-use software. We expect depreciation and amortization expenses to increase in future periods as we continue to capitalize internal-use software and amortize intangible assets resulting from asset acquisitions and business combinations (including possible future transactions).

Goodwill impairment

During the first quarter of 2016 we recorded an impairment charge of $160.6 million on our consolidated statements of operations as the implied fair value of goodwill was less than the carrying amount. See “Item 1. Financial Statements - Note 7” for further details of the impairment charge to goodwill.

Loss on change in fair value of contingent consideration

Loss on change in fair value of contingent consideration was $0.2 million for the six months ended June 30, 2017, as compared to zero for the same period in 2016. This increase was the result of changes in value of mark-to-market contingent liabilities acquired through business combinations during 2016. See “Item 1. Financial Statements - Note 15” for further details regarding the fair value of our mark-to-market contingent liabilities.

Discussion of Non-Operating Results

Interest income (expense), net

Interest income consists of interest from investing cash in money market funds and interest from both our short-term and long-term investments. We expect our average cash and cash equivalents to decline in future periods as we use those funds for operations.

In December 2016, the Company issued $125.0 million aggregate principal amount of its 2.00% Convertible Senior Notes due 2021 (the “2021 Notes”). Holders of the 2021 Notes are entitled to cash interest payments, which are payable semiannually in arrears on June 1 and December 1 of each year, beginning on June 1, 2017, at a rate equal to 2.00% per annum. In addition, we incurred $4.6 million of debt issuance costs in connection with the 2021 Notes, which we are amortizing to non-cash interest expense using the straight line method over the contractual term of the 2021 Notes. We recorded interest expense (including amortization of deferred financing costs) of approximately $0.9 million and $1.7 million related to our 2021 Notes for the three and six months ended June 30, 2017, respectively. See “Item 1. Financial Statements - Note 8” for further details of our convertible debt offering. Interest expense also includes amortization of bond premiums related to our investments.

Income (loss) from affiliate

During the second quarter of 2016, the Company acquired an equity stake in GPAC for $3.0 million. The Company will be allocated its proportional share of GPAC’s profits and losses for each reporting period. Evolent Health, Inc.’s proportional share of the losses of GPAC was $0.6 million and $1.1 million for the three and six months ended June 30, 2017, respectively, and less than $0.1 million for the three and six months ended June 30, 2016.

Provision (benefit) for income taxes

Our income tax expense and benefit relates to federal and state jurisdictions in the United States. The Company recorded $0.7 million and $0.3 million in income tax benefit for the three and six months ended June 30, 2017, which resulted in effective tax rates of 3.4% and 0.7%, respectively. The Company recorded $0.4 million and $1.4 million in income tax benefit for the three and six months ended June 30, 2016, which resulted in effective tax rates of 3.0% and 0.7%, respectively. The difference between our effective tax rate and our statutory rate is due primarily to the fact that we have certain permanent items which include, but are not limited to, income attributable to the non-controlling interest, and the impact of certain tax deduction limits related to meals and entertainment and other permanent nondeductible expenses. In addition, the Company maintains a full valuation allowance recorded against its net deferred tax assets, with the exception of indefinite lived components and components expected to reverse outside of the net operating loss carryover period as part of the outside basis difference in our partnership interest in Evolent Health LLC.

As discussed in “Item 1. Financial Statements - Note 4,” pursuant to the 2017 Secondary Offerings, the Company increased its ownership in Evolent Health LLC from 77.4% to 96.1% as of June 30, 2017. As a result, the Company reduced the indefinite portion of the deferred tax liability related to the book basis compared to the tax basis in our partnership interest in Evolent Health LLC by $8.6 million and $11.4 million for the three and six months ended June 30, 2017. The effect of this change in the deferred tax liability was recorded as additional paid-in capital.

During the three and six months ended June 30, 2017, management examined all sources of taxable income that may be available for the realization of its net deferred tax assets. Given the Company’s cumulative loss position, management concluded that there are no current sources of taxable income and we are currently reflecting a full valuation allowance in our financial statements. As of June 30, 2017, the Company had $11.2 million of deferred tax liability that would not provide a source of income to recognize the deferred tax assets.

Net income (loss) attributable to non-controlling interests

We consolidate the results of Evolent Health LLC as we have 100% of the voting rights of the entity; however, as of June 30, 2017, we owned only 96.1% of the economic rights of the results of operations of Evolent Health LLC and, therefore, eliminate the non-controlling interest from our results of operations. For the three and six months ended June 30, 2017, our results reflect net losses of $2.8 million and $7.9 million, respectively, attributable to non-controlling interests, which represents 14.6% and 19.5% of the operating losses of Evolent Health LLC. For the corresponding periods in 2016, our results reflect net losses of $3.6 million and $54.7 million attributable to non-controlling interests, respectively, which represents 28.6% and 29.1%, of the operating losses of Evolent Health LLC. The Company’s economic interest in Evolent Health LLC increased as compared to the prior period as a result of Class B Exchanges in connection with the 2017 Secondary Offerings, as well as our issuance of shares of Class A common stock in business combinations.

REVIEW OF CONSOLIDATED FINANCIAL CONDITION

Liquidity and Capital Resources

Since its inception, the Company has incurred operating losses and net cash outflows from operations. The Company incurred operating losses of $19.1 million and $40.6 million for the three and six months ended June 30, 2017, respectively, and operating losses of $12.6 million and $187.7 million for the three and six months ended June 30, 2016, respectively. Net cash used in operating activities was $44.7 million and $21.9 million for the six months ended June 30, 2017 and 2016, respectively. As of June 30, 2017, the Company had $100.0 million of cash and cash equivalents.

We believe our current cash, short-term investments and other sources of liquidity will be sufficient to meet our working capital and capital expenditure requirements for the next twelve months as of the date the financial statements were available to be issued. Our future capital requirements will depend on many factors, including our rate of revenue growth, the expansion of our sales and marketing activities and the timing and extent of our spending to support our acquisition and investment efforts and expansion into other markets. We may also seek to invest in, or acquire complementary businesses, applications or technologies.

Cash and Cash Equivalents, Restricted Cash and Restricted Investments and Investments

As of June 30, 2017, the Company had $100.0 million of cash and cash equivalents, $22.1 million in restricted cash and restricted investments and $24.0 million of investments.

Cash Flows

The following summary of cash flows (in thousands) has been derived from our financial statements included in "Item 1. Financial Statements:"

	For the Six Months Ended June 30,	
	2017	2016
Net cash provided by (used in) operating activities	$(44,712)	$(21,918)
Net cash provided by (used in) investing activities	7,739	(18,466)
Net cash provided by (used in) financing activities	2,385	(204)

Operating Activities

Cash flows used in operating activities of $44.7 million for the six months ended June 30, 2017, were due primarily to our net loss of $42.8 million, partially offset by non-cash items, including depreciation and amortization expenses of $13.5 million and stock-based compensation expense of $10.5 million