

Performant Financial Corp  
Form 10-Q  
May 10, 2013  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended March 31, 2013

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 001-35628

**PERFORMANT FINANCIAL CORPORATION**

(Exact name of registrant as specified in its charter)

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**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

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

**Performant Financial Corporation**

**333 North Canyons Parkway**

**Livermore, CA 94551**

**(925) 960-4800**

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

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

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

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

Large accelerated filer  Accelerated filer

Non-accelerated filer  Smaller reporting company

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

The number of shares of Common Stock outstanding as of May 9, 2013 was 47,700,961.

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**QUARTERLY REPORT ON FORM 10-Q**  
**FOR THE QUARTER ENDED MARCH 31, 2013**

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## Consolidated Balance Sheets

(In thousands, except per share amounts)

	March 31, 2013 (Unaudited)	December 31, 2012
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 39,347	\$ 37,843
Trade accounts receivable, net of allowance for doubtful accounts of \$53 and \$65, respectively and estimated allowance for appeals of \$371 and \$1,199, respectively	19,424	23,044
Deferred income taxes	3,798	3,798
Prepaid expenses and other current assets	3,258	2,876
Income tax receivable	2,092	0
Debt issuance costs, current portion	1,108	1,125
<b>Total current assets</b>	<b>69,027</b>	<b>68,686</b>
Property, equipment, and leasehold improvements, net	21,450	20,669
Identifiable intangible assets, net	35,312	36,244
Goodwill	81,572	81,572
Debt issuance costs, net	3,578	3,844
Other assets	709	730
<b>Total assets</b>	<b>\$ 211,648</b>	<b>\$ 211,745</b>
<b>Liabilities and Stockholders Equity</b>		
Liabilities:		
Current liabilities:		
Current maturities of notes payable	\$ 11,040	\$ 11,040
Accrued salaries and benefits	6,149	9,288
Accounts payable	1,436	1,403
Other current liabilities	6,062	8,252
Income taxes payable	0	430
Deferred revenue	1,278	2,187
Estimated liability for appeals	6,509	4,378
<b>Total current liabilities</b>	<b>32,474</b>	<b>36,978</b>
Notes payable, net of current portion	133,969	136,729
Deferred income taxes	11,271	11,271
Other liabilities	2,417	2,694
<b>Total liabilities</b>	<b>180,131</b>	<b>187,672</b>
Commitments and contingencies		
Stockholders equity:		
Common stock, \$0.0001 par value. Authorized, 500,000 shares at March 31, 2013 and December 31, 2012; issued and outstanding 46,721 and 45,392 shares at March 31, 2013 and December 31, 2012, respectively	4	4
Additional paid-in capital	41,593	35,970
Accumulated deficit	(10,080)	(11,901)

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Total stockholders' equity	31,517	24,073
Total liabilities and stockholders' equity	\$ 211,648	\$ 211,745

*See accompanying notes to consolidated financial statements.*

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Consolidated Statements of Operations

(In thousands, except per share amounts)

(Unaudited)

	<b>Three Months Ended March 31,</b>	
	<b>2013</b>	<b>2012</b>
Revenues	\$ 49,363	\$ 45,878
Operating expenses:		
Salaries and benefits	23,982	18,641
Other operating expenses	18,868	16,141
<b>Total operating expenses</b>	<b>42,850</b>	<b>34,782</b>
Income from operations	6,513	11,096
Debt extinguishment costs	0	(3,679)
Interest expense	(2,965)	(3,190)
Interest income	0	31
Income before provision for income taxes	3,548	4,258
Provision for income taxes	1,727	1,742
Net income	\$ 1,821	\$ 2,516
Accrual for preferred stock dividends	0	1,571
Net income available to common shareholders	\$ 1,821	\$ 945
Net income per share attributable to common shareholders		
Basic	\$ 0.04	\$ 0.02
Diluted	\$ 0.04	\$ 0.02
Weighted average shares		
Basic	46,121	42,985
Diluted	49,007	46,225

*See accompanying notes to consolidated financial statements.*

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**PERFORMANT FINANCIAL CORPORATION AND SUBSIDIARIES**

Consolidated Statement of Changes in Stockholders' Equity

For the Three Months Ended March 31, 2013

(In thousands)

(Unaudited)

	Common Stock		Additional	Accumulated	Total
	Shares	Amount	Paid-In Capital	Deficit	
Balance, December 31, 2012	45,392	\$ 4	\$ 35,970	\$ (11,901)	\$ 24,073
Exercise of stock options	1,329	0	735	0	735
Stock-based compensation expense	0	0	712	0	712
Income tax benefit from employee stock options	0	0	4,176	0	4,176
Net income	0	0	0	1,821	1,821
Balance, March 31, 2013	46,721	\$ 4	\$ 41,593	\$ (10,080)	\$ 31,517

*See accompanying notes to consolidated financial statements.*

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## Consolidated Statements of Cash Flows

(In thousands)

(Unaudited)

	<b>Three Months Ended March 31,</b>	
	<b>2013</b>	<b>2012</b>
<b>Cash flows from operating activities:</b>		
Net income	\$ 1,821	\$ 2,516
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,509	2,214
Write-off of unamortized debt issuance costs	0	335
Stock-based compensation	712	52
Interest expense from debt issuance costs and amortization of discount note payable	314	282
Interest income on notes receivable from stockholders	0	(28)
Changes in operating assets and liabilities:		
Trade accounts receivable	3,620	(4,911)
Prepaid expenses and other current assets	(382)	806
Income tax receivable	(2,092)	0
Other assets	21	(35)
Accrued salaries and benefits	(3,139)	(2,073)
Accounts payable	33	649
Other current liabilities	(2,190)	(1,586)
Income taxes payable	(430)	2
Deferred revenue	(909)	3,894
Estimated liability for appeals	2,131	777
Other liabilities	(57)	(52)
Net cash provided by operating activities	1,962	2,842
<b>Cash flows from investing activities:</b>		
Purchase of property, equipment, and leasehold improvements	(2,359)	(1,203)
Purchase of perpetual software license and computer equipment	0	(760)
Net cash used in investing activities	(2,359)	(1,963)
<b>Cash flows from financing activities:</b>		
Borrowing under notes payable	0	136,500
Borrowing under line of credit	0	4,500
Redemption of preferred stock	0	(43,973)
Repayment of notes payable	(2,760)	(95,185)
Repayment of line of credit	0	(8,198)
Debt issuance costs paid	0	(2,235)
Proceeds from exercise of stock options	735	20
Income tax benefit from employee stock options	4,176	0
Payment of purchase obligation	(250)	0
Net cash provided by (used) in financing activities	1,901	(8,571)
Net increase (decrease) in cash and cash equivalents	1,504	(7,692)
Cash and cash equivalents at beginning of period	37,843	20,004



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Cash and cash equivalents at end of period	\$ 39,347	\$ 12,312
Supplemental disclosures of cash flow information:		
Cash paid for income taxes	\$ 1,550	\$ 1,740
Cash paid for interest	\$ 2,559	\$ 2,912
Cash paid as debt extinguishment	\$ 0	\$ 3,344
Supplemental disclosure of non-cash investing and financing activities:		
Obligation payable to sellers of perpetual license	\$ 0	\$ 3,250
Issuance of common stock as part of debt issuance costs	\$ 0	\$ 2,796

*See accompanying notes to consolidated financial statements.*

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**PERFORMANT FINANCIAL CORPORATION AND SUBSIDIARIES**

Notes To Consolidated Financial Statements

For the Three Months Ended March 31, 2013 and 2012

(Unaudited)

**1. Organization and Description of Business**

***(a) Basis of Presentation and Organization***

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. Generally Accepted Accounting Principles, or U.S. GAAP, for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by U.S. GAAP for complete financial statements. In the opinion of management, the unaudited interim financial statements furnished herein include all adjustments necessary (consisting only of normal recurring adjustments) for a fair presentation of our and our subsidiaries' financial position at March 31, 2013, the results of our operations for the three months ended March 31, 2013 and 2012 and cash flows for the three months ended March 31, 2013 and 2012. Interim financial statements are prepared on a basis consistent with our annual consolidated financial statements. The interim financial statements included herein should be read in conjunction with the consolidated financial statements and related notes included in our annual report on Form 10-K for the years ended December 31, 2012, 2011 and 2010.

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

Our consolidated financial statements include the operations of Performant Financial Corporation (PFC), its wholly owned subsidiary Performant Business Services, Inc., and its wholly owned subsidiaries Performant Recovery, Inc. (Recovery), and Performant Technologies, Inc. PFC is a Delaware corporation headquartered in California and was formed in 2003. Performant Business Services, Inc. is a Nevada corporation founded in 1997. Recovery is a California corporation founded in 1976. Performant Technologies, Inc. is a California corporation that was formed in 2004. All significant intercompany balances and transactions have been eliminated in consolidation.

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

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

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

Revenue is recognized upon the collection of defaulted loan and debt payments. Loan rehabilitation revenue is recognized when the rehabilitated loans are sold (funded) by clients. Incentive revenue is recognized upon receipt of official notification of incentive award from customers. Under the Company's RAC contract with CMS, the Company recognizes revenues when the healthcare provider has paid CMS for a given claim or offset. Providers have the right to appeal a claim and may pursue additional appeals if the initial appeal is found in favor of CMS. The Company accrues an estimated liability for appeals based on the amount of commissions received which are subject to appeal and which the Company estimates are probable of being returned to providers following successful appeal. At March 31, 2013, a total of \$6.9 million was presented as an allowance against revenue, representing the Company's estimate of claims that may be overturned. Of this amount, \$0.4 million was related to amounts in accounts receivable and \$6.5 million was related to commissions which had already been received. The \$6.5 million balance at March 31, 2013, and the \$4.4 million balance as of December 31, 2012, represents the Company's best estimate of the probable amount of losses related to appeals of claims for which commissions were previously collected. In addition to the \$6.5 million amount accrued at March 31, 2013,

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the Company estimates that it is reasonably possible that it could be required to pay an additional amount up to approximately \$1.8 million as a result of potentially successful appeals. To the extent that required payments by the Company exceed the amount accrued, revenues in the applicable period would be reduced by the amount of the excess.

**Table of Contents****2. Property, Equipment, and Leasehold Improvements**

Property, equipment, and leasehold improvements consist of the following at March 31, 2013 and December 31, 2012 (in thousands):

	March 31, 2013	December 31, 2012
Land	\$ 1,767	\$ 1,767
Building and leasehold improvements	5,518	5,500
Furniture, equipment, and automobile	4,547	4,408
Computer hardware and software	43,000	40,886
	54,832	52,561
Less accumulated depreciation and amortization	(33,382)	(31,892)
<b>Property, equipment and leasehold improvements, net</b>	<b>\$ 21,450</b>	<b>\$ 20,669</b>

Depreciation and amortization expense of property, equipment and leasehold improvements was \$1.6 million and \$1.3 million for the three months ended March 31, 2013 and 2012, respectively.

**3. Credit Agreement**

On March 19, 2012 we recapitalized, entering into a credit agreement (the Agreement) consisting of a Term A Loan of \$57.0 million, a Term B Loan of \$79.5 million, and a revolving credit facility of \$11.0 million. In connection with the recapitalization, our old credit facility, scheduled to mature in 2012, was extinguished, and our indebtedness on the old facility was paid in full. On June 28, 2012, the Agreement was amended to increase the Term B Loan to \$99 million. Payments under the Agreement for the next five years and thereafter are as follows (in thousands):

Year Ending December 31,	Amount
Remainder of 2013	\$ 8,280
2014	11,040
2015	11,040
2016	11,040
2017	10,252
Thereafter	93,357
<b>Total</b>	<b>\$ 145,009</b>

The Term A Loan is charged interest either at Prime (subject to a 2.50% floor) +4.25% or LIBOR (subject to a 1.50% floor) +5.25%, which was 6.75% at March 31, 2013. The Term A loan requires quarterly payments of \$2.5 million beginning in June 2012, with the remaining outstanding principal balance due March 19, 2017. As of March 31, 2013, the Term A loan ending balance, including the current portion was \$47.0 million.

The Term B loan is charged interest at Prime +4.75% (subject to a 2.50% floor) or LIBOR (subject to a 1.50% floor) +5.75% which was 7.25% at March 31, 2013. The Term B loan requires quarterly payments of \$0.2 million beginning in June 2012, with the outstanding principal balance due March 19, 2018. As of March 31, 2013, the Term B loan ending balance, including the current portion was \$98.0 million.

We have a line of credit under the Agreement which allows for borrowings of up to \$11 million. Borrowings accrue interest at Prime + 4.25% or LIBOR + 5.25%, which was 7.5% at March 31, 2013. Both the Prime and the LIBOR alternatives are subject to minimum rate floors. In addition, a facility fee of 0.5% is assessed on the commitment amount. There were no outstanding borrowings under this line of credit at March 31, 2013, and a letter of credit outstanding in the amount of \$1.4 million, leaving remaining borrowing capacity under the line of credit of \$9.6 million at March 31, 2013. The line of credit expires in March 19, 2017.

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The Agreement contains certain restrictive financial covenants, which require, among other things, that we meet a minimum fixed charge coverage ratio and maximum total debt to EBITDA ratio. Additionally, these covenants restrict the Company and its subsidiaries' ability to incur certain types or amounts of indebtedness, incur liens on certain assets, make material changes in corporate structure or the nature of its business, dispose of material assets, engage in a change in control transaction, make

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certain foreign investments, enter into certain restrictive agreements, or engage in certain transactions with affiliates. We were in compliance with all such covenants at March 31, 2013.

Debt extinguishment costs of \$3.7 million were expensed, including \$3.3 million of fees paid to lenders, and \$0.3 million of unamortized debt issuance costs associated with the old credit facility.

**4. Commitments under Operating Leases**

We have entered into various non-cancelable operating lease agreements for certain of our office facilities and equipment with original lease periods expiring between 2013 and 2017. Certain of these arrangements have free rent periods and /or escalating rent payment provisions, and we recognize rent expense under such arrangements on a straight-line basis.

Future minimum rental commitments under non-cancelable leases as of March 31, 2013 are as follows (in thousands):

<b>Year Ending December 31,</b>	<b>Amount</b>
Remainder of 2013	\$ 1,328
2014	1,801
2015	1,441
2016	1,016
2017	789
Thereafter	65
<b>Total</b>	<b>\$ 6,440</b>

Operating lease expense totaled \$0.6 million and \$0.6 million for the three months ended March 31, 2013 and 2012, respectively.

**5. Capital Stock****Secondary Offering**

In January 2013, we completed a secondary offering in which selling stockholders sold 9,200,000 shares of Common Stock at a public offering price of \$10.65 per share. The Company did not receive any proceeds from the sale of the shares by the selling stockholders. The Company paid related offering expenses of \$0.6 million. In addition, a financial advisor to the Company was paid \$1.0 million for financial advisory services. These costs have been expensed, and are included in other operating expenses.

**6. Stock-based Compensation**

Total stock-based compensation expense charged as salaries and benefits expense in the consolidated statements of operations was \$0.7 million and \$0 million for the three months ended March 31, 2013 and 2012, respectively.

The following table shows stock option activity for the three months ended March 31, 2013:

	<b>Outstanding Options</b>	<b>Weighted average exercise price per share</b>	<b>Weighted average remaining contractual life (Years)</b>	<b>Aggregate Intrinsic Value (in thousands)</b>
Outstanding at December 31, 2012	7,909,724	\$ 3.85	5.89	\$ 49,410
Granted	90,000	13.55		
Forfeited	(96,214)	10.60		

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Exercised	(1,312,980)		0.56		
Outstanding at March 31, 2013	6,590,530	\$	4.54	6.32	\$ 50,989
Vested or expected to vest <sup>(1)</sup> at March 31, 2013	6,452,344	\$	4.57	6.34	\$ 49,777
Exercisable at March 31, 2013	3,631,531	\$	0.72	4.11	\$ 41,993

<sup>(1)</sup> Options expected to vest reflect an estimated forfeiture rate.

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We estimated the total fair value of the March 2013 grants to be \$0.7 million using a Black-Scholes option pricing model, and the following assumptions:

Expected volatility	56.40%
Expected dividends	0.00
Expected term (years)	6.50
Risk-free interest rate	1.23%

**7. Income Taxes**

Our effective income tax rate changed to 48.7% for the three months ended March 31, 2013 from 40.9% for the three months ended March 31, 2012. The increase in the effective rate is primarily due to the lack of deductibility of offering expenses of \$0.6 million and financial advisory fees of \$1.0 million associated with the secondary offering described in Note 5.

We file income tax returns with the U.S. federal government and various state jurisdictions. We are no longer subject to U.S. federal income tax examinations for years before 2008. We operate in a number of state and local jurisdictions, most of which have never audited our records. Accordingly, we are subject to state and local income tax examinations based upon the various statutes of limitations in each jurisdiction. We are currently being examined by the IRS and California.

**8. Earnings per Share**

For the three months ended March 31, 2013, basic income per share is calculated by dividing net income available to holders of Common Stock by the sum of the weighted average number of shares of Common Stock outstanding during the period. For the three months ended March 31, 2012, basic income per share is calculated by dividing net income available to holders of Common Stock by the sum of the weighted average number of shares of Common Stock outstanding during the period plus the weighted average number of shares of Series A Convertible Preferred Stock outstanding during the period. The shares of Series A Convertible Preferred Stock are included in the basic denominator because they can be converted into shares of Common Stock for no cash consideration, and are thus considered outstanding shares of Common Stock in computing basic earnings per share. Diluted income per share is calculated by dividing net income available to common shareholders by the weighted average number of shares of Common Stock and dilutive common share equivalents outstanding during the period. Common share equivalents consist of stock options and restricted stock units. The Company excluded from the calculation of diluted earnings per share for the three months ended March 31, 2013 options to purchase 2,539,000 shares whose combined exercise price, unamortized fair value and excess tax benefits were greater during the period than the average price for the Company's common stock because their effect would be anti-dilutive.

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

		Three Months Ended March 31,	
		2013	2012
Weighted average shares outstanding	basic	46,121	42,985
Dilutive effect of stock options		2,886	3,240
Weighted average shares outstanding	diluted	49,007	46,225

**9. Related Party Transactions**

Our notes payable are held by a number of lenders, some of whom also invested in our stock. As a result, these entities are considered related parties. Interest expense under these arrangements totaled \$2.6 million and \$2.9 million for the three months ended March 31, 2013 and 2012, respectively.

**10. Subsequent Events**

In April 2013, we completed a secondary offering in which selling stockholders sold 6,500,000 shares of Common Stock at a public offering price of \$12 per share. The Company did not receive any proceeds from the sale of the shares by the selling stockholders. The Company paid the related offering expenses. In addition, the Company was required to pay an affiliate a fee equal to 1% of the aggregate gross proceeds of the secondary offering. The Company paid \$0.8 million to the affiliate in April 2013 upon successful closing of the secondary offering.





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

**Overview**

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

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

**Sources of Revenues**

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

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2013</b>	<b>2012</b>
	<b>(in thousands)</b>	
Student Lending	\$ 33,272	\$ 29,168
Healthcare	10,285	12,069
Other	5,806	4,641
 Total Revenues	 \$ 49,363	 \$ 45,878



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### ***Student Lending***

We derive the majority of our revenues from the recovery of student loans. These revenues are contract-based and consist primarily of contingency fees based on a specified percentage of the amount we enable our clients to recover. Our contingency fee percentage for a particular recovery depends on the type of recovery facilitated. We also receive incremental performance incentives based upon our performance as compared to other contractors with the Department of Education, which are comprised of additional inventory allocation volumes and incentive fees.

We believe the size and the composition of our student loan inventory at any point provides us with a significant degree of revenue visibility for our student loan revenues. Based on data compiled from over two decades of experience with the recovery of defaulted student loans, at the time we receive a placement of student loans, we are able to make a reasonably accurate estimate of the recovery outcomes likely to be derived from such placement and the revenues we are likely able to generate based on the anticipated recovery outcomes.

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

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

For certain guaranty agency, or GA, clients, we have entered into Master Service Agreements, or MSAs. Under these agreements, clients provide their entire inventory of outsourced loans or receivables to us for recovery on an exclusive basis, rather than just a portion, as with traditional contracts that are split among various service providers. In certain circumstances, we engage subcontractors to assist in the recovery of a portion of the client's portfolio. We also receive success fees for the recovery of loans under MSAs and our revenues under MSA arrangements include fees earned by the activities of our subcontractors. As of March 31, 2013, we had three MSA clients in the student loan market.

### ***Healthcare***

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



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To accelerate our ability to provide Medicare audit and recovery services across our region following our award of the RAC contract, we outsourced certain aspects of our healthcare recovery process to three different subcontractors. Two of these subcontractors provide a specific service to us in connection with our claims recovery process, and one subcontractor is engaged to provide all of the audit and recovery services for claims within a portion of our region. According to CMS, the geographic area allocated to this subcontractor represented approximately 17% of the total Medicare spending in our region in 2009. We recognize all of the revenues generated by the claims recovered through these subcontractor relationships, and we recognize the fees that we pay to these subcontractors in our expenses.

### *Other*

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

### **Operating Metrics**

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

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2013</b>	<b>2012</b>
	<b>(dollars in thousands)</b>	
<b>Student Lending:</b>		
Placement Volume	\$ 1,745,281	\$ 1,001,808
Placement Revenue as a percentage of Placement Volume	1.91%	2.91%
<b>Healthcare:</b>		
Net Claim Recovery Volume	90,410	106,100
Claim Recovery Fee Rate	11.38%	11.38%

*Placement Volume.* Our Placement Volume represents the dollar volume of defaulted student loans first placed with us during the specified period by public and private clients for recovery. Placement Volume allows us to measure and track trends in the amount of inventory our clients in the student lending market are placing with us during any period. The revenues associated with the recovery of a portion of these loans may be recognized in subsequent accounting periods, which assists management in estimating future revenues and in allocating resources necessary to address current Placement Volumes.

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

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

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



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### **Costs and Expenses**

We generally report two categories of operating expenses: salaries and benefits and other operating expense. Salaries and benefits expenses consist primarily of salaries and performance incentives paid and benefits provided to our employees. Other operating expense includes expenses related to our use of subcontractors, other production related expenses, including costs associated with data processing, retrieval of medical records, printing and mailing services, amortization and other outside services, as well as general corporate and administrative expenses. We expect a significant portion of our expenses to increase as we grow our business. However, we expect certain expenses, including our corporate and general administrative expenses, to grow at a slower rate than our revenues. As a result, and over the long term, we expect our overall expenses to modestly decline as a percentage of revenues.

We have and will continue to incur additional professional fees and other expenses resulting from future expansion and the compliance requirements of operating as a public company, including increased audit and legal expenses, investor relations expenses, increased insurance expenses, particularly for directors and officers liability insurance, and the costs of complying with Section 404 of the Sarbanes-Oxley Act. While these costs may initially increase as a percentage of our revenues, we expect that in the future these expenses will increase at a slower rate than our overall business volume, and that they may eventually represent a smaller percentage of our revenues.

### **Factors Affecting Our Operating Results**

#### ***Allocation of Placement Volume***

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

Typically we are able to anticipate with reasonable accuracy the timing and volume of placements of defaulted student loans and other receivables based on historical patterns and regular communication with our clients. Occasionally, however, placements are delayed due to factors outside of our control. For example, a technology system upgrade at the Department of Education significantly decreased the volume of student loan placements by the Department of Education to all recovery vendors, including us. While we and the other recovery vendors received substantially larger placement volume in the fourth quarter of 2012, the majority of the revenues from these placements will be delayed until the third quarter of 2013 because we do not begin to earn rehabilitation revenues from a given placement until at least nine months after receipt of a placement. While we believe that this technology system upgrade is substantially complete we believe that there remains a backlog of defaulted student loans that have not been placed with recovery vendors. In addition, for approximately twelve months beginning in September 2011, because of this technology system upgrade, the Department of Education was not able to process a portion of rehabilitated student loans and accordingly we were not able to recognize certain revenues associated with rehabilitation of loans for this client. However, the Department of Education continued to pay us based on invoices submitted and we recorded these cash receipts as deferred revenues on our balance sheet. The amount of placement volume that we receive is also dependent on the client relationships that we maintain. We analyze the profitability of each of our student lending clients, and sometimes determine that our resources servicing a specific client should be allocated elsewhere.

#### ***Claim Recovery Volume***

While we are entitled to review Medicare records for all Part A and Part B claims in our region, we are not permitted to identify an improper claim unless that particular type of claim has been pre-approved by CMS to ensure compliance with applicable Medicare payment policies, as well as national and local coverage determinations. The growth of our revenues is determined primarily by the aggregate volume of Medicare claims in our region and our ability to identify improper payments within these claims. However, the long-term growth of these revenues will also be affected by the scope of the issues pre-approved by CMS.

Further, our claim recovery volume is currently impacted by a system adjustment that is being implemented by CMS for its Periodic Interim Payment, or PIP, providers. PIP providers are reimbursed for Medicare claims through different processes than other healthcare providers, and



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CMS is in the process of making certain system adjustments in order to allow these claims to be processed. Prior to April 2012, we were not permitted to audit Medicare claims for these PIP providers, which we estimate to account for approximately 20% of Medicare claims in our region. The improper payments to PIP providers that we have identified were not processed by CMS from April 2012 until January 2013, when a small portion of such payments began to be processed manually. As a

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result, we estimate that we had approximately \$6 million of delayed revenue related to identified improper payments to PIP providers as of December 31, 2012. Of this approximate \$6 million of delayed revenue, we have only been able to recognize approximately \$0.2 million in revenues from identified improper payments to PIP providers during the three months ended March 31, 2013, but we have incurred expenses related to these claims. CMS remains in the process of implementing the necessary changes to its systems that would allow these claims to be processed automatically and allow us to recognize the significant majority of these revenues. It is expected that the necessary upgrade will be complete in the second quarter of 2013, although this is outside of our control and the failure of CMS to process these and future claims on a timely basis will delay our recognition of the related revenues.

In addition, it is possible that transition procedures that may be implemented by CMS in connection with the re-bidding process for the RAC contract could result in an interruption in our ability to review records and identify improper claims and as a result cause a delay in recognizing certain revenues. While we originally expected this interruption to last several weeks, a protest related to the new RAC contract was filed by one of the current RAC vendors, and this interruption may be extended. While we believe that it is likely that CMS will seek to minimize disruption due to the volume of improper payments at stake, any prolonged interruption will adversely affect our results of operations.

Healthcare providers have also taken various actions aimed at limiting Medicare audit and recovery activities. For example, in November 2012 the American Hospital Association and four hospitals filed a lawsuit against Kathleen Sebelius, the Secretary of the Department of Health and Human Services. The lawsuit claims, among other things, that CMS is acting improperly in completely denying payment for claims initially made under Medicare Part A (inpatient) that should have been made under Medicare Part B (outpatient), rather than remitting the difference between the Part A and Part B payments. A bill has also been introduced in the U.S. Congress that would also permit healthcare providers to resubmit such claims for payment for Part B services. CMS has recently proposed rules that would permit healthcare providers to resubmit certain of these claims for payment for Part B services and we do not expect that recovery auditors will be compensated on a complete denial for Part A claims under the new RAC contract. This type of improper claim has accounted for a substantial portion of the claims that we have identified under our RAC contract.

### ***Contingency Fees***

Our revenues consist primarily of contract-based contingency fees. The contingency fee percentages that we earn are set by our clients or agreed upon during the bid process, and may change from time to time either under the terms of existing contracts or pursuant to the terms of contract renewals. For example, our contractual arrangement with the Department of Education has recently changed as a result of the Department of Education's decision to have its recovery vendors promote IBR to defaulted student loans. The IBR program provides flexibility on the required monthly payment for student loan borrowers at an amount intended to be affordable based on a borrower's income and family size. As a result of the increased application of the IBR program to defaulted student loans, we expect that there will be an increase in the number of loans that become eligible for rehabilitation because more defaulted student loan borrowers will be able to make qualifying payments. In connection with the implementation of the IBR program, the Department of Education has reduced the contingency fee rate that we will receive for rehabilitating student loans by approximately 13% effective as of March 1, 2013. We expect that revenues derived from the increased volume of rehabilitated students loans will offset the decrease in contingency fee rates that we receive from the Department of Education.

### ***Regulatory Matters***

Each of the markets which we serve is highly regulated. Accordingly, changes in regulations that affect the types of loans, receivables and claims that we are able to service or the manner in which any such delinquent loans, receivables and claims can be recovered will affect our revenues and results of operations. For example, the passage of the Student Aid and Fiscal Responsibility Act, or SAFRA, in 2010 had the effect of transferring the origination of all government-supported student loans to the Department of Education, thereby ending all student loan originations guaranteed by the GAs. Loans guaranteed by the GAs represented approximately 70% of government-supported student loans originated in 2009. While the GAs will continue to service existing outstanding student loans for years to come, this legislation will over time shift the portfolio of student loans that we manage toward the Department of Education, and further concentrate our sources of revenues and increase our reliance on our relationship with the Department of Education. In addition, our entry into the healthcare market was facilitated by passage of the Tax Relief and Health Care Act of 2006, which mandated CMS to contract with private firms to audit Medicare claims in an effort to increase the recovery of improper Medicare payments. Any changes to the regulations that affect the student loan industry or the recovery of defaulted student loans or the Medicare program generally or the audit and recovery of Medicare claims could have a significant impact on our revenues and results of operations.

### ***Client Concentration***

Our revenues from the student loan market depend on our ability to maintain our contracts with some of the largest providers of student loans. In 2012, four providers of student loans each accounted for more than 10% of our revenues during such period and they collectively accounted for 55% of our total revenues during this period. Our contracts with these clients entitle them to unilaterally terminate their contractual relationship

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with us at any time without penalty. If we lose one of our significant clients, including if one of our significant clients is consolidated by an entity that does not use our services, if the terms of compensation for our services change or if there is a reduction in the level of placements provided by any of these clients, our revenues could decline.

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Our contract with CMS for the recovery of improper Medicare payments began generating significant revenues during 2011 and represented 26% of our total revenues in the year ended December 31, 2012. CMS issued a request for quotes in connection with the re-bidding for the RAC contract in February 2013. Although our RAC contract is currently set to expire in 2014, CMS may terminate our RAC contract as early as August 2013 in connection with the re-bidding process for new RAC contracts although any award may be delayed due to a protest filed in relation to the proposed RAC contract by one of the current RAC vendors. While we believe our performance under the existing agreement and the experience we have gained in performing this contract position us well to renew the agreement, failure to renew the agreement or renewal on substantially less favorable terms could significantly harm our revenues and results of operations.

### ***Macroeconomic Factors***

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

### **Critical Accounting Policies**

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

### ***Revenue Recognition***

The majority of our contracts are contingency fee based. We recognize revenues on these contingency fee based contracts when third-party payors remit payments to our clients or remit payments to us on behalf of our clients, and, consequently, the contingency is deemed to have been satisfied. Under our RAC contract with CMS, we recognize revenues when the healthcare provider has paid CMS for a given claim or incurs an offset against future Medicare claims. Providers have the right to appeal a claim and may pursue additional appeals if the initial appeal is found in favor of CMS. We accrue an estimated liability for appeals based on the amount of commissions received which are subject to appeal and which we estimate may be returned to providers following successful appeal. This estimated liability for appeals is an offset to revenues on our income statement. Our estimates are based on our historical experience with appeals activity under our CMS contract since January 2010. During the three months ended March 31, 2013, we reserved an amount equal to 14% of gross revenues from our CMS contract. The \$6.5 million balance as of March 31, 2013, represents our best estimate of the probable amount of losses related to appeals of claims for which commissions were previously collected and recognized as revenues. We estimate that it is reasonably possible that we could be required to pay an additional amount up to approximately \$1.8 million as a result of potentially successful appeals. To the extent that required payments by us related to successful appeals exceed the amount accrued, revenues in the applicable period would be reduced by the amount of the excess. We similarly accrue an allowance against accounts receivable related to commissions yet to be collected, which was \$0.4 million as of March 31, 2013, based on the same estimates used to establish the estimated liability for appeals of commissions received. Our inability to correctly estimate the estimated liabilities and allowance against accounts receivable could adversely affect our revenues in future periods.

### ***Goodwill***

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

Specifically, goodwill impairment is determined using a two-step test. The first step of the goodwill impairment test is used to identify potential impairment by comparing the fair value of a reporting unit with its book value, including goodwill. If the fair value of the reporting unit exceeds its book value, goodwill is considered not impaired and the second step of the impairment test is unnecessary. If the book value of the reporting unit exceeds its fair value, the second step of the goodwill impairment test is performed to measure the amount of impairment loss, if any. The second step of the goodwill impairment test compares the implied fair value of the reporting unit's goodwill with the book value of that goodwill. If the book value of the reporting unit's goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount

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equal to that excess. The implied fair value of goodwill is determined in the same manner as the amount of goodwill recognized in a business combination. That is, the fair value of

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the reporting unit is allocated to all of the assets and liabilities of that unit as if the reporting unit had been acquired in a business combination and the fair value of the reporting unit was the purchase price paid to acquire the reporting unit.

**Impairments of Depreciable Intangible Assets**

We evaluate depreciable intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. Depreciable intangible assets consist of client contracts and related relationships, and are being amortized over their estimated useful life, which is generally 20 years. We evaluate the client contracts intangible at the individual contract level. The recoverability of such assets is measured by a comparison of the carrying amount of the assets to future undiscounted net cash flows expected to be generated by the assets. If the assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. There was no impairment expense for depreciable intangible assets for the three months ended March 31, 2013 and 2012.

**Results of Operations****Three Months Ended March 31, 2013 compared to the Three Months Ended March 31, 2012**

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

	Three Months Ended March 31,			
	2013	2012	\$ Change	% Change
	(in thousands)			
<b>Consolidated Statement of Operations Data:</b>				
Revenues	\$ 49,363	\$ 45,878	\$ 3,485	8%
Operating expenses:				
Salaries and benefits	23,982	18,641	5,341	29%
Other operating expense	18,868	16,141	2,727	17%
Total operating expenses	42,850	34,782	8,068	23%
Income from operations	6,513	11,096	(4,583)	(41)%
Debt extinguishment costs		(3,679)	3,679	(100)%
Interest expense	(2,965)	(3,190)	225	(7)%
Interest income		31	(31)	(100)%
Income before provision for income taxes	3,548	4,258	(710)	(17)%
Provision for income taxes	1,727	1,742	(15)	(0.9)%
Net income	\$ 1,821	\$ 2,516	\$ (695)	(28)%
Accrual for preferred stock dividends		1,571	(1,571)	(100)%
Net income available to common shareholders	\$ 1,821	\$ 945	\$ 876	93%

**Revenues**

Total revenues were \$49.4 million for the three months ended March 31, 2013, an increase of \$3.5 million, or 8%, compared to total revenues of \$45.9 million for the three months ended March 31, 2012. This increase in revenues is primarily due to an increase of \$4.1 million in student lending revenues, which was primarily due to our ability to recognize rehabilitation revenues in the three months ended March 31, 2013, which we were not able to recognize in the three months ended March 31, 2012, due to placement delays associated with the Department of Education's technology system upgrade. This increase in student lending revenues was partially offset by a \$1.8 million decrease in revenues from our RAC contract with CMS, due primarily to our inability to audit certain healthcare providers in the fourth quarter of 2012 following Hurricane Sandy.



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

Salaries and benefits expense was \$24.0 million for the three months ended March 31, 2013, an increase of \$5.3 million, or 29%, compared to salaries and benefits expense of \$18.6 million for the three months ended March 31, 2012. This increase is primarily due to hiring of new employees to provide services under our RAC contract with CMS, an increase in expenses associated with the engagement of additional software engineers and an increase in expenses associated with the hiring of additional administrative employees.

### ***Other Operating Expense***

Other operating expense was \$18.9 million for the three months ended March 31, 2013, an increase of \$2.7 million, or 17%, compared to other operating expense of \$16.1 million for the three months ended March 31, 2012. This increase is primarily due to \$1.6 million of expenses incurred in connection with our secondary offering completed in February 2013, and \$1.1 million of increased expenses related to the growth in the Company's healthcare and student loan recovery activities, as well as increased professional fees related to operating as a public company.

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

As a result of the factors described above, income from operations was \$6.5 million for the three months ended March 31, 2013, compared to \$11.1 million for the three months ended March 31, 2012, representing a decrease of \$4.6 million, or 41%.

### ***Debt Extinguishment Costs***

As a result of the entry into our new credit facility and the repayment of all amounts owed under our then existing credit facility in March 2012, we incurred debt extinguishment costs of \$3.7 million, comprised of approximately \$3.3 million in fees paid to the lenders in connection with our new credit facility and approximately \$0.3 million of unamortized debt issuance costs associated with our old credit facility. We did not incur any debt extinguishment costs in the three months that ended March 31, 2013.

### ***Interest Expense***

Interest expense was \$3.0 million for the three months ended March 31, 2013, compared to \$3.2 million for the three months ended March 31, 2012, representing a decrease of \$0.2 million, or 7%, due to lower interest rates under our new credit agreement as compared to the interest rates under our old credit agreement.

### ***Income Taxes***

Income tax expense was \$1.7 million for the three months ended March 31, 2013, compared to \$1.7 million for the three months ended March 31, 2012. Our effective income tax increased to 48.7% for the three months ended March 31, 2013, from 40.9% for the three months ended March 31, 2012. The increase in our effective tax rate is primarily due to the secondary offering expenses described above, which are not deductible for tax purposes. Absent these expenses, our effective tax rate in the 2013 period would have been approximately 40%.

### ***Net Income***

As a result of the factors described above, net income was \$1.8 million for the three months ended March 31, 2013, which represented a decrease of \$0.7 million compared to net income of \$2.5 million for the three months ended March 31, 2012.

### **Adjusted EBITDA and Adjusted Net Income**

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

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





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

although depreciation and amortization are non-cash charges, the assets being depreciated and amortized may have to be replaced in the future, and adjusted EBITDA does not reflect cash capital expenditure requirements for such replacements or for new capital expenditure requirements;

adjusted EBITDA does not reflect interest expense on our indebtedness;

adjusted EBITDA does not reflect changes in, or cash requirements for, our working capital needs;

adjusted EBITDA does not reflect tax payments;

adjusted EBITDA and adjusted net income do not reflect the potentially dilutive impact of equity-based compensation;

adjusted EBITDA and adjusted net income do not reflect the impact of certain non-operating expenses resulting from matters we do not consider to be indicative of our core operating performance; and

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

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

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2013</b>	<b>2012</b>
<b>Adjusted EBITDA:</b>		
Net income	\$ 1,821	\$ 2,516
Provision for income taxes	1,727	1,742
Interest expense	2,965	3,190
Interest income		(31)
Debt extinguishment costs <sup>(1)</sup>		3,679
Secondary offering expense <sup>(2)</sup>	1,624	
Depreciation and amortization	2,509	2,214
Non-core operating expenses <sup>(3)</sup>		29
Advisory fee <sup>(4)</sup>		309
Stock based compensation	712	52
Adjusted EBITDA	\$ 11,358	\$ 13,700

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	Three Months Ended March 31,	
	2013	2012
<b>Adjusted Net Income:</b>		
Net income	\$ 1,821	\$ 2,516
Debt extinguishment costs <sup>(1)</sup>		3,679
Secondary offering expense <sup>(2)</sup>	1,624	
Non core operating expenses <sup>(3)</sup>		29
Advisory fee <sup>(4)</sup>		309
Stock based compensation	712	52
Amortization of intangibles <sup>(5)</sup>	933	875
Deferred financing amortization costs <sup>(6)</sup>	285	282
Tax adjustments <sup>(7)</sup>	(1,422)	(2,090)
Adjusted net income	\$ 3,953	\$ 5,652

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- (1) Represents debt extinguishment costs comprised of approximately \$3.3 million of fees paid to lenders in connection with our new credit facility and approximately \$0.3 million of unamortized debt issuance costs in connection with our old credit facility.
- (2) Represents direct and incremental costs associated with the Company's secondary offering.
- (3) Represents costs related to strategic corporate development activities.
- (4) Represents expenses incurred under an advisory services agreement with Parthenon Capital Partners, which was terminated in April 2012.
- (5) Represents amortization of capitalized expenses related to the acquisition of Performant by an affiliate of Parthenon Capital Partners in 2004, and also an acquisition in the first quarter of 2012 to enhance our analytics capabilities.
- (6) Represents amortization of capitalized financing costs related to debt offerings conducted in 2009, 2010 and 2012.
- (7) Represents tax adjustments assuming a marginal tax rate of 40%.

**Liquidity and Capital Resources**

Our primary sources of liquidity are cash flows from operations, term loans, and the proceeds received from our initial public offering on August 15, 2012. Cash and cash equivalents, which totaled \$39.3 million as of March 31, 2013, consist primarily of cash on deposit with banks. We expect that operating cash flows will continue to be a primary source of liquidity for our operating needs. There are currently no borrowings outstanding under our revolving credit facility other than a \$1.4 million letter of credit. Due to our operating cash flows, our existing cash and cash equivalents and availability under our revolving credit facility, we believe that we have the ability to meet our working capital and capital expenditure needs for the foreseeable future.

The following table summarizes our cash and cash equivalents balance at March 31, 2013 and December 31, 2012 (in thousands):

	March 31, 2013	December 31, 2012
Total cash and cash equivalents	\$ 39,347	\$ 37,843

The increase in the balance of our cash and cash equivalents compared with the end of the fourth quarter of 2012 was due primarily to increased cash generated from operations of \$2.0 million, \$4.2 million from the income tax benefit of the exercise of employee stock options, and \$0.7 million of proceeds from the exercise of stock options, partially offset by \$2.4 million of capital expenditures, and principal repayments of \$2.8 million on our long-term debt.

The following table presents information regarding our cash flows for the three months ended March 31, 2013 and 2012:

	Three Months Ended March 31,	
	2013	2012
	(in thousands)	
Net cash provided by operating activities	\$ 1,962	\$ 2,842
Net cash used in investing activities	(2,359)	(1,963)
Net cash used in financing activities	(1,901)	(8,571)

*Cash flows from operating activities*

Cash provided by operating activities for the three months ended March 31, 2013 was \$2.0 million. The increase in net cash provided by operating activities for the three months ended March 31, 2013 was primarily due to a decrease in accounts receivable of \$3.6 million as a result of the timing of collection of receipts, an increase in the estimated liability for appeals related to the RAC contract CMS of \$2.1 million offset by a decrease in accrued salaries and benefits of \$3.1 million.

Cash provided by operating activities for the three months ended March 31, 2012 was \$2.8 million, primarily due to an increase in deferred revenue of \$4 million resulting from the collection of cash receipts for which revenue recognition was delayed on the rehabilitation of student loans due to the Department of Education's technology system upgrade, an increase in the estimated liability for appeals related to our RAC contract with CMS of \$0.8 million, which was offset by an increase in accounts receivable of \$4.9 million.



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### *Cash flows from investing activities*

Cash used in investing activities totaled \$2.4 million for the three months ended March 31, 2013, as we used cash primarily for capital expenditures related to our facilities, data storage and related equipment, and to enhance to our proprietary software functionality. During the three months ended March 31, 2012, we used \$1.2 million for the acquisition of computer hardware and software to enhance our technology platform and improve our telecommunications systems and \$0.8 million for the purchase of a perpetual software license.

### *Cash flows from financing activities*

Cash provided by financing activities for the three months ended March 31, 2013, totaled \$1.9 million, which was primarily attributable to \$4.2 million of income tax benefit from the exercise of employee stock options, partially offset by \$2.8 million of principal repayments on long-term debt under our credit facility.

Cash used in financing activities for the three months ended March 31, 2012 totaled \$8.6 million, which was primarily attributable to \$95.2 million used to repay our old notes payable, \$44.0 million used to redeem 3.9 million shares of preferred stock plus accrued dividends, \$8.2 million used to repay our lines of credit, and \$2.2 million used for debt issuance costs. These uses of cash were offset by net proceeds of \$136.5 million from new term loans, and \$4.5 million in new revolving credit facility borrowings.

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

On March 19, 2012, we, through our wholly owned subsidiary, entered into a \$147.5 million credit agreement with Madison Capital Funding LLC as administrative agent, ING Capital LLC as syndication agent, and other lenders party thereto. The senior credit facility consists of (i) a \$57.0 million term A loan, (ii) a \$79.5 million term B loan, and (iii) a \$11.0 million revolving credit facility, which had a borrowing capacity of \$9.6 million as of June 30, 2012. On June 28, 2012, we increased the amount of our borrowings under our term B loan by \$19.5 million. We may also request the lenders to increase the size of the term B loan or other term loans by up to an additional \$10.5 million at any time prior to March 19, 2014.

All borrowings under the credit agreement bear interest at a rate per annum equal to an applicable margin plus, at our option, either (i) a base rate determined by reference to the highest of (a) the prime rate published in the Wall Street Journal or another national publication, (b) the federal funds rate plus 0.5%, and (c) 2.5% or (ii) a London Interbank Offered Rate, or Libor, rate determined by reference to the highest of (a) a Libor rate published in Reuters or another national publication and (b) 1.5%. The term A loan and the revolving credit facility have an applicable margin of 4.25% for base rate loans and 5.25% for Libor rate loans. The term B loan has an applicable margin of 4.75% for base rate loans and 5.75% for Libor rate loans. The minimum per annum interest rate that we are required to pay is 6.75% for the term A loan and revolving credit facility and 7.25% for the term B loan. Interest is due at the end of each month for base rate loans and at the end of each Libor period for Libor rate loans unless the Libor period is greater than 3 months, in which case interest is due at the last day of each 3-month interval of such Libor period.

The credit agreement requires us to prepay the two term loans on a prorated basis and then to prepay the revolving credit facility under certain circumstances: (i) with 100% of the net cash proceeds of any asset sale or other disposition of assets by us or our subsidiaries where the net cash proceeds exceed \$1 million, (ii) with a percentage of our annual excess cash flow each year where such percentage ranges from 25%-75% depending on our total debt to EBITDA ratio reduced by any voluntary prepayments that are made on our term loans during the same period and (iii) with any net cash proceeds from a qualified initial public offering by us, less net proceeds applied to redeem any outstanding preferred equity or convertible debt, to pay a common shareholder dividend not to exceed \$20 million or, if we comply with an adjusted EBITDA ratio set forth in the agreement, to our cash balances in an amount not to exceed \$75 million. We applied the proceeds from our recent initial public offering to our cash balances.

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

incur additional indebtedness;

create or permit liens;



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pay dividends or other distributions to our equity holders;

purchase or redeem certain equity interests of our equity holders, including any warrants, options and other security rights;

pay management fees or similar fees to any of our equity holders;

make any redemption, prepayment, defeasance, repurchase or any other payment with respect to any subordinated debt;

consolidate or merge;

sell assets, including the capital stock of our subsidiaries;

enter into transactions with our affiliates;

enter into different business lines; and

make investments.

The credit agreement also requires us to meet certain financial covenants, including maintaining a fixed charge coverage ratio and a total debt to EBITDA ratio as such terms are defined in our credit agreement. These financial covenants are tested at the end of each quarter beginning on March 31, 2013. The table below further describes these financial covenants, as well as our current status under these covenants as of March 31, 2013.

Financial Covenant	Covenant Requirement	Actual Ratio at March 31, 2013
Fixed charge coverage ratio (minimum)	1.20 to 1.0	1.48
Total debt to EBITDA ratio (maximum)	3.25 to 1.0	2.31

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

We do not hold or issue financial instruments for trading purposes. We conduct all of our business in U.S. currency and therefore do not have any direct foreign currency risk. We do have exposure to changes in interest rates with respect to the borrowings under our senior secured credit facility, which bear interest at a variable rate based on the prime rate or LIBOR. For example, if the interest rate on our borrowings increased 100 basis points (1%) from the credit facility floor of 1.5%, our annual interest expense would increase by approximately \$1.5 million. In July 2012, we entered into an interest rate cap agreement per the terms of our senior secured credit agreement. The interest rate cap agreement is effective beginning in October 2012, and matures in October 2014, with a total notional amount of \$75 million and a cap on LIBOR at 2.0%. If the LIBOR rate were to increase by 100 basis points (1.0%) above the credit facility floor of 1.5% for a year, we would receive a payment from the interest rate cap of approximately \$0.4 million.

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

**ITEM 4. DISCLOSURE CONTROLS AND PROCEDURES**



**Evaluation of Disclosure Controls and Procedures**

We maintain a system of disclosure controls and procedures that are designed to ensure that information required to be disclosed in the Company's reports under the Securities Exchange Act of 1934, as amended, or the Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's, or the SEC's rules and forms, and that such information is accumulated and communicated to management, including our Chief Executive Officer and the Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives.

Management, with the participation of our Chief Executive Officer and our Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures, as defined in Rule 13a-15(e) under the Exchange Act, as of the fiscal year

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covered by this Report on Form 10-Q. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were functioning effectively at the reasonable assurance level as of March 31, 2013.

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

There was no change in our internal control over financial reporting during the quarter ended March 31, 2013, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## **PART II. OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS**

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

### **ITEM 1A. RISK FACTORS**

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

#### **Risks Related to Our Business**

***Revenues generated from our five largest clients represented 81% of our revenues for the year ended December 31, 2012, and any termination of or deterioration in our relationship with any of these clients would result in a decline in our revenues.***

We derive a substantial majority of our revenues from a limited number of clients, including the Department of Education, CMS and three GAs. Revenues from our five largest clients represented 81% of our revenues for the year ended December 31, 2012. We expect that our revenues will become increasingly concentrated with our major clients as a result of rising business volumes under our RAC contract, which accounted for approximately 26% of our revenues for the year ended December 31, 2012. If we lose one of these clients or if the terms of our relationships with any of these clients become less favorable to us, our revenues would decline, which would harm our business, financial condition and results of operations.

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

Substantially all of our existing contracts for the recovery of student loan and other receivables, which represented approximately 63% of our revenues in 2012, enable our clients to unilaterally terminate their contractual relationship with us at any time without penalty, potentially leading to loss of business or renegotiation of terms. Our contracts generally are subject to a periodic rebidding process at the end of the contract term. Further, most of our contracts in these markets allow our clients to unilaterally change the volume of loans and other receivables that are placed with us at any given time. In addition, most of our contracts are not exclusive, with our clients retaining multiple service providers with whom we must compete for placements of loans or other obligations. Therefore, despite our contractual relationships with our clients, our contracts do not provide assurance that we will generate a minimum amount of revenues or that we will receive a specific volume of placements.

Our revenues and operating results would be negatively affected if our student loan and receivables clients, which include four of our five largest clients in 2012, do not renew their agreements with us upon contract expiration, reduce the volume of student loan placements provided to us, modify the terms of service, including the success fees we are able to earn upon recovery of defaulted student loans, or any of these clients establish more favorable relationships with our competitors. For example, our contractual arrangement with the Department of Education has recently changed as a result of the Department of Education's decision to have its recovery vendors promote income-based repayment, or IBR, to defaulted student loans. The IBR program provides flexibility on the required monthly payment for student loan borrowers at an amount

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intended to be affordable based on a borrower's income and family size. As a result of the increased application of the IBR program to defaulted student loans, we expect that there will be an increase in the number of loans that become eligible for rehabilitation because more defaulted student loan borrowers will be able to make qualifying payments. In connection with the implementation of the IBR program, the Department of Education has reduced the

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contingency fee rate that we will receive for rehabilitating student loans by approximately 13% effective as of March 1, 2013. Any changes in the contingency fee percentages or other compensation terms that we are paid under existing and future contracts could have a significant impact on our revenues and operating results.

*We face significant competition in all of the markets in which we operate and an inability to compete effectively in the future could harm our relationships with our clients, which would impact our ability to maintain our revenues and operating results.*

We operate in very competitive markets. In providing our services to the student loan and other receivables markets, we face competition from many other companies. Initially, we compete with these companies to be one of typically several firms engaged to provide recovery services to a particular client and, if we are successful in being engaged, we then face continuing competition from the client's other retained firms based on the client's benchmarking of the recovery rates of its several vendors. One of our largest clients, Department of Education, is expected to initiate a contract re-compete process during the first half of 2013. In addition, those recovery vendors who produce the highest recovery rates from a client often will be allocated additional placements and in some cases additional success fees. Accordingly, maintaining high levels of recovery performance, and doing so in a cost-effective manner, are important factors in our ability to maintain and grow our revenues and net income and the failure to achieve these objectives could harm our business, financial condition and results of operations.

Similarly, we faced a highly competitive bidding process to become one of the four prime RAC contractors that provide recovery services for improper Medicare payments and we are currently participating in a competitive bidding process for this contract. CMS issued a request for quotes in connection with the re-bidding for the RAC contracts in February 2013. Although our RAC contract is currently set to expire in 2014, CMS may terminate our RAC contract as early as August 2013 in connection with the re-bidding process for new RAC contracts although any award may be delayed due to a protest filed in relation to the proposed RAC contract by one of the current RAC vendors. The failure to retain this contract or a significant adverse change in the terms of this contract, which generated approximately 26% of our revenues in the year ended December 31, 2012, would seriously harm our revenues and operating results.

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

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

We have historically derived and are likely to continue to derive a significant portion of our revenues from the U.S. federal government. For the year ended December 31, 2012, revenues under contracts with the U.S. federal government accounted for approximately 42% of our total revenues, compared to 27% for the year ended December 31, 2011. In addition, fees payable by the U.S. federal government are expected to become a larger percentage of our total revenues over the next several years as a result of legislation that has transferred responsibility for all new student loan origination to the Department of Education. The continuation and exercise of renewal options on existing government contracts and any new government contracts are, among other things, contingent upon the availability of adequate funding for the applicable federal government agency. Changes in federal government spending could directly affect our financial performance. For example, the Obama Administration's proposed budget for the year ending September 30, 2013, like its proposed budget for fiscal 2012, includes a proposal designed to redirect federal government spending to an alternative federal program by decreasing the amount that GAs are compensated when they rehabilitate defaulted loans. The loss of business from the U.S. federal government, or significant policy changes or financial pressures within the agencies of the U.S. federal government that we serve would result in a significant decrease in our revenues, which would adversely affect our business, financial condition and results of operations.

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

The two principal markets in which we provide our recovery services, government-supported student loans and the Medicare program, are a subject of significant legislative and regulatory focus and we cannot anticipate how future changes in government policy may affect our business and operations. For example, SAFRA significantly changed the structure of the government-supported student loan market by assigning responsibility for all new government-supported student loan originations to the Department of Education, rather than originations by private institutions and backed by one of 31 government-supported GAs. This legislation, and any future changes in the legislation and regulations that govern these markets, may require us to adapt our business to the new circumstances and we may be unable to do so in a manner that does not adversely affect our business and operations.



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

The majority of our historical revenues from the student loan market have come from our relationships with the GAs. As a result of SAFRA, the Department of Education will ultimately become the sole source of revenues in this market, although the GAs will continue to service their existing student loan portfolios for many years to come. As a result, over time, defaults on student loans originated by the Department of Education will predominate and our ability to maintain the revenues we had previously received from a number of GA clients will depend on our relationship with a single client, the Department of Education. While we have 22 years of experience in performing student loan recovery services for the Department of Education, we are one of 17 unrestricted recovery service providers on the current Department of Education contract. In the year ended December 31, 2012, student loan recovery work for the Department of Education generated revenues of \$29.0 million, or approximately 14% of our total revenues. The Department of Education is expected to initiate a contract re-compete process during the first half of 2013. If our relationship with the Department of Education terminates or deteriorates or if the Department of Education, ultimately as the sole holder of defaulted student loans, requires its contractors to agree to less favorable terms, our revenues would significantly decrease, and our business, financial condition and results of operations would be harmed.

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

As a result of SAFRA, which terminated the ability of the GAs to originate government-supported student loans, some have speculated that there may be consolidation among the 31 GAs. If GAs that are our clients are combined with GAs with whom we do not have a relationship, we could suffer a loss of business. We currently have relationships with 11 of the 31 GAs and three of our GA clients were each responsible for more than 10% of our total revenues in the year ended December 31, 2012. The consolidation of our GA clients with others and the failure to provide recovery services to the consolidated entity could decrease our revenues, which could negatively impact our business, financial condition and results of operations.

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

While we are the prime contractor responsible for review of Medicare records for all Part A and Part B claims in our region pursuant to the terms of our RAC contract with CMS, we are not permitted to seek the recovery of an improper claim unless that particular type of claim has been pre-approved by CMS to ensure compliance with applicable Medicare payment policies, as well as national and local coverage determinations. While the revenues we earn under our contract with CMS are determined primarily by the aggregate volume of Medicare claims in our region and our ability to successfully identify improper payments within these claims, the long-term growth of the revenues we derive under our RAC contract will also depend in part on CMS expanding the scope of potentially improper claims that we are allowed to pursue under our RAC contract. If we are unable to continue to identify improper claims within the types of claims that we are permitted to pursue from time to time or if CMS does not expand the scope of potentially improper claims that we are allowed to pursue, our results of operations could be adversely affected.

In addition, healthcare providers have taken various actions aimed at limiting Medicare audit and recovery activities. For example, in November 2012 the American Hospital Association and four hospitals filed a lawsuit against Kathleen Sebelius, the Secretary of the Department of Health and Human Services. The lawsuit claims, among other things, that CMS is acting improperly in completely denying payment for claims initially made under Medicare Part A (inpatient) that should have been made under Medicare Part B (outpatient), rather than remitting the difference between the Part A and Part B payments. A bill has been introduced in the U.S. Congress that would permit healthcare providers to resubmit such claims for payment for Part B services and CMS has recently proposed rules that would permit healthcare providers to resubmit certain of these claims for payment for Part B services. This type of improper claim has accounted for a substantial portion of the claims that we have identified under our RAC contract.

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

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

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

the time to resolve bid protests related to the CMS contract;

the timing of placements of student loans and other receivables which are entirely in the discretion of our clients;

the schedules of government agencies for awarding contracts;

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our ability to successfully identify improper Medicare claims and the number and type of potentially improper claims that CMS authorizes us to pursue under our RAC contract;

the loss or gain of significant clients or changes in the contingency fee rates or other significant terms of our business arrangements with our significant clients;

technological and operational issues that may affect our clients and regulatory changes in the markets we service; and

general industry and macroeconomic conditions.

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

Further, our claim recovery volume is currently impacted by a system adjustment that is being implemented by CMS for its PIP providers. PIP providers are reimbursed for Medicare claims through different processes than other healthcare providers, and CMS is in the process of making certain system adjustments in order to allow these claims to be processed. Prior to April 2012, we were not permitted to audit Medicare claims for these PIP providers, which we estimate to account for approximately 20% of Medicare claims in our region. The improper payments to PIP providers that we have identified were not processed by CMS from April 2012 until January 2013, when a small portion of such payments began to be processed manually. As a result, we estimate that we had approximately \$6 million of delayed revenue related to identified improper payments to PIP providers as of December 31, 2012. Of this approximate \$6 million of delayed revenue, we have only been able to recognize approximately \$0.2 million in revenues from identified improper payments to PIP providers during the three months ended March 31, 2013, but we have incurred expenses related to these claims. CMS remains in the process of implementing the necessary changes to its systems that would allow these claims to be processed automatically and allow us to recognize the significant majority of these revenues. It is expected that the necessary upgrade will be complete in the second quarter of 2013, although this is outside of our control and the failure of CMS to process these and future claims on a timely basis will delay our recognition of the related revenues.

In addition, it is possible that transition procedures that may be implemented by CMS in connection with the re-bidding process for the RAC contract could result in an interruption in our ability to review records and identify improper claims and as a result cause a delay in recognizing certain revenues. While we originally expected this interruption to last several weeks, a protest related to the new RAC contract was filed by one of the current RAC vendors, and this interruption may be extended. While we believe that it is likely that CMS will seek to minimize disruption due to the volume of improper payments at stake, any prolonged interruption will adversely affect our results of operations.

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

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

***We may not be able to maintain or increase our profitability, and our recent financial results may not be indicative of our future financial results.***

We may not succeed in maintaining our profitability on a quarterly or annual basis and could incur quarterly or annual losses in future periods. We have incurred additional operating expenses associated with being a public company and we intend to continue to increase our operating



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expenses as we grow our business. We also expect to continue to make investments in our proprietary technology platform and hire additional employees and subcontractors as we expand our healthcare recovery and other operations, thus incurring additional expenses. If our revenues do not increase to offset these increases in expenses, our operating results could be adversely affected. Our historical revenues and net income growth rates are not indicative of future growth rates.

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

Our business has expanded significantly, especially in recent years with the expansion of our services in the healthcare market, and we intend to maintain our focus on growth. However, our continued focus on growth and the expansion of our business may place additional demands on our management, operations and financial resources and will require us to incur additional expenses. We cannot be sure that we will be able to manage our growth effectively. In order to successfully manage our growth, our expenses will increase to recruit, train and manage additional qualified employees and subcontractors and to expand and enhance our administrative infrastructure and continue to improve our management, financial and information systems and controls. If we cannot manage our growth effectively, our expenses may increase and our results of operations could be negatively affected.

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

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

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

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

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

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

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

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

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

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

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We engage subcontractors to provide certain services to our clients. These subcontractors participate to varying degrees in our recovery activities with regards to all of the services we provide. While most of our subcontractors provide specific services to us, we engage one subcontractor to provide all of the audit and recovery services under our contract with CMS within a portion of our region. According to CMS, the geographic area allocated to this subcontractor accounted for approximately 17% of total Medicare spending in our region in 2009. While we believe that we perform appropriate due diligence before we hire subcontractors, our subcontractors may not provide adequate service or otherwise comply with the terms set forth in their agreements. In the event a subcontractor provides deficient performance to one or more of our clients, any such client may reduce the volume of services we are providing under an existing contract or may terminate the relevant contract entirely and we may face claims for breach of contract. Any such disruption in our relations with our clients as a result of services provided by any of our subcontractors could adversely affect our revenues and operating results.

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

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

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

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

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

Our student loan recovery business is subject to regulation and oversight by various state and federal agencies, particularly in the area of consumer protection. The Fair Debt Collection Practices Act, or FDCPA, and related state laws provide specific guidelines that we must follow in communicating with holders of student loans and regulates the manner in which we can recover defaulted student loans. Some state attorney generals have been active in this area of consumer protection regulation. We are subject, and may be subject in the future, to inquiries and audits from state and federal regulators, as well as frequent litigation from private plaintiffs regarding compliance under the FDCPA and related state regulations. We are also subject to the Fair Credit Reporting Act, or FCRA, which regulates consumer credit reporting and may impose liability on us to the extent adverse credit information reported to a credit bureau is false or inaccurate. Our compliance with the FDCPA, FCRA and other federal and state regulations that affect our student loan recovery business may result in significant costs, including litigation costs. We may also become subject to regulations promulgated by the United States Consumer Financial Protection Bureau, or CFPB, which was established in July 2011 as part of the Dodd-Frank Act to, among other things, establish regulations regarding consumer financial protection laws. In addition, the CFPB has investigatory and enforcement authority with respect to whether persons are engaged in unlawful acts or practices in connection with the collection of consumer debts. On April 12, 2013, we received a Civil Investigative Demand, or a CID, from the CFPB requesting production of documents and answers to questions generally related to the Company's debt collection practices and procedures. The CFPB has not alleged a violation by us of any law or regulation. We are in the process of responding to the CID. Changes to existing regulations or the adoption of new regulations could adversely affect our business and results of operations if we are not able to adapt our services and client relationships to meet the new regulatory structure.

In addition, changing laws, regulations and standards relating to corporate governance and public disclosure are creating uncertainty for public companies, increasing legal and financial compliance costs and making some activities more time consuming.



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

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

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

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

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

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

Our management may conclude that our internal control over our financial reporting is not effective. As we only recently became a public company following the completion of our initial public offering on August 15, 2012, we have limited accounting personnel and other resources with which to address our internal controls and procedures. If we fail to timely achieve and maintain the adequacy of our internal control over financial reporting, we may not be able to produce reliable financial reports or help prevent fraud. Our failure to achieve and maintain effective internal control over financial reporting could prevent us from filing our periodic reports on a timely basis, which could result in the loss of investor confidence in the reliability of our financial statements, harm our business and negatively impact the trading price of our common stock.

We are required to disclose changes made in our internal controls and procedures on a quarterly basis. However, our independent registered public accounting firm is not required to formally attest to the effectiveness of our internal control over financial reporting pursuant to Section 404 until the later of the year following our first annual report required to be filed with the SEC, or the date we are no longer an emerging growth company as defined in the JOBS Act, if we continue to take advantage of the exemptions contained in the JOBS Act. At such time, our independent registered public accounting firm may issue a report that is adverse in the event it is not satisfied with the level at which our controls are documented, designed or operating. Our remediation efforts may not enable us to avoid a material weakness in the future.



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

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

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

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

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

The success of our business depends in part upon our proprietary technology platform. We rely on a combination of copyright, patent, trademark, and trade secret laws, as well as on confidentiality procedures and non-compete agreements, to establish and protect our proprietary technology rights. The steps we have taken to deter misappropriation of our proprietary technology may be insufficient to protect our proprietary information. Any infringement or misappropriation of our patents, trademarks, trade secrets, or other intellectual property rights could adversely affect any competitive advantage we currently derive or may derive from our proprietary technology platform and we may incur significant costs associated with litigation that may be necessary to enforce our intellectual property rights.

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

Our competitors protect their proprietary rights by means of patents, trade secrets, copyrights, trademarks and other intellectual property. Any party asserting that we infringe, misappropriate or violate their intellectual property rights may force us to defend ourselves, and potentially our clients, against the alleged claim. These claims and any resulting lawsuit, if successful, could be time-consuming and expensive to defend, subject us to significant liability for damages or invalidation of our proprietary rights, prevent us from operating all or a portion of our business or force us to redesign our services or technology platform or cause an interruption or cessation of our business operations, any of which could adversely affect our business and operating results. In addition, any litigation relating to the infringement of intellectual property rights could harm our relationships with current and prospective clients. The risk of such claims and lawsuits could increase if we increase the size and scope of our services in our existing markets or expand into new markets.

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

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



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

As of March 31, 2013, our total debt was \$145.0 million. For the three months ended March 31, 2013, our consolidated interest expense was \$3.0 million. Our ability to make scheduled payments or to refinance our debt obligations and to fund our other liquidity needs depends on our financial and operating performance, which is subject to prevailing economic and competitive conditions and to certain financial, business and other factors beyond our control. We cannot make assurances that we will maintain a level of cash flows from operating activities sufficient to permit us to pay the principal and interest on our indebtedness and to fund our other liquidity needs. If our cash flows and capital resources are insufficient to fund our debt service obligations and allow us to maintain compliance with the covenants under our credit agreement or to fund our other liquidity needs, we may be forced to reduce or delay capital expenditures, sell assets or operations, seek additional capital or restructure or refinance our indebtedness. We cannot ensure that we would be able to take any of these actions, that these actions would be successful and permit us to meet our scheduled debt service obligations or that these actions would be permitted under the terms of our existing or future debt agreements, including our credit agreement. If we cannot make scheduled payments on our debt, we will be in default and, as a result, our debt holders could declare all outstanding principal and interest to be due and payable, the lenders under our credit agreement could terminate their commitments to lend us money and foreclose against the assets securing our borrowings and we could be forced into bankruptcy or liquidation.

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

***We are subject to certain phase-in provisions of the NASDAQ Marketplace Rules and, as a result, we will not immediately be subject to certain corporate governance provisions. As a result, you do not have the same protections afforded to stockholders of companies that are subject to such requirements.***

Because of our public offering in February 2013, Parthenon Capital Partners no longer controls a majority of our common stock. As a result, we ceased to be a controlled company within the meaning of the corporate governance standards of the NASDAQ Global Select Market, or NASDAQ. However, we currently rely on phase-in provisions under the NASDAQ rules that exempt us until February 5, 2014 from certain stock exchange corporate governance requirements, including:

the requirement that a majority of the board of directors consists of independent directors;

the requirement that nominating and corporate governance matters be decided solely by independent directors; and

the requirement that employee and officer compensation matters be decided solely by independent directors.

As a result, we currently do not have a majority of independent directors and our nominating and corporate governance and compensation functions are not decided solely by independent directors. Accordingly, you do not have the same protections afforded to stockholders of companies that are subject to all of the stock exchange corporate governance requirements.

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

Since our initial public offering in August 2012, the price of our common stock, as reported by NASDAQ, has ranged from a low sales price of \$7.55 on November 27, 2012 to a high sales price of \$14.09 on March 4, 2013. The trading price of our common stock may be significantly affected by various factors, including: quarterly fluctuations in our operating results; the financial projections we may provide to the public, any changes in those projections or our failure to meet those projections; changes in investors' and analysts' perception of the business risks and conditions of our business; our ability to meet the earnings estimates and other performance expectations of financial analysts or investors; unfavorable commentary or downgrades of our stock by equity research analysts; termination of lock-up agreements or other restrictions on the ability of our existing stockholders to sell their shares after this offering or our public offering in February 2013; changes in our capital structure,

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such as future issuances of debt or equity securities; lawsuits threatened or filed against us; strategic actions by us or our competitors, such as acquisitions or restructurings; new legislation or regulatory actions; changes in our relationship with any of our significant clients; fluctuations in the stock prices of our peer companies or in stock markets in general; and general economic conditions.

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### ***Future sales, or the perception of future sales, of our common stock may lower our stock price.***

Sales of our common stock in the public market, or the perception that these sales could occur, could cause the market price of our common stock to decline. As of the completion of our public offering in April 2013, approximately 46,720,569 shares of our common stock were outstanding, assuming that there were no exercises of options after March 31, 2013. Of these shares, 63,584 non-public shares will be eligible for sale beginning May 2, 2013 following the expiration of the lock-up agreement from our public offering completed in February 2013, and 19,861,661 shares are subject to lock-up agreements restricting the sale of those shares until June 18, 2013 as a result of our public offering completed in April 2013. Such shares are also to the requirements of Rule 144 or Rule 701. In addition, certain holders of shares of common stock have the right, subject to certain exceptions and conditions, to require us to register their shares of common stock under the Securities Act of 1933, as amended, and they also have the right to participate in future registrations of securities by us. Registration of any of these outstanding shares of common stock would result in such shares becoming freely tradable without compliance with Rule 144 upon effectiveness of the applicable registration statement.

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

Parthenon Capital Partners beneficially owns approximately 37.1% of our common stock as of May 9, 2013. As a result of its ownership, Parthenon Capital Partners has the ability to influence the outcome of matters submitted to a vote of stockholders and, through our board of directors, the ability to influence decision-making with respect to our business direction and policies. Parthenon Capital Partners may have interests different from our other stockholders' interests, and may vote in a manner adverse to those interests. Matters over which Parthenon Capital Partners can, directly or indirectly, exercise influence include:

the election of our board of directors and the appointment and removal of our officers;

mergers and other business combination transactions, including proposed transactions that would result in our stockholders receiving a premium price for their shares;

other acquisitions or dispositions of businesses or assets;

incurrence of indebtedness and the issuance of equity securities;

repurchase of stock and payment of dividends; and

the issuance of shares to management under our equity incentive plans.

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

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

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

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

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

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the effect of delaying or deterring a change in control, could limit the opportunity for our stockholders to receive a premium for their shares of our common stock, and could also affect the price that some investors are willing to pay for our common stock.

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

*Sale of Unregistered Securities*

None.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

**ITEM 4. MINE SAFETY DISCLOSURES**

Not applicable.

**ITEM 5. OTHER INFORMATION**

Not applicable.

**ITEM 6. EXHIBITS**

(A) Exhibits:

Exhibit No.	Description
10.1	2012 Stock Incentive Plan and form agreements thereunder.
31.1	Certification of the Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a).
31.2	Certification of the Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a).
32.1(1)	Certification of the Chief Executive Officer pursuant to 18 USC Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2(1)	Certification of the Chief Financial Officer pursuant to 18 USC Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS(2)	XBRL Instance Document
101.SCH(2)	XBRL Taxonomy Extension Scheme
101.CAL(2)	XBRL Taxonomy Extension Calculation Linkbase
101.DEF(2)	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB(2)	XBRL Taxonomy Extension Label Linkbase
101.PRE(2)	XBRL Taxonomy Extension Presentation Linkbase

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

or Exchange Act.

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**SIGNATURES**

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

Date: May 10, 2013

PERFORMANT FINANCIAL CORPORATION

By: /s/ Lisa Im  
Lisa Im

*Chief Executive Officer (Principal*

*Executive Officer) and Director*

By: /s/ Hakan Orvell  
Hakan Orvell

*Chief Financial Officer (Principal*

*Financial and Accounting Officer)*

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