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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-Q**

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**(Mark One)**

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

For the quarterly period ended September 30, 2022

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

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**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)

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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, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Emerging growth company

Non-accelerated filer  Smaller reporting company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Securities registered pursuant to Section 12(b) of the Act:

<u>Title of each class</u>	<u>Trading Symbol(s)</u>	<u>Name of exchange on which registered</u>
Common Stock, par value \$.0001 per share	PFMT	The Nasdaq Stock Market LLC

The number of shares of Common Stock outstanding as of November 8, 2022 was 74,278,495.

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**PERFORMANT FINANCIAL CORPORATION**  
**QUARTERLY REPORT ON FORM 10-Q**  
**FOR THE QUARTER ENDED SEPTEMBER 30, 2022**  
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**PERFORMANT FINANCIAL CORPORATION AND SUBSIDIARIES**

## Consolidated Balance Sheets

(In thousands)

	September 30, 2022 (Unaudited)	December 31, 2021
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 25,591	\$ 17,347
Restricted cash	81	2,203
Trade accounts receivable, net of allowance for doubtful accounts of \$0 and \$0, respectively	15,850	20,808
Contract assets	9,735	8,113
Prepaid expenses and other current assets	2,395	3,077
Income tax receivable	3,211	3,159
Total current assets	56,863	54,707
Property, equipment, and leasehold improvements, net	10,681	15,708
Goodwill	47,372	47,372
Right-of-use assets	2,394	3,235
Other assets	970	963
Total assets	\$ 118,280	\$ 121,985
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities:		
Current maturities of notes payable, net of unamortized debt issuance costs of \$16 and \$11, respectively	\$ 859	\$ 489
Accrued salaries and benefits	6,532	8,476
Accounts payable	785	1,124
Other current liabilities	2,304	3,732
Contract liabilities	531	634
Estimated liability for appeals and disputes	1,148	1,190
Lease liabilities	1,303	1,862
Total current liabilities	13,462	17,507
Notes payable, net of current portion and unamortized debt issuance costs of \$341 and \$416, respectively	18,409	19,084
Lease liabilities	1,365	1,803
Other liabilities	1,148	1,168
Total liabilities	34,384	39,562
Commitments and contingencies (note 3 and note 4)		
Stockholders' equity:		
Common stock, \$0.0001 par value. Authorized, 500,000 shares at September 30, 2022 and December 31, 2021 respectively; issued and outstanding 74,212 and 69,281 shares at September 30, 2022 and December 31, 2021, respectively	7	7
Additional paid-in capital	141,437	133,662
Accumulated deficit	(57,548)	(51,246)
Total stockholders' equity	83,896	82,423
Total liabilities and stockholders' equity	\$ 118,280	\$ 121,985

See accompanying notes to consolidated financial statements.

**PERFORMANT FINANCIAL CORPORATION AND SUBSIDIARIES**

Consolidated Statements of Operations  
(In thousands, except per share amounts)  
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2022	2021	2022	2021
Revenues	\$ 27,178	\$ 28,582	\$ 79,942	\$ 92,814
Operating expenses:				
Salaries and benefits	21,759	19,686	63,101	67,071
Other operating expenses	7,733	8,781	23,945	29,896
Total operating expenses	29,492	28,467	87,046	96,967
Income (loss) from operations	(2,314)	115	(7,104)	(4,153)
Gain on sale of certain recovery contracts	—	579	382	2,428
Gain on sale of land and buildings	1,120	—	1,120	—
Interest expense	(277)	(2,394)	(648)	(5,866)
Loss before provision for income taxes	(1,471)	(1,700)	(6,250)	(7,591)
Provision for (benefit from) income taxes	(11)	(9)	52	61
Net loss	\$ (1,460)	\$ (1,691)	\$ (6,302)	\$ (7,652)
Net loss per share				
Basic	\$ (0.02)	\$ (0.03)	\$ (0.09)	\$ (0.13)
Diluted	\$ (0.02)	\$ (0.03)	\$ (0.09)	\$ (0.13)
Weighted average shares				
Basic	74,021	62,127	72,480	57,512
Diluted	74,021	62,127	72,480	57,512

See accompanying notes to consolidated financial statements.

**PERFORMANT FINANCIAL CORPORATION AND SUBSIDIARIES**

## Consolidated Statement of Changes in Stockholders' Equity

(In thousands)

(Unaudited)

	Three Months Ended September 30, 2022					Three Months Ended September 30, 2021				
	Common Stock		Additional Paid-In Capital	Accumulated Deficit	Total	Common Stock		Additional Paid-In Capital	Accumulated Deficit	Total
	Shares	Amount				Shares	Amount			
Balances at beginning of period	73,818	\$ 7	\$140,506	\$ (56,088)	\$ 84,425	56,401	\$ 6	\$ 89,784	\$ (46,919)	\$ 42,871
Common stock issued under stock plans, net of shares withheld for employee taxes	394	—	—	—	—	639	—	(23)	—	(23)
Stock-based compensation expense	—	—	931	—	931	—	—	540	—	540
Proceeds from exercise of stock options	—	—	—	—	—	—	—	41	—	41
Proceeds from public offering, net of costs	—	—	—	—	—	12,104	1	42,648	—	42,649
Net loss	—	—	—	(1,460)	(1,460)	—	—	—	(1,691)	(1,691)
Balances at end of period	<u>74,212</u>	<u>\$ 7</u>	<u>\$141,437</u>	<u>\$ (57,548)</u>	<u>\$ 83,896</u>	<u>69,144</u>	<u>\$ 7</u>	<u>\$132,990</u>	<u>\$ (48,610)</u>	<u>\$ 84,387</u>

	Nine Months Ended September 30, 2022					Nine Months Ended September 30, 2021				
	Common Stock		Additional Paid-In Capital	Accumulated Deficit	Total	Common Stock		Additional Paid-In Capital	Accumulated Deficit	Total
	Shares	Amount				Shares	Amount			
Balances at beginning of period	69,281	\$ 7	\$133,662	\$ (51,246)	\$ 82,423	54,764	\$ 5	\$ 82,933	\$ (40,958)	\$ 41,980
Common stock issued under stock plans, net of shares withheld for employee taxes	1,068	—	—	—	—	1,976	1	(633)	—	(632)
Stock-based compensation expense	—	—	2,212	—	2,212	—	—	1,963	—	1,963
Recognition of warrants associated with notes payable	—	—	—	—	—	—	—	5,237	—	5,237
Recognition of earnout shares issued	—	—	—	—	—	300	—	801	—	801
Proceeds from exercise of stock options	3,863	—	5,563	—	5,563	—	—	41	—	41
Proceeds from public offering, net of costs	—	—	—	—	—	12,104	1	42,648	—	42,649
Net loss	—	—	—	(6,302)	(6,302)	—	—	—	(7,652)	(7,652)
Balances at end of period	<u>74,212</u>	<u>\$ 7</u>	<u>\$141,437</u>	<u>\$ (57,548)</u>	<u>\$ 83,896</u>	<u>69,144</u>	<u>\$ 7</u>	<u>\$132,990</u>	<u>\$ (48,610)</u>	<u>\$ 84,387</u>

See accompanying notes to consolidated financial statements.

**PERFORMANT FINANCIAL CORPORATION AND SUBSIDIARIES**

## Consolidated Statements of Cash Flows

(In thousands)

(Unaudited)

	Nine Months Ended September 30,	
	2022	2021
<b>Cash flows from operating activities:</b>		
Net loss	\$ (6,302)	\$ (7,652)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:		
Loss on disposal of assets and impairment of long-lived assets	40	718
Depreciation and amortization	3,355	3,883
Right-of-use assets amortization	841	1,413
Stock-based compensation	2,212	1,963
Interest expense from debt issuance costs	71	2,453
Gain on sale of certain recovery contracts	(382)	(2,428)
Gain on sale of land and buildings	(1,120)	—
Changes in operating assets and liabilities:		
Trade accounts receivable	4,958	4,270
Contract assets	(1,622)	(484)
Prepaid expenses and other current assets	682	1,245
Income tax receivable	(52)	1,305
Other assets	(7)	120
Accrued salaries and benefits	(1,944)	(3,739)
Accounts payable	(339)	422
Contract liabilities and other current liabilities	(1,515)	(1,363)
Estimated liability for appeals, disputes, and refunds	(42)	1,240
Lease liabilities	(997)	(1,635)
Other liabilities	(19)	(445)
Net cash (used in) provided by operating activities	<u>(2,182)</u>	<u>1,286</u>
<b>Cash flows from investing activities:</b>		
Purchase of property, equipment, and leasehold improvements	(2,198)	(2,695)
Proceeds from sale of certain recovery contracts	382	3,171
Proceeds from sales of property, equipment, and leasehold improvements	4,934	—
Net cash provided by investing activities	<u>3,118</u>	<u>476</u>
<b>Cash flows from financing activities:</b>		
Repayment of notes payable	(375)	(8,438)
Debt issuance costs paid	(2)	(150)
Taxes paid related to net share settlement of stock awards	—	(633)
Proceeds from exercise of warrants	5,563	41
Proceeds from public offering, net of costs	—	42,648
Net cash provided by financing activities	<u>5,186</u>	<u>33,468</u>
Net increase in cash, cash equivalents and restricted cash	<u>6,122</u>	<u>35,230</u>
Cash, cash equivalents and restricted cash at beginning of period	19,550	18,296
Cash, cash equivalents and restricted cash at end of period	<u>\$ 25,672</u>	<u>\$ 53,526</u>
<b>Reconciliation of the Consolidated Statements of Cash Flows to the Consolidated Balance Sheets:</b>		
Cash and cash equivalents	\$ 25,591	\$ 51,323
Restricted cash	81	2,203
Total cash, cash equivalents and restricted cash at end of period	<u>\$ 25,672</u>	<u>\$ 53,526</u>
<b>Non-cash financing activities:</b>		
Recognition of earnout shares issued	\$ —	\$ 801
Recognition of warrants associated with notes payable	\$ —	\$ 5,237
<b>Supplemental disclosures of cash flow information:</b>		
Cash paid (received) for income taxes	\$ 267	\$ (683)
Cash paid for interest	\$ 449	\$ 3,413

See accompanying notes to consolidated financial statements.

**PERFORMANT FINANCIAL CORPORATION AND SUBSIDIARIES**

Notes to Consolidated Financial Statements  
(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 accounting principles generally accepted in the United States of America ("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 interim unaudited consolidated financial statements furnished herein include all adjustments necessary (consisting only of normal recurring adjustments) for a fair presentation of our financial position at September 30, 2022, and the results of our operations for the three and nine months ended September 30, 2022 and 2021, and cash flows for the nine months ended September 30, 2022 and 2021. 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 year ended December 31, 2021.

Performant Financial Corporation (the Company, we, or our) is a leading provider of technology-enabled audit, recovery, and analytics services in the United States with a focus in the healthcare payment integrity services industry. The Company works with healthcare payers through claims auditing and eligibility-based (also known as coordination-of-benefits or COB) services to identify improper payments. The Company engages clients in both government and commercial markets. The Company also has a call center which serves clients with complex consumer engagement needs. Clients of the Company typically operate in complex and highly regulated environments and contract for their payment integrity needs in order to reduce losses on improper healthcare payments.

The Company historically worked in recovery markets such as defaulted student loans, federal and state treasury receivables, and commercial recovery. However, with the ongoing impact of the COVID-19 pandemic, and the continued pause on student loan recovery work, the Company sold certain of its non-healthcare recovery contracts in 2021 and did not renew or restart existing contracts, nor pursued new non-healthcare recovery opportunities.

The Company's consolidated financial statements include the operations of Performant Financial Corporation (Performant), its wholly-owned subsidiary Performant Business Services, Inc. (PBS), and PBS's wholly-owned subsidiaries Performant Recovery, Inc. (PRI), and Performant Technologies, LLC (PTL). The Company's consolidated financial statements also included the operations of Premiere Credit of North America, LLC (Premiere) through the end of 2021, when the entity was dissolved. Performant is a Delaware corporation headquartered in California and was formed in 2003. PBS is a Nevada corporation founded in 1997. PRI is a California corporation founded in 1976. PTL is a California limited liability company that was originally formed in 2004. All intercompany balances and transactions have been eliminated in consolidation.

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

The preparation of the consolidated financial statements, in conformity with U.S. GAAP, requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities, primarily accounts receivable, contract assets, goodwill, right-of-use assets, estimated liability for appeals and disputes, lease liabilities, other liabilities, provision for income taxes, and disclosure of contingent 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 these estimates.

***(b) Revenues, Accounts Receivable, Contract Assets, Contract Liabilities, Estimated Liability for Appeals and Disputes***

The Company derives its revenues primarily from providing audit, recovery, and analytics services. Revenues are recognized upon completion of these services for its customers, in an amount that reflects the consideration the Company expects to be entitled to in exchange for those services.

The Company determines revenue recognition through the following steps:

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

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

The Company's contracts generally contain a single performance obligation, delivered over time as a series of services that are substantially the same and have the same pattern of transfer to the client, as the promise to transfer the individual services is not separately identifiable from other promises in the contracts and, therefore, not distinct.

The Company's contracts are composed primarily of variable consideration. Fees earned under the Company's audit and recovery service contracts consist primarily of contingency fees based on a specified percentage of the amount the Company enables its clients to recover. The contingency fee percentage for a particular recovery depends on the type of recovery or claim facilitated.

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

The Company estimates variable consideration only if it can reasonably measure the progress toward complete satisfaction of the performance obligation using an output method based on reliable information and recognizes such revenue over the performance period only if it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur. Any change made to the measure of progress toward complete satisfaction of the Company's performance obligation is recorded as a change in estimate. The Company exercises judgment to estimate the amount of constraint on variable consideration based on the facts and circumstances of the relevant contract operations and the availability and reliability of data. The Company reviews the constraint on variable consideration at least quarterly. Although the Company believes the estimates made are reasonable and appropriate, different assumptions and estimates could materially impact the amount of variable consideration recognized.

For contracts that contain a refund right, these amounts are considered variable consideration and the Company estimates its refund liability for each claim, as needed, and recognizes revenue net of such estimate.

Under certain contracts, consideration can include periodic performance-based bonuses which can be awarded based on the Company's performance under the specific contract. These performance-based bonuses are considered variable and may be constrained by the Company until there is not a risk of a significant reversal.

The Company has applied the as-invoiced practical expedient or the variable consideration allocation exception to contracts with performance obligations that have an average remaining duration of less than a year.

For healthcare claims audit contracts, the Company may recognize revenue upon delivering its findings from claims audits, when sufficient reliable information is available to the Company for estimating the variable consideration earned based on an output metric that reasonably measures the Company's satisfaction of its performance obligation.

For eligibility-based or COB contracts, the Company recognizes revenue when insurance companies or other responsible parties have remitted payments to its clients.



For customer care / outsourced services, the Company recognizes revenues based on the volume of processed transactions or the quantity of labor hours provided.

For certain recovery contracts, revenue is recognized when the clients collect on amounts owed to them as a result of the Company's services. For student loan recovery services, loan rehabilitation revenue was recognized when the rehabilitated loans are funded by clients. Bonuses were recognized upon receipt of official notification of bonus awards from customers.

The following table presents revenue disaggregated by category for the three and nine months ended September 30, 2022 and 2021 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2022	2021	2022	2021
	(in thousands)		(in thousands)	
Eligibility-based	\$ 13,142	\$ 12,727	39,773	32,215
Claims-based	10,377	7,280	28,866	19,680
Healthcare Total	23,519	20,007	68,639	51,895
Recovery <sup>(1)</sup>	41	5,490	166	31,072
Customer Care / Outsourced Services	3,618	3,085	11,137	9,847
Total Revenues	\$ 27,178	\$ 28,582	\$ 79,942	\$ 92,814

<sup>(1)</sup> Represented student lending, state and municipal tax authorities, IRS and Department of Treasury markets, as well as Premiere.

Trade accounts receivable are recorded at the invoiced amount and do not bear interest. Amounts collected on trade accounts receivable are included in cash used in operating activities in the consolidated statements of cash flows. The Company determines the allowance for doubtful accounts by specific identification. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote. The allowance for doubtful accounts was \$0 at each of September 30, 2022 and December 31, 2021.

Contract assets were approximately \$9.7 million and \$8.1 million as of September 30, 2022 and December 31, 2021, respectively. Contract assets relate to the Company's rights to consideration for services completed during the respective periods, but not invoiced at the reporting date, and receipt of payment is conditional upon factors other than the passage of time. Contract assets primarily consist of commissions the Company estimates it has earned from claims audit findings submitted to healthcare clients. The increase in contract assets primarily resulted from additional consideration earned for services provided to healthcare clients, offset by invoiced amounts.

Contract assets are recorded to accounts receivable when the Company's right to payment becomes unconditional, which is generally when healthcare providers have paid our clients. There was no impairment loss related to contract assets for the nine months ended September 30, 2022.

Contract liabilities were \$0.5 million and \$0.6 million as of September 30, 2022 and December 31, 2021, respectively. The Company's contract liabilities relate to certain reimbursable costs due to a healthcare client.

Healthcare providers of our clients have the right to appeal claims audit findings and may pursue additional appeals if the initial appeal is found in favor of healthcare clients. For eligibility or COB contracts, insurance companies or other responsible parties may dispute the Company's findings regarding our clients not being the primary payer of healthcare claims. Total estimated liability for appeals and disputes was \$1.1 million as of September 30, 2022 and \$1.2 million as of December 31, 2021. This represents the Company's best estimate of the amount probable of being refunded to the Company's healthcare clients.

The Company determined that it does not have any material costs related to obtaining or fulfilling a contract that are recoverable and as such, these contract costs are generally expensed as incurred.

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

At September 30, 2022, prepaid expenses and other current assets were \$2.4 million and included approximately \$1.6 million related to prepaid software licenses and maintenance agreements, \$0.2 million for prepaid insurance, and \$0.6 million for various other prepaid expenses. At December 31, 2021, prepaid expenses and other current assets were \$3.1 million and included approximately \$1.4 million related to prepaid software licenses and maintenance agreements, \$1.1 million for prepaid insurance, and \$0.6 million for various other prepaid expenses.

***(d) Impairment of Goodwill and Long-Lived Assets***

The balance of goodwill was \$47.4 million as of September 30, 2022 and \$47.4 million as of December 31, 2021, both of which were net of accumulated impairment loss of \$34.2 million. Goodwill is reviewed for impairment at least annually in December or as certain events or conditions arise during the year. The Company may first assess qualitative factors for indicators of impairment to determine whether it is necessary to perform the quantitative goodwill impairment test. In performing the quantitative assessment of goodwill, if the carrying value of the Company, as one reporting unit, exceeds its fair value, goodwill is considered impaired. The amount of impairment loss is measured as the difference between the carrying value and the fair value of the reporting unit.

Impairment testing is based upon the best information available and estimates of fair value which incorporate assumptions marketplace participants would use in making their estimates of fair value. Significant assumptions and estimates are required, including, but not limited to, our market capitalization, projecting future cash flows and other assumptions, to estimate the fair value of the reporting unit. Although the Company believes the assumptions and estimates made are reasonable and appropriate, different assumptions and estimates could materially impact the amount of impairment. Based on management's analysis, there was no impairment to goodwill as of September 30, 2022.

Long-lived assets and intangible assets that are subject to amortization are evaluated for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets or intangibles may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of the assets to future undiscounted net cash flows expected to be generated by the assets. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. For the nine months ended September 30, 2022, there was no impairment. For the nine months ended September 30, 2021, there was a \$0.6 million non-cash impairment charge to long-lived assets, included in other operating expenses.

***(e) Other Current Liabilities***

As of September 30, 2022, other current liabilities primarily included \$1.9 million for services received for which we have not received an invoice, \$0.1 million for estimated workers' compensation claims incurred but not reported, \$0.1 million for 3rd party fees, and \$0.2 million for accrued interest under our Credit Agreement (Note 3). As of December 31, 2021, other current liabilities primarily included \$3.6 million for services received for which we have not received an invoice, \$0.1 million for estimated workers' compensation claims incurred but not reported, 3rd party fees, and equipment financing payables.

***(f) New Accounting Pronouncements***

In August 2020, the Financial Accounting Standards Board (FASB) issued ASU 2020-06, "Debt-Debt with Conversion and Other Options (Subtopic 470-20) and Derivatives and Hedging-Contracts in Entity's Own Equity (Subtopic 815-40): Accounting for Convertible Instruments and Contracts in an Entity's Own Equity", which is intended to simplify the accounting for convertible instruments by removing certain separation models in Subtopic 470-20, Debt-Debt with Conversion and Other Options, for convertible instruments. The pronouncement is effective for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2021, with early adoption permitted. The Company's adoption of ASU 2020-06 as of January 1, 2022 had no impact on our financial position, results of operations, or cash flows.

In February 2020, the FASB issued ASU 2020-02, “Financial Instruments - Credit Losses (Topic 326) and Leases (Topic 842) – Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 119 and Update to SEC Section on Effective Date Related to Accounting Standards Update No. 2016-02, Leases (Topic 842).” This ASU provides updated guidance on how an entity should measure credit losses on financial instruments, including trade receivables, held at the reporting date. The amendments make each Topic easier to understand and easier to apply by eliminating inconsistencies and providing clarifications. It also addresses transition and open effective date information for Topic 842. ASU 2016-13, ASU 2018-19, ASU 2019-04, ASU 2019-05, ASU 2019-11 and ASU 2020-02 (collectively, “ASC 326”) are effective for public entities for fiscal years beginning after December 15, 2019, except for Smaller Reporting Companies. This ASU is effective for the Company for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2022. The Company is in the process of evaluating the effects of the provisions of this pronouncement on our financial statements.

## 2. Property, Equipment, and Leasehold Improvements

Property, equipment, and leasehold improvements consist of the following at September 30, 2022 and December 31, 2021 (in thousands):

	September 30, 2022	December 31, 2021
Land	\$ —	\$ 1,943
Building and leasehold improvements	3,849	7,411
Furniture and equipment	3,257	5,757
Computer hardware and software	75,584	74,850
	82,690	89,961
Less accumulated depreciation and amortization	(72,009)	(74,253)
Property, equipment and leasehold improvements, net	\$ 10,681	\$ 15,708

Depreciation expense of property, equipment and leasehold improvements was \$1.1 million and \$0.8 million for the three months ended September 30, 2022 and 2021, respectively, and \$3.4 million and \$3.2 million for the nine months ended September 30, 2022 and 2021 respectively.

The Company sold two buildings and related land during the three months ended September 30, 2022, which resulted in a gain of \$1.1 million in the consolidated statements of cash flows.

## 3. Notes Payable

As of September 30, 2022, \$19.6 million was outstanding under the credit agreement with MUFG Union Bank, N.A. (the Credit Agreement). The Company’s interest rate at September 30, 2022 was 5.3%.

On December 17, 2021, the Company entered into a Credit Agreement with MUFG Union Bank, N.A. The Credit Agreement includes a \$20 million term loan commitment, which was fully advanced at closing and a \$15 million revolving loan commitment, which remains undrawn as of September 30, 2022. A portion of the revolving loan commitment of up to \$2.5 million is available for the issuance of letters of credit. Subject to certain customary exceptions, the obligations under the Credit Agreement are, or will be, guaranteed by each of the Company’s existing and future, direct or indirect, domestic subsidiaries. The obligations of the Company under the Credit Agreement are secured by liens on substantially all of the assets of the Company and each of its domestic subsidiaries that are guarantors under the Credit Agreement.

The Credit Agreement matures on December 17, 2026. The proceeds from the term loan under the Credit Agreement were used by the Company, together with cash on hand, to repay in full its credit agreement dated as of August 17, 2017, with ECMC Group, Inc. (as amended, the Prior Credit Agreement), and to pay fees and expenses in connection with the Credit Agreement.

Pursuant to the Credit Agreement, the Company is required to repay the aggregate outstanding principal amount of the term loan under the Credit Agreement in quarterly installments which commenced on March 31, 2022 in an amount that would result in amortization of (a) 2.5% of the term loan principal in the first full year following commencement of amortization, (b) 5.0% of the term loan principal in the second full year following commencement of amortization, (c) 7.5% of the term loan principal in each of the third and fourth full years following commencement of amortization, and (d) 10% of the term loan principal in the fifth full year (or portion thereof) following commencement of amortization. In addition, the Company must make mandatory prepayments of the term loan principal under the Credit Agreement with the net cash proceeds received in connection with certain specified events, including certain asset sales, casualty and condemnation events (subject to customary reinvestment rights). Any remaining outstanding principal balance of the term loan under the Credit Agreement is repayable on the maturity date. Amounts repaid or prepaid by the Company with respect to the term loan under the Credit Agreement cannot be reborrowed.

The Company may, at its option, prepay any revolving loan borrowings under the Credit Agreement, in whole or in part, at any time and from time to time without premium or penalty (except in certain circumstances). Borrowings of revolving loans under the Credit Agreement are also subject to mandatory prepayment in the event that outstanding borrowings and letter of credit usage exceed aggregate revolving loan commitments then in effect.

Under the Credit Agreement, loans may bear interest based on term SOFR (the secured overnight financing right) or an annual base rate, as applicable, plus an applicable margin based on the Company's leverage ratio each quarter that may range between 2.50% per annum and 3.00% per annum in the case of term SOFR loans and between 1.50% per annum and 2.00% per annum in the case of base rate loans. In addition, a commitment fee based on the unused availability of the revolving credit facility is also payable which may vary from 0.30% per annum to 0.40% per annum, also based on the Company's leverage ratio.

The Credit Agreement contains certain customary representations, warranties, and affirmative and negative covenants of the Company and its subsidiaries that restrict the Company's and its subsidiaries' ability to take certain actions, including: incurrence of indebtedness, creation of liens, making certain investments, mergers or consolidations, dispositions of assets, assignments, sales or transfers of equity in subsidiaries, repurchase or redemption of capital stock, entering into certain transactions with affiliates, or changing the nature of the Company's business. The Credit Agreement also contains two financial covenants, which require the Company to maintain, as of the last day of each fiscal quarter commencing with March 31, 2022, (a) a total leverage ratio of not greater than (i) 3.00 to 1.00 through September 30, 2022 and (ii) 2.50 to 1.00 thereafter and (b) a fixed charge coverage ratio of not less than 1.20 to 1.00. The obligations under the Credit Agreement may be accelerated or the commitments terminated upon the occurrence of events of default under the Credit Agreement, which include payment defaults, defaults in the performance of affirmative and negative covenants, the inaccuracy of representations or warranties, bankruptcy and insolvency related defaults, cross defaults to other material indebtedness, defaults arising in connection with changes in control, and other customary events of default.

As of September 30, 2022, the Company was in compliance with all financial covenants under the Credit Agreement.

Outstanding debt obligations were as follows (in thousands):

	September 30, 2022	December 31, 2021
Principal amount	\$ 19,625	\$ 20,000
Less unamortized discount and issuance costs	(357)	(427)
Notes payable, net of unamortized discount and issuance costs	19,268	19,573
Less current maturities, net of unamortized discount and issuance costs	(859)	(489)
Long-term notes payable, net of current maturities and unamortized discount and issuance costs	\$ 18,409	\$ 19,084

The following is a schedule, by years, of maturities of notes payable as of September 30, 2022 (in thousands):

<b>Year Ending December 31,</b>	<b>Amount</b>
Remainder of 2022	\$ 125
2023	1,000
2024	1,500
2025	1,500
2026	15,500
Total notes payable	<u>\$ 19,625</u>

#### 4. Leases

The Company has entered into various non-cancelable operating lease agreements for office facilities and equipment with original lease periods expiring between 2022 and 2025. Certain of these arrangements have free rent periods and/or escalating rent payment provisions. As such, the Company recognizes rent expense under such arrangements on a straight-line basis in accordance with U.S. GAAP. Some leases include options to renew. The Company does not assume renewals in its determination of the lease term unless the renewals are deemed to be reasonably assured at lease commencement. The lease agreements do not contain any material residual value guarantees or material restrictive covenants. Leases with an initial term of twelve months or less are not recorded on the balance sheet.

Operating lease expense was \$0.5 million and \$0.6 million for the three months ended September 30, 2022 and 2021, respectively, and \$1.6 million and \$1.8 million for the nine months ended September 30, 2022 and 2021, respectively.

Supplemental cash flow and other information related to operating leases were as follows:

	<u>September 30, 2022</u>	<u>September 30, 2021</u>
Weighted Average Remaining Lease Term (in years)	2.3	2.5
Weighted Average Discount Rate	6.1%	6.4%
Cash paid for amounts included in the measurement of operating lease liabilities	\$0.5 million	\$2.1 million

The following is a schedule, by years, of maturities of lease liabilities as of September 30, 2022 (in thousands):

<b>Year Ending December 31,</b>	<b>Amount</b>
Remainder of 2022	\$ 403
2023	1,337
2024	697
2025	441
Total undiscounted cash flows	<u>\$ 2,878</u>
Less imputed interest	(210)
Present value of lease liabilities	<u>\$ 2,668</u>

#### 5. Stock-Based Compensation

##### *(a) Stock Options*

Total stock-based compensation expense charged as salaries and benefits expense in the consolidated statements of operations was \$0.9 million and \$0.5 million for the three months ended September 30, 2022 and 2021 respectively, and \$2.2 million and \$2.0 million for the nine months ended September 30, 2022 and 2021, respectively.

The following table sets forth a summary of the Company's stock option activity for the nine months ended September 30, 2022:

	Outstanding Options	Weighted average exercise price per share	Weighted average remaining contractual life (Years)	Aggregate Intrinsic Value (in thousands)
Outstanding at December 31, 2021	1,593,101	\$ 10.51	0.82	\$ 7
Granted	—	—	—	—
Forfeited	(1,343,101)	10.55	—	—
Exercised	—	—	—	—
Outstanding at September 30, 2022	250,000	\$ 10.31	1.13	\$ 1
Vested, exercisable, expected to vest <sup>(1)</sup> at September 30, 2022	250,000	\$ 10.31	1.13	\$ 1
Exercisable at September 30, 2022	250,000	\$ 10.31	1.13	\$ 1

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

The Company recognizes share-based compensation costs as expense on a straight-line basis over the option vesting period, which generally is four years. As of September 30, 2022, all options have vested and there was no unrecognized compensation costs.

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

The following table summarizes restricted stock unit and performance stock unit activity for the nine months ended September 30, 2022:

	Number of Awards	Weighted average grant date fair value per share
Outstanding at December 31, 2021	2,935,351	\$ 2.85
Granted	2,390,406	2.67
Forfeited	(234,483)	2.64
Vested and converted to shares, net of units withheld for taxes	(1,067,698)	2.41
Outstanding at September 30, 2022	4,023,576	\$ 2.87
Expected to vest at September 30, 2022	3,550,968	\$ 2.87

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

As of September 30, 2022, there was approximately \$9.2 million of total unrecognized compensation cost related to unvested restricted stock units granted to employees. This unrecognized compensation cost is expected to be recognized over an estimated weighted-average amortization period of approximately 3.3 years.

#### **6. Income Taxes**

The Company's effective income tax rate is (1)% for the nine months ended September 30, 2022 and (1)% for the nine months ended September 30, 2021. Similar to September 30, 2021, the primary driver of the effective income tax rate is the overall losses from operations for the nine months ended September 30, 2022 for which no benefit is recognized due to valuation allowance.

The Company files income tax returns with the U.S. federal government and various state jurisdictions. The Company operates in a number of state and local jurisdictions, most of which have never audited our records. Accordingly, the Company is subject to state and local income tax examinations based upon the various statutes of limitations in each jurisdiction. For tax years before 2017, earlier tax years are subject to examination and assessment to the extent of net operating losses carryback refunds requested. The Company has ongoing federal examinations by the Internal Revenue Service for tax years 2017 and 2018.

## 7. Net Income (Loss) per Share

For the three and nine months ended September 30, 2022 and 2021, basic net income (loss) per share is calculated by dividing net income (loss) by the sum of the weighted average number of shares of common stock outstanding during the period. Diluted earnings per share is calculated by dividing net income by the weighted average number of shares of common stock and dilutive common share equivalents outstanding during the period. Common share equivalents consist of stock options, restricted stock units, performance stock units, and warrants. When there is a loss in the period, dilutive common share equivalents are excluded from the calculation of diluted earnings per share, as their effect would be anti-dilutive. For example, for the nine months ended September 30, 2022 and 2021, respectively, diluted weighted average shares outstanding are the same as basic average shares outstanding. When there is net income in the period, the Company excludes stock options, restricted stock units, performance stock units, and warrants from the calculation of diluted earnings per share when their combined exercise price and unamortized fair value exceeds the average market price of 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 September 30,		Nine Months Ended September 30,	
	2022	2021	2022	2021
Weighted average shares outstanding – basic	74,021	62,127	72,480	57,512
Dilutive effect of stock options	—	—	—	—
Weighted average shares outstanding – diluted	74,021	62,127	72,480	57,512

Since the Company was in a loss position for all periods presented, basic net loss per share is the same as diluted net loss per share, as the inclusion of all potential common shares outstanding would have been anti-dilutive. Potentially dilutive securities that were not included in the diluted per share calculations because they would be anti-dilutive were as follows (shares in thousands):

	September 30, 2022	September 30, 2021
Options to purchase common stock	250	1,661
RSUs	4,024	3,056
Warrants outstanding	2,447	6,310
Total	6,721	11,027

## 8. Subsequent Events

We have evaluated subsequent events through the date these consolidated financial statements are filed with the Securities and Exchange Commission and there are no other events that have occurred that would require adjustments or disclosures to our consolidated financial statements.

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

*You should read the following discussion in conjunction with our 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 ability to generate revenue following long implementation periods associated with new customer contracts; the high level of revenue concentration among our largest customers; our client relationships and our ability to maintain such client relationships; many of our customer contracts are subject to periodic renewal, are not exclusive, do not provide for committed business volumes; downturns in domestic or global economic conditions and other macroeconomic factors; our ability to generate sufficient cash flows to fund our ongoing operations and other liquidity needs; our ability to hire and retain employees with specialized skills that are required for our healthcare business; anticipated trends and challenges in our business and competition in the markets in which we operate; the impact of COVID-19 on our business and operations, opportunities and expectations for the markets in which we operate; our ability to maintain compliance with the covenants in our debt agreements; the adaptability of our technology platform to new markets and processes; failure of our or third parties' operating systems and technology infrastructure could disrupt our operation and the threat of breach of the Company's security measures or failure or unauthorized access to confidential data that we possess; our growth strategy of expanding in our existing markets and considering strategic alliances or acquisitions; maintaining, protecting and enhancing our intellectual property; our expectations regarding future expenses; expected future financial performance; and our ability to comply with and adapt to industry regulations and compliance demands. The forward-looking statements in this report speak only as of the date hereof. We expressly disclaim any obligation or undertaking to release publicly any updates or revisions to any forward-looking statements contained herein to reflect any change in our expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.*

### Overview

We provide technology-enabled audit, recovery, and analytics services in the United States with a focus in the healthcare payment integrity industry. We work with healthcare payers through claims auditing and eligibility-based (also known as coordination-of-benefits or COB) services to identify improper payments. We engage clients in both government and commercial markets. We also have a call center which serves clients with complex consumer engagement needs. Our clients typically operate in complex and highly regulated environments and contract for their payment integrity needs in order to reduce losses on improper healthcare payments.

We historically worked in recovery markets such as defaulted student loans, federal treasury and state tax receivables, and commercial recovery. However, with the ongoing impact of the COVID-19 pandemic and the Department of Education's decision to continue to pause student loan recovery work, we sold certain of our non-healthcare recovery contracts in 2021 and decided not to renew or restart existing recovery contracts, nor pursue new non-healthcare recovery opportunities.

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



## Sources of Revenues

We derive a substantial portion of our revenues from services provided to our clients in the healthcare market. We also derive revenues from our outsourced call center services. In 2021, we also derived revenues in recovery markets such as defaulted student loans, federal treasury and state tax receivables, and commercial recovery.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2022	2021	2022	2021
	(in thousands)		(in thousands)	
Eligibility-based	\$ 13,142	\$ 12,727	\$ 39,773	\$ 32,215
Claims-based	10,377	7,280	28,866	19,680
Healthcare Total	23,519	20,007	68,639	51,895
Recovery <sup>(1)</sup>	41	5,490	166	31,072
Customer Care / Outsourced Services	3,618	3,085	11,137	9,847
Total Revenues	\$ 27,178	\$ 28,582	\$ 79,942	\$ 92,814

(1) Represented student lending, state and municipal tax authorities, IRS, Department of the Treasury, and Premiere.

### Healthcare Revenues

We derive revenues from both commercial and government clients by providing healthcare payment integrity services, which include claims-based and eligibility-based services. Revenues earned under claims-based contracts in the healthcare market are driven by auditing, identifying, and sometimes recovering improperly paid claims through both automated and manual review of such claims. Eligibility-based services, which may also be referred to as coordination-of-benefits, involve identifying and recovering payments in situations where our client should not be the primary payer of healthcare claims because a member has other forms of insurance coverage. We are paid contingency fees by our clients based on a percentage of the dollar amount of improper claims recovered as a result of our efforts. The revenues we recognize are net of our estimate of claims that may be overturned by appeal or disputed following payment by the provider.

For our healthcare business, our business strategy is focused on utilizing our technology-enabled services platform to provide claims-based, eligibility-based, and analytical services for healthcare payers. Revenues from our healthcare services were \$68.6 million for the nine months ended September 30, 2022 compared to revenues of \$51.9 million from our healthcare services during for the nine months ended September 30, 2021.

In 2017, the centers for Medicare and Medicaid Services (CMS) awarded us the Medicare Secondary Payer, Commercial Payment Center (MSP CRC) contract. The original contract term was 1 base year, plus 3 option years. CMS exercised all three option years, and then extended the term for an additional year, for a total term of 5 years. Under this agreement, we are responsible for coordination-of-benefits, which includes identifying and recovering payments in situations where Medicare should not be the primary payer of healthcare claims because a beneficiary has other forms of insurance coverage, such as through an employer group health plan or certain other payers. Consistent with Federal procurement guidelines, the contract is being recompeted and we have responded to a Request for Quote (RFQ) from CMS. The RFQ has an award term of 1 base year, plus 5 option years.

In 2016, CMS awarded two new Medicare Recovery Audit Contractor (RAC) contracts to us, for audit Regions 1 and 5. The RAC contract award for Region 1 allows us to continue our audit of payments under Medicare's Part A and Part B for all provider types other than Durable Medical Equipment, Prosthetics, Orthotics and Supplies (DMEPOS) and home health and hospice within an 11 state region in the Northeast and Midwest. The Region 5 RAC contract provides for the post-payment review of DMEPOS and home health and hospice claims nationally.

In March 2021, we were re-awarded the Region 1 RAC contract by CMS after a competitive procurement process. The renewed contract has an 8.5-year term.

In January 2022, we were awarded the indefinite delivery, indefinite quantity (IDIQ) contract by the U.S. Department of Health and Human Services, Office of the Inspector General (HHS OIG), which has a base term of one year and four additional 1-year options. Under the IDIQ contract, we will provide medical review and consultative services associated with the oversight activities of the HHS OIG, primarily assessing services and claims for Medicare fee-for-service payments for Part A and Part B. This contract was awarded via a full-and-open competitive procurement.

In November 2022, we were re-awarded the Medicare RAC contract for Region 2. This contract was initially awarded to us through a procurement process on March 24, 2022, and following a voluntary corrective action process that was initiated by CMS, the agency re-affirmed its initial contract award. The contract for Region 2 has an initial 8.5-year term.

Currently our healthcare clients continue to expand the scope of services that we provide, and we continue to implement new programs for existing and new healthcare clients. We believe this growth trend should continue as our suite of payment integrity services and our customer relationships continue to mature. We currently anticipate that our healthcare revenues will drive the majority of our overall revenue growth.

### ***Recovery Revenues***

Historically, recovery market revenues contributed a majority of our revenues. However, certain regulatory changes and the COVID-19 pandemic had a significant impact on our recovery revenues, which led to our decision to sell certain non-healthcare recovery contracts, and to not renew or restart other existing non-healthcare recovery contracts, nor pursue new non-healthcare recovery opportunities, during the course of 2021. As a result, in 2022 and going forward, we expect our revenues from the non-healthcare recovery market will be minimal.

### ***Customer Care / Outsourced Services Revenues***

We derive revenues from first party call center and other outsourced services for certain clients. Our revenues for these services include contingent fees based on the volume of processed transactions and the quantity of labor hours provided to our clients.

### **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 expenses include expenses related to our use of subcontractors, other production related expenses, including costs associated with data processing, retrieval of medical records, printing and mailing services, amortization and other outside services, as well as general corporate and administrative expenses.

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

Our results of operations are influenced by a number of factors, including costs associated with commencing new contracts, claim recovery volume, contingency fees, regulatory matters, client contract cancellation and macroeconomic factors.

### ***Costs Associated with Commencing New Contracts***

When we obtain an engagement with a new client or a new contract with an existing client, it typically takes a long period of time to plan our services in detail, which includes integrating our technology, processes and resources with the client's operations and hiring new employees, before we receive any revenues from the new client or new contract. Due to the upfront costs we incur in connection with the implementation of new contracts and the delays we face in recognizing initial revenue from any such new contracts, our profitability can be negatively impacted by any delays associated with new contract implementations. Our clients may also experience delays in obtaining approvals or managing protests from unsuccessful bidders or delays associated with system implementations, as we had experienced with the implementation of our first RAC contracts with CMS. If we are not able to pay the upfront expenses out of cash from operations or availability of borrowings under our lending arrangements, we may scale back our operations or alter our business plans, either of which could prevent us from earning future revenues under any such new client or new contract engagements.

### ***Claims Recovery Volume***

The number of claims that we are allowed or permitted to audit on behalf of our healthcare clients within our claims-based services has a direct impact on our revenues. Most of our contracts in our claims-based services permit our clients to unilaterally change the amount of claims that we are able to audit on the client's behalf at any given time. Further, the type and scale of claims which are deemed permissible for us to audit by certain of our healthcare clients may change from time-to-time. Non-permissible claims may result from client product lines which are determined by our clients to be out of scope of our audit services, claims related to excluded providers or excluded provider groups, changes in policy, or other factors such as geographies disrupted by natural disasters or a global pandemic like the COVID-19 pandemic. For example, the COVID-19 pandemic has had a negative impact on overall hospital utilization rates in the United States. This negative impact on overall hospital utilization rates has caused delays with the healthcare industry as a whole, which in turn has had a negative impact on our healthcare business.

Claims volume provided by our healthcare clients also impact our eligibility-based services. To the extent the volume of claims is negatively impacted by any of the factors set forth above, our revenues and results of operations will be adversely impacted.

### ***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. Changes in contingency fee percentages set by our clients may have a material effect on our revenues and results of operations.

### ***Regulatory Matters***

Each of the markets which we serve is highly regulated. Accordingly, changes in regulations that affect the types of receivables and claims that we are able to service or audit or the manner in which any such receivables and claims can be recovered will affect our revenues and results of operations.

For example, in March 2020, CMS paused medical review activities under our two RAC contracts as a result of the COVID-19 pandemic, which were later resumed in August 2020.

In addition, our entry into the healthcare market was facilitated by the 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 Medicare program or the audit and recovery of Medicare claims could have a significant impact on our revenues and results of operations.

### ***Client Contract Cancellation or Non-Renewal***

We derive a substantial portion of our revenues from contracts with a limited number of our largest clients. Substantially all of our contracts (i) entitle our clients to unilaterally terminate their contractual relationship with us at any time without penalty and (ii) are subject to competitive procurement or renewal processes from time to time. Our revenues could decline if we lose one or more of our significant clients either due to a contract cancellation or our inability to be awarded a new contract in connection with a competitive renewal process, or if one of our significant clients decides to limit the amount of claims that we are allowed to audit or 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. Further, our revenues could be adversely affected if any of our significant clients is acquired by an entity that does not wish to continue to use our services.

### ***Macroeconomic Factors***

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

### ***Revenue Recognition***

We derive our revenues primarily from providing audit, recovery, and analytics services. Revenues are recognized upon completion of these services for our customers, in an amount that reflects the consideration we expect to be entitled to in exchange for those services.

We determine revenue recognition through the following steps:

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

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

Our contracts generally contain a single performance obligation, delivered over time as a series of services that are substantially the same and have the same pattern of transfer to a client, as the promise to transfer the individual services is not separately identifiable from other promises in the contracts and, therefore, not distinct.

Our contracts are composed primarily of variable consideration. Fees earned under our audit and recovery service contracts consist primarily of contingency fees based on a specified percentage of the amount we enable our clients to recover. The contingency fee percentage for a particular recovery depends on the type of recovery or claim facilitated.

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

We estimate variable consideration only if we can reasonably measure our progress toward complete satisfaction of the performance obligation using an output method based on reliable information, and recognize such revenue over the performance period only if it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur. Any change made to the measure of progress toward complete satisfaction of our performance obligation is recorded as a change in estimate. We exercise judgment to estimate the amount of constraint on variable consideration based on the facts and circumstances of the relevant contract operations and availability and reliability of data. Although we believe the estimates made are reasonable and appropriate, different assumptions and estimates could materially impact the amount of variable consideration.

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

Under certain contracts, consideration can include periodic performance-based bonuses which can be awarded based on our performance under the specific contract. These performance-based awards are considered variable and may be constrained by us until there is not a risk of a material reversal.

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

Trade accounts receivable are recorded at the invoiced amount and do not bear interest. Amounts collected on trade accounts receivable are included in cash used in operating activities in the consolidated statements of cash flows. The Company determines the allowance for doubtful accounts by specific identification. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote. The allowance for doubtful accounts was \$0 at each of September 30, 2022 and December 31, 2021.

Contract assets totaled \$9.7 million and \$8.1 million as of September 30, 2022 and December 31, 2021, respectively. Contract assets relate to our right to consideration for services completed, but not invoiced at the reporting date, and receipt of payment is conditional upon factors other than the passage of time. Contract assets primarily consist of commissions we estimate we have earned from completed claims audit findings submitted to healthcare clients. The increase in contract assets resulted primarily from additional consideration earned for services provided to our healthcare clients, offset by invoiced amounts.

Contract assets are recorded to accounts receivable when our rights to payment become unconditional, which is generally when healthcare providers or payers have paid our clients. There was no impairment loss related to contract assets for the nine months ended September 30, 2022 and 2021.

Contract liabilities totaled \$0.5 million and \$0.6 million as of September 30, 2022 and December 31, 2021, respectively. Our contract liabilities relate to certain reimbursable costs due to a client.

Healthcare providers have the right to appeal claims audit findings and may pursue additional appeals if the initial appeal is found in favor of healthcare clients. For eligibility or COB contracts, insurance companies or other responsible parties may dispute our findings regarding our clients not being the primary payer of healthcare claims. Total estimated liability for appeals and disputes was \$1.1 million as of September 30, 2022 and \$1.2 million as of December 31, 2021. This represents our best estimate of the amount probable of being refunded to our healthcare clients.

#### ***Recent Accounting Pronouncements***

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

## Results of Operations

### Three Months Ended September 30, 2022 compared to the Three Months Ended September 30, 2021

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

	Three Months Ended September 30,			
	2022	2021	\$ Change	% Change
(in thousands)				
<b>Consolidated Statement of Operations Data:</b>				
Revenues	\$ 27,178	\$ 28,582	\$ (1,404)	(5)%
Operating expenses:				
Salaries and benefits	21,759	19,686	(2,073)	(11)%
Other operating expenses	7,733	8,781	1,048	12 %
Total operating expenses	29,492	28,467	(1,025)	(4)%
Income (loss) from operations	(2,314)	115	(2,429)	2,112 %
Gain on sale of certain recovery contracts	—	579	(579)	(100)%
Gain on sale of land and buildings	1,120	—	1,120	100 %
Interest expense	(277)	(2,394)	2,117	88 %
Loss before provision for income taxes	(1,471)	(1,700)	229	13 %
Provision for income taxes	(11)	(9)	2	(22)%
Net loss	\$ (1,460)	\$ (1,691)	\$ 231	14 %

### Revenues

Total revenues were \$27.2 million for the three months ended September 30, 2022, a decrease of approximately 5%, compared to total revenues of \$28.6 million for the three months ended September 30, 2021.

Healthcare revenues were \$23.5 million for the three months ended September 30, 2022, representing an increase of \$3.5 million, or 18%, compared to the three months ended September 30, 2021. This increase in healthcare revenues was primarily attributable to the continued growth from our fully implemented statements of work, as well as numerous new program implementations. Revenues from eligibility-based services during the three months ended September 30, 2022 were \$13.1 million, or 3% higher than the three months ended September 30, 2021. Revenues from claims-based services during the three months ended September 30, 2022 were \$10.4 million, or 43% higher than the three months ended September 30, 2021.

Recovery revenues were \$41 thousand for the three months ended September 30, 2022, compared to \$5.5 million for the three months ended September 30, 2021. The decrease was primarily due to our decision in 2021 to sell certain of our recovery contracts and to not renew or extend our other existing recovery contracts as a result of the adverse impacts of certain regulatory changes and the COVID-19 pandemic on our recovery business.

Customer Care / Outsourced Services revenues were approximately \$3.6 million, representing an increase of \$0.5 million, or 17%, compared to the three months ended September 30, 2021. The change was due to increased demand for our outsourced services.

### Salaries and Benefits

Salaries and benefits expense was \$21.8 million for the three months ended September 30, 2022, an increase of \$2.1 million, or 11%, compared to salaries and benefits expense of \$19.7 million for the three months ended September 30, 2021. The increase in salaries and benefits expense was primarily driven by an increase in headcount related to continued growth in our healthcare business during the period.

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

Other operating expenses were \$7.7 million for the three months ended September 30, 2022, compared to other operating expenses of \$8.8 million for the three months ended September 30, 2021. The decrease in other operating expenses was primarily due to the cessation of non-healthcare recovery activity, which largely occurred by the end of 2021, and a decrease in professional services.

### ***Loss from Operations***

As a result of the factors described above, loss from operations was \$2.3 million for the three months ended September 30, 2022, compared to income from operations of \$0.1 million for the three months ended September 30, 2021. This increase of \$2.4 million in loss from operations during the three months ended September 30, 2022 was driven primarily by a decrease in total revenues as a result of the cessation of our non-healthcare recovery business which largely occurred during 2021, and an increase in total operating expenses due to the increase in employee headcount required by the continued growth in our healthcare business, during the period.

### ***Gain on Sale of Land and Buildings***

Gain from the sale of land and buildings was \$1.1 million for the three months ended September 30, 2022. We sold two office buildings and the related land that were previously utilized by employees working on recovery contracts.

### ***Interest Expense***

Interest expense was \$0.3 million during the three months ended September 30, 2022, compared to \$2.4 million for the three months ended September 30, 2021, representing a decrease of \$2.1 million. This decrease in interest expense is primarily due to a lower principal balance related to our refinance in December 2021, and lower interest rate during the three months ended September 30, 2022.

### ***Income Taxes***

We recognized an income tax benefit of \$11 thousand for the three months ended September 30, 2022, compared to an income tax benefit of \$9 thousand for the three months ended September 30, 2021. Our effective income tax rate was 1% for the three months ended September 30, 2022 and 2021. Similar to the three months ended September 30, 2021, the primary driver of our effective income tax rate is the overall losses from operations for the three months ended September 30, 2022 for which no benefit is recognized due to recognition of a full valuation allowance.

### ***Net Loss***

As a result of the factors described above, net loss was \$1.5 million for the three months ended September 30, 2022, which represented a decrease in net loss of approximately \$0.2 million, or 14%, compared to net loss of \$1.7 million for the three months ended September 30, 2021.

**Nine months ended September 30, 2022 compared to the Nine months ended September 30, 2021**

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

	Nine Months Ended September 30,			
	2022	2021	\$ Change	% Change
(in thousands)				
<b>Consolidated Statement of Operations Data:</b>				
Revenues	\$ 79,942	\$ 92,814	\$ (12,872)	(14)%
Operating expenses:				
Salaries and benefits	63,101	67,071	3,970	6 %
Other operating expenses	23,945	29,896	5,951	20 %
Total operating expenses	87,046	96,967	9,921	10 %
Loss from operations	(7,104)	(4,153)	(2,951)	(71)%
Gain on sale of certain recovery contracts	382	2,428	(2,046)	(84)%
Gain on sale of land and buildings	1,120	—	1,120	100 %
Interest expense	(648)	(5,866)	5,218	89 %
Loss before provision for income taxes	(6,250)	(7,591)	1,341	18 %
Provision for income taxes	52	61	9	15 %
Net loss	\$ (6,302)	\$ (7,652)	\$ 1,350	18 %

**Revenues**

Total revenues were \$79.9 million for the nine months ended September 30, 2022, a decrease of approximately (14)%, compared to total revenues of \$92.8 million for the nine months ended September 30, 2021.

Healthcare revenues were \$68.6 million for the nine months ended September 30, 2022, representing an increase of \$16.7 million, or 32%, compared to the nine months ended September 30, 2021. This increase in healthcare revenues was primarily attributable to the continued growth from our fully implemented statements of work and numerous new program implementations. Revenues from eligibility-based services during the nine months ended September 30, 2022 were \$7.6 million, or 23% higher than the nine months ended September 30, 2021, which included a \$3.3 million charge to revenue to accrue a refund liability to a client. Revenues from claims-based services during the nine months ended September 30, 2022 were \$9.2 million, or 47%, higher than the nine months ended September 30, 2021.

Recovery revenues were \$0.2 million for the nine months ended September 30, 2022, compared to \$31.1 million during the nine months ended September 30, 2021. The decrease was primarily due to our decision to sell certain of our recovery contracts and to not renew or extend our other existing recovery contracts as a result of the adverse impacts of certain regulatory changes and the COVID-19 pandemic on our recovery business.

Customer Care / Outsourced Services revenues were approximately \$11.1 million for the nine months ended September 30, 2022 compared to \$9.8 million for the nine months ended September 30, 2021. The change was due to increased demand for our outsourced services.

**Salaries and Benefits**

Salaries and benefits expense was \$63.1 million for the nine months ended September 30, 2022, a decrease of \$4.0 million, or 6%, compared to salaries and benefits expense of \$67.1 million for the nine months ended September 30, 2021. The decrease in salaries and benefits expense was primarily driven by lower headcount related to the cessation of non-healthcare recovery activity which largely occurred by the end of 2021, partially offset by an increase in headcount related to continued growth in our healthcare business during the period.



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

Other operating expenses were \$23.9 million for the nine months ended September 30, 2022, compared to other operating expenses of \$29.9 million for the nine months ended September 30, 2021. The decrease in other operating expenses was primarily due to the cessation of non-healthcare recovery activity which largely occurred by the end of 2021, and a decrease in professional services, but partially offset by an increase in expenses related to growth in our healthcare business.

### ***Loss from Operations***

As a result of the factors described above, loss from operations was \$7.1 million for the nine months ended September 30, 2022, compared to loss from operations of \$4.2 million for the nine months ended September 30, 2021. This increase of \$3.0 million in loss from operations was driven primarily by a greater decrease in total revenues as a result of the cessation of our non-healthcare recovery business, as compared to a smaller relative decrease in total operating expenses due to the continued growth in our healthcare business during the nine months ended September 30, 2022.

### ***Gain on Sale of Land and Buildings***

Gain from the sale of land and buildings was \$1.1 million for the nine months ended September 30, 2022. We sold two office buildings and the related land that were previously utilized by employees working on recovery contracts.

### ***Interest Expense***

Interest expense was \$0.6 million for the nine months ended September 30, 2022, compared to \$5.9 million for the nine months ended September 30, 2021, representing a decrease of \$5.2 million. This decrease in interest expense is due primarily to a lower principal balance related to the refinance of our then existing indebtedness in December 2021, and lower interest rate during the nine months ended September 30, 2022.

### ***Income Taxes***

We recognized an income tax expense of \$52 thousand for the nine months ended September 30, 2022, compared to an income tax expense of \$61 thousand for the nine months ended September 30, 2021. Our effective income tax rate was (1)% for the nine months ended September 30, 2022, and 2021. Similar to the nine months ended September 30, 2021, the primary driver of our effective tax rate is the overall losses from operations for the nine months ended September 30, 2022 for which no benefit is recognized due to recognition of a full valuation allowance.

### ***Net Loss***

As a result of the factors described above, net loss was \$6.3 million for the nine months ended September 30, 2022, which represented a decrease in net loss of approximately \$1.4 million, or 18%, compared to net loss of \$7.7 million for the nine months ended September 30, 2021.

## 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-U.S. 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 U.S. GAAP financial measure to these non-U.S. GAAP financial measures.

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

Our use of adjusted EBITDA and adjusted net income has limitations as an analytical tool, and you should not consider it in isolation or as a substitute for analysis of our results as reported under U.S. 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 U.S. GAAP results. The following tables present a reconciliation of adjusted EBITDA and adjusted net income for each of the periods indicated:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2022	2021	2022	2021
	(in thousands)		(in thousands)	
<b>Adjusted EBITDA:</b>				
Net income (loss)	\$ (1,460)	\$ (1,691)	\$ (6,302)	\$ (7,652)
Provision for (benefit from) income taxes	(11)	(9)	52	61
Interest expense <sup>(1)</sup>	277	2,394	648	5,866
Stock-based compensation	931	540	2,212	1,963
Depreciation and amortization	1,095	843	3,355	3,883
Impairment of long-lived assets	—	—	—	636
Severance expenses <sup>(4)</sup>	10	380	189	1,876
Non-core operating expenses <sup>(5)</sup>	3	\$ 775	9	2,683
Gain on sale of certain recovery contracts <sup>(6)</sup>	—	(579)	(382)	(2,428)
Gain on sale of land and buildings <sup>(7)</sup>	\$ (1,120)	\$ —	\$ (1,120)	\$ —
Adjusted EBITDA	\$ (275)	\$ 2,653	\$ (1,339)	\$ 6,888

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2022	2021	2022	2021
	(in thousands)		(in thousands)	
<b>Adjusted Net Income (Loss):</b>				
Net income (loss)	\$ (1,460)	\$ (1,691)	\$ (6,302)	\$ (7,652)
Stock-based compensation	931	540	2,212	1,963
Amortization of intangible assets <sup>(2)</sup>	—	72	—	689
Amortization of debt issuance costs <sup>(3)</sup>	23	1,320	71	2,453
Impairment of long-lived assets	—	—	—	636
Severance expenses <sup>(4)</sup>	10	380	189	1,876
Non-core operating expenses <sup>(5)</sup>	3	—	9	2,683
Gain on sale of certain recovery contracts <sup>(6)</sup>	—	(579)	(382)	(2,428)
Gain on sale of land and buildings <sup>(7)</sup>	(1,120)	—	(1,120)	—
Tax adjustments <sup>(8)</sup>	(42)	(690)	(269)	(2,165)
Adjusted net income (loss)	\$ (1,655)	\$ 127	\$ (5,592)	\$ (1,945)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2022	2021	2021	2021
	(in thousands)		(in thousands)	
<b>Adjusted Net Income (Loss) Per Diluted Share:</b>				
Net income (loss)	\$ (1,460)	\$ (1,691)	\$ (6,302)	\$ (7,652)
Plus: Adjustment items per reconciliation of adjusted net income (loss)	(195)	1,818	710	5,707
Adjusted net income (loss)	\$ (1,655)	\$ 127	\$ (5,592)	\$ (1,945)
Adjusted net income (loss) per diluted share	\$ (0.02)	\$ —	\$ (0.08)	\$ (0.03)
Diluted average shares outstanding <sup>(9)</sup>	74,021	67,948	72,480	57,512

<sup>(1)</sup> Represents interest expense and amortization of debt issuance costs related to our Credit Agreement and Prior Credit Agreement.

<sup>(2)</sup> Represents amortization of intangibles related to the acquisition of Performant by an affiliate of Parthenon Capital Partners in 2004.

<sup>(3)</sup> Represents amortization of debt issuance costs related to our Credit Agreement and Prior Credit Agreement.

<sup>(4)</sup> Represents severance expenses incurred in connection with a reduction in force for our non-healthcare recovery services.

<sup>(5)</sup> Represents professional fees related to strategic corporate development activities.

<sup>(6)</sup> Represents gain on the sale of certain non-healthcare recovery contracts.

<sup>(7)</sup> Represents gain on the sale of land and two office buildings.

<sup>(8)</sup> Represents tax adjustments assuming a marginal tax rate of 27.5% at full profitability.

<sup>(9)</sup> While net loss for the three months ended September 30, 2021 is \$(1,691), the computation of adjusted net income (loss) results in adjusted net income of \$127. Therefore, the calculation of the adjusted earnings per diluted share for the three months ended September 30, 2021 includes dilutive common share equivalents of 5,821 added to the basic weighted average shares of 62,127.

## Liquidity and Capital Resources

Our primary sources of liquidity are cash flows from operations, and cash and cash equivalents on hand. Cash and cash equivalents, which includes restricted cash and consists primarily of cash on deposit with banks, totaled \$25.7 million as of September 30, 2022 and \$19.6 million as of December 31, 2021. On December 17, 2021, we entered into the Credit Agreement with MUFG Union Bank, N.A. The Credit Agreement includes a \$20 million term loan commitment, which was fully advanced at closing, and a \$15 million revolving loan commitment, which remains undrawn as of September 30, 2022. A portion of the revolving loan commitment of up to \$2.5 million is available for the issuance of letters of credit.

Our ability to fund our business plans, capital expenditures 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, and the availability of cash and cash equivalents on hand and borrowings under our current Credit Agreement. Our current financial projections show that we expect to be able to maintain a level of cash flows from operating activities sufficient to permit us to fund our ongoing and planned business operations and to fund our other liquidity needs. If, however, we are required to obtain additional borrowings to fund our ongoing or future business operations, there can be no assurance that we will be successful in obtaining such additional borrowings or upon terms that are acceptable to us.

Our Credit Agreement contains, and any agreements to refinance our debt likely will contain, certain financial covenants, including the maintenance of minimum fixed charge coverage ratio and total debt to EBITDA ratio, as well as restrictive covenants that require us to 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. We are in compliance with our covenants under the Credit Agreement. However, conditions may change for a variety of reasons in the future that may affect our ability to maintain compliance with our financial or restrictive covenants. Our failure to comply with these financial covenants or the restrictive 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.

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

Cash used in operating activities was \$2.2 million for the nine months ended September 30, 2022, primarily as a result of changes in accrued salaries and benefits, and contract liabilities and other current liabilities during the period. Cash provided by operating activities was \$1.3 million for the nine months ended September 30, 2021, primarily as a result of changes in trade accounts receivable, offset by contract assets.

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

Cash provided by investing activities of \$3.1 million for the nine months ended September 30, 2022 primarily related to proceeds from the sale of land and buildings, offset by capital expenditures for information technology, data storage, hardware, telecommunication systems and security enhancements to our information technology systems. Cash used in investing activities for the nine months ended September 30, 2021 was \$0.5 million, which was used primarily for similar cash expenditure purposes as set forth above.

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

Cash provided by financing activities of \$5.2 million for the nine months ended September 30, 2022 was primarily attributable to \$5.6 million in proceeds from the exercise of warrants by ECMC, offset by \$0.4 million in repayments of notes payable. Cash used in financing activities for the nine months ended September 30, 2021 was \$33.5 million, primarily attributable to repayments of notes payable during the period.

### ***Restricted Cash***

As of September 30, 2022, restricted cash included in current assets on our consolidated balance sheet was \$0.1 million.

### ***Notes Payable***

On December 17, 2021, we entered into the Credit Agreement with MUFG Union Bank, N.A. The Credit Agreement includes a \$20 million term loan commitment, which was fully advanced at closing and a \$15 million revolving loan commitment, which remains undrawn as of September 30, 2022. A portion of the revolving loan commitment of up to \$2.5 million is available for the issuance of letters of credit. Subject to certain customary exceptions, the obligations under the Credit Agreement are, or will be, guaranteed by each of our existing and future, direct or indirect, domestic subsidiaries. Our obligations under the Credit Agreement are secured by liens on substantially all of our assets and each of our domestic subsidiaries that are guarantors under the Credit Agreement.

As of September 30, 2022, \$19.6 million was outstanding under the Credit Agreement. Our interest rate for outstanding borrowing under the Credit Agreement at September 30, 2022 was 5.3%.

The Credit Agreement matures on December 17, 2026. The proceeds from the term loan under the Credit Agreement were used, together with cash on hand, to refinance our credit agreement dated as of August 17, 2017, with ECMC Group, Inc. (as amended, the Prior Credit Agreement), and to pay fees and expenses in connection with the Credit Agreement.

Pursuant to the Credit Agreement, we are required to repay the aggregate outstanding principal amount of the term loan under the Credit Agreement in quarterly installments which commenced on March 31, 2022 in an amount that would result in amortization of (a) 2.5% of the term loan principal in the first full year following commencement of amortization, (b) 5.0% of the term loan principal in the second full year following commencement of amortization, (c) 7.5% of the term loan principal in each of the third and fourth full years following commencement of amortization, and (d) 10% of the term loan principal in the fifth full year (or portion thereof) following commencement of amortization. In addition, we must make mandatory prepayments of the term loan principal under the Credit Agreement with the net cash proceeds received in connection with certain specified events, including certain asset sales, casualty and condemnation events (subject to customary reinvestment rights). Any remaining outstanding principal balance of the term loan under the Credit Agreement is repayable on the maturity date. Amounts repaid or prepaid with respect to the term loan under the Credit Agreement cannot be reborrowed.

We may, at our option, prepay any revolving loan borrowings under the Credit Agreement, in whole or in part, at any time and from time to time without premium or penalty (except in certain circumstances). Borrowings of revolving loans under the Credit Agreement are also subject to mandatory prepayment in the event that outstanding borrowings and letter of credit usage exceed aggregate revolving loan commitments then in effect.

Under the Credit Agreement, loans generally may bear interest based on term SOFR (the secured overnight financing right) or an annual base rate, as applicable, plus an applicable margin based on our leverage ratio each quarter that may range between 2.50% per annum and 3.00% per annum, in the case of term SOFR loans and between 1.50% per annum and 2.00% per annum in the case of base rate loans. In addition, a commitment fee based on unused availability of the revolving credit facility is also payable which may vary from 0.30% per annum to 0.40% per annum, also based on our leverage ratio.

The Credit Agreement contains certain customary representations, warranties, and affirmative and negative covenants by us and our subsidiaries that restrict the Company's and its subsidiaries' ability to take certain actions, including: incurrence of indebtedness, creation of liens, making certain investments, mergers or consolidations, dispositions of assets, assignments, sales or transfers of equity in subsidiaries, repurchase or redemption of capital stock, entering into certain transactions with affiliates, or changing the nature of the Company's business. The Credit Agreement also contains two financial covenants, which require us to maintain, as of the last day of each fiscal quarter commencing with March 31, 2022, (a) a total leverage ratio of not greater than (i) 3.00 to 1.00 through September 30, 2022 and (ii) 2.50 to 1.00 thereafter and (b) a fixed charge coverage ratio of not less than 1.20 to 1.00. The obligations under the Credit Agreement may be accelerated or the commitments terminated upon the occurrence of events of default under the Credit Agreement, which include payment defaults, defaults in the performance of affirmative and negative covenants, the inaccuracy of representations or warranties, bankruptcy and insolvency related defaults, cross defaults to other material indebtedness, defaults arising in connection with changes in control, and other customary events of default.

As of September 30, 2022, we were in compliance with all financial covenants under the Credit Agreement.

Our obligations under the Credit Agreement are secured by substantially all of our subsidiaries' assets and are guaranteed by the Company and its subsidiaries, other than the borrowers.

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

We do not hold or issue financial instruments for trading purposes. We conduct all of our business in U.S. currency and therefore do not have any material direct foreign currency risk. We do have exposure to changes in interest rates with respect to the borrowings under our senior secured credit facility, which bear interest at a variable rate based on SOFR. For example, if the interest rate on our borrowings increased 100 basis points (1%) from the credit facility floor of 1.0%, our annual interest expense would increase by approximately \$0.2 million.

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

### **ITEM 4. DISCLOSURE CONTROLS AND PROCEDURES**

#### **Evaluation of Disclosure Controls and Procedures**

We maintain a system of disclosure controls and procedures that are designed to ensure that information required to be disclosed in the Company's reports under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to management, including our Chief Executive Officer and the Chief Accounting Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable, not absolute, assurance of achieving the desired control objectives. Our disclosure controls and procedures have been designed to meet reasonable assurance standards. Additionally, in designing disclosure controls and procedures, our management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures. The design of any disclosure controls and procedures also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

Management, with the participation of our Chief Executive Officer and our Chief Accounting Officer, has evaluated the effectiveness of our disclosure controls and procedures, as defined in Rule 13a-15(e) under the Exchange Act, as of the fiscal quarter covered by this Quarterly Report on Form 10-Q. Based on that evaluation, our Chief Executive Officer and Chief Accounting Officer concluded that our disclosure controls and procedures were functioning effectively at the reasonable assurance level as of September 30, 2022.

**Changes in Internal Control over Financial Reporting**

There was no change in our internal control over financial reporting during the quarter ended September 30, 2022, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## **PART II. OTHER INFORMATION**

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

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

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

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

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

*We typically face a long period to start up a new contract which may cause us to incur expenses before we receive revenues from new client or new contract 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 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, which can be a substantial period of time. Our clients may also experience delays in obtaining approvals or managing protests from unsuccessful bidders, or delays associated with technology or system implementations, such as the delays experienced with the implementation of our first RAC contract with CMS. We incur significant expenses associated with new contracts before we receive corresponding revenues under any such new contract, because we operate under a model in which we generally hire employees to provide services to a new client once a contract is signed and otherwise incur significant upfront implementation expenses. If we are not able to pay the upfront expenses for commencing new contracts out of cash from operations or availability of cash on hand or borrowings under our lending arrangements, we may be required to scale back our operations or alter our business plans to account for cash shortages, either of which could prevent us from earning future revenues under any such new client or contract engagements. Further, if we are not successful in maintaining contractual commitments after the expenses we incur during our typically long implementation cycle, our cash flows and results of operations could be adversely affected.

*Revenues generated from a limited number of our largest clients represent a substantial majority of our revenues. Any termination of or deterioration in our relationship with any of our significant clients would result in a decline in our revenues.*

We derive a substantial portion of our revenues from a limited number of our largest clients. Substantially all of our contracts (i) entitle our clients to unilaterally terminate their contractual relationship with us at any time without penalty and (ii) are subject to competitive procurement or renewal processes from time to time. For example, we were recently notified by CMS of a "request for quote" or contract renewal process related to our existing MSP CRC contract. Further, substantially all of our contracts allow our clients to unilaterally change the amount of work available to us. If one of our largest clients terminates any of our existing contracts, or chooses not to renew an existing contract in connection with a competitive procurement or renewal process, our revenues and results of operations may be materially harmed. Further, if one of our significant clients decides to limit the amount of claims that we are allowed to audit or 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, which would harm our business, financial condition and results of operations. Lastly, our revenues could be adversely affected if one of our significant clients is acquired by an entity that does not wish to continue to use our services.



***Many of our contracts with our clients 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.***

Many of our existing contracts enable our clients to terminate their contractual relationship with us at any time without penalty, potentially leading to loss of business or renegotiation of terms. Further, most of our contracts allow our clients to unilaterally change the amount of work available to us or the payment terms at any given time. In addition, many of our contracts are not exclusive, with our clients retaining multiple service providers with whom we must continue to compete for additional work. 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 work. For example, in March 2020, CMS paused medical review activities under our then current RAC contracts related to the COVID-19 pandemic, which were later resumed in August 2020. This pause in medical review activities under our RAC contracts had a negative impact on our 2020 and 2021 results of operations. If any of our clients modify terms of service, including the success fees we are able to earn, or any of these clients establish more favorable relationships with our competitors, our future revenues may be adversely affected.

***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. We currently hold five contracts with agencies of the U.S. federal government within our healthcare business. The continuation and exercise of renewal options on our U.S. federal government contracts and any new U.S. federal government contracts are, among other things, contingent upon succeeding within competitive bidding processes, changes in federal government spending, the availability of adequate funding for the applicable federal government agency, or other regulatory changes, such as the pause in activities under our RAC contracts in 2020 as a result of the COVID-19 pandemic, could adversely affect our financial performance. 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.

***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 overall healthcare spending in the U.S. and the volume of healthcare claims that we audit on behalf of our clients, which are both impacted by domestic and global economic conditions, rates of unemployment and similar factors, movements in interest rates, and changes in healthcare costs, governmental policies toward Medicare expenditures or the healthcare industry taken as a whole. Changes in the overall economy could lead to a reduction in overall recovery rates by our clients, which in turn could adversely affect our business, financial condition and results of operations. For example, our business and the businesses of our customers have been materially and adversely affected by recent inflationary trends and the impact of the COVID-19 pandemic which have caused, and are expected to continue to cause, a slowdown in global economic activity, which has resulted in a significant negative impact on our financial condition and results of operations. Political tensions resulting in economic instability, such as due to military activity or civil hostilities among Russia and Ukraine and the related response, including sanctions or other restrictive actions, by the United States and/or other countries, or other similar events, may have an adverse impact on our business, financial condition, and results of operations.

***We may not have sufficient cash flows from operations or availability of funds under our lending arrangements to fund our ongoing operations and our other liquidity needs, which could adversely affect our business and financial condition.***

Our ability to fund our business plans, capital expenditures 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 and the availability of cash on hand and borrowings under our existing lending facility. We cannot make assurances that we will maintain a level of cash flows from operating activities sufficient to permit us to fund our ongoing and planned business operations and to fund our other liquidity needs. If we are required to obtain borrowings to fund our ongoing or future business operations, there can be no assurance that we will be successful in obtaining such borrowings or upon terms that are acceptable to us. While we believe our financial projections are attainable, there can be no assurances that our financial results will be recognized in a timeframe necessary to meet our ongoing cash requirements. If our cash flows and capital resources are insufficient to fund our planned business operations or to fund our other liquidity needs, we may be forced to reduce or delay capital expenditures, alter our business plans, curtail the services we provide to our current or future clients, sell assets or operations, seek additional capital or restructure or refinance our indebtedness, any of which could have an adverse effect on our financial condition and results of operations.

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

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

***Our ability to derive revenues under our current healthcare contracts will depend in part on the number and types of potentially improper claims that we are allowed to audit or otherwise pursue by our clients, 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.***

Our revenues under our current healthcare contracts depend in part on the number and types of potentially improper claims that we are allowed to audit or otherwise pursue on behalf of our clients. For example, under CMS's Medicare recovery audit program, RAC contractors have not been permitted to seek the recovery of an improper claim unless that particular type of claim has been pre-approved by CMS to ensure compliance with applicable Medicare payment policies, as well as national and local coverage determinations. As work under the first RAC contract progressed, CMS placed increasing restrictions on the scope of audits permitted by RAC contractors and these restrictions have not been relaxed under our current RAC contracts. Accordingly, the long-term growth of revenues we derive under our two existing RAC contracts, or any additional contracts we may enter into with CMS, will depend on the scope of improper claims that CMS allows us to pursue and our ability to successfully identify improper claims within the permitted scope.

In addition, our commercial healthcare clients also have the ability to unilaterally restrict or expand the type and volume of claims we are allowed to audit or otherwise provide services. Any future limitations on the type or volume of claims that we are permitted to audit or otherwise review on behalf of our clients in the healthcare market could have a material negative impact on 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 face significant competition in connection with obtaining, retaining and performing under our client contracts, and an inability to compete effectively in the future could harm our relationships with our clients, which would impact our ability to maintain our revenues and operating results.***

We operate in highly competitive markets and face significant competition from other companies in providing our services and sourcing contracts with new clients or new contracts with existing clients. Accordingly, maintaining high levels of service under our contracts, and doing so in a cost-effective manner, are important factors in our ability to maintain existing contracts and obtain new contracts and grow our revenues and net income. Any failure to achieve these objectives could result in the loss of existing contractual relationships either by a client's decision to terminate existing contractual relationship or in connection with a competitive contract re-bidding process, or the inability to obtain new client contracts, any of which could harm our business, financial condition and results of operations. Some of our current and potential competitors in the markets in which we operate may have greater financial, marketing, technological or other resources than we do. The ability of any of our competitors and potential competitors to adopt new and effective technology to better serve our markets may allow them to gain market strength. Increasing levels of competition in the future could result in lower fees, lower volumes of contracted 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 novel coronavirus (COVID-19) pandemic has had and may continue to have a material adverse impact on our business, results of operations and financial condition, as well as on the operations and financial performance of many of our customers. We are unable to predict the extent to which the prolonged duration of COVID-19 pandemic as well as any new coronavirus variants, and associated impacts will continue to adversely impact our business, results of operations, and financial condition.***

Our business and the businesses of our customers have been and may continue to be materially and adversely affected by the impact of the COVID-19 pandemic that has caused, and may continue to cause, the global slowdown in economic activity. Because the severity, magnitude and duration of the COVID-19 pandemic and its economic consequences are uncertain, rapidly changing and difficult to predict, the COVID-19 pandemic's impact on our operations and financial performance, as well as its impact on our ability to successfully execute our business strategies and initiatives, remains uncertain and difficult to predict. Further, the ultimate impact of the COVID-19 pandemic on our operations and financial performance depends on many factors that are not within our control, including, but not limited to: governmental and business actions that have been and continue to be taken in response to the pandemic; the impact of the COVID-19 pandemic and actions taken in response on global and regional economies and economic activity; the availability of federal, state or local funding programs; general economic uncertainty and financial market volatility; global economic conditions and levels of economic growth; and the pace of economic recovery when the COVID-19 pandemic subsides.

Given the economic hardships caused as a result of the COVID-19 pandemic, certain of our customers have chosen and may continue to choose to delay the services that we provide, and additional customers may choose to similarly delay the audit and recovery services that we provide, either of which could have a material negative impact on our revenues and results of operations. In addition, the COVID-19 pandemic has also had a negative impact on overall hospital utilization rates in the United States. This negative impact on overall hospital utilization rates has caused delays with the healthcare industry as a whole, which in turn has had a negative impact on our healthcare business. Any additional disruptions to the services that we provide to our customers as a result of the COVID-19 pandemic or otherwise could result in a negative impact on our revenues and results of operations.

Further, a prolonged period of generating lower cash flows from operations as a result of the COVID-19 pandemic could adversely affect our financial condition and the achievement of our strategic objectives. Conditions in the financial and credit markets may also limit the availability of funding or increase the cost of funding, which could adversely affect our business, financial position and results of operations. While we believe our financial projections are attainable, there can be no assurances that our financial results will be recognized in a timeframe necessary to meet our ongoing cash requirements.

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

Our ability to make scheduled payments under our Credit Agreement 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, such as the recent global economic downturn as the result of the COVID-19 pandemic. 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, alter our business plans, curtail the services we provide to our current or future clients, 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 with MUFG Union Bank. 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, and foreclose against the assets securing our borrowings and we could be forced into bankruptcy or liquidation.

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

***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, but are not limited to, the following:

- the schedules of government agencies for awarding contracts;
- our ability to maintain contractual commitments after the expenses we incur during our typically long implementation cycle for new customer contracts;
- our ability to successfully identify improper Medicare claims and the number and type of potentially improper claims that CMS authorizes us to pursue under our RAC contacts;
- our ability to continue to generate revenues under our private healthcare contracts;
- 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.

***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, global health crises, 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 services to current or potential clients may be reduced, and we may incur significant liabilities.***

Our 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 services, or result in termination of contracts with those clients affected by any such breach, regulatory action, and claims against us.

Our business is increasingly dependent on critical, complex, and interdependent information technology (IT) systems, including internet-based systems, some of which are managed or hosted by third parties, to support business processes as well as internal and external communications. The size and complexity of our IT systems make us potentially vulnerable to IT system breakdowns, malicious intrusion, and computer viruses, which may result in the impairment of our ability to operate our business effectively. In addition, having a significant portion of our employees work remotely due to the COVID-19 pandemic can strain our information technology infrastructure, which may affect our ability to operate effectively, may make us more susceptible to communications disruptions, and expose us to greater cybersecurity risks.

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.

***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.

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

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

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

The success of our business depends in part upon our proprietary technology platform. We rely on a combination of copyright, trademark, and trade secret laws, as well as on confidentiality procedures and non-compete agreements, to establish and protect our proprietary technology rights. The steps we have taken to deter misappropriation of our proprietary technology may be insufficient to protect our proprietary information. In particular, we may not be able to protect our trade secrets, know-how and other proprietary information adequately. Although we use reasonable efforts to protect this proprietary information and technology, our employees, consultants and other parties may unintentionally or willfully disclose our information or technology to competitors. Enforcing a claim that a third party illegally obtained and is using any of our proprietary information or technology is expensive and time consuming, and the outcome is unpredictable. We rely, in part, on nondisclosure, confidentiality and invention assignment agreements with our employees, consultants and other parties to protect our trade secrets, know-how and other intellectual property and proprietary information. These agreements may not be self-executing, or they may be breached, and we may not have adequate remedies for such breach. Moreover, third parties may independently develop similar or equivalent proprietary information or otherwise gain access to our trade secrets, know-how and other proprietary information. Any infringement, misappropriation or other violation of our patents, trademarks, copyrights, trade secrets, or other intellectual property rights could adversely affect any competitive advantage we currently derive or may derive from our proprietary technology platform and we may incur significant costs associated with litigation that may be necessary to enforce our intellectual property rights.

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

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

## **Risks Related to Regulations and Legislation**

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

The markets in which we operate are highly regulated, and any future changes in the regulatory landscape could have a material effect on our business and financial condition. For example, the Medicare program, is a subject of significant legislative and regulatory focus, and we cannot anticipate how future changes in government policy may affect our business and operations. 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.

### ***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.***

As a public company, we are subject to the reporting requirements of the Securities Exchange Act of 1934, or the Exchange Act, the Sarbanes-Oxley Act of 2002, or the Sarbanes-Oxley Act, the Dodd-Frank Act and other applicable securities rules and regulations. In particular, 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. In addition, commencing in fiscal year 2021, we were required to adhere to the auditor attestation requirements with respect to the to the effectiveness of our internal control over financial reporting under Section 404 of the Sarbanes-Oxley Act. Compliance with such auditor attestation requirements has resulted in significant increases in both the time devoted to and the expenses incurred in connection with our financial reporting obligations. Our management may conclude that our internal control over our financial reporting is not effective. 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 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 (HIPAA), as amended, and related state laws subject us to substantial restrictions and requirements with respect to the use and disclosure of the personal health information that we obtain in connection with our contracts with CMS and we must establish administrative, physical and technical safeguards to protect the confidentiality of this information. Similar protections extend to the type of personal financial and other information we acquire from our student loan, state tax and federal receivables clients. We are required to notify affected individuals and government agencies of data security breaches involving protected health and certain personally identifiable information. These laws and regulations also require that we develop, implement and maintain written, comprehensive information security programs containing safeguards that are appropriate to protect personally identifiable information or health information against unauthorized access, misuse, destruction or modification. Federal law generally does not preempt state law in the area of protection of personal information, and as a result we must also comply with state laws and regulations. Regulation of privacy, data use and security require that we incur significant expenses, which could increase in the future as a result of additional regulations, all of which adversely affects our results of operations. Failure to comply with these laws and regulations can result in penalties and in some cases expose us to civil lawsuits.

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

Our student loan recovery business is subject to regulation and oversight by various state and federal agencies, particularly in the area of consumer protection. The Fair Debt Collection Practices Act (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 (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 are also subject to regulations promulgated by the United States Consumer Financial Protection Bureau (CFPB), which, among other things, establishes 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.

### **Risks Related to our Common Stock**

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

Since our initial public offering in August 2012, the price of our common stock, as reported by NASDAQ Global Select Market, has ranged from a low sales price of \$0.54 on June 1, 2020 to a high sales price of \$14.09 on March 4, 2013. The trading price of our common stock may be significantly affected by various factors, including: quarterly fluctuations in our operating results; the financial projections we may provide to the public, any changes in those projections or our failure to meet those projections; changes in investors' and analysts' perception of the business risks and conditions of our business; our ability to meet the earnings estimates and other performance expectations of financial analysts or investors; unfavorable commentary or downgrades of our stock by equity research analysts; changes in our capital structure, such as future issuances of debt or equity securities; our success or failure to obtain new contract awards; lawsuits threatened or filed against us; strategic actions by us or our competitors, such as acquisitions or restructurings; new legislation or regulatory actions; changes in our relationship with any of our significant clients; fluctuations in the stock prices of our peer companies or in stock markets in general; and general economic conditions.

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

Prescott Group Management, L.L.C. and Mill Road Capital Management LLC beneficially owned approximately 20.8% and 4.8% of our common stock, respectively, as of September 30, 2022. As a result of their ownership, these significant stockholders have the ability to influence the outcome of matters submitted to a vote of stockholders and, through our board of directors, the ability to influence decision making with respect to our business direction and policies. Mill Road Capital Management LLC currently has a representative sitting on our Board of Directors. These significant stockholders may have interests different from our other stockholders' interests and may vote in a manner adverse to those interests. Matters over which these significant stockholders can, directly or indirectly, exercise influence include:

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



In addition, even though Parthenon Capital Partners does not currently have a representative sitting on our Board of Directors, Parthenon Capital Partners does have a contractual right to designate a number of directors proportionate to its stock ownership if and when Parthenon owns greater than 10% of our common stock. 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.

## **General Risks**

***We may undertake strategic transactions or other corporate restructuring that prove unsuccessful, strain or divert our resources and harm our results of operations and stock price.***

We may consider strategic transactions or other corporate restructurings that could include the acquisition of other companies in our industry or in new markets, or the sale or divestiture of, or the wind down of existing portions of our business. We may not be able to successfully complete any such strategic transaction and, if completed, any such acquisition or divestiture 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, the amortization expenses related to intangible assets, and the potential impairment charges related to intangible assets or goodwill, all of which could adversely affect our results of operations and stock price. Further, despite any projected cost savings related to any proposed divestiture or wind down of any existing portion of our business, any such divestiture or wind down could result in an adverse effect on our revenues and results of operations.

***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.

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

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

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

**None.**

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

**None.**

**ITEM 4. MINE SAFETY DISCLOSURES**

**Not Applicable.**

**ITEM 5. OTHER INFORMATION**

**None.**

## ITEM 6. EXHIBITS

### (A) Exhibits:

Exhibit No.	Description
31.1	<a href="#">Certification of the Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a)</a>
31.2	<a href="#">Certification of the Principal Financial Officer pursuant to Rule 13a-14(a)/15d-14(a)</a>
32.1 <sup>(1)</sup>	<a href="#">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</a>
32.2 <sup>(1)</sup>	<a href="#">Certification of the Principal Financial Officer pursuant to 18 USC Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</a>
101.INS <sup>(2)</sup>	XBRL Instance Document
101.SCH <sup>(2)</sup>	XBRL Taxonomy Extension Scheme
101.CAL <sup>(2)</sup>	XBRL Taxonomy Extension Calculation Linkbase
101.DEF <sup>(2)</sup>	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB <sup>(2)</sup>	XBRL Taxonomy Extension Label Linkbase
101.PRE <sup>(2)</sup>	XBRL Taxonomy Extension Presentation Linkbase
104	Cover Page Interactive Data File (formatted as Inline XBRL and contained in Exhibit 101).

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<sup>(1)</sup> 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.

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



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

I, Lisa Im, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Performant Financial Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 9, 2022

/s/ Lisa Im

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Lisa Im

Chief Executive Officer

## CERTIFICATION

I, Ian Johnston, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Performant Financial Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 9, 2022

/s/ Ian Johnston

**Ian Johnston**

**Vice President and Chief Accounting Officer (Principal Financial Officer)**

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

I, Lisa Im, Chief Executive Officer of Performant Financial Corporation, do hereby certify to the best of my knowledge, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report of Performant Financial Corporation on Form 10-Q for the quarter ended September 30, 2022 to which this certification is attached fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Quarterly Report on Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of Performant Financial Corporation.

Date: November 9, 2022

By:           /s/ Lisa Im            
      **Lisa Im**  
      **Chief Executive Officer**

**CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

I, Ian Johnston, Vice President and Chief Accounting Officer (Principal Financial Officer) of Performant Financial Corporation, do hereby certify to the best of my knowledge, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report of Performant Financial Corporation on Form 10-Q for the quarter ended September 30, 2022 to which this certification is attached fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Quarterly Report on Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of Performant Financial Corporation.

Date: November 9, 2022

By:

/s/ Ian Johnston

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**Ian Johnston**

**Vice President and Chief Accounting Officer (Principal  
Financial Officer)**