TRIO-TECH INTERNATIONAL
Form 10-K/A
September 30, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K/A
Amendment No. 1

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

For the fiscal year ended June 30, 2016

OR

o 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 1-14523

TRIO-TECH INTERNATIONAL
(Exact name of Registrant as specified in its Charter)

California (State or other jurisdiction of incorporation or organization)	95-2086631 (I.R.S. Employer Identification Number)
16139 Wyandotte Street Van Nuys, California (Address of principal executive offices)	91406 (Zip Code)

Registrant's Telephone Number: 818-787-7000

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

Title of each class	Name of each exchange On which registered
Common Stock, no par value	The NYSE MKT

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in rule 405 of the Securities Act. o Yes þNo

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. oYes þ No

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405) is not contained herein, and will not be contained, to the best of Registrant's knowledge, in a definitive proxy statement or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. þ

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one): Large Accelerated Filer o Accelerated File o Non-Accelerated Filer (Do not check if a smaller reporting company o Smaller Reporting Company þ

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). o Yes þNo

The aggregate market value of voting stock held by non-affiliates of Registrant, based upon the closing price of $2.79 for shares of the registrant's Common Stock on December 31, 2015, the last business day of the registrant's most recently completed second fiscal quarter as reported by the NYSE MKT, was approximately $5,570,000. In calculating such aggregate market value, shares of Common Stock held by each officer, director and holder of 5% or more of the outstanding Common Stock (including shares with respect to which a holder has the right to acquire beneficial ownership within 60 days) were excluded because such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

The number of shares of Common Stock outstanding as of September 1, 2016 was 3,513,055.

Documents Incorporated by Reference

Part III of this Form 10-K incorporates by reference information from Registrant's Proxy Statement for its 2016 Annual Meeting of Shareholders to be filed with the Commission under Regulation 14A within 120 days of the end of the fiscal year covered by this Form 10-K.

EXPLANATORY NOTE

The purpose of this Amendment No. 1 of Form 10–K/A to Trio-Tech International's Annual Report on Form 10–K for the period ended June 30, 2016, which was timely filed with the Securities and Exchange Commission on September 28, 2016 (the "Form 10–K"), is solely to correct typographical errors in the dates on (a) the signature pages of the Form 10-K, (b) the Report of Independent Registered Public Accounting Firm and (c) the Consent of Independent Registered Accounting Firm attached as Exhibit 23.1 to Form 10-K. As required by Rule 12b-15 promulgated under the Securities Exchange Act of 1934, as amended, Trio-Tech International has furnished new certifications which appear in Exhibits 31.1, 31.2 and 32.

Other than those mentioned above, there are no other changes made to the Form 10–K for the period ended 30 June 2016. This Amendment No. 1 speaks as of the original filing date of the Form 10–K, does not reflect events that may have occurred subsequent to the original filing date and does not modify or update in any way disclosures made in the original Form 10–K except to correct the dates noted above.

TRIO-TECH INTERNATIONAL

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TRIO-TECH INTERNATIONAL

PART I

ITEM 1 – BUSINESS (IN THOUSANDS, EXCEPT PERCENTAGES AND SHARE AMOUNTS)

Cautionary Statement Regarding Forward-Looking Statements

The discussions of Trio-Tech International's (the "Company") business and activities set forth in this Form 10-K and in other past and future reports and announcements by the Company may contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and assumptions regarding future activities and results of operations of the Company. In light of the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995, the following factors, among others, could cause actual results to differ materially from those reflected in any forward-looking statements made by or on behalf of the Company: market acceptance of Company products and services; changing business conditions or technologies and volatility in the semiconductor industry, which could affect demand for the Company's products and services; the impact of competition; problems with technology; product development schedules; delivery schedules; changes in military or commercial testing specifications which could affect the market for the Company's products and services; difficulties in profitably integrating acquired businesses, if any, into the Company; risks associated with conducting business internationally and especially in Southeast Asia, including currency fluctuations and devaluation, currency restrictions, local laws and restrictions and possible social, political and economic instability; credit risks in the Chinese real estate industry; changes in macroeconomic conditions and credit market conditions; and other economic, financial and regulatory factors beyond the Company's control. In some cases, you can identify forward-looking statements by the use of terminology such as "may," "will," "expects," "plans," "anticipates," "estima "potential," "believes," "can impact," "continue," or the negative thereof or other comparable terminology.

Unless otherwise required by law, the Company undertakes no obligation to update forward-looking statements to reflect subsequent events, changed circumstances, or the occurrence of unanticipated events. You are cautioned not to place undue reliance on such forward-looking statements.

General

Trio-Tech International was incorporated in 1958 under the laws of the State of California. As used herein, the term "Trio-Tech" or "Company" or "we" or "us" or "Registrant" includes Trio-Tech International and its subsidiaries unless the context otherwise indicates. The mailing address and executive offices are located at 16139 Wyandotte Street, Van Nuys, California 91406, and the telephone number is (818) 787-7000.

During fiscal year 2016, the Company operated its business in four segments: manufacturing, testing services, distribution and real estate. Geographically, the Company operates in the U.S., Singapore, Malaysia, Thailand and China. It operates six testing service facilities; one in the United States and five in Southeast Asia. It operates two manufacturing facilities: one in the United States and the other in Southeast Asia. Its distribution segment and real estate segment operate primarily in Southeast Asia. Its major customers are concentrated in Southeast Asia and they are either semiconductor chip manufacturers or testing facilities that purchase testing equipment. For information relating to revenues, profit and loss and total assets for each of the segments, see Note 19 - Business Segments contained in the consolidated financial statements included in this Form 10-K.

Company History – Certain Highlights for Fiscal Year 2016

2011	SHI International Pte. Ltd. achieved ISO 9001:2008 certification. Universal (Far East) Pte. Ltd. Singapore re-certified to ISO 9001:2008 standards. Trio-Tech (Tianjin) Co., Ltd. certified for ISO/TS 16949:2009 standards.
2012	Trio-Tech (Tianjin) Co., Ltd. acquired TS16949 certification.
2013	Trio-Tech International Pte. Ltd., Singapore, Trio-Tech (Malaysia) Sdn. Bhd., Trio-Tech (Suzhou) Co., Ltd. Trio-Tech (Bangkok) Co., Ltd. and Trio-Tech (Tianjin) Co., Ltd. re-certified to ISO 9001:2008 standards. Trio-Tech International Pte. Ltd., Singapore, re-certified to ISO 14001:2004 standards. Trio-Tech Malaysia (Malaysia) Sdn. Bhd. achieved ISO/TS16949 LOC certification. Trio-Tech Tianjin Co., Ltd. re-certified to ISO/TS16949 LOC certification. Trio-Tech International Pte. Ltd., Singapore, re-certified to biz SAFE Level 3 Workplace Safety and Health standards.
2014	Trio-Tech International Pte. Ltd., Singapore, re-certified to ISO 17025:2005 standards. Universal (Far East) Pte. Ltd. Singapore re-certified to ISO 9001:2008 standards.
2015	Trio-Tech (Tianjin) Co., Ltd., re-certified to ISO 9001:2008 standards. Trio-Tech International Pte. Ltd., Singapore, Trio-Tech (Malaysia) Sdn. Bhd. and Trio-Tech (Bangkok) Co., Ltd. re-certified to ISO 9001:2008 standards. (Aug 2015) Trio-Tech International Pte. Ltd., Singapore, re-certified to ISO 14001:2004 standards. (Aug 2015)
2016	Trio-Tech (Tianjin) Co., Ltd., re-certified to ISO 14001:2004 standards. (July 2016) Trio-Tech (Tianjin) Co., Ltd., re-certified to OHSAS 18001:2007 standards. (July 2016)

Overall Business Strategies

Our core business is and historically has been in the semiconductor industry (testing services, manufacturing and distribution). Revenue from this industry accounted for 99.6% of our revenue for the fiscal year 2016 as compared to 99.5% in fiscal year 2015. The semiconductor industry has experienced periods of rapid growth, but has also experienced downturns, often in connection with, or in anticipation of, maturing product cycles of both semiconductor companies' and their customers' products and declines in general economic conditions. To reduce our risks associated with sole industry focus and customer concentration, the Company expanded its business into the real estate investment and oil and gas equipment fabrication businesses in 2007 and 2009, respectively. Real Estate segment contributed only 0.4% to the total revenue and has been insignificant since the property market in China has slowed down due to control measures in China. However, we are in the process of winding-up the oil & gas equipment fabrication operations, which discontinued its operations in December 2012.

To achieve our strategic plan for our semiconductor business, we believe that we must pursue and win new business in the following areas:

Primary markets – Capturing additional market share within our primary markets by offering superior products and services to address the needs of our major customers.

Growing markets – Expanding our geographic reach in areas of the world with significant growth potential.

New markets – Developing new products and technologies that serve wholly new markets.

Complementary strategic relationships – Through complementary acquisitions or similar arrangements, we believe we can expand our markets and strengthen our competitive position. As part of our growth strategy, the Company continues to selectively assess opportunities to develop strategic relationships, including acquisitions, investments and joint development projects with key partners and other businesses.

Business Segments

Testing Services

Our testing services are rendered to manufacturers and purchasers of semiconductors and other entities who either lack testing capabilities or whose in-house screening facilities are insufficient for testing devices in order for them to make sure that these products meet certain commercial specifications. Customers outsource their test services either to accommodate fluctuations in output or to benefit from economies that can be offered by third party service providers.

Our laboratories perform a variety of tests, including stabilization bake, thermal shock, temperature cycling, mechanical shock, constant acceleration, gross and fine leak tests, electrical testing, microprocessor equipment contract cleaning services, static and dynamic burn-in tests, reliability lab services and vibration testing. We also perform qualification testing, consisting of intense tests conducted on small samples of output from manufacturers who require qualification of their processes and devices.

We use our own proprietary equipment for certain burn-in, centrifugal and leak tests, and commercially available equipment for various other environmental tests. We conduct the majority of our testing operations in Southeast Asia with facilities in Singapore, Malaysia, Thailand and China, which have been certified to the relevant ISO quality management standards.

Manufacturing

We manufacture both front-end and back-end semiconductor test equipment and related peripherals at our facilities in Singapore and the United States.

Front-End Products

Artic Temperature Controlled Wafer Chucks

Artic Temperature Controlled Wafer Chucks are used for test, characterization and failure analysis of semiconductor wafers and such other components at accurately controlled cold and hot temperatures. These systems provide excellent performance to meet the most demanding customer applications. Several unique mechanical design features provide excellent mechanical stability under high probing forces and across temperature ranges.

Wet Process Stations

Wet Process Stations are used for cleaning, rinsing and drying semiconductor wafers, flat panel display magnetic disks, and other microelectronic substrates. After the etching or deposition of integrated circuits, wafers are typically sent through a series of 100 to 300 additional processing steps. At many of these processing steps, the wafer is washed and dried using Wet Process Stations.

Back-End Products

Autoclaves and HAST (Highly Accelerated Stress Test) Equipment

We manufacture autoclaves, HAST systems and specialized test fixtures. Autoclaves provide pressurized, saturated vapor (100% relative humidity) test environments for fast and easy monitoring of integrated circuit manufacturing processes. HAST systems provide a fast and cost-effective alternative to conventional non-pressurized temperature and humidity testing.

Burn-in Equipment and Boards

We manufacture burn-in systems, burn-in boards and burn-in board test systems. Burn-in equipment is used to subject semiconductor devices to elevated temperatures while testing them electrically to identify early product failures and to assure long-term reliability. Burn-in boards are used to mount devices during high temperature environmental stressing tests.

We provide integrated burn-in automation solutions to improve products' yield, reduce processing downtime and improve efficiency. In addition, we develop a cooling solution, which is used to cool or maintain the temperature of high power heat dissipation semiconductor devices.

Component Centrifuges and Leak Detection Equipment

We manufacture centrifuges that perform high speed constant acceleration to test the mechanical integrity of ceramic and other hermetically sealed semiconductor devices and electronic parts for high reliability and aerospace applications. Leak detection equipment is designed to detect leaks in hermetic packaging. The bubble tester is used for gross leak detection. A visual bubble trail will indicate when a device is defective.

Distribution

In addition to marketing our proprietary products, we distribute complementary products made by manufacturers mainly from the United States, Europe, Taiwan and Japan. The products include environmental chambers, handlers, interface systems, vibration systems, shaker systems, solderability testers and other semiconductor equipment. Besides equipment, we also distribute a wide range of components such as connectors, sockets, LCD display panels and touch-screen panels. Furthermore, our range of products are mainly targeted for industrial products rather than consumer products whereby the life cycle of the industrial products can last from 3 years to 7 years.

Real Estate

Beginning in 2007, TTI has invested in real estate property in Chongqing, China, which has generated investment income from the rental revenue from real estate we purchased in Chongqing, China, and investment returns from deemed loan receivables, which are classified as other income. The rental income is generated from the rental properties in MaoYe and FuLi in Chongqing, China. In the second quarter of fiscal 2015, the investment in JiaSheng, which was deemed as loans receivable, was transferred to down payment for purchase of investment property in China.

Product Research and Development

We focus our research and development activities on improving and enhancing both product design and process technology. We conduct product and system research and development activities for our products in Singapore and the United States. Research and development expenses were $200 and $182 in fiscal year 2016 and 2015, respectively. Our Singapore operations increased their research and development expenses in fiscal year 2016, due to an increase in payroll related expenses.

Marketing, Distribution and Services

We market our products and services worldwide, directly and through independent sales representatives and our own marketing sales team. We have approximately five independent sales representatives operating in the United States and another twenty in various foreign countries. Of the twenty-five sales representatives, eight are representing the distribution segment and seventeen are representing the testing services segment and the manufacturing segment for various products and services produced and provided from our facilities in different locations.

Dependence on Limited Number of Customers

In fiscal years 2016 and 2015, combined sales of equipment and services to our three largest customers accounted for approximately 69.8% and 72.2%, respectively, of our total net revenue. Of those sales, $20,862 (60.6%) and $21,503 (63.4%) were from one major customer. Although the major customer is a U.S. company, the revenue generated from it was from facilities located outside of the U.S. The majority of our sales and services in fiscal years 2016 and 2015 were to customers outside of the United States.

Backlog

The following table sets forth the Company's backlog at the dates indicated:

	For the Year Ended June 30,	
	2016	2015
Manufacturing backlog	$3,657	$3,323
Testing services backlog	818	721
Distribution backlog	1,292	1,021
Real estate backlog*	537	103
	$6,304	$5,168

*Real estate backlog is based on the rental income from a non-cancellable lease.

Based on our past experience, we do not anticipate any significant cancellations or re-negotiation of sales. The purchase orders for the manufacturing, testing services and distribution businesses generally require delivery within 12 months from the date of the purchase order and certain costs are incurred before delivery. In the event of a cancellation of a confirmed purchase order, we require our customers to reimburse us for all costs incurred. We do not anticipate any difficulties in meeting delivery schedules. The backlog is based on estimates provided by our customers and is not based on customer's purchase order as it is a practice that the purchase orders are provided only during the process of delivery.

Materials and Supplies

Our products are designed by our engineers and are assembled and tested at our facilities in the United States, China and Singapore. We purchase all parts and certain components from outside vendors for assembly purposes. We have no written contracts with any of our key suppliers. As these parts and components are available from a variety of sources, we believe that the loss of any one of our suppliers would not have a material adverse effect on our results of operations taken as a whole.

Competition

Our ability to compete depends on our ability to develop, introduce and sell new products or enhanced versions of existing products on a timely basis and at competitive prices, while reducing our costs.

There are numerous testing laboratories in the areas where we operate that perform a range of testing services similar to those offered. However, due to severe competition in the Southeast Asia testing and burn-in services industry there has been a reduction in the total number of competitors. The existence of competing laboratories and the purchase of testing equipment by semiconductor manufacturers and users are potential threats to our future testing services revenue and earnings. Although these laboratories and new competitors may challenge us at any time, we believe that other factors, including reputation, long service history and strong customer relationships, are instrumental in determining our position in the market.

The distribution segment sells a wide range of equipment to be used for testing products. As the semiconductor equipment industry is highly competitive, we offer a one-stop service alternative to customers by complementing our products with design consultancy and other value-added services.

The principal competitive factors in the manufacturing industry include product performance, reliability, service and technical support, product improvements, price, established relationships with customers and product familiarity. We make every effort to compete favorably with respect to each of these factors. Although we have competitors for our various products, we believe that our products compete favorably with respect to each of the above factors. We have been in business for more than 58 years and have operation facilities mostly located in Southeast Asia. Those factors combined have helped us to establish and nurture long-term relationships with customers and will allow us to continue doing business with our existing customers upon their relocation to other regions where we have a local presence or are able to reach.

Patents

In fiscal years 2016 and 2015, we did not register any patents within the U.S.

It is typical in the semiconductor industry to receive notices from time to time alleging infringement of patents or other intellectual property rights of others. We do not believe that we infringe on the intellectual property rights of any others. However, should any claims be brought against us, the cost of litigating such claims and any damages

could materially and adversely affect our business, financial condition, and results of operations.

Employees

As of June 30, 2016, we had approximately 629 full time employees and no part time employees. Geographically, approximately 10 full time employees were located in the United States and approximately 619 full time employees in Southeast Asia. None of our employees are represented by a labor union.

There were approximately 54 employees in the manufacturing segment, 536 employees in the testing services segment, 4 employees in the distribution segment, 3 employees in the real estate segment and 32 employees in general administration, logistics and others.

ITEM 1A – RISK FACTORS

As a smaller reporting company as defined by Rule 12b-2 of the Securities Exchange Act of 1934, we are not required to provide the information required by this item.

ITEM 1B – UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 2 – PROPERTIES

As of the date of filing of this Form 10-K, we believe that we are utilizing approximately 82% of our fixed property capacity. We also believe that our existing facilities are adequate and suitable to cover any sudden increase in our needs in the foreseeable future.

The following table presents the relevant information regarding the location and general character of our principal manufacturing and testing facilities:

Location	Segment	Approx. Sq. Ft. Occupied	Owned (O) or Leased (L) & Expiration Date
16139 Wyandotte Street, Van Nuys, CA 91406, United States of America	Corporate Testing Services/ Manufacturing	5,200	(L) Mar.
1004, Toa Payoh North, Singapore Unit No. HEX 07-01/07,	Testing Services	6,864	(L) Sept.
Unit No. HEX 07-01/07, (ancillary site)	Testing Services	2,605	

We are also subject to the Fair Credit Reporting Act, or FCRA, which regulates consumer credit report
which may impose liability on us to the extent that the adverse credit information reported on a consur
credit bureau is false or inaccurate. State law, to the extent it is not preempted by the FCRA, may also
restrictions or liability on us with respect to reporting adverse credit information. Our compliance efforts
initial and ongoing training of employees working with consumer credit reports, monitoring of performan
periodic review and risk assessments. Violations of FCRA, which are deemed to be unfair or deceptive act
the Federal Trade Commission Act, are enforced by the FTC or by a private action by an individual c
Civil actions by consumers may seek damages per violation, with punitive damages, attorneys fees and co
recoverable. Under the Federal Trade Commission Act, penalties for engaging in unfair or deceptive acts
punished by fines for each vi

State Law Compliance and Security Breach Re

Many states impose an obligation on any entity that holds personally identifiable information o
information to adopt appropriate security to protect such data against unauthorized access, misuse, destruc
modification. Many states have enacted laws requiring holders of personal information to take certain ac
response to data breach incidents, such as providing prompt notification of the breach to affected individu
government authorities. In many cases, these laws are limited to electronic data, but states are incre
enacting or considering stricter and broader requirements. Massachusetts has enacted a regulation that r
any entity that holds, transmits or collects certain personal information about its residents to adopt a writ
security plan meeting the requirements set forth in the statute. We have implemented and maintain pl
technical and administrative safeguards intended to protect all personal data and have processes in place t
us in complying with applicable laws and regulations regarding the protection of this data and p

responding to any security incidents. We have adopted a system security plan and security breach i
response plans to address our compliance with thes

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Intellectual Pr

Our intellectual property is a significant component of our business, most notably the intellectual p underlying our proprietary technology-enabled services platform through which we provide our defaulte recovery and other services. To protect our intellectual property, we rely on a combination of inte property rights, including patents, trade secrets, trademarks and copyrights. We also utilize cus confidentiality and other contractual protections, including employee and third-party confidential invention assignment agre

As of December 31, 2012, we have two U.S. patents, both covering aspects of the workflow mana systems and methods incorporated into our technology-enabled services platform. These patents will ex December 2019. We routinely assess appropriate occasions for seeking additional patent protection fo aspects of our platform and other technologies that we believe may provide competitive advantage business. We also rely on certain unpatented proprietary expertise and other know-how, licensed and a third-party technologies, and continuous improvements and other developments of our various technolog intended to maintain our leadership position in the in

As of December 31, 2012, we own five trademarks registered with the U.S. Patent and Trademark Performant, Performant Recovery, Performant Technologies, Discovery Analytics and Performant B Services. We are in the process of registering additional trademarks supporting our business, and w common law trademark rights in numerous additional trade

We have registered copyrights covering various copyrighted material relevant to our business. We als unregistered copyrights in many components of our software systems. We may not be able to us unregistered copyrights to prevent misappropriation of such content by unauthorized parties in the however, we rely on our extensive information technology security measures and contractual arrangemen employees and third-party contractors to minimize the opportunities for any such misuse of this c

We are not subject to any material intellectual property claims alleging that we infringe, misapprop otherwise violate the intellectual property rights of any third party, nor have we asserted any material inte property infringement claim against any thir

Emp

As of December 31, 2012, we had approximately 1,500 full-time employees. None of our employees is a r of a labor union and we consider our employee relations to b

Available Infor

The SEC maintains an Internet site at http://www.sec.gov that contains our the Annual Report on Form quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports, if any, o filings filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as an or the Exchange Act, proxy and information statements. All reports that we file with the SEC may be re copied at the SEC s Public Reference Room at 100 F Street, N.E., Washington, DC, 20549. Information a operation of the Public Reference Room can be obtained by calling the SEC at 1-800-SEC

ITEM 1A. Risk Factors

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

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Risks Related to Our B

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

We derive a substantial majority of our revenues from a limited number of clients, including the Depart Education, CMS and three GAs. Revenues from our five largest clients represented 81% of our revenues year ended December 31, 2012. We expect that our revenues will become increasingly concentrated w major clients as a result of rising business volumes under our RAC contract, which accounted for approx 25.8% of our revenues in 2012, compared to approximately 13.2% of our revenues in 2011. If we lose these clients or if the terms of our relationships with any of these clients become less favorable to revenues would decline, which would harm our business, financial condition and results of ope

Many of our contracts with our clients for the recovery of student loans and other receivables are su periodic renewal or re-bidding processes, are not exclusive and do not commit our clients to provide sp volumes of business and, as a consequence, there is no assurance that we will be able to maint revenues and operating

Substantially all of our existing contracts for the recovery of student loan and other receivables represented approximately 63.0% of our revenues in 2012, enable our clients to unilaterally termina contractual relationship with us at any time without penalty, potentially leading to loss of busi renegotiation of terms. Our contracts generally are subject to a periodic rebidding process at the en contract term. Further, most of our contracts in these markets allow our clients to unilaterally change the of loans and other receivables that are placed with us at any given time. In addition, most of our contracts exclusive, with our clients retaining multiple service providers with whom we must compete for placem loans or other obligations. Therefore, despite our contractual relationships with our clients, our contracts provide assurance that we will generate a minimum amount of revenues or that we will receive a specific of plac

Our revenues and operating results would be negatively affected if our student loans and receivables which include four of our five largest clients in 2012, do not renew their agreements with us upon expiration, reduce the volume of student loan placements provided to us, modify the terms of service, in the success fees we are able to earn upon recovery of defaulted student loans, or any of these clients e more favorable relationships with our competitors. For example, we have been advised that our con arrangement with the Department of Education is under review as a result of the Department of Edu decision to have its recovery vendors promote income-based repayment, or IBR, to defaulted student loa IBR program provides flexibility on the required monthly payment for student loan borrowers at an intended to be affordable based on a borrower s income and family size. As a result of the increased appli the IBR program to defaulted student loans, we expect that there will be an increase in the number of loa become eligible for rehabilitation because more defaulted student loan borrowers will be able to make qu payments. In connection with the implementation of the IBR program, we have been advised that the Depa of Education will reduce the contingency fee rate that we will receive for rehabilitating student l approximately 18% effective March 1, 2013, although this change is still subject to further revi finalization by the Department of Education. Any changes in the contingency fee percentages compensation terms that we are paid under existing and future contracts could have a significant impac revenues and operating

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

We operate in very competitive markets. In providing our services to the student loan and other rec markets, we face competition from many other companies. Initially, we compete with these companies to

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of typically several firms engaged to provide recovery services to a particular client and, if we are succe
being engaged, we then face continuing competition from the client s other retained firms based on th
benchmarking of the recovery rates of its several vendors. Those recovery vendors who produce the
recovery rates from a client often will be allocated additional placements and in some cases additional
fees. Accordingly, maintaining high levels of recovery performance, and doing so in a cost-effective man
important factors in our ability to maintain and grow our revenues and net income and the failure to achie
objectives could harm our business, financial condition and results of ope

Similarly, we faced a highly competitive bidding process to become one of the four prime RAC contract
provide recovery services for improper Medicare payments. CMS issued a request for quotes in connecti
the re-bidding for the RAC contract in February 2013. Although our RAC contract is currently set to e
2014, CMS may terminate our RAC contract as early as August 2013 in connection with the re-bidding
for new RAC contracts. We expect that this process will be competitive. The failure to retain this contr
significant adverse change in the terms of this contract, which generated approximately 25.8% of our reve
the year ended December 31, 2012, would seriously harm our ability to maintain or increase our reven
operating

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

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

We have historically derived and are likely to continue to derive a significant portion of our revenues f
U.S. federal government. For the year ended December 31, 2012, revenues under contracts with the U.S.
government accounted for approximately 42% of our total revenues, compared to 27% for the yea
December 31, 2011. In addition, fees payable by the U.S. federal government are expected to become
percentage of our total revenues over the next several years as a result of legislation that has tra
responsibility for all new student loan origination to the Department of Education. The continuation and e
of renewal options on existing government contracts and any new government contracts are, among othe
contingent upon the availability of adequate funding for the applicable federal government agency. Cha
federal government spending could directly affect our financial performance. For example, the
Administration s proposed budget for the year ending September 30, 2013, included a proposal de
redirect federal government spending to an alternative federal program by decreasing the amount that
compensated when they rehabilitate defaulted loans. While the Obama Administration s budget proposa
approved by Congress, in June 2012, a bill containing similar provisions reducing the compensation of
rehabilitation of defaulted student loans was subsequently introduced in the U.S. Senate. The loss of b
from the U.S. federal government, or significant policy changes or financial pressures within the agencie
U.S. federal government that we serve would result in a significant decrease in our revenues, which
adversely affect our business, financial condition and results of ope

Future legislative or regulatory changes affecting the markets in which we operate could impair our b and oper

The two principal markets in which we provide our recovery services, government-supported student lo
the Medicare program, are a subject of significant legislative and regulatory focus and we cannot anticip
future changes in government policy may affect our business and operations. For example, SAFRA signi

changed the structure of the government-supported student loan market by assigning responsibility for government-supported student loan originations to the Department of Education, rather than originat private institutions and backed by one of 31 government-supported GAs. This legislation, and any future c in the legislation and regulations that govern these markets, may require us to adapt our business to t circumstances and we may be unable to do so in a manner that does not adversely affect our busin ope

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

The majority of our historical revenues from the student loan market have come from our relationships v GAs. As a result of SAFRA, the Department of Education will ultimately become the sole source of reve this market, although the GAs will continue to service their existing student loan portfolios for many y come. As a result, over time, defaults on student loans originated by the Department of Educati predominate and our ability to maintain the revenues we had previously received from a number of GA will depend on our relationship with a single client, the Department of Education. While we have 22 y experience in performing student loan recovery services for the Department of Education, we are 17 unrestricted recovery service providers on the current Department of Education contract. In 2012, stude recovery work for the Department of Education generated revenues of $29.0 million, or approximately 13 our total revenues. The Department of Education is expected to initiate a contract re-compete process dur first half of 2013. If our relationship with the Department of Education terminates or deteriorates o Department of Education, ultimately as the sole holder of defaulted student loans, requires its contractors t to less favorable terms, our revenues would significantly decrease, and our business, financial condit results of operations would be h

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

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

Our ability to derive revenues under our RAC contract will depend in part on the number and t potentially improper claims that we are allowed to pursue by CMS as well as the amounts that we are a to recover for CMS, and our results of operations may be harmed if the scope of claims that we are allo pursue is l

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

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Further, the improper claims approved by CMS and identified by us may be challenged by affected part
these challenges may lead to changes in our RAC contract instituted by CMS. For example, in Novemb
the American Hospital Association and four hospitals filed a lawsuit against Kathleen Sebelius, the Secr
the Department of Health and Human Services. The lawsuit claims, among other things, that CMS is
improperly in completely denying payment for claims initially made under Medicare Part A (inpatie
should have been made under Medicare Part B (outpatient), rather than remitting the difference between t
A and Part B payments. This type of improper claim has accounted for a substantial portion of the cla
have identified under our RAC contract. If our contingency fee payment from CMS for identifying these
is based on the difference between a Part A and Part B payment, our revenues may be h

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

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

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

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

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

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

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

general industry and macroeconomic conditions.

For example, a technology system upgrade at the Department of Education caused fluctuations in our op
results. This upgrade significantly decreased the volume of student loan placements by the Departr
Education to all recovery vendors, including us, during 2011 and through September 30, 2012. While we
other recovery vendors have recently received substantially larger placement volume in the fourth qu
2012 as a result of the completion of this technology system upgrade, the majority of the revenues fror
placements will be delayed until the third quarter of 2013 because we do not begin to earn rehabilitation re
from a given placement until at least nine months after receipt of a placement. In addition, for approxi
twelve months beginning in September 2011, this technology system upgrade prevented the Departr
Education from processing a portion of rehabilitated student loans and accordingly we were not able to rec
certain revenues associated with rehabilitation of loans for this client. However, the Department of Ed
continued to pay us based on invoices submitted and we recorded these cash receipts as deferred revenues
balanc

Further, our claim recovery volume is currently impacted by a system adjustment that is being impleme
CMS for its Periodic Income Payment providers, or PIP providers. PIP providers are reimbursed for M

claims through different processes than other healthcare providers, and CMS is in the process of making
system adjustments in order to allow these claims to be processed. Prior to April 2012, we were not perm
audit Medicare claims for these PIP providers, which we estimate to account for approximately 20% of M
claims in our region. The improper payments to PIP providers that we have identified were not proce
CMS from April 2012 until January 2013, when a small portion of such payments began to be pro
manually. As a result, we will not recognize any revenues from identified improper payments to PIP provi
of December 31, 2012, but we have incurred expenses related to these claims. We estimate that this dela
recognition of approximately $6 million in revenues in 2012, although we began to recognize a portion o
revenues starting in the first quarter of 2013. CMS remains in the process of implementing the necessary c

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to its systems that would allow these claims to be processed automatically and allow us to recogniz
revenues and we believe that the necessary upgrade will be complete in the second quarter of 2013. W
believe that this delay in automatic processing is temporary, we are uncertain as to when automatic pro
will begin and the failure of CMS to process these and future claims on a timely basis will delay our reco
of the revenues until this is resolved. Because our revenues are dependent on many factors, some of wh
outside of our control, we may experience significant fluctuations in our results of operations and as
volatility in our stoc

Downturns in domestic or global economic conditions and other macroeconomic factors could ha business and results of oper

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

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

We may not succeed in maintaining our profitability on a quarterly or annual basis and could incur quar
annual losses in future periods. We have incurred additional operating expenses associated with being a
company and we intend to continue to increase our operating expenses as we grow our business. We also
to continue to make investments in our proprietary technology platform and hire additional employ
subcontractors as we expand our healthcare recovery and other operations, thus incurring additional expe
our revenues do not increase to offset these increases in expenses, our operating results could be ad
affected. Our historical revenues and net income growth rates are not indicative of future growt

We may not be able to manage our growth effectively and our results of operations could be neg a

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

A failure of our operating systems or technology infrastructure, or those of our third-party vend subcontractors, could disrupt the operation of our bu

A failure of our operating systems or technology infrastructure, or those of our third-party vend
subcontractors, could disrupt our operations. Our operating systems and technology infrastructure are susc
to damage or interruption from various causes, including acts of God and other natural disasters, power
computer systems failures, Internet and telecommunications or data network failures, operator error, co
viruses, losses of and corruption of data and similar events. The occurrence of any of these events could r
interruptions, delays or cessations in service to our clients, reduce the attractiveness of our recovery serv

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current or potential clients and adversely impact our financial condition and results of operations. While w
backup systems in many of our operating facilities, an extended outage of utility or network services ma
our ability to operate our business. Further, the situations we plan for and the amount of insurance cover
maintain for losses as result of failures of our operating systems and infrastructure may not be adequate
particul

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

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

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

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

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

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

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

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

We engage subcontractors to provide certain services to our clients. These subcontractors participate to
degrees in our recovery activities with regards to all of the services we provide. While most of our subcon
provide specific services to us, we engage one subcontractor to provide all of the audit and recovery s
under our contract with CMS within a portion of our region. According to CM

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geographic area allocated to this subcontractor accounted for approximately 17% of total Medicare spen
our region in 2009. While we believe that we perform appropriate due diligence before we hire subcont
our subcontractors may not provide adequate service or otherwise comply with the terms set forth
agreements. In the event a subcontractor provides deficient performance to one or more of our clients, a
client may reduce the volume of services we are providing under an existing contract or may termi
relevant contract entirely and we may face claims for breach of contract. Any such disruption in our r
with our clients as a result of services provided by any of our subcontractors could adversely affect our re
and operating

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

Our recovery services depend in part on third-party providers, including software vendors and utility and n
providers. Our ability to service our clients depends on these third-party providers meeting our expectati
contractual obligations in a timely and effective manner. Our business could be materially and adversely a
and we might incur significant additional liabilities, if the services provided by these third-party providers
meet our expectations or if they terminate or refuse to renew their relationships with us on similar con

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

We are subject to a wide array of federal and state laws and regulations regarding the use and discl
confidential personal information and security. For example, the federal Health Insurance Portabi
Accountability Act of 1996, as amended, or HIPAA, and related state laws subject us to substantial rest
and requirements with respect to the use and disclosure of the personal health information that we o
connection with our audit and recovery services under our contract with CMS and we must e
administrative, physical and technical safeguards to protect the confidentiality of this information.
protections extend to the type of personal financial and other information we acquire from our student lo
tax and federal receivables clients. We are required to notify affected individuals and government age
data security breaches involving protected health and certain personally identifiable information. These l
regulations also require that we develop, implement and maintain written, comprehensive information s
programs containing safeguards that are appropriate to protect personally identifiable information o
information against unauthorized access, misuse, destruction or modification. Federal law generally d
preempt state law in the area of protection of personal information, and as a result we must also comp
state laws and regulations. Regulation of privacy, data use and security requires that we incur sig
expenses, which could increase in the future as a result of additional regulations, all of which adversely
our results of operations. Failure to comply with these laws and regulations can result in penalties and i
cases expose us to civil l

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

Our student loan recovery business is subject to regulation and oversight by various state and federal a
particularly in the area of consumer protection. The Fair Debt Collection Practices Act, or FDCPA, and
state laws provide specific guidelines that we must follow in communicating with holders of student lo
regulates the manner in which we can recover defaulted student loans. Some state attorney generals ha
active in this area of consumer protection regulation. We are subject, and may be subject in the fu
inquiries and audits from state and federal regulators, as well as frequent litigation from private p
regarding compliance under the FDCPA and related state regulations. We are also subject to the Fai
Reporting Act, or FCRA, which regulates consumer credit reporting and may impose liability on us to the
adverse credit information reported to a credit bureau is false or inaccurate. Our compliance with the F

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FCRA and other federal and state regulations that affect our student loan recovery business may r
significant costs, including litigation costs. We may also become subject to regulations promulgated
United States Consumer Financial Protection Bureau, or CFPB, which was established in July 2011 as par
Dodd-Frank Act to, among other things, establish regulations regarding consumer financial protectio
Changes to existing regulations or the adoption of new regulations could adversely affect our business and
of operations if we are not able to adapt our services and client relationships to meet the new regulatory st

The requirements of being a public company may strain our resources, divert management s atten
affect our ability to attract and retain executive management and qualified board me

As a public company, we are subject to the reporting requirements of the Exchange Act, the Sarbanes-Ox
of 2002, or the Sarbanes-Oxley Act, the Dodd-Frank Act and other applicable securities rules and regu
Compliance with these rules and regulations has increased our legal and financial compliance costs, mad
activities more difficult, time-consuming or costly and increased or will continue to increase demand
systems and resources, particularly after we are no longer an emerging growth company. The Exc
requires, among other things, that we file annual, quarterly and current reports with respect to our busin
operating results. The Sarbanes-Oxley Act requires, among other things, that we maintain effective dis
controls and procedures and internal control over financial reporting. In order to maintain and, if re
improve our disclosure controls and procedures and internal control over financial reporting to m
standard, significant resources and management oversight may be required. As a result, management s
may be diverted from other business concerns, which could adversely affect our business and operating
Although we have already hired additional employees to comply with these requirements, we may need
more employees in the future or engage outside consultants, which will increase our costs and ex

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

However, for as long as we remain an emerging growth company as defined in the Jumpstart Ou
Startups Act of 2012, or the JOBS Act, we may take advantage of certain exemptions from various re
requirements that are applicable to other public companies that are not emerging growth companies,
but not limited to, not being required to comply with the auditor attestation requirements of Section 40
Sarbanes-Oxley Act, reduced disclosure obligations regarding executive compensation in our periodic
and proxy statements, and exemptions from the requirements of holding a nonbinding advisory vote on ex
compensation and shareholder approval of any golden parachute payments not previously approved. V
take advantage of these reporting exemptions until we are no longer an emerging growth c

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

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

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

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

Our management may conclude that our internal control over our financial reporting is not effective. As
recently became a public company following the completion of our initial public offering on August 15, 20
have limited accounting personnel and other resources with which to address our internal contr
procedures. If we fail to timely achieve and maintain the adequacy of our internal control over fi
reporting, we may not be able to produce reliable financial reports or help prevent fraud. Our failure to
and maintain effective internal control over financial reporting could prevent us from filing our periodic
on a timely basis, which could result in the loss of investor confidence in the reliability of our fi
statements, harm our business and negatively impact the trading price of our commo

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

Litigation may result in substantial costs of defense, damages or settlement, any of which could subje
significant costs and ex

We are party to lawsuits in the normal course of business, particularly in connection with our stude
recovery services. For example, we are regularly subject to claims that we have violated the guideli
procedures that must be followed under federal and state laws in communicating with consumer debtors.
not ultimately prevail or otherwise be able to satisfactorily resolve any pending or future litigation, whi
result in substantial costs of defense, damages or settlement. In the future, we may be required to a

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business practices or pay substantial damages or settlement costs as a result of litigation proceedings
could adversely affect our business operations and results of ope

We typically face a long period to implement a new contract which may cause us to incur expenses be receive revenues from new client relatio

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

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

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

Claims by others that we infringe their intellectual property could force us to incur significant costs o the way we conduct our bu

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

We may make acquisitions that prove unsuccessful, strain or divert our resources and harm our re operations and stock

We may consider acquisitions of other companies in our industry or in new markets. We may not be
successfully complete any such acquisition and, if completed, any such acquisition may fail to achi
intended financial results. We may not be able to successfully integrate any acquired businesses with o
and we may be unable to maintain our standards, controls and policies. Further, acquisitions may place ad
constraints on our resources by diverting the attention of our management from other business co

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Moreover, any acquisition may result in a potentially dilutive issuance of equity securities, the incurr
additional debt and amortization of expenses related to intangible assets, all of which could adversely af
results of operations and stoc

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

As of December 31, 2012, our total debt was $147.8 million. For the year ended December 31, 20 consolidated interest expense was approximately $12.4 million. Our ability to make scheduled paymen refinance our debt obligations and to fund our other liquidity needs depends on our financial and op performance, which is subject to prevailing economic and competitive conditions and to certain fi business and other factors beyond our control. We cannot make assurances that we will maintain a level flows from operating activities sufficient to permit us to pay the principal and interest on our indebtednes fund our other liquidity needs. If our cash flows and capital resources are insufficient to fund our debt obligations and allow us to maintain compliance with the covenants under our credit agreement or to f other liquidity needs, we may be forced to reduce or delay capital expenditures, sell assets or operatio additional capital or restructure or refinance our indebtedness. We cannot ensure that we would be able any of these actions, that these actions would be successful and permit us to meet our scheduled debt obligations or that these actions would be permitted under the terms of our existing or future debt agre including our credit agreement. If we cannot make scheduled payments on our debt, we will be in default a result, our debt holders could declare all outstanding principal and interest to be due and payable, the under our credit agreement could terminate their commitments to lend us money and foreclose against th securing our borrowings and we could be forced into bankruptcy or liqu

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

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

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

Risks Related to Our Commo

We are subject to certain phase-in provisions of the NASDAQ Marketplace Rules and, as a result, we immediately be subject to certain corporate governance pro

Because of our public offering in February 2013, Parthenon Capital Partners no longer controls a majorit common stock. As a result, we will no longer be a controlled company within the meaning of the governance standards of the NASDAQ Global Select Market. However, we will rely on phase-in provis certain stock exchange corporate governance requirements, in

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

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

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

We intend to utilize each of these phase-in provisions. As a result, we do not have a majority of indep
directors and our nominating and corporate governance and compensation functions are not decided so
independent directors. Accordingly, you do not have the same protections afforded to stockholders of con
that are subject to all of the stock exchange corporate governance requir

The price of our common stock could be v

Since our initial public offering in August 2012, the price of our common stock, as reported by NASDA
ranged from a low sales price of $7.55 on November 27, 2012 to a high sales price of $14.09 on March 4
The trading price of our common stock may be significantly affected by various factors, including: q
fluctuations in our operating results; the financial projections we may provide to the public, any changes i
projections or our failure to meet those projections; changes in investors and analysts perception of th
risks and conditions of our business; our ability to meet the earnings estimates and other perfo
expectations of financial analysts or investors; unfavorable commentary or downgrades of our stock by
research analysts; termination of lock-up agreements or other restrictions on the ability of our e
stockholders to sell their shares after our public offering in February 2013 and our initial public offering; c
in our capital structure, such as future issuances of debt or equity securities; lawsuits threatened or filed
us; strategic actions by us or our competitors, such as acquisitions or restructurings; new legislation or reg
actions; changes in our relationship with any of our significant clients; fluctuations in the stock prices of c
companies or in stock markets in general; and general economic con

Future sales, or the perception of future sales, of our common stock may lower our stoc

If our existing stockholders sell a large number of shares of our common stock, the market price of our co
stock could decline significantly. In addition, the perception in the public market that our existing stock
might sell shares of common stock could depress the market price of our common stock, regardless of th
plans of our existing stockholders. As of March 20, 2013, a total of 46,720,569 shares of common stoc
outstanding, assuming that there are no exercises of options after December 31, 2012. Of these sha
9,200,000 shares of common stock sold in our February 2013 offering and the 10,350,000 shares that we
in our initial public offering, will be freely tradable in the public market without restriction or further regi
under the Securities Act of 1933, or the Securities Act, unless these shares are held by affiliates, as t
defined in Rule 144 under the Securities Act. 27,728,773 shares are subject to lock-up agreements entered
connection with our February 2013 offering restricting the sale of those shares until May 2013, unless oth
extended. The underwriters may waive the lock-up restriction and allow any of the stockholders subjec
restriction to sell their shares at an

Our significant stockholder has the ability to control significant corporate activities and our n
stockholder s interests may not coincide wi

Parthenon Capital Partners beneficially owned approximately 48.7% of our common stock as of March 20
As a result of its ownership, Parthenon Capital Partner has the ability to influence the outcome of
submitted to a vote of stockholders and, through our board of directors, the ability to control decision-
with respect to our business direction and policies. Parthenon Capital Partners may have interests differe
our other stockholders interests, and may vote in a manner adverse to those interests. Matters ov
Parthenon Capital Partners can, directly or indirectly, exercise influence i

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

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

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other acquisitions or dispositions of businesses or assets;

incurrence of indebtedness and the issuance of equity securities;

repurchase of stock and payment of dividends; and

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

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

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

Our amended and restated certificate of incorporation and amended and restated bylaws contain provisio could have the effect of rendering more difficult or discouraging an acquisition deemed undesirable by ou of directors. Our corporate governance documents include the following provisions: establishing a cla board of directors so that not all members of our board are elected at one time; providing that directors removed by stockholders only for cause at such time as Parthenon Capital Partners no longer beneficially majority of our outstanding shares; authorizing blank check preferred stock, which could be issued with liquidation, dividend and other rights superior to our common stock; limiting the ability of our stockho call and bring business before special meetings and to take action by written consent in lieu of a meeting time as Parthenon Capital Partners no longer beneficially owns a majority of our outstanding shares; limit ability to engage in certain business combinations with any interested stockholder, other than Parthen Partners, for a three-year period following the time that the stockholder became an interested stock requiring advance notice of stockholder proposals for business to be conducted at meetings of our stock and for nominations of candidates for election to our board of directors; requiring a super majority v certain amendments to our amended and restated certificate of incorporation and amended and restated after the time when Parthenon Capital Partners ceased to beneficially own a majority of our outstanding which occurred in February 2013; and limiting the determination of the number of directors on our b directors and, when Parthenon Capital Partners is no longer our majority stockholder, the filling of vacan newly created seats on the board, to our board of directors then in office. These provisions, alone or to could have the effect of delaying or deterring a change in control, could limit the opportunity for our stock to receive a premium for their shares of our common stock, and could also affect the price that some inves willing to pay for our commo

Because we do not intend to pay cash dividends in the foreseeable future, you may not receive any ret investment unless you are able to sell your common stock for a price greater than your purchase

For the foreseeable future, we intend to retain any earnings to finance the development and expansion business, and we do not anticipate paying any cash dividends on our common stock. In addition, our ab pay dividends is subject to restrictive covenants contained in our credit agreement. As a result, you m receive any return on investment unless you are able to sell your common stock for a price greater tha purchas

ITEM 1B. Unresolved Staff Comments

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ITEM 2. Pro

Fa

As of December 31, 2012, we operated five separate office locations throughout the United States. The la
these facilities is in Livermore, California and serves as our corporate headquarters, as well as a data cen
production location. Our Livermore facility represents approximately 50,291 square feet and has
expiration of September 2017. We also lease production centers in California, Oregon, Florida and Te
own a production/data center in C

We believe that our facilities are adequate for current operations and that additional space will be avai
required. See note (6) to our consolidated financial statements included elsewhere in this Annual Report o
10-K for information regarding our lease oblig

ITEM 3. Legal Proce

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

ITEM 4. Mine Safety Disclosures

Not app

PA

ITEM 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purcha Equity Securities

Market For Our Common

Our common stock began trading on the NASDAQ Global Select market under the symbol PFMT on A
2012. Prior to that, there was no public market for our common stock. The table sets forth, for the
indicated below, the high and low sales prices per share of our common stock as reported by NASDA
August 10

2012	High	Low
Third Quarter (beginning August 10, 2012)	12.18	9.20
Fourth Quarter	11.84	7.55

On March 20, 2013, the closing price as reported by NASDAQ of our common stock was $13.00 pe

Stockh

As of December 31, 2012, we had approximately 38 holders of record of our commo

Div

Our board of directors does not currently intend to pay regular dividends on our common stock. Howe
expect to reevaluate our dividend policy on a regular basis and may, subject to compliance with the cover
our credit agreement and other considerations, determine to pay dividends in the future. Our ability
dividends is subject to restrictive covenants contained in our credit agre

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Securities Authorized for Issuance Under Equity Compensatio

Information regarding the securities authorized for issuance under our equity compensation plans can b
under Item 12 of this Annual Report on For

Unregistered Sales of Equity Se

In connection with the consummation of our IPO, we paid $0.9 million to FTP Securities LLC, or FT P
through the issuance of 103,500 shares of our common stock valued at $9.00 per share as considera
financial advisory services provided by FT Partners. The securities issued were exempt from regi
pursuant to Section 4(2) of the Securities Act of 1933, as an

Issuer Purchases of Equity Se

ITEM 6. Selected Financial Data

The selected consolidated balance sheet data as of December 31, 2012 and 2011, and the selected cons
statements of operations data for each year ended December 31, 2012, 2011 and 2010, have been derive
our audited consolidated financial statements which are included elsewhere in this annual report. The s
consolidated balance sheet data as of December 31, 2010, 2009 and 2008, and the selected cons
statements of operations data for the years ended December 31, 2009 and 2008 have been derived fr
audited consolidated financial statements not included in this annual report. Historical results are not nec
indicative of future results. You should read the following selected consolidated historical financial data b
conjunction with the section titled Management s Discussion and Analysis of Financial Condition and
Operations and the consolidated financial statements, related notes, and other financial information in
this Annual Report on Form 10-K. The selected consolidated financial data in this section is not inte
replace the consolidated financial statements and is qualified in its entirety by the consolidated fi
statements and related notes and schedule included in this Annual Report on For

	Year Ended December 31,				
	2012	**2011**	**2010**	**2009**	**2**
			(in thousands)		
Consolidated Statement of Operations Data:					
Revenues	$ 210,073	$ 162,974	$ 123,519	$ 109,832	$ 9
Operating expenses:					
Salaries and benefits	83,002	67,082	58,113	53,728	4
Other operating expense	71,305	49,199	33,655	32,110	2
Impairment of trade name		13,400			
Total operating expenses	154,307	129,681	91,768	85,838	7
Income from operations	55,766	33,293	31,751	23,994	2
Debt extinguishment costs[1]	(3,679)				
Interest expense	(12,414)	(13,530)	(15,230)	(16,017)	(1
Interest income	64	125	118	104	
Income before provision for income taxes	39,737	19,888	16,639	8,081	
Provision for income taxes	16,786	7,516	6,664	3,071	
Net income	$ 22,951	$ 12,372	$ 9,975	$ 5,010	$

Accrual for preferred stock dividends	2,038	6,495	5,771	5,128	
Net income (loss) available to common shareholders	$ 20,913	$ 5,877	$ 4,204	$ (118)	$

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	Year Ended December 31,				
	2012	2011	2010	2009	2
Net income (loss) per share attributable to common shareholders(2)					
Basic	$ 0.48	$ 0.14	$ 0.10	$ (0.00)	$
Diluted	$ 0.44	$ 0.13	$ 0.09	$ (0.00)	$
Weighted average shares (in thousands)					
Basic	43,985	42,962	42,962	42,962	4
Diluted	47,599	45,742	45,019	42,962	4

(1) Represents debt extinguishment costs comprised of approximately $3.3 million of fees paid to lenders connection with our new credit facility and approximately $0.3 million of unamortized debt issuance c connection with our old credit facility.

(2) Please see Note 1 to our consolidated financial statements for an explanation of the calculations of our and diluted net income per share of common stock.

	As of December 31, (in thousands)				
	2012	2011	2010	2009	20
Consolidated Balance Sheet Data:					
Cash and cash equivalents	$ 37,843	$ 20,004	$ 11,078	$ 8,924	$
Total assets	211,745	182,299	181,390	180,735	18
Total debt	147,769	103,383	117,331	127,298	13
Total liabilities	187,672	139,756	151,231	161,077	16
Redeemable preferred stock		58,248	51,753	45,982	4
Total stockholders (deficit) equity	24,073	(15,705)	(21,594)	(26,324)	(2

ITEM 7. Management s Discussion and Analysis of Financial Condition and Results of Operations

Ov

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

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

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Sources of Re

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

	2012	Year Ended December 31, 2011 (in thousands)	2010
Student Lending	$ 132,445	$ 122,253	$ 103,672
Healthcare	54,747	21,549	1,821
Other	22,881	19,172	18,026
Total Revenues	$ 210,073	$ 162,974	$ 123,519

Student L

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

Based on data compiled from over two decades of experience with the recovery of defaulted student loans
time we receive a placement of student loans, we are able to make a reasonably accurate estimate of the re
outcomes likely to be derived from such placement and the revenues we are likely able to generate based
anticipated recovery out

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

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Student Loan Recovery Outcomes

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

For certain guaranty agency, or GA, clients, we have entered into Master Service Agreements, or MSAs these agreements, clients provide their entire inventory of outsourced loans or receivables to us for reco an exclusive basis, rather than just a portion, as with traditional contracts that are split among various providers. In certain circumstances, we engage subcontractors to assist in the recovery of a portion of the portfolio. We also receive success fees for the recovery of loans under MSAs and our revenues unde arrangements include fees earned by the activities of our subcontractors. As of December 31, 2012, we ha MSA clients in the student loan

Hea

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

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

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

Operating M

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

	Year Ended December 31,		
	2012	2011	201
	(dollars in thousands)		
Student Lending:			
Placement Volume	$ 5,768,945	$ 6,241,483	$ 5,294
Placement Revenue as a percentage of Placement Volume	2.30%	1.96%	
Healthcare:			
Net Claim Recovery Volume	$ 482,202	$ 188,573	$ 15
Claim Recovery Fee Rate	11.35%	11.43%	1

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

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

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

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

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Costs and Ex

We generally report two categories of operating expenses: salaries and benefits and other operating e
Salaries and benefits expenses consist primarily of salaries and performance incentives paid and b
provided to our employees. Other operating expense includes expenses related to our use of subcontractor
production related expenses, including costs associated with data processing, retrieval of medical r
printing and mailing services, amortization and other outside services, as well as general corpor
administrative expenses. In addition to our main components of operating expenses, in 2011 we incurred
million impairment expense to write off the carrying amount of the trade name intangible asset due to our
retire our Diversified Collection Services, Inc. trade name, which we report as impairment of trade nar
expect a significant portion of our expenses to increase as we grow our business. However, we expect
expenses, including our corporate and general administrative expenses, to grow at a slower rate t
revenues. As a result, and over the long term, we expect our overall expenses to modestly decline as a perc
of re

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

Factors Affecting Our Operating

Our results of operations are influenced by a number of factors, including allocation of placement volume
recovery volume, contingency fees, regulatory matters, effects of client concentration and macroec

Allocation of Placement

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

Typically we are able to anticipate with reasonable accuracy the timing and volume of placements of de
student loans and other receivables based on historical patterns and regular communication with our
Occasionally, however, placements are delayed due to factors outside of our control. For example, a tech
system upgrade at the Department of Education significantly decreased the volume of student loan placem
the Department of Education to all recovery vendors, including us. While we and the other recovery v
have recently received substantially larger placement volume in the fourth quarter of 2012 as a resul
completion of this technology system upgrade, the majority of the revenues from these placements
delayed until the third quarter of 2013 because we do not begin to earn rehabilitation revenues from
placement until at least nine months after receipt of a placement. In addition, for approximately twelve
beginning in September 2011, the Department of Education was not able to process a po

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rehabilitated student loans and accordingly we were not able to recognize certain revenues associat
rehabilitation of loans for this client. However, the Department of Education continued to pay us b
invoices submitted and we recorded these cash receipts as deferred revenues on our balance sheet. The am
placement volume that we receive is also dependent on the client relationships that we maintain. We anal
profitability of each of our student lending clients, and sometimes determine that our resources serv
specific client should be allocated elsewhere. As a result of this process, we decided to terminate an unpr
contract with a commercial bank, which we do not expect will have a significant effect on revenues or net
in future periods. Our decision to terminate this contract, as discussed above, accounts for a substantial po
the 7.6% decrease in Placement Volume in the year ended December 31, 2012, compared to the prior year

Claim Recovery V

While we are entitled to review Medicare records for all Part A and Part B claims in our region, we
permitted to identify an improper claim unless that particular type of claim has been pre-approved by C
ensure compliance with applicable Medicare payment policies, as well as national and local co
determinations. The growth of our revenues is determined primarily by the aggregate volume of Medicare
in our region and our ability to identify improper payments within these claims. However, the long-term
of these revenues will also be affected by the scope of the issues pre-approved by

Further, our claim recovery volume is currently impacted by a system adjustment that is being impleme
CMS for its PIP providers. PIP providers are reimbursed for Medicare claims through different process
other healthcare providers, and CMS is in the process of making certain system adjustments in order t
these claims to be processed. Prior to April 2012, we were not permitted to audit Medicare claims for th
providers, which we estimate to account for approximately 20% of Medicare claims in our region. The in
payments to PIP providers that we have identified were not processed by CMS from April 2012 until J
2013, when a small portion of such payments began to be processed manually. As a result, we will not rec
any revenues from identified improper payments to PIP providers as of December 31, 2012, but we have in
expenses related to these claims. We estimate that this delayed our recognition of approximately $6 mi
revenues in 2012, although we began to recognize a portion of these revenues starting in the first quarter o
CMS remains in the process of implementing the necessary changes to its systems that would allow these
to be processed automatically and allow us to recognize these revenues. While we believe that this d
automatic processing is temporary, we are uncertain of when automatic processing will begin and the fa
CMS to process these and future claims on a timely basis will delay our recognition of the revenues unti
re

In addition, the improper claims approved by CMS and identified by us may be challenged by affected
and these challenges may lead to changes in our RAC contract instituted by CMS. For example, in No
2012 the American Hospital Association and four hospitals filed a lawsuit against Kathleen Sebel
Secretary of the Department of Health and Human Services. The lawsuit claims, among other things, that C
acting improperly in completely denying payment for claims initially made under Medicare Part A (inp
that should have been made under Medicare Part B (outpatient), rather than remitting the difference betw
Part A and Part B payments. This type of improper claim has accounted for a substantial portion of the cla
have identified under our RAC contract. If our contingency fee payment from CMS for identifying these
is based on the difference between a Part A and Part B payment, our future revenues may be e

Contingenc

Our revenues consist primarily of contract-based contingency fees. The contingency fee percentages that w
are set by our clients or agreed upon during the bid process, and may change from time to time either un
terms of existing contracts or pursuant to the terms of contract renewals. For example, we have been advis
our contractual arrangement with the Department of Education is under review as a result of the Depa

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of Education s decision to have its recovery vendors promote IBR to defaulted student loans. The IBR
provides flexibility on the required monthly payment for student loan borrowers at an amount intende
affordable based on a borrower s income and family size. As a result of the increased application of
program to defaulted student loans, we expect that there will be an increase in the number of loans that l
eligible for rehabilitation because more defaulted student loan borrowers will be able to make qua
payments. In connection with the implementation of the IBR program, we have been advised that the Depa
of Education will reduce the contingency fee rate that we will receive for rehabilitating student lo
approximately 18% effective March 1, 2013, although this change is still subject to further revi
finalization by the Department of Education. We expect that revenues derived from the increased vol
rehabilitated students loans will offset the decrease in contingency fee rates that we receive from the Depa
of Edu

Regulatory I

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

Client Concen

Our revenues from the student loan market depend on our ability to maintain our contracts with some
largest providers of student loans. In 2012, four providers of student loans each accounted for more than
our revenues during such period and they collectively accounted for 55% of our total revenues during this
Our contracts with these clients entitle them to unilaterally terminate their contractual relationship with us
time without penalty. If we lose one of our significant clients, including if one of our significant cl
consolidated by an entity that does not use our services, if the terms of compensation for our services chan
there is a reduction in the level of placements provided by any of these clients, our revenues could d

Our contract with CMS for the recovery of improper Medicare payments began generating significant re
during 2011 and represented 25.8% of our total revenues in the year ended December 31, 2012. CMS i
request for quotes in connection with the re-bidding for the RAC contract in February 2013. Although ou
contract is currently set to expire in 2014, CMS may terminate our RAC contract as early as August 2
connection with this re-bidding process. While we believe our performance under the existing agreement
experience we have gained in performing this contract position us well to renew the agreement, failure to
the agreement or renewal on substantially less favorable terms could significantly harm our revenues and
of ope

Macroeconomic I

Certain macroeconomic factors influence our business and results of operations. These include the inc
volume of student loan originations in the U.S. as a result of increased tuition costs and student enrollm
default rate of student loan borrowers, the growth in Medicare expenditures resultin

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increasing healthcare costs, as well as the fiscal budget tightening of federal, state and local governme
result of general economic weakness and lower tax re

Critical Accounting I

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

Revenue Reco

The majority of our contracts are contingency fee based. We recognize revenues on these contingency fe
contracts when third-party payors remit payments to our clients or remit payments to us on behalf of our
and, consequently, the contingency is deemed to have been satisfied. Under our RAC contract with C
recognize revenues when the healthcare provider has paid CMS for a given claim or incurs an offset
future Medicare claims. Providers have the right to appeal a claim and may pursue additional appeals if th
appeal is found in favor of CMS. We accrue an estimated liability for appeals based on the am
commissions received which are subject to appeal and which we estimate are probable of being retu
providers following successful appeal. This estimated liability for appeals is an offset to revenues on our
statement. Our estimates are based on our historical experience with appeals activity under our CMS c
since January 2010. During the year ended December 31, 2012, we reserved an amount equal to 14% o
revenues from our CMS contract. We have increased our estimated liability for appeal in 2012 due to
trends in our historical data related to the likelihood of successful appeals. Commencing on December 31
we established a separate line item in the current liabilities section of our balance sheet entitled E
liability for appeals to reflect our estimate of this liability. The $4.4 million balance as of December 3
represents our best estimate of the probable amount of losses related to appeals of claims for which comm
were previously collected. We estimate that it is reasonably possible that we could be required to pay u
additional approximately $1.5 million as a result of potentially successful appeals. To the extent that r
payments by us related to successful appeals exceed the amount accrued, revenues in the applicable period
be reduced by the amount of the excess. We similarly accrue an allowance against accounts receivable re
commissions yet to be collected, which was $1.2 million as of December 31, 2012, based on the same es
used to establish the estimated liability for appeals of commissions received. Our inability to correctly e
the estimated liabilities and allowance against accounts receivable could adversely affect our revenues in
P

G

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

Specifically, goodwill impairment is determined using a two-step test. The first step of the goodwill impa
test is used to identify potential impairment by comparing the fair value of a reporting unit with its book
including goodwill. If the fair value of the reporting unit exceeds its book value, goodwill is conside
impaired and the second step of the impairment test is unnecessary. If the book valu

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reporting unit exceeds its fair value, the second step of the goodwill impairment test is performed to meas
amount of impairment loss, if any. The second step of the goodwill impairment test compares the impl
value of the reporting unit s goodwill with the book value of that goodwill. If the book value of the report
goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount e
that excess. The implied fair value of goodwill is determined in the same manner as the amount of go
recognized in a business combination. That is, the fair value of the reporting unit is allocated to all of the
and liabilities of that unit as if the reporting unit had been acquired in a business combination and the fai
of the reporting unit was the purchase price paid to acquire the reporting unit. In September 2011, the Fi
Accounting Standards Board, or FASB, issued Accounting Standards Update, or ASU, 20
Intangibles Goodwill and Other (Topic 350): Testing Goodwill for Impairment. This ASU permits an e
make a qualitative assessment of whether it is more likely than not that a reporting unit s fair value is les
carrying amount before applying the two-step goodwill impairment test. If an entity concludes it is no
likely than not that the fair value of a reporting unit is less than its carrying amount, it need not perfo
two-step impairment test. The ASU permits early adoption, and based on our qualitative assessm
concluded that we are not required to perform the two-step impairment test at December 31, 20
December 31

Impairments of Depreciable Intangible

We evaluate depreciable intangible assets for impairment whenever events or changes in circumstances i
that the carrying amount of such assets may not be recoverable. Depreciable intangible assets consist o
contracts and related relationships, and are being amortized over their estimated useful life, which is gener
years. We evaluate the client contracts intangible at the individual contract level. The recoverability
assets is measured by a comparison of the carrying amount of the assets to future undiscounted net cas
expected to be generated by the assets. If the assets are considered to be impaired, the impairmen
recognized is measured by the amount by which the carrying amount of the assets exceeds the fair valu
assets. There was no impairment expense for depreciable intangible assets in 2012, 2011 o

Results of Ope

Year Ended December 31, 2012 compared to the Year Ended December 3

The following table represents our historical operating results for the periods pre

	Year Ended December 31,			
	2012	2011	$ Change	% Change
	(in thousands)			
Consolidated Statement of Operations Data:				
Revenues	$ 210,073	$ 162,974	$ 47,099	29
Operating expenses:				
Salaries and benefits	83,002	67,082	15,920	24
Other operating expense	71,305	49,199	22,106	45
Impairment of trade name		13,400	(13,400)	-100
Total operating expenses	154,307	129,681	24,626	19
Income from operations	55,766	33,293	22,473	68
Debt extinguishment costs	(3,679)		(3,679)	0
Interest expense	(12,414)	(13,530)	1,116	-8
Interest income	64	125	(61)	-49
Income before provision for income taxes	39,737	19,888	19,849	100
Provision for income taxes	16,786	7,516	9,270	123

Net income	$ 22,951	$ 12,372	$ 10,579	86
Accrual for preferred stock dividends	2,038	6,495	(4,457)	-69
Net income available to common shareholders	$ 20,913	$ 5,877	$ 15,036	256

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Re

Total revenues were $210.1 million for the year ended December 31, 2012, an increase of $47.1 mi
28.9%, compared to total revenues of $163.0 million for the year ended December 31, 2011. This incr
revenues is primarily due to an increase of $33.2 million in revenues received from CMS under our RAC c
as a result of higher claim recovery volume and an increase of $4.8 million generated fron
default-aversion service contract that commenced in May 2012, for a new service offering we provide i
markets we serve. Revenues from student lending increased by 8.3% in 2012 to $132.4 million from
million in the prior year

Salaries and B

Salaries and benefits expense was $83.0 million for the year ended December 31, 2012, an incr
$15.9 million, or 23.7%, compared to salaries and benefits expense of $67.1 million for the yea
December 31, 2011. This increase is primarily due to hiring of new employees to provide services un
RAC contract with CMS, an increase in expenses associated with the engagement of additional s
engineers to assist in the integration of a recently acquired software license and an increase in ex
associated with the hiring of additional administrative emp

Other Operating E

Other operating expense was $71.3 million for the year ended December 31, 2012, an increase of $22.1 r
or 44.9%, compared to other operating expense of $49.2 million for the year ended December 31, 201
increase is primarily due to (i) an additional $10 million of subcontractor fees incurred in connecti
increased services provided under the RAC contract and MSA contracts and (ii) $1.3 million paid to an a
of Parthenon Capital Partners in connection with the termination of an advisory services agreement,
additional $0.9 million paid to Parthenon Capital Partners at the closing of our initial public offering a
result of the termination of the advisory agre

Impairment of Trade

We did not recognize an impairment expense for intangible assets in 2012. In 2011, we recorded $13.4 mi
impairment expense to write off the carrying value of our former trade name, Diversified Collection S
Inc., due to our decision to retire that trade

Income from Ope

As a result of the factors described above, income from operations was $55.8 million for the yea
December 31, 2012, compared to $33.3 million for the year ended December 30, 2011, representing an i
of $22.5 million, or

Debt Extinguishmen

As a result of the entry into our new credit facility and the repayment of all amounts owed under o
existing credit facility in March 2012, we incurred debt extinguishment costs of $3.7 million, compr
approximately $3.3 million in fees paid to the lenders in connection with our new credit facil
approximately $0.3 million of unamortized debt issuance costs associated with our old credit facility. We
incur a similar expense in the year ended December 31

Interest E

Interest expense was $12.4 million for the year ended December 31, 2012 compared to $13.5 million for t
ended December 31, 2011, representing a decrease of 8.2% due to lower interest rates under the new
agreement as compared to the interest rates under our old credit agre

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Income

Income tax expense was $16.8 million for the year ended December 31, 2012 compared to $7.5 million year ended December 31, 2011, representing an increase of 123.3% consistent with the increase in income provision for income taxes. Our effective income tax rate increased to 42.2% for the year ended Decem 2012 from 37.8% for the year ended December 31, 2011. Approximately 2.5% of the increase resul changes in the state tax rate, which include a 2011 one-time benefit from a change in California tax law o In addition, approximately 1.9% of the increase was due to the non-deductible termination of an a services agreement i

Net I

As a result of the factors described above, net income was $23.0 million for the year ended December 31 which represented an increase of $10.6 million compared to net income of $12.4 million for the yea December 31

Year Ended December 31, 2011 compared to the Year Ended December 3

The following table presents our historical operating results for the periods pre

	Year Ended December 31,			
	2011	2010	$ Change	% Chang
		(in thousands)		
Consolidated Statement of Operations Data:				
Revenues	$ 162,974	$ 123,519	$ 39,455	32
Operating expenses:				
Salaries and benefits	67,082	58,113	8,969	15
Other operating expense	49,199	33,655	15,544	46
Impairment of trade name	13,400		13,400	0
Total operating expenses	129,681	91,768	37,913	41
Income from operations	33,293	31,751	1,542	5
Interest expense	(13,530)	(15,230)	1,700	-11
Interest income	125	118	7	6
Income before provision for income taxes	19,888	16,639	3,249	20
Provision for income taxes	7,516	6,664	852	13
Net income	$ 12,372	$ 9,975	2,397	24

Re

Total revenues were $163.0 million for the year ended December 31, 2011, an increase of $39.5 mil 31.9%, compared to total revenues of $123.5 million for the year ended December 31, 2010. Of this in $19.7 million is attributable to increased recovery activity on our RAC contract with CMS and reflects t full-year of our recovery activity related to this contract. The remaining increase was primarily a resu increase in revenues from our student lending markets, due largely to an approximately 17.9% incr placement volume from 2010 t

Salaries and B

Salaries and benefits was $67.1 million for the year ended December 31, 2011, an increase of $9.0 mil
15.4%, compared to salaries and benefits expense of $58.1 million for the year ended December 31, 201
increase is primarily due to an increase in employee headcount associated with hiring to staff our ope
under the RAC contract. Our employee headcount was 1,280 as of December 31, 2011, an increase of
14.3%, over the employee headcount of 1,120 as of December 31

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Other Operating E

Other operating expense was $49.2 million for the year ended December 31, 2011, an increase of $15.5 r
or 46.2%, compared to other operating expense of $33.7 million for the year ended December 31, 201
increase is primarily due to the use of subcontractors as we expand our operations in our healthcare ma
help address the new and significant claims activity, along with increases in payments to healthcare provid
the transfer of medical records as required under the RAC contract. In addition, we recorded a $1.2
expense in 2011 related to a legal settlement that was paid out in the first quarter o

Income From Ope

As a result of the factors described above, income from operations was $33.3 million, for the yea
December 31, 2011, as compared to $31.8 million for the year ended December 31, 2010. This ref
expense of $13.4 million related to impairment expenses to write off the carrying amount of the trad
intangible assets due to the retirement of a former trade name. Income from operations excluding this e
totaled $46.7 million for the year ended December 31, 2011, which represents an increase of $14.9 mil
47.1%, as compared to income from operations for the year ended December 31

Interest E

Interest expense was $13.5 million for the year ended December 31, 2011, a decrease of $1.7 million fron
million for the year ended December 31, 2010. The reduction in interest expense is due primarily to lowe
payable balances resulting from principal repay

Income

Income tax expense of $7.5 million for the year ended December 31, 2011, represented an effective tax
37.8% of income before provision for income tax. Income tax expense of $6.7 million was recorded for t
ended December 31, 2010, and represented an effective tax rate o

Net I

As a result of the factors described above, net income was $12.4 million for the year ended December 31
which represented an increase of $2.4 million over net income of $10.0 million for the year ended Decem
2010. Excluding the impairment expenses to write off the carrying amount of the trade name, net income
have been $20.7 million for the year ended December 31

Liquidity and Capital Res

Our principal sources of liquidity are cash flows from operations, term loans, and the proceeds received fr
initial public offering in August 2012. Cash and cash equivalents, which totaled $37.8 millio
December 31, 2012, consist primarily of cash on deposit with banks. We expect that operating cash flo
continue to be a primary source of liquidity for our operating needs. There are currently no borr
outstanding under our revolving credit facility other than a $1.4 million letter of credit. Due to our operati
flows, our existing cash and cash equivalents and availability under our revolving credit facility, we belie
we have the ability to meet our working capital and capital expenditure needs for the foreseeable

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The following table presents information regarding our cash flows for the years ended December 31, 201
an

	2012	Year Ended December 31, 2011 (in thousands)	2010
Net cash provided by operating activities	$ 37,005	$ 28,985	$ 18,214
Net cash used in investing activities	(12,193)	(6,111)	(4,921)
Net cash used in financing activities	(6,973)	(13,948)	(11,139)

Cash flows from operating a

Operating activities provided $37.0 million of cash during the year ended December 31, 2012, an increase
million, compared to cash provided by operating activities of $29.0 million for the year ended Decem
2011 primarily due to the increase in net income for the year ended December 31, 2012 to $23.0
compared to $12.4 million for 2011. Cash used to pay accrued salary and benefits totaled $9.3 million in 2
compared to the $7.1 million in accrued salaries and benefits payable for the comparable period i
Accounts payable increased $1.3 million in 2012 compared to 2011, primarily due to timing. The es
liability for appeals for revenue received from CMS totaled $4.4 million in 2012, compared $0.5 million i
due to higher claim recovery volumes under our RAC contract wit

We generated $29.0 million of cash from operating activities during the year ended December 31
primarily resulting from our net income of $12.4 million, non-cash depreciation and amortization of $7.8
an impairment expense to write off the carrying amount of the trade name intangible asset due to the ret
of the Diversified Collection Services, Inc. trade name of $13.4 million and changes in operating ass
liabilities of $3.8 million, offset by non-cash deferred income taxes of $9.6

We generated $18.2 million of cash from operating activities during the year ended December 31
primarily resulting from our net income of $10.0 million, non-cash depreciation, amortization and impair
intangible assets of $7.2 million and interest expense from debt issuance costs of $2.0 million, partially o
non-cash changes in operating assets and liabilities of $1.5

Cash flows from investing a

Investing activities resulted in cash outflow of $12.2 million during the year ended December 31, 20
primary uses of cash associated with investing activities in 2012 were $11.4 million for property, equipm
leasehold improvements, to enhance our proprietary technology platform, improve our telecommuni
systems, upgrade our IT infrastructure for storage and operating activities, and $0.8 million for the purch
perpetual software license. We used $6.1 million and $4.9 million of cash in investing activities for the pu
of property, equipment and leasehold improvements during the years ended December 31, 2011 an
primarily for investments in information technology systems and infrastructure to support increased b
v

Cash flows from financing a

For the year ended December 31, 2012, our primary financing activities were $156 million in proceeds fro
loans, $12.8 million of net proceeds from our IPO which was completed in August 2012, and $4.5 mi
revolving credit facility borrowings. These proceeds were offset by $103.4 million used for the repaymen
old notes payable and repayment of principal on our new term loans, $12.7 million used for the repaymen
old and new lines of credit, $60.3 million used to redeem 5.3 million shares of preferred stock, and $3.1
used for debt issuance costs.We used $13.9 million of cash in financing activities for the repayment o
payable during the year ended December 31, 2011. We used $11.1 million of cash in financing activities
the year ended December 31, 2010, comprised of $10.0 million used for the repayment of notes paya
$1.2 million used for debt issuanc

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Long-ter

On March 19, 2012, we, through our wholly owned subsidiary, entered into a $147.5 million credit agr with Madison Capital Funding LLC as administrative agent, ING Capital LLC as syndication agent, an lenders party thereto. The senior credit facility consists of (i) a $57.0 million term A loan that matures in 2017, (ii) a $79.5 million term B loan that matures in March 2018 , and (iii) a $11.0 million revolvin facility that expires in March 2017, which had a borrowing capacity of $9.6 million as of December 31, 20 June 28, 2012, we increased the amount of our borrowings under our term B loan by $19.5 million. We m request the lenders to increase the size of the term B loan or other term loans by up to an additional $10.5 at any time prior to March 19

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

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

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

incur additional indebtedness;

create or permit liens;

pay dividends or other distributions to our equity holders;

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

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

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

consolidate or merge;

sell assets, including the capital stock of our subsidiaries;

enter into transactions with our affiliates;

enter into different business lines; and

make investments.

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The credit agreement also requires us to meet certain financial covenants, including maintaining a fixed
coverage ratio and a total debt to EBITDA ratio as such terms are defined in our credit agreement
financial covenants are tested at the end of each quarter beginning on December 31, 2012. The table
further describes these financial covenants, as well as our status under these covenants as of December 31

Financial Covenant	Covenant Requirement	Actual Ratio at December 31, 2012
Fixed charge coverage ratio (minimum)	1.20 to 1.0	1.93
Total debt to EBITDA ratio (maximum)	3.25 to 1.0	2.11

Contractual Obli

The following summarizes our contractual obligations as of December 31

		Payments Due by Period			
Contractual Obligations	*Total*	*Less Than 1 Year*	*1-3 Years*	*3-5 Years*	*M T 5*
Long-Term Debt Obligations	$ 147,769	$ 11,040	$ 22,080	$ 21,293	$ 9
Interest Payments	45,785	10,446	18,611	15,255	
Operating Lease Obligations	6,754	1,740	3,178	1,771	
Purchase Obligations	3,698	3,650	48		
Total	$ 204,006	$ 26,876	$ 43,917	$ 38,319	$ 9

(1) We entered into our new credit agreement on March 19, 2012 and amended it on June 28, 2012, with a
outstanding indebtedness under our prior loan facility paid in full. Long-term debt obligations and inte
payments presented in this table relate solely to our new credit agreement, as amended.

Adjusted EBITDA and Adjusted Net I

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

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

Our use of adjusted EBITDA and adjusted net income has limitations as an analytical tool, and you sho
consider it in isolation or as a substitute for analysis of our results as reported under GAAP. Some o
limitatio

although depreciation and amortization are non-cash charges, the assets being depreciated and am
may have to be replaced in the future, and adjusted EBITDA does not reflect cash capital expendi
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;

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

adjusted EBITDA and adjusted net income do not reflect the impact of certain non-operating exp
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
reduces its usefulness as a comparative measure.

Because of these limitations, you should consider adjusted EBITDA and adjusted net income alongsi
financial performance measures, including net income and our other GAAP

The following tables present a reconciliation of adjusted EBITDA and adjusted net income for the year
December 31, 2012, 2011 and 2010 to actual net income for these p

	Year Ended December 31		
	2012	**2011**	**2**
		(in thousands)	
Reconciliation of Adjusted EBITDA:			
Net income	$ 22,951	$ 12,372	$
Provision for income taxes	16,786	7,516	
Interest expense	12,414	13,530	1
Interest income	(64)	(125)	
Debt extinguishment costs[(1)]	3,679		
Depreciation and amortization	9,505	7,766	
Impairment of trade name[(2)]		13,400	
Non-core operating expenses[(3)]	47	2,548	
Advisory fee[(4)]	2,641	634	
Stock based compensation	1,614	120	
Adjusted EBITDA	$ 69,573	$ 57,761	$ 4

	Year Ended December 31		
	2012	**2011**	**2**
		(in thousands)	
Reconciliation of Adjusted Net Income:			
Net income	$ 22,951	$ 12,372	$
Debt extinguishment costs[(1)]	3,679		
Impairment of trade name[(2)]		13,400	
Non core operating expenses[(3)]	47	2,548	
Advisory fee[(4)]	2,641	634	
Stock based compensation	1,614	120	
Amortization of intangibles[(5)]	3,676	3,043	
Deferred financing amortization costs[(6)]	1,161	1,254	
Tax adjustments[(7)]	(5,126)	(8,400)	(
Adjusted net income	$ 30,643	$ 24,971	$ 1

(1) Represents debt extinguishment costs comprised of approximately $3.3 million of fees paid to lenders
connection with our new credit facility and approximately $0.3 million of unamortized debt issuance c
connection with our old credit facility.

(2)

Represents impairment expenses to write off the carrying amount of the trade name intangible asset du
the plan to retire the Diversified Collection Services, Inc. trade name.

(3) Represents professional fees and settlement costs related to strategic corporate development activities
$1.2 million legal settlement in 2011.

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(4) Represents expenses incurred under an advisory services agreement with Parthenon Capital Partners, v
was terminated in April 2012. See Note 11 Related Party Transactions.
(5) Represents amortization of capitalized expenses related to the acquisition of Performant by an affiliate
Parthenon Capital Partners in 2004 and an acquisition in the first quarter of 2012 to enhance our analy
capabilities.
(6) Represents amortization of capitalized financing costs related to debt offerings conducted in 2009, 201
2012.
(7) Represents tax adjustments assuming a marginal tax rate of 40%.

Off-Balance Sheet Arrang

We have no off-balance sheet arrange

Recent Accounting Pronounc

Under the JOBS Act, emerging growth companies can delay adopting new or revised accounting standar such time as those standards apply to private companies. However, we do not intend to elect to take advan this extended transition period provided in Section 7(a)(2)(B) of the Securities Act as allo Section 107(b)(1) of the JOI

In December 2011, FASB issued ASU No. 2011-11, *Balance Sheet (Topic 210): Disclosures about Of Assets and Liabilities*. ASU 2011-11 requires an entity to disclose information about offsetting and arrangements to enable users of financial statements to understand the effect of those arrangement financial position, and to allow investors to better compare financial statements prepared under GAA financial statements prepared under International Financial Reporting Standards (IFRS). The new standa effective for annual periods beginning January 1, 2013, and interim periods within those annual p Retrospective application is required. We have implemented the provisions of ASU 2011-11 as of Jan 2013. We do not believe our adoption of the new guidance will have an impact on our consolidated fi stat

In June 2011, the FASB issued ASU 2011-05, *Comprehensive Income (Topic 220): Present Comprehensive Income*. Under this ASU, an entity will have the option to present the components of net and comprehensive income in either one or two consecutive financial statements. The ASU eliminates the in GAAP to present other comprehensive income in the statement of changes in equity. An entity shoul the ASU retrospectively. For a nonpublic entity, the ASU is effective for fiscal years ending after Decem 2012, and interim and annual periods thereafter. Early adoption is permitted. In December 2011, the decided to defer the effective date of those changes in ASU 2011-05 that relate only to the presenta reclassification adjustments in the statement of income by issuing ASU 2011-12, *Comprehensive Income 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Accumulated Other Comprehensive income in Accounting Standards Update 2011-05*. We adopted th guidance with no impact to our consolidated financial state

In May 2011, the FASB issued ASU 2011-04, *Fair Value Measurement (Topic 820): Amendments to A Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS*. The new stand not extend the use of fair value but, rather, provide guidance about how fair value should be applied v already is required or permitted under IFRS or GAAP. For GAAP, most of the changes are clarificat existing guidance or wording changes to align with IFRS. A nonpublic entity is required to apply th prospectively for annual periods beginning after December 15, 2011. We adopted this new guidance v impact to our consolidated financial state

ITEM 7A. Quantitative and Qualitative Disclosures about Mark

We do not hold or issue financial instruments for trading purposes. We conduct all of our business currency and therefore do not have any direct foreign currency risk. We do have exposure to changes in

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rates with respect to the borrowings under our senior secured credit facility, which bear interest at a varia based on the prime rate or LIBOR. For example, if the interest rate on our borrowings increased 100 basis (1%) from the credit facility floor of 1.5%, our annual interest expense would increase by approxi $1.5 million. In July 2012, we entered into an interest rate cap agreement per the terms of our senior s credit agreement. The interest rate cap agreement is effective beginning in October 2012, and matures in O 2014, with a total notional amount of $75 million and a cap on LIBOR at 2.0%. If the LIBOR rate increase by 100 basis points (1.0%) above the credit facility floor of 1.5% for a year, we would re payment from the interest rate cap of approximately $0.4 r

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

ITEM 8. Financial Statements and Supplementary Data

Our consolidated financial statements and notes thereto and the reports of KPMG LLP are set forth in th to Financial Statements under Item 15, Exhibits, Financial Statement Schedules, and is incorporated he ref

ITEM 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

ITEM 9A. Controls and Procedures

Evaluation of Disclosure Controls and Proc

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

Management, with the participation of our Chief Executive Officer and our Chief Financial Offic evaluated the effectiveness of our disclosure controls and procedures, as defined in Rule 13a-15(e) ur Exchange Act, as of the fiscal year covered by this Annual Report on Form 10-K. Based on that evaluati Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedure functioning effectively at the reasonable assurance level as of December 31

Management s Report on Internal Control over Financial Re

Our management is responsible for establishing and maintaining adequate internal control over fi reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) to provide reasonable ass regarding the reliability of our financial reporting and the preparation of our consolidated financial stateme external purposes in accordance with United States Generally Accepted Accounting Principles (US Under the supervision of, and with the participation of our Chief Executive Officer and Chief Financial C management assessed the effectiveness of internal control over financial reporting as of December 31

Management based its assessment on criteria established in Internal Control Integrated Framework iss
Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this e
management concluded that its internal control over financial reporting was effective as of December 31

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Changes in Internal Control over Financial Rep

There was no change in our internal control over financial reporting during the quarter ended Decem
2012, that has materially affected, or is reasonably likely to materially affect, our internal control over fi
reporting, other than those noted

ITEM 9B. Other Inforr

PART III

ITEM 10. Directors, Executive Officers and Corporate Gove

This Item is incorporated by reference to our definitive proxy statement on Schedule 14A, which will b
within 120 days after the close of the fiscal year covered by this report on Form 10-K, or if our proxy state
not filed by that date, will be included in an amendment to this Report on Forn

ITEM 11. Executive Compen

This Item is incorporated by reference to our definitive proxy statement on Schedule 14A, which will b
within 120 days after the close of the fiscal year covered by this report on Form 10-K, or if our proxy state
not filed by that date, will be included in an amendment to this Report on Forn

ITEM 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockho Matters

This Item is incorporated by reference to our definitive proxy statement on Schedule 14A, which will b
within 120 days after the close of the fiscal year covered by this report on Form 10-K, or if our proxy state
not filed by that date, will be included in an amendment to this Report on Forn

ITEM 13. Certain Relationships and Related Transactions, and Director Independence

This Item is incorporated by reference to our definitive proxy statement on Schedule 14A, which will b
within 120 days after the close of the fiscal year covered by this report on Form 10-K, or if our proxy state
not filed by that date, will be included in an amendment to this Report on Forn

ITEM 14. Principal Accounting Fees and Services

This Item is incorporated by reference to our definitive proxy statement on Schedule 14A, which will b
within 120 days after the close of the fiscal year covered by this report on Form 10-K, or if our proxy state
not filed by that date, will be included in an amendment to this Report on Forn

PART IV

ITEM 15. Exhibits, Financial Statement Schedules

(a) Financial State

Financial Statements. The financial statements filed as part of this report are identified in the I
Consolidated Financial Statements on pa

Financial Statement Schedules. See Item 15(c)

Exhibits. See Item 15(b)

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(b) E

The following exhibits are filed herewith or are incorporated by reference to exhibits previously filed v
Securities and Exchange Commission. The Company shall furnish copies of exhibits for a reasona
(covering the expense of furnishing copies) upon r

Exhibit Number	Description
3.1	Restated Certificate of Incorporation of Registrant (incorporated by reference to Exhibit 3.1 the Company s Registration Statement on Form S-1/A filed July 23, 2012)
3.2	Amended and Restated Bylaws of Registrant (incorporated by reference to Exhibit 3.2(b) to Company s Registration Statement on Form S-1/A filed July 23, 2012)
4.2	Amended and Restated Registration Rights Agreement, dated as of August 15, 2012, among Registrant and the persons listed thereon (incorporated by reference to Exhibit 4.2 to the Company s Registration Statement on Form S-1/A filed July 23, 2012)
10.1	Form of Indemnification Agreement between the Registrant and its officers and directors (incorporated by reference to Exhibit 10.1 to the Company s Registration Statement on For filed July 30, 2012)
10.2	2004 Equity Incentive Plan and form of agreements thereunder (incorporated by reference t Exhibit 10.2 to the Company s Registration Statement on Form S-1 filed July 3, 2012)
10.3	2004 DCS Holdings Stock Option Plan and form of agreements thereunder (incorporated by reference to Exhibit 10.3 to the Company s Registration Statement on Form S-1 filed July 3
10.4	2007 Stock Option Plan and form of agreements thereunder (incorporated by reference to Exhibit 10.4 to the Company s Registration Statement on Form S-1 filed July 3, 2012)
10.5	Recovery Audit Contractor contract by and between Diversified Collection Services, Inc. ar Center for Medicare and Medicaid Services dated as of October 3, 2008, as amended (incorp by reference to Exhibit 10.5 to the Company s Registration Statement on Form S-1/A filed 2012)
10.6	Credit Agreement, dated as of March 19, 2012, by and among DCS Business Services, Inc., Lenders party Hereto, Madison Capital Funding LLC, and ING Capital (incorporated by ref to Exhibit 10.6 to the Company s Registration Statement on Form S-1/A filed July 23, 2012
10.7	Form of Change of Control Agreement, as amended (incorporated by reference to Exhibit 1 the Company s Registration Statement on Form S-1/A filed July 30, 2012)
10.8	Employment Agreement between the Registrant and Lisa Im, dated as of April 15, 2012, as amended (incorporated by reference to Exhibit 10.8 to the Company s Registration Stateme Form S-1/A filed July 23, 2012)
10.9	Employment Agreement between the Registrant and Jon D. Shaver dated as of March 31, 20 amended (incorporated by reference to Exhibit 10.9 to the Company s Registration Stateme Form S-1/A filed July 23, 2012)
10.10	Repurchase Agreement between the Registrant and Lisa C. Im dated as of July 3, 2012 (incorporated by reference to Exhibit 10.10 to the Company s Registration Statement on Fo filed July 3, 2012)
10.11	Repurchase Agreement between the Registrant and Jon D. Shaver dated as of July 3, 2012 (incorporated by reference to Exhibit 10.11 to the Company s Registration Statement on Fo filed July 3, 2012)

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Exhibit Number	Description
10.12	Director Nomination Agreement between the Registrant and Parthenon DCS Holdings, LLC as of July 20, 2012 (incorporated by reference to Exhibit 10.12 to the Company s Registrati Statement on Form S-1/A filed July 23, 2012)
10.13	Advisory Services Agreement between Diversified Collection Services, Inc. and Parthenon C LLC dated as of January 8, 2004, as amended (incorporated by reference to Exhibit 10.13 to Company s Registration Statement on Form S-1/A filed July 23, 2012)
10.14	Termination of the Advisory Services Agreement between Diversified Collection Services, I and Parthenon Capital, LLC dated as of January 8, 2004, as amended, dated as of April 13, 2 (incorporated by reference to Exhibit 10.14 to the Company s Registration Statement on Fo S-1/A filed July 23, 2012)
10.15	2012 Stock Incentive Plan (incorporated by reference to Exhibit 10.15 to the Company s Registration Statement on Form S-1/A filed July 23, 2012)
21	List of Subsidiaries
23	Consent of KPMG LLP, Independent Registered Public Accounting Firm
24	Powers of Attorney (included in the signature page to this report)
31.1	Rule 13a-14(a)/15d-14(a) Certification, executed by Lisa C. Im
31.2	Rule 13a-14(a)/15d-14(a) Certification, executed by Hakan L. Orvell
32.1	Furnished Statement of the Chief Executive Officer under 18 U.S.C. Section 1350
32.2	Furnished Statement of the Chief Financial Officer under 18 U.S.C. Section 1350
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Scheme
101.CAL	XBRL Taxonomy Extension Calculation Linkbase
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase
101.PRE	XBRL Taxonomy Extension Presentation Linkbase

Schedules not listed above have been omitted because they are not applicable or required, or the infor required to be set forth therein is included in the Consolidated Financial Statements or Notes

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Index to Consolidated Financial Statements

Consolidated Financial Statements of Performant Financial Corporation and Subsidiaries For the Years Ended December 31, 2012, 2011 and 2010

Report of Independent Registered Public Accounting Firm

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Consolidated Statements of Operations

Consolidated Statements of Changes in Redeemable Preferred Stock and Stockholders Equity (Deficit)

Consolidated Statements of Cash Flows

Notes to Consolidated Financial Statements

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Stock

Performant Financial Corp

We have audited the accompanying consolidated balance sheets of Performant Financial Corporat
subsidiaries as of December 31, 2012 and 2011, and the related consolidated statements of operations, cha
redeemable preferred stock and stockholders equity (deficit), and cash flows for each of the yea
three-year period ended December 31, 2012. These consolidated financial statements are the responsibility
Company s management. Our responsibility is to express an opinion on these consolidated financial st
based on our

We conducted our audits in accordance with the standards of the Public Company Accounting Oversigh
(United States). Those standards require that we plan and perform the audit to obtain reasonable assuranc
whether the financial statements are free of material misstatement. An audit includes examining, on a tes
evidence supporting the amounts and disclosures in the financial statements. An audit also includes assess
accounting principles used and significant estimates made by management, as well as evaluating the
financial statement presentation. We believe that our audits provide a reasonable basis for our o

In our opinion, the consolidated financial statements referred to above present fairly, in all material respe
financial position of Performant Financial Corporation and subsidiaries as of December 31, 2012 and 20
the results of their operations and their cash flows for each of the years in the three-year perioc
December 31, 2012, in conformity with U.S. generally accepted accounting prin

/s/ KPM

San Francisco, Ca

March 2

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PERFORMANT FINANCIAL CORPORATION AND SUBSIDIARIES

Consolidated Balance Sheets

(In thousands, except per share amounts)

Assets	December 31, 2012	Decemb 201
Current assets:		
Cash and cash equivalents	$ 37,843	$ 2
Trade accounts receivable, net of allowance for doubtful accounts of $65 and $77, respectively and estimated allowance for appeals of $1,199 and $484, respectively	23,044	1
Deferred income taxes	3,798	
Prepaid expenses and other current assets	2,876	
Debt issuance costs, current portion	1,125	
Total current assets	68,686	4
Property, equipment, and leasehold improvements, net	20,669	1
Identifiable intangible assets, net	36,244	3
Goodwill	81,572	8
Debt issuance costs	3,844	
Other assets	730	
Total assets	$ 211,745	$ 18
Liabilities, Redeemable Preferred Stock and Stockholders Equity (Deficit)		
Liabilities:		
Current liabilities:		
Current maturities of notes payable	$ 11,040	$
Accrued salaries and benefits	9,288	
Accounts payable	1,403	
Other current liabilities	8,252	
Income taxes payable	430	
Deferred revenue	2,187	
Estimated liability for appeals	4,378	
Total current liabilities	36,978	2
Notes payable, net of current portion	136,729	8
Line of credit, drawn		
Deferred compensation		
Deferred income taxes	11,271	1
Other liabilities	2,694	
Total liabilities	187,672	13
Commitments and contingencies		
Redeemable preferred stock		
Series A convertible preferred stock, $0.0001 par value. Authorized, 50,000 and 18,000 shares; issued and outstanding, 0 and 5,296 shares at December 31, 2012 and 2011, respectively		5

Stockholders equity (deficit):		
Due from stockholders		(
Common stock, $0.0001 par value. Authorized, 500,000 and 50,000 shares at December 31, 2012 and 2011, respectively; issued and outstanding 45,392 and 37,667 shares at December 31, 2012 and 2011, respectively	4	
Additional paid-in capital	35,970	1
Accumulated deficit	(11,901)	(3
Total stockholders equity (deficit)	24,073	(1
Total liabilities, redeemable preferred stock, and stockholders equity (deficit)	$ 211,745	$ 18

See accompanying notes to consolidated financial stat

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PERFORMANT FINANCIAL CORPORATION AND SUBSIDIARIES

Consolidated Statements of Operations

(In thousands, except per share amounts)

	For the Years Ended December		
	2012	**2011**	**20**
Revenues	$ 210,073	$ 162,974	$ 12
Operating expenses:			
Salaries and benefits	83,002	67,082	5
Other operating expenses	71,305	49,199	3
Impairment of trade name		13,400	
Total operating expenses	154,307	129,681	9
Income from operations	55,766	33,293	3
Debt extinguishment costs	(3,679)		
Interest expense	(12,414)	(13,530)	(1
Interest income	64	125	
Income before provision for income taxes	39,737	19,888	1
Provision for income taxes	16,786	7,516	
Net income	$ 22,951	$ 12,372	$
Accrual for preferred stock dividends	2,038	6,495	
Net income available to common shareholders	$ 20,913	$ 5,877	$
Net income per share attributable to common shareholders (see Note 1)			
Basic	$ 0.48	$ 0.14	$
Diluted	$ 0.44	$ 0.13	$
Weighted average shares (see Note 1)			
Basic	43,985	42,962	4
Diluted	47,599	45,742	4

See accompanying notes to consolidated financial stat

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PERFORMANT FINANCIAL CORPORATION AND SUBSIDIARIES

Consolidated Statements of Changes in Redeemable Preferred Stock and Stockholders Equity (Deficit)

For the Years Ended December 31, 2012, 2011 and 2010

(In thousands)

	Redeemable Preferred Stock Series A Convertible Preferred Stock		**Due From Stockholders**	**Common Stock**		**Additional Paid-In Capital**	**Accumulated Deficit**	**T**
	Shares	**Amount**		**Shares**	**Amount**			
Balance, December 31, 2009	5,296	$ 45,982	$ (2,161)	37,667	$ 4	$ 18,728	$ (42,895)	$ (2
Increase in redemption value of Series A preferred stock		5,771					(5,771)	(
Interest on notes receivable from stockholders			(103)					
Stock-based compensation expense			106			523		
Net income							9,975	
Balance, December 31, 2010	5,296	51,753	(2,158)	37,667	4	19,251	(38,691)	(2
Increase in redemption value of Series A preferred stock		6,495					(6,495)	(
Interest on notes receivable from stockholders			(108)					
Stock-based compensation expense						120		
Net income							12,372	1
Balance, December 31, 2011	5,296	58,248	(2,266)	37,667	4	19,371	(32,814)	(1
Increase in redemption value of Series A preferred stock		2,038					(2,038)	(
Conversion of Series A preferred stock to Series B preferred stock which was immediately redeemed for cash		(60,286)						
Conversion of Series B preferred stock to	(5,296)			5,296				

common							
Exercise of stock options			284		175		
Issuance of stock			2,243		15,420		1
Purchase of treasury stock			(98)		(1,225)		(
Interest on notes receivable from stockholders		(57)					
Repayment of notes receivable from stockholders		2,323					
Stock-based compensation expense					1,614		
Income tax benefit from employee stock options					615		
Net income						22,951	2
Balance, December 31, 2012	$	$	45,392	$ 4	$ 35,970	$ (11,901)	$ 2

See accompanying notes to consolidated financial stat

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PERFORMANT FINANCIAL CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cash Flows

(In thousands)

	For the Years Ended December		
	2012	**2011**	**2**
Cash flows from operating activities:			
Net income	$ 22,951	$ 12,372	$
Adjustments to reconcile net income to net cash provided by operating activities:			
Loss on disposal of assets	51		
Impairment of intangible asset		13,400	
Depreciation and amortization	9,505	7,766	
Write-off of unamortized debt issuance costs	335		
Deferred income taxes	(1,826)	(9,640)	
Stock-based compensation	1,614	120	
Interest expense from debt issuance costs and amortization of discount note payable	1,272	1,254	
Interest income on notes receivable from stockholders	(57)	(108)	
Changes in operating assets and liabilities:			
Trade accounts receivable	(3,646)	(5,392)	
Prepaid expenses and other current assets	416	(94)	
Other assets	(71)	372	
Accrued salaries and benefits	2,150	2,542	
Accounts payable	1,343	(3)	
Other current liabilities	(1,223)	4,714	
Income taxes payable	(40)	470	
Deferred revenue	(27)	2,214	
Estimated liability for appeals	3,928	450	
Other liabilities	330	(1,452)	
Net cash provided by operating activities	37,005	28,985	
Cash flows from investing activities:			
Purchase of property, equipment, and leasehold improvements	(11,356)	(6,111)	
Purchase of perpetual software license and computer equipment	(837)		
Net cash used in investing activities	(12,193)	(6,111)	
Cash flows from financing activities:			
Borrowing under notes payable	156,000		
Borrowing under line of credit	4,500		
Redemption of preferred stock	(60,286)		
Repayment of notes payable	(103,416)	(13,948)	
Repayment of line of credit	(12,698)		
Debt issuance costs paid	(3,074)		
Proceeds from exercise of stock options	175		
Proceeds from issuance of stock	12,624		
Repayment of promissory notes from stockholders	2,323		
Income tax benefit from employee stock options	615		
Payment to stockholders	(1,761)		
Purchase of treasury stock	(1,225)		
Payment of purchase obligation	(750)		
Net cash used in financing activities	(6,973)	(13,948)	(
Net increase in cash and cash equivalents	17,839	8,926	

Cash and cash equivalents at beginning of year	20,004	11,078	
Cash and cash equivalents at end of year	$ 37,843	$ 20,004	$
Supplemental disclosures of cash flow information:			
Cash paid for income taxes	$ 18,037	$ 15,830	$
Cash paid for interest	$ 11,178	$ 12,246	$
Cash paid as debt extinguisment	$ 3,344	$	$
Supplemental disclosure of non-cash investing and financing activities:			
Obligation to sellers of perpetual license	$ 3,250	$	$
Issuance of common stock as part of debt issuance costs	$ 2,796	$	$

See accompanying notes to consolidated financial stat

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PERFORMANT FINANCIAL CORPORATION AND SUBSIDIARIES

Notes To Consolidated Financial Statements

For the Years Ended December 31, 2012, 2011 and 2010

1. Summary of Significant Accounting Policies

(a) Organization and Nature of Business

Performant Financial Corporation (the Company) is a leading provider of technology-enabled recov analytics services in the United States. Company services help identify, restructure and recover delinq defaulted assets and improper payments for both government and private clients in a broad range of m Company clients typically operate in complex and regulated environments and outsource their recovery n order to reduce losses on billions of dollars of defaulted student loans, improper healthcare payme delinquent state tax and federal treasury receivables. The Company generally provides our service outsourced basis, where we handle many or all aspects of the clients recovery p

The Company s consolidated financial statements include the operations of Performant Financial Co (PFC), its wholly owned subsidiary Performant Business Services, Inc., and its wholly owned subs Performant Recovery, Inc. (Recovery), and Performant Technologies, Inc. Effective August 13, 20 changed the name of our wholly owned subsidiary from DCS Business Services, Inc. (DCSBS) to Perf Business Services, Inc., and DCSBS wholly owned subsidiaries from Diversified Collection Serv (DCS), and Vista Financial, Inc. (VFI), to Performant Recovery, Inc., and Performant Technologie respectively. PFC is a Delaware corporation headquartered in California and was formed in 2003. Perf Business Services, Inc. is a Nevada corporation founded in 1997. Recovery is a California corporation fou 1976. Performant Technologies, Inc. is a California corporation that was formed i

The Company is managed and operated as one business, with a single management team that reports to th Executive C

(b) Principles of Consolidation

The accompanying consolidated financial statements have been prepared in accordance with U.S. Ge Accepted Accounting Principles, or U.S. GAAP. The Company consolidates entities in which it has con financial interest, and as of December 31, 2012, all of the Company s subsidiaries are 100% ow significant intercompany balances and transactions have been eliminated in consoli

(c) Use of Estimates in the Preparation of Consolidated Financial Statements

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

(d) Stock Split

On July 26, 2012, the Company effected a two-for-one stock split of the Company s shares of Commo
Accordingly, all per share amounts, average shares outstanding, shares outstanding, and equit
compensation presented in the consolidated financial statements and notes have been adjusted retroact
reflect the stock split. Shareholders deficit has been retroactively adjuste

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effect to the stock split for all periods presented by reclassifying the par value of the additional shares is
connection with the stock split to additional paid-in capital. Concurrently with the stock split, the aut
Common Stock was increased from 25,000,000 shares to 60,000,000 shares. On August 15, 2012, the aut
Common Stock was increased to 500,000,000 shares and the authorized preferred stock was incre
50,000,000

(e) Cash and Cash Equivalents

Cash and cash equivalents include demand deposits and highly liquid debt instruments with original matur
three months or less when purchased. These investments can include money market funds that invest in
liquid U.S. government and agency obligations, certificates of deposit, bankers acceptances, and co

The Company collects monies on behalf of its clients. Cash is often held on behalf of the clients in vario
accounts and is subsequently remitted to the clients based on contractual agreements. Cash held in the
accounts for contracting agencies is not included in the Company s assets (No

(f) Hosted Service Installation and Implementation Deliverables

In 2008, the Company entered into a long-term contract to provide hosted services to a client beginning in
2009. The Company determined that certain installation and implementation deliverables were not separa
of accounting within the contract, and should be combined for revenue recognition purposes with the
service deliverable. Accordingly, revenue for these contract elements is being taken ratably f
commencement of hosted services in March 2009 through the contract period of March 2018. Addition
Company deferred the direct incremental costs associated with the installation and implementation deliv
with the costs being expensed ratably from the March 2009 commencement of services through Marc

(g) Property, Equipment, and Leasehold Improvements

Property, equipment, and leasehold improvements are stated at cost, net of accumulated depreciation. F
and equipment are depreciated using the straight-line method over estimated useful lives ranging fr
7 years. Buildings are depreciated using the straight-line method over 31.5 years. Leasehold improvem
amortized using the straight-line method over the shorter of the estimated life of the asset or the remaini
of the lease. Computer software and computer hardware are depreciated using the straight-line meth
3 years and 5 years, respe

Maintenance and repairs are charged to expense as incurred. Improvements that extend the useful lives o
are capi

When property is sold or retired, the cost and the related accumulated depreciation are removed f
consolidated balance sheet and any gain or loss from the transaction is included in the consolidated statem
ope

(h) Goodwill and Other Intangible Assets

Goodwill represents the excess of purchase price and related costs over the fair value assigned to the net a
businesses acquired. Goodwill is not amortized, but instead is reviewed for impairment at least an
Impairment is the condition that exists when the carrying amount of goodwill is not recoverable and its c
amount exceeds its fair value. In accordance with Accounting Standard Update (ASU) 2011-08, *Inta*
Goodwill and Other (Topic 350): Testing Goodwill for Impairment, the Company performed a qua
assessment of whether it is more likely than not that goodwill fair value is less than its carrying amount fo

and concluded that there was no

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perform an impairment test. The Company performed a qualitative assessment of whether it is more like
not that goodwill fair value is less than its carrying amount for 2011, and again concluded that there was n
to perform an impairment test. The Company applied impairment tests to its goodwill and determined
impairment loss had occurred durin

Identifiable intangible assets consist of customer contracts and related relationships, a perpetual licen
covenants not to compete. Customer contracts and related relationships are amortized over their estimated
life of 4 20 years. The perpetual license is amortized over its estimated useful life of

(i) Impairment of Long-Lived Assets

Long-lived assets are evaluated for impairment whenever events or changes in circumstances indicate
carrying amount of such assets or intangibles may not be recoverable. Recoverability of assets to be h
used is measured by a comparison of the carrying amount of the assets to future undiscounted net cas
expected to be generated by the assets. If such assets are considered to be impaired, the impairme
recognized is measured by the amount by which the carrying amount of the assets exceeds the fair valu
assets. The Company did not recognize an impairment expense for intangible assets in 2012 and 2010. I
the Company recorded $13.4 million of impairment expense to write off the carrying amount of its form
name, Diversified Collection Services, Inc. (DCS). The Company determined that the DCS trade name wo
be used in the future, and retired the trade name intangible asset acco

(j) System Developments

The Company follows the provisions of Financial Accounting Standards Board (FASB) Accounting Sta
Update (ASC) Subtopic 350-40, *Internal-Use Software*, which specifies that costs incurred during the app
stage of development should be capitalized. All other costs are expensed as incurred. During 2012, 20
2010, costs of $5.4 million, $2.5 million and $2.1 million respectively, were capitalized for project
application stage of development, with depreciation expense of $2.4 million, $2.1 million and $1.5
respectively, for completed p

(k) Debt Issuance Costs

Debt issuance costs represent loan and legal fees paid in connection with the issuance of long-term deb
issuance cost is amortized to interest expense in accordance with key terms of the notes as an

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

Revenue is recognized upon the collection of defaulted loan and debt payments. Loan rehabilitation rev
recognized when the rehabilitated loans are sold (funded) by clients. Incentive revenue is recognized upon
of official notification of incentive award from customers. Under the Company s RAC contract with C
Company recognizes revenues when the healthcare provider has paid CMS for a given claim or offset. Pr
have the right to appeal a claim and may pursue additional appeals if the initial appeal is found in favor o
The Company accrues an estimated liability for appeals based on the amount of commissions received wh
subject to appeal and which the Company estimates are probable of being returned to providers fol
successful appeal. At December 31, 2012, a total of $5.6 million was presented as an allowance against r
representing the Company s estimate of claims that may be overturned. Of this amount, $1.2 million wa
to amounts in accounts receivable and $4.4 million was related to commissions which had already been re
The balances at December 31, 2012 and 2011, were $4.4 million and $0.5 million, respectively, repres
Company s best estimate of the probable amount of losses r

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appeals of claims for which commissions were previously collected. In addition to the $4.4 million
accrued at December 31, 2012, the Company estimates that it is reasonably possible that it could be requ
pay an additional amount up to approximately $1.5 million as a result of potentially successful appeals.
extent that required payments by the Company exceed the amount accrued, revenues in the applicable
would be reduced by the amount of the

For the year ended December 31, 2012, the Company had 5 clients whose individual revenues exceeded
the Company s total revenues. The dollar amount and percent of total revenue of each of the 5
summarized in the table below (in thou

Rank	2012 Revenue	Percent of total revenue
1	$ 54,130	25.8%
2	39,183	18.7%
3	29,027	13.8%
4	25,469	12.1%
5	22,397	10.7%

For the year ended December 31, 2011, the Company had 5 clients whose individual revenues exceeded
the Company s total revenues. The dollar amount and percent of total revenue of each of the 5
summarized in the table below (in thou

Rank	2011 Revenue	Percent of total revenue
1	$ 30,732	18.9%
2	28,504	17.5%
3	21,812	13.4%
4	21,549	13.2%
5	17,934	11.0%

For the year ended December 31, 2010, the Company had 4 clients whose individual revenues exceeded
the Company s total revenues. The dollar amount and percent of total revenue of each of the 4
summarized in the table below (in thou

Rank	2010 Revenue	Percent of total revenue
1	$ 27,881	22.6%
2	20,776	16.8%
3	17,287	14.0%
4	15,445	12.5%

Revenue from the largest three customers was 58%, 50% and 53% of total revenue in 2012, 2011 an
respectively. Accounts receivable due from these three customers were 63%, 25% and 41% of tot
receivables at December 31, 2012, 2011 and 2010, respectively. Trade accounts receivable are recorde
invoiced amount and do not bear interest. Amounts collected on trade accounts receivable are include
cash provided by operating activities in the consolidated statements of cash flows. The Company determi
allowance for doubtful accounts by specific identification. Account balances are charged off aga
allowance after all means of collection have been exhausted and the potential for recovery is considered
The allowance for doubtful accounts was $0.1 million and $0.1 million at December 31, 2012 an
respe

(m) Legal Expenses

The Company recognizes legal fees related to litigation as they are in

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(n) Comprehensive Income

The Company has no components of comprehensive income other than its net income. Acco comprehensive income is equivalent to net i

(o) Fair Value of Financial Instruments

The Company s financial instruments include cash and cash equivalents, accounts receivable, accounts and accrued liabilities, short-term debt and long-term debt. The carrying values of cash and cash equi accounts receivable, accounts payable, and accrued liabilities approximate their fair values based on o their short-term maturities. The carrying values of short-term debt and long-term debt approximate fair v which their variable interest rates approximate mark

(p) Income Taxes

The Company accounts for income taxes under the asset-and-liability method. Deferred income tax ass liabilities are recognized for future tax consequences attributable to differences between the carrying v assets and liabilities for financial reporting purposes and for taxation purposes. Deferred income tax ass liabilities are measured using the enacted tax rates expected to apply to taxable income in the years i those temporary differences are expected to be recovered or settled. The effect of a change in tax r deferred income tax assets and liabilities is recognized in income in the period that includes the enactme Valuation allowances are established when necessary to reduce deferred tax assets to the amount expecte r

The Company recognizes the effect of income tax positions only if those positions are more likely tha being sustained. Recognized income tax positions are measured at the largest amount that is greater th likely of being realized. Changes in recognition or measurement are reflected in the period in which the ch judgment

(q) Preferred Stock

The carrying amounts of preferred stock are periodically increased by amounts representing divide currently declared or paid, but which would be payable under certain redemption features. Such incr carrying amounts are recorded against retained ea

(r) Stock Options

The Company accounts for its employee stock-based compensation awards in accordance with FAS Topic 718, *Compensation Stock Compensation*. FASB ASC Topic 718 requires that all employee sto compensation is recognized as a cost in the financial statements and that for equity-classified awards, suc measured at the grant date fair value of the award. The Company estimates grant date fair value us Black-Scholes-Merton option-pricing

FASB ASC Topic 718 also requires that excess tax benefits recognized in equity related to stock option e are reflected as financing cash inflows. The Company recognized income tax benefits resulting from the e of stock options in 2012, 2011 and 2010 of $0.6 million, $0 million and $0 million, resp

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(s) Earnings per Share

Basic earnings per share is calculated by dividing net income available to common shareholders by the the weighted average number of common shares outstanding during the period plus the weighted average of Series A preferred shares outstanding during the period. The Series A shares are included in th denominator because they could be converted into common shares for no cash consideration (via con units as further described in Note 7), and were thus considered outstanding common shares in computin earnings per share. Diluted earnings per share is calculated by dividing net income available to c shareholders by the weighted average number of common shares and dilutive common shares equi outstanding during the period. The Company s common share equivalents consist of stock

The following table reconciles the basic to diluted weighted average shares outstanding using the treasur method (shares in thou

	Year Ended December 31,		
	2012	**2011**	**2010**
Weighted average shares outstanding basic	43,985	42,962	42,962
Dilutive effect of stock options	3,614	2,780	2,057
Weighted average shares outstanding diluted	47,599	45,742	45,019

For the year ended December 31, 2012, the Company excluded from the calculation of diluted earnings pe options to purchase 2,364,000 shares because such outstanding options combined exercise price, unamor value and excess tax benefits were greater than the average market price of our common shares in each c periods because their effect would be anti-dilutive (i.e., including such options would result in higher e per

(t) Recent Accounting Pronouncements

In December 2011, the FASB issued ASU No. 2011-11, *Balance Sheet (Topic 210): Disclosures about Of Assets and Liabilities*. ASU 2011-11 requires an entity to disclose information about offsetting and arrangements to enable users of financial statements to understand the effect of those arrangement financial position, and to allow investors to better compare financial statements prepared under U.S. GAA financial statements prepared under International Financial Reporting Standards (IFRS). The new standa effective for annual periods beginning January 1, 2013, and interim periods within those annual p Retrospective application is required. The Company implemented the provisions of ASU 2011-1 January 1, 2013. The Company does not believe its adoption of the new guidance will have an impac consolidated financial sta

In June 2011, the FASB issued ASU 2011-05, *Comprehensive Income (Topic 220): Present Comprehensive Income*. Under this ASU, an entity will have the option to present the components of net and comprehensive income in either one or two consecutive financial statements. The ASU eliminates the in U.S. GAAP to present other comprehensive income in the statement of changes in equity. An entity apply the ASU retrospectively. For a nonpublic entity, the ASU is effective for fiscal years endi December 15, 2012, and interim and annual periods thereafter. Early adoption is permitted. In Decembe the FASB decided to defer the effective date of those changes in ASU 2011-05 that relate only to the prese of reclassification adjustments in the statement of operations by issuing ASU 2011-12, *Comprehensive (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Ite of Accumulated Other Comprehensive income in Accounting Standards Update No. 2011-05.* The Co adopted this new accounting guidance with no impact to our consolidated financial state

In May 2011, the FASB issued ASU 2011-04, Fair Value Measurement (Topic 820): *Amendments to A Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*. The new stand not extend the use of fair value but, rather, provide guidance about h

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value should be applied where it already is required or permitted under IFRS or U.S. GAAP. For U.S. most of the changes are clarifications of existing guidance or wording changes to align with IFRS. A no entity is required to apply the ASU prospectively for annual periods beginning after December 15, 20 Company adopted ASU 2011-04 in 2012 with no impact to our consolidated financial stat

(v) Reclassifications

Certain reclassifications have been made to the 2011 balances to conform to the 2012 presentatio reclassifications have no effect on net income or retained earnings as previously re

2. Acquisition

In February 2012, the Company purchased a perpetual software license and computer equipment from H non-public Florida company, in a transaction valued at $3.68 million. The purchase agreement calls for a $4.0 million in cash payments to be made over an approximate 3 year period, beginning with an initial p of $0.8 million which was made in February 2012, followed by quarterly payments of $0.3 million. As pa transaction valuation, these payments were discounted to a present value using an estimate of our incre borrowi

The HOPS proprietary software platform provides data filtering services for government and commercia plans to help identify improper payments made to health providers, and enhances our existing service off recovery of improper pa

The purchase is being treated as a business combination for accounting purposes; the following table sum the estimated fair values of the assets acquired at the acquisition date (in thou

	February 1, 2012
Computer equipment	$ 280
Perpetual license	3,250
Customer relationships	150
Total identifiable assets acquired	$ 3,680

The acquired intangible assets will be amortized over their estimated useful lives, which are 5 and 4 years perpetual license and customer relationships, respe

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The following represents our pro forma Consolidated Statements of Income as if HOPS had been included
consolidated results for the years ending December 31, 2012 and 2011 (in thousands, except for per shar

	For the year ended December 31, 2012	For the year ended December 31, 2011
Total revenue	$ 211,329	$ 164,230
Net income available to common shareholders	$ 18,751	$ 3,715
Earnings per share attributable to common shareholders		
Basic	$ 0.43	$ 0.09
Diluted	$ 0.39	$ 0.08

3. Property, Equipment, and Leasehold Improvements

Property, equipment, and leasehold improvements consist of the following at December 31, 2012 and 2
thou

	December 31, 2012	December 31, 2011
Land	$ 1,767	$ 1,767
Building and leasehold improvements	5,500	4,797
Furniture, equipment, and automobile	4,408	3,612
Computer hardware and software	40,886	31,197
	52,561	41,373
Less accumulated depreciation and amortization	(31,892)	(26,458)
Property, equipment and leasehold improvements, net	$ 20,669	$ 14,915

Depreciation and amortization expense of property, equipment and leasehold improvements was $5.8 r
$4.7 million and $4.2 million for the years ended December 31, 2012, 2011 and 2010, respe

4. Identifiable Intangible Assets

Identifiable intangible assets consist of the following at December 31, 2012 and 2011 (in thou

December 31, 2012	Gross Amounts	Accumulated Amortization	Net
Amortizable intangibles:			
Customer contracts and related relationships	$ 62,198	$ (28,608)	$ 33,590
Perpetual license	3,250	(596)	2,654

Total intangible assets	$ 65,448	$ (29,204)	$ 36,244

December 31, 2011	**Gross Amounts**	**Accumulated Amortization**	**Net**
Amortizable intangibles:			
Customer contracts and related relationships	$ 62,046	$ (25,530)	$ 36,516
Total intangible assets	$ 62,046	$ (25,530)	$ 36,516

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For the years ended December 31, 2012, 2011 and 2010, amortization expense related to intangibl
amounted to $3.7 million, $3.0 million and $3.0, respe

The estimated aggregate amortization expense for each of the five following fiscal years is as foll
thou

Year Ending December 31,	Amount
2013	$ 3,731
2014	3,731
2015	3,731
2016	3,696
2017	3,097
Thereafter	18,258
Total	$ 36,244

5. Credit Agreement

On March 19, 2012, the Company recapitalized entering into a credit agreement (the Agreement) consisti
Term A Loan of $57.0 million, a Term B Loan of $79.5 million, and a revolving credit facility of $11.0
In connection with the recapitalization, our old credit facility, scheduled to mature in 2012, was extinguish
our indebtedness on the old facility was paid in full. As of December 31, 2011, the indebtedness on
facility consisted of $33.2 million under the Term A-2 Loan, $62 million under the Term B Loan a
million under the line of credit. On June 28, 2012, the Agreement was amended to increase the Term B
$99 million. Payments under the Agreement are as follows (in thou

Year Ending December 31,	Amount
2013	$ 11,040
2014	11,040
2015	11,040
2016	11,040
2017	10,253
Thereafter	93,356
Total	$ 147,769

Proceeds from the new Term A, Term B, and revolving credit facility borrowings were used along wit
million of our cash to repay our old notes payable and line of credit in the amount of $103.4 millior
redeem 3,897,000 shares of Series A Convertible Preferred Stock plus accrued dividends for a total o
million. Fees paid in conjunction with the credit agreement totaled $8.1 million, including an agency
$1.5 million to an entity associated with our majority stockholder, and an agreement to grant 215,000 sh
Common Stock valued at approximately $2.8 million to an investment bank acting as a

Proceeds from the additional Term B borrowings were used to redeem the remaining 1,399,000 shares o
A Convertible Preferred Stock outstanding plus accrued dividends for a total of $16.3 million. Fees
conjunction with the credit agreement totaled $0.8 million, including an agency fee for $0.2 million to a
associated with our majority stockholder. Remaining proceeds of $2.3 million were used along with existi
to pay off the line of credit balance of $4.5

The Term A Loan is charged interest either at Prime (subject to a 2.50% floor) +4.25% or LIBOR (subj
1.50% floor) +5.25%, which was 6.75% at December 31, 2012. The Term A loan requires quarterly paym
$2.5 million beginning in June 2012, with the remaining outstanding principal balance due March 19, 20
of December 31, 2012, the Term A loan ending balance, including the current portion was $49.5 r

The Term B loan is charged interest at Prime +4.75% (subject to a 2.50% floor) or LIBOR (subject to a
floor) +5.75% which was 7.25% at December 31, 2012. The Term B loan requires qu

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payments of $0.2 million beginning in June 2012, with the outstanding principal balance due March 19, 20
of December 31, 2012, the Term B loan ending balance, including the current portion was $98.3 r

The Company has a line of credit under the Agreement which allows for borrowings of up to $11 r
Borrowings accrue interest at Prime + 4.25% or LIBOR + 5.25%, which was 6.75% at December 31, 201
the Prime and the LIBOR alternatives are subject to minimum rate floors. In addition, a facility fee of
assessed on the commitment amount. There were no outstanding borrowings under this line of c
December 31, 2012, and a letter of credit outstanding in the amount of $1.4 million, leaving remaining bor
capacity under the line of credit of $9.6 million at December 31, 2012. The line of credit expires in Ma

The Agreement contains certain restrictive financial covenants, which require, among other things, that w
a minimum fixed charge coverage ratio of 1.20 and maximum total debt to EBITDA ratio of 3.25. Additi
these covenants restrict the Company and its subsidiaries ability to incur certain types or am
indebtedness, incur liens on certain assets, make material changes in corporate structure or the natur
business, dispose of material assets, engage in a change in control transaction, make certain foreign inves
enter into certain restrictive agreements, or engage in certain transactions with affiliates. We were in com
with all such covenants at December 31

During our March 19, 2012 recapitalization, debt issuance costs of $5.0 million were capitalized, includi
million of agent fees paid to an entity associated with our majority stockholder, and $0.8 million paid
parties for legal and other services and a grant of 215,044 shares of Common Stock issued as compensatio
investment bank acting as financial advisor valued at approximately $2.8 million, based upon a price of
share. These costs are being amortized to expense over the life of the new

The Company capitalized an additional $0.8 million related to our June 28, 2012 amendment to the Agre
which included $0.2 million of agent fees paid to an entity associated with our majority stockholde
$0.04 million paid to third parties for legal and other services. Debt issuance costs are being amortized to
expense over the life of the new loans. Accumulated amortization of debt issuance costs amou
$0.9 million at December 31

Debt extinguishment costs of $3.7 million were expensed, including $3.3 million of fees paid to lenders, a
million of unamortized debt issuance costs associated with the old credit f

6. Commitments and Contingencies

The Company leases office facilities and certain equipment. In January 2012, we renewed two of our fa
leases and entered into a new lease agreement for approximately 6,000 square feet in Livermore, Cal

Future minimum rental commitments under non-cancelable leases as of December 31, 2012 are as foll
thou

Year Ending December 31,	Amount
2013	$ 1,740
2014	1,769
2015	1,409
2016	986
2017	785
Thereafter	65
Total	$ 6,754

Lease expense was $2.4 million, $1.9 million and $1.9 million for the year ended December 31, 2012, 20
2010, respe

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7. Capital Stock

Prior to August 15, 2012, the total number of shares of capital stock that the Company has authority to
96,000,000, consisting of 18,000,000 shares of Series A Participating Senior Preferred Stock (Series A Pr
Stock), $0.0001 par value per share (Series A Preferred Stock); 18,000,000 shares of Series B Redeemable
Preferred Stock, $0.0001 par value per share (Series B Preferred Stock); and 60,000,000 shares of Co
Stock, $0.0001 par value per share. On August 15, 2012, the authorized Common Stock was incre
500,000,000 shares and the authorized preferred stock was increased to 50,000,000

(a) Series A Preferred Stock

Issuance On May 23, 2006, the Company sold 5,295,676 shares of Series A Preferred Stock to shareho
price of $5.67 per share, receiving gross proceeds of $30,000,000, and net proceeds of $29,925,000 after is
costs of $

Dividends The holders of Series A Preferred Stock were entitled to receive dividends as declared by t
of directors. The dividends accrued on a daily basis at the rate of 12% per annum on the sum of the Liqu
Value plus accumulated dividends and accrued and unpaid dividends thereon from the date of issuanc
Preferred Stock. As of December 31, 2011, the Company had accrued dividends payable of $28,248,000 re
as an increase to the Series A Preferred

Voting Each share of Series A Preferred Stock entitled the holder to cast a number of votes per share
the number of votes that the holder would be entitled to cast assuming that such shares of Series A Pr
Stock had been converted into shares of Common

Liquidation In the event of any liquidation, dissolution, or winding up of the Company, before any dis
or payment to holders of Common Stock, but on parity with the holders of Series B Preferred Stock, ho
shares of Series A Preferred Stock were entitled to be paid an amount equal to the Liquidation Value of $5
share plus any accumulated or accrued but unpaid dividends thereon. In addition to the payments set forth
the holders of shares of Series A Preferred Stock were entitled to participate, on a parity and ratab
per-share basis with the holders of Common Stock, with respect to all such distributions or payments
holders of Series A Preferred Stock would have been entitled to receive with respect to the number of sh
Common Stock into which such holders shares of Series A Preferred Stock were convertible immediately
any relevant record date or payment date in connection with liquidation, dissolution, or winding up, but
the extent that shares of Common Stock would have participated in such distributions or payments (ar
payment shall be junior to all equity securities of the Company that rank senior to the Common Stock, inc
without limitation the Series B Preferred

Conversion The Series A Preferred Stock was convertible into Conversion Units (as defined below), at
one Conversion Unit for one share of Series A Preferred Stock. A Conversion Unit consisted of (i) the nu
shares of Common Stock determined by dividing the Liquidation Value of the Series A Preferred Stock
Conversion Price then in effect (the Common Portion) and (ii) one share of Series B Preferred Sto
Series B Portion) subject to adjustments. If upon conversion there were any unpaid, accrued, or accum
dividends due on the shares of Series A Preferred Stock, such dividends continued to be deferred, b
considered unpaid, accrued, or accumulated dividends (as the case may be) due on the Series B Preferred

Optional conversion Each share of Series A Preferred Stock was convertible, at the option of th
thereof, into a Conversion Unit at any time after the date of issuance of such share.

Automatic conversion Each share of Series A Preferred Stock automatically could have been co
into Conversion Units on the date specified by written consent or agreement of the holders of a m
of the then outstanding shares of Series A Preferred Stock.

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Conversion price The initial Conversion Price of the shares issued in May 2006 was $5.67 per s
order to prevent dilution of the conversion rights granted to the holders of the Series A Preferred S
the Conversion Price was subject to adjustment from time to time under certain circumstances. If
Company (i) declared a dividend on the Common Stock payable in shares of its capital stock (incl
Common Stock), (ii) subdivided the outstanding Common Stock, (iii) combined the outstanding
Common Stock into a smaller number of shares, or (iv) issued any shares of its capital stock in a
reclassification of the Common Stock, then, in each such case, the Conversion Price was to be
proportionately adjusted so that, in connection with a conversion of the shares of Series A Preferr
Stock after such date, the holder of shares of Series A Preferred Stock would have been entitled to
receive the aggregate number and kind of shares of capital stock, which, if the conversion had occ
immediately prior to such date, the holder would have owned upon such conversion and been enti
receive by virtue of such dividend, subdivision, combination, or reclassification.

(b) Redemption of Series A Preferred Stock

On March 19, 2012, the Company recapitalized. As part of the recapitalization, 3,897,000 shares of S
Convertible Preferred Stock were converted into conversion units, which consisted of one share of S
Preferred Stock and one share of Common Stock. The Series B Preferred shares plus accrued dividend
redeemed for cash of $44 million, and 3,897,000 shares of Common Stock were issued to the holder
redeemed Series A Convertible Preferred

In June 2012, the remaining 1,399,000 shares of Series A Convertible Preferred Stock were convert
conversion units of one share of Series B Preferred Stock and one share of Common Stock. The shares S
Preferred Stock plus accrued dividends were redeemed for cash of $16.3 million and 1,399,000 sh
Common Stock were issued to the holders of the redeemed Series A Convertible Preferred

(c) Issuance of Shares of Common Stock as Compensation

As part of the March 19, 2012 recapitalization, the Company issued to its financial advisor as compens
connection with the debt portion of the recapitalization 215,000 shares of Common Stock va
approximately $2.8 million based upon a price of $13 per share. This amount represents debt issuance co
is being amortized to expense over the 5 to 6 year life of the loans described in

(d) Initial Public Offering

In August 2012, the Company completed its initial public offering (IPO) in which we issued a
1,924,000 shares of Common Stock at a public offering price of $9.00 per share. The Company recei
proceeds of $12.6 million after deducting underwriter discounts and commissions of $1.0 million an
offering expenses of approximately $3.6 million. In addition, a financial advisor to the Company was pa
million through the issuance of 103,500 shares of Common Stock valued at $9.00 pe

8. Stock-based Compensation

(a) Stock Options

The Company has established the 2004 DCS Holdings Stock Option Plan, the DCS Holdings, Inc. 2004
Incentive Plan (Performant Financial Corporation is the new name of DCS Holdings, Inc.), the Perf
Financial Corporation 2007 Stock Option Plan, and the Performant Financial Corporation 2012 Stock In
Plan (the Plans). Under the terms of the 2004 DCS Holdings Stock Option Plan, stock options may be gran
up to 4,000,000 shares of the Company s authorized but unissued Common Stock. The 2004 DCS Holdin
Option Plan was terminated on the completion of the Company s initial public offering in August 2012. N

of our common stock are available under our 2004 Stock Option Plan other than for satisfying exercises o
options granted under this plan prior to termi

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Under the terms of the DCS Holdings, Inc. 2004 Equity Incentive Plan, incentive and nonqualified stock o
stock bonuses, and rights to acquire restricted stock may be granted for up to 3,600,000 shares of the Con
authorized but unissued Common Stock. Options granted under the DCS Holdings, Inc. 2004 Equity In
Plan generally vest over a four-year period. The Company s DCS Holdings, Inc. 2004 Equity Incentive
terminated on the completion of its initial public offering in August 2012. No shares of our common st
available under our 2004 Equity Incentive Plan other than for satisfying exercises of stock options grante
this plan prior to term

Under the terms of the Performant Financial Corporation 2007 Stock Option Plan, incentive and nonqu
stock options may be granted for up to 4,000,000 shares of the Company s authorized but unissued C
Stock. Options granted under the Performant Financial Corporation 2007 Stock Option Plan generally ves
five-year period. Performant Financial Corporation 2007 Stock Option Plan was terminated on the comple
its initial public offering in August 2012. No shares of our common stock are available under our 200
Option Plan other than for satisfying exercises of stock options granted under this plan prior to term

The terms of the Performant Financial Corporation 2012 Stock Incentive Plan provides for the gra
incentive stock options within the meaning of Section 422 of the Code to employees and the gra
nonstatutory stock options, restricted stock, stock appreciation rights, stock unit awards and cash-based aw
employees, non-employee directors and consultants. The Company has reserved 4,300,000 shares of co
stock under the 2012 Plan. Options granted under the Performant Financial Corporation 2012 Stock In
Plan generally vest over a five-year

The exercise price of incentive stock options shall generally not be less than 100% of the fair market valu
Common Stock subject to the option on the date that the option is granted. The exercise price of nonqu
stock options shall generally not be less than 85% of the fair market value of the Common Stock subjec
option on the date that the option is granted. Options issued under the Plans have a maximum term of 1
and vest over schedules determined by the board of directors. Options issued under the Plans generally
for immediate vesting of unvested shares in the event of a sale of the Co

Total stock-based compensation expense charged as salaries and benefits expense in the consolidated stat
of operations was $1.6 million, $0.1 million and $0.6 million for the years ended December 31, 2012, 20
2010, respe

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The following table sets forth a summary of our stock option activity for the year ended Decem

	Outstanding Options	Weighted average exercise price per share	Weighted average remaining contractual life (Years)	Aggregate Instrinsic Val (in thousands)
Outstanding at December 31, 2009	5,443,500	$ 0.61	6.90	
Granted	202,000	1.50		
Forfeited	(134,750)	0.56		
Exercised				
Outstanding at December 31, 2010	5,510,750	0.64	6.00	
Granted	180,000	5.50		
Forfeited	(25,282)	0.74		
Exercised	(718)	0.50		
Outstanding at December 31, 2011	5,664,750	0.80	5.20	
Granted	2,549,109	10.32		
Forfeited	(19,077)	7.99		
Exercised	(285,058)	0.61		
Outstanding at December 31, 2012	7,909,724	$ 3.85	5.89	$ 49,41
Vested or expected to vest[(1)] at December 31, 2012	7,514,238	$ 3.66	5.64	$ 48,38
Exercisable at December 31, 2012	4,854,960	$ 0.64	3.86	$ 45,92

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

The weighted-average grant-date exercise price of stock options granted during the years December 31, 2012, 2011 and 2010 was $10.32, $5.50 and $1.50, respectively, per share. The aggregate i value of our stock options (the amount by which the market price of the stock on the date of exercise ex the exercise price of the option) exercised during the years ended December 31, 2012, 2011 and 2010, w million, $0 million and $0 million, respectively. At December 31, 2012, 2011, and 2010, there was $12.0 r $0.6 million and $0.4 million, respectively, of unrecognized stock-based compensation expense re non-vested stock-based compensation arrangements, which the Company expects to recognize weighted-average period of 4.21 years as stock-based compensation ex

Net cash proceeds from the exercise of stock options were $0.2 million, $0 million and $0 million durin 2011 and 2010, respectively. For the years ended December 31, 2012, 2011 and 2010, we realized a $0.6 r $0 million and $0 million tax benefit from the exercise of stock options, respe

The fair value of each option grant was estimated using the Black-Scholes option pricing model. Ex volatilities are calculated based on the historical volatility data of comparable peer companies over comparable to the expected term of the options issued. The expected term of the award is determined b the average of the vesting term and the contractual term. Management monitors share option exerc employee termination patterns to estimate forfeiture rates within the valuation model. Separate gr employees that have similar groups of employees with similar historical exercise behavior are con separately for valuation pu

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We estimated the fair value of options granted using a Black-Scholes option pricing model with the fol
assum

	For the Year Ended December 31,		
	2012	2011	2010
Expected volatility	48.3%	39.8%	40.6%
Expected dividends	0.0	0.0	0.0
Expected term (years)	6.5	6.3	6.3
Risk-free interest rate	1.01%	1.2%	2.8%
Weighted-average estimated fair value of options granted during the year	$ 5.22	$ 2.23	$ 0.66

Valuation and Amortization Method The Company estimates the fair value of stock options granted u Black-Scholes-Merton option pricing model. The fair value is then amortized on a straight line basis o requisite service periods of the awards, which is generally the vesting period. Stock options typically hav year life from the grant date and vesting periods of four to five years. The fair value of the Company s stock is based on the market price of the stock on the date o

Expected Term The Company s expected term represents the period that the Company s stock-based expected to be outstanding. For awards granted subject only to service vesting requirements, the Co utilizes the simplified method under the provisions of FASB ASC 718-10-S99-1 (Staff Accounting B No. 107) for estimating the expected term of the stock-based

Expected Volatility Because there is insufficient history of the Company s stock price returns, the Comp sufficient historical volatility data for its equity awards. Accordingly, the Company calculates the ex volatility using comparable peer companies over a term comparable to the expected term of the options

Expected Dividend The Company has never paid dividends on its common shares and currently does n to do so. Accordingly, the dividend yield percentage is zero for all p

Risk-Free Interest Rate The risk-free interest rate used in the Black Scholes valuation method is base U.S. Treasury constant maturity interest rate whose term is consistent with the expected life of our stock o

(b) Restricted Stock

Option Agreements issued under the 2004 DCS Holdings Stock Option Plan allow for the participants to e options whether or not vesting has occurred, provided that the participants enter into a restricted stock agre The restricted stock agreement is to specify that the stock issued for unvested options will continue vestin the unvested shares subject to repurchase at the lower of original cost and fair marke

In January 2005, two executives exercised a portion of their options, including unvested options, by enteri restricted stock agreements with the Company. The restricted stock agreements allow for the execu receive dividend payments, subject to forfeiture if the executives leave the Company prior to the vesting restricted shares. On February 4, 2005, forfeitable dividends of $1 million were paid on the executives restricted shares. This amount has been recorded as due from stockholders in the equity cap consolidated balance sheet, and is being amortized into compensation expense as the underlying un restricted shares vest. Compensation expense associated with the forfeitable dividends received on un restricted shares was $0 million, $0 million and $0.1 million in 2012, 2011 and 2010, respe

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9. Employee Benefit Plan

The Company has a 401(k) Salary Deferral Plan (the Plan) covering all full-time employees who ha certain service requirements. Employees may contribute a portion of their salary up to the maximu established by the Internal Revenue Code for such plans. Employer contributions are discretionary. No m contributions were made during 2012, 2011 an

10. Income Taxes

The Company s income tax expense (benefit) consists of the following (in tho

	2012	2011	2010
Current:			
Federal	$ 15,142	$ 14,053	$ 5,500
State	3,470	3,103	1,132
	18,612	17,156	6,632
Deferred:			
Federal	$ (1,599)	$ (7,350)	$ (172)
State	(227)	(2,290)	204
	(1,826)	(9,640)	32
Total Expense (Benefit)	$ 16,786	$ 7,516	$ 6,664

A reconciliation of the income tax expense calculated using the applicable federal statutory rates to th income tax expense for the years ended December 31, 2012, 2011 and 2010 is as f

	2012	2011	2010
Federal income at the statutory rate	35%	35%	35%
State income tax, net of federal benefit	5%	3%	5%
Permanent differences	2%	1%	2%
Other	0%	-1%	-2%
	42%	38%	40%

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The following table summarizes the components of the Company s deferred tax assets and liabili
December 31, 2012, and 2011 (in thou

	2012	2011
Deferred tax assets:		
Bad debt reserve	$ 26	$ 3
Vacation accrual	909	31
Remeasurement expense nonqualified stock options	1,767	1,13
Amortization of deferred finance costs	3,082	1,82
Acquisition costs	197	22
Bonus accrual		48
State tax deferral	1,373	1,04
Stock option compensation		69
Deferred revenue	91	1,28
State tax credits	566	38
Estimated liability for appeals	1,260	36
Other	82	55
	9,353	8,34
Valuation allowance	(351)	(14
	9,002	8,19
Deferred tax liabilities:		
Identifiable intangible assets	(13,007)	(14,30
Book versus tax depreciation	(3,446)	(3,02
Amortization of deferred finance costs		(13
Other	(22)	(2
	(16,475)	(17,49
Net deferred tax liabilities	$ (7,473)	$ (9,29

The Company believes that it is more likely than not that the results of future operations will generate su
taxable income to realize the deferred tax assets, except for certain state tax credits. Income tax exp
allocated to the subsidiaries included in the consolidated tax return on the basis of the subsidiaries stand-
pro

The Company has a valuation allowance of approximately $0.4 million as of December 31, 2012 re
California enterprise zone tax credits for which it is not more likely than not that the tax benefit will be r
The total amount of the valuation allowance represented includes increases from the amount recorde
December 31, 2011 due to the generation of additional tax credits in 2012, for which it is not more likely t
that the tax benefit will be r

The Company has state tax credits of $0.6 million which can be carried forward indefinitely. The Comp
state net operating loss carryforwards of $0.4 million which expire in 2020. The following table reconc
Company s unrecognized tax benefits as of December 31, 2012 from its unrecognized tax benefits as of D
31, 2011 (in thou

Unrecognized tax benefits balance at December 31, 2011	$
Increase related to prior year tax positions	11

Decrease related to prior year tax positions	
Increase related to current year tax positions	16
Settlements	
Lapse of statute of limitations	
Unrecognized tax benefits balance at December 31, 2012	$ 27

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At December 31, 2012 and 2011, we had approximately $0.3 million and $0 million of unrecognized tax b respectively. We do not expect any significant change in unrecognized tax benefits during the next months. The Company records interest expense and penalties related to unrecognized tax benefits in general, and administrative expenses. The amount of accrued interest was not material at December 31, 20 2011, respectively. No penalties were recognized in 2012 or accrued at December 31, 2012 and respectively. Unrecognized tax benefits of approximately $0.3 million which, if recognized, would fa affect the Company s effective income

The Company files federal and state income tax returns. For years before 2008, the Company is no longer to federal or state tax exami

11. Related Party Transactions

Our notes payable, both before and after the recapitalization of March 19, 2012, are held by a number of l some of whom also invested in our stock. As a result, these entities are considered related parties. expense under these arrangements totaled $11.1 million, $12.3 million and $13.2 million for the years December 31, 2012, 2011 and 2010, respectively, and the debt extinguishment expense associated w recapitalization totaled $3.3 million for the year ended December 31

In an agreement dated April 13, 2012, the Company and an affiliate of Parthenon Capital Partners termin existing advisory services agreement, which called for quarterly payments of $0.1 million. As par April 13, 2012 termination agreement, the Company agreed to pay Parthenon Capital $1.3 million i quarterly installments of $0.1 million beginning in April 2012, provided that the remaining balance will b due and payable immediately upon the closing of an IPO or the sale of the Company. The Company p quarterly installments of $0.1 million and paid the remaining balance of $1.1 million on August 15, 20 date the IPO closed. In addition, the agreement specifies that the affiliate will be due a fee equal to 1% aggregate gross proceeds of an IPO offering or 1% of the aggregate consideration paid in connection w sale of the Company, as applicable. The Company expensed and paid $0.9 million to Parthenon Capital P in August 2012 upon successful closing of th

12. Other Commitments and Contingencies

(a) Trust Funds

The Company collects principal and interest payments and collection costs on defaulted loans for contracting agencies. Cash collections for some of the Company s customers are held in trust in bank controlled by the Company. The Company remits trust funds to the contracting agencies on a regular bas amount of cash held in trust and the related liability are separated from and not included in the Company and liabilities. Cash held in trust for customers totaled $1.4 million and $1.8 million at December 31, 20 2011, respe

(b) Litigation

The Company, during the ordinary course of its operations, has been named in various legal suits and several of which are still pending. In the opinion of management and the Company s legal counsel, su actions will not have a material effect on the Company s financial position or results of operations or ca

13. Subsequent Events

In January 2013, the Company completed a secondary offering in which selling stockholders issued a
9,200,000 shares of common stock at a public offering price of $10.65 per share. The Company did not
any proceeds from the sale of the shares by the selling stockholders. The Company paid the related c
ex

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registr
duly caused this report to be signed on its behalf by the undersigned, thereunto duly auth

PERFORMANT FINANCIAL CORPORATION

By: /s/ Lisa C. Im
Lisa C. Im
Chief Executive Officer
Date: March 2

POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below con
and appoints Lisa C. Im and Hakan L. Orvell, and each of them, his or her true and lawful attorneys-in-fac
with full power of substitution, for him or her in any and all capacities, to sign any amendments to this re
Form 10-K and to file the same, with exhibits thereto and other documents in connection therewith, w
Securities and Exchange Commission, hereby ratifying and confirming all that each of said attorneys-in
their substitute or substitutes may do or cause to be done by virtue

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below
following persons on behalf of the registrant and in the capacities and on the dates inc

Name	Title	Date
/s/ Lisa C. Im **Lisa C. Im**	Chief Executive Officer (Principal Executive Officer) and Director	March 21, 2
/s/ Hakan L. Orvell **Hakan L. Orvell**	Chief Financial Officer (Principal Financial and Accounting Officer)	March 21, 2
/s/ Dr. Jon D. Shaver **Dr. Jon D. Shaver**	Chairman of the Board and Director	March 21, 2
/s/ Todd R. Ford **Todd R. Ford**	Director	March 21, 2
/s/ Brian P. Golson **Brian P. Golson**	Director	March 21, 2
/s/ William D. Hansen **William D. Hansen**	Director	March 21, 2

/s/ William C. Kessinger	Director	March 21, 2
William C. Kessinger		
/s/ Jeffrey S. Stein	Director	March 21, 2
Jeffrey S. Stein		

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SCHEDULE II VALUATION AND QUALIFYING ACC

For the years ended December 31, 2012, 2011 ar

Allowance for doubtful accounts (in thou

Description	Balance at Beginning of Period		Additions Charged against Revenue	Recoveries	Charge-offs	Bala End o
2012	$	77		2	(14)	$
2011	$	45	28	14	(10)	$
2010	$	221	37		(213)	$

Estimated allowance and liability for appeals RAC Contract (in tho

Description	Balance at Beginning of		Additions Charged against Revenue	Appeals found in Providers Favor	Balan End of
2012	$	934	8,589	(3,946)	$
2011	$	101	1,743	(910)	
2010	$		101		

* Includes $1,199, $484 and $101 related to the estimated allowance for appeals that apply to uncollected accounts receivable as of 2012, 2011 and 2010, respectively.

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EXHIBIT INDEX

Exhibit Number	Description
3.1	Restated Certificate of Incorporation of Registrant (incorporated by reference to Exhibit 3.1 the Company s Registration Statement on Form S-1/A filed July 23, 2012)
3.2	Amended and Restated Bylaws of Registrant (incorporated by reference to Exhibit 3.2(b) to Company s Registration Statement on Form S-1/A filed July 23, 2012)
4.2	Amended and Restated Registration Rights Agreement, dated as of August 15, 2012, among Registrant and the persons listed thereon (incorporated by reference to Exhibit 4.2 to the Company s Registration Statement on Form S-1/A filed July 23, 2012)
10.1	Form of Indemnification Agreement between the Registrant and its officers and directors (incorporated by reference to Exhibit 10.1 to the Company s Registration Statement on For filed July 30, 2012)
10.2	2004 Equity Incentive Plan and form of agreements thereunder (incorporated by reference t Exhibit 10.2 to the Company s Registration Statement on Form S-1 filed July 3, 2012)
10.3	2004 DCS Holdings Stock Option Plan and form of agreements thereunder (incorporated by reference to Exhibit 10.3 to the Company s Registration Statement on Form S-1 filed July 3
10.4	2007 Stock Option Plan and form of agreements thereunder (incorporated by reference to E 10.4 to the Company s Registration Statement on Form S-1 filed July 3, 2012)
10.5	Recovery Audit Contractor contract by and between Diversified Collection Services, Inc. ar Center for Medicare and Medicaid Services dated as of October 3, 2008, as amended (incor by reference to Exhibit 10.5 to the Company s Registration Statement on Form S-1/A filed 2012)
10.6	Credit Agreement, dated as of March 19, 2012, by and among DCS Business Services, Inc., Lenders party Hereto, Madison Capital Funding LLC, and ING Capital (incorporated by ref to Exhibit 10.6 to the Company s Registration Statement on Form S-1/A filed July 23, 201
10.7	Form of Change of Control Agreement, as amended (incorporated by reference to Exhibit 1 the Company s Registration Statement on Form S-1/A filed July 30, 2012)
10.8	Employment Agreement between the Registrant and Lisa Im, dated as of April 15, 2012, as amended (incorporated by reference to Exhibit 10.8 to the Company s Registration Stateme Form S-1/A filed July 23, 2012)
10.9	Employment Agreement between the Registrant and Jon D. Shaver dated as of March 31, 2 amended (incorporated by reference to Exhibit 10.9 to the Company s Registration Stateme Form S-1/A filed July 23, 2012)
10.10	Repurchase Agreement between the Registrant and Lisa C. Im dated as of July 3, 2012 (incorporated by reference to Exhibit 10.10 to the Company s Registration Statement on Fo filed July 3, 2012)
10.11	Repurchase Agreement between the Registrant and Jon D. Shaver dated as of July 3, 2012 (incorporated by reference to Exhibit 10.11 to the Company s Registration Statement on Fo filed July 3, 2012)
10.12	Director Nomination Agreement between the Registrant and Parthenon DCS Holdings, LLC as of July 20, 2012 (incorporated by reference to Exhibit 10.12 to the Company s Registrat Statement on Form S-1/A filed July 23, 2012)
10.13	Advisory Services Agreement between Diversified Collection Services, Inc. and Parthenon Capital, LLC dated as of January 8, 2004, as amended (incorporated by reference to Exhibit to the Company s Registration Statement on Form S-1/A filed July 23, 2012)

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Exhibit Number	Description
10.14	Termination of the Advisory Services Agreement between Diversified Collection Services, I and Parthenon Capital, LLC dated as of January 8, 2004, as amended, dated as of April 13, 2 (incorporated by reference to Exhibit 10.14 to the Company s Registration Statement on Form S-1/A filed July 23, 2012)
10.15	2012 Stock Incentive Plan (incorporated by reference to Exhibit 10.15 to the Company s Registration Statement on Form S-1/A filed July 23, 2012)
21	List of Subsidiaries
23	Consent of KPMG LLP, Independent Registered Public Accounting Firm
24	Powers of Attorney (included in the signature page to this report)
31.1	Rule 13a-14(a)/15d-14(a) Certification, executed by Lisa C. Im
31.2	Rule 13a-14(a)/15d-14(a) Certification, executed by Hakan L. Orvell
32.1	Furnished Statement of the Chief Executive Officer under 18 U.S.C. Section 1350
32.2	Furnished Statement of the Chief Financial Officer under 18 U.S.C. Section 1350
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Scheme
101.CAL	XBRL Taxonomy Extension Calculation Linkbase
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase
101.PRE	XBRL Taxonomy Extension Presentation Linkbase