R1 RCM INC.
Form 10-Q
August 09, 2018

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q

(Mark One)

þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2018
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: 001-34746
R1 RCM INC.
(Exact name of registrant as specified in its charter)

Delaware	02-0698101
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
401 North Michigan Avenue Suite 2700 Chicago, Illinois	60611
(Address of principal executive offices)	(Zip code)

(312) 324-7820
(Registrant's telephone number, including area code)
Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	o	Accelerated filer	ý	Non-accelerated filer	o	Smaller reporting company	o	Emerging growth company	o
				(Do not check if a smaller reporting company)					

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No R

As of August 2, 2018, the registrant had 109,982,377 shares of common stock, par value $0.01 per share, outstanding.

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(In millions, except share and per share data)

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R1 RCM Inc.
Consolidated Balance Sheets
(In millions, except share and per share data)

	June 30, 2018 (unaudited)	December 31, 2017
Assets		
Current assets:		
Cash and cash equivalents	$ 38.8	$ 164.9
Current portion of restricted cash equivalents	2.0	—
Accounts receivable, net	40.9	8.2
Accounts receivable, net - related party	40.3	15.4
Prepaid income taxes	0.5	0.6
Prepaid expenses and other current assets	26.6	13.2
Total current assets	149.1	202.3
Property, equipment and software, net	90.7	48.3
Intangible assets, net	199.4	—
Goodwill	244.7	—
Non-current deferred tax assets	47.6	70.5
Non-current portion of restricted cash equivalents	1.5	1.5
Other assets	20.1	13.4
Total assets	$ 753.1	$ 336.0
Liabilities		
Current liabilities:		
Accounts payable	14.6	7.2
Current portion of customer liabilities	8.5	1.1
Current portion of customer liabilities - related party	23.3	27.1
Accrued compensation and benefits	53.0	37.8
Current portion of long-term debt	2.7	—
Other accrued expenses	35.4	16.7
Total current liabilities	137.5	89.9
Non-current portion of customer liabilities - related party	17.4	11.5
Long-term debt	255.6	—
Long-term debt - related party	101.1	—
Other non-current liabilities	19.2	11.9
Total liabilities	$ 530.8	$ 113.3
8.00% Series A convertible preferred stock: par value $0.01 per share, 370,000 authorized, 236,672 shares issued and outstanding as of June 30, 2018 (aggregate liquidation value of $241.4); 370,000 authorized, 227,483 shares issued and outstanding as of December 31, 2017 (aggregate liquidation value of $232.0)	198.6	189.3
Stockholders' equity (deficit)		
Common stock, $0.01 par value, 500,000,000 shares authorized, 122,726,673 shares issued and 109,970,001 shares outstanding at June 30, 2018; 116,650,388 shares issued and 104,409,961 shares outstanding at December 31, 2017	1.2	1.2
Additional paid-in capital	359.8	337.9
Accumulated deficit	(270.7)	(244.5)

Accumulated other comprehensive loss	(4.1)	(1.6)
Treasury stock, at cost, 12,756,672 shares as of June 30, 2018; 12,240,427 shares as of December 31, 2017	(62.5)	(59.6)
Total stockholders’ equity (deficit)	23.7	33.4
Total liabilities and stockholders’ equity (deficit)	$ 753.1	$ 336.0

See accompanying notes to consolidated financial statements.

R1 RCM Inc.
Consolidated Statements of Operations and Comprehensive Income (Loss)
(In millions, except share and per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
	(Unaudited)		(Unaudited)	
Net services revenue ($141.9 million and $278.1 million for the three and six months ended June 30, 2018, respectively, and $87.7 million and $163.1 million for the three and six months ended June 30, 2017, respectively, from related party)	$207.9	$ 99.4	$355.2	$ 186.3
Operating expenses:				
Cost of services	189.9	96.4	328.6	177.3
Selling, general and administrative	22.5	12.2	39.5	26.5
Other	13.2	1.0	15.6	1.2
Total operating expenses	225.6	109.6	383.7	205.0
Income (loss) from operations	(17.7)	(10.2)	(28.5)	(18.7)
Net interest (expense) income	(5.8)	—	(5.6)	0.1
Income (loss) before income tax provision	(23.5)	(10.2)	(34.1)	(18.6)
Income tax provision (benefit)	(20.6)	(3.5)	(7.9)	(3.6)
Net income (loss)	$(2.9)	$ (6.7)	$(26.2)	$ (15.0)
Net income (loss) per common share:				
Basic	$(0.07)	$ (0.11)	$(0.33)	$ (0.23)
Diluted	$(0.07)	$ (0.11)	$(0.33)	$ (0.23)
Weighted average shares used in calculating net income (loss) per common share:				
Basic	108,157,583	102,467,078	107,001,002	101,918,797
Diluted	108,157,583	102,467,078	107,001,002	101,918,797
Consolidated statements of comprehensive income (loss)				
Net income (loss)	(2.9)	(6.7)	(26.2)	(15.0)
Other comprehensive income (loss):				
Net change on derivatives designated as cash flow hedges, net of tax	(0.4)	—	(0.6)	—
Foreign currency translation adjustments	(1.4)	—	(1.9)	0.8
Comprehensive income (loss)	$(4.7)	$ (6.7)	$(28.7)	$ (14.2)

Reconciliation of net income (loss) to income (loss) available to common shareholders:

Basic:				
Net income (loss)	$(2.9)	$(6.7)	$(26.2)	$(15.0)
Less dividends on preferred shares	(4.8)	(4.4)	(9.4)	(8.7)
Less income allocated to preferred shareholders	—	—	—	—
Net income (loss) available/allocated to common shareholders - basic	$(7.7)	$(11.1)	$(35.6)	$(23.7)
Diluted:				
Net income (loss)	$(2.9)	$(6.7)	$(26.2)	$(15.0)
Less dividends on preferred shares	(4.8)	(4.4)	(9.4)	(8.7)
Less income allocated to preferred shareholders	—	—	—	—
Net income (loss) available/allocated to common shareholders - diluted	$(7.7)	$(11.1)	$(35.6)	$(23.7)

See accompanying notes to consolidated financial statements.

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R1 RCM Inc.
Consolidated Statements of Stockholders’ Equity (Deficit) (unaudited)
(In millions, except share and per share data)

	Common Stock		Treasury Stock		Additional Paid-In Capital	Accumulated Deficit	Accumulated other comprehensive (loss)	Total
	Shares	Amount	Shares	Amount				
Balance at December 31, 2017	116,650,388	$ 1.2	(12,240,427)	$ (59.6)	$ 337.9	$ (244.5)	$ (1.6)	$ 33.4
Share-based compensation expense	—	—	—	—	7.9	—	—	7.9
Reclassification of equity award	—	—	—	—	1.3	—	—	1.3
Issuance of common stock related to share-based compensation plans	293,103	—	—	—	—	—	—	—
Issuance of Common Stock and Stock Warrants	4,665,594	—	—	—	19.3	—	—	19.3
Exercise of vested stock options	1,117,588	—	—	—	2.8	—	—	2.8
Dividends paid/accrued dividends	—	—	—	—	(9.4)	—	—	(9.4)
Acquisition of treasury stock related to equity award plans	—	—	(497,300)	(2.9)	—	—	—	(2.9)
Forfeitures	—	—	(18,945)	—	—	—	—	—
Net Change on derivatives designated as cash flow hedges, net of tax of $0.2	—	—	—	—	—	—	(0.6)	(0.6)
Foreign currency translation adjustments	—	—	—	—	—	—	(1.9)	(1.9)
Net (loss) income	—	—	—	—	—	(26.2)	—	(26.2)
Balance at June 30, 2018	122,726,673	$ 1.2	(12,756,672)	$ (62.5)	$ 359.8	$ (270.7)	$ (4.1)	$ 23.7

See accompanying notes to consolidated financial statements.

R1 RCM Inc.
Consolidated Statements of Cash Flows
(In millions)

	Six Months Ended June 30,	
	2018	2017
	(Unaudited)	
Operating activities		
Net income (loss)	$(26.2)	$(15.0)
Adjustments to reconcile net income (loss) to net cash used in operations:		
Depreciation and amortization	13.4	7.0
Amortization of debt issuance costs	0.4	—
Share-based compensation	9.0	5.9
Loss on disposal	0.7	0.2
Provision (recovery) for doubtful receivables	0.2	0.1
Deferred income taxes	(10.5)	(4.1)
Changes in operating assets and liabilities:		
Accounts receivable and related party accounts receivable	(21.6)	(13.2)
Prepaid income taxes	(0.8)	3.5
Prepaid expenses and other assets	(7.3)	(9.2)
Accounts payable	1.4	(2.3)
Accrued compensation and benefits	7.9	(0.4)
Other liabilities	11.4	(0.4)
Customer liabilities and customer liabilities - related party	0.9	5.0
Net cash used in operating activities	(21.1)	(22.9)
Investing activities		
Purchases of property, equipment, and software	(15.3)	(23.2)
Acquisition of IMX, net of cash acquired	(465.3)	—
Net cash used in investing activities	(480.6)	(23.2)
Financing activities		
Issuance of senior secured debt, net of discount and issuance costs	253.1	—
Issuance of subordinated notes, net of discount and issuance costs	105.9	—
Issuance of common stock and stock warrants, net of issuance costs	19.3	—
Exercise of vested stock options	2.8	—
Purchase of treasury stock	—	(1.2)
Shares withheld for taxes	(2.9)	(1.9)
Net cash provided (used in) by financing activities	378.2	(3.1)
Effect of exchange rate changes in cash, cash equivalents and restricted cash	(0.6)	0.4
Net increase (decrease) in cash, cash equivalents and restricted cash	(124.1)	(48.8)
Cash, cash equivalents and restricted cash, at beginning of period	166.4	182.7
Cash, cash equivalents and restricted cash, at end of period	$42.3	$133.9
Supplemental disclosures of cash flow information		
Accrued dividends payable to Preferred Stockholders	$4.7	$4.4
Accrued and other liabilities related to purchases of property, equipment and software	$10.3	$1.0
Accounts payable related to purchases of property, equipment and software	$1.2	$1.7
Income taxes paid	$(1.3)	$(0.6)
Income taxes refunded	$0.4	$3.4

See accompanying notes to consolidated financial statements.

R1 RCM Inc.
Notes to Unaudited Consolidated Financial Statements

1. Business Description and Basis of Presentation
Business Description
R1 RCM Inc. (the "Company") is a leading provider of revenue cycle management ("RCM") services to healthcare providers. The Company helps healthcare providers generate sustainable improvements in their operating margins and cash flows while also enhancing patient, physician and staff satisfaction for its customers. The Company does so by deploying a unique operating model that leverages its extensive healthcare site experience, innovative technology and process excellence.

The Company's primary service offering consists of end-to-end RCM, which encompasses patient registration, insurance and benefit verification, medical treatment documentation and coding, bill preparation and collections. The Company deploys its RCM services through an operating partner relationship or a co-managed relationship. Under an operating partner relationship, the Company provides comprehensive revenue cycle infrastructure to providers, including all revenue cycle personnel, technology, and process workflow. Under a co-managed relationship, the Company leverages its customers' existing RCM staff and processes, and supplements them with the Company's infused management, subject matter specialists, proprietary technology and other resources. The Company also offers modular services, allowing customers to engage the Company for only specific components of its end-to-end RCM service offering. The Company's PAS offering complements the Company's RCM offering by strengthening customer's compliance with certain third-party payer requirements and limiting denials of claims. For example, the Company's PAS offering helps customers determine whether to classify a hospital visit as an in-patient or an out-patient observation case for billing purposes.

Ascension
On February 16, 2016, the Company entered into a long-term strategic partnership with Ascension Health Alliance, the parent of the Company's largest customer and the nation's largest Catholic and non-profit health system, and TowerBrook Capital Partners ("TowerBrook"), an investment management firm (the "Transaction"). As part of the Transaction, the Company amended and restated its Master Professional Services Agreement ("A&R MPSA") with Ascension Health ("Ascension") effective February 16, 2016 with a term of ten years. Pursuant to the A&R MPSA and with certain limited exceptions, the Company will become the exclusive provider of RCM services and PAS with respect to acute care services provided by the hospitals affiliated with Ascension that execute supplement agreements with the Company.
On and effective as of June 24, 2018, the Company and Ascension Health entered into a Supplement (the "Supplement") to the A&R MPSA. Pursuant to the Supplement, the Company will provide RCM services for physician groups that receive services from Ascension's National Revenue Service Center and other groups associated with Ascension hospital systems. Each such physician group will be required to execute an addendum to the Supplement for those physician groups to receive services under the Supplement. Ascension has agreed that the Company may provide services to additional physician groups affiliated with or acquired by Ascension over time. The Supplement also provides for the re-badging of certain centrally-based revenue cycle operations employees who support Ascension's physician groups. The Company expects to begin providing services under the Supplement during the fourth quarter of 2018.

On June 24, 2018, the Company and Ascension entered into an amendment to the A&R MPSA (the "Presence Amendment") to provide that the Company will enter into a supplement to the A&R MPSA to provide for RCM services and PAS services for acute care to Presence Health hospitals in accordance with terms set forth in the Presence Amendment. Presence Health is a part of AMITA Health, which is a joint venture of Ascension's Alexian Brothers Health System and Adventist Midwest Health, part of Adventist Health System. If the Company enters into a new master professional services agreement with AMITA Health for end-to-end RCM services in the future, the end-to-end RCM business with Presence will be governed by such new agreement.

Intermountain

On January 23, 2018, the Company entered into an Amended and Restated Services Agreement (the “Intermountain Services Agreement”) with IHC Health Services, Inc. (“Intermountain”) having a 10-year term. Pursuant to the Intermountain Services Agreement, the Company will provide revenue cycle management services to Intermountain hospitals and medical group providers under the operating partner model. In addition, the Company will provide revenue cycle management services to Intermountain’s homecare, hospice and palliative care, durable medical equipment and infusion therapy business. In conjunction with the execution of the Intermountain Services Agreement, the Company entered into a Securities Purchase Agreement (the “Intermountain Purchase Agreement”) with Intermountain, pursuant to which the Company sold to Intermountain, in private placements under the Securities Act of 1933, as amended (the "Securities Act"), (i) 4,665,594 shares of common stock and (ii) a warrant to acquire up to 1,500,000 shares of Common Stock at an initial exercise price of $6.00 per share, on the terms and subject to the conditions set forth in the warrant, for an aggregate purchase price of $20 million.

Intermedix

On May 8, 2018, the Company completed the acquisition of Intermedix Holdings, Inc. ("Intermedix") through the merger of Project Links Merger Sub, Inc. (“Merger Sub”), a wholly-owned indirect subsidiary of the Company, with and into Intermedix, with Intermedix surviving the merger as a wholly-owned indirect subsidiary of the Company (the “Acquisition”). The purchase price for the Acquisition was $460 million, subject to customary adjustments for cash, debt, transaction expenses and normalized working capital. The Company funded the purchase price for the Acquisition and the Company’s associated transaction expenses with a combination of cash on hand and the incurrence of additional indebtedness. Intermedix is one of the largest providers of RCM and practice management ("PM") services to physician groups and emergency medical service ("EMS") providers in the United States ("U.S."). Intermedix has a diverse customer base of approximately 700 customers and 2,500 employees located in offices within the U.S., Lithuania, the United Kingdom and New Zealand. Refer to Note 4, Acquisition, and Note 11, Debt, for further discussion on the Intermedix acquisition and related financing.

Basis of Presentation

The accompanying unaudited consolidated financial statements reflect the Company's financial position as of June 30, 2018, the results of operations of the Company for the three and six months ended June 30, 2018 and 2017, and the cash flows of the Company for the six months ended June 30, 2018 and 2017. These financial statements include the accounts of R1 RCM Inc. and its wholly owned subsidiaries. All material intercompany amounts have been eliminated in consolidation. These financial statements have been prepared in accordance with United States generally accepted accounting principles ("GAAP") for interim financial reporting and as required by the rules and regulations of the U.S. Securities and Exchange Commission (the “SEC”). Accordingly, certain information and footnote disclosures required for complete financial statements are not included herein. In the opinion of management, all adjustments, consisting of normal recurring adjustments, considered necessary for a fair presentation of the interim financial information, have been included. Operating results for the three and six months ended June 30, 2018 are not necessarily indicative of the results that may be expected for any other interim period or for the fiscal year ending December 31, 2018.

When preparing financial statements in conformity with GAAP, the Company must make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses and related disclosures at the date of the financial statements. Actual results could differ from those estimates. For a more complete discussion of the Company’s significant accounting policies and other information, the unaudited consolidated financial statements and notes thereto should be read in conjunction with the audited consolidated financial statements included in the

Company's Annual Report on Form 10-K for the year ended December 31, 2017 (the "2017 10-K").
In conjunction with the Acquisition, the Company has internally restricted cash on its Consolidated Balance Sheet as of June 30, 2018. The Company defines internally restricted cash as cash that is collected on behalf of certain customers that is not available for immediate or general business usage. In accordance with contractual

arrangements, this cash is remitted to customers, generally within 60 days of receipt. As of June 30, 2018, internally restricted cash of $7.3 million is included within cash and cash equivalents on the Company's Consolidated Balance Sheets. Amounts that will be remitted to customers are included as collections payable to clients within the current portion of customer liabilities in the Company's Consolidated Balance Sheets.

2. Recent Accounting Pronouncements

Recently Issued Accounting Standards and Disclosures

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842) ("ASU 2016-02"), which supersedes existing guidance on accounting for leases in Topic 840, Leases. ASU 2016-02 generally requires all leases to be recognized in the consolidated balance sheet. The provisions of ASU 2016-02 are effective for reporting periods beginning after December 15, 2018; early adoption is permitted. The Company plans to adopt ASU 2016-02 on January 1, 2019 on a prospective basis and is currently evaluating the impact of the adoption of this guidance on its consolidated financial statements.

On January 1, 2018, the Company adopted ASU 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash ("ASU 2016-18"), using a retrospective transition method. ASU 2016-18 is intended to reduce diversity in practice in the classification and presentation of changes in restricted cash on the Consolidated Statement of Cash Flows. ASU 2016-18 requires that the Consolidated Statement of Cash Flows explain the change in total cash and cash equivalents and amounts generally described as restricted cash or restricted cash equivalents when reconciling the beginning-of-period and end-of-period total amounts. Upon adoption of ASU 2016-18, restricted cash equivalents of $1.5 million as of December 31, 2017, June 30, 2017, and January 1, 2017 were reclassified to be included within the reconciliation of beginning and ending cash and restricted cash equivalents on the Company's Consolidated Statement of Cash Flows. Restricted cash equivalents of $1.5 million and $2.0 million in current portion of restricted cash equivalents are included in the ending cash balance on the Company's Consolidated Statement of Cash Flows as of June 30, 2018.

In August 2016, the FASB issued ASU 2016-15, Classification of Certain Cash Receipts and Cash Payments (a consensus of the FASB Emerging Issues Task Force). This ASU addresses the following eight specific cash flow issues: Debt prepayment or debt extinguishment costs; settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing; contingent consideration payments made after a business combination; proceeds from the settlement of insurance claims; proceeds from the settlement of corporate-owned life insurance policies (including bank-owned life insurance policies); distributions received from equity method investees; beneficial interests in securitization transactions; and separately identifiable cash flows and application of the predominance principle. The Company adopted this standard on January 1, 2018. The adoption of this standard did not have a material impact on the Company's consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, Intangibles-Goodwill and Other (Topic 350)-Simplifying the Test for Goodwill Impairment (“ASU 2017-04”). ASU 2017-04 simplifies the accounting for goodwill impairments by eliminating the requirement to compare the implied fair value of goodwill with its carrying amount as part of step two of the goodwill impairment test referenced in Accounting Standards Codification (“ASC”) 350, Intangibles - Goodwill and Other (“ASC 350”). As a result, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An impairment charge should be recognized for the amount by which the carrying amount exceeds the reporting unit’s fair value. However, the impairment loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. ASU 2017-04 is effective for annual reporting periods beginning after December 15, 2019, including any interim impairment tests within those annual periods, with early application permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. In June 2018, the Company elected to early adopt ASU 2017-04, and the adoption had no impact on the Company's consolidated financial statements.

3. Fair Value of Financial Instruments

R1 RCM Inc.
Notes to Unaudited Consolidated Financial Statements

The Company records its financial assets and liabilities at fair value. The accounting standard for fair value (i) defines fair value as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants at the measurement date, (ii) establishes a framework for measuring fair value, (iii) establishes a hierarchy of fair value measurements based upon the ability to observe inputs used to value assets and liabilities, (iv) requires consideration of nonperformance risk and (v) expands disclosures about the methods used to measure fair value. The accounting standard establishes a three-level hierarchy of measurements based upon the reliability of observable and unobservable inputs used to arrive at fair value. Observable inputs are independent market data, while unobservable inputs reflect the Company’s assumptions about valuation. The three levels of the hierarchy are defined as follows:

- Level 1: Observable inputs such as quoted prices in active markets for identical assets and liabilities;
- Level 2: Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly. These include quoted prices for similar assets or liabilities in active markets and quoted prices for identical or similar assets or liabilities in markets that are not active, and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets; and
- Level 3: Valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

The carrying amounts of the Company’s financial instruments, which include financial assets such as cash and cash equivalents, restricted cash equivalents, accounts receivable, net, and certain other current assets, as well as financial liabilities such as accounts payable, accrued service costs, accrued compensation and benefits and certain other accrued expenses approximate their fair values, due to the short-term nature of these instruments. The Company believes the carrying value of debt approximates fair value due to the relatively short time period between debt issuance and June 30, 2018. Other than the Company's derivative financial instruments, the Company does not have any financial assets or liabilities that are required to be measured at fair value on a recurring basis. See Note 22, Derivative Financial Instruments, for a discussion of the fair value of the Company's forward currency derivative contracts.

4. Acquisition

Intermedix Holdings, Inc.

On May 8, 2018, the Company completed the acquisition of Intermedix. The Acquisition has been accounted for under ASC 805, Business Combinations. Accordingly, the accounts of the acquired company, after adjustments to reflect fair values assigned to assets and liabilities, have been included in the Company’s consolidated financial statements since the date of the Acquisition.

The purchase price for the Acquisition was $460 million, subject to customary adjustments for cash, debt, transaction expenses and normalized working capital. The Company funded the purchase price for the Acquisition and the Company’s associated transaction expenses with a combination of cash on hand and the incurrence of additional indebtedness through a term loan and subordinated debt (see Note 11, Debt). The purchase price has been provisionally allocated, on a preliminary basis, to assets acquired and liabilities assumed based on their preliminary estimated fair values as of the completion of the Acquisition.

The Company is continuing its review of the fair value estimate of assets acquired and liabilities assumed during the measurement period, which will conclude as soon as the Company receives the information about facts and circumstances that existed as of the acquisition date or learn that more information is not available. This measurement period will not exceed one year from the acquisition date. At the effective date of the Acquisition, the assets acquired and liabilities assumed are generally required to be measured at fair value.

Given the timing of the Acquisition, the fair value estimate of assets acquired and liabilities assumed are pending completion of multiple elements, including gathering further information about the identification and

R1 RCM Inc.
Notes to Unaudited Consolidated Financial Statements

completeness of all assets and liabilities acquired, the finalization of an independent appraisal and valuations of fair value of the assets acquired and liabilities assumed and final review by the Company's management. Accordingly, management considers the balances shown in the following table to be preliminary. Some of the more significant amounts that are not yet finalized relate to the fair value of accounts receivable, accounts payable, property, equipment and software, intangible assets, operating leases or commitments, contingent liabilities and income and non-income related taxes. Accordingly, there could be material adjustments to the consolidated financial statements, including changes in our depreciation and amortization expense related to the valuation of property equipment, and software, and intangible assets acquired and their respective useful lives among other adjustments.

The final determination of the assets acquired and liabilities assumed will be based on the established fair value of the assets acquired and the liabilities assumed as of the acquisition date. The excess of the purchase price over the fair value of net assets acquired is allocated to goodwill. The final determination of the purchase price, fair values and resulting goodwill may differ significantly from what is reflected in these consolidated financial statements.

The preliminary of the fair value of assets acquired and liabilities assumed is (in millions):

	Purchase Price Allocation
Total purchase consideration	$ 469.2
Allocation of consideration to assets acquired and liabilities assumed	
Cash and cash equivalents	$ 3.9
Accounts receivable, net	35.8
Prepaid income taxes	0.1
Prepaid expenses and other current assets	11.5
Property, equipment and software, net	30.8
Intangible assets, net	201.6
Goodwill	244.7
Other assets	0.5
Accounts payable	(6.4)
Current portion of customer liabilities	(8.6)
Accrued compensation and benefits	(6.8)
Other accrued expenses	(4.4)
Deferred income tax liabilities	(33.5)
Net assets acquired	$ 469.2

The fair value of accounts receivables acquired is $35.8 million, with the gross contractual amount being $37.4 million. The Company expects $1.6 million to be uncollectible.

The goodwill recognized is attributable primarily to synergies that are expected to be achieved from the integration of Intermedix. None of the goodwill is expected to be deductible for income tax purposes. As of June 30, 2018, there were no changes in the recognized amounts of goodwill resulting from the acquisition of Intermedix.

Included in the Consolidated Statements of Operations and Comprehensive Income (Loss) for the three and six months ended June 30, 2018 are net sales of $27.6 million and a loss before income taxes of $1.8 million related to the operations of Intermedix since the acquisition date of May 8, 2018.

The Company retained Bank of America to provide both advisory and financing services related to the Acquisition. The amount of debt issuance costs paid to Bank of America was $4.1 million.

R1 RCM Inc.
Notes to Unaudited Consolidated Financial Statements

Pro Forma Results

The following table summarizes, on a pro forma basis, the combined results of the Company as though the Acquisition had occurred as of January 1, 2017. These pro forma results are not necessarily indicative of either the actual consolidated results had the Intermedix Acquisition occurred as of January 1, 2017 or of the future consolidated operating results. Pro forma results are (in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Net services revenue	$229.9	$147.7	$425.7	$282.5
Net income (loss)	$(1.8)	$(10.0)	$(29.1)	$(30.9)

Supplemental pro-forma earnings were adjusted to exclude $11.9 million of acquisition-related costs incurred by the Company in 2018 and include those costs in 2017. Adjustments were also made to earnings to adjust depreciation and amortization to reflect fair value of identified assets acquired, to record the effects of extinguishing the debt of Intermedix and replacing it with the debt of the Company, and to record the income tax effect of these adjustments.

5. Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable is comprised of unpaid balances pertaining to modular services and end-to-end RCM customers, net receivable balances for end-to-end RCM customers after considering cost reimbursements owed to such customers, including related accrued balances, and amounts due from physician RCM and PM customers.
The Company maintains an estimated allowance for doubtful accounts to reduce its accounts receivable to the amount that it believes will be collected. This allowance is based on the Company's historical experience, its assessment of each customer's ability to pay, the length of time a balance has been outstanding, input from key Company resources assigned to each customer, and the status of any ongoing operations with each applicable customer.
Movements in the allowance for doubtful accounts are as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Beginning balance	$329	$107	$363	$66
Provision (recoveries)	268	50	237	91
Write-offs	—	(6)	(3)	(6)
Ending balance	$597	$151	$597	$151

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6. Property, Equipment and Software
Property, equipment and software consist of the following (in millions):

	June 30, 2018	December 31, 2017
Buildings and land	$4.6	$ —
Computer and other equipment	40.6	28.7
Leasehold improvements	30.2	22.3
Software	71.1	44.5
Office furniture	9.4	7.4
Property, equipment and software, gross	155.9	102.9
Less accumulated depreciation and amortization	(65.2)	(54.6)
Property, equipment and software, net	$90.7	$ 48.3

During the six months ended June 30, 2018, the Company capitalized $14.9 million of computer equipment and software related to a capital lease and financing, of which $4.9 million and $4.9 million are recorded in other accrued expenses and other non-current liabilities, respectively.
The following table summarizes the allocation of depreciation and amortization expense between cost of services and selling, general and administrative expenses (in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Cost of services	$5.2	$3.5	$9.8	$6.4
Selling, general and administrative	1.1	0.3	1.4	0.6
Total depreciation and amortization	$6.3	$3.8	$11.2	$7.0

7. Intangible Assets

In conjunction with the Acquisition of Intermedix, the Company acquired certain intangible assets. Prior to the Acquisition of Intermedix on May 8, 2018, the Company did not have any intangible assets. As discussed in Note 4, Acquisition, the amounts and estimated useful lives are preliminary. The following table provides the gross carrying value and accumulated amortization for each major class of intangible asset at June 30, 2018 (in millions, except weighted average useful life):

		June 30, 2018		
	Weighted Average Useful Life	Gross Carrying Value	Accumulated Amortization	Net Book Value
Customer relationships	17 years	$154.0	$ (1.3)	$152.7
Tradename	Indefinite	14.0	—	14.0
Technology	6 years	30.4	(0.7)	29.7
Non-Competition agreements	3 years	0.9	(0.1)	0.8
Favorable leasehold interests	7 years	2.3	(0.1)	2.2
Total intangible assets		$201.6	$ (2.2)	$199.4

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A preliminary fair value of the identifiable intangible assets was derived, utilizing the following valuation methodology:

	Valuation Methodology
Customer relationships	Income approach to derive the present value of future cash flows from customer relationship.
Technology	The cost, market, and income approaches were used. • Cost approach - value is based on the current technology cost. • Market approach - value is based on sales of similar technologies. • Income approach - value based on identifiable discrete cash flows related to the technology.
Non-competition agreements	Income approach to compare cash flows with and without the non-compete.
Tradename	Relief from Royalty Method was utilized to determine the present value of savings from owning the asset.
Favorable leasehold interests	Income approach to derive the present value of the market versus contractual rent.

Intangible asset amortization expense was $2.2 million for the three and six months ended June 30, 2018, and $0 for the three and six months ended June 30, 2017.

Estimated annual amortization expense related to intangible assets with definite lives as of June 30, 2018 is as follows (in millions):

Remainder of 2018	$7.4
2019	14.7
2020	14.7
2021	14.6
2022	14.5
Thereafter	119.5
Total	$185.4

8. Goodwill

In conjunction with the Acquisition, the Company recorded goodwill. ASC 350, Goodwill and Other Intangible Assets, requires that goodwill be tested for impairment at the reporting unit level on an annual basis and between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of the reporting unit below its carrying value. In the first six months of 2018, there were no events or circumstances that would have required an interim impairment test. Annually, during the fourth quarter, goodwill and other acquired intangible assets with indefinite lives are tested for impairment.

There were no changes to the carrying amount of goodwill during six months ended June 30, 2017. Changes in the carrying amount of goodwill for the six months ended June 30, 2018 were (in millions):

	Goodwill
Balance as of December 31, 2017	$ —
Acquisitions	244.7
Balance as of June 30, 2018	$ 244.7

9. Revenue Recognition

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The Company follows the guidance under Topic 606, Revenue from Contracts with Customers (“Topic 606”). Revenue is measured based on consideration specified in a contract with a customer, and excludes any sales incentives and amounts collected on behalf of third parties. The Company recognizes revenue when it satisfies a performance obligation by transferring control over a service to a customer, which is typically over the contact term. Estimates of variable consideration are included in revenue to the extent that it is probable that a significant reversal of cumulative revenue will not occur once the uncertainty is resolved.

Nature of Goods and Services

The Company's primary source of revenue is its end-to-end RCM services fees. The Company also generates revenue through its physician group and EMS providers RCM services, and modular RCM services, where customers will engage the Company for only specific components of its end-to-end RCM service offering on a fixed-fee or transactional basis, as well as its PAS and PM offerings.

Revenue Cycle Management

RCM services fees are primarily variable and performance related, and are generally viewed as the consideration earned in satisfaction of a single performance obligation which is considered a series. Variable consideration for end-to-end RCM services are allocated to and recognized over the related time period as the amounts reflect the consideration the Company is entitled to and relate specifically to the Company’s efforts to satisfy its performance obligation. Fees for physician group and EMS provider RCM services are variable consideration contingent on customer collections and inputs to the Company’s revenue estimates typically include historical service fees and historical customer collection amounts. RCM services fees consist of net operating fees, incentive fees, and other fees.

Net Operating Fees

The Company’s net operating fees consist of:

i) gross base fees invoiced to customers; less

ii) corresponding costs of customers’ revenue cycle operations which the Company pays pursuant to its RCM agreements, including salaries and benefits for the customers' RCM personnel, and related third-party vendor costs; plus

iii) fees accrued for physician group and EMS provider RCM services.

The Company recognizes revenue related to net operating fees ratably as the performance obligation for the RCM services is satisfied. Base fees are typically billed in advance of the quarter and paid in three monthly payments as the entity performs and the customer simultaneously receives and consumes the benefits provided by the services provided. The costs of customers’ revenue cycle operations which the Company pays pursuant to its RCM agreements are accrued based on the service period. RCM services fees for physician groups and EMS providers are invoiced on a monthly basis and payment terms are typically 30 days.

Incentive Fees

The Company recognizes revenue related to incentive fees ratably as the performance obligation for RCM services is satisfied, to the extent that it is probable that a significant reversal of cumulative revenue will not occur once the uncertainty is resolved. Incentive fees are structured to reflect quarterly or annual performance and are evaluated on a contract-by-contract basis. Incentive fees are typically billed and paid on a quarterly basis.

RCM Other

The Company recognizes revenue related to other RCM fees as RCM services are provided. These services typically consist of the Company's modular RCM services offering, which consists of an obligation to provide services for a specific component of its end-to-end RCM service offering. Fees are typically variable in nature with the entire amount being included in revenue in the month of service. The customer simultaneously receives and consumes the benefits provided by the services and the fees are typically billed on a monthly basis with payment terms of up to 30 days. To the extent that certain service fees are fixed and not subject to refund, adjustment or concession, these fees are generally recognized into revenue ratably as the performance obligation is satisfied.

The Company recognizes revenue from PAS in the period in which the service is performed. The Company’s PAS arrangements typically consist of an obligation to provide specific services to customers on a when and if needed basis. These services are provided under a fixed price per unit arrangement. These contracts are evaluated on a contract-by-contract basis. Fees for the Company's PAS arrangements are typically billed on a monthly basis with 30 to 60 day payment terms.

PM services arrangements include a single performance obligation, constituting a series, to manage and administer various non-clinical aspects of a customer's physician practice, which may be comprised of numerous physical office locations. Consideration for PM services is typically variable in nature and allocated to and recognized over the related time period as the amounts reflect the consideration the Company is entitled to and relate specifically to the Company’s effort to satisfy its performance obligation. PM services fees are invoiced on a monthly basis and payment terms are typically 30 days.

Bundled Services

Modular RCM services may be sold separately or bundled in a contract. End-to-end RCM services are typically sold separately but may be bundled with PAS. PAS are commonly sold separately. The typical length of an end-to-end RCM contract is three to ten years (subject to the parties' respective termination rights) but varies from customer to customer. PAS and modular RCM agreements generally vary in length between one and three years.

For bundled arrangements, the Company accounts for individual services as a separate performance obligation if a service is separately identifiable from other items in the bundled arrangement and if a customer can benefit from it on its own or with other resources that are readily available to the customer. The transaction price is allocated between separate services in a bundle based on their relative standalone selling prices. The standalone selling prices are determined based on the prices at which the Company separately sells its RCM, PAS, PM, or modular services. PAS are provided at a customer’s election but do not represent material rights as the services are priced at standalone selling price throughout the life of the agreement.

Disaggregation of Revenue

In the following table, revenue is disaggregated by source of revenue (in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Net operating fees	$181.7	$80.1	$309.3	$150.8
Incentive fees	9.9	7.1	17.9	12.7
Other	16.3	12.2	28.0	22.8
Net service revenue	$207.9	$99.4	$355.2	$186.3

Contract Balances

The following table provides information about receivables, contract assets, and contract liabilities from contracts with customers (in millions):

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	June 30, 2018	December 31, 2017
Receivables, which are included in accounts receivable, net	$81.2	$ 23.6
Contract assets	0.8	—
Contract liabilities	21.9	15.5

The Company recognized a decrease in revenue of $0.4 million and an increase in revenue of $1.7 million for the three and six months ended June 30, 2018 and 2017 related to changes in transaction price estimates. The Company recognized revenue of $0 million for both the three and six months ended June 30, 2018, and $0 million and $1.4 million for the three and six months ended June 30, 2017 related to services performed in periods prior to the parties reaching an agreement that creates enforceable rights and obligations.

A receivable is recognized in the period the Company provides services when the Company's right to consideration is unconditional. Payment terms on invoiced amounts are typically 30-60 days.

Significant changes in the contract assets and the contract liabilities balances are as follows (in millions):

	Six Months Ended June 30, 2018		Six Months Ended June 30, 2017	
	Contract assets	Contract liabilities	Contract assets	Contract liabilities
Revenue recognized that was included in the contract liability balance at the beginning of the period	—	$ 50.3	—	$ 29.6
Increases due to cash received, excluding amounts recognized as revenue during the period	—	$ 5.9	—	$ 2.2
Acquisitions	$0.8	$ 1.4	—	—

The Company recognized revenue of $50.3 million and $29.6 million during the six months ended June 30, 2018 and 2017, which amounts were included in contract liabilities at the beginning of the respective periods. These revenue amounts include $47.8 million and $29.6 million for the six months ended June 30, 2018 and 2017, respectively, related to advanced billings which become accounts receivable and contract liabilities on the first day of the respective service period.

Transaction Price Allocated to the Remaining Performance Obligation

The following table includes estimated revenue expected to be recognized in the future related to performance obligations that are unsatisfied (or partially unsatisfied) at the end of the reporting period (in millions). The estimated revenue does not include amounts of variable consideration that are constrained.

	RCM Net operating fees	Incentive fees	Other
2018	$44.1	$ 1.0	$2.4
2019	19.4	—	2.8
2020	10.7	—	2.8

2021	5.3	—	2.8
Thereafter	0.4	—	11.6
Total	$79.9	$ 1.0	$22.4

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The amounts presented in the table above include variable fee estimates for the non-cancellable term of the Company's physician groups and EMS providers RCM services contracts, primarily consist of fixed fees which are typically recognized ratably as the performance obligation is satisfied, and incentive fees which are measured cumulatively over the contractually defined performance period.

Estimates of revenue expected to be recognized in future periods also exclude unexercised customer options to purchase services within the Company's PAS contracts that do not represent material rights to the customer. Customer options that do not represent a material right are only accounted for in accordance with Topic 606 when the customer exercises its option to purchase additional goods or services.

The Company does not disclose information about remaining performance obligations with an original expected duration of one year or less. The Company has elected certain of the optional exemptions from the disclosure requirement for remaining performance obligations for specific situations in which an entity need not estimate variable consideration to recognize revenue. Accordingly, the Company applies a practical expedient to its stand-alone PAS contracts and modular RCM services and does not disclose information about variable consideration from remaining performance obligations when the Company has a right to consideration from a customer in an amount that corresponds directly with the value to the customer of the entity's performance completed to date. PAS performance obligations are typically short in duration (often less than 1 day) with any uncertainty related to the associated variable consideration resolved as each increment of service (completion of a level of care review or an appeal) is completed which reflects the value the Customer receives from the Company’s fulfillment of the performance obligation. Modular RCM services performance obligations for variable consideration are of short duration with fees corresponding to the value the customer has realized, for example, patient accounts collected on behalf of the Customer or medical record lines transcribed.

For end-to-end RCM contracts, the Company does not disclose information about remaining, wholly unsatisfied performance obligations for variable consideration that the Company is able to allocate to one or more, but not all, of the performance obligations in its contracts. Company’s end-to-end RCM services performance obligations are satisfied over time and are substantially the same from period to period under either a co-managed or operating partner model. Fees are variable and consist of net operating fees and incentive fees with the uncertainty related to net operating fees and certain incentive fees being resolved quarterly with the uncertainty of other incentive fees being resolved annually. The information presented in the table above includes estimates for incentive fees where the uncertainty related to the final fee is resolved on longer than a quarterly basis and to the extent the Company does not believe the associated consideration is constrained.

10. Customer Liabilities

Customer liabilities include (i) accrued service costs (amounts due and accrued for cost reimbursements), (ii) refund liabilities (amounts potentially due as a refund to the Company's customers on incentive fees), (iii) collections payable to clients (consisting primarily of amounts collected on behalf of the Company’s physician group customers to be remitted within twelve months) and (iv) deferred revenue (contract liabilities) (fixed or variable fees amortized to revenue over the service period). Deferred customer billings are classified as current based on the customer contract end dates or other termination events that fall within twelve months of the balance sheet dates. Accrued service cost, refund liabilities and contract liabilities are classified as current or non-current based on the anticipated period in which the liabilities are expected to be settled or the revenue is expected to be recognized.

Customer liabilities consist of the following (in millions):

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	June 30, 2018	December 31, 2017
Accrued service costs, current	$19.9	$ 23.7
Collections payable to clients, current	7.3	—
Refund liabilities, current	0.1	0.5
Deferred revenue (contract liabilities), current	4.5	4.0
Current portion of customer liabilities (1)	$31.8	$ 28.2
Deferred revenue (contract liabilities), non-current	17.4	11.5
Non-current portion of customer liabilities (1)	$17.4	$ 11.5
Total customer liabilities	$49.2	$ 39.7

(1) Current and non-current portion of customer liabilities includes amounts for a related party. See Note 19, Related Party Transactions, for further discussion.

11. Debt

The carrying amounts of debt at June 30, 2018 and December 31, 2017 are (in millions):

	June 30, 2018	December 31, 2017
Senior Revolver	$—	$ —
Senior Term Loan	270.0	—
Notes (primarily with related parties)	110.0	—
Unamortized discount and issuance costs	(20.6)	—
Total debt	359.4	—
Less: Current maturities	(2.7)	—
Total long-term debt	$356.7	$ —

Credit Agreement and Note Purchase Agreement

On May 8, 2018, the Company and certain of its subsidiaries entered into (1) a new senior credit agreement (the “Credit Agreement”) with Bank of America, N.A., as administrative agent, and the lenders named therein, for the new senior secured credit facilities (the “Senior Secured Credit Facilities”), consisting of a $270.0 million senior secured term loan facility (the “Senior Term Loan”) issued at 97% of par and a $25.0 million senior secured revolving credit facility (the “Senior Revolver”); and (2) a new subordinated note purchase agreement (the “Note Purchase Agreement”) with TI IV ACHI Holdings, LP, IHC Health Services, Inc. and Ascension Health Alliance d/b/a Ascension, as purchasers, consisting of the issuance and sale of $110.0 million aggregate principal amount of subordinated notes due 2026 (the "Notes") issued at 98% of par.

Senior Secured Credit Facilities

The Senior Term Loan has a seven-year maturity and the Senior Revolver has a five-year maturity. The Credit Agreement provides that the Company may make one or more offers to the lenders, and consummate transactions with individual lenders that accept the terms contained in such offers, to extend the maturity date of the lender’s term loans and/or revolving commitments, subject to certain conditions, and any extended term loans or revolving commitments will constitute a separate class of term loans or revolving commitments.

All of the Company's obligations under the Senior Secured Credit Facilities are guaranteed by the subsidiary guarantors named therein (the "Subsidiary Guarantors"). Pursuant to (1) the Security Agreement, dated as of May 8, 2018 (the "Security Agreement"), among the Company, the Subsidiary Guarantors and Bank of America, N.A., as administrative agent, and (2) the Guaranty, dated as of May 8, 2018 (the "Guaranty"),

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among the Company, the Subsidiary Guarantors and Bank of America, N.A., as administrative agent, subject to certain exceptions, the obligations under the Senior Secured Credit Facilities are secured by a pledge of 100% of the capital stock of certain domestic subsidiaries owned by the Company and a security interest in substantially all of the Company’s tangible and intangible assets and the tangible and intangible assets of each Subsidiary Guarantor.

The Senior Revolver includes borrowing capacity available for letters of credit and for borrowings on same-day notice, referred to as the “swing loans.” Any issuance of letters of credit or making of a swing loan will reduce the amount available under the revolving credit facility. As of June 30, 2018, the Company had no borrowings and no letters of credit under the Senior Revolver.

At the Company’s option, the Company may add one or more new term loan facilities or increase the commitments under the Senior Revolver (collectively, the “Incremental Borrowings”) in an aggregate amount of up to $25.0 million plus any additional amounts so long as certain conditions, including a consolidated first lien leverage ratio (as defined in the Credit Agreement) of not more than 3.75 to 1.00 (on a pari passu basis) or 5.50 to 1.00 (on a junior basis), in each case on a pro forma basis, are satisfied plus the amount of certain voluntary prepayments of Senior Term Loans.

Borrowings under the Senior Secured Credit Facilities bear interest, at the Company’s option, at: (i) an ABR rate equal to the greater of (a) the prime rate of Bank of America, N.A., (b) the federal funds rate plus 0.5% per annum, and (c) the Eurodollar rate for an interest period of one-month beginning on such day plus 100 basis points, plus 4.25% (provided that the Eurodollar rate applicable to the Term Loan Facility shall not be less than 0.00% per annum); or (ii) the Eurodollar rate (provided that the Eurodollar rate applicable to the Term Loan Facility shall not be less than 0.00% per annum), plus 5.25%. The interest rate as of June 30, 2018 was 7.62%. The Company is also required to pay an unused commitment fee to the lenders under the Senior Revolver at a rate of 0.50% of the average daily unutilized commitments thereunder if the first lien net leverage ratio is greater than 2.00 to 1.00, or at a rate of 0.375% at any other time. The Company must also pay customary letter of credit fees, including a fronting fee as well as administration fees.

The Credit Agreement requires the Company to make mandatory prepayments, subject to certain exceptions, with: (i) beginning with fiscal year 2019, 75% (which percentage will be reduced upon the achievement of certain first lien net leverage ratios) of the Company’s annual excess cash flow; (ii) 100% of net cash proceeds of all non-ordinary course assets sales or other dispositions of property or casualty events, subject to certain exceptions and thresholds; and (iii) 100% of the net cash proceeds of any debt incurrence, other than debt permitted under the Credit Agreement. The Company is required to repay the Senior Term Loan portion of the Senior Secured Credit Facilities in quarterly principal installments of 0.25% of the principal amount commencing on September 30, 2018, with the balance payable at maturity. If, on or prior to May 8, 2019, the Company prepays or reprices any portion of the Senior Term Loan, the Company will be required to pay a prepayment premium of 1% of the loans being prepaid or repriced.

The Credit Agreement contains two financial covenants. (1) The Company is required to maintain at the end of each fiscal quarter, commencing with the quarter ending September 30, 2018, a consolidated first lien net leverage ratio of not more than 5.50 to 1.00. This consolidated ratio will step down in increments to 4.00 to 1.00 commencing with the fiscal quarter ending September 30, 2020. (2) The Company is required to maintain at the end of each such fiscal quarter, commencing with the quarter ending September 30, 2018, a consolidated interest coverage ratio of not less than 1.75 to 1.00. This consolidated ratio will step up in increments to 2.50 to 1.00 commencing with the fiscal quarter ending September 30, 2020.

The Credit Agreement also contains a number of covenants that, among other things, restrict, subject to certain exceptions, the Company’s ability and the ability of its subsidiaries to: (i) incur additional indebtedness; (ii) create liens on assets; (iii) engage in mergers or consolidations; (iv) sell assets; (v) pay dividends and distributions or repurchase the Company’s capital stock; (vi) make investments, loans or advances; (vii) repay certain junior indebtedness; (viii) engage in certain transactions with affiliates; (ix) enter into sale and leaseback transactions; (x) amend material agreements governing certain of the Company's junior indebtedness; (xi) change the Company's lines of business; (xii) make certain acquisitions; and (xiii) limitations on the letter of credit cash collateral account. The Credit Agreement contains customary affirmative covenants and events of default.

Note Purchase Agreement

The Notes issued pursuant to the Note Purchase Agreement each have an eight-year maturity, as extended in accordance with the Notes from time to time.

All of the Company's obligations under the Note Purchase Agreement are guaranteed by the Subsidiary Guarantors pursuant to the Subsidiary Guaranty, dated as of May 8, 2018 (the "Subsidiary Guaranty"), among the Company, the Subsidiary Guarantors and the Purchasers (as defined in the Notes). The obligations under the Note Purchase Agreement are unsecured.

As of June 30, 2018, $105.0 million of the Notes were due to related parties. For the three and six months ended June 30, 2018, $2.2 million of interest was payable to related parties.

The Notes bear interest at 14.0% per annum, increasing by 1.0% per annum on May 8, 2021, and by an additional 1.0% per annum on each subsequent anniversary until the Notes are repaid in full. Interest is payable quarterly in cash; provided, that, subject to the subordination agreement, (i) for any fiscal quarters ending on or prior to May 8, 2019, at the Company's election, up to 75% of the interest payments will be payable in kind and the remaining amount of such interest payment will be payable quarterly in cash; (ii) for any fiscal quarters ending after May 8, 2019 and on or prior to May 8, 2020, at the Company's election, up to 50% of the interest payments will be payable in kind and the remaining amount of such interest payment will be payable quarterly in cash; and (iii) for any subsequent fiscal quarters, at the Company's election, up to 25% of the interest payments will be payable in kind and the remaining amount of such interest payment will be payable quarterly in cash.

The Note Purchase Agreement does not require any mandatory prepayments. Any voluntary prepayment of the obligations pursuant to the Note Purchase Agreement (other than in connection with a change of control) shall be subject to a prepayment premium of (a) if such prepayment is made before May 8, 2019, 3.0% of the principal amount of the obligations prepaid, (b) if such prepayment is made on or after May 8, 2019 but prior to May 8, 2020, 2.0% of the principal amount of the obligations prepaid, (c) if such prepayment is made on or after May 8, 2020 but prior to May 8, 2021, 1.0% of the principal amount of the obligations prepaid, and (d) if such prepayment is made on or after May 8, 2021, 0.0% of the principal amount of the obligations prepaid.

The Note Purchase Agreement also contains a number of covenants that, among other things, restrict, subject to certain exceptions, the Company's ability and the ability of its subsidiaries to: (i) create liens on assets; (ii) engage in mergers or consolidations or sell all or substantially all of their respective assets; and (iii) pay dividends and distributions or repurchase the Company's capital stock. The Note Purchase Agreement contains customary affirmative covenants and events of default.

Debt Issuance Costs

The Company incurred debt issuance costs of $11.1 million in relation to the Credit Agreement and Note Purchase Agreement which were allocated to the respective agreements.

12. Stockholders’ Equity (Deficit)

Intermountain Purchase Agreement

As discussed in Note 1, Business Description and Basis of Presentation, on January 23, 2018, the Company entered into the Intermountain Purchase Agreement, pursuant to which the Company sold to Intermountain, in private placements under the Securities Act, (i) 4,665,594 shares of common stock, at a purchase price of $4.2867 per share (representing the per share average closing price of the Company’s Common Stock for the period from January 1, 2018 to January 12, 2018), and (ii) a warrant to acquire up to 1,500,000 shares of Common Stock at an initial exercise price of $6.00 per share, on the terms and subject to the conditions set forth in the Warrant Agreement, for an aggregate purchase price of $20 million. As a result of the sale of the common stock and warrant, the Company recorded $47 thousand to common stock and $19.3 million to additional paid-in-capital, net of $0.7 million of issuance costs.

Preferred Stock and Warrant

The Company has 5,000,000 shares of authorized preferred stock, each with a par value of $0.01. The preferred stock may be issued from time to time in one or more series. The board of directors of the Company ("Board") is authorized to determine the rights, preferences, privileges and restrictions of the Company’s authorized but unissued shares of preferred stock. On February 16, 2016, at the close of the Transaction, the Company issued to TCP-ASC ACHI Series LLLP, a limited liability limited partnership jointly owned by Ascension Health Alliance and investment funds affiliated with TowerBrook (the "Investor"): (i) 200,000 shares of its 8.00% Series A Convertible Preferred Stock, par value $0.01 per share (the "Series A Preferred Stock" or "Preferred Stock"), for an aggregate price of $200 million and (ii) an exercisable warrant to acquire up to 60 million shares of its common stock with an exercise price of $3.50 per common share and a term of ten years. The Series A Preferred Stock is immediately convertible into shares of common stock. As of June 30, 2018 and December 31, 2017, the Company had 236,672 and 227,483 shares of Preferred Stock outstanding, respectively. See Note 16, 8% Series A Convertible Preferred Stock, for additional information.

Common Stock

Each outstanding share of the Company's common stock, par value $0.01 per share ("common stock"), is entitled to one vote per share on all matters submitted to a vote by shareholders. Subject to the rights of any preferred stock which may from time to time be outstanding, the holders of outstanding shares of common stock are entitled to receive dividends and, upon liquidation or dissolution, are entitled to receive pro rata all assets legally available for distribution to stockholders. No dividends were declared or paid on the common stock during 2018 or 2017.

Treasury Stock

On November 13, 2013, the Board authorized a repurchase of up to $50.0 million of the Company’s common stock in the open market or in privately negotiated transactions. The timing and amount of any shares repurchased will be determined by the Company based on its evaluation of market conditions and other factors. The repurchase program may be suspended or discontinued at any time at the sole discretion of the Board. Any repurchased shares will be available for use in connection with the Company’s stock plans and for other corporate purposes. The Company funds the repurchases from cash on hand. During the year ended December 31, 2017, the Company repurchased 855,474 shares of the Company's stock for $2.5 million. During the three and six months ended June 30, 2018, no shares were repurchased. No shares have been retired. As of June 30, 2018 and December 31, 2017, the Company held in treasury 5,321,393 shares of repurchased stock, respectively.

Treasury stock also includes repurchases of Company stock related to employees’ tax withholding upon vesting of restricted shares. For the three and six months ended June 30, 2018, the Company repurchased 134,898 and 497,300 shares related to employees’ tax withholding upon vesting of restricted shares, respectively. Additionally, treasury stock includes restricted stock awards that have been canceled or forfeited. See Note 13, Share-Based Compensation.

13. Share-Based Compensation

The share-based compensation expense relating to the Company’s stock options, restricted stock awards ("RSAs"), restricted stock units ("RSUs") and performance-based restricted stock units ("PBRSUs") for the three months ended June 30, 2018 and 2017 was $5.1 million and $2.2 million, respectively, with related tax benefits of

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approximately $1.3 million and $0.8 million, respectively. The share-based compensation expense relating to the Company's stock options, RSAs, RSUs and PBRSUs for the six months ended June 30, 2018 and 2017 was $9.0 million and $5.8 million, respectively, with related tax benefit of approximately $2.3 million and $2.2 million, respectively.

As of January 1, 2017, the Company adopted ASU 2016-09. The Company elected to change its accounting policy to account for forfeitures as they occur under the new standard. The change was applied on a modified retrospective basis with a cumulative effect adjustment recorded to increase accumulated deficit by $0.9 million, increase additional paid-in capital by $1.5 million and increase non-current deferred tax assets by $0.6 million as of January 1, 2017. Excess tax benefits and shortfalls for share-based payments are now included in operating activities rather than in financing activities.

Amendments related to accounting for excess tax benefits and shortfalls have been adopted prospectively, resulting in recognition of excess tax benefits and shortfalls in income tax expenses (benefit) rather than additional paid-in capital. The Company recognized $1.3 million of tax benefit and $0.0 million of income tax expense from windfalls and shortfalls associated with vesting and exercises of equity awards for the three months ended June 30, 2018 and 2017, respectively. The Company recognized $2.0 million of tax benefit and $0.9 million of income tax expense from windfalls and shortfalls associated with vesting and exercises of equity awards for the six months ended June 30, 2018 and 2017, respectively.
Total share-based compensation costs that have been included in the Company's consolidated statements of operations were as follows (in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Share-Based Compensation Expense Allocation Details:				
Cost of services	$1.5	$1.0	$2.8	$2.1
Selling, general and administrative	3.5	1.1	6.1	3.6
Other	0.1	0.1	0.1	0.1
Total share-based compensation expense (1)	$5.1	$2.2	$9.0	$5.8

(1) Includes $0.1 million in share-based compensation expense paid in cash during the three and six months ended June 30, 2017, respectively. No shared-based compensation expense was paid in cash during the three or six month periods ended June 30, 2018. In addition to the share-based compensation expense recorded above, $0.1 million and $0.2 million of share-based compensation expense was capitalized to deferred contract costs for the three and six months ended June 30, 2018, respectively, and $0 million and $0.3 million during the three and six months ended June 30, 2017, respectively. See Note 20, Deferred Contract Costs, for further discussion.
The Company uses the Black-Scholes option pricing model to estimate the fair value of its service-based options as of its grant date. Monte Carlo simulations are used to estimate the fair value of its PBRSUs. The PBRSUs vest upon satisfaction of both time-based requirements and performance targets based on share price. Expected life is based on the market condition to which the vesting is tied.
The following table sets forth the significant assumptions used in the Black-Scholes option pricing model and the Monte Carlo simulations and the calculation of share-based compensation expense for the six months ended June 30, 2018 and 2017:

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	Six Months Ended June 30, 2018	2017
Expected dividend yield	—	—
Risk-free interest rate	2.3% to 2.7%	1.9% to 2.3%
Expected volatility	40% to 45%	45%
Expected term (in years)	2.59 to 6.25	6.25 to 6.29

The risk-free interest rate input is based on U.S. Treasury instruments, and expected volatility of the share price based upon review of the historical volatility levels of the Company’s common stock in conjunction with that of public companies that operate in similar industries or are similar in terms of stage of development or size and a projection of this information toward its future expected volatility. The Company used the simplified method to estimate the expected option life for 2018 and 2017 option grants. The simplified method was used due to the lack of sufficient historical data available to provide a reasonable basis upon which to estimate the expected term of each stock option.

Stock options

A summary of the options activity during the six months ended June 30, 2018 is shown below:

	Shares	Weighted-Average Exercise Price
Outstanding at December 31, 2017	17,742,966	$ 4.70
Granted	204,942	5.53
Exercised	(1,117,588)	2.55
Canceled/forfeited	(1,284,812)	2.52
Outstanding at June 30, 2018	15,545,508	5.04
Outstanding, vested and exercisable at June 30, 2018	7,986,285	7.22
Outstanding, vested and exercisable at December 31, 2017	5,778,376	$ 8.87

Restricted stock awards

A summary of the RSA activity during the six months ended June 30, 2018 is shown below:

	Shares	Weighted-Average Grant Date Fair Value
Outstanding and unvested at December 31, 2017	2,352,490	$ 3.03
Granted	—	—
Vested	(1,184,687)	3.07
Forfeited	(18,945)	3.35
Outstanding and unvested at June 30, 2018	1,148,858	$ 3.03

RSA vesting is based on the passage of time. The amount of share-based compensation expense is based on the fair value of the Company's common stock on the respective grant dates and is recognized ratably over the vesting period.

The Company's RSA agreements allow employees to surrender to the Company shares of common stock upon vesting of their RSAs in lieu of their payment of the required personal employment-related taxes. During the

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six months ended June 30, 2018 and 2017, employees delivered to the Company 404,466 and 713,753 shares of stock, respectively, which the Company recorded at a cost of approximately $2.2 million and $1.8 million, respectively. Shares surrendered for payment of personal employment-related taxes are held in treasury.

Restricted stock units

A summary of the RSU activity during the six months ended June 30, 2018 is shown below:

	Shares	Weighted-Average Grant Date Fair Value
Outstanding and unvested at December 31, 2017	1,183,500	$ 2.50
Granted	417,008	7.96
Vested	(294,825)	2.40
Forfeited	(73,885)	2.49
Outstanding and unvested at June 30, 2018	1,231,798	$ 4.37

The Company's RSU agreements allow employees to surrender to the Company shares of common stock upon vesting of their RSUs in lieu of their payment of the required personal employment-related taxes. During the six months ended June 30, 2018 and 2017, employees delivered to the Company 92,834 and 50,762 shares of stock, respectively, which the Company recorded at a cost of approximately $0.7 million and $0.2 million, respectively. Shares surrendered for payment of personal employment-related taxes are held in treasury.

Performance-based restricted stock units

In the third quarter of 2017, the Company began to grant PBRSUs to its employees. The PBRSUs vest upon satisfaction of both time-based requirements and performance targets based on share price with awards vesting between December 31, 2019 and December 31, 2021. Depending on the average price of the stock for the 60 days prior to the end of the vesting period, the number of shares vesting could be between 0% and 350% of the number of PBRSUs originally granted. Based on the established price targets, 11,052,549 is the maximum number of shares that could vest.

A summary of the PBRSU activity during the six months ended June 30, 2018 is shown below:

	Shares	Weighted-Average Grant Date Fair Value
Outstanding and unvested at December 31, 2017	4,785,900	$ 3.37
Granted	1,456,671	8.29
Vested	—	—
Forfeited	(863,761)	