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

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)
Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended June 30, 2017
OR

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from to

Commission File Number: 001-37415

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

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

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

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer” and “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

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

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

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

Evolent Health, Inc.
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Explanatory Note

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

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

FORWARD-LOOKING STATEMENTS - CAUTIONARY LANGUAGE

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

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

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

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

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

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

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

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

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

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

See accompanying Notes to Consolidated Financial Statements

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EVOLENT HEALTH, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited, in thousands, except per share data)

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

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

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

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

See accompanying Notes to Consolidated Financial Statements
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EVOLENT HEALTH, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited, in thousands)

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

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

See accompanying Notes to Consolidated Financial Statements

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

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

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

See accompanying Notes to Consolidated Financial Statements

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EVOLENT HEALTH, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Organization

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

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

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

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

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

Basis of Presentation

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

Summary of Significant Accounting Policies

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

Accounting Estimates and Assumptions

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

Principles of Consolidation

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

Operating Segments

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

Restricted Cash and Restricted Investments

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

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

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

Goodwill

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

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

Change in Accounting Principle

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

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

3. Recently Issued Accounting Standards

Adoption of New Accounting Standards

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

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

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

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

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

Future Adoption of New Accounting Standards

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

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

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

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

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

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

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

4. Transactions

Business Combinations

Aldera

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

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

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

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

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

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

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

Valence Health

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

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

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