

Evolent Health, Inc.
Form 10-Q
May 10, 2018

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2018

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

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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 May 7, 2018, there were 77,065,740 shares of the registrant’s Class A common stock outstanding and 880,646 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 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.

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;
- uncertainty in the public exchange market;
- the uncertain impact of CMS waivers to Medicaid rules;
- the uncertain impact the results of the 2018 congressional, state and local elections, as well as subsequent 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 acquisition of assets from New Mexico Health Connections (“NMHC”) and 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 assets from NMHC and the acquisition of Valence Health, including future revenues 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, selection bias in at-risk membership and the ability to control and, if necessary, reduce health care costs, particularly in New Mexico;
- 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;
- risks related to governmental payor audits and actions, including whistleblower claims;
- 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;
- inadequate 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 ability to contain health care costs, implement increases in premium rates on a timely basis, maintain adequate reserves for policy benefits or maintain cost effective provider agreements;

the risk of a significant reduction in the enrollment in our health plan;

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 are sold or 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 second amended and restated certificate of incorporation and second 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 second 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 expectations regarding the additional management attention and costs that will be required as we transition from an "emerging growth company" to a "large accelerated filer"; 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. Our Annual Report on Form 10-K for the year ended December 31, 2017 (the "2017 Form 10-K"), 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 March 31, 2018	As of December 31, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	\$200,316	\$238,433
Restricted cash and restricted investments	33,364	62,398
Accounts receivable, net (amounts related to affiliates: 2018 - \$7,267; 2017 - \$3,358)	66,138	48,947
Prepaid expenses and other current assets (amounts related to affiliates: 2018 - \$12; 2017 - \$25)	17,369	8,404
Notes receivable	16,000	20,000
Contract assets	4,092	—
Total current assets	337,279	378,182
Restricted cash and restricted investments	3,393	3,287
Investments in and advances to affiliates	5,521	1,531
Property and equipment, net	60,430	50,922
Prepaid expenses and other non-current assets	10,045	9,328
Contract assets	1,551	—
Contract cost assets	9,982	—
Intangible assets, net	242,863	241,261
Goodwill	635,246	628,186
Total assets	\$1,306,310	\$1,312,697

LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT)

Liabilities

Current liabilities:

Accounts payable (amounts related to affiliates: 2018 - \$3,491; 2017 - \$10,284)	\$22,445	\$42,930
Accrued liabilities (amounts related to affiliates: 2018 - \$656; 2017 - \$719)	37,955	29,572
Accrued compensation and employee benefits	16,508	35,390
Deferred revenue	33,328	24,807
Claims reserves	6,699	—
Total current liabilities	116,935	132,699
Long-term debt, net of discount	121,623	121,394
Other long-term liabilities	11,368	9,861
Deferred tax liabilities, net	1,470	2,437
Total liabilities	251,396	266,391

Commitments and Contingencies (See Note 9)

Shareholders' Equity (Deficit)

Class A common stock - \$0.01 par value; 750,000,000 shares authorized; 76,979,298 and 74,723,597

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shares issued and outstanding as of March 31, 2018, and December 31, 2017, respectively	770	747
Class B common stock - \$0.01 par value; 100,000,000 shares authorized; 880,646 and 2,653,544		
shares issued and outstanding as of March 31, 2018, and December 31, 2017, respectively	9	27
Additional paid-in-capital	953,322	924,153
Accumulated other comprehensive income (loss)	—	—
Retained earnings (accumulated deficit)	89,041	85,952
Total shareholders' equity (deficit) attributable to Evolent Health, Inc.	1,043,142	1,010,879
Non-controlling interests	11,772	35,427
Total shareholders' equity (deficit)	1,054,914	1,046,306
Total liabilities and shareholders' equity (deficit)	\$1,306,310	\$1,312,697

See accompanying Notes to Consolidated Financial Statements

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EVOLENT HEALTH, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)

(unaudited, in thousands, except per share data)

	For the Three Months Ended March 31,	
	2018	2017
Revenue		
Transformation services ⁽¹⁾	\$6,505	\$10,235
Platform and operations services ⁽¹⁾	109,818	96,003
Premiums	23,391	—
Total revenue	139,714	106,238
Expenses		
Cost of revenue (exclusive of depreciation and amortization expenses presented separately below) ⁽¹⁾	71,975	67,528
Claims expenses	16,749	—
Selling, general and administrative expenses ⁽¹⁾	55,526	53,550
Depreciation and amortization expenses	9,496	6,615
Loss on change in fair value of contingent consideration	100	—
Total operating expenses	153,846	127,693
Operating income (loss)	(14,132)	(21,455)
Interest income	1,072	185
Interest expense	(853)	(954)
Income (loss) from affiliates	(131)	(522)
Other income (expense), net	(18)	2
Income (loss) before income taxes and non-controlling interests	(14,062)	(22,744)
Provision (benefit) for income taxes	3	405
Net income (loss)	(14,065)	(23,149)
Net income (loss) attributable to non-controlling interests	(439)	(5,137)
Net income (loss) attributable to Evolent Health, Inc.	\$(13,626)	\$(18,012)
Earnings (Loss) Available for Common Shareholders		
Basic	\$(13,626)	\$(18,012)
Diluted	(13,626)	(18,012)
Earnings (Loss) per Common Share		
Basic	\$(0.18)	\$(0.34)
Diluted	(0.18)	(0.34)
Weighted-Average Common Shares Outstanding		
Basic	75,375	52,599
Diluted	75,375	52,599
Comprehensive income (loss)		
Net income (loss)	\$(14,065)	\$(23,149)
Other comprehensive income (loss), net of taxes, related to:		
Foreign currency translation adjustment	—	—
Total comprehensive income (loss)	(14,065)	(23,149)

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Total comprehensive income (loss) attributable to non-controlling interests	(439)	(5,137)
Total comprehensive income (loss) attributable to Evolent Health, Inc.	\$(13,626)	\$(18,012)

⁽¹⁾ See Note 16 for amounts related to affiliates included in these line items.

See accompanying Notes to Consolidated Financial Statements

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EVOLENT HEALTH, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited, in thousands)

	For the Three Months Ended March 31,	
	2018	2017
Cash Flows from Operating Activities		
Net income (loss)	\$(14,065)	\$(23,149)
Adjustments to reconcile net income (loss) to net cash and restricted cash provided by (used in) operating activities:		
Loss from affiliates	131	522
Change in fair value of contingent consideration	100	—
Depreciation and amortization expenses	9,496	6,615
Amortization of deferred financing costs	229	229
Stock-based compensation expense	3,795	5,104
Deferred tax provision (benefit)	(42)	) 405
Contract cost amortization	570	—
Accretion of bond premium/discounts	—	57
Other	(206)	) 159
Changes in assets and liabilities, net of acquisitions:		
Accounts receivables, net	(16,937)	) (4,003)
Prepaid expenses and other current and noncurrent assets	(12,610)	) (629)
Contract assets	(198)) —
Contract cost assets	(355)) —
Accounts payable	2,334	4,222
Accrued liabilities	5,209	(6,727)
Accrued compensation and employee benefits	(19,570)	) (21,424)
Deferred revenue	10,869	4,581
Claims reserves	6,699	—
Other long-term liabilities	(154)	) (727)
Net cash and restricted cash provided by (used in) operating activities	(24,705)	) (34,765)
Cash Flows from Investing Activities		
Cash paid for asset acquisitions or business combinations	(11,676)) —
Principal repayment for implementation funding loan	4,000	—
Amount received from Vestica Healthcare LLC escrow	500	—
Maturities and sales of investments	—	10,600
Investments in and advances to affiliates	(4,000)) —
Purchases of property and equipment	(9,553)	) (5,978)
Maturities of restricted investments	8,044	—
Net cash and restricted cash provided by (used in) investing activities	(12,685)	) 4,622
Cash Flows from Financing Activities		
Change in restricted cash held on behalf of partners for claims processing	(22,268)	) (8,501)
Proceeds from stock option exercises	1,461	542
Taxes withheld and paid for vesting of restricted stock units	(800)	) (667)
Net cash and restricted cash provided by (used in) financing activities	(21,607)) (8,626)

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Effect of exchange rate on cash and cash equivalents and restricted cash	(4)	—
Net increase (decrease) in cash and cash equivalents and restricted cash	(59,001	)	(38,769)
Cash and cash equivalents and restricted cash as of beginning-of-period	295,363		170,029
Cash and cash equivalents and restricted cash as of end-of-period	\$236,362		\$131,260

See accompanying Notes to Consolidated Financial Statements

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EVOLENT HEALTH, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (DEFICIT)

(unaudited, in thousands)

	Class A		Class B		Additional	Accum-	Retained		Total
	Common	Stock	Common	Stock	Paid-in	ulated	Earnings	Non-	Equity
	Shares	Amount	Shares	Amount	Capital	Other	Accum-	controlling	(Deficit)
						Income	ulated	Interests	
						(Loss)	Deficit)		
Balance as of December 31, 2016	52,587	\$ 506	15,347	\$ 153	\$ 555,250	\$ —	\$ 146,617	\$ 209,588	\$ 912,114
Stock-based compensation expense	—	—	—	—	20,437	—	—	—	20,437
Exercise of stock options	788	28	—	—	4,054	—	—	—	4,082
Restricted stock units vested, net of shares withheld for taxes	149	2	—	—	(1,274)	—	—	—	(1,272)
Shares released 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 2017 Securities Offerings	—	—	—	—	12,857	—	—	—	12,857
Issuance of Class A common stock during August 2017 Primary	8,816	88	—	—	166,859	—	—	—	166,947
Reclassification of non-controlling interests	—	—	—	—	(3,824)	—	—	—	—