R1 RCM INC.
Form 10-Q
October 31, 2017

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 September 30, 2017
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 (Do not check if a smaller reporting company)	o	Smaller reporting company	o	Emerging growth company	o

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 October 28, 2017, the registrant had 104,515,603 shares of common stock, par value $0.01 per share, outstanding.

Table of Contents

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

PART I — FINANCIAL INFORMATION
ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

	September 30, 2017 (unaudited)	December 31, 2016
Assets		
Current assets:		
Cash and cash equivalents	$ 142.8	$ 181.2
Accounts receivable, net	7.7	4.0
Accounts receivable, net - related party	18.0	1.8
Prepaid income taxes	0.9	3.8
Prepaid expenses and other current assets	16.1	13.8
Total current assets	185.5	204.6
Property, equipment and software, net	50.2	32.8
Non-current deferred tax assets	105.8	169.9
Restricted cash equivalents	1.5	1.5
Other assets	11.4	6.3
Total assets	$ 354.4	$ 415.1
Liabilities		
Current liabilities:		
Accounts payable	6.9	7.9
Current portion of customer liabilities	0.9	69.7
Current portion of customer liabilities - related party	20.1	14.2
Accrued compensation and benefits	29.2	24.8
Other accrued expenses	16.1	18.5
Total current liabilities	73.2	135.1
Non-current portion of customer liabilities	0.3	1.0
Non-current portion of customer liabilities - related party	9.1	110.0
Other non-current liabilities	12.2	9.7
Total liabilities	$ 94.8	$ 255.8
8.00% Series A convertible preferred stock: par value $0.01 per share, 370,000 authorized, 223,023 shares issued and outstanding as of September 30, 2017 (aggregate liquidation value of $227.5); 370,000 authorized, 210,160 shares issued and outstanding as of December 31, 2016 (aggregate liquidation value of $214.4)	184.7	171.6
Stockholders' equity (deficit)		
Common stock, $0.01 par value, 500,000,000 shares authorized, 116,639,819 shares issued and 104,505,034 shares outstanding at September 30, 2017; 116,425,524 shares issued and 106,659,542 shares outstanding at December 31, 2016	1.2	1.2
Additional paid-in capital	339.8	349.2
Accumulated deficit	(204.3)	(304.7)
Accumulated other comprehensive loss	(2.2)	(2.8)
	(59.6)	(55.2)

Treasury stock, at cost, 12,134,785 shares as of September 30, 2017; 9,765,982 shares as of December 31, 2016		
Total stockholders’ equity (deficit)	74.9	(12.3)
Total liabilities and stockholders’ equity (deficit)	$ 354.4	$ 415.1

See accompanying notes to consolidated financial statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
	(Unaudited)		(Unaudited)	
Net services revenue ($112.2 million and $275.3 million for the three and nine months ended September 30, 2017, respectively, and $22.7 and $366.2 million for the three and nine months ended September 30, 2016 from related party, respectively)	$123.2	$ 125.5	$309.5	$ 486.4
Operating expenses:				
Cost of services	111.8	47.4	289.1	137.6
Selling, general and administrative	15.1	16.2	41.6	58.4
Other	1.4	0.5	2.6	20.0
Total operating expenses	128.3	64.1	333.3	216.0
Income (loss) from operations	(5.1)	61.4	(23.8)	270.4
Net interest income	—	0.1	0.1	0.2
Income (loss) before income tax provision	(5.1)	61.5	(23.7)	270.6
Income tax provision (benefit)	(1.5)	24.1	(5.1)	106.6
Net income (loss)	$(3.6)	$ 37.4	$(18.6)	$ 164.0
Net income (loss) per common share:				
Basic	$(0.08)	$ 0.18	$(0.31)	$ 0.62
Diluted	$(0.08)	$ 0.18	$(0.31)	$ 0.62
Weighted average shares used in calculating net income (loss) per common share:				
Basic	102,225,412	100,934,561	102,022,199	99,870,685
Diluted	102,225,412	122,176,280	102,022,199	121,018,450
Consolidated statements of comprehensive income (loss)				
Net income (loss)	(3.6)	37.4	(18.6)	164.0
Other comprehensive loss:				
Foreign currency translation adjustments	(0.2)	0.2	0.6	—
Comprehensive income (loss)	$(3.8)	$ 37.6	$(18.0)	$ 164.0

Reconciliation of net income (loss) to income (loss) available to common shareholders:				
Basic:				
Net income (loss)	$(3.6)	$37.4	$(18.6)	$164.0
Less dividends on preferred shares	(4.4)	(4.1)	(13.1)	(58.5)
Less income allocated to preferred shareholders	—	(15.1)	—	(43.4)
Net income (loss) available/allocated to common shareholders - basic	$(8.0)	$18.2	$(31.7)	$62.1
Diluted:				
Net income (loss)	$(3.6)	$37.4	$(18.6)	$164.0
Less dividends on preferred shares	(4.4)	(4.1)	(13.1)	(58.5)
Less income allocated to preferred shareholders	—	(15.0)	—	(43.1)
Net income (loss) available/allocated to common shareholders - diluted	$(8.0)	$18.3	$(31.7)	$62.4

See accompanying notes to consolidated financial statements.

R1 RCM Inc.
Consolidated Statements of Stockholders' Equity (Deficit) (unaudited)
(In millions, except 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, 2016	116,425,524	$ 1.2	(9,765,982)	$ (55.2)	$ 349.2	$ (304.7)	$ (2.8)	$ (12.3)
Impact of adoption of Topic 606	—	—	—	—	—	113.4	—	113.4
Impact of adoption of ASU 2016-09	—	—	—	—	1.5	(0.9)	—	0.6
Adjusted Balance at January 1, 2017	116,425,524	1.2	(9,765,982)	(55.2)	350.7	(192.2)	(2.8)	101.7
Share-based compensation expense	—	—	—	—	8.6	—	—	8.6
Issuance of common stock related to share-based compensation plans	155,535	—	—	—	—	—	—	—
Exercise of vested stock options	58,760	—	—	—	0.1	—	—	0.1
Dividends paid/accrued dividends	—	—	—	—	(13.1)	—	—	(13.1)
Acquisition of treasury stock related to equity award plans	—	—	(728,798)	—	—	—	—	—
Treasury stock purchases and forfeitures	—	—	(1,640,005)	(4.4)	—	—	—	(4.4)
Reclassification of excess share-based compensation	—	—	—	—	(6.5)	6.5	—	—
Foreign currency translation adjustments	—	—	—	—	—	—	0.6	0.6
Net (loss) income	—	—	—	—	—	(18.6)	—	(18.6)
Balance at September 30, 2017	116,639,819	$ 1.2	(12,134,785)	$ (59.6)	$ 339.8	$ (204.3)	$ (2.2)	$ 74.9

See accompanying notes to consolidated financial statements.

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

	Nine Months Ended September 30,	
	2017	2016
	(Unaudited)	
Operating activities		
Net income (loss)	$(18.6)	$164.0
Adjustments to reconcile net income (loss) to net cash used in operations:		
Depreciation and amortization	11.5	7.3
Share-based compensation	8.2	25.2
Loss on disposal	0.2	—
Provision (recovery) for doubtful receivables	0.1	0.1
Deferred income taxes	(5.6)	106.5
Changes in operating assets and liabilities:		
Accounts receivable and related party accounts receivable	(15.4)	1.2
Prepaid income taxes	3.0	0.2
Prepaid expenses and other assets	(6.7)	(7.9)
Accounts payable	0.3	(1.4)
Accrued compensation and benefits	4.3	8.3
Other liabilities	(0.3)	3.0
Customer liabilities and customer liabilities - related party	14.7	(375.8)
Net cash used in operating activities	(4.3)	(69.3)
Investing activities		
Purchases of property, equipment, and software	(30.1)	(10.4)
Proceeds from maturation of short-term investments	—	1.0
Net cash used in investing activities	(30.1)	(9.4)
Financing activities		
Series A convertible preferred stock and warrant issuance, net of issuance costs	—	178.7
Exercise of vested stock options	—	0.1
Purchase of treasury stock	(2.0)	(2.0)
Shares withheld for taxes	(2.4)	—
Net cash (used in) provided by financing activities	(4.4)	176.8
Effect of exchange rate changes in cash	0.4	0.3
Net increase (decrease) in cash and cash equivalents	(38.4)	98.4
Cash and cash equivalents, at beginning of period	181.2	103.5
Cash and cash equivalents, at end of period	$142.8	$201.9
Supplemental disclosures of cash flow information		
Accrued dividends payable to Preferred Stockholders	$4.5	$6.1
Accrued liabilities related to purchases of property, equipment and software	$2.6	$0.5
Accounts payable related to purchases of property, equipment and software	$0.6	$—
Income taxes paid	$(1.1)	$(0.7)
Income taxes refunded	$3.4	$0.6

See accompanying notes to consolidated financial statements.

6

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 and physician advisory services ("PAS") 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 achieves these results for its customers by managing healthcare providers' revenue cycle operations, which encompass processes including patient registration, insurance and benefit verification, medical treatment documentation and coding, bill preparation and collections from patients and payers. 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 a co-managed relationship or an operating partner relationship. 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. Under an operating partner relationship, the Company provides comprehensive revenue cycle infrastructure to providers, including all revenue cycle personnel, technology, and process workflow. 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.
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.
Basis of Presentation
The accompanying unaudited consolidated financial statements reflect the Company's financial position as of September 30, 2017, the results of operations for the three and nine months ended September 30, 2017 and 2016, and the cash flows of the Company for the nine months ended September 30, 2017 and 2016. 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 nine months ended September 30, 2017 are not necessarily indicative of the results that may be expected for any other interim period or for the fiscal year ending December 31, 2017. Beginning with the quarter ended March 31, 2017, the Company changed the presentation in its financial statements to be stated in millions instead of thousands. Therefore, previously reported amounts for

fiscal 2016 may differ due to rounding.

R1 RCM Inc.
Notes to Unaudited Consolidated Financial Statements

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, 2016 (the "2016 10-K"). As of January 1, 2017, the Company adopted Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers (Topic 606) ("ASU 2014-09") and ASU No. 2016-09, Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting ("ASU 2016-09"). See Note 6, Revenue Recognition, and Note 9, Share-Based Compensation, for discussion on the impact of the adoption of these standards on the Company's policies for revenue and stock compensation, respectively.

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 provisions of ASU 2016-02 are to be applied using a modified retrospective approach. The Company is currently evaluating the impact of the adoption of this prospective guidance on its consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash ("ASU 2016-18"). 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. ASU 2016-18 also requires a reconciliation between the total of cash and cash equivalents and restricted cash presented in the Consolidated Statement of Cash Flows and the cash and cash equivalents balance presented in the Consolidated Balance Sheet. The guidance is effective for interim and annual periods beginning after December 15, 2017, and early adoption is permitted. The guidance requires application using a retrospective transition method. The Company is currently evaluating the impact of the adoption of this prospective guidance on its consolidated financial statements.

3. Fair Value of Financial Instruments

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

8

R1 RCM Inc.
Notes to Unaudited Consolidated Financial Statements

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 does not have any financial assets or liabilities that are required to be measured at fair value on a recurring basis.

4. Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable is comprised of unpaid balances pertaining to non-RCM services fees and net receivable balances for RCM customers after considering cost reimbursements owed to such customers, including related accrued balances.

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 customer 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 September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Beginning balance	$151	$41	$66	$99
Provision (recoveries)	(6)	114	85	87
Write-offs	—	(7)	(6)	(38)
Ending balance	$145	$148	$145	$148

5. Property, Equipment and Software

Property, equipment and software consist of the following (in millions):

	September 30, 2017	December 31, 2016
Computer and other equipment	$ 29.2	$ 23.3
Leasehold improvements	21.4	16.0
Software	42.8	28.1
Office furniture	7.4	4.9
Property, equipment and software, gross	100.8	72.3
Less accumulated depreciation and amortization	(50.6)	(39.5)
Property, equipment and software, net	$ 50.2	$ 32.8

R1 RCM Inc.
Notes to Unaudited Consolidated Financial Statements

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 September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Cost of services	$4.0	$2.6	$10.4	$6.9
Selling, general and administrative	0.5	0.1	1.1	0.4
Total depreciation and amortization	$4.5	$2.7	$11.5	$7.3

6. Revenue Recognition

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.

Periods prior to January 1, 2017

Revenue is generally recognized when all of the following criteria are met: (i) persuasive evidence of an arrangement exists, (ii) services have been rendered, (iii) the fee is fixed or determinable and (iv) collectability is reasonably assured.

Net service fees, as reported in the consolidated statement of operations and comprehensive income (loss), consist of: (a) RCM services fees and (b) professional service fees earned on a fixed fee, transactional fee or time and materials basis. The Company’s primary source of revenue is RCM services fees. RCM services fees are primarily contingent, but along with fixed fees are generally viewed as one deliverable. To the extent that certain RCM services fees are fixed and not subject to refund, adjustment or concession, such fees are generally recognized as revenue on a straight-line basis over the term of the contract.

On a limited basis, the Company enters into contracts with multiple accounting elements which may include a combination of fixed fee or transactional fee elements. The selling price of each element is determined by using management's best estimate of selling price. Revenues are recognized in accordance with the accounting policies for the separate elements.

RCM services fees that are contingent in nature are recognized as revenue once all the criteria for revenue recognition are met, which is generally at the end of a contract or other contractual agreement event. Revenue is recognized for RCM services fees upon the contract reaching the end of its stated term (such that the contractual relationship will not continue in its current form) to the extent that: (i) cash has been received for invoiced fees and (ii) there are no disputes at the conclusion of the term of the contract.

If fees or services are disputed by a customer at the end of a contract, a settlement agreement entered into with the customer triggers revenue recognition. An other "contractual agreement event" occurs when a renewal, amendment to an existing contract, or other settlement agreement is executed in which the parties reach agreement on prior fees.

Revenue is recognized up to the amount covered by such agreements.

RCM services fees consist of the following contingent fees: (i) Net Operating Fees and (ii) Incentive Fees.

Net Operating Fees

R1 RCM Inc.
Notes to Unaudited Consolidated Financial Statements

The Company generates net operating fees to the extent the Company is able to assist customers in reducing the cost of revenue cycle operations. In limited cases, the Company earns a fixed fee instead of a fee based on the mechanics described below. 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; less

iii) any cost savings the Company shares with customers.

Net operating fees are recorded as deferred customer billings until the Company recognizes revenue for a customer contract at the end of a contract or reaches an "other contractual agreement event". The amount of unpaid costs of customers’ revenue cycle operations and shared cost savings are reported as accrued service costs within customer liabilities in the consolidated balance sheets.

Incentive Fees

The Company generates revenue in the form of performance-based fees when the Company improves the customers’ financial or operational metrics. These performance metrics vary by customer contract. However, certain contracts contain a contract-to-date performance metric that is not resolved until the end of the term of the contract.

Periods commencing January 1, 2017

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 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 offering.

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. 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.

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.

R1 RCM Inc.
Notes to Unaudited Consolidated Financial Statements

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.

Other Services

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.

Bundled Services

Modular RCM services may be sold separately or bundled in a contract and end-to-end RCM services are typically sold separately but may be bundled with PAS services. PAS services 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, or modular services. PAS services 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. In certain situations, the Company allocates variable consideration to a distinct service, or services, within a contract. The Company allocates variable payments to one or more, but not all, of the distinct services in a contract when (i) the variable payment relates specifically to the Company’s efforts to transfer the distinct service and (ii) the variable payment is for an amount that depicts the amount of consideration to which the Company expects to be entitled in exchange for transferring the promised services to its customer.

Disaggregation of Revenue

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

R1 RCM Inc.
Notes to Unaudited Consolidated Financial Statements

	Three Months Ended September 30, 2017	Nine Months Ended September 30, 2017
RCM services: net operating fees	$ 104.6	$ 255.4
RCM services: incentive fees	7.5	20.2
RCM services: other	2.8	9.8
Other services fees	8.3	24.1
Total net service revenue	$ 123.2	$ 309.5

Contract Balances

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

	September 30, 2017	At adoption
Receivables, which are included in accounts receivable, net	25.7	30.5
Contract assets	—	—
Contract liabilities	12.5	20.9

The Company recognized revenue of $0.3 million for the three months ended September 30, 2017 related to changes in transaction price estimates during the quarter for certain revenue cycle management contracts.

The Company recognized a decrease in revenue of $0.4 million during the three months ended September 30, 2017, which amount was included in contract liabilities at the beginning of the period.

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 during the three months ended September 30, 2017 are as follows (in millions):

	Three Months Ended September 30, 2017	
	Contract assets	Contract liabilities
Revenue recognized that was included in the contract liability balance at the beginning of the period	—	40.9
Increases due to cash received, excluding amounts recognized as revenue during the period	—	1.9
Transferred to receivables from contract assets recognized at the beginning of the period	—	—
Increases as a result of cumulative catch-up adjustment arising from changes in the estimate of the stage of completion, excluding amounts transferred to receivables during the 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.

R1 RCM Inc.
Notes to Unaudited Consolidated Financial Statements

	RCM Net operating fees	Incentive fees	Other	Other Other Services fees
2017	$3.4	$ 6.1	$1.4	$ —
2018	13.5	9.7	2.9	—
2019	—	—	2.7	—
2020	—	—	2.2	—
Thereafter	—	—	11.3	—
Total	$16.9	$ 15.8	$20.5	$ —

The amounts presented in the table above primarily consist of fixed fees which are typically recognized ratably as the performance obligation is satisfied or 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 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 the practical expedient in paragraph 606-10-55-18 to its stand-alone PAS contracts and modular RCM services and does not disclose information about variable consideration from remaining performance obligations for which the Company recognizes revenue. 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.
The Company also applies the guidance in paragraph 606-10-50-14A(b) to variable consideration within its end-to-end RCM contracts and 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 in accordance with paragraph 606-10-32-40. The 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.
Changes in Accounting Policies

Except for the changes below, the Company has consistently applied the accounting policies to all periods presented in these consolidated financial statements.

The Company adopted Topic 606 with a date of the initial application of January 1, 2017. As a result, the Company has changed its accounting policy for revenue recognition as detailed below.

The Company adopted Topic 606, effective January 1, 2017, using the modified retrospective method, applying Topic 606 to contracts that were not complete as of the date of initial application. Therefore, the comparative information

R1 RCM Inc.
Notes to Unaudited Consolidated Financial Statements

has not been adjusted and continues to be reported under Topic 605. The details of the significant changes and quantitative impact of the changes are set out below.

RCM services fees

RCM services fees that are variable in nature were recognized under Topic 605 as revenue once all the criteria for revenue recognition are met, which is generally at the end of a contract or other contractual agreement event. Revenue previously has been recognized for RCM service fees upon the contract reaching the end of its stated term (such that the contract relationship will not continue in its current form) to the extent that cash has been received for invoiced fees and there are no disputes at the conclusion of the term of the contract.

Under Topic 606, the Company recognizes service fees that are variable in nature over time as the service is provided to the customer to the extent that it is probable that a significant reversal of cumulative revenue will not occur once the uncertainty related to the estimated revenue is subsequently resolved. Net operating fees are typically recognized on a quarterly basis as the RCM services are rendered and measurement of the net operating fees earned during the distinct performance period is objectively determinable. Incentive fees are calculated quarterly based upon contractually defined agreed-upon performance metrics and are recognized as revenue to the extent that it is probable that a significant reversal of cumulative revenue will not occur once any uncertainty related to the estimated revenue is subsequently resolved.

Fixed fees are generally recognized over the term of the contract on a ratable basis as the performance obligation is satisfied.

Other services fees

The PAS contract between the Company and customer typically stipulates the price per unit the Company is entitled to for each unit of service performed. Certain contracts include minimum fees and volume discounts but the Company does not know the quantity or mix of service types the customer will request until the request is made. The length of time it takes the Company to perform each service can vary depending on the nature of the service or complexity of the specific situation or case. Revenue previously had been recognized for PAS service fees when the service was completed.

Under Topic 606, the Company recognizes revenue on a monthly basis when services are completed during the month consistent with recognition under Topic 605.

Deferred contract costs

Eligible, one-time, nonrecurring fulfillment costs associated with the initial phases of the Ascension A&R MPSA and with the transition of additional Ascension hospitals under separate contracts are deferred and subsequently amortized. These costs are amortized on a straight-line basis over the expected period of benefit. Under Topic 606, the Company will continue to amortize associated assets over the remaining life of the contract as services are provided.

Impacts on Financial Statements

The following tables summarize the impacts of adopting Topic 606 on the Company’s consolidated financial statements as of and for the three and nine months ended September 30, 2017 (in millions, except per share data):

15

R1 RCM Inc.
Notes to Unaudited Consolidated Financial Statements

i. Consolidated balance sheets

Impact of changes in accounting policies	
As reported September 30, 2017	Adjustments