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, 2019

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 001-36841

Inovalon Holdings, Inc.
(Exact name of registrant as specified in its charter)

Delaware	**47-1830316**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
4321 Collington Road,	
Bowie, Maryland	**20716**
(Address of principal executive offices)	(Zip Code)

(301) 809-4000
Registrant's telephone number, including area code

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

Title of Each Class	Name Of Each Exchange On Which Registered	Ticker Symbol
Class A Common Stock, $0.000005 par value per share	NASDAQ Global Select Market	INOV

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 every Interactive Data File required to be submitted 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 such files). Yes ☒ No ☐

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

Large accelerated filer	☒	Accelerated filer	☐	Non-accelerated filer	☐	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 July 19, 2019, the registrant had 73,924,009 shares of Class A common stock outstanding and 80,287,495 shares of Class B common stock outstanding.

INOVALON HOLDINGS, INC.

FORM 10-Q
FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2019

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PART I—FINANCIAL INFORMATION

Item 1. *Consolidated Financial Statements*

INOVALON HOLDINGS, INC.
CONSOLIDATED BALANCE SHEETS
(Unaudited, in thousands, except share and par value amounts)

	June 30, 2019	December 31, 2018
ASSETS		
Current assets:		
Cash and cash equivalents	$ 129,850	$ 115,591
Short-term investments	503	7,000
Accounts receivable (net of allowances of $4,667 and $3,350 at June 30, 2019 and December 31, 2018, respectively)	115,440	104,405
Prepaid expenses and other current assets	21,283	34,801
Income tax receivable	5,228	10,330
Total current assets	272,304	272,127
Non-current assets:		
Property, equipment and capitalized software, net	136,592	141,758
Operating lease right-of-use assets	47,567	—
Goodwill	955,881	956,029
Intangible assets, net	509,110	535,343
Other assets	19,498	16,158
Total assets	$ 1,940,952	$ 1,921,415
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	$ 32,220	$ 31,295
Accrued compensation	21,660	25,298
Other current liabilities	39,050	51,384
Deferred revenue	19,934	20,628
Credit facilities	9,800	9,800
Operating lease liabilities	9,095	—
Finance lease liabilities	2,386	2,905
Total current liabilities	134,145	141,310
Non-current liabilities:		
Credit facilities, less current portion	936,583	939,514
Operating lease liabilities, less current portion	42,900	—
Finance lease liabilities, less current portion	13,545	13,927
Other liabilities	48,540	33,406
Deferred income taxes	99,105	110,669
Total liabilities	1,274,818	1,238,826
Commitments and contingencies (Note 8)		
Stockholders' equity:		
Common stock, $0.000005 par value, 900,000,000 shares authorized, zero shares issued and outstanding at each of June 30, 2019 and December 31, 2018, respectively	—	—
Class A common stock, $0.000005 par value, 750,000,000 shares authorized; 88,549,955 shares issued and 73,929,780 shares outstanding at June 30, 2019; 86,679,575 shares issued and 72,059,400 shares outstanding at December 31, 2018	—	—
Class B common stock, $0.000005 par value, 150,000,000 shares authorized; 80,287,495 shares issued and outstanding at June 30, 2019; 80,608,685 shares issued and outstanding at December 31, 2018	1	1
Preferred stock, $0.0001 par value, 100,000,000 shares authorized, zero shares issued and outstanding at June 30, 2019 and December 31, 2018, respectively	—	—
Additional paid-in-capital	625,908	618,674
Retained earnings	266,686	270,471
Treasury stock, at cost, 14,620,175 shares at June 30, 2019 and December 31, 2018, respectively	(199,817)	(199,817)
Other comprehensive loss	(26,644)	(6,740)
Total stockholders' equity	666,134	682,589
Total liabilities and stockholders' equity	$ 1,940,952	$ 1,921,415

See notes to consolidated financial statements.

INOVALON HOLDINGS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited, in thousands, except per-share amounts)

	Three Months Ended June 30, 2019	Three Months Ended June 30, 2018	Six Months Ended June 30, 2019	Six Months Ended June 30, 2018
Revenue	$ 156,977	$ 152,798	$ 302,468	$ 245,553
Expenses:				
Cost of revenue[(1)]	41,118	39,015	78,321	72,506
Sales and marketing[(1)]	14,306	12,045	27,832	19,947
Research and development[(1)]	7,898	7,545	16,099	13,966
General and administrative[(1)]	45,694	60,174	99,317	109,570
Depreciation and amortization	27,420	26,906	54,467	43,286
Restructuring expense	—	9,464	—	9,464
Total operating expenses	136,436	155,149	276,036	268,739
Income (Loss) from operations	20,541	(2,351)	26,432	(23,186)
Other income and (expenses):				
Interest income	664	154	1,274	1,549
Interest expense	(16,649)	(15,568)	(33,191)	(17,450)
Other expense, net	—	(511)	(11)	(1,631)
Income (Loss) before taxes	4,556	(18,276)	(5,496)	(40,718)
Provision for (Benefit from) income taxes	18	(7,810)	(1,711)	(13,418)
Net income (loss)	$ 4,538	$ (10,466)	$ (3,785)	$ (27,300)
Net income (loss) attributable to common stockholders, basic and diluted	$ 4,403	$ (10,466)	$ (3,785)	$ (27,300)
Net income (loss) per share attributable to common stockholders, basic and diluted:				
Basic net income (loss) per share	$ 0.03	$ (0.07)	$ (0.03)	$ (0.19)
Diluted net income (loss) per share	$ 0.03	$ (0.07)	$ (0.03)	$ (0.19)
Weighted average shares of common stock outstanding:				
Basic	148,136	147,181	147,956	143,301
Diluted	148,478	147,181	147,956	143,301

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(1) Includes stock-based compensation expense as follows:				
Cost of revenue	$ 78	$ (87)	$ 155	$ 53
Sales and marketing	339	(401)	639	68
Research and development	379	330	749	958
General and administrative	1,986	2,802	6,478	5,313
Total stock-based compensation expense	$ 2,782	$ 2,644	$ 8,021	$ 6,392

See notes to consolidated financial statements.

INOVALON HOLDINGS, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
(Unaudited, in thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	**2018**	**2019**	**2018**
Net income (loss)	$ 4,538	$ (10,466)	$ (3,785)	$ (27,300)
Other comprehensive loss:				
Realized losses on cash flow hedges reclassified from accumulated other comprehensive income, net of tax of $(193), $(268), $(363) and $(268), respectively	409	570	768	570
Net change in unrealized losses on cash flow hedges, net of tax of $5,799, $64, $9,783 and $64, respectively	(12,260)	(135)	(20,684)	(135)
Realized losses on short-term investments reclassified from accumulated other comprehensive income, net of tax of $0, $0, $0 and $(319), respectively	—	—	—	716
Net change in unrealized gains and (losses) on available-for-sale investments, net of tax of $(1), $(14), $(6) and $91, respectively	1	31	12	(204)
Reclassification of income tax effects of the Tax Cuts and Jobs Act of 2017	—	—	—	(102)
Comprehensive loss	$ (7,312)	$ (10,000)	$ (23,689)	$ (26,455)

See notes to consolidated financial statements.

INOVALON HOLDINGS, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(Unaudited, in thousands, except share amounts)

	Issued Class A Common Stock		Issued Class B Common Stock		Treasury Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total Stockholders' Equity
	Shares	Amount	Shares	Amount	Shares	Amount				
Balance—January 1, 2019	86,679,575	$ —	80,608,685	$ 1	(14,620,175)	$(199,817)	$618,674	$270,471	$ (6,740)	$ 682,589
Stock-based compensation expense	—	—	—	—	—	—	5,163	—	—	5,163
Conversion Class B to Class A common stock	460,000	—	(460,000)	—	—	—	—	—	—	—
Issuance of shares related to restricted stock units and awards	759,409	—	—	—	—	—	—	—	—	—
Shares withheld for employee taxes upon conversion of restricted stock	(82,978)	—	—	—	—	—	(1,086)	—	—	(1,086)
Other comprehensive loss	—	—	—	—	—	—	—	—	(8,054)	(8,054)
Net loss	—	—	—	—	—	—	—	(8,323)	—	(8,323)
Balance—March 31, 2019	87,816,006	$ —	80,148,685	$ 1	(14,620,175)	$(199,817)	$622,751	$262,148	$ (14,794)	$ 670,289
Stock-based compensation expense	—	—	—	—	—	—	2,740	—	—	2,740
Exercise of stock options	85,038	—	139,270	—	—	—	1,817	—	—	1,817
Conversion Class B to Class A common stock	460	—	(460)	—	—	—	—	—	—	—
Issuance of shares related to restricted stock units and awards	753,800	—	—	—	—	—	—	—	—	—
Shares withheld for employee taxes upon conversion of restricted stock	(105,349)	—	—	—	—	—	(1,400)	—	—	(1,400)
Other comprehensive loss	—	—	—	—	—	—	—	—	(11,850)	(11,850)
Net income	—	—	—	—	—	—	—	4,538	—	4,538
Balance—June 30, 2019	88,549,955	$ —	80,287,495	$ 1	(14,620,175)	$(199,817)	$625,908	$266,686	$ (26,644)	$ 666,134

INOVALON HOLDINGS, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (Continued)
(Unaudited, in thousands, except share amounts)

	Issued Class A Common Stock		Issued Class B Common Stock		Treasury Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive (Loss) Income	Total Stockholders' Equity
	Shares	Amount	Shares	Amount	Shares	Amount				
Balance—January 1, 2018	77,588,018	$ —	80,957,495	$ 1	(14,620,175)	$(199,817)	$534,159	$308,905	$ (476)	$ 642,772
Stock-based compensation expense	—	—	—	—	—	—	3,723	—	—	3,723
Exercise of stock options	211,002	—	—	—	—	—	1,450	—	—	1,450
Conversion Class B to Class A common stock	348,810	—	(348,810)	—	—	—	—	—	—	—
Issuance of shares related to restricted stock units and awards	452,657	—	—	—	—	—	—	—	—	—
Shares withheld for employee taxes upon conversion of restricted stock	(33,980)	—	—	—	—	—	(459)	—	—	(459)
Other comprehensive income	—	—	—	—	—	—	—	—	379	379
Adjustment to retained earnings for adoption of ASC 606	—	—	—	—	—	—	—	628	—	628
Adjustment to retained earnings for adoption of ASU 2018-02	—	—	—	—	—	—	—	102	—	102
Net loss	—	—	—	—	—	—	—	(16,834)	—	(16,834)
Balance—March 31, 2018	78,566,507	$ —	80,608,685	$ 1	(14,620,175)	$(199,817)	$538,873	$292,801	$ (97)	$ 631,761
Stock-based compensation expense	—	—	—	—	—	—	2,609	—	—	2,609
Issuance of common stock related to business combination	7,598,731	—	—	—	—	—	70,000	—	—	70,000
Exercise of stock options	21,059	—	—	—	—	—	163	—	—	163
Conversion Class B to Class A common stock	—	—	—	—	—	—	—	—	—	—
Issuance of shares related to restricted stock units and awards	466,474	—	—	—	—	—	—	—	—	—
Shares withheld for employee taxes upon conversion of restricted stock	(60,521)	—	—	—	—	—	(610)	—	—	(610)
Other comprehensive income	—	—	—	—	—	—	—	—	466	466
Net loss	—	—	—	—	—	—	—	(10,466)	—	(10,466)
Balance—June 30, 2018	86,592,250	$ —	80,608,685	$ 1	(14,620,175)	$(199,817)	$611,035	$282,335	$ 369	$ 693,923

See notes to consolidated financial statements.

INOVALON HOLDINGS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited, in thousands)

	Six Months Ended June 30,	
	2019	2018
Cash flows from operating activities:		
Net loss	$ (3,785)	$ (27,300)
Adjustments to reconcile net income to net cash provided by operating activities:		
Stock-based compensation expense	8,021	6,392
Depreciation	28,234	25,638
Amortization of intangibles	26,233	17,648
Amortization of debt issuance costs and debt discount	2,155	1,024
Deferred income taxes	(1,836)	(13,151)
Restructuring expense, non-cash	—	8,583
Change in fair value of contingent consideration	517	8,700
Other	1,703	1,895
Changes in assets and liabilities:		
Accounts receivable	(12,351)	(7,312)
Prepaid expenses and other current assets	(1,634)	(3,222)
Income taxes receivable	5,239	(330)
Other assets	(3,552)	(5,727)
Accounts payable and accrued expenses	2,432	(10,676)
Accrued compensation	(4,105)	2,336
Other current and non-current liabilities	(6,665)	11,385
Deferred revenue	(694)	4,241
Net cash provided by operating activities	39,912	20,124
Cash flows from investing activities:		
Maturities of short-term investments	6,464	87,901
Sales of short-term investments	—	161,772
Purchases of property and equipment	(8,510)	(16,476)
Investment in capitalized software	(16,776)	(22,532)
Acquisition, net of cash acquired of $0 and $23,850, respectively	—	(1,082,740)
Net cash used in investing activities	(18,822)	(872,075)
Cash flows from financing activities:		
Proceeds from credit facility borrowings, net of discount	—	965,300
Repayment of credit facility borrowings	(4,900)	(236,250)
Payments for debt issuance costs	—	(18,269)
Proceeds from exercise of stock options	1,817	1,613
Finance lease liabilities paid	(1,262)	(311)
Tax payments for equity award issuances	(2,486)	(1,069)
Net cash (used in) provided by financing activities	(6,831)	711,014
Increase (Decrease) in cash and cash equivalents	14,259	(140,937)
Cash and cash equivalents, beginning of period	115,591	208,944
Cash and cash equivalents, end of period	$ 129,850	$ 68,007
Supplementary cash flow disclosure:		
Income taxes (received) paid, net	$ (5,254)	$ 107
Interest paid	31,465	11,131
Non-cash transactions:		
Operating lease obligations incurred	20,570	—
Finance lease obligations incurred	20	4,602
Accruals for purchases of property, equipment	893	7,292
Accruals for investment in capitalized software	1,427	1,841
Acquisition consideration	—	83,580

See notes to consolidated financial statements.

INOVALON HOLDINGS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements have been prepared by Inovalon Holdings, Inc. ("Inovalon" or the "Company") in accordance with accounting principles generally accepted in the United States ("GAAP") for interim financial reporting and as required by Rule 10-01 of Regulation S-X. Accordingly, the unaudited consolidated financial statements may not include all of the information and notes required by GAAP for audited financial statements. The year-end December 31, 2018 consolidated balance sheet data included herein was derived from audited financial statements but does not include all disclosures required by GAAP for complete financial statements. In the opinion of the Company's management, the accompanying unaudited consolidated financial statements contain all adjustments, consisting of items of a normal and recurring nature, necessary to present fairly the Company's financial position as of June 30, 2019, the results of operations, comprehensive loss, and stockholders' equity, for the three and six month periods ended June 30, 2019 and 2018, and cash flows for the six months ended June 30, 2019 and 2018. The results of operations for the three and six month periods ended June 30, 2019 and 2018 are not necessarily indicative of the results to be expected for the full year. The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts of assets and liabilities, and related disclosures, as of the date of the financial statements, and the amounts of revenue and expenses reported during the period. Actual results could differ from estimates. The information contained herein should be read in conjunction with the audited financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2018 (the "2018 Form 10-K").

Certain prior period amounts have been reclassified within the consolidated statements of operations, within the current and non-current liabilities section of the consolidated balance sheets, and within the operating section of the consolidated statements of cash flows to conform with current period presentation. Such reclassifications had no impact on net loss, current and non-current liabilities, or net cash provided by operating activities as previously reported.

The accompanying unaudited consolidated financial statements include the accounts of Inovalon and its wholly owned subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation.

The Company's management considers events or transactions that occur after the balance sheet date but before the financial statements are issued to provide additional evidence relative to certain estimates or to identify matters that require additional disclosure. Subsequent events have been evaluated through the date of issuance of these financial statements.

Recently Adopted Accounting Standards

In February 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2016-02, *Leases (Topic 842)*, and in July 2018 and in March 2019 issued subsequent clarifying guidance (collectively, "ASU 2016-02"). ASU 2016-02 requires the recognition of lease assets and lease liabilities on the balance sheet and enhanced disclosure about leasing arrangements. The Company adopted the new standard on January 1, 2019 using the additional transition approach, while prior period amounts are not adjusted and continue to be reported in accordance with the Company's historic accounting under Accounting Standards Codification ("ASC") 840. Refer to "Note 5—Leases."

In June 2018, the FASB issued ASU 2018-07, *Compensation–Stock Compensation (Topic 718)*. ASU 2018-07 expands the scope of ASC 718, *Compensation–Stock Compensation: Improvements to Nonemployee Share-Based Payment Accounting,* to include share-based payment transactions for acquired goods and services from non-employees. This update includes changing the accounting for non-employee stock-based compensation as it relates to the award measurement date, the fair value measurement of the awards, and forfeitures, among other changes to align the accounting with ASC 718. The Company adopted the new standard on January 1, 2019. There was no material impact of adoption on its consolidated financial statements and notes disclosures.

In October 2018, the FASB issued ASU 2018-16, *Derivatives and Hedging (Topic 815): Inclusion of the Secured Overnight Financing Rate (SOFR) Overnight Index Swap (OIS) Rate as a Benchmark Interest Rate for Hedge Accounting Purposes* in response to the potential transition away from the London Interbank Offer Rate ("LIBOR"). This update permits the use of the Overnight Index Swap Rate based on the Secured Overnight Financing Rate as a U.S. benchmark interest rate for hedge accounting purposes under ASC Topic 815. The Company will apply the requirements of the new standard on a prospective basis beginning January 1, 2019 for any new or redesignated hedging agreements. Refer to "Note 7—Fair Value Measurements."

Recently Issued Accounting Standards

There have been no developments to recently issued accounting standards, including the expected dates of adoption and estimated effects on the Company's consolidated financial statements and note disclosures, from those disclosed in the 2018 Form 10-K, that would be expected to impact the Company.

2. REVENUE

The Company primarily derives its revenues through the sale or subscription licensing of its platform solutions and services. The following table disaggregates revenue by offering (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
Platform solutions(1)	$ 140,289	$ 138,209	$ 270,241	$ 217,175
Services(2)	16,688	14,589	32,227	28,378
Total revenue	$ 156,977	$ 152,798	$ 302,468	$ 245,553

(1) Platform solutions include arrangements for technology-based offerings representing subscription-based cloud-based platform offerings and legacy platform solutions that are not cloud-based and not billed under a subscription-based contract structure.

(2) Services include advisory, implementation, and support services under time and materials, fixed price, or retainer-based contracts.

Contract Balances

The Company had an unbilled receivables balance of $21.0 million and $20.5 million as of June 30, 2019 and December 31, 2018, respectively. Unbilled receivables are classified as accounts receivable on the consolidated balance sheet. The Company had deferred commissions of $9.2 million and $5.7 million as of June 30, 2019 and December 31, 2018, respectively.

The Company had a deferred revenue balance of $19.9 million and $20.6 million as of June 30, 2019 and December 31, 2018, respectively. Revenue recognized during the three and six months ended June 30, 2019 that was included in the deferred revenue balance at the beginning of the year was $6.4 million and $13.1 million, respectively.

3. NET INCOME (LOSS) PER SHARE

Holders of all outstanding classes of common stock participate ratably in earnings on an identical per share basis as if all shares were a single class. Basic earnings per share (“EPS”) is computed by dividing net income (loss) by the weighted average number of shares of common stock (Class A common stock and Class B common stock) outstanding during the period. Diluted EPS is computed by dividing net income by the sum of the weighted average number of shares of common stock outstanding and potentially dilutive securities outstanding during the period under the treasury stock method. If the Company incurs a loss from continuing operations, diluted EPS is computed in the same manner as basic EPS. Potentially dilutive securities include stock options, restricted stock units (“RSUs”) and restricted stock awards (“RSAs”). Under the treasury stock method, dilutive securities are assumed to be exercised at the beginning of the periods and as if funds obtained thereby were used to purchase common stock at the average market price during the period. Securities are excluded from the computations of diluted earnings per share if their effect would be anti-dilutive to EPS.

On February 18, 2015, the date of the completion of the Company’s IPO, the Company’s 2015 Omnibus Incentive Plan (the “2015 Plan”) became effective. The 2015 Plan provided for the grant of incentive stock options, within the meaning of Section 422 of the Internal Revenue Code of 1986, as amended (the “Code”), to the Company’s employees and any parent and subsidiary employees, and for the grant of non-qualified stock options, stock appreciation rights, restricted stock, RSAs, RSUs, dividend equivalent rights, cash-based awards (including annual cash incentives and long-term cash incentives), and any combination thereof to the Company’s employees, directors, and consultants and to employees, directors, and consultants of certain affiliated entities. At the Company’s annual meeting of stockholders held on June 5, 2019, the Company’s stockholders, upon the recommendation of the Board of Directors of the Company (the “Board”), approved the Amended and Restated 2015 Omnibus Incentive Plan (the “Amended Plan”), which was previously adopted by the Board on February 14, 2019, subject to the approval by the stockholders. The Amended Plan (i) increases the maximum number of shares of the Company’s Class A common stock available for issuance by 6,000,000 shares to a total of 13,335,430; (ii) removes the provisions regarding Section 162(m) of the Code that are no longer relevant due to recent changes to the Code pursuant to the Tax Cuts and Jobs Act of 2017, which eliminated the “performance-based compensation” exception to the deduction limitation under Section 162(m) of the Code and (iii) extends the term of the Amended Plan until the tenth anniversary of the date of Board approval of the Amended Plan.

The Company has issued RSAs under the Amended Plan. The Company considers issued and unvested RSAs to be participating securities as the holders of these RSAs have a non-forfeitable right to dividends in the event of the Company’s declaration of a dividend on shares of Class A and Class B common stock. Subsequent to the issuance of the participating securities, the Company applied the two-class method required in calculating net income (loss) per share of Class A and Class B common stock. Under the two-class method, net income attributable to common stockholders is determined by allocating undistributed earnings, calculated as net income, less earnings attributable to participating securities. The net income per share attributable to common stockholders is allocated based on the contractual participation rights of the Class A common stock and Class B common stock as if the income for the period has been distributed. As the liquidation and dividend rights are identical for both classes of common stock, the net income attributable to common stockholders is allocated on a proportionate basis. If the Company incurs a loss from continuing operations, losses are not allocated to participating securities.

The following table reconciles the weighted average shares outstanding for basic and diluted EPS for the periods indicated (in thousands, except per share amounts):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
Basic				
Numerator:				
Net income (loss)	$ 4,538	$ (10,466)	$ (3,785)	$ (27,300)
Undistributed earnings allocated to participating securities	(135)	—	—	—
Net income (loss) attributable to common stockholders—basic	$ 4,403	$ (10,466)	$ (3,785)	$ (27,300)
Denominator:				
Weighted average shares used in computing net income per share attributable to common stockholders—basic	148,136	147,181	147,956	143,301
Net income (loss) per share attributable to common stockholders—basic	$ 0.03	$ (0.07)	$ (0.03)	$ (0.19)
Diluted				
Numerator:				
Net income (loss) attributable to common stockholders—diluted	$ 4,403	$ (10,466)	$ (3,785)	$ (27,300)
Denominator:				
Number of shares used for basic EPS computation	148,136	147,181	147,956	143,301
Effect of dilutive securities	342	—	—	—
Weighted average shares used in computing net loss per share attributable to common stockholders—diluted	148,478	147,181	147,956	143,301
Net income (loss) per share attributable to common stockholders—diluted	$ 0.03	$ (0.07)	$ (0.03)	$ (0.19)

The computation of diluted EPS does not include certain awards, on a weighted average basis, because their inclusion would have an anti-dilutive effect on EPS. The awards excluded because of their anti-dilutive effect are as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
Awards excluded from the computation of diluted net income (loss) per share because their inclusion would have been anti-dilutive	5	141	5	132

4. SHORT-TERM INVESTMENTS

As of June 30, 2019, short-term investments consisted of the following (in thousands):

	Amortized Cost	Estimated Fair Value
Available-for-sale securities:		
Corporate notes and bonds	$ 503	$ 503
Total available-for-sale securities	$ 503	$ 503

As of December 31, 2018, short-term investments consisted of the following (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-sale securities:				
Corporate notes and bonds	$ 7,018	$ —	$ (18)	$ 7,000
Total available-for-sale securities	$ 7,018	$ —	$ (18)	$ 7,000

The following table summarizes the estimated fair value of our short-term investments, designated as available-for-sale and classified by the contractual maturity date of the securities as of the dates shown (in thousands):

	June 30, 2019	December 31, 2018
Due in one year or less	$ 503	$ 7,000

The Company did not have available-for-sale securities in a gross unrealized loss position as of June 30, 2019.

5. LEASES

The Company adopted ASU 2016-02 as of January 1, 2019. Leases held on or after January 1, 2019 are presented under ASC 842, while prior period amounts are not adjusted and continue to be reported in accordance with the Company's historic accounting under ASC 840. The Company recorded a right-of-use asset of $34.8 million and a lease liability of $40.5 million. Additionally, the Company recorded a reclassification of $2.1 million from current liabilities and $3.6 million from non-current liabilities, related to deferred rent, cease-use lease liabilities, and tenant improvement liabilities related to the implementation of ASC 842.

The Company elected the following practical expedients under ASC 842-10-65-1 including (1) the package of transition provisions related to expired and existing leases that allows an entity to use the historical assessment of whether contracts are or contain leases, lease classification, and initial direct costs, and (2) the practical expedient that allows for the use of hindsight in determining the lease term.

The Company determines whether a contract is or contains a lease at inception. At the lease commencement date, the Company records a liability for the lease obligation and a corresponding asset representing the right to use the underlying asset over the lease term. Leases with an initial term of 12 months or less are not recorded on the consolidated balance sheet and are recognized in expense using a straight-line basis for all asset classes. Variable lease payments are expensed as incurred, which primarily include maintenance costs, services provided by the lessor, and other charges reimbursed to the lessor.

The Company leases office space, data center facilities, printers, and equipment with remaining lease terms ranging from one year to twelve years, some of which contain renewal or purchase options. The exercise of these options is at the Company's sole discretion. The Company has entered into sublease agreements for unoccupied leased office space and records sublease income netted against rent expense. Additionally, the Company is required to maintain a standby letter of credit in the amount of $1.0 million to satisfy the requirements of a certain lease agreement.

Certain of the Company's leases contain lease and non-lease components. For leases held on or after January 1, 2019, the Company has elected the practical expedient under ASC 842-10-15-37 for all asset classes which allows companies to account for lease and non-lease components as a single lease component.

The Company's leases do not contain an implicit rate of return, therefore an incremental borrowing rate was determined. The Company assessed which rate would be most reflective of a reasonable rate the Company would be able to borrow based on asset class and lease term.

Finance lease right-of-use assets of $15.4 million are included in property, equipment, and capitalized software, net on the consolidated balance sheet.

The following table presents components of lease expense for the three and six months ended June 30, 2019 (in thousands):

	Three Months Ended June 30, 2019	Six Months Ended June 30, 2019
Finance lease cost		
Amortization of right-of-use assets	$ 491	$ 1,041
Interest on lease liabilities	127	261
Operating lease cost	3,502	5,613
Variable lease cost	469	963
Sublease income	(317)	(634)
Total lease cost	$ 4,272	$ 7,244

Maturities of lease liabilities as of June 30, 2019 are as follows (in thousands):

	Operating Leases	Finance Leases
2019	$ 2,411	$ 1,361
2020	3,921	2,937
2021	8,730	2,381
2022	8,288	1,185
2023	6,835	1,275
Thereafter	37,585	8,816
Total future minimum lease payments	67,770	17,955
Less: Interest	(15,775)	(2,024)
Total	$ 51,995	$ 15,931

Future non-cancellable lease payments as of December 31, 2018 are as follows (in thousands):

	Operating Leases	Finance Leases
Year ending December 31,		
2019	$ 11,250	$ 3,509
2020	7,059	2,567
2021	5,898	2,017
2022	5,303	1,181
2023	3,821	1,275
Thereafter	15,599	8,831
Total future minimum lease payments	48,930	19,380
Less: Interest	—	(2,548)
Total	$ 48,930	$ 16,832

Supplemental cash flow information related to leases for the three and six months ended June 30, 2019 are as follows (in thousands):

	Three Months Ended June 30, 2019	Six Months Ended June 30, 2019
Cash paid for amounts included in the measurement of lease liabilities:		
Operating cash flows for operating leases	$ 3,416	$ 6,989
Operating cash flows for financing leases	127	260
Financing cash flows for financing leases	679	1,262
Right-of-use assets obtained in exchange for lease liabilities:		
Operating leases	$ 17,810	$ 20,800
Finance leases	20	20

Supplemental balance sheet information related to leases as of June 30, 2019 are as follows:

	June 30, 2019
Weighted average remaining lease term:	
Operating leases	5 years
Financing leases	8 years
Weighted average discount rate:	
Operating leases	4.7%
Financing leases	3.1%

6. DEBT

On April 2, 2018, the Company entered into a credit agreement (the "2018 Credit Agreement") with a group of lenders and Morgan Stanley Senior Funding, Inc. ("MSSF"), as administrative agent, providing for (i) a term loan B facility with the Company as borrower in a total principal amount of $980.0 million (the "2018 Term Facility"); and (ii) a revolving credit facility with the Company as borrower in a total principal amount of up to $100.0 million (the "2018 Revolving Facility" and, together with the 2018 Term Facility, the "2018 Credit Facilities"). The 2018 Revolving Facility will terminate on April 2, 2023 and the 2018 Term Facility will mature on April 2, 2025. The entire $980.0 million 2018 Term Facility was borrowed on April 2, 2018 and was used to pay off all of the Company's existing debt obligations as well as to provide the financing necessary to fund, in part, the cash consideration paid to acquire ABILITY (as defined in Note 9—Business Combinations*)*. As of June 30, 2019, the Company had $100.0 million available to it consisting of $99.0 million on the 2018 Revolving Facility and a letter of credit of $1.0 million.

At the option of the Company, the loans outstanding under the 2018 Term Facility will bear interest either at: (i) Adjusted LIBOR plus an applicable rate of 3.50% or (ii) the Alternate Base Rate ("ABR") plus an applicable margin. The Company may elect interest periods of one, two, three or six months for Adjusted LIBOR borrowings. As set forth in the 2018 Credit Agreement, the ABR is the higher of: (i) the rate that MSSF as administrative agent announces from time to time as its prime or base commercial lending rate, as in effect from time to time, (ii) the Federal Funds Effective Rate plus ½ of 1.0% and (iii) one-month Adjusted LIBOR plus 1.0%.

The following table discloses the outstanding debt at each balance date as follows (in thousands):

	June 30, 2019	December 31, 2018
2018 Term Facility(1)	$ 946,383	$ 949,314
Less: current portion	9,800	9,800
Non-current Credit Facilities	$ 936,583	$ 939,514

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(1) The 2018 Term Facility is presented net of unamortized deferred financing fees and original issue discount ("OID") of $26.3 million and $28.2 million as of June 30, 2019 and December 31, 2018, respectively.

The Company and its Restricted Subsidiaries (as defined in the 2018 Credit Agreement) are subject to certain affirmative and negative covenants under the 2018 Credit Agreement, and the 2018 Credit Agreement includes certain customary representations and warranties of the Company. As of June 30, 2019, the Company is in compliance with the covenants under the 2018 Credit Agreement.

7. FAIR VALUE MEASUREMENTS

The following table presents the fair value hierarchy for financial assets and liabilities measured at fair value on a recurring basis as of June 30, 2019 (in thousands):

	Level 1	Level 2	Level 3	Total
Cash equivalents:				
Money market funds	$ 41,038	$ —	$ —	$ 41,038
Short-term investments:				
Corporate notes and bonds	—	503	—	503
Other current liabilities:				
Interest rate swaps	—	(6,465)	—	(6,465)
Contingent consideration	—	—	(17,881)	(17,881)
Other liabilities				
Interest rate swaps	—	(32,800)	—	(32,800)
Contingent consideration	—	—	(14,460)	(14,460)
Total	$ 41,038	$ (38,762)	$ (32,341)	$ (30,065)

The following table presents the fair value hierarchy for financial assets and liabilities measured at fair value on a recurring basis as of December 31, 2018 (in thousands):

	Level 1	Level 2	Level 3	Total
Cash equivalents:				
Money market funds	$ 34,064	$ —	$ —	$ 34,064
Short-term investments:				
Corporate notes and bonds	—	7,000	—	7,000
Other current liabilities:				
Interest rate swaps	—	(1,778)	—	(1,778)
Contingent consideration	—	—	(15,182)	(15,182)
Other liabilities:				
Interest rate swaps	—	(8,151)	—	(8,151)
Contingent consideration	—	—	(16,642)	(16,642)
Total	$ 34,064	$ (2,929)	$ (31,824)	$ (689)

The Company determines the fair value of its security holdings based on pricing from its pricing vendors. The valuation techniques used to measure the fair value of financial instruments having Level 2 inputs were derived from non-binding consensus prices that are corroborated by observable market data or quoted market prices for similar instruments. Such market prices may be quoted prices in active markets for identical assets (Level 1 inputs) or pricing determined using inputs other than quoted prices that are observable either directly or indirectly (Level 2 inputs). The Company performs procedures to ensure that appropriate fair values are recorded such as comparing prices obtained from other sources.

The following table presents financial instruments measured at fair value using unobservable inputs (Level 3) (in thousands):

	Fair Value Measurements Using Unobservable Inputs (Level 3)	
	June 30, 2019	December 31, 2018
Balance, beginning of period	$ (31,824)	$ (7,400)
Fair value adjustment(1)(2)	(165)	(6,159)
Accretion expense (recognized in general and administrative expenses)	(352)	(1,053)
Contingent consideration attributable to and assumed from ABILITY Acquisition	—	(17,212)
Total	$ (32,341)	$ (31,824)

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(1) During 2019, the Company recognized an adjustment of $0.3 million recognized in goodwill, which was a purchase accounting adjustment attributable to the ABILITY Acquisition, partially offset by an adjustment of $0.1 million recognized in general and administrative expenses related to the change in fair value of contingent consideration.

(2) During 2018, the Company recognized an adjustment of $5.6 million in general and administrative expenses related to the change in fair value of contingent consideration, and an adjustment of $0.6 million recognized in goodwill, which was a purchase accounting adjustment attributable to the ABILITY Acquisition.

2018 Credit Facilities

The Company records debt on the balance sheet at carrying value. The estimated fair value of the Company's debt is determined based on Level 2 inputs including current market rates for similar types of borrowings. The following table presents the carrying value and fair value of the Company's debt (including the current portion thereof) as of June 30, 2019 (in thousands):

	June 30, 2019
Carrying value	$ 946,383
Fair value	$ 945,200

Interest Rate Swaps

In connection with the 2018 Credit Agreement, the Company entered into four interest rate swaps during the second quarter of 2018, each of which mature in March 2025, to mitigate the risk of a rise in interest rates. These interest rate swaps mitigate the exposure on the variable component of interest on the Company's 2018 Credit Facility. The interest rate swaps fix the LIBOR component of interest on $700.0 million of the 2018 Term Facility at a weighted average rate of approximately 2.8%. See "Note 6—Debt" for additional information. These interest rate swaps are designated as cash flow hedges and are deemed highly effective under ASC 815, *Derivatives and Hedging*. The interest rate swaps are recorded on the balance sheet at fair value as either assets or liabilities and any changes to the fair value are recorded through accumulated other comprehensive income and reclassified into interest expense in the same period in which the hedged transaction is recognized in earnings. Cash flows from interest rate swaps are reported in the same category as the cash flows from the items being hedged.

The following table presents the fair value of interest rate swaps on the balance sheet as of June 30, 2019 (in thousands):

	Liability Derivative	
	Balance Sheet Location	Fair Value
Interest rate swap contract	Other current liabilities	$ (6,465)
Interest rate swap contract	Other liabilities	$ (32,800)

The following table presents the fair value of interest rate swaps on the balance sheet as of December 31, 2018 (in thousands):

	Liability Derivative	
	Balance Sheet Location	Fair Value
Interest rate swap contract	Other current liabilities	$ (1,778)
Interest rate swap contract	Other liabilities	$ (8,151)

The following table presents the location and amount of gains and losses on interest rate swaps included in other comprehensive income ("OCI") and the statement of operations for the three and six months ended June 30, 2019 and 2018 (in thousands):

Three Months Ended June 30, 2019	Gain (Loss) recognized in OCI	Statement of Operations Location	(Gain) Loss reclassified from OCI
Interest rate swap contract	$ (18,059)	Interest expense	$ 602

Six Months Ended June 30, 2019	Gain (Loss) recognized in OCI	Statement of Operations Location	(Gain) Loss reclassified from OCI
Interest rate swap contract	$ (30,467)	Interest expense	$ 1,131

Three and Six Months Ended June 30, 2018	Gain (Loss) recognized in OCI	Statement of Operations Location	(Gain) Loss reclassified from OCI
Interest rate swap contract	$ (199)	Interest expense	$ 838

The net amount of accumulated other comprehensive income expected to be reclassified to interest expense in the next 12 months is $6.6 million.

8. COMMITMENTS AND CONTINGENCIES

Legal Proceedings—From time to time the Company is involved in various litigation matters arising out of the normal course of business. The Company consults with legal counsel on those issues related to litigation and seeks input from other experts and advisors with respect to such matters. Estimating the probable losses or a range of probable losses resulting from litigation, government actions and other legal proceedings is inherently difficult and requires an extensive degree of judgment, particularly where the matters involve indeterminate claims for monetary damages, may involve discretionary amounts, present novel legal theories, are in the early stages of the proceedings, or are subject to appeal. Whether any losses, damages or remedies ultimately resulting from such matters could reasonably have a material effect on the Company's business, financial condition, results of operations, or cash flows will depend on a number of variables, including, for example, the timing and amount of such losses or damages (if any) and the structure and type of any such remedies. The Company's management does not presently expect any litigation matters to have a material adverse impact on the consolidated financial statements of the Company.

There have been no significant or material developments to current legal proceedings, including the estimated effects on the Company's consolidated financial statements and note disclosures, subsequent to the disclosure previously provided in Note 11 of the Notes to the Consolidated Financial Statements in the 2018 Form 10-K, other than the following update with respect to the *Xiang v. Inovalon Holdings, Inc., et.al*., No. 1:16-cv-04923 case filed in the United States District Court for the Southern District of New York on June 24, 2016 against the Company, certain officers, directors and underwriters in the Company's initial public offering. As previously disclosed, on February 20, 2019, the parties executed a settlement agreement, which was subject to Court approval, providing for the dismissal of all claims against the defendants in connection with the securities class action suit, and providing for a payment to the class of $17 million, of which the Company agreed to contribute $1.7 million, which was recorded in the Company's 2018 financial statements, with the remaining amounts paid by the Company's insurance carriers. On July 15, 2019, the Court entered an Order and Final Judgment, granting final approval of the settlement and dismissing the litigation.

9. BUSINESS COMBINATIONS

2018 Acquisition

ABILITY Network, Inc.

On April 2, 2018, the Company completed the acquisition (the "ABILITY Acquisition") of Butler Group Holdings, Inc., a Delaware corporation ("Butler"), and its wholly-owned subsidiaries, including, without limitation, ABILITY Network Inc., a Delaware corporation ("ABILITY"), for aggregate consideration of $1.19 billion (the "Purchase Price") in cash and restricted shares of the Company's Class A Common Stock.

ABILITY is a leading cloud-based Software-as-a-service ("SaaS") technology company helping to simplify the administrative and clinical complexities of healthcare. Through the *my*ABILITY® software platform, an integrated set of cloud-based applications for providers, ABILITY provides core connectivity, administrative, clinical, and quality analysis, management, and performance improvement capabilities to more than 44,000 acute, post-acute and ambulatory point-of-care provider facilities. The extensive datasets, on-demand compute capability, advanced analytics, and broad healthcare ecosystem connectivity enabled by the Inovalon ONE® Platform provide a significant expansion of application offerings within the *my*ABILITY® software platform while also expanding the nature and reach of high-value solutions for Inovalon's existing payer, pharma, and device client-base. The combination of Inovalon and ABILITY creates a vertically integrated cloud-based platform empowering the achievement of real-time, value-based care from payers, manufacturers, and diagnostics all the way to the patient's point of care.

A summary of the final composition of the stated Purchase Price and fair value of the stated Purchase Price is as follows (in thousands):

Purchase Price	$	1,220,800
Working capital adjustment		(630)
Shareholder payable adjustment		880
Subtotal		1,221,050
Fair value adjustments:		
Restricted stock marketability discount		(30,000)
Total fair value purchase price	$	1,191,050

The final composition of the fair value of the consideration transferred is as follows (in thousands):

Cash	$	1,107,220
Issuance of Class A common stock		70,000
Contingent consideration		14,460
Working capital adjustment		(630)
Total fair value purchase price	$	1,191,050

The ABILITY Acquisition was accounted for using the acquisition method of accounting under ASC No. 805, *Business Combinations*, which requires that assets acquired and liabilities assumed are recognized at their estimated fair values. The excess of the aggregate consideration over the estimated fair values has been allocated to goodwill.

In addition, ASC No. 805 requires that the consideration transferred be measured at the closing date of the ABILITY Acquisition at the then-current market prices. The Company finalized the Purchase Price allocation as of March 31, 2019.

The following table summarizes the net assets acquired and liabilities assumed (in thousands):

		Fair Value
Cash and cash equivalents	$	23,850
Accounts receivable		16,739
Income tax receivable[(2)]		688
Prepaid expenses and other current assets		3,025
Property and equipment		3,095
Goodwill[(1)(2)]		770,949
Intangible assets[(1)]		490,000
Other assets		1,252
Accounts payable and accrued expenses		(6,863)
Deferred revenue		(7,000)
Other current liabilities		(507)
Other liabilities		(5,291)
Deferred tax liabilities[(2)]		(98,887)
Total consideration transferred	$	1,191,050

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(1) The Company allocated a portion of the goodwill associated with the ABILITY Acquisition to the Inovalon reporting unit based on expected revenue synergies. As a result, the fair value of the customer relationships intangible asset was adjusted by $23.0 million.

(2) The Company recognized a net purchase accounting adjustment of $1.8 million resulting in a decrease to goodwill. This adjustment was driven by a $7.5 million decrease to deferred tax liabilities primarily attributable to the tax impact related to the reduction to the fair value of the customer relationships intangible assets and an adjustment to income tax receivable of $0.2 million. These reductions to goodwill were partially offset by a $5.0 million increase in deferred tax liabilities related

to tax basis goodwill and provision-to-tax adjustments from ABILITY's 2017 tax return filings and an adjustment of $0.9 million to the shareholder payable attributable to the ABILITY Acquisition.

The amounts attributed to identified intangible assets are summarized in the table below (in thousands):

	Estimated Useful Life	Fair Value	Measurement Period Adjustments	Adjusted Fair Value
Customer relationships	12-14 years	$ 408,000	$ (23,000)	$ 385,000
Technology	12-14 years	86,000	—	86,000
Trade names	16-18 years	19,000	—	19,000
Total intangible assets		$ 513,000	$ (23,000)	$ 490,000

Acquisition-related costs were expensed as incurred. During 2018, the Company incurred acquisition-related costs of $6.5 million. Acquisition-related costs were recognized within "General and administrative" expenses in the accompanying consolidated statements of operations.

The following table presents revenue and income before taxes of ABILITY, included in the consolidated statements of operations (in thousands):

	Three Months Ended June 30, 2018
Revenue	$ 37,520
Income before taxes	$ 5,798

The following pro forma financial information is based on Inovalon's and Butler's historical consolidated financial statements as adjusted to give effect to pro forma events that are (1) directly attributable to the ABILITY Acquisition, (2) factually supportable, and (3) with respect to the unaudited pro forma condensed combined statements of operations, expected to have a continuing impact on the combined results. The pro forma adjustments include, but are not limited to: (i) amortization of acquired intangible assets, (ii) net increase to interest expense resulting from the extinguishment of the 2014 Credit Facilities and historical Butler debt, borrowings under the 2018 Term Facility and the amortization of related debt issuance costs, and (iii) elimination of non-recurring acquisition and integration-related expenses. The following consolidated pro forma financial information is unaudited and gives effect to the transactions as if they had occurred on January 1, 2018 (in thousands):

	Three Months Ended June 30, 2018	Six Months Ended June 30, 2018
Revenue	$ 152,798	$ 282,917
Loss before taxes	$ (16,543)	$ (43,619)

The unaudited pro forma revenue and loss before taxes was prepared for informational purposes only based on estimates and assumptions that the Company believes to be reasonable and is not necessarily indicative of the results of operations that would have occurred if the ABILITY Acquisition had been completed on the date indicated nor of the future financial position or results of operations following completion of the ABILITY Acquisition.

Item 2. ***Management's Discussion and Analysis of Financial Condition and Results of Operations***

The following discussion and analysis should be read in conjunction with our unaudited consolidated financial statements and the related notes included elsewhere in this Quarterly Report on Form 10-Q and with our audited consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2018, as filed with the Securities and Exchange Commission (the "SEC") on February 20, 2019 (the "2018 Form 10-K"). Unless we otherwise indicate or the context requires, references to the "Company," "Inovalon," "we," "our," and "us" refer to Inovalon Holdings, Inc. and its consolidated subsidiaries.

Note Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act"), and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). All statements contained in this Quarterly Report other than statements of historical fact, including but not limited to statements regarding our future results of operations and financial position, our business strategy and plans, market growth, and our objectives for future operations, are forward-looking statements. The words "believe," "may," "see," "will," "estimate," "continue," "anticipate," "intend," "expect," and similar expressions are intended to identify forward-looking statements. We have based these forward-looking statements largely on our current expectations and projections about future events and trends that we believe may affect our financial condition, results of operations, business strategy, short-term and long-term business operations and objectives and financial needs. Moreover, we operate in a very competitive and rapidly changing environment. New risks emerge from time to time. It is not possible for our management to predict all risks, nor can we assess the impact of all factors on our business 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 we may make. In light of these risks, uncertainties and assumptions, the future events and trends discussed in this Quarterly Report may not occur and actual results could differ materially and adversely from those anticipated or implied in the forward-looking statements.

Factors that may cause actual results to differ from expected results include, among others:

- our future financial performance, including our ability to continue and manage our growth;
- our ability to retain our client base and sell additional services to them;
- the effect of the concentration of our revenue among our top clients;
- our ability to innovate and adapt our platforms and toolsets;
- the effects of regulations applicable to us, including regulations relating to data protection and data privacy;
- the effects of consolidation in the healthcare industry;
- the ability to successfully integrate our acquisitions, including ABILITY, and the ability of the acquired business to perform as expected;
- the ability to enter into new agreements with existing or new platforms, products, and solutions in the timeframes expected, or at all;
- the successful implementation and adoption of new platforms, products and solutions;
- the effects of changes in tax legislation for jurisdictions within which we operate, including recent changes in U.S. tax laws;
- the ability to protect the privacy of our clients' data and prevent security breaches;
- the effect of current or future litigation;
- the effect of competition on our business;
- the efficacy of our platforms and toolsets; and
- the timing and size of business realignment and restructuring charges.

Forward-looking statements are only current predictions and are subject to known and unknown risks, uncertainties, and other factors that may cause our actual results, levels of activity, performance, or achievements to be materially different from those anticipated by such statements. These factors include, among other factors, those set forth in our 2018 Form 10-K, under the heading Part I, Item 1A, "Risk Factors."

You should not rely upon forward-looking statements as predictions of future events. The events and circumstances reflected in the forward-looking statements may not be achieved or occur. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance, or achievements. We are under no duty to, and we disclaim any obligation to, update any of these forward- looking statements after the date of this Quarterly Report or to conform these statements to actual results or revised expectations.

Overview

We are a leading provider of cloud-based platforms empowering data-driven healthcare. Through the Inovalon ONE® Platform, Inovalon brings to the marketplace a national-scale capability to interconnect with the healthcare ecosystem, aggregate and analyze data in real-time, and empower the application of resulting insights to drive meaningful impact at the point of care. Leveraging its platform, unparalleled proprietary data sets, and industry-leading subject matter expertise, Inovalon enables better care, efficiency, and financial performance across the healthcare ecosystem. From health plans and provider organizations, to pharmaceutical, medical device, and diagnostics companies, Inovalon's unique achievement of value is delivered through the effective progression of "Turning Data into Insight, and Insight into Action®." Supporting thousands of clients, including 24 of the top 25 U.S. health plans and 22 of the top 25 global pharma companies, Inovalon's technology platforms and analytics are informed by data pertaining to more than 976,000 physicians, 535,000 clinical facilities, 278 million Americans, and nearly 46 billion medical events.

We generate the substantial majority of our revenue through the sale or subscription licensing of our platform solutions, as well as revenue from related arrangements for advisory, implementation, and support services.

Quarterly Key Metrics

We review certain metrics quarterly, including the key metrics shown in the table below. We believe the key metrics illustrated in the table below are indicative of our overall level of analytical activity and our underlying growth in the business. Data resulting from the integration with ABILITY is not yet fully reflected within the MORE² Registry® dataset and is therefore not fully reflected within the related data metrics below as of this date.

	June 30,	
	2019	**2018**
	(in thousands)	
MORE² Registry® dataset metrics[(1)]		
Unique patient count[(2)]	278,629	252,603
Medical event count[(3)]	45,776,969	39,333,463
Trailing twelve month Patient Analytics Months (PAM)[(1)(4)]	55,068,958	46,152,155

(1) MORE² Registry® dataset metrics and Trailing twelve month PAM, each of which is presented in the table, are key operating metrics that management uses to assess our level of operational activity. While we believe that each of these metrics is indicative of our overall level of analytical activity and the underlying growth in our business, increases or decreases in these metrics do not necessarily correlate to proportional increases or decreases in revenue, or net income. For instance, although increased levels of analytical activity historically have corresponded to increases in revenue over the long term, differences in fees charged for different analytical packages exist and differences in how analytics trigger the applicability of our data-driven intervention platforms may result in increases in analytical activity that do not result in proportional increases in revenue, or net income (and vice versa). Accordingly, while we believe the presentation of these operating metrics is helpful to investors in understanding our business, these metrics have limitations and should not be considered as substitutes for analysis of our financial results reported under generally accepted accounting principles ("GAAP"). In addition, we believe that other companies, including companies in our industry, do not present similar operating metrics and that there is no commonly accepted method of calculating these metrics, which may reduce their usefulness as comparative measures.

(2) Unique patient count is defined as each unique, longitudinally matched, de-identified natural person represented in our MORE² Registry® as of the end of the period presented.

(3) Medical event count is defined as the total number of discrete medical events as of the end of the period presented (for example, a discrete medical event typically results from the presentation of a patient to a physician for the diagnosis of diabetes and congestive heart failure in a single visit, the presentation of a patient to an emergency department for chest pain, etc.).

(4) PAM is defined as the sum of the analytical processes performed on each respective patient within patient populations covered by clients under contract. As used in the metric, an "analytical process" is a distinct set of data calculations undertaken by us which is initiated and completed within our platform solutions to examine a specific question such as whether a patient is believed to have a condition such as diabetes, or worsening of the disease, during a specific time period.

Trends and Factors Affecting Our Future Performance

A number of factors influence our growth and performance. We see many of these factors as being more quantitatively driven, such as the rate of growth of the underlying data counts within our datasets, the ongoing investment in innovation, and our revenue mix of subscription-based platform offerings. Additionally, there are several factors that influence our growth and performance that are less quantitatively driven, including seasonality, macro-economic forces, and trends within healthcare (such as payment models, incentivization, and regulatory oversight) that can be driven by changes in federal and state laws and regulations, as well as private sector market forces.

Growth of Datasets. Healthcare costs in the United States have been increasing significantly for many years. This rise in healthcare costs has driven a broad transition from consumption-based payment models to quality and value-based payment models across the healthcare landscape. As a result, the specific disease and comorbidity status, clinical and quality outcomes, resource utilization, and care details of the individual patient have become increasingly relevant to the various constituents across the healthcare delivery system. Concurrently, the count and complexity of diseases, diagnostics, and treatments—as well as payment models and regulatory oversight requirements—have soared. In this setting, granular data has become critical to determining and improving quality and financial performance in healthcare. Our MORE² Registry® is our largest principal dataset and serves as a proxy for our general growth of datasets within Inovalon. The growth of our datasets that inform our analytical capabilities and comparative analytics is a key aspect of our provision of value to our clients and is indicative of our overall growth and capabilities.

Innovation and Platform Development. Our business model is based upon our ability to deliver value to our clients through our platform solutions and related services focused on the achievement of meaningful and measurable improvements in clinical quality outcomes and financial performance in healthcare. Our ability to deliver this value is dependent in part on our ability to continue to innovate, design new capabilities, enter into new agreements with clients for new platforms, and bring these capabilities to market in an enterprise scale. Our continued ability to innovate our platform and bring differentiated capabilities to market is an important aspect of our business success.

Our investment in innovation includes costs for research and development, capitalized software development, and capital expenditures related to hardware and software platforms on which our platform solutions are deployed as summarized below (in thousands, except percentages).

	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
Investment in Innovation:				
Research and development(1)	$ 7,898	$ 7,545	$ 16,099	$ 13,966
Capitalized software development(2)	8,801	11,366	16,708	21,662
Research and development infrastructure investments(3)	411	727	1,581	9,492
Total investment in innovation	$ 17,110	$ 19,638	$ 34,388	$ 45,120
As a percentage of revenue				
Research and development(1)	5%	5%	5%	6%
Capitalized software development(2)	6%	7%	6%	9%
Research and development infrastructure investments(3)	—%	—%	1%	4%
Total investment in innovation	11%	12%	12%	19%

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(1) Research and development primarily includes employee costs related to the development and enhancement of our service offerings.

(2) Capitalized software development includes capitalized costs incurred to develop and enhance functionality for our platform solutions.

(3) Research and development infrastructure investments include strategic capital expenditures related to hardware and software platforms under development or enhancement.

Mix of Subscription-Based Platform Offerings and Legacy Solutions. In 2018, we executed an intentional transition in our offering portfolio from legacy platform solutions to subscription-based cloud-based platform offerings with add-on advisory services. Subscription-based cloud-based platform offerings are generally defined as modular, cloud-based solutions that utilize dynamic, high-speed cloud-based compute and storage, offer enhanced data visualization capabilities, and are tied to subscription-based contract structures where revenue is predominantly based on factors such as the number of patients under contract or similar relevant metrics (e.g., the number of prescriptions issued), the size of the client, and/or a specific period of time. Additionally, we expanded our offerings of cloud-based SaaS solutions enabled by the Inovalon ONE® Platform which utilize Artificial Intelligence and machine learning application. Legacy platform solutions are generally defined as solutions historically not cloud-based in nature and not tied to subscription-based contract structures. We believe subscription-based cloud-based platform offerings provide more advanced capabilities, higher value, and greater visibility to clients, as well as improved visibility, market differentiation, and financial performance for us. Over time, we expect that subscription-based cloud-based platform offerings will continue to represent an increasing share of our total revenue, contributing to an increasing base of recurring revenue.

Additionally, through the ABILITY acquisition, we have expanded our subscription-based cloud-based platform offering revenues and we continue to achieve revenue synergies realized through i) the infusion of Inovalon's data and analytics into ABILITY's existing offerings, ii) the combination of the Inovalon ONE® Platform and *my*ABILITY® Platform capabilities to introduce new and more vertically integrated offerings which appeal to both organizations' traditional market base, iii) the enhancement of Inovalon's offerings from ABILITY's provider point-of-care data, connectivity, and workflow presence, and iv) the leveraging of ABILITY's sales channel, techniques and capacity.

Breadth of Healthcare Industry Connectivity. The healthcare industry is undergoing a significant transition as it becomes increasingly data-driven. As part of this transition, participants across the healthcare industry, including health plans, pharmaceutical companies, medical device manufacturers, and diagnostic companies, are increasingly interested in achieving timely and seamless access to relevant data and being able to drive impact directly with providers and their patients. Concurrently, providers are also increasingly interested in access to more advanced analytical tools to support and improve their clinical and financial performance. Enhancing and expanding our industry connectivity with payer administrative systems, provider facilities, diagnostic systems, pharmacy systems, healthcare industry systems (e.g., electronic healthcare record systems, health information exchange systems, claims processing systems, decision support systems, etc.), and other healthcare clinical and business systems, offers the potential for increased differentiation in the healthcare marketplace as well as improved efficiency of our operations.

Client and Analytical Process Count Growth. Our business is generally driven by the number of underlying patients for which our platform solutions are being utilized. As such, we track the number of analytical processes that we run on patients each month in fulfillment of our client contracts, as totaled for the trailing 12 months. We believe that PAM is indicative of our overall level of analytical activity, and we expect our period-to-period comparisons of our PAM to be indicative of underlying growth of our business, although changes in levels of analytical activity do not always directly translate to changes in financial performance of our business. Differences in fees charged for different analytical packages exist and differences in how analytics trigger the applicability of our data-driven intervention platforms may result in increases in analytical activity that do not result in proportional increases in revenue, or net income (and vice versa). Therefore, in situations in which a new engagement is initiated for analytical processes that have a higher than average fee rate, revenue could expand disproportionately faster than the increase in PAM. Likewise, if engagements for analytical processes that have a higher than average fee rate are concluded then such conclusions can negatively affect revenue disproportionately more than PAM.

Seasonality. The nature of our customers' end-market results in partial seasonality reflected in both revenue and cost of revenue differences during the year. Regulatory impact of data submission deadlines in, for example, January, March, June, and September drive some degree of predictable timing of analytics and data processing activity variances from quarter to quarter. Further, regulatory clinical encounter deadlines of June 30th and December 31st drive predictable intervention concentrations variances from quarter to quarter. The timing of these factors results in analytical and intervention activity mix variances, which have limited predictable impact in the aggregate on our financial performance from quarter to quarter. However, quarter to quarter financial performance may increasingly vary from historical seasonal trends as we continue to expand into adjacent markets and increase the portion of our revenue generated from new offerings. Further, we also expect the impact of seasonality to decrease over time as we expand our mix of revenue generated from a subscription-based model. The timing of new contract signings and their respective implementations can also lead to variances in our seasonal revenue performance.

Regulatory, Economic and Industry Trends. Our clients are affected, sometimes directly and sometimes counter-intuitively, by macro-economic trends such as economic growth (or economic recession), inflation, and unemployment. Further, industry trends in federal and state laws and regulations, as well as emerging trends in private sector payment models, affect our clients' businesses and their need for technologies and services to support these challenges. These factors have various effects on our business, and on occasion have resulted in the slowing or cessation of the decision-making process by clients adopting our technologies and services. On the other hand, changes in macro-economic trends and the industry landscape have accelerated the need for our technologies and services from time-to-time, particularly as regulators introduce complex requirements with which our clients must comply.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations are based on our unaudited consolidated financial statements, which have been prepared in accordance with GAAP. In connection with the preparation of our unaudited consolidated financial statements, we are required to make assumptions and estimates about future events and apply judgments that affect the reported amounts of assets and liabilities, the disclosures of contingent assets and liabilities as of the date of the financial statements, and the reported amounts of revenues and expenses during the reporting periods. We base our assumptions, estimates, and judgments on historical experience, current trends, and other factors we believe to be relevant at the time we prepare our unaudited consolidated financial statements. The accounting estimates used in the preparation of our unaudited consolidated financial statements will change as new events occur, as more experience is acquired, as additional information is obtained, and as our operating environment changes. On a regular basis, we review the accounting policies, assumptions, and evaluate and update our assumptions, estimates, and judgments to ensure that our unaudited consolidated financial statements are presented fairly and in accordance with GAAP. However, because future events and their effects cannot be determined with certainty, actual results could differ from our assumptions and estimates, and such differences could be material.

Critical accounting policies are those policies that affect our more significant judgments and estimates used in the preparation of our unaudited consolidated financial statements. For a more detailed discussion of our critical accounting policies, please refer to our 2018 Form 10-K.

Components of Results of Operations

Revenue

We earn revenue primarily through the sale or subscription licensing of our platform solutions, as well as revenue from related arrangements for advisory, implementation, and support services.

Platform solutions include arrangements for technology-based offerings representing subscription-based cloud-based platform offerings, including solutions offered through the *my*ABILITY® software platform, and legacy platform solutions that are not cloud-based and not billed under a subscription-based contract structure. Our platform solutions revenue is driven primarily by cloud-based data connectivity, analytics, intervention, and visualization software that enables the identification and resolution of gaps in care, quality, utilization, compliance, and/or other gaps that may impact our clients' achievement of greater healthcare quality and financial performance associated with value-based care. Revenue is predominantly based on the number of clients, the number of patients or similar relevant metrics (e.g., the number of prescriptions issued), the size of the client, the number of analytical services contracted for by a client and the contractually negotiated price of such services. Additionally, revenue is based on the number of identified and/or resolved gaps in care, quality, utilization, compliance, and/or other gaps resulting from our analytical services at a contractually negotiated transactional price for each identified and/or resolved gap.

The majority of our platform solutions contracts contain a series of separately identifiable and distinct services that represent performance obligations that are satisfied over time. Revenue is allocated to platform solutions by determining the standalone selling price of each performance obligation. Revenue is generally recognized on our platform offerings over the contract term. For certain contracts, we have determined that we will recognize revenue when we have the right to invoice.

As our platform solutions are increasingly integrated into our clients' operations, the timing and delivery of implementations vary.

Service revenue represents revenue that is generated from strategic advisory, implementation and support services. Revenue from our services arrangements is generally provided under time and materials, fixed-price, or retainer-based contracts, based on agreed upon billing rates applied to direct labor hours expended plus the costs of other items used in the performance of the contract. We recognize revenue when we have the right to invoice the customer using the allowable practical expedient since the right to invoice the customer corresponds with the performance obligations completed. Revenues under fixed-price and retainer-based contracts are recognized ratably over the contract period or upon contract completion.

Cost of Revenue

Cost of revenue consists primarily of expenses for employees who provide direct contractual services to our clients, including salaries, benefits, discretionary incentive compensation, employment taxes, severance, and equity compensation costs. Cost of revenue also includes expenses associated with the integration, and verification of data and other service costs incurred to fulfill our revenue contracts. Cost of revenue does not include allocated amounts for occupancy expense and depreciation and amortization. Many of the elements of our cost of revenue are relatively variable and semi-variable, and can be reduced in the near-term to help offset any decline in our revenue.

Our business and operational models are designed to be highly scalable and leverage variable costs to support revenue generating activities. While we may grow our headcount over time to capitalize on our market opportunities, we believe our increased investment in automation, electronic health record integration capabilities, and economies of scale in our operating model, will position us to grow our platform solutions revenue at a greater rate than our cost of revenue.

Sales and Marketing

Sales and marketing expense consists primarily of employee-related expenses, including salaries, benefits, commissions, discretionary incentive compensation, employment taxes, severance, and equity compensation costs for our employees engaged in sales, sales support, business development, and marketing. Sales and marketing expense also includes operating expenses for marketing programs, research, trade shows and brand messages, and public relations costs. Our sales and marketing expense excludes any allocation of occupancy expense and depreciation and amortization.

We expect our sales and marketing expenses to continue to increase in absolute dollar terms as we strategically invest to expand our business, although it may vary from period to period as a percentage of total revenues.

Research and Development

Research and development expense (one component of our investment in innovation) consists primarily of employee-related expenses, including salaries, benefits, discretionary incentive compensation, employment taxes, severance, and equity compensation costs for our software developers, engineers, analysts, project managers, and other employees engaged in the development and enhancement of our service offerings. Research and development expense also includes certain third party consulting fees. Our research and development expense excludes any allocation of occupancy expense and depreciation and amortization.

We expect to continue our focus on developing new product offerings and enhancing our existing product offerings. As a result, we expect our research and development expense to increase in absolute dollars, although it may vary from period to period as a percentage of revenue**.**

General and Administrative

Our general and administrative expense consists primarily of employee-related expenses including salaries, benefits, discretionary incentive compensation, employment taxes, severance, and equity compensation costs, for employees who are responsible for management information systems, administration, human resources, finance, legal, and executive management. General and administrative expense also includes occupancy expenses (including rent, utilities, communications, and facilities maintenance), professional fees, consulting fees, insurance, travel, contingent consideration, transaction costs, integration costs, and other expenses. Our general and administrative expense excludes depreciation and amortization.

In the near term, we expect our general and administrative expense to continue to increase in absolute dollars to support business growth. Over the long term, we expect general and administrative expense to decrease as a percentage of revenue.

Depreciation and Amortization Expense

Our depreciation and amortization expense consists primarily of depreciation of fixed assets, amortization of capitalized software development costs, and amortization of acquisition-related intangible assets.

We expect our depreciation and amortization expense to increase as we expand our business organically and through acquisitions.

Interest Income

Interest income represents interest earned net of amortization of premium for purchased interest from our available-for-sale short-term investments.

We expect our interest income to fluctuate in proportion to the amount of funds we invest, according to our corporate investment policy, in available-for-sale short-term investments and considering prevailing available interest rate yields on such investment grade debt securities.

Interest Expense

Interest expense represents interest incurred on our 2018 Credit Facilities (as defined below, under the heading Liquidity and Capital Resources—Debt) and related interest rate swaps.

We expect our interest expense to increase in connection with the debt commitment discussed in “Note 6—Debt” and to fluctuate in proportion to our outstanding principal balance under the 2018 Credit Facilities (as defined below, under the heading Liquidity and Capital Resources—Debt) and the prevailing London Interbank Offer Rate (“LIBOR”) interest rate.

Provision for Income Taxes

Provision for income taxes consists of federal and state income taxes in the United States and foreign income taxes from the territory of Puerto Rico, including deferred income taxes reflecting the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes, and excess tax benefits or deficiencies derived from exercises of stock options and vesting of restricted stock.

Our effective tax rate has decreased due to the Tax Cuts and Jobs Act of 2017 (the “Tax Act”), which was signed into law on December 22, 2017 and was effective January 1, 2018, and in the future may fluctuate due to the recognition of excess tax benefits and tax deficiencies associated with stock-based compensation transactions which are considered to be discrete items.

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RESULTS OF OPERATIONS

The following table sets forth our consolidated statement of operations data for each of the periods presented (in thousands, except percentages):

	Three Months Ended June 30,		Change from 2018 to 2019		Six Months Ended June 30,		Change from 2018 to 2019	
	2019	2018	$	%	2019	2018	$	%
Revenue	$ 156,977	$ 152,798	$ 4,179	3 %	$ 302,468	$ 245,553	$ 56,915	23 %
Expenses:								
Cost of revenue(1)	41,118	39,015	2,103	5 %	78,321	72,506	5,815	8 %
Sales and marketing(1)	14,306	12,045	2,261	19 %	27,832	19,947	7,885	40 %
Research and development(1)	7,898	7,545	353	5 %	16,099	13,966	2,133	15 %
General and administrative(1)	45,694	60,174	(14,480)	(24)%	99,317	109,570	(10,253)	(9)%
Depreciation and amortization	27,420	26,906	514	2 %	54,467	43,286	11,181	26 %
Restructuring expense	—	9,464	*	*%	—	9,464	*	*%
Total operating expenses	136,436	155,149	(18,713)	(12)%	276,036	268,739	7,297	3 %
Income (Loss) from operations	20,541	(2,351)	22,892	*%	26,432	(23,186)	49,618	*%
Other income and (expenses):								
Interest income	664	154	510	331 %	1,274	1,549	(275)	(18)%
Interest expense	(16,649)	(15,568)	(1,081)	7 %	(33,191)	(17,450)	(15,741)	90 %
Other expense, net	—	(511)	*	*%	(11)	(1,631)	*	*
Income (Loss) before taxes	4,556	(18,276)	22,832	125 %	(5,496)	(40,718)	35,222	87 %
Provision for (Benefit from) income taxes	18	(7,810)	7,828	100 %	(1,711)	(13,418)	11,707	87 %
Net income (loss)	$ 4,538	$ (10,466)	$ 15,004	143 %	$ (3,785)	$ (27,300)	$ 23,515	86 %

(1) Includes stock-based compensation expense as follows:

Cost of revenue	$ 78	$ (87)	$ 165	190 %	$ 155	$ 53	$ 102	192 %
Sales and marketing	339	(401)	740	185 %	639	68	571	840 %
Research and development	379	330	49	15 %	749	958	(209)	(22)%
General and administrative	1,986	2,802	(816)	(29)%	6,478	5,313	1,165	22 %
Total stock-based compensation expense	$ 2,782	$ 2,644	$ 138	5 %	$ 8,021	$ 6,392	$ 1,629	25 %

* Asterisk denotes not meaningful.

The following table sets forth our consolidated statement of operations data for each of the periods presented as a percentage of revenue:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
Revenue	100 %	100 %	100 %	100 %
Expenses:				
Cost of revenue	26 %	26 %	26 %	30 %
Sales and marketing	9 %	8 %	9 %	8 %
Research and development	5 %	5 %	5 %	6 %
General and administrative	29 %	39 %	33 %	45 %
Depreciation and amortization	17 %	18 %	18 %	18 %
Restructuring expense	— %	6 %	— %	4 %
Total operating expenses	86 %	102 %	91 %	111 %
Income (Loss) from operations	14 %	(2)%	9 %	(11)%
Other income and (expenses):				
Interest income	*%	— %	*%	1 %
Interest expense	(11)%	(10)%	(11)%	(7)%
Other expense, net	*%	— %	*%	*%
Income (Loss) before taxes	3 %	(12)%	(2)%	(17)%
Provision for (Benefit from) income taxes	— %	(5)%	(1)%	(5)%
Net income (loss)	3 %	(7)%	(1)%	(12)%

* Asterisk denotes not meaningful.

Comparison of the Three and Six Months Ended June 30, 2019 and 2018

Revenue

Revenue for the three months ended June 30, 2019 was $157.0 million, an increase of $4.2 million, or 3%, compared with revenue of $152.8 million for the three months ended June 30, 2018. This increase was primarily attributable to $9.4 million in revenue contributed from new clients signed resulting from continued adoption of subscription-based platform offerings including cloud-based SaaS solutions enabled by the Inovalon ONE® Platform, which was partially offset by a decrease of $5.2 million in revenue from existing clients primarily due to the timing of deliveries in the prior year which offset increased revenues from existing clients in the current year.

Revenue for the six months ended June 30, 2019 was $302.5 million, an increase of $56.9 million, or 23%, compared with revenue of $245.6 million for the six months ended June 30, 2018. This increase was primarily attributable to $39.8 million in revenue from the acquired business of ABILITY, through the anniversary date of the acquisition, and an increase of $20.7 million in revenue contributed from new clients signed resulting from continued adoption of subscription-based platform offerings including cloud-based SaaS solutions enabled by the Inovalon ONE® Platform, which was partially offset by a decrease of $3.6 million in revenue from existing clients primarily due to the timing of deliveries in the prior year which offset increased revenues from existing clients in the current year.

Cost of Revenue

During the three months ended June 30, 2019, cost of revenue increased by $2.1 million, or 5%, compared with the three months ended June 30, 2018. The increase in cost of revenue was primarily attributable to an increase in employee-related expenses of $4.2 million, which was partially offset by a decrease in professional third-party costs of $1.8 million. Cost of revenue as a percentage of revenue was 26% for both the three months ended June 30, 2019 and 2018.

During the six months ended June 30, 2019, cost of revenue increased by $5.8 million, or 8%, compared with the six months ended June 30, 2018. The increase in cost of revenue was primarily attributable to incremental cost of revenue of $5.0 million attributable to the acquired business of ABILITY, through the anniversary date of the acquisition, and an increase in employee-related expenses of $4.7 million, which was partially offset by a decrease in professional third-party costs of $3.1 million. Cost of revenue as a percentage of revenue was 26% and 30% for the six months ended June 30, 2019 and 2018, respectively, reflecting the factors discussed above as well as an increase in the mix of higher-margin platform solutions and cloud-based SaaS solutions as a percentage of revenue.

Sales and Marketing

During the three months ended June 30, 2019, sales and marketing expenses increased by $2.3 million, or 19%, compared with the three months ended June 30, 2018. The increase was primarily attributable to an increase in employee-related expenses of $1.8 million. Sales and marketing expenses as a percentage of revenue was 9% and 8% for the three months ended June 30, 2019 and 2018, respectively.

During the six months ended June 30, 2019, sales and marketing expenses increased by $7.9 million, or 40%, compared with the six months ended June 30, 2018. The increase was primarily attributable to sales and marketing expenses of $5.3 million attributable to the acquired business of ABILITY, through the anniversary date of the acquisition, and an increase in employee-related expenses of $2.3 million. Sales and marketing expenses as a percentage of revenue was 9% and 8% for the six months ended June 30, 2019 and 2018, respectively.

Research and Development

During the three months ended June 30, 2019, research and development expense increased by $0.4 million, or 5%, compared with the three months ended June 30, 2018. The increase was primarily attributable to an increase in employee-related expenses of $1.7 million, which was partially offset by a decrease in professional third-party costs of $1.6 million.

During the six months ended June 30, 2019, research and development expense increased by $2.1 million, or 15%, compared with the six months ended June 30, 2018. The increase was primarily attributable to an increase in employee-related expenses of $2.8 million, and incremental expense of $2.5 million attributable to the acquired business of ABILITY, through the anniversary date of the acquisition, which was partially offset by a decrease in professional third-party costs of $3.4 million.

General and Administrative

During the three months ended June 30, 2019, general and administrative expenses decreased by $14.5 million, or 24%, compared with the three months ended June 30, 2018. The decrease was primarily attributable to an adjustment in the prior year to increase the fair value of contingent consideration that was not present in the current year resulting in a reduction in expense of $9.6 million, a decrease in professional third-party costs of $3.8 million, and a decrease in transaction and integration costs of $1.6 million. General and administrative expenses as a percentage of revenue was 29% and 39% for the three months ended June 30, 2019 and 2018, respectively.

During the six months ended June 30, 2019, general and administrative expenses decreased by $10.3 million, or 9%, compared with the six months ended June 30, 2018. The decrease was primarily attributable to an adjustment in the prior year to increase the fair value of contingent consideration that was not present in the current year resulting in a reduction in expense of $10.3 million, a decrease in transaction and integration costs of $3.8 million, and a decrease in professional third-party costs of $3.5 million, which was partially offset by incremental expenses of $7.5 million attributable to the acquired business of ABILITY, through the anniversary date of the acquisition. General and administrative expenses as a percentage of revenue was 33% and 45% for the six months ended June 30, 2019 and 2018, respectively.

Depreciation and Amortization

During the three months ended June 30, 2019, depreciation and amortization expense increased by $0.5 million, or 2%, compared with the three months ended June 30, 2018.

During the six months ended June 30, 2019, depreciation and amortization expense increased by $11.2 million, or 26%, compared with the six months ended June 30, 2018. The increase was primarily attributable to an increase in amortization of acquired intangible assets of $8.6 million.

Interest Income

During the three months ended June 30, 2019, interest income increased by $0.5 million, compared with the three months ended June 30, 2018. During the six months ended June 30, 2019, interest income decreased by $0.3 million, compared with the six months ended June 30, 2018.

Interest Expense

During the three months ended June 30, 2019, interest expense increased by $1.1 million, compared with the three months ended June 30, 2018. The increase in interest expense was primarily attributable to an increase in expense related to the interest rate swaps entered into in connection with the 2018 Term Facility.

During the six months ended June 30, 2019, interest expense increased by $15.7 million, compared with the six months ended June 30, 2018. The increase in interest expense was primarily attributable an increase in borrowings in connection with the 2018 Term Facility (as defined below, under the heading Liquidity and Capital Resources—Debt) and an increase in expense related to the interest rate swaps entered into in connection with the 2018 Term Facility.

Provision For (Benefit from) Income Taxes

During the three months ended June 30, 2019, the provision for income taxes was $18.0 thousand compared to a benefit from income taxes of $7.8 million for the three months ended June 30, 2018. During the six months ended June 30, 2019, the benefit from income taxes was $1.7 million compared to $13.4 million for the six months ended June 30, 2018. Our effective tax rate for the six months ended June 30, 2019 was approximately 31.1%, compared with approximately 33.0% for the six months ended June 30, 2018. The decrease in our effective tax rate is primarily a result of prior year transaction costs that were not deductible and resulted in a higher prior year effective tax rate.

Liquidity and Capital Resources

Sources of Liquidity

Our principal sources of liquidity have been cash generated by operating activities and proceeds from our 2018 Credit Facilities. Our cash generated from such means has been sufficient to fund our growth, including our capital expenditures. As of June 30, 2019, our cash, cash equivalents and short-term investments totaled $130.4 million, of which $0.5 million represented short-term, available-for-sale, investment grade, domestic debt-securities, compared with $83.7 million of cash, cash equivalents, and short-term investments as of June 30, 2018, of which $15.7 million represented short-term, available-for-sale, investment grade, domestic debt-securities.

We believe our current cash, cash equivalents, and short-term investments balance, expected cash generated by operating activities and availability of cash under our 2018 Credit Facilities are sufficient to fund our operations, finance our strategic initiatives, and fund our investment in innovation and new service offerings, for the foreseeable future. There can be no assurance that we will continue to generate cash flows at or above current levels or that we will be able to maintain our ability to borrow under our 2018 Credit Facilities.

Debt

On September 19, 2014, we entered into a Credit and Guaranty Agreement with a group of lenders and Goldman Sachs Bank USA, as administrative agent, providing for a senior unsecured term loan facility in the original principal amount of $300.0 million (the "2014 Term Facility") and a senior unsecured revolving credit facility in the maximum principal amount of $100.0 million (the "2014 Revolving Credit Facility" and, together with the Term Facility, the "2014 Credit Facilities").

On April 2, 2018, we paid in full all existing debt obligations under the 2014 Credit Facilities and terminated all commitments to extend further credit thereunder. On April 2, 2018, we entered into a credit agreement with a group of lenders and Morgan Stanley Senior Funding, Inc., as administrative agent, to provide a secured credit facility which is comprised of: (i) a term loan B facility with us as borrower in a total principal amount of $980.0 million (the "2018 Term Facility"); and (ii) a revolving credit facility with us as borrower in a total principal amount of up to $100.0 million (the "2018 Revolving Facility" together with the 2018 Term Facility, the "2018 Credit Facilities"). As of June 30, 2019, we had $100.0 million available to us consisting of $99.0 million under the 2018 Revolving Facility and a letter of credit of $1.0 million. See "Note 6—Debt" in the Notes to our unaudited consolidated financial statements included under Part I, Item 1 within this Quarterly Report on Form 10-Q for additional information.

As of June 30, 2019, we had outstanding indebtedness under the 2018 Term Facility and finance lease liabilities of $946.4 million and $15.9 million, respectively. As of June 30, 2018, we had outstanding indebtedness under the 2018 Term Facility and finance lease liabilities of $949.8 million and $16.7 million, respectively. The 2018 Term Facility has a seven year term and is an amortizing facility with quarterly principal payments and monthly interest payments. Scheduled principal payments totaling $4.9 million and scheduled interest payments totaling $31.5 million were paid during the six months ended June 30, 2019. As of June 30, 2019, we were in compliance with the covenants under the 2018 Credit Agreement.

Cash Flows

Operating Cash Flow Activities

Cash provided by operating activities during the six months ended June 30, 2019 was $39.9 million, representing an increase in cash inflow of $19.8 million compared with the six months ended June 30, 2018. The increase in cash provided by operating activities was primarily driven by an increase in operating income and an increase of $5.4 million in cash received for income taxes due to net tax refunds during the six months ended June 30, 2019 compared with net tax payments during the six months ended June 30, 2018.

Investing Cash Flow Activities

Cash used in investing activities during the six months ended June 30, 2019 was $18.8 million compared with $872.1 million during the six months ended June 30, 2018. The change in cash used in investing activities was primarily due to the acquisition of ABILITY in the prior year, which was partially offset by a decrease in sales and maturities of short term investments of $243.2 million and a decrease in capital expenditures of $13.7 million.

We make investments in innovation, including research and development expense, capital software development costs, and research and development infrastructure investments, on a recurring basis.

Financing Cash Flow Activities

Cash used in financing activities during the six months ended June 30, 2019 was $6.8 million, compared with cash provided by financing activities of $711.0 million during the six months ended June 30, 2018. The change in cash used in financing activities was primarily due to proceeds from the 2018 Term Facility net of repayment of the 2014 Credit Facility borrowings in the prior year.

Contractual Obligations

During the six months ended June 30, 2019, there have been no material changes, outside of the ordinary course of business, in our contractual obligations previously disclosed under the caption “Contractual Obligations” in our 2018 Form 10-K.

Off-Balance Sheet Arrangements

As of June 30, 2019, we did not have any off-balance sheet arrangements.

Recently Issued Accounting Standards

Recently issued accounting standards and their expected impact, if any, are discussed in “Note 1—Basis of Presentation”, in the notes to our unaudited consolidated financial statements, included under Item 1 within this Quarterly Report on Form 10-Q and in “Note 2—Summary of Significant Accounting Policies,” in the notes to our consolidated financial statements, included under Item 15 within our 2018 Form 10-K.

Item 3. ***Quantitative and Qualitative Disclosures About Market Risk***

There have been no material changes to our market risk subsequent to the previous disclosure in Part I—Item 1A (“Risk Factors”) of our 2018 Form 10-K.

Item 4. ***Controls and Procedures***

Disclosure Controls and Procedures

Our management, with the participation of our chief executive officer (“CEO”) and chief financial officer (“CFO”), has evaluated the effectiveness of our disclosure controls and procedures, (as defined in Rules 13a- 15(e) and 15d- 15(e) under the Exchange Act), as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on such evaluation, our CEO and CFO have concluded that, as of June 30, 2019, our disclosure controls and procedures were designed at a reasonable assurance level to ensure that material information relating to Inovalon Holdings, Inc., including its consolidated subsidiaries, is made known to our CEO and CFO by others within those entities, particularly during the period in which this report was being prepared and that our disclosure controls and procedures were effective in providing reasonable assurance that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the rules and forms of the SEC, and that such information is accumulated and communicated to our management, including our CEO and CFO, as appropriate, to allow timely decisions regarding required disclosure.

Changes in Internal Control

There have been no changes in the Company’s internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act) during the three months ended June 30, 2019 that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

PART II—OTHER INFORMATION

Item 1. Legal Proceedings

See “Note 8—Commitments and Contingencies” in the Notes to our unaudited consolidated financial statements included under Part I, Item 1 within this Quarterly Report on Form 10-Q.

Item 1A. Risk Factors

For a discussion of potential risks and uncertainties related to our Company see the information in Part I, Item 1A (“Risk Factors”) of our 2018 Form 10-K for the year ended December 31, 2018. There have been no material changes to the risk factors previously disclosed in our 2018 Form 10-K.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Unregistered Sales of Equity Securities

None.

Use of Proceeds from Registered Securities

None.

Purchases of Equity Securities by the Issuer or Affiliated Purchasers

None.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

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Item 6. Exhibits

EXHIBIT INDEX

Exhibit Number		Description of Document
10.1		Amended and Restated 2015 Omnibus Incentive Plan (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K dated June 5, 2019).
31.1	*	Certification of Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	*	Certification of Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	**	Certification of Chief Executive Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	**	Certification of Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	*	XBRL Instance Document
101.SCH	*	XBRL Taxonomy Extension Schema
101.CAL	*	XBRL Taxonomy Extension Calculation Linkbase
101.DEF	*	XBRL Taxonomy Extension Definition Linkbase
101.LAB	*	XBRL Taxonomy Extension Label Linkbase
101.PRE	*	XBRL Taxonomy Extension Presentation Linkbase

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* Filed herewith.

** This certification is deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (Exchange Act), or otherwise subject to the liability of that section, nor shall it be deemed incorporated by reference into any filing under the Securities Act of 1933, as amended (Securities Act), or the Exchange Act.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: July 31, 2019

INOVALON HOLDINGS, INC.

By: /s/ KEITH R. DUNLEAVY, M.D.

Keith R. Dunleavy, M.D.
Chief Executive Officer & Chairman
(Principal Executive Officer)

By: /s/ JONATHAN R. BOLDT

Jonathan R. Boldt
Chief Financial Officer
(Principal Financial Officer)

EXHIBIT 31.1

CERTIFICATION

I, Keith R. Dunleavy, M.D., certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Inovalon Holdings, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations, and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's Board of Directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize, and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ KEITH R. DUNLEAVY, M.D.

Keith R. Dunleavy, M.D.
Chief Executive Officer & Chairman
(Principal Executive Officer)

Date: July 31, 2019

EXHIBIT 31.2

CERTIFICATION

I, Jonathan R. Boldt, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Inovalon Holdings, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations, and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's Board of Directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize, and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ JONATHAN R. BOLDT

Jonathan R. Boldt
Chief Financial Officer
(Principal Financial Officer)

Date: July 31, 2019

EXHIBIT 32.1

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Inovalon Holdings, Inc. (the "Company") on Form 10-Q for the period ended June 30, 2019 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Keith R. Dunleavy, M.D., the Chief Executive Officer and Chairman of the Company, certify, to my knowledge, pursuant to 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. the Report fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934, as amended; and

2. the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ KEITH R. DUNLEAVY, M.D.

Keith R. Dunleavy, M.D.
Chief Executive Officer & Chairman
(Principal Executive Officer)

Date: July 31, 2019

EXHIBIT 32.2

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Inovalon Holdings, Inc. (the "Company") on Form 10-Q for the period ended June 30, 2019 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Jonathan R. Boldt, the Chief Financial Officer of the Company, certify, to my knowledge, pursuant to 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. the Report fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934, as amended; and

2. the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ JONATHAN R. BOLDT

Jonathan R. Boldt
Chief Financial Officer
(Principal Financial Officer)

Date: July 31, 2019