

ENCORE CAPITAL GROUP INC

Form 10-Q

November 07, 2013

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**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 September 30, 2013

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: 000-26489

**ENCORE CAPITAL GROUP, INC.**

(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**3111 Camino Del Rio North, Suite 1300**

**San Diego, California**

**48-1090909**  
(IRS Employer  
Identification No.)

**92108**

(Address of principal executive offices)

(Zip code)

(877) 445 - 4581

(Registrant's telephone number, including area code)

(Not Applicable)

(Former name, former address and former fiscal year, if changed since last report)

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

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

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

| Class                          | Outstanding at October 30, 2013 |
|--------------------------------|---------------------------------|
| Common Stock, \$0.01 par value | 25,421,823 shares               |

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**ENCORE CAPITAL GROUP, INC.**

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**Table of Contents****PART I FINANCIAL INFORMATION****Item 1 Condensed Consolidated Financial Statements (Unaudited)****ENCORE CAPITAL GROUP, INC.****Condensed Consolidated Statements of Financial Condition**

(In Thousands, Except Par Value Amounts)

(Unaudited)

|  | September 30,<br>2013 | December 31,<br>2012 |
|--|-----------------------|----------------------|
| <b>Assets</b>  |                       |                      |
| Cash and cash equivalents  | \$ 110,156            | \$ 17,510            |
| Investment in receivable portfolios, net   | 1,595,642             | 873,119              |
| Deferred court costs, net  | 39,004                | 35,407               |
| Receivables secured by property tax liens, net   | 186,190               | 135,100              |
| Property and equipment, net  | 50,050                | 23,223               |
| Other assets   | 120,441               | 31,535               |
| Goodwill   | 489,520               | 55,446               |
| <b>Total assets<sup>(1)</sup></b>  | <b>\$ 2,591,003</b>   | <b>\$ 1,171,340</b>  |
| <b>Liabilities and stockholders equity</b>   |                       |                      |
| <b>Liabilities:</b>  |                       |                      |
| Accounts payable and accrued liabilities   | \$ 106,632            | \$ 45,450            |
| Deferred tax liabilities, net  | 110,453               | 8,236                |
| Debt   | 1,806,680             | 706,036              |
| Other liabilities  | 6,967                 | 5,802                |
| <b>Total liabilities<sup>(1)</sup></b>   | <b>2,030,732</b>      | <b>765,524</b>       |
| <b>Stockholders equity:</b>  |                       |                      |
| Redeemable noncontrolling interest   | 12,231                |                      |
| Commitments and contingencies  |                       |                      |
| Convertible preferred stock, \$.01 par value, 5,000 shares authorized, no shares issued and outstanding  |                       |                      |
| Common stock, \$.01 par value, 50,000 shares authorized, 25,412 shares and 23,191 shares issued and outstanding as of September 30, 2013 and December 31, 2012, respectively | 254                   | 232                  |
| Additional paid-in capital   | 171,548               | 88,029               |
| Accumulated earnings   | 371,676               | 319,329              |
| Accumulated other comprehensive gain (loss)  | 455                   | (1,774)              |

|   |              |              |
|---|--------------|--------------|
| Total Encore Capital Group, Inc. stockholders equity                          | 543,933      | 405,816      |
| Noncontrolling interest   | 4,107        |              |
| Total stockholders equity   | 548,040      | 405,816      |
| Total liabilities, redeemable noncontrolling interest and stockholders equity | \$ 2,591,003 | \$ 1,171,340 |

- (1) The Company's consolidated assets as of September 30, 2013 included \$1,067,007 of assets from its variable interest entity, or VIE, that can only be used to settle obligations of the VIE. These assets include cash and cash equivalents of \$54,584; investment in receivable portfolios, net, of \$596,160; property and equipment, net, of \$14,249; other assets of \$32,102; and goodwill of \$369,912. The Company's consolidated liabilities as of September 30, 2013, included \$864,432 of liabilities of its VIE, whose creditors have no recourse to the Company. These liabilities include accounts payable and accrued liabilities of \$31,817; deferred tax liabilities of \$6,978; debt of \$825,524; and other liabilities of \$113. See further details of the assets and liabilities of the Company's VIE in Note 12, Variable Interest Entity.

*See accompanying notes to condensed consolidated financial statements*

**Table of Contents****ENCORE CAPITAL GROUP, INC.****Condensed Consolidated Statements of Income**

(In Thousands, Except Per Share Amounts)

(Unaudited)

|  | Three Months Ended<br>September 30, |                | Nine Months Ended<br>September 30, |                 |
|--|-------------------------------------|----------------|------------------------------------|-----------------|
|  | 2013                                | 2012           | 2013                               | 2012            |
| <b>Revenues</b>  |                                     |                |                                    |                 |
| Revenue from receivable portfolios, net                      | \$ 225,387                          | \$ 140,682     | \$ 518,094                         | \$ 405,818      |
| Other revenues   | 5,792                               | 426            | 6,473                              | 614             |
| Net interest income tax lien business                        | 4,379                               | 4,110          | 11,698                             | 6,442           |
| <b>Total revenues</b>  | <b>235,558</b>                      | <b>145,218</b> | <b>536,265</b>                     | <b>412,874</b>  |
| <b>Operating expenses</b>                                    |                                     |                |                                    |                 |
| Salaries and employee benefits                               | 52,253                              | 25,397         | 114,054                            | 72,891          |
| Cost of legal collections                                    | 50,953                              | 43,544         | 137,694                            | 123,203         |
| Other operating expenses                                     | 19,056                              | 14,829         | 46,118                             | 38,854          |
| Collection agency commissions                                | 14,158                              | 4,227          | 22,717                             | 12,352          |
| General and administrative expenses                          | 33,486                              | 14,091         | 77,429                             | 46,331          |
| Depreciation and amortization                                | 4,523                               | 1,533          | 8,527                              | 4,193           |
| <b>Total operating expenses</b>                              | <b>174,429</b>                      | <b>103,621</b> | <b>406,539</b>                     | <b>297,824</b>  |
| Income from operations                                       | 61,129                              | 41,597         | 129,726                            | 115,050         |
| <b>Other (expense) income</b>                                |                                     |                |                                    |                 |
| Interest expense   | (29,186)                            | (7,012)        | (43,522)                           | (19,024)        |
| Other (expense) income                                       | (299)                               | 610            | (4,262)                            | 771             |
| <b>Total other expense</b>                                   | <b>(29,485)</b>                     | <b>(6,402)</b> | <b>(47,784)</b>                    | <b>(18,253)</b> |
| <b>Income from continuing operations before income taxes</b> | <b>31,644</b>                       | <b>35,195</b>  | <b>81,942</b>                      | <b>96,797</b>   |
| Provision for income taxes                                   | (10,272)                            | (13,887)       | (30,110)                           | (38,393)        |
| <b>Income from continuing operations</b>                     | <b>21,372</b>                       | <b>21,308</b>  | <b>51,832</b>                      | <b>58,404</b>   |
| Loss from discontinued operations, net of tax                | (308)                               |                | (308)                              | (9,094)         |
| <b>Net income</b>  | <b>21,064</b>                       | <b>21,308</b>  | <b>51,524</b>                      | <b>49,310</b>   |

|  |     |     |
|--|-----|-----|
| Net loss attributable to noncontrolling interest | 822 | 822 |
|--|-----|-----|

|  |           |           |           |           |
|--|-----------|-----------|-----------|-----------|
| Net income attributable to Encore Capital Group, Inc. stockholders | \$ 21,886 | \$ 21,308 | \$ 52,346 | \$ 49,310 |
|--|-----------|-----------|-----------|-----------|

**Amounts attributable to Encore Capital Group, Inc.:**

|   |           |           |           |           |
|---|-----------|-----------|-----------|-----------|
| Income from continuing operations             | \$ 22,194 | \$ 21,308 | \$ 52,654 | \$ 58,404 |
| Loss from discontinued operations, net of tax | (308)     |           | (308)     | (9,094)   |

|            |           |           |           |           |
|------------|-----------|-----------|-----------|-----------|
| Net income | \$ 21,886 | \$ 21,308 | \$ 52,346 | \$ 49,310 |
|------------|-----------|-----------|-----------|-----------|

**Earnings (loss) per share attributable to Encore Capital Group, Inc.:**

|                                       |           |         |           |           |
|---------------------------------------|-----------|---------|-----------|-----------|
| Basic earnings (loss) per share from: |           |         |           |           |
| Continuing operations                 | \$ 0.87   | \$ 0.85 | \$ 2.16   | \$ 2.34   |
| Discontinued operations               | \$ (0.01) | \$      | \$ (0.01) | \$ (0.36) |

|                              |         |         |         |         |
|------------------------------|---------|---------|---------|---------|
| Net basic earnings per share | \$ 0.86 | \$ 0.85 | \$ 2.15 | \$ 1.98 |
|------------------------------|---------|---------|---------|---------|

|   |           |         |           |           |
|---|-----------|---------|-----------|-----------|
| Diluted earnings (loss) per share from: |           |         |           |           |
| Continuing operations                   | \$ 0.82   | \$ 0.82 | \$ 2.06   | \$ 2.25   |
| Discontinued operations                 | \$ (0.01) | \$      | \$ (0.01) | \$ (0.35) |

|                                |         |         |         |         |
|--------------------------------|---------|---------|---------|---------|
| Net diluted earnings per share | \$ 0.81 | \$ 0.82 | \$ 2.05 | \$ 1.90 |
|--------------------------------|---------|---------|---------|---------|

|                                      |        |        |        |        |
|--------------------------------------|--------|--------|--------|--------|
| Weighted average shares outstanding: |        |        |        |        |
| Basic                                | 25,535 | 25,071 | 24,323 | 24,930 |
| Diluted                              | 27,183 | 26,047 | 25,561 | 25,920 |

*See accompanying notes to condensed consolidated financial statements*

**Table of Contents****ENCORE CAPITAL GROUP, INC.****Condensed Consolidated Statements of Comprehensive Income**

(Unaudited, In Thousands)

|  | <b>Three Months Ended<br/>September 30,</b> |             | <b>Nine Months Ended<br/>September 30,</b> |             |
|--|---|-------------|--|-------------|
|  | <b>2013</b>                                 | <b>2012</b> | <b>2013</b>                                | <b>2012</b> |
| Net income   | \$ 21,064                                   | \$ 21,308   | \$ 51,524                                  | \$ 49,310   |
| Other comprehensive (loss) gain, net of tax:                                 |   |             |  |             |
| Unrealized (loss) gain on derivative instruments                             | (768)                                       | 1,841       | (1,722)                                    | 1,205       |
| Unrealized gain (loss) on foreign currency translation                       | 4,648                                       |             | 3,951                                      | (472)       |
| Other comprehensive gain, net of tax   | 3,880                                       | 1,841       | 2,229                                      | 733         |
| Comprehensive income   | 24,944                                      | 23,149      | 53,753                                     | 50,043      |
| Comprehensive gain attributable to noncontrolling interest                   |   |             |  |             |
| Net loss   | 822   |             | 822  |             |
| Unrealized gain on foreign currency translation                              | (2,633)                                     |             | (2,633)                                    |             |
| Comprehensive gain attributable to noncontrolling interests                  | (1,811)                                     |             | (1,811)                                    |             |
| Comprehensive income attributable to Encore Capital Group, Inc. stockholders | \$ 23,133                                   | \$ 23,149   | \$ 51,942                                  | \$ 50,043   |

*See accompanying notes to condensed consolidated financial statements*



**Table of Contents****ENCORE CAPITAL GROUP, INC.****Condensed Consolidated Statements of Cash Flows**

(Unaudited, In Thousands)

|  | <b>Nine Months Ended<br/>September 30,</b> |             |
|--|--|-------------|
|  | <b>2013</b>                                | <b>2012</b> |
| <b>Operating activities:</b>   |  |             |
| Net income   | \$ 51,524                                  | \$ 49,310   |
| Adjustments to reconcile net income to net cash provided by operating activities |  |             |
| Depreciation and amortization  | 8,527                                      | 4,193       |
| Impairment charge for goodwill and identifiable intangible assets                |  | 10,400      |
| Amortization of loan costs and premium on receivables secured by tax liens       | 5,411                                      | 2,091       |
| Stock-based compensation expense   | 9,163                                      | 6,710       |
| Recognized loss on termination of derivative contract                            | 3,630                                      |             |
| Deferred income taxes  | (217)                                      | 1,823       |
| Excess tax benefit from stock-based payment arrangements                         | (5,238)                                    | (3,600)     |
| Loss on sale of discontinued operations  |  | 2,416       |
| Reversal for allowances on receivable portfolios, net                            | (7,658)                                    | (1,506)     |
| Changes in operating assets and liabilities, net of effects of acquisitions      |  |             |
| Other assets   | (647)                                      | (20)        |
| Deferred court costs   | 2,544                                      | 945         |
| Prepaid income tax and income taxes payable                                      | (25,785)                                   | (8,407)     |
| Accounts payable, accrued liabilities and other liabilities                      | (1,388)                                    | 1,798       |
| Net cash provided by operating activities  | 39,866                                     | 66,153      |
| <b>Investing activities:</b>   |  |             |
| Cash paid for acquisitions, net of cash acquired                                 | (413,055)                                  | (186,731)   |
| Purchases of receivable portfolios, net of put-backs                             | (156,438)                                  | (406,865)   |
| Collections applied to investment in receivable portfolios, net                  | 418,024                                    | 313,205     |
| Originations and purchases of receivables secured by tax liens                   | (100,278)                                  | (22,912)    |
| Collections applied to receivables secured by tax liens                          | 51,111                                     | 24,967      |
| Payment on termination of derivative contract                                    | (3,630)                                    |             |
| Purchases of property and equipment  | (8,178)                                    | (3,665)     |
| Other  | (1,950)                                    |             |
| Net cash used in investing activities  | (214,394)                                  | (282,001)   |
| <b>Financing activities:</b>   |  |             |
| Payment of loan costs  | (17,152)                                   | (1,832)     |
| Proceeds from credit facilities  | 522,065                                    | 390,399     |
| Repayment of credit facilities   | (491,462)                                  | (163,048)   |
| Proceeds from senior secured notes   | 151,670                                    |             |

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|  |            |           |
|--|------------|-----------|
| Repayment of senior secured notes  | (10,000)   |           |
| Proceeds from issuance of convertible senior notes                           | 172,500    |           |
| Repayment of preferred equity certificates                                   | (39,743)   |           |
| Payment of convertible hedge transactions                                    | (18,113)   |           |
| Taxes paid related to net share settlement of equity awards                  | (9,270)    | (2,287)   |
| Excess tax benefit from stock-based payment arrangements                     | 5,238      | 3,600     |
| Other  | (1,073)    | 232       |
| Net cash provided by financing activities                                    | 264,660    | 227,064   |
| Net increase in cash and cash equivalents                                    | 90,132     | 11,216    |
| Effect of exchange rate changes on cash                                      | 2,514      |           |
| Cash and cash equivalents, beginning of period                               | 17,510     | 8,047     |
| Cash and cash equivalents, end of period                                     | \$ 110,156 | \$ 19,263 |
| Supplemental disclosures of cash flow information:                           |            |           |
| Cash paid for interest   | \$ 48,243  | \$ 18,634 |
| Cash paid for income taxes   | 54,499     | 36,840    |
| Supplemental schedule of non-cash investing and financing activities:        |            |           |
| Fixed assets acquired through capital lease                                  | 1,189      | 2,817     |
| <i>See accompanying notes to condensed consolidated financial statements</i> |            |           |

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**Table of Contents****ENCORE CAPITAL GROUP, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(Unaudited)

**Note 1: Ownership, Description of Business and Summary of Significant Accounting Policies**

Encore Capital Group, Inc. ( Encore ), through its subsidiaries (collectively, the Company ), is a global leading provider of debt recovery solutions for consumers and property owners across a broad range of financial assets. The Company purchases portfolios of defaulted consumer receivables at deep discounts to face value and manages them by working with individuals as they repay their obligations and work toward financial recovery. Defaulted receivables are consumers' unpaid financial commitments to credit originators, including banks, credit unions, consumer finance companies, commercial retailers, and telecommunication companies. Defaulted receivables may also include receivables subject to bankruptcy proceedings. Encore's subsidiary, Janus Holdings Luxembourg S.a.r.l. ( Janus Holdings ), through its indirectly held United Kingdom based subsidiary Cabot Credit Management Limited ( Cabot ), is a market leader in debt management in the United Kingdom specializing in higher balance, semi-performing accounts. In addition, through Encore's subsidiary, Propel Financial Services, LLC ( Propel ), the Company assists Texas and Nevada property owners who are delinquent on their property taxes by paying these taxes on behalf of the property owners in exchange for payment agreements collateralized by the existing tax liens on the property. Propel also acquires tax lien certificates directly from taxing authorities outside of Texas.

**Portfolio Purchasing and Recovery**

*United States.* The Company purchases receivable portfolios based on robust, account-level valuation methods and employs a suite of proprietary statistical and behavioral models across the full extent of its operations. These investments allow the Company to value portfolios accurately (and limit the risk of overpaying), avoid buying portfolios that are incompatible with its methods or goals and precisely align the accounts it purchases with its operational channels to maximize future collections. As a result, the Company has been able to realize significant returns from the receivables it acquires. The Company maintains strong relationships with many of the largest credit and telecommunication providers, and possesses one of the industry's best collection staff retention rates.

The Company uses insights discovered during its purchasing process to build account collection strategies. The Company's proprietary consumer-level collectability analysis is the primary determinant of whether an account will be actively serviced post-purchase. The Company continuously refines this analysis to determine the most effective collection strategy to pursue for each account it owns. After the Company's preliminary analysis, it seeks to collect on only a fraction of the accounts it purchases, through one or more of its collection channels. The channel identification process is analogous to a funneling system, where the Company first differentiates those consumers who it believes are not able to pay from those who are able to pay. Consumers who the Company believes are financially incapable of making any payments, facing extenuating circumstances or hardships (such as medical issues), serving in the military, or currently receiving social security as their only source of income are excluded from the next step of its collection process and are designated as inactive. The remaining pool of accounts in the funnel then receives further evaluation. At that point, the Company analyzes and determines a consumer's perceived willingness to pay. Based on that analysis, the Company will pursue collections through letters and/or phone calls to its consumers. Despite its efforts to reach consumers and work out a settlement option, only a small number of consumers who are contacted choose to engage with the Company. Those who do are often offered deep discounts on their obligations, or are presented with payment plans that are better suited to meet their daily cash flow needs. The majority of contacted consumers, however, ignore both the Company's calls and letters, and therefore the Company must then make the difficult decision whether or not

to pursue collections through legal means.

The Company continually monitors applicable changes to laws governing statutes of limitations and disclosures to consumers. The Company maintains policies, system controls, and processes designed to ensure that accounts past the applicable statute of limitations do not get placed into legal collections. Additionally, in written and verbal communications with consumers, the Company provides disclosures to the consumer that the account is past its applicable statute of limitations and, therefore, the Company will not pursue collections through legal means.

***United Kingdom.*** Through Cabot, portfolio receivables are purchased using a proprietary pricing model. This model allows Cabot to value portfolios with a high degree of accuracy and quantify portfolio performance in order to maximize future collections. As a result, Cabot has been able to realize significant returns from the assets it has acquired. Cabot maintains strong relationships with many of the largest financial service providers in the United Kingdom.

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Cabot also uses insights discovered during its purchasing process to build account collection strategies. Cabot's proprietary consumer-level collectability analysis is the primary determinant of how an account will be serviced post-purchase. Cabot continuously refines this analysis to determine the most effective collection strategy to pursue for each account it owns. In recent years, Cabot has concentrated on buying portfolios that are described as semi-performing in which over 50% of accounts have made a payment in three of the last four months immediately prior to the portfolio purchase. Cabot will try to establish contact with these consumers in order to transfer payment arrangements and gauge the willingness of these consumers to pay. Consumers who Cabot believes are financially incapable of making any payments, those having negative disposable income, or those experiencing hardships (such as medical issues or mental incapacity), are placed on hold and handled outside of normal collections routines.

The remaining pool of accounts in the funnel then receives further evaluation. At that point, Cabot analyzes and determines a consumer's perceived willingness to pay. Based on that analysis, Cabot pursues collections through letters and/or phone calls to its consumers. Where contact is made and consumers indicate a willingness to pay, a patient approach of forbearance is applied using regulatory protocols within the United Kingdom to assess affordability and ensure that plans are fair and balanced and therefore sustainable.

Where consumers are not locatable or refuse to engage in a constructive dialogue, Cabot will pass these accounts through a litigation scorecard and rule set in order to assess suitability for legal action.

## **Tax Lien Business**

Propel's principal activities are the acquisition and servicing of residential and commercial tax liens on real property. These liens take priority over most other liens. By funding tax liens, Propel provides state and local taxing authorities and governments with much needed tax revenue. To the extent permitted by local law, Propel works with property owners to structure affordable payment plans designed to allow them to keep their property while paying their property tax obligation over time. Propel maintains a foreclosure rate of less than one-half of one percent.

Propel's receivables secured by property tax liens include tax lien transfers ( TLTs ) and tax lien certificates ( TLCs ). With TLTs, property owners choose to have the taxing authority transfer their tax lien to Propel. Propel pays their tax lien obligation to the taxing authority and the property owner pays Propel over time at a lower interest rate than is being assessed by the taxing authority. TLTs provide property owners with repayment plans that are both affordable and flexible when compared with other payment options. Propel also purchases TLCs directly from taxing authorities, securing rights to future property tax payments, interest and penalties. In most cases, TLCs continue to be serviced by the taxing authority. When the taxing authority is paid, it repays the Company the outstanding balance of the lien plus interest, which is negotiated at the time of the purchase.

## ***Financial Statement Preparation and Presentation***

The accompanying interim condensed consolidated financial statements have been prepared by Encore, without audit, in accordance with the instructions to the Quarterly Report on Form 10-Q, and Rule 10-01 of Regulation S-X promulgated by the United States Securities and Exchange Commission (the SEC ) and, therefore, do not include all information and footnotes necessary for a fair presentation of its consolidated financial position, results of operations and cash flows in accordance with accounting principles generally accepted in the United States ( GAAP ).

In the opinion of management, the unaudited financial information for the interim periods presented reflects all adjustments, consisting of only normal and recurring adjustments, necessary for a fair presentation of the Company's consolidated financial position, results of operations, and cash flows. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements included in the Company's Annual

Report on Form 10-K for the fiscal year ended December 31, 2012. Operating results for interim periods are not necessarily indicative of operating results for an entire fiscal year.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts and the disclosure of contingent amounts in the Company's financial statements and the accompanying notes. Actual results could materially differ from those estimates.

***Basis of Consolidation***

The consolidated financial statements have been prepared in conformity with GAAP, and reflect the accounts and operations of the Company and those of its subsidiaries in which the Company has a controlling financial interest. The Company also consolidates Variable Interest Entities ( VIE ), for which it is the primary beneficiary. The primary beneficiary has both (a) the power to direct the activities of the VIE that most significantly affect the entity's economic performance, and (b) the obligation to absorb losses or the right to receive benefits. The Company has determined that its less than wholly owned subsidiary Janus Holdings is a VIE, and the Company is the primary beneficiary of the VIE. As a result, the financial results of Janus Holdings are consolidated under the VIE consolidation model. Refer to Note 12, Variable Interest Entity, for further details. The Company evaluates its relationships with the VIE on an ongoing basis to ensure that it continues to be the primary beneficiary. All intercompany transactions and balances have been eliminated in consolidation.

**Table of Contents****Translation of Foreign Currencies**

The financial statements of Janus Holdings are measured using their local currency Great British Pounds as the functional currency. Janus Holdings assets and liabilities are translated as of the end of the balance sheet date and revenue and expenses are translated at an average rate over the period. Currency translation adjustments are recorded as a component of other comprehensive income. Transaction gains and losses are included in other (expense) income.

**Reclassifications**

Certain immaterial amounts in the 2012 consolidated financial statements have been reclassified to conform to the 2013 presentation.

**Note 2: Discontinued Operations**

On May 16, 2012, the Company completed the sale of substantially all of the assets and certain of the liabilities of its bankruptcy servicing subsidiary, Ascension Capital Group, Inc. ( Ascension ), to a subsidiary of American InfoSource, L.P. ( AIS ). As part of the sale, the Company agreed to fund certain agreed-upon operating losses in the first year of AIS ownership of the Ascension business, not to exceed \$4.0 million. If the Ascension business becomes profitable under AIS ownership, the Company will be paid an earn-out equal to 40% of Ascension s EBITDA for the first five years commencing May 16, 2012. The Company received no proceeds from the sale and recognized the entire \$4.0 million loss contingency during the second quarter of 2012. Additionally, the Company did not receive any earn-out from AIS during the first year subsequent to the sale.

During the quarter ending September 30, 2013, the Company incurred \$0.5 million in expense related to Ascension, which is presented as a discontinued operation in the Company s condensed consolidated statements of income for the three and nine months ended September 30, 2013 and 2012. The following table presents the revenue and loss from discontinued operations (*in thousands*):

|   | Three Months Ended<br>September 30, |      | Nine Months Ended<br>September 30, |             |
|---|-------------------------------------|------|------------------------------------|-------------|
|   | 2013                                | 2012 | 2013                               | 2012        |
| Revenue   | \$                                  | \$   | \$                                 | \$ 5,704    |
| Loss from discontinued operations before<br>income taxes        | \$ (500)                            | \$   | \$ (500)                           | \$ (11,942) |
| Income tax benefit  | 192                                 |      | 192                                | 4,678       |
| Loss from discontinued operations                               | (308)                               |      | (308)                              | (7,264)     |
| Loss on sale of discontinued operations,<br>before income taxes |                                     |      |                                    | (2,416)     |
| Income tax benefit  |                                     |      |                                    | 586         |
| Loss on sale of discontinued operations                         |                                     |      |                                    | (1,830)     |
| Total loss from discontinued operations                         | \$ (308)                            | \$   | \$ (308)                           | \$ (9,094)  |

**Note 3: Business Combinations**

***Cabot Acquisition***

On July 1, 2013, the Company, through its wholly owned subsidiary Encore Europe Holdings S.a.r.l. ( *Encore Europe* ), completed its acquisition (the *Cabot Acquisition* ) of 50.1% of the equity interest in Janus Holdings, the indirect holding company of United Kingdom based Cabot from certain funds advised by J.C. Flowers & Co. LLC ( *J.C. Flowers* ) pursuant to a Securities Purchase Agreement (as amended, the *Purchase Agreement* ). Pursuant to the terms and conditions of the Purchase Agreement, Encore Europe purchased from J.C. Flowers: (i) E Bridge preferred equity certificates issued by Janus Holdings, with a face value of £10,218,574 (and any accrued interest thereof) (the *E Bridge PECs* ), (ii) E preferred equity certificates issued by Janus Holdings with a face value of £96,729,661 (and any accrued interest thereof) (the *E PECs* ), (iii) 3,498,563 E shares of Janus Holdings (the *E Shares* ), and (iv) 100 A shares of Cabot Holdings S.a.r.l. ( *Cabot Holdings* ), the direct subsidiary of Janus Holdings, for an aggregate purchase price of approximately £115.1 million. The E Bridge PECs, E PECs, and E Shares represent 50.1% of all of the issued and outstanding equity and debt securities of Janus Holdings. The remaining 49.9% of Janus Holdings' equity and debt securities are owned by J.C. Flowers and include: (a) J Bridge preferred equity certificates with a face value of £10,177,781 (the *J Bridge PECs* ) (represents the amount after the partial redemption of the J Bridge PECs contemplated in the Purchase Agreement and discussed in Note 11, *Debt* ), (b) J preferred equity certificates with a face value of £96,343,515 (the *J PECs* ), (c) 3,484,597 J shares of Janus Holdings (the *J Shares* ), and (d) 100 A shares of Cabot Holdings.



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Through its acquisition of Janus Holdings, the Company's effective equity ownership of Cabot will amount to approximately 42.9%, after reflecting the ownership of the noncontrolling interests and the redemption or conversion of the E Bridge PECs and the J Bridge PECs. The E Bridge PECs and the J Bridge PECs may be redeemed at any time prior to June 18, 2014. Any E Bridge PECs and J Bridge PECs that remain unredeemed as of June 18, 2014 will be converted into E Shares and E PECs, or J Shares and J PECs, as the case may be, in proportion to the number of E Shares and E PECs, or J Shares and J PECs, as applicable, outstanding on the closing date of the Cabot Acquisition. The E Bridge PECs, E PECs, J Bridge PECs and J PECs accrue interest at 12% per annum.

The following diagram summarizes Cabot's corporate structure after the Company's completion of the Cabot Acquisition. Encore has no interest in the J.C. Flowers entities or the employee benefit trust and they are not included in the Company's consolidated financial statements.

The Cabot Acquisition was accounted for using the acquisition method of accounting and, accordingly, the tangible and intangible assets acquired and liabilities assumed were recorded at their estimated fair values as of the date of the acquisition. Fair value measurements have been applied based on assumptions that market participants would use in the pricing of the respective assets and liabilities. As of the date of this Quarterly Report on Form 10-Q, the Company is still finalizing the allocation of the purchase price. The initial purchase price allocation presented below was based on the preliminary assessment of assets acquired and liabilities assumed, which is subject to change based on the final valuation study that is expected to be completed by the second quarter of 2014.

The components of the preliminary purchase price allocation for the Cabot Acquisition are as follows (*in thousands*):

|                                       |                   |
|---------------------------------------|-------------------|
| <b>Purchase price:</b>                |                   |
| Cash paid at acquisition              | \$ 177,246        |
| <b>Allocation of purchase price:</b>  |                   |
| Cash                                  | \$ 57,520         |
| Investment in receivable portfolios   | 558,951           |
| Property and equipment                | 13,672            |
| Other assets                          | 20,772            |
| Preferred equity certificates assumed | (211,549)         |
| Debt assumed                          | (559,907)         |
| Other liabilities assumed             | (44,727)          |
| Redeemable noncontrolling interests   | (12,064)          |
| Noncontrolling interests              | (4,051)           |
| Identifiable intangible assets        | 7,011             |
| Goodwill                              | 351,618           |
| <b>Total net assets acquired</b>      | <b>\$ 177,246</b> |

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The goodwill recognized is primarily attributable to (i) the ability to capitalize on Cabot's existing operating platform to gain immediate access to the debt management business in Europe and (ii) substantial synergies that are expected to be achieved through Cabot's ability to leverage the Company's analytic capacities and efficient operating platform. The entire goodwill of \$351.6 million related to the Cabot Acquisition was assigned to the Company's portfolio purchasing reporting unit and is not deductible for income tax purposes.

As discussed above, the Company purchased a majority interest in Janus Holdings. The Company has determined that Janus Holdings is a VIE and the Company is the primary beneficiary of the VIE. In accordance with authoritative guidance, the Company consolidates the financial results of Janus Holdings under the VIE consolidation model. The J Bridge PECs, J PECs, and any accrued interest are legal form debt, and are included as debt in the Company's consolidated financial statements. In addition, certain other minority owners hold preferred equity certificates at the Cabot Holdings level. These preferred equity certificates and accrued interests are also included as debt. The Company's preliminary valuation study indicated that the fair value of these preferred equity certificates approximates face value. The J shares represent noncontrolling interest at the Janus Holdings level, and the 100 A shares owned by J.C. Flowers represent noncontrolling interest at the Cabot Holdings level, and have been fair valued at the time of acquisition.

In connection with the Cabot Acquisition, the Company entered into an Investors Agreement with J.C. Flowers. Pursuant to the Investors Agreement, J.C. Flowers has the right, at certain times, to offer to sell its interest in Janus Holdings to the Company. The Company would then have the right, but not the obligation, to acquire J.C. Flowers interest at the offered price, or allow J.C. Flowers to offer Janus Holdings for sale to others. As a result, the noncontrolling interests owned by J.C. Flowers have been reflected as redeemable noncontrolling interests in the accompanying condensed consolidated statements of financial condition. The remaining noncontrolling interests represent other minority owners' share of interests in Cabot Holdings.

Total acquisition and integration costs related to the Cabot Acquisition were approximately \$3.3 million and \$6.4 million for the three and nine months ended September 30, 2013, respectively, and have been expensed in the accompanying condensed consolidated statements of income within general and administrative expenses.

The amount of revenue and net income included in the Company's condensed consolidated statement of income for the three months ended September 30, 2013 directly related to the Cabot Acquisition, excluding the acquisition and integration costs, was \$46.5 million and \$4.4 million, respectively. The revenue and loss for the three months ended September 30, 2013 at Janus Holdings was \$46.5 million and \$1.4 million, respectively. This loss is due to the fact that Janus Holdings recognizes all interest expense related to the outstanding preferred equity certificates owed to Encore, J.C. Flowers, and management. The loss attributable to noncontrolling interests included in the Company's consolidated statement of income of \$0.8 million for the three months ended September 30, 2013 represents the total loss at Janus Holdings of \$1.4 million multiplied by the noncontrolling ownership interest of 57.1%. The difference of \$5.8 million between what was included in the Company's financial statements and what was reported by Janus Holdings, represents Encore's share of preferred equity certificate interest income recognized at Encore Europe and the loss attributable to noncontrolling interests.

The following table summarizes the operating performance of Janus Holdings and Encore Europe (*in thousands*):

|  |                      |                     |
|--|----------------------|---------------------|
| <b>Three Months Ended September 30, 2013</b> |                      |                     |
|  | <b>Encore Europe</b> |                     |
| <b>Janus Holdings</b>                        | <b>Encore Europe</b> | <b>Consolidated</b> |

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|   |           |          |           |
|---|-----------|----------|-----------|
| Total revenues                                    | \$ 46,472 | \$       | \$ 46,472 |
| Total operating expenses                          | (23,640)  |          | (23,640)  |
| Income from operations                            | 22,832    |          | 22,832    |
| Interest expense non-PEC                          | (12,319)  |          | (12,319)  |
| PEC interest (expense) income                     | (10,875)  | 4,998    | (5,877)   |
| Other income                                      | 96        |          | 96        |
| (Loss) income before income taxes                 | (266)     | 4,998    | 4,732     |
| Provision for income taxes                        | (1,174)   |          | (1,174)   |
| Net (loss) income                                 | (1,440)   | 4,998    | 3,558     |
| Net loss attributable to noncontrolling interests | 822       |          | 822       |
| Net (loss) income attributable to Encore          | \$ (618)  | \$ 4,998 | \$ 4,380  |

**Table of Contents****AACC Merger**

On June 13, 2013, the Company completed its merger (the AACC Merger) with Asset Acceptance Capital Corp. (AACC), a leading provider of debt management and recovery solutions in the United States. The purchase price consisted of \$150.8 million in cash consideration and 1.7 million shares of Encore common stock valued at \$37.30 per share. In addition, the Company paid off approximately \$165.7 million of AACC debt on the closing date of the AACC Merger.

The AACC Merger was accounted for using the acquisition method of accounting and, accordingly, the tangible and intangible assets acquired and liabilities assumed were recorded at their estimated fair values as of the date of the merger. Fair value measurements have been applied based on assumptions that market participants would use in the pricing of the respective assets and liabilities. As of the date of this Quarterly Report on Form 10-Q, the Company is still finalizing the allocation of the purchase price. The initial purchase price allocation presented below was based on the preliminary assessment of assets acquired and liabilities assumed, which is subject to change based on the final valuation study that is expected to be completed by the second quarter of 2014.

The components of the preliminary purchase price allocation for the AACC Merger are as follows (*in thousands*):

|  |            |
|--|------------|
| <b>Purchase price:</b>                   |            |
| Cash paid at acquisition                 | \$ 316,485 |
| Stock consideration                      | 62,352     |
| <br>                                     |            |
| Total purchase price                     | \$ 378,837 |
| <br><b>Allocation of purchase price:</b> |            |
| Cash                                     | \$ 23,156  |
| Investment in receivable portfolios      | 381,233    |
| Deferred court costs                     | 6,141      |
| Property and equipment                   | 11,003     |
| Other assets                             | 16,004     |
| Liabilities assumed                      | (128,341)  |
| Identifiable intangible assets           | 1,470      |
| Goodwill                                 | 68,171     |
| <br>                                     |            |
| Total net assets acquired                | \$ 378,837 |

The entire goodwill of \$68.2 million related to AACC was assigned to the Company's portfolio purchasing reporting unit and is not deductible for income tax purposes. The goodwill recognized is primarily attributable to expected synergies when combining AACC with the Company.

Total acquisition and integration costs related to the AACC Merger were approximately \$1.8 million and \$7.9 million for the three and nine months ended September 30, 2013, respectively, and were expensed in the accompanying condensed consolidated statements of income within general and administrative expenses. The amount of revenue and net income included in the Company's condensed consolidated statement of income for the three months ended September 30, 2013 related to AACC was \$49.1 million and \$7.3 million, respectively. The amount of revenue and net income included in the Company's condensed consolidated statement of income for the nine months ended

September 30, 2013 related to AACC was \$59.1 million and \$8.2 million, respectively.

The following summary presents unaudited pro forma consolidated results of operations for the three and nine months ended September 30, 2013 and 2012 as if the Cabot Acquisition and AACC Merger had occurred on January 1, 2012. The following unaudited pro forma financial information does not necessarily reflect the actual results that would have occurred had Encore, Cabot, and AACC been combined during the periods presented, nor is it necessarily indicative of the future results of operations of the combined companies (*in thousands*):

|   | <b>Three Months Ended</b> |             | <b>Nine Months Ended</b> |             |
|---|---------------------------|-------------|--------------------------|-------------|
|   | <b>September 30,</b>      |             | <b>September 30,</b>     |             |
|   | <b>2013</b>               | <b>2012</b> | <b>2013</b>              | <b>2012</b> |
| Consolidated pro forma revenue  | \$ 235,558                | \$ 236,693  | \$ 712,237               | \$ 693,718  |
| Consolidated pro forma income from continuing operations attributable to Encore | 22,194                    | 27,743      | 68,731                   | 75,928      |

**Note 4: Earnings per Share**

Basic earnings per share is calculated by dividing net earnings attributable to Encore by the weighted average number of shares of common stock outstanding during the period. Diluted earnings per share is calculated on the basis of the weighted average number of

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shares of common stock plus the effect of dilutive potential common shares outstanding during the period using the treasury stock method. Dilutive potential common shares include outstanding stock options, restricted stock, and the dilutive effect of the convertible senior notes.

A reconciliation of shares used in calculating earnings per basic and diluted shares follows (*in thousands*):

|  | <b>Three Months Ended<br/>September 30,</b> |             | <b>Nine Months Ended<br/>September 30,</b> |             |
|--|---|-------------|--|-------------|
|  | <b>2013</b>                                 | <b>2012</b> | <b>2013</b>                                | <b>2012</b> |
| Weighted average common shares outstanding basic   | 25,535                                      | 25,071      | 24,323                                     | 24,930      |
| Dilutive effect of stock-based awards              | 843   | 976         | 940  | 990         |
| Dilutive effect of convertible senior notes        | 805   |             | 298  |             |
| Weighted average common shares outstanding diluted | 27,183                                      | 26,047      | 25,561                                     | 25,920      |

No anti-dilutive employee stock options were outstanding during the three and nine months ended September 30, 2013. Employee stock options to purchase approximately 210,000 and 335,000 shares of common stock during the three and nine months ended September 30, 2012, respectively, were outstanding but not included in the computation of diluted earnings per share because the effect on diluted earnings per share would be anti-dilutive.

For the three and nine months ended September 30, 2013, diluted earnings per share includes the effect of common shares issuable upon conversion of the Company's convertible senior notes due 2017. During the periods, the notes were convertible at a conversion price equivalent to approximately \$31.56 per share of the Company's common stock as a result of the conditions of the notes. As a result, the amount in excess of the principal is presumed to be settled in common shares and is reflected in the calculation of diluted earnings per share. However, as described in Note 11,

Debt Convertible Senior Notes 2017 Convertible Senior Notes, the convertible note hedge transactions and warrant transactions entered into in connection with the notes have the effect of increasing the effective conversion price of those notes to \$44.1875 per share. For the three and nine months ended September 30, 2012, the Company's convertible senior notes were not convertible at a premium and thus the impact of an assumed conversion was not applicable.

In conjunction with the issuance of convertible senior notes due 2017, the Company sold warrants to purchase approximately 3.6 million shares of its common stock. As of September 30, 2013, all of these warrants were outstanding but were not included in the computation of diluted earnings per share because the warrants' exercise price of \$44.1875 was greater than the average share price of the Company's common stock during the three and nine months ended September 30, 2013; therefore, the effect of the warrants was anti-dilutive for those periods.

**Note 5: Fair Value Measurements**

The authoritative guidance for fair value measurements defines fair value as the price that would be received upon sale of an asset or the price paid to transfer a liability, in an orderly transaction between market participants at the measurement date (*i.e.*, the exit price). The guidance utilizes a fair value hierarchy that prioritizes the inputs used in valuation techniques to measure fair value into three broad levels. The following is a brief description of each level:

Level 1: Observable inputs such as quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2: Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly. These include quoted prices for similar assets or liabilities in active markets and quoted prices for identical or similar assets or liabilities in markets that are not active.

Level 3: Unobservable inputs, including inputs that reflect the reporting entity's own assumptions.

**Table of Contents*****Financial Instruments Required To Be Carried At Fair Value***

Financial assets and liabilities measured at fair value on a recurring basis are summarized below (*in thousands*):

|                                     | <b>Fair Value Measurements as of<br/>September 30, 2013</b> |                |                |              |
|-------------------------------------|---|----------------|----------------|--------------|
|                                     | <b>Level 1</b>  | <b>Level 2</b> | <b>Level 3</b> | <b>Total</b> |
| <b>Assets</b>                       |   |                |                |              |
| Interest rate cap                   | \$  | \$ 206         | \$             | \$ 206       |
| <b>Liabilities</b>                  |   |                |                |              |
| Interest rate swap agreements       | \$  | \$ (139)       | \$             | \$ (139)     |
| Foreign currency exchange contracts |   | (5,567)        |                | (5,567)      |
| <b>Temporary Equity</b>             |   |                |                |              |
| Redeemable noncontrolling interests | \$  | \$             | \$ (12,231)    | \$ (12,231)  |

|                                     | <b>Fair Value Measurements as of<br/>December 31, 2012</b> |                |                |              |
|-------------------------------------|--|----------------|----------------|--------------|
|                                     | <b>Level 1</b>   | <b>Level 2</b> | <b>Level 3</b> | <b>Total</b> |
| <b>Liabilities</b>                  |  |                |                |              |
| Interest rate swap agreements       | \$   | \$ (645)       | \$             | \$ (645)     |
| Foreign currency exchange contracts |  | (2,010)        |                | (2,010)      |

***Derivative Contracts:***

The Company uses derivative instruments to minimize its exposure to fluctuations in interest rates and foreign currency exchange rates. The Company's derivative instruments primarily include interest rate swap agreements and foreign currency exchange contracts. Fair values of these derivative instruments are estimated using industry standard valuation models. These models project future cash flows and discount the future amounts to a present value using market-based observable inputs, including interest rate curves, foreign currency exchange rates, and forward and spot prices for currencies.

***Redeemable Noncontrolling Interests:***

As discussed in Note 3, *Business Combinations*, the minority shareholder in the Company's Janus Holdings subsidiary, J.C. Flowers, has the right, at certain times, to offer to sell its interest in Janus Holdings to the Company. The Company would then have the right, but not the obligation, to acquire J.C. Flowers' interest at the offered price, or allow J.C. Flowers to offer Janus Holdings for sale to others. The noncontrolling interests subject to this arrangement are included in temporary equity as redeemable noncontrolling interests, and are adjusted to their estimated redemption amounts each reporting period with a corresponding adjustment to additional paid-in capital. Future reductions in the carrying amounts are subject to a floor amount that is equal to the fair value of the redeemable noncontrolling interests at the time they were originally recorded. The recorded value of the redeemable noncontrolling interests cannot go below the floor level. These adjustments will not affect the calculation of earnings per share. There is no change in fair value of the redeemable noncontrolling interests for the three months ended September 30, 2013. The components of the change in the redeemable noncontrolling interests for the periods ended September 30, 2013 are presented in the following table:



|  | <b>September 30,<br/>2013</b> |        |
|--|-------------------------------|--------|
| Balance at beginning of period   | \$                            |        |
| Initial redeemable noncontrolling interest related to business combination                 |                               | 12,064 |
| Net loss attributable to redeemable noncontrolling interests                               |                               | (615)  |
| Effect of foreign currency translation attributable to redeemable noncontrolling interests |                               | 782    |
| Balance at end of period   | \$                            | 12,231 |

***Financial Instruments Not Required To Be Carried At Fair Value***

*Investment in Receivable Portfolios:*

The Company records its investment in receivable portfolios at cost, which represents a significant discount from the contractual receivable balances due. The Company computes the fair value of its investment in receivable portfolios by discounting the estimated future cash flows generated by its proprietary forecasting models, using an estimated market participant cost to collect of approximately 50.3% and a discount rate of approximately 12.0% for United States portfolios and an estimated market participant cost to collect of approximately 29.7% and a discount rate of approximately 18.2% for United Kingdom portfolios. Using this method, the fair value of investment in receivable portfolios approximates book value as of September 30, 2013 and December 31, 2012, respectively. A 100 basis point fluctuation in the cost to collect and discount rate used would result in an increase or decrease in the fair value by approximately \$37.9 million and \$18.3 million, respectively, as of September 30, 2013. This fair value calculation does not represent, and should not be construed to represent, the underlying value of the Company or the amount which could be realized if its investment in receivable

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portfolios were sold. The carrying value of the investment in receivable portfolios was \$1.6 billion and \$873.1 million as of September 30, 2013 and December 31, 2012, respectively.

### *Deferred Court Costs:*

The Company capitalizes deferred court costs and provides a reserve for those costs that it believes will ultimately be uncollectible. The carrying value of net deferred court costs approximates fair value.

### *Receivables Secured By Property Tax Liens:*

The fair value of receivables secured by property tax liens is estimated as follows: for TLT receivables, the fair value is estimated by discounting the future cash flows of the portfolio using a discount rate equivalent to the current rate at which similar portfolios would be originated and; for TLC receivables, the fair value is estimated by discounting the expected future cash flows of the portfolio using a discount rate equivalent to the interest rate expected when acquiring these certificates. The carrying value of receivables secured by property tax liens approximates fair value. Additionally, the carrying value of the related interest receivable also approximates fair value.

### *Debt:*

Encore's senior secured notes and borrowings under its revolving credit and term loan facilities are carried at historical amount, adjusted for additional borrowings less principal repayments, which approximate fair value.

Encore's convertible senior notes are carried at historical cost, adjusted for the debt discount. The carrying value of the convertible senior notes was \$287.5 million, net of debt discount of \$43.8 million, and \$115.0 million, net of debt discount of \$14.4 million as of September 30, 2013 and December 31, 2012, respectively. The fair value estimate for these convertible senior notes incorporates quoted market prices, which was approximately \$384.7 million and \$128.3 million as of September 30, 2013 and December 31, 2012, respectively.

Cabot's senior secured notes due 2019 are carried at the fair value determined at the time of the Cabot Acquisition. Cabot's senior secured notes due 2020 are carried at historical cost. The carrying values of both the Cabot senior secured notes approximate their respective fair values.

Cabot's senior revolving credit facility is carried at historical costs, adjusted for additional borrowings less principal repayments, which approximate fair value.

The Company's preferred equity certificates are legal obligations to the noncontrolling shareholders at its Janus Holdings and Cabot Holdings subsidiaries. They are carried at the face amount, plus any accrued interest. The Company determined, at the time of the Cabot Acquisition and at September 30, 2013, that the carrying value of these preferred equity certificates approximates fair value.

## **Note 6: Derivatives and Hedging Instruments**

The Company uses derivative instruments to manage risks related to interest rates and foreign currency. The Company's outstanding interest rate swap contracts and foreign currency exchange contracts qualify for hedge accounting treatment under the authoritative guidance for derivatives and hedging. The Company's Cabot subsidiary also holds an interest rate cap that is used to manage its risk related to interest rate fluctuations. The Company does not apply hedge accounting on the interest rate cap contract. The impact of the interest rate cap contract to the Company's consolidated financial statements for the three months ended September 30, 2013, was immaterial.

***Interest Rate Swaps***

The Company may periodically enter into derivative financial instruments, typically interest rate swap agreements, to reduce its exposure to fluctuations in interest rates on variable interest rate debt and their impact on earnings and cash flows. As of September 30, 2013, the Company had three interest rate swap agreements outstanding with a total notional amount of \$75.0 million. Under the swap agreements, the Company receives floating interest rate payments based on one-month reserve-adjusted LIBOR and makes interest payments based on fixed interest rates. The Company intends to continue electing the one-month reserve-adjusted LIBOR as the benchmark interest rate on the debt being hedged through its term. No credit spread was hedged. The Company designates its interest rate swap instruments as cash flow hedges.

The authoritative accounting guidance requires companies to recognize derivative instruments as either an asset or liability measured at fair value in the statement of financial position. The effective portion of the change in fair value of the derivative instrument is recorded in other comprehensive income ( OCI ). The ineffective portion of the change in fair value of the derivative instrument, if any, is recognized in interest expense in the period of change. From the inception of the hedging program, the Company has determined that the hedging instruments are highly effective.

**Table of Contents*****Foreign Currency Exchange Contracts***

The Company has operations in India, which exposes the Company to foreign currency exchange rate fluctuations due to transactions denominated in Indian rupees, such as employee salaries and rent expenditures. To mitigate this risk, the Company enters into derivative financial instruments, principally forward contracts, which are designated as cash flow hedges, to mitigate fluctuations in the cash payments of future forecasted transactions in Indian rupees for up to 36 months. The Company adjusts the level and use of derivatives as soon as practicable after learning that an exposure has changed and reviews all exposures and derivative positions on an ongoing basis.

Gains and losses on cash flow hedges are recorded in OCI until the hedged transaction is recorded in the consolidated financial statements. Once the underlying transaction is recorded in the consolidated financial statements, the Company reclassifies the OCI on the derivative into earnings. If all or a portion of the forecasted transaction is cancelled, this would render all or a portion of the cash flow hedge ineffective and the Company would reclassify the ineffective portion of the hedge into earnings. The Company generally does not experience ineffectiveness of the hedge relationship and the accompanying consolidated financial statements do not include any such gains or losses.

As of September 30, 2013, the total notional amount of the forward contracts to buy Indian rupees in exchange for United States dollars was \$52.8 million. As of September 30, 2013, all outstanding contracts qualified for hedge accounting treatment. The Company estimates that approximately \$2.2 million of net derivative loss included in OCI will be reclassified into earnings within the next 12 months. No gains or losses were reclassified from OCI into earnings as a result of forecasted transactions that failed to occur during the three and nine months ended September 30, 2013 and 2012.

The Company may periodically enter into other foreign currency exchange contracts to mitigate its risk that cash flows and earnings will be adversely affected by foreign currency exchange rate fluctuations. In anticipation of the Cabot Acquisition, on June 7, 2013, the Company entered into a European style zero-cost collar foreign exchange contract with a notional amount of £132.1 million (approximately \$206.0 million), which was equal to the anticipated purchase price for the Cabot Acquisition. The collar was set to expire on August 13, 2013, which was the anticipated date of closing of the Cabot Acquisition. The collar was used to offset the risk of changes in the foreign exchange rate relating to the purchase price for the Company's interest in Janus Holdings. The Company did not apply hedge accounting on this foreign exchange contract. Due to the early closing of the Cabot Acquisition, the foreign exchange contract was terminated on June 28, 2013 at a loss of \$3.6 million, which was recorded as other expenses in the Company's condensed consolidated statements of income in the second quarter of 2013 and is included in the nine months ended September 30, 2013. This foreign exchange loss was offset by a decrease in the estimated purchase price for Cabot of approximately \$4.3 million.

The Company does not enter into derivative instruments for trading or speculative purposes.

The following table summarizes the fair value of derivative instruments as recorded in the Company's condensed consolidated statements of financial condition (*in thousands*):

|  | September 30, 2013 |            | December 31, 2012 |            |
|--|--------------------|------------|-------------------|------------|
|  | Balance Sheet      |            | Balance Sheet     |            |
|  | Location           | Fair Value | Location          | Fair Value |
| Derivatives designated as hedging instruments: |                    |            |                   |            |

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|  |                   |          |                   |          |
|--|-------------------|----------|-------------------|----------|
| Interest rate swaps                                | Other liabilities | \$ (139) | Other liabilities | \$ (645) |
| Foreign currency exchange contracts                | Other liabilities | (5,567)  | Other liabilities | (2,010)  |
| Derivatives not designated as hedging instruments: |                   |          |                   |          |
| Interest rate cap                                  | Other assets      | 206      |                   |          |

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|                                     | Gain or (Loss)<br>Recognized in OCI-<br>Effective Portion<br>Three Months Ended<br>September 30, |        | Location of Gain<br>or (Loss)<br>Reclassified from<br>OCI into<br>Income - Effective<br>Portion | Gain or (Loss)<br>Reclassified<br>from OCI into<br>Income - Effective<br>Portion<br>Three Months Ended<br>September 30, |       | Location of<br>Gain or (Loss)<br>Recognized -<br>Ineffective<br>Portion and<br>Amount<br>Excluded from<br>Effectiveness<br>Testing | Amount of<br>Gain or (Loss)<br>Recognized -<br>Ineffective<br>Portion and<br>Amount<br>Excluded from<br>Effectiveness<br>Testing<br>Three Months Ended<br>September 30, |      |
|-------------------------------------|--|--------|---|---|-------|--|---|------|
|                                     | 2013   | 2012   |   | 2013  | 2012  |  | 2013  | 2012 |
| Interest rate swaps                 | \$ 132   | \$ 62  | Interest expense  | \$  | \$    | Other (expense) income   | \$  | \$   |
| Foreign currency exchange contracts | (1,871)  | 2,131  | Salaries and employee benefits  | (622)   | (389) | Other (expense) income   |   |      |
| Foreign currency exchange contracts | (381)  | 377    | General and administrative expenses   | (119)   | (69)  | Other (expense) income   |   |      |
|                                     |  |        |   |   |       |  |   |      |
|                                     | Gain or (Loss)<br>Recognized in OCI-<br>Effective Portion<br>Nine Months Ended<br>September 30,  |        | Location of Gain<br>or (Loss)<br>Reclassified from<br>OCI into<br>Income - Effective<br>Portion | Gain or (Loss)<br>Reclassified<br>from OCI into<br>Income - Effective<br>Portion<br>Nine Months Ended<br>September 30,  |       | Location of<br>Gain or (Loss)<br>Recognized -<br>Ineffective<br>Portion and<br>Amount<br>Excluded from<br>Effectiveness<br>Testing | Amount of<br>Gain or (Loss)<br>Recognized -<br>Ineffective<br>Portion and<br>Amount<br>Excluded from<br>Effectiveness<br>Testing<br>Nine Months Ended<br>September 30,  |      |
|                                     | 2013   | 2012   |   | 2013  | 2012  |  | 2013  | 2012 |
| Interest rate swaps                 | \$ 506   | \$ (9) | Interest expense  | \$  | \$    | Other (expense) income   | \$  | \$   |
| Foreign currency exchange contracts | (3,809)  | (69)   | Salaries and employee benefits  | (890)   | (946) | Other (expense) income   |   |      |
| Foreign currency                    | (809)  | 173    | General and administrative  | (171)   | (164) | Other (expense) income   |   |      |

**Note 7: Investment in Receivable Portfolios, Net**

In accordance with the authoritative guidance for loans and debt securities acquired with deteriorated credit quality, discrete receivable portfolio purchases during a quarter are aggregated into pools based on common risk characteristics. Once a static pool is established, the portfolios are permanently assigned to the pool. The discount (*i.e.*, the difference between the cost of each static pool and the related aggregate contractual receivable balance) is not recorded because the Company expects to collect a relatively small percentage of each static pool's contractual receivable balance. As a result, receivable portfolios are recorded at cost at the time of acquisition. The purchase cost of the portfolios includes certain fees paid to third parties incurred in connection with the direct acquisition of the receivable portfolios.

In compliance with the authoritative guidance, the Company accounts for its investments in receivable portfolios using either the interest method or the cost recovery method. The interest method applies an internal rate of return ( IRR ) to the cost basis of the pool, which remains unchanged throughout the life of the pool, unless there is an increase in subsequent expected cash flows. Subsequent increases in expected cash flows are generally recognized prospectively through an upward adjustment of the pool's IRR over its remaining life. Subsequent decreases in expected cash flows do not change the IRR, but are recognized as an allowance to the cost basis of the pool, and are reflected in the consolidated statements of comprehensive income as a reduction in revenue, with a corresponding valuation allowance, offsetting the investment in receivable portfolios in the consolidated statements of financial condition.

The Company utilizes its proprietary forecasting models to continuously evaluate the economic life of each pool. The collection forecast of each pool is generally estimated to be between 84 to 96 months based on the expected collection period of each pool (up to 120 months for Cabot's semi-performing pools). The Company often experiences collections beyond the 84 to 96 month collection forecast. As of September 30, 2013, the total estimated remaining collections beyond the 84 to 96 month collection forecast, which are not



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included in the calculation of the Company's IRRs, were \$142.6 million. The collection forecast estimates for Cabot include a 120 month collection period which is included in its estimated remaining collections and is used for calculating its IRRs.

The Company accounts for each static pool as a unit for the economic life of the pool (similar to one loan) for recognition of revenue from receivable portfolios, for collections applied to the cost basis of receivable portfolios, and for provision for loss or allowance. Revenue from receivable portfolios is accrued based on each pool's IRR applied to each pool's adjusted cost basis. The cost basis of each pool is increased by revenue earned and decreased by gross collections and portfolio allowances.

If the amount and timing of future cash collections on a pool of receivables are not reasonably estimable, the Company accounts for such portfolios on the cost recovery method as Cost Recovery Portfolios. The accounts in these portfolios have different risk characteristics than those included in other portfolios acquired during the same quarter, or the necessary information was not available to estimate future cash flows and, accordingly, they were not aggregated with other portfolios. Under the cost recovery method of accounting, no income is recognized until the purchase price of a Cost Recovery Portfolio has been fully recovered.

Accretable yield represents the amount of revenue the Company expects to generate over the remaining life of its existing investment in receivable portfolios based on estimated future cash flows. Total accretable yield is the difference between future estimated collections and the current carrying value of a portfolio. All estimated cash flows on portfolios where the cost basis has been fully recovered are classified as zero basis cash flows.

The following table summarizes the Company's accretable yield and an estimate of zero basis future cash flows at the beginning and end of the period presented (*in thousands*):

|   | <b>Accretable<br/>Yield</b> | <b>Estimate of<br/>Zero Basis<br/>Cash Flows</b> | <b>Total</b> |
|---|-----------------------------|--|--------------|
| Balance at December 31, 2012                        | \$ 984,944                  | \$ 17,366  | \$ 1,002,310 |
| Revenue recognized, net                             | (135,072)                   | (5,611)  | (140,683)    |
| Net additions to existing portfolios <sup>(1)</sup> | 173,634                     | 7,061  | 180,695      |
| Additions for current purchases <sup>(1)</sup>      | 66,808                      |  | 66,808       |
| Balance at March 31, 2013                           | \$ 1,090,314                | \$ 18,816  | \$ 1,109,130 |
| Revenue recognized, net                             | (144,186)                   | (7,838)  | (152,024)    |
| Net additions to existing portfolios <sup>(1)</sup> | 30,458                      | 10,784   | 41,242       |
| Additions for current purchases <sup>(1), (2)</sup> | 645,865                     |  | 645,865      |
| Balance at June 30, 2013                            | \$ 1,622,451                | \$ 21,762  | \$ 1,644,213 |
| Revenue recognized, net                             | (218,182)                   | (7,205)  | (225,387)    |

|   |              |           |              |
|---|--------------|-----------|--------------|
| Net additions to existing portfolios <sup>(1)</sup> | 29,101       | 3,048     | 32,149       |
| Additions for current purchases <sup>(1), (2)</sup> | 975,380      |           | 975,380      |
| Balance at September 30, 2013                       | \$ 2,408,750 | \$ 17,605 | \$ 2,426,355 |

|   | Accretable Yield | Estimate of Zero Basis Cash Flows | Total        |
|---|------------------|-----------------------------------|--------------|
| Balance at December 31, 2011                        | \$ 821,527       | \$ 32,676                         | \$ 854,203   |
| Revenue recognized, net                             | (119,340)        | (7,065)                           | (126,405)    |
| Net additions to existing portfolios <sup>(1)</sup> | 131,039          | 3,608                             | 134,647      |
| Additions for current purchases <sup>(1)</sup>      | 119,533          |                                   | 119,533      |
| Balance at March 31, 2012                           | \$ 952,759       | \$ 29,219                         | \$ 981,978   |
| Revenue recognized, net                             | (131,624)        | (7,107)                           | (138,731)    |
| Net additions to existing portfolios <sup>(1)</sup> | 77,473           | 13,738                            | 91,211       |
| Additions for current purchases <sup>(1)</sup>      | 178,332          |                                   | 178,332      |
| Balance at June 30, 2012                            | \$ 1,076,940     | \$ 35,850                         | \$ 1,112,790 |
| Revenue recognized, net                             | (134,295)        | (6,387)                           | (140,682)    |
| Net additions to existing portfolios <sup>(1)</sup> | 71,730           | (2,041)                           | 69,689       |
| Additions for current purchases <sup>(1)</sup>      | 36,387           |                                   | 36,387       |
| Balance at September 30, 2012                       | \$ 1,050,762     | \$ 27,422                         | \$ 1,078,184 |

(1) Estimated remaining collections and accretable yield include anticipated collections beyond the 84 to 96 month collection forecast for United States portfolios.

(2) Includes \$381.2 million of portfolios acquired in connection with the AACC Merger and \$559.0 million of portfolios acquired in connection with the Cabot Acquisition discussed in Note 3, Business Combinations.

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During the three months ended September 30, 2013, the Company purchased receivable portfolios with a face value of \$13.4 billion for \$617.9 million, or a purchase cost of 4.6% of face value. Purchases of charged-off credit card, telecom and consumer bankruptcy portfolios include \$559.0 million of portfolios acquired in conjunction with the Cabot Acquisition. The estimated future collections at acquisition for all portfolios purchased during the quarter amounted to \$1.5 billion.

During the nine months ended September 30, 2013, the Company purchased receivable portfolios with a face value of \$83.9 billion for \$1.1 billion, or a purchase cost of 1.3% of face value. Purchases of charged-off credit card, telecom and consumer bankruptcy portfolios include \$559.0 million of portfolios acquired in conjunction with the Cabot Acquisition and \$381.2 million acquired in conjunction with the AACC Merger. The lower purchase rate for the nine months ended September 30, 2013 is due to the portfolio acquired in conjunction with the AACC Merger, which included all portfolios owned, including accounts that have no value and which the Company has no intention to collect. No-value accounts would typically not be included in a portfolio purchase transaction, as the sellers would remove them from the sale file. The estimated future collections at acquisition for all portfolios purchased during the nine months ended September 30, 2013, amounted to \$2.6 billion.

During the three months ended September 30, 2012, the Company purchased receivable portfolios with a face value of \$1.1 billion for \$47.3 million, or a purchase cost of 4.5% of face value. The estimated future collections at acquisition for these portfolios amounted to \$80.4 million. During the nine months ended September 30, 2012, the Company purchased receivable portfolios with a face value of \$10.0 billion for \$408.8 million, or a purchase cost of 4.1% of face value. The estimated future collections at acquisition for these portfolios amounted to \$717.3 million.

All collections realized after the net book value of a portfolio has been fully recovered ( Zero Basis Portfolios ) are recorded as revenue ( Zero Basis Revenue ). During the three months ended September 30, 2013 and 2012, Zero Basis Revenue was approximately \$4.2 million and \$5.5 million, respectively. During the nine months ended September 30, 2013 and 2012, Zero Basis Revenue was approximately \$13.6 million and \$17.6 million, respectively.

The following tables summarize the changes in the balance of the investment in receivable portfolios during the following periods (*in thousands, except percentages*):

|   | <b>Three Months Ended September 30, 2013</b> |                                     |                                  |              |
|---|--|-------------------------------------|----------------------------------|--------------|
|   | <b>Accrual Basis<br/>Portfolios</b>          | <b>Cost Recovery<br/>Portfolios</b> | <b>Zero Basis<br/>Portfolios</b> | <b>Total</b> |
| Balance, beginning of period                          | \$ 1,090,922                                 | \$ 5,776                            | \$                               | \$ 1,096,698 |
| Purchases of receivable portfolios <sup>(1)</sup>     | 616,779                                      | 1,073                               |                                  | 617,852      |
| Gross collections <sup>(2)</sup>                      | (371,482)                                    | (983)                               | (7,205)                          | (379,670)    |
| Put-backs and recalls                                 | (755)  | (242)                               |                                  | (997)        |
| Foreign currency adjustments                          | 36,372                                       |                                     |                                  | 36,372       |
| Revenue recognized                                    | 218,182                                      |                                     | 4,227                            | 222,409      |
| Portfolio allowances reversals, net                   |  |                                     | 2,978                            | 2,978        |
| Balance, end of period                                | \$ 1,590,018                                 | \$ 5,624                            | \$                               | \$ 1,595,642 |
| Revenue as a percentage of collections <sup>(3)</sup> | 58.7%  | 0.0%                                | 58.7%                            | 58.6%        |

## Three Months Ended September 30, 2012

|  | Accrual Basis<br>Portfolios | Cost Recovery<br>Portfolios | Zero Basis<br>Portfolios | Total      |
|--|-----------------------------|-----------------------------|--------------------------|------------|
| Balance, beginning of period                                 | \$ 869,859                  | \$                          | \$                       | \$ 869,859 |
| Purchases of receivable portfolios                           | 47,311                      |                             |                          | 47,311     |
| Gross collections <sup>(2)</sup>                             | (239,577)                   |                             | (6,388)                  | (245,965)  |
| Put-backs and recalls  | (267)                       |                             |                          | (267)      |
| Revenue recognized   | 134,496                     |                             | 5,469                    | 139,965    |
| (Portfolio allowances) portfolio allowance<br>reversals, net | (202)                       |                             | 919                      | 717        |
| Balance, end of period                                       | \$ 811,620                  | \$                          | \$                       | \$ 811,620 |
| Revenue as a percentage of collections <sup>(3)</sup>        | 56.1%                       | 0.0%                        | 85.6%                    | 56.9%      |

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|   | <b>Accrual Basis<br/>Portfolios</b> | <b>Cost Recovery<br/>Portfolios</b> | <b>Zero Basis<br/>Portfolios</b> | <b>Total</b>        |
|---|-------------------------------------|-------------------------------------|----------------------------------|---------------------|
| Balance, beginning of period                          | \$ 873,119                          | \$                                  | \$                               | \$ 873,119          |
| Purchases of receivable portfolios <sup>(1)</sup>     | 1,098,663                           | 1,073                               |                                  | 1,099,736           |
| Transfer of portfolios                                | (6,649)                             | 6,649                               |                                  |                     |
| Gross collections <sup>(2)</sup>                      | (905,751)                           | (1,825)                             | (20,652)                         | (928,228)           |
| Put-backs and recalls                                 | (2,512)                             | (273)                               | (2)                              | (2,787)             |
| Foreign currency adjustments                          | 35,708                              |                                     |                                  | 35,708              |
| Revenue recognized                                    | 496,804                             |                                     | 13,632                           | 510,436             |
| Portfolio allowances reversals, net                   | 636                                 |                                     | 7,022                            | 7,658               |
| <b>Balance, end of period</b>                         | <b>\$ 1,590,018</b>                 | <b>\$ 5,624</b>                     | <b>\$</b>                        | <b>\$ 1,595,642</b> |
| Revenue as a percentage of collections <sup>(3)</sup> | 54.8%                               | 0.0%                                | 66.0%                            | 55.0%               |

**Nine Months Ended September 30, 2012**

|   | <b>Accrual Basis<br/>Portfolios</b> | <b>Cost Recovery<br/>Portfolios</b> | <b>Zero Basis<br/>Portfolios</b> | <b>Total</b>      |
|---|-------------------------------------|-------------------------------------|----------------------------------|-------------------|
| Balance, beginning of period                              | \$ 716,454                          | \$                                  | \$                               | \$ 716,454        |
| Purchases of receivable portfolios                        | 408,757                             |                                     |                                  | 408,757           |
| Gross collections <sup>(2)</sup>                          | (696,957)                           |                                     | (20,560)                         | (717,517)         |
| Put-backs and recalls                                     | (1,892)                             |                                     |                                  | (1,892)           |
| Revenue recognized  | 386,685                             |                                     | 17,627                           | 404,312           |
| (Portfolio allowances) portfolio allowance reversals, net | (1,427)                             |                                     | 2,933                            | 1,506             |
| <b>Balance, end of period</b>                             | <b>\$ 811,620</b>                   | <b>\$</b>                           | <b>\$</b>                        | <b>\$ 811,620</b> |
| Revenue as a percentage of collections <sup>(3)</sup>     | 55.5%                               | 0.0%                                | 85.7%                            | 56.3%             |

(1) Purchases of portfolio receivables include \$381.2 million acquired in connection with the AACC Merger in June 2013 and \$559.0 million acquired in connection with the Cabot Acquisition in July 2013 discussed in Note 3, Business Combinations.

(2) Does not include amounts collected on behalf of others.

(3) Revenue as a percentage of collections excludes the effects of net portfolio allowances or net portfolio allowance reversals.

The following table summarizes the change in the valuation allowance for investment in receivable portfolios during the periods presented (*in thousands*):

|                                    | <b>Valuation Allowance</b>              |             |  |             |
|------------------------------------|---|-------------|--|-------------|
|                                    | <b>Three Months Ended September 30,</b> |             | <b>Nine Months Ended September 30,</b> |             |
|                                    | <b>2013</b>                             | <b>2012</b> | <b>2013</b>                            | <b>2012</b> |
| Balance at beginning of period     | \$ 100,593                              | \$ 108,705  | \$ 105,273                             | \$ 109,494  |
| Provision for portfolio allowances |   | 1,616       | 479                                    | 5,491       |
| Reversal of prior allowances       | (2,978)                                 | (2,333)     | (8,137)                                | (6,997)     |
| Balance at end of period           | \$ 97,615                               | \$ 107,988  | \$ 97,615                              | \$ 107,988  |

The Company currently utilizes various business channels for the collection of its receivables. The following table summarizes the total collections by collection channel and geographic area (*in thousands*):

|                                    | <b>Three Months Ended September 30,</b> |             | <b>Nine Months Ended September 30,</b> |             |
|------------------------------------|---|-------------|--|-------------|
|                                    | <b>2013</b>                             | <b>2012</b> | <b>2013</b>                            | <b>2012</b> |
| <b>United States:</b>              |   |             |  |             |
| Legal collections                  | \$ 153,556                              | \$ 111,334  | \$ 409,511                             | \$ 335,782  |
| Collection sites                   | 119,080                                 | 116,928     | 362,495                                | 338,439     |
| Collection agencies <sup>(1)</sup> | 39,607                                  | 17,715      | 88,795                                 | 43,344      |
| Subtotal                           | 312,243                                 | 245,977     | 860,801                                | 717,565     |
| <b>United Kingdom:</b>             |   |             |  |             |
| Collection sites                   | 37,931                                  |             | 37,931                                 |             |
| Collection agencies                | 29,496                                  |             | 29,496                                 |             |

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|                   | Three Months Ended September 30, 2013 |            | Nine Months Ended September 30, 2012 |            |
|-------------------|---------------------------------------|------------|--------------------------------------|------------|
|                   | 2013                                  | 2012       | 2013                                 | 2012       |
| Subtotal          | 67,427                                |            | 67,427                               |            |
| Total collections | \$ 379,670                            | \$ 245,977 | \$ 928,228                           | \$ 717,565 |

- (1) Collections through our collection agency channel in the United States include accounts subject to bankruptcy filings collected by others. Additionally, collection agency collections often include accounts purchased from a competitor where we maintain the collection agency servicing until the accounts can be recalled and placed in our collection channels.

**Note 8: Receivables Secured by Property Tax Liens, Net**

The Company's receivables secured by property tax liens include TLTs and TLCs. Repayment of the tax liens is generally dependent on the property owner but can also come through payments from other lien holders or foreclosure on the properties. The Company evaluates the entire portfolio of tax liens for impairment. The primary factor the Company uses to evaluate each receivable is the lien to value ratio, which is typically less than 15% and rarely exceeds 25%. The Company has not experienced any losses on receivables secured by property tax liens in its portfolio. In addition, management believes, based on the fact that the tax liens that collateralize the TLTs and TLCs are in a priority position over most other liens on the properties, that it will not experience any material losses on the ultimate collection of these receivables. Therefore, no allowance has been provided for as of September 30, 2013.

The following table presents the Company's aging analysis of receivables secured by tax liens as of September 30, 2013 and December 31, 2012 (*in thousands*):

|                       | September 30,<br>2013 | December 31,<br>2012 |
|-----------------------|-----------------------|----------------------|
| Current               | \$ 113,985            | \$ 101,052           |
| 31-60 days past due   | 12,500                | 10,175               |
| 61-90 days past due   | 4,269                 | 1,982                |
| > 90 days past due    | 24,530                | 21,891               |
| Tax lien transfer     | 155,284               | 135,100              |
| Tax lien certificates | 30,906                |                      |
|                       | \$ 186,190            | \$ 135,100           |

**Note 9: Deferred Court Costs, Net**

Within the United States, the Company contracts with a nationwide network of attorneys that specialize in collection matters. The Company generally refers charged-off accounts to its contracted attorneys when it believes the related consumer has sufficient assets to repay the indebtedness and has, to date, been unwilling to pay. In connection with the Company's agreement with the contracted attorneys, it advances certain out-of-pocket court costs ( Deferred Court

Costs ). The Company capitalizes Deferred Court Costs in its consolidated financial statements and provides a reserve for those costs that it believes will ultimately be uncollectible. The Company determines the reserve based on its analysis of court costs that have been advanced and those that have been recovered. Historically, the Company wrote off Deferred Court Costs not recovered within three years of placement. However, as a result of a history of court cost recoveries beyond three years, the Company has determined that court costs are recovered over a longer period of time. As a result, in January 2013, on a prospective basis, the Company began increasing its deferral period from three years to five years. Collections received from these debtors are first applied against related court costs with the balance applied to the debtors' account.

Deferred Court Costs consist of the following as of the dates presented (*in thousands*):

|                       | <b>September 30,<br/>2013</b> | <b>December 31,<br/>2012</b> |
|-----------------------|-------------------------------|------------------------------|
| Court costs advanced  | \$ 365,714                    | \$ 279,314                   |
| Court costs recovered | (132,750)                     | (94,827)                     |
| Court costs reserve   | (193,960)                     | (149,080)                    |
|                       | \$ 39,004                     | \$ 35,407                    |



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A roll forward of the Company's court cost reserve is as follows (*in thousands*):

|  | <b>Court Cost Reserve</b> |              |                          |              |
|--|---------------------------|--------------|--------------------------|--------------|
|  | <b>Three Months Ended</b> |              | <b>Nine Months Ended</b> |              |
|  | <b>September 30,</b>      |              | <b>September 30,</b>     |              |
|  | <b>2013</b>               | <b>2012</b>  | <b>2013</b>              | <b>2012</b>  |
| Balance at beginning of period                 | \$ (176,094)              | \$ (132,780) | \$ (149,080)             | \$ (130,454) |
| Provision for court costs                      | (17,866)                  | (13,378)     | (44,880)                 | (37,536)     |
| Write-off of reserve after the deferral period |                           | 5,651        |                          | 27,483       |
| Balance at end of period                       | \$ (193,960)              | \$ (140,507) | \$ (193,960)             | \$ (140,507) |

**Note 10: Other Assets**

Other assets consist of the following (*in thousands*):

|  | <b>September 30,</b> | <b>December 31,</b> |
|--|----------------------|---------------------|
|  | <b>2013</b>          | <b>2012</b>         |
| Debt issuance costs, net of amortization | \$ 29,275            | \$ 14,397           |
| Prepaid income taxes                     | 24,975               |                     |
| Deferred tax assets                      | 13,229               |                     |
| Service fee receivable                   | 12,662               |                     |
| Prepaid expenses                         | 12,710               | 6,399               |
| Identifiable intangible assets, net      | 10,481               | 487                 |
| Interest receivable                      | 6,851                | 4,042               |
| Security deposit India building leases   | 2,405                | 1,696               |
| Recoverable legal fees                   | 2,573                | 1,521               |
| Other                                    | 5,280                | 2,993               |
|  | \$ 120,441           | \$ 31,535           |

**Note 11: Debt**

The Company is in compliance with all covenants under its financing arrangements. The components of the Company's consolidated debt and capital lease obligations are as follows (*in thousands*):

|                                  | <b>September 30,</b> | <b>December 31,</b> |
|----------------------------------|----------------------|---------------------|
|                                  | <b>2013</b>          | <b>2012</b>         |
| Encore revolving credit facility | \$ 343,000           | \$ 258,000          |
| Encore term loan facility        | 166,813              | 148,125             |
| Encore senior secured notes      | 62,500               | 72,500              |

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|                               |              |            |
|-------------------------------|--------------|------------|
| Encore convertible notes      | 287,500      | 115,000    |
| Less: Debt discount           | (43,846)     | (14,442)   |
| Propel TLT facility           | 131,292      | 117,601    |
| Propel TLC facility           | 26,977       |            |
| Cabot senior secured notes    | 591,081      |            |
| Add: Debt premium             | 44,164       |            |
| Preferred equity certificates | 190,279      |            |
| Capital lease obligations     | 6,920        | 9,252      |
|                               | \$ 1,806,680 | \$ 706,036 |

***Encore Revolving Credit Facility and Term Loan Facility***

Encore's Amended and Restated Credit Agreement (the Restated Credit Agreement) includes a term loan facility tranche of \$150.0 million, a six-month term loan facility tranche of \$48.6 million, a revolving credit facility tranche of \$613.9 million and an accordion feature that would allow the Company to increase the revolving credit facility by an additional \$162.5 million. Including the accordion feature, the maximum amount that can be borrowed under the Restated Credit Agreement is \$975.0 million. The term loan facility and the revolving credit facility have five-year maturities expiring in November 2017, except with respect to a \$50.0 million subtranche of the term loan facility, which has a three-year maturity, expiring in November 2015. The \$48.6 million six-month term loan facility tranche matures in November 2013. The Restated Credit Agreement includes several financial institutions and lenders and is led by an administrative agent.

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The Restated Credit Agreement includes a basket to allow for investments in unrestricted subsidiaries and a subordinated debt basket of \$300.0 million, among other things.

Provisions of the Restated Credit Agreement include, but are not limited to:

A revolving loan of \$613.9 million, interest at a floating rate equal to, at the Company's option, either: (1) reserve adjusted London Interbank Offered Rate ( LIBOR ), plus a spread that ranges from, depending on the Company's cash flow leverage ratio, 250 to 300 basis points; or (2) Alternate Base Rate, plus a spread that ranges from, depending on the Company's cash flow leverage ratio, 150 to 200 basis points. Alternate Base Rate, as defined in the agreement, means the highest of (i) the per annum rate which the administrative agent publicly announces from time to time as its prime lending rate, as in effect from time to time, (ii) the federal funds effective rate from time to time, plus 0.5% and (iii) reserved adjusted LIBOR determined on a daily basis for a one month interest period, plus 1.0%;

A \$100.0 million five-year term loan, interest at a floating rate equal to, at the Company's option, either: (1) reserve adjusted LIBOR, plus a spread that ranges from 250 to 300 basis points, depending on the Company's cash flow leverage ratio; or (2) Alternate Base Rate, plus a spread that ranges from 150 to 200 basis points, depending on the Company's cash flow leverage ratio. Principal amortizes \$1.3 million in 2012, \$5.0 million in 2013, \$5.6 million in 2014, \$8.1 million in 2015, \$10.0 million in 2016, and \$5.0 million in 2017 with the remaining principal due at the end of the term;

A \$50.0 million three-year term loan, interest at a floating rate equal to, at the Company's option, either: (1) reserve adjusted LIBOR, plus a spread that ranges from 200 to 250 basis points, depending on the Company's cash flow leverage ratio; or (2) Alternate Base Rate, plus a spread that ranges from 100 to 150 basis points, depending on the Company's cash flow leverage ratio. Principal amortizes \$0.6 million in 2012, \$2.5 million in 2013, \$2.8 million in 2014, \$2.8 million in 2015 with the remaining principal due at the end of the term;

A \$48.6 million six-month term loan, interest at a floating rate equal to, at the Company's option, either: (1) reserve adjusted LIBOR, plus a spread that ranges from 250 to 300 basis points, depending on the Company's cash flow leverage ratio; or (2) Alternate Base Rate, plus a spread that ranges from 150 to 200 basis points, depending on the Company's cash flow leverage ratio. Principal amortizes in six equal monthly installments;

A borrowing base equal to (1) the lesser of (i) (a) 55% of eligible estimated remaining collections for consumer receivables subject to bankruptcy proceedings, provided that the amount described in this clause (i)(a) may not exceed 35% of the amount described in clauses (i)(a) and (i)(b), plus (b) 30% 35% (depending on the Company's trailing 12-month cost per dollar collected) of all other eligible estimated remaining collections, initially set at 33%, and (ii) the product of the net book value of all receivable portfolios acquired on or after January 1, 2005 multiplied by 95%, minus (2) (x) the aggregate principal amount outstanding of the Senior Secured Notes (as defined below) plus (y) the aggregate principal amount outstanding under the term loans;

The allowance of additional unsecured indebtedness not to exceed \$300.0 million;

Restrictions and covenants, which limit the payment of dividends and the incurrence of additional indebtedness and liens, among other limitations;

Repurchases of up to \$50.0 million of Encore's common stock, subject to compliance with certain covenants and available borrowing capacity. The Company has repurchased approximately \$50.0 million common stock during the fourth quarter of 2012 and in January 2013;

A change of control definition, which excludes acquisitions of stock by Red Mountain Capital Partners LLC, JCF FPK LLP and their respective affiliates of up to 50% of the outstanding shares of Encore's voting stock;

Events of default which, upon occurrence, may permit the lenders to terminate the facility and declare all amounts outstanding to be immediately due and payable;

An acquisition limit of \$100.0 million; and

Collateralization by all assets of the Company, other than the assets of the Propel entities or any foreign or unrestricted subsidiaries.

At September 30, 2013, the outstanding balance under the Restated Credit Agreement was \$509.8 million, which bore a weighted average interest rate of 3.07% and 4.16% for the three months ended September 30, 2013 and 2012, respectively, and a weighted average interest rate of 3.13% and 4.13% for the nine months ended September 30, 2013 and 2012, respectively.

***Encore Senior Secured Notes***

In 2010 and 2011, Encore entered into an aggregate of \$75.0 million in senior secured notes with certain affiliates of Prudential Capital Group (the Senior Secured Notes ). \$25.0 million of the Senior Secured Notes bear an annual interest rate of 7.375%, mature in 2018 and require quarterly principal amortization payments of \$1.25 million. Prior to May 2013, these notes required quarterly payments

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of interest only. Prior to May 2013, these notes required quarterly interest payments only. The remaining \$50.0 million of Senior Secured Notes bear an annual interest rate of 7.75%, mature in 2017 and require quarterly principal amortization payments of \$2.5 million. Prior to December 2012, these notes required quarterly interest payments only. As of September 30, 2013, \$62.5 million is outstanding under these obligations.

The Senior Secured Notes are guaranteed in full by certain of Encore's subsidiaries. Similar to, and *pari passu* with, Encore's credit facility, the Senior Secured Notes are also collateralized by all assets of the Company other than the assets of the Propel entities and any foreign and unrestricted subsidiaries including Janus Holdings. The Senior Secured Notes may be accelerated and become automatically and immediately due and payable upon certain events of default, including certain events related to insolvency, bankruptcy, or liquidation. Additionally, the Senior Secured Notes may be accelerated at the election of the holder or holders of a majority in principal amount of the Senior Secured Notes upon certain events of default by Encore, including the breach of affirmative covenants regarding guarantors, collateral, most favored lender treatment, minimum revolving credit facility commitment or the breach of any negative covenant. If Encore prepays the Senior Secured Notes at any time for any reason, payment will be at the higher of par or the present value of the remaining scheduled payments of principal and interest on the portion being prepaid. The discount rate used to determine the present value is 50 basis points over the then current Treasury Rate corresponding to the remaining average life of the senior secured notes. The covenants are substantially similar to those in the Restated Credit Agreement. Prudential Capital Group and the administrative agent for the lenders of the Restated Credit Agreement have an intercreditor agreement related to their pro rata rights to the collateral, actionable default, powers and duties and remedies, among other topics. The terms of the Senior Secured Notes were amended and restated on May 9, 2013 in connection with the Restated Credit Agreement in order to properly align certain provisions between the two agreements.

***Encore Convertible Senior Notes*****2017 Convertible Senior Notes**

On November 27, 2012, Encore sold \$100.0 million in aggregate principal amount of 3.0% convertible senior notes due November 27, 2017 in a private placement transaction. On December 6, 2012, the initial purchasers exercised, in full, their option to purchase an additional \$15.0 million of the convertible senior notes, which resulted in an aggregate principal amount of \$115.0 million of the convertible senior notes outstanding (collectively, the 2017 Convertible Notes). Interest on the 2017 Convertible Notes is payable semi-annually, in arrears, on May 27 and November 27 of each year, beginning on May 27, 2013. The 2017 Convertible Notes are the Company's general unsecured obligations. The 2017 Convertible Notes will be convertible into cash up to the aggregate principal amount of the 2017 Convertible Notes to be converted and the Company will pay or deliver, as the case may be, cash, shares of the Company's common stock or a combination of cash and shares of the Company's common stock, at the Company's election, in respect of the remainder, if any, of the Company's conversion obligation in excess of the aggregate principal amount of the 2017 Convertible Notes being converted. The 2017 Convertible Notes will be convertible at an initial conversion rate of 31.6832 shares of the Company's common stock per \$1,000 principal amount of 2017 Convertible Notes, subject to adjustment upon certain events, which is equivalent to an initial conversion price of approximately \$31.56 per share of the Company's common stock. As of September 30, 2013, none of the conditions allowing holders of the 2017 Convertible Notes to convert their notes had occurred.

In accordance with authoritative guidance related to derivatives and hedging and earnings per share calculation, only the conversion spread of the 2017 Convertible Notes is included in the diluted earnings per share calculation, if dilutive. Under such method, the settlement of the conversion spread has a dilutive effect when the average share price of the Company's common stock during any quarter exceeds \$31.56. The average share price of the Company's common stock for the three and nine months ended September 30, 2013 exceeded \$31.56. The dilutive effect from the

2017 Convertible Notes was approximately 0.8 million and 0.3 million shares for the three and nine months ended September 30, 2013, respectively. See Note 4, Earnings per Share for additional information.

Concurrent with the pricing of the 2017 Convertible Notes, the Company entered into privately negotiated convertible note hedge transactions (together, the Convertible Note Hedge Transactions ) with certain counterparties. The Convertible Note Hedge Transactions collectively cover, subject to customary anti-dilution adjustments, the number of shares of the Company s common stock underlying the 2017 Convertible Notes, as described below. Concurrently with entering into the Convertible Note Hedge Transactions, the Company also entered into separate, privately negotiated warrant transactions (together, the Warrant Transactions ) with the same counterparties, whereby the Company sold to the counterparties warrants to purchase, collectively, subject to customary anti-dilution adjustments, up to the same number of shares of the Company s common stock as in the Convertible Note Hedge Transactions. Subject to certain conditions, the Company may settle the warrants in cash or on a net-share basis.

The Convertible Note Hedge Transactions are expected generally to reduce the potential dilution and/or offset the potential cash payments the Company is required to make in excess of the principal amount upon conversion of the 2017 Convertible Notes in the event that the market price per share of the Company s common stock, is greater than the strike price of the Convertible Note Hedge Transactions, which initially corresponds to the conversion price of the 2017 Convertible Notes and is subject to anti-dilution adjustments. If, however, the market price per share of the Company s common stock, as measured under the terms of the Warrant Transactions, exceeds the strike price of the warrants, there would nevertheless be dilution to the extent that such market price exceeds the strike price of the warrants, unless the Company elects, subject to certain conditions, to settle the Warrant Transactions in cash. The strike price of the

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Warrant Transactions will initially be \$44.1875 per share of the Company's common stock and is subject to certain adjustments under the terms of the Warrant Transactions. Taken together, the Convertible Note Hedge Transactions and the Warrant Transactions have the effect of increasing the effective conversion price of the 2017 Convertible Notes to \$44.1875 per share. The average share price of the Company's common stock for the three months ended September 30, 2013 did not exceed \$44.1875.

The Convertible Note Hedge Transactions and the Warrant Transactions are separate transactions, in each case, entered into by the Company with certain counterparties, and are not part of the terms of the 2017 Convertible Notes and will not affect any holder's rights under the 2017 Convertible Notes. Holders of the 2017 Convertible Notes will not have any rights with respect to the Convertible Note Hedge Transactions or the Warrant Transactions. In accordance with authoritative guidance, the Company recorded the net cost of the Convertible Note Hedge Transactions and the Warrant Transactions as a reduction in additional paid in capital, and will not recognize subsequent changes in fair value of these financial instruments in its consolidated financial statements.

**2020 Convertible Senior Notes**

On June 24, 2013, Encore sold \$150.0 million in aggregate principal amount of 3.0% convertible senior notes due July 1, 2020 in a private placement transaction. On July 18, 2013, the initial purchasers exercised, in full, their option to purchase an additional \$22.5 million of the convertible senior notes, which resulted in an aggregate principal amount of \$172.5 million of the convertible senior notes outstanding (collectively, the 2020 Convertible Notes). The 2020 Convertible Notes are general unsecured obligations of the Company. Interest on the 2020 Convertible Notes is payable semi-annually, in arrears, on January 1 and July 1 of each year, beginning on January 1, 2014. Prior to January 1, 2020, the 2020 Convertible Notes will be convertible only during specified periods, if certain conditions are met. On or after January 1, 2020, the 2020 Convertible Notes will be convertible regardless of these conditions. Upon conversion, holders will receive cash, shares of the Company's common stock or a combination of cash and shares of the Company's common stock, at the Company's election. The conversion rate for the 2020 Convertible Notes is 21.8718 shares per \$1,000 principal amount, which is equivalent to an initial conversion price of approximately \$45.72 per share of common stock. As of September 30, 2013, none of the conditions allowing holders of the 2020 Convertible Notes to convert their notes had occurred.

As noted above, upon conversion, holders of the Company's 2020 Convertible Notes will receive cash, shares of the Company's common stock or a combination of cash and shares of the Company's common stock, at the Company's election. However, the Company's current intent is to settle conversions through combination settlement (*i.e.*, convertible into cash up to the aggregate principal amount, and shares of the Company's common stock or a combination of cash and shares of the Company's common stock, at the Company's election, for the remainder). As a result and in accordance with authoritative guidance related to derivatives and hedging and earnings per share, only the conversion spread is included in the diluted earnings per share calculation, if dilutive. Under such method, the settlement of the conversion spread has a dilutive effect when the average share price of the Company's common stock during any quarter exceeds \$45.72.

In connection with the pricing of the 2020 Convertible Notes, the Company entered into privately negotiated capped call transactions (the Capped Call Transactions) with one or more of the initial purchasers (or their affiliates) and one or more other financial institutions (the Option Counterparties). The Capped Call Transactions cover, collectively, the number of shares of the Company's common stock underlying the 2020 Convertible Notes, subject to anti-dilution adjustments substantially similar to those applicable to the 2020 Convertible Notes. The cost of the Capped Call Transactions was approximately \$18.1 million. In accordance with authoritative guidance, the Company recorded the net cost of the Capped Call Transactions as a reduction in additional paid in capital, and will not recognize subsequent changes in fair value of these financial instruments in its consolidated financial statements.



The Capped Call Transactions are expected generally to reduce the potential dilution and/or offset the cash payments the Company is required to make in excess of the principal amount upon conversion of the 2020 Convertible Notes in the event that the market price of the Company's common stock is greater than the strike price of the Capped Call Transactions (which initially corresponds to the initial conversion price of the 2020 Convertible Notes and is subject to certain adjustments under the terms of the Capped Call Transactions), with such reduction and/or offset subject to a cap based on the cap price of the Capped Call Transactions. The cap price of the Capped Call Transactions is \$61.5475 per share, and is subject to certain adjustments under the terms of the Capped Call Transactions.

The Capped Call Transactions are separate transactions, in each case, entered into by the Company with the Option Counterparties, and are not part of the terms of the 2020 Convertible Notes and will not affect any holder's rights under the 2020 Convertible Notes. Holders of the 2020 Convertible Notes do not have any rights with respect to the Capped Call Transactions.

The net proceeds from the sale of the 2020 Convertible Notes were approximately \$167.4 million, after deducting the initial purchasers' discounts and commissions and the estimated offering expenses paid by the Company. The Company used approximately \$18.1 million of the net proceeds from this offering to pay the cost of the Capped Call Transactions and used the remainder of the net proceeds from this offering to pay a portion of the purchase price for the Cabot Acquisition and for general corporate purposes.

The Company determined that the fair value of the 2020 Convertible Notes at the date of issuance was approximately \$140.2 million, and designated the residual value of approximately \$32.3 million as the equity component. Additionally, the Company allocated approximately \$4.9 million of the \$6.0 million original 2020 Convertible Notes issuance cost as debt issuance costs and the remaining \$1.1 million as equity issuance costs.

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Authoritative guidance related to debt with conversion and other options requires that, for convertible debt instruments that may be settled fully or partially in cash upon conversion, issuers must separately account for the liability and equity components in a manner that will reflect the entity's nonconvertible debt borrowing rate when interest cost is recognized in subsequent periods. Additionally, debt issuance costs are required to be allocated in proportion to the allocation of the liability and equity components and accounted for as debt issuance costs and equity issuance costs, respectively.

The balances of the liability and equity components of all of the convertible notes outstanding were as follows (*in thousands*):

|  | <b>September 30,<br/>2013</b> | <b>December 31,<br/>2012</b> |
|--|-------------------------------|------------------------------|
| Liability component principal amount           | \$ 287,500                    | \$ 115,000                   |
| Unamortized debt discount                      | (43,846)                      | (14,442)                     |
| <b>Liability component net carrying amount</b> | <b>\$ 243,654</b>             | <b>\$ 100,558</b>            |
| Equity component                               | \$ 46,954                     | \$ 14,702                    |

The debt discount is being amortized into interest expense over the remaining life of the convertible notes using the effective interest rates, which are 6.0 % and 6.35% for the 2017 and 2020 Convertible Notes, respectively.

Interest expense related to the convertible notes was as follows (*in thousands*):

|   | <b>Three Months Ended<br/>September 30,<br/>2013</b> | <b>Nine Months Ended<br/>September 30, 2013</b> |
|---|--|---|
| Interest expense stated coupon rate             | \$ 2,141   | \$ 3,947  |
| Interest expense amortization of debt discount  | 1,570  | 2,887   |
| <b>Total interest expense convertible notes</b> | <b>\$ 3,711</b>                                      | <b>\$ 6,834</b>                                 |

***Propel Tax Lien Transfer Facility***

Propel has a \$160.0 million syndicated loan facility (the Propel TLT Facility).

The Propel TLT Facility has a three-year term and includes the following key provisions:

Interest at Propel's option, at either: (1) LIBOR, plus a spread that ranges from 300 to 375 basis points, depending on Propel's cash flow leverage ratio; or (2) Prime Rate, which is defined in the agreement as the rate of interest per annum equal to the sum of (a) the interest rate quoted in the

Money Rates section of *The Wall Street Journal* from time to time and designated as the Prime Rate *plus* (b) the Prime Rate Margin, which is a spread that ranges from 0 to 75 basis points, depending on Propel's cash flow leverage ratio;

A borrowing base of 90% of the face value of the tax lien collateralized payment arrangements;

Interest payable monthly; principal and interest due at maturity;

Restrictions and covenants, which limit, among other things, the payment of dividends and the incurrence of additional indebtedness and liens;

Events of default which, upon occurrence, may permit the lender to terminate the Propel TLT Facility and declare all amounts outstanding to be immediately due and payable; and

A \$40.0 million accordion feature.

The Propel TLT Facility is primarily collateralized by the TLT tax liens and requires Propel to maintain various financial covenants, including a minimum interest coverage ratio and a maximum cash flow leverage ratio.

At September 30, 2013, the outstanding balance on the Propel TLT Facility was \$131.3 million, which bore a weighted average interest rate of 3.64% and 3.54% for the three months ended September 30, 2013 and 2012, respectively, and a weighted average interest rate of 3.52% and 3.56% for the nine months ended September 30, 2013 and 2012, respectively.

#### ***Propel Tax Lien Certificate Facility***

On May 9, 2013, the Company, through subsidiaries of Propel, entered into a \$100.0 million revolving credit facility (the Propel TLC Facility). The Propel TLC Facility is used to purchase TLCs from taxing authorities.

The Propel TLC Facility has a four-year term and includes the following key provisions:

During the first two years of the four-year term, the committed amount can be drawn on a revolving basis. During the following two years, no additional draws are permitted, and all proceeds from the TLCs are used to repay any amounts

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outstanding under the facility. After the four-year period ends, if any amounts are still outstanding, an alternate interest rate applies until all amounts owed are repaid;

Prior to the expiration of the four-year term, interest at a per annum floating rate equal to LIBOR plus a spread of 325 basis points;

Following the expiration of the four-year term or upon the occurrence of an event of default, interest at 400 basis points plus the greater of (i) a per annum floating rate equal to LIBOR plus a spread of 325 basis points, or (ii) Prime Rate, which is defined in the agreement as the rate most recently announced by the lender at its branch in San Francisco, California, from time to time as its prime commercial rate for United States dollar-denominated loans made in the United States;

Proceeds from the TLCs are applied to pay interest, principal and other obligations incurred in connection with the Propel TLC Facility on a monthly basis as defined in the agreement;

Special purpose entity covenants designed to protect the bankruptcy-remoteness of the borrowers and additional restrictions and covenants, which limit, among other things, the payment of certain dividends, the occurrence of additional indebtedness and liens and use of the collections proceeds from the TLCs; and

Events of default which, upon occurrence, may permit the lender to terminate the Propel TLC Facility and declare all amounts outstanding to be immediately due and payable.

The Propel TLC Facility is collateralized by the TLCs acquired under the Propel TLC Facility. At September 30, 2013, the outstanding balance on the Propel TLC Facility was \$27.0 million and, for the three and nine months ended September 30, 2013, bore a weighted average interest rate of 5.34% and 5.11%, respectively.

***Cabot Senior Secured Notes***

On September 20, 2012, Cabot Financial (Luxembourg) S.A. ( Cabot Financial ), an indirect subsidiary of Janus Holdings, issued £265.0 million in aggregate principal amount of 10.375% Senior Secured Notes due 2019 (the Cabot 2019 Notes ). Interest on the Cabot 2019 Notes is payable semi-annually, in arrears, on April 1 and October 1 of each year.

On August 2, 2013, Cabot Financial issued £100 million in aggregate principal amount of 8.375% Senior Secured Notes due 2020 (the Cabot 2020 Notes and, together with the Cabot 2019 Notes, the Cabot Notes ). Interest on the Cabot 2020 Notes is payable semi-annually, in arrears, on February 1 and August 1 of each year, beginning on February 1, 2014. The total debt issuance cost associated with the Cabot 2020 Notes was approximately \$4.9 million.

Of the proceeds from the issuance of the Cabot 2020 Notes, approximately £75 million was used to repay all amounts outstanding under the senior credit facilities of Cabot Financial (UK) Limited ( Cabot Financial UK ), an indirect subsidiary of Janus Holdings, £25 million was used to partially repay a portion of the J Bridge PECs (as anticipated in the Purchase Agreement discussed in Note 3, Business Combinations ) to J.C. Flowers.

The Cabot Notes are fully and unconditionally guaranteed by the following indirect subsidiaries of the Company: Cabot, Cabot Financial Limited, and all material subsidiaries of Cabot Financial Limited (other than Cabot Financial). The Cabot Notes are secured by a first ranking security interest in all the outstanding shares of Cabot Financial and the guarantors (other than Cabot) and substantially all the assets of Cabot Financial and the guarantors (other than Cabot).

Interest expense related to the Cabot Notes was as follows (*in thousands*):

|                               |                              | <b>Three Months Ended<br/>September 30, 2013</b> |
|-------------------------------|------------------------------|--|
| Interest expense              | stated coupon rate           | \$ 12,857  |
| Interest income               | appreciation of debt premium | (1,367)  |
| <b>Total interest expense</b> | <b>Cabot Notes</b>           | <b>\$ 11,490</b>                                 |

***Cabot Senior Revolving Credit Facility***

On September 20, 2012, Cabot Financial UK entered into an agreement for a senior committed revolving credit facility of £50.0 million (the Cabot Credit Agreement ). This agreement was amended and restated on June 28, 2013 to increase the size of the revolving credit facility to £85.0 million (the Cabot Credit Facility ).

The Cabot Credit Facility has a five-year term expiring in September 2017, and includes the following key provisions:

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Interest at LIBOR plus a maximum of 4.0% depending on the loan to value ( LTV ) ratio determined quarterly, calculated as being the ratio of the net financial indebtedness of Cabot (as defined in the Cabot Credit Agreement) to Cabot's estimated remaining collections capped at 84-months;

A restrictive covenant that limits the LTV ratio to 0.75;

Additional restrictions and covenants which limit, among other things, the payment of dividends and the incurrence of additional indebtedness and liens; and

Events of default which, upon occurrence, may permit the lenders to terminate the Cabot Credit Facility and declare all amounts outstanding to be immediately due and payable.

The Cabot Credit Facility is unconditionally guaranteed by the following indirect subsidiaries of the Company: Cabot, Cabot Financial Limited, and all material subsidiaries of Cabot Financial Limited. The Cabot Notes are secured by a first ranking security interest in all the outstanding shares of Cabot Financial UK and the guarantors (other than Cabot) and substantially all the assets of Cabot Financial UK and the guarantors (other than Cabot).

At September 30, 2013, there were no outstanding borrowings under the Cabot Credit Facility.

## ***Preferred Equity Certificates***

As discussed in Note 3, *Business Combinations*, on July 1, 2013, the Company, through Encore Europe, completed the Cabot Acquisition by acquiring E Bridge PECs, E PECs, and E Shares that represent 50.1% of all of the issued and outstanding equity and debt securities of Janus Holdings. The remaining 49.9% of Janus Holdings' equity and debt securities constitute J Bridge PECs, J PECs, and J shares owned by J.C. Flowers. All of the PECs accrue interest at 12% per annum. In accordance with authoritative guidance related to debt and equity securities, the J Bridge PECs, J PECs and any accrued interests thereof are classified as liabilities and are included in debt in the Company's accompanying condensed consolidated statements of financial condition. In addition, certain other minority owners hold PECs at the Cabot Holdings level (the *Management PECs*). These PECs are also included in debt in the Company's accompanying condensed consolidated statements of financial condition. The E Bridge PECs and E PECs held by the Company, and their related interest eliminate in consolidation and therefore are not included in debt. As noted above, the J Bridge PECs, J PECs and Management PECs are included in debt in the Company's accompanying condensed consolidated statements of financial condition. However, as these liabilities are held by the noncontrolling interest holders and do not require the payment of cash interest expense, they have characteristics similar to equity with a preferred return. The ultimate payment of the accumulated interest would be satisfied only in connection with the disposition of the noncontrolling interests of J.C. Flowers and management.

The Company determined, at the time of the Cabot Acquisition, that the fair value of the preferred equity certificates and the respective accrued interests approximated their face value.

As anticipated in the Purchase Agreement, and as discussed in Note 3, *Business Combinations*, in August 2013, Cabot made a payment of approximately \$41.2 million to J.C. Flowers for a partial redemption of the J Bridge PECs.

As of September 30, 2013, the outstanding balance of the PECs and their accrued interests was \$190.3 million.

## ***Capital Lease Obligations***

The Company has capital lease obligations primarily for computer equipment. As of September 30, 2013, the Company's combined obligations for these equipment leases were approximately \$6.9 million. These lease obligations require monthly or quarterly payments through May 2018 and have implicit interest rates that range from zero to approximately 7.7%.

**Note 12: Variable Interest Entity**

On July 1, 2013, the Company, through Encore Europe, completed its acquisition of 50.1% of the equity interest in Janus Holdings. See Note 3, "Business Combinations" for more information. The Company has determined that Janus Holdings is a VIE, and the Company is the primary beneficiary of the VIE. As a result, the financial results of Janus Holdings are consolidated under the VIE consolidation model. A VIE is defined as a legal entity whose equity owners do not have sufficient equity at risk, or, as a group, the holders of the equity investment at risk lack any of the following three characteristics: decision-making rights, the obligation to absorb losses, or the right to receive the expected residual returns of the entity. The primary beneficiary is identified as the variable interest holder that has both the power to direct the activities of the VIE that most significantly affect the entity's economic performance and the obligation to absorb expected losses or the right to receive benefits from the entity that could potentially be significant to the VIE. The key activities that affect Cabot's economic performance include, but are not limited to, operational budgets and purchasing decisions. Through its control of the board of directors of Cabot's immediate parent company, the Company controls the key operating activities at Cabot. The Company evaluates its relationships with the VIE on an ongoing basis to ensure that it continues to be the primary beneficiary.

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The Company considers that the rights granted to J.C. Flowers under the contractual arrangements are more protective in nature rather than participating rights.

The Company does not intend to provide financial support to Janus Holdings.

The Company's consolidated assets as of September 30, 2013 included assets from Janus Holdings that can only be used to settle obligations of Janus Holdings. The Company's consolidated liabilities as of September 30, 2013, included liabilities of Janus Holdings, whose creditors have no recourse to the Company. The following table presents Janus Holdings' assets and liabilities (after elimination of intercompany transactions and balances) in the Company's consolidated statement of financial position as of September 30, 2013 (*in thousands*):

|  | <b>September 30,<br/>2013</b> |                  |
|--|-------------------------------|------------------|
| <b>Assets</b>                            |                               |                  |
| Cash and cash equivalents                | \$                            | 54,584           |
| Investment in receivable portfolios, net |                               | 596,160          |
| Property and equipment, net              |                               | 14,249           |
| Other assets                             |                               | 32,102           |
| Goodwill                                 |                               | 369,912          |
| <b>Total assets</b>                      | <b>\$</b>                     | <b>1,067,007</b> |
| <b>Liabilities</b>                       |                               |                  |
| Accounts payable and accrued liabilities | \$                            | 31,817           |
| Deferred tax liabilities, net            |                               | 6,978            |
| Debt                                     |                               | 825,524          |
| Other liabilities                        |                               | 113              |
| <b>Total liabilities</b>                 | <b>\$</b>                     | <b>864,432</b>   |

**Note 13: Income Taxes**

During the three months ended September 30, 2013 and 2012, the Company recorded an income tax provision of \$10.3 million and \$13.9 million, respectively. During the nine months ended September 30, 2013 and 2012, the Company recorded an income tax provision of \$30.1 million and \$38.4 million, respectively.

The effective tax rates for the respective periods are shown below:

|   | <b>Three Months Ended September 30,</b> |             | <b>Nine Months Ended September 30,</b> |             |
|---|---|-------------|--|-------------|
|   | <b>2013</b>                             | <b>2012</b> | <b>2013</b>                            | <b>2012</b> |
| Federal provision                             | 35.0%                                   | 35.0%       | 35.0%                                  | 35.0%       |
| State provision                               | 5.2%                                    | 6.5%        | 5.2%                                   | 6.5%        |
| State benefit                                 | (1.8%)                                  | (2.3%)      | (1.8%)                                 | (2.3%)      |
| Changes in state apportionment <sup>(1)</sup> | (4.0%)                                  | (0.5%)      | (1.7%)                                 | 0.7%        |



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|  |        |        |        |        |
|--|--------|--------|--------|--------|
| Tax reserves <sup>(2)</sup>            | 1.8%   | 0.0%   | 0.7%   | 0.0%   |
| International provision <sup>(3)</sup> | (4.8%) | (0.5%) | (2.0%) | (0.6%) |
| Permanent items <sup>(4)</sup>         | 1.1%   | 1.3%   | 1.3%   | 0.4%   |
| Effective rate                         | 32.5%  | 39.5%  | 36.7%  | 39.7%  |

(1) Represents changes in state apportionment methodologies.

(2) Represents reserves taken for certain tax position adopted by the Company.

(3) Relates primarily to the lower tax rate on the income attributable to Cabot.

(4) Represents a provision for nondeductible items.

The Company's subsidiary in Costa Rica is operating under a 100% tax holiday through December 31, 2018 and a 50% tax holiday for the subsequent four years. The impact of the tax holiday in Costa Rica for the three and nine months ended September 30, 2013 and 2012 was immaterial.

As of September 30, 2013, the Company had a gross unrecognized tax benefit of \$17.6 million that, if recognized, would result in a net tax benefit of approximately \$15.3 million and would have a positive effect on the Company's effective tax rate. During the three and nine months ended September 30, 2013, there was an increase in the gross unrecognized tax benefit of \$2.2 million primarily as a result of the Cabot acquisition as discussed in Note 3, Business Combinations.

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During the three and nine months ended September 30, 2013, the Company did not provide for United States income taxes or foreign withholding taxes on the quarterly undistributed earnings from continuing operations of its subsidiaries operating outside of the United States. Undistributed earnings of these subsidiaries during the three and nine months ended September 30, 2013, were approximately \$1.5 million and \$4.7 million, respectively. Such undistributed earnings are considered permanently reinvested.

**Note 14: Purchase Concentrations**

The following table summarizes purchases by seller sorted by total aggregate cost (*in thousands, except percentages*):

|  | <b>Nine Months Ended<br/>September 30, 2013</b> |               |
|--|---|---------------|
|  | <b>Cost</b>                                     | <b>%</b>      |
| Portfolios acquired in Cabot Acquisition | \$ 558,951                                      | 50.8%         |
| Portfolios acquired in AACC Merger       | 381,233   | 34.7%         |
| Seller 1                                 | 24,610  | 2.2%          |
| Seller 2                                 | 24,067  | 2.2%          |
| Seller 3                                 | 17,151  | 1.6%          |
| Other sellers                            | 93,724  | 8.5%          |
| <b>Total purchases</b>                   | <b>\$ 1,099,736</b>                             | <b>100.0%</b> |

**Note 15: Commitments and Contingencies*****Litigation***

The Company is involved in disputes and legal actions from time to time in the ordinary course of business. The Company, along with others in its industry, is routinely subject to legal actions in the United States based on the Fair Debt Collection Practices Act ( FDCPA ), comparable state statutes, the Telephone Consumer Protection Act ( TCPA ), state and federal unfair competition statutes, and common law causes of action. The violations of law alleged in these actions often include claims that the Company lacks specified licenses to conduct its business, attempts to collect debts on which the statute of limitations has run, has made inaccurate assertions of fact in support of its collection actions, and/or has acted improperly in connection with its efforts to contact consumers. These cases are frequently styled as supposed class actions.

On March 8, 2013, March 19, 2013 and March 20, 2013, three actions entitled *Shell v. Asset Acceptance Capital Corp., et. al.*, *Neumann v. Asset Acceptance Capital Corp., et. al.*, and *Jaluka v. Asset Acceptance Capital Corp. et. al.*, respectively, were filed in the Macomb County Circuit Court of the State of Michigan. On April 19, 2013, a fourth action entitled *Dix v. Asset Acceptance Capital Corp. et al* was filed in the Court of Chancery of the State of Delaware. These actions were brought by purported stockholders of AACC, against the Company, AACC, and certain other named entities and individuals, and allege, among other things, that the Company has aided and abetted AACC's directors in breaching their fiduciary duties of care, loyalty and candor or disclosure owed to AACC stockholders. Plaintiffs in the actions sought, among other things, injunctive relief prohibiting consummation of the proposed acquisition, or rescission of the proposed acquisition (in the event the transaction has already been consummated), as well as costs and disbursements, including reasonable attorneys' and experts' fees, and other equitable or injunctive relief as the court may deem just and proper. The plaintiffs did not specify the dollar amount of damages sought in

each action. On June 2, 2013, AACC entered into a Memorandum of Understanding (the "MOU") with the plaintiffs in the Michigan actions and Delaware action that sets forth the parties' agreement in principle for settlement. As explained in the MOU, without admitting any wrongdoing, AACC agreed to make certain additional disclosures related to the proposed merger, and to enter into a stipulation of settlement providing for the certification of a class, for settlement purposes only, that includes certain persons or entities who held shares of AACC common stock and the release of all asserted claims. On September 16, 2013, AACC entered into a stipulation of settlement which sets forth the terms of the MOU. On October 7, 2013, the Michigan court preliminarily approved the stipulation of settlement. Upon final approval by the Michigan court, which has yet to and may not occur, the attorneys for the class members intend to seek an award of attorneys' fees and costs incurred in a total amount not to exceed \$550,000, which the defendants have agreed to not oppose.

Except as described above and in the Company's Quarterly Reports on Form 10-Q for the quarters ended March 31, 2013 and June 30, 2013, there have been no material developments in any of the legal proceedings disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2012.

In certain legal proceedings, the Company may have recourse to insurance or third party contractual indemnities to cover all or portions of its litigation expenses, judgments, or settlements. In accordance with authoritative guidance, the Company records loss contingencies in its financial statements only for matters in which losses are probable and can be reasonably estimated. Where a range of loss can be reasonably estimated with no best estimate in the range, the Company records the minimum estimated liability. The Company continuously assesses the potential liability related to the Company's pending litigation and revises its estimates when additional

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information becomes available. As of September 30, 2013, the Company has no material reserves for litigation. Additionally, based on the current status of litigation matters, either the estimate of exposure is immaterial to the Company's financial statements or an estimate cannot yet be determined. The Company's legal costs are recorded to expense as incurred.

**Purchase Commitments**

In the normal course of business, the Company enters into forward flow purchase agreements and other purchase commitment agreements. As of September 30, 2013, the Company has entered into agreements to purchase receivable portfolios with a face value of approximately \$562.8 million for a purchase price of approximately \$58.5 million. The Company has no purchase commitments beyond December 2014.

**Note 16: Segment Information**

The Company conducts business primarily through two reportable segments: portfolio purchasing and recovery and tax lien business. The Company's management relies on internal management reporting processes that provide segment revenue, segment operating income, and segment asset information in order to make financial decisions and allocate resources. The operating results from the Company's tax lien business segment are immaterial to the Company's total consolidated operating results. However, total assets from the tax lien business segment are significant as compared to the Company's total consolidated assets. As a result, in accordance with authoritative guidance on segment reporting, the Company's tax lien business segment is determined to be a reportable segment.

Segment operating income includes income from operations before depreciation, amortization of intangible assets, and stock-based compensation expense. The following table provides a reconciliation of revenue and segment operating income by reportable segment to consolidated results and was derived from the segments' internal financial information as used for corporate management purposes (*in thousands*):

|   | Three Months Ended September 30, |            | Nine Months Ended September 30, |            |
|---|----------------------------------|------------|---------------------------------|------------|
|   | 2013                             | 2012       | 2013                            | 2012       |
| <b>Revenues:</b>                                      |                                  |            |                                 |            |
| Portfolio purchasing and recovery                     | \$ 230,885                       | \$ 140,682 | \$ 523,659                      | \$ 405,818 |
| Tax lien business                                     | 4,673                            | 4,536      | 12,606                          | 7,056      |
|   | \$ 235,558                       | \$ 145,218 | \$ 536,265                      | \$ 412,874 |
| <b>Operating income:</b>                              |                                  |            |                                 |            |
| Portfolio purchasing and recovery                     | \$ 67,803                        | \$ 42,980  | \$ 143,961                      | \$ 123,079 |
| Tax lien business                                     | 1,832                            | 2,055      | 3,455                           | 2,874      |
|   | 69,635                           | 45,035     | 147,416                         | 125,953    |
| Depreciation and amortization                         | (4,523)                          | (1,533)    | (8,527)                         | (4,193)    |
| Stock-based compensation                              | (3,983)                          | (1,905)    | (9,163)                         | (6,710)    |
| Other expense   | (29,485)                         | (6,402)    | (47,784)                        | (18,253)   |
| Income from continuing operations before income taxes | \$ 31,644                        | \$ 35,195  | \$ 81,942                       | \$ 96,797  |

Additionally, assets are allocated to operating segments for management review. As of September 30, 2013, total segment assets were \$2.3 billion and \$237.3 million for the portfolio purchasing and recovery segment and tax lien business segment, respectively.

The following presents information about geographic areas in which the Company operates (*in thousands*):

|                           | Three Months Ended September 30, 2013 |            | Nine Months Ended September 30, 2012 |            |
|---------------------------|---------------------------------------|------------|--------------------------------------|------------|
|                           | 2013                                  | 2012       | 2013                                 | 2012       |
| Revenues <sup>(1)</sup> : |                                       |            |                                      |            |
| United States             | \$ 189,086                            | \$ 145,218 | \$ 489,793                           | \$ 412,874 |
| United Kingdom            | 46,472                                |            | 46,472                               |            |
|                           | \$ 235,558                            | \$ 145,218 | \$ 536,265                           | \$ 412,874 |

<sup>(1)</sup> Revenues are attributed to countries based on location of customer.

**Note 17: Goodwill and Identifiable Intangible Assets**

In accordance with authoritative guidance, goodwill is tested at the reporting unit level annually for impairment and in interim periods if certain events occur that indicate the fair value of a reporting unit may be below its carrying value.

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As of September 30, 2013, the Company has two reporting units that carry goodwill: portfolio purchasing and recovery and tax lien business. Annual testing is performed as of October 1<sup>st</sup> for the portfolio purchasing and recovery reporting unit and as of April 1<sup>st</sup> for the tax lien business reporting unit.

The Company's acquired intangible assets are summarized as follows (*in thousands*):

|  | As of September 30, 2013 |                          |                     | As of December 31, 2012 |                          |                     |
|--|--------------------------|--------------------------|---------------------|-------------------------|--------------------------|---------------------|
|  | Gross Carrying Amount    | Accumulated Amortization | Net Carrying Amount | Gross Carrying Amount   | Accumulated Amortization | Net Carrying Amount |
| Intangible assets subject to amortization:                 |                          |                          |                     |                         |                          |                     |
| Customer relationships                                     | \$ 1,494                 | \$ (42)                  | \$ 1,452            | \$ 570                  | \$ (83)                  | \$ 487              |
| Developed technologies                                     | 4,681                    | (234)                    | 4,447               |                         |                          |                     |
| Trade name and other                                       | 2,876                    | (256)                    | 2,620               |                         |                          |                     |
| <b>Total intangible assets subject to amortization</b>     | <b>\$ 9,051</b>          | <b>\$ (532)</b>          | <b>\$ 8,519</b>     | <b>\$ 570</b>           | <b>\$ (83)</b>           | <b>\$ 487</b>       |
| Intangible assets not subject to amortization:             |                          |                          |                     |                         |                          |                     |
| Goodwill - portfolio purchasing and recovery               |                          |                          | \$ 444,130          |                         |                          | \$ 6,047            |
| Goodwill - tax lien business                               |                          |                          | 45,390              |                         |                          | 49,399              |
| Other intangibles  |                          |                          | 1,962               |                         |                          |                     |
| <b>Total intangible assets not subject to amortization</b> |                          |                          | <b>\$ 491,482</b>   |                         |                          | <b>\$ 55,446</b>    |

The changes in carrying amount of goodwill by reporting unit for the nine months ended September 30, 2013 are as follows (*in thousands*):

|  | Portfolio Purchasing and Recovery | Tax Lien business      |
|--|-----------------------------------|------------------------|
| Balance, December 31, 2012             | \$ 6,047                          | \$ 49,399              |
| Goodwill acquired                      | 419,969                           |                        |
| Goodwill adjustment                    | (180)                             | (4,009) <sup>(1)</sup> |
| Effect of foreign currency translation | 18,294                            |                        |
| <b>Balance, September 30, 2013</b>     | <b>\$ 444,130</b>                 | <b>\$ 45,390</b>       |

(1)

As a result of its final valuation study related to the Company's acquisition of Propel, during the three months ended March 31, 2013, the Company made an adjustment to the initial purchase price allocation, increasing receivables secured by tax liens and decreasing goodwill by approximately \$4.0 million.

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

*This Quarterly Report on Form 10-Q contains forward-looking statements relating to Encore Capital Group, Inc. ( Encore ) and its subsidiaries (which we may collectively refer to as the Company, we, our or us ) within the meaning of the securities laws. The words believe, expect, anticipate, estimate, project, intend, plan, will, may, and similar expressions often characterize forward-looking statements. These statements may include, but are not limited to, projections of collections, revenues, income or loss, estimates of capital expenditures, plans for future operations, products or services and financing needs or plans, as well as assumptions relating to these matters. Although we believe that the expectations reflected in these forward-looking statements are reasonable, we caution that these expectations or predictions may not prove to be correct or we may not achieve the financial results, savings or other benefits anticipated in the forward-looking statements. These forward-looking statements are necessarily estimates reflecting the best judgment of our senior management and involve a number of risks and uncertainties, some of which may be beyond our control or cannot be predicted or quantified, that could cause actual results to differ materially from those suggested by the forward-looking statements. Many factors, including but not limited to those set forth in our Annual Report on Form 10-K under Part I, Item 1A. Risk Factors and those set forth in our subsequent Quarterly Reports on Form 10-Q under Part II, Item 1A Risk Factors, could cause our actual results, performance, achievements or industry results to be very different from the results, performance, achievements or industry results expressed or implied by these forward-looking statements. Our business, financial condition or results of operations could also be materially and adversely affected by other factors besides those listed. Forward-looking statements speak only as of the date the statements were made. We do not undertake any obligation to update or revise any forward-looking statements to reflect new information or future events, or for any other reason, even if experience or future events make it clear that any expected results expressed or implied by these forward-looking statements will not be realized. In addition, it is generally our policy not to make any specific projections as to future earnings, and we do not endorse projections regarding future performance that may be made by third parties.*

**Our Business and Operating Segments**

We are a global leading provider of debt recovery solutions for consumers and property owners across a broad range of financial assets. We purchase portfolios of defaulted consumer receivables at deep discounts to face value and manage them by working with individuals as they repay their obligations and work toward financial recovery. Defaulted receivables are consumers' unpaid financial commitments to credit originators, including banks, credit unions, consumer finance companies, commercial retailers, and telecommunication companies. Defaulted receivables may also include receivables subject to bankruptcy proceedings. Our subsidiary, Janus Holdings Luxembourg S.a.r.l. ( Janus Holdings ), through its indirectly held United Kingdom based subsidiary Cabot Credit Management Limited ( Cabot ), is a market leader in debt management in the United Kingdom specializing in higher balance, semi-performing (i.e., debt portfolios in which over 50% of accounts have made a payment in three of the last four months immediately prior to the portfolio purchase) accounts. In addition, through our subsidiary, Propel Financial Services, LLC ( Propel ), we assist Texas and Nevada property owners who are delinquent on their property taxes by paying these taxes on behalf of the property owners in exchange for payment agreements collateralized by a tax lien on the property. Through Propel, we also purchase tax lien certificates directly from taxing authorities.

We conduct business through two operating segments: portfolio purchasing and recovery and tax lien business. The operating results from our tax lien business segment are immaterial to our total consolidated operating results. However, the total segment assets are significant as compared to our total consolidated assets. As a result, in accordance with authoritative guidance on segment reporting, our tax lien business segment is determined to be a reportable segment.



Our long-term growth strategy involves growing our core portfolio purchasing and recovery business (including by purchasing portfolios from issuers, purchasing portfolios from competitors or by acquiring competitors directly), expanding into new asset classes, and expanding into new geographies.

### **Portfolio Purchasing and Recovery**

*United States.* Our portfolio purchasing and recovery segment purchases receivables based on robust, account-level valuation methods and employs proprietary statistical and behavioral models across the full extent of our operations. These investments allow us to value portfolios accurately (and limit the risk of overpaying), avoid buying portfolios that are incompatible with our methods or goals and align the accounts we purchase with our operational channels to maximize future collections. As a result, we have been able to realize significant returns from the receivables we acquire. We maintain strong relationships with many of the largest credit and telecommunication providers in the United States and believe we possess one of the industry's best collection staff retention rates.

While seasonality does not have a material impact on our portfolio purchasing and recovery segment, collections are generally strongest in our first calendar quarter, slower in the second and third calendar quarters, and slowest in the fourth calendar quarter. Relatively higher collections in the first quarter could result in a lower cost-to-collect ratio compared to the other quarters, as our fixed costs would be constant and applied against a larger collection base. The seasonal impact on our business may be influenced by our purchasing levels, the types of portfolios we purchase, and our operating strategies.

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Collection seasonality with respect to our portfolio purchasing and recovery segment can also affect our revenue recognition rate. Generally, revenue for each pool group declines steadily over time, whereas collections can fluctuate from quarter to quarter based on seasonality, as described above. In quarters with lower collections (*e.g.*, the fourth calendar quarter), revenue as a percentage of collections can be higher than in quarters with higher collections (*e.g.*, the first calendar quarter).

In addition, seasonality could have an impact on the relative level of quarterly earnings. In quarters with stronger collections, total costs are higher as a result of the additional efforts required to generate those collections. Since revenue for each pool group declines steadily over time, in quarters with higher collections and higher costs (*e.g.*, the first calendar quarter), all else being equal, earnings could be lower than in quarters with slower collections and lower costs (*e.g.*, the fourth calendar quarter). Additionally, in quarters where a greater percentage of collections come from our legal and agency outsourcing channels, cost to collect will be higher than if there were more collections from our internal collection sites.

**United Kingdom.** Through Cabot, we purchase receivable portfolios using a proprietary pricing model. This model allows Cabot to value portfolios with a high degree of accuracy and quantify portfolio performance in order to maximize future collections. As a result, Cabot has been able to realize significant returns from the assets it has acquired. Cabot maintains strong relationships with many of the largest financial service providers in the United Kingdom.

While seasonality does not have a material impact on Cabot's collections, collections are generally strongest in its second and third calendar quarters and slower in the first and fourth quarters, largely driven by the impact of the December holiday season and the New Year holiday, and the related impact on its customers' ability to repay their balances. This drives a higher level of plan defaults over this period, which is typically repaired across the first quarter of the following year. The August vacation season in the United Kingdom also has an unfavorable effect on the level of collections, but this is traditionally compensated for by higher collections in July and September.

**Tax Lien Business**

Our tax lien business segment focuses on the property tax financing industry. Propel's principal activity is originating and servicing property tax lien transfers in the states of Texas and Nevada and investing in tax lien certificates in other states. For tax lien transfers, with the property owner's consent, we pay the property owner's delinquent property taxes directly to the taxing authority, which then transfers its tax lien to us. This lien takes priority over most other liens. By funding tax liens, we provide state and local taxing authorities and governments with much needed tax revenue. We then enter into a payment agreement with the property owner, creating an affordable payment plan designed to permit the property owner to keep his or her property. For tax lien certificates, we purchase the tax lien certificates directly from taxing authorities, securing rights to future property tax payments, interest and penalties. Tax lien certificates we invest in are collateralized by the underlying property, and in most cases, continue to be serviced by the taxing authority. When the taxing authority is paid, it repays us the outstanding balance of the lien plus interest, which is negotiated at the time of the purchase. Revenue from our tax lien business segment comprised 2% of total consolidated revenues for the three and nine months ended September 30, 2013. Operating income from our tax lien business segment comprised 3% and 2% of our total consolidated operating income for the three and nine months ended September 30, 2013, respectively.

**Cabot Acquisition**

On July 1, 2013, through our wholly owned subsidiary Encore Europe Holdings S.a.r.l., we completed the purchase (the Cabot Acquisition) of 50.1% of the equity interest in Janus Holdings, the indirect holding company of Cabot,

from an affiliate of J.C. Flowers & Co. LLC ( J.C. Flowers ). Our effective equity ownership of Cabot will amount to approximately 42.9%, after reflecting the ownership of the noncontrolling interests and the redemption or conversion of the E Bridge preferred equity certificates and the J Bridge preferred equity certificates by June 2014. Cabot is a market leader in debt management in the United Kingdom specializing in higher balance, semi-performing accounts. We expect that the Cabot Acquisition will provide Cabot with access to more capital, which will enable Cabot to purchase additional debt and expand into other asset categories. In addition, the Cabot Acquisition provides synergy opportunities through Cabot's ability to leverage our analytic capabilities and efficient operating platform. Our initial focus will be to help Cabot expand into the large secondary and tertiary markets by leveraging our analytical insights in these markets and utilizing our workforce in India, during the day, when this site would otherwise be dormant. The Cabot Acquisition also enables us to deploy capital globally in a market that we believe has strong growth potential. Cabot will continue to be a stand-alone entity. It will retain its current staff and brand and continue to be run as its own company. The condensed consolidated statements of comprehensive income for the three and nine months ended September 30, 2013 include the results of operations of Janus Holdings only since the closing date of the Cabot Acquisition.

### **AACC Merger**

On June 13, 2013, we completed our merger with Asset Acceptance Capital Corp. ( AACC ), another leading provider of debt management and recovery solutions in the United States (the AACC Merger ). We believe that our operating and cost advantages will improve the profitability of AACC's investments and that the AACC Merger will provide us with valuable operations capabilities and synergy opportunities. We expect our combined organization to operate at our lower cost-to-collect within three to four quarters.

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However, the success of the merger will depend on our ability to successfully integrate AACC's business with our business in a cost-effective manner that does not disrupt the existing business relationships of either company. See Item 1A "Risk Factors" in our Form 10-Q for the second quarter ended June 30, 2013 for more information. The condensed consolidated statements of comprehensive income for the three and nine months ended September 30, 2013 include the results of operations of AACC only since the closing date of the AACC Merger.

In January 2012, Asset Acceptance, LLC, a subsidiary of AACC, entered into a consent decree with the Federal Trade Commission ( "FTC" ). The consent decree ended an FTC investigation into Asset Acceptance, LLC's compliance with the Federal Trade Commission Act, Fair Debt Collection Practices Act and Fair Credit Reporting Act. As part of the consent decree, Asset Acceptance, LLC agreed to undertake certain consumer protection practices, including, among other things, furnishing additional disclosures when collecting debt past the statute of limitations, and paid a civil penalty of \$2,500,000. These practices continue to apply to the portfolios we purchased as a result of the AACC Merger. We do not expect compliance with the consent decree to have a material effect on our business.

### ***Variable Interest Entity***

As discussed in Note 1, "Ownership, Description of Business and Summary of Significant Accounting Policies" in the notes to our condensed consolidated financial statements, we have determined that our less than wholly owned subsidiary, Janus Holdings is a Variable Interest Entity, or VIE, and that we are the primary beneficiary of the VIE. As a result, the financial results of Janus Holdings are consolidated under the VIE consolidation model. Consequently, all financial data included in "Management's Discussion and Analysis of Financial Condition and Results of Operations" has been presented as though we own 100% of Janus Holdings.

## **Purchases and Collections**

### ***Portfolio Pricing, Supply and Demand***

#### ***United States Markets***

Prices for portfolios offered for sale directly from credit issuers continued to remain elevated during the third quarter of 2013, especially for fresh portfolios. Fresh portfolios are portfolios that are generally transacted within six months of the consumer's account being charged-off by the financial institution. We believe this price increase is due to a reduction in the supply of charged-off accounts and continued demand in the marketplace. We believe that the reduction in supply is partially due to shifts in underwriting standards by financial institutions, which have resulted in lower volumes of charged-off accounts. We believe that this reduction in supply is also the result of certain financial institutions temporarily halting their sales of charged-off accounts while they conduct audits of debt management and recovery companies, including Encore. We expect that pricing will remain at these elevated levels for some period of time. We believe that pricing will not decline until buyers who have paid prices that are too high recognize that they are unable to realize a profit or until the financial institutions complete their audits of debt management and recovery companies and resume selling their charged-off accounts in volumes greater than current levels. The AACC Merger accounted for a significant portion of our 2013 forecasted purchases and, as a result, we slowed our purchasing efforts in the third quarter of 2013 as compared to the third quarter of 2012.

We believe that smaller competitors are being driven out of the portfolio purchasing market because of the high cost to operate due to regulatory pressure and because the issuers are being more selective with buyers in the marketplace, resulting in consolidation within the portfolio purchasing and recovery industry. We believe this favors larger participants in this market, such as us, because the larger market participants are better able to adapt to these pressures. Furthermore, as smaller competitors decide to exit the market, it may provide additional opportunities for us to

purchase portfolios from competitors or to acquire competitors directly.

***United Kingdom Markets***

While prices for portfolios offered for sale directly from credit issuers in the United Kingdom remain at levels higher than historical averages, as a result of a backlog caused by issuers reducing their sales volumes during the 2008-2010 time period, we believe that the supply of debt sold to debt purchasers has increased and is expected to increase further in the coming year. Additionally, over the last few years, portfolios are being sold earlier in the life cycle, and therefore, include a higher proportion of paying accounts. We expect that as a result of an increase in available funding to industry participants and lower return requirements for certain debt purchasers, pricing will remain elevated. However, we also believe that as Cabot's business increases in scale, and with anticipated improvements in the rate of collections and improved efficiencies in collections, Cabot's margins will remain competitive.

**Table of Contents****Purchases by Type**

The following table summarizes the types of charged-off consumer receivable portfolios we purchased for the periods presented (*in thousands*):

|                                   |                               | Three Months Ended September 30, 2013 |           | Nine Months Ended September 30, 2012 |            |
|-----------------------------------|-------------------------------|---------------------------------------|-----------|--------------------------------------|------------|
|                                   |                               | 2013                                  | 2012      | 2013                                 | 2012       |
| Credit card                       | United States <sup>(1)</sup>  | \$ 31,089                             | \$ 28,547 | \$ 454,926                           | \$ 338,776 |
| Credit card                       | United Kingdom <sup>(2)</sup> | 586,037                               |           | 586,037                              |            |
| Consumer bankruptcy receivables   |                               |                                       |           |                                      |            |
| United States <sup>(1), (3)</sup> |                               |                                       |           | 39,897                               |            |
| Telecom                           |                               | 726                                   | 18,764    | 18,876                               | 69,981     |
|                                   |                               | \$ 617,852                            | \$ 47,311 | \$ 1,099,736                         | \$ 408,757 |

- (1) Purchases of consumer portfolio receivables in the United States for the nine month periods ended September 30, 2013 include \$381.2 million acquired in connection with the AACC Merger (\$345.5 million for credit card and \$35.7 million for consumer bankruptcy receivables).
- (2) Purchases of consumer portfolio receivables in the United Kingdom for the three and nine month periods ended September 30, 2013 include \$559.0 million acquired in connection with the Cabot Acquisition.
- (3) Represents portfolio receivables subject to Chapter 13 and Chapter 7 bankruptcy proceedings acquired from issuers and resellers.

During the three months ended September 30, 2013, we invested \$617.9 million to acquire charged-off credit card and telecom portfolios, with face values aggregating \$13.4 billion, for an average purchase price of 4.6% of face value. This is a \$570.6 million increase in the amount invested, compared with the \$47.3 million invested during the three months ended September 30, 2012, to acquire charged-off credit card and telecom portfolios with a face value aggregating \$1.1 billion, for an average purchase price of 4.5% of face value. Purchases of charged-off credit card and telecom portfolios include \$559.0 million of portfolio acquired in conjunction with the Cabot Acquisition. The period-over-period increase in purchases is related to the purchase of this portfolio.

During the nine months ended September 30, 2013, we invested \$1.1 billion to acquire charged-off credit card, telecom and consumer bankruptcy portfolios, with face values aggregating \$83.9 billion, for an average purchase price of 1.3% of face value. This is a \$691.0 million increase, or 169.0%, in the amount invested, compared with the \$408.8 million invested during the nine months ended September 30, 2012, to acquire charged-off portfolios with a face value aggregating \$10.0 billion, for an average purchase price of 4.1% of face value. Purchases of charged-off credit card, telecom and consumer bankruptcy portfolios include \$559.0 million of portfolio acquired in conjunction with the Cabot Acquisition and \$381.2 million of portfolio acquired in conjunction with the AACC Merger. The increase in purchases and decrease in the percentage of face value are related to these purchases.

Average purchase price, as a percentage of face value, varies from period to period depending on, among other things, the quality of the accounts purchased and the length of time from charge off to the time we purchase the portfolios. The low purchase rate for the nine month period ending September 30, 2013 is related to the portfolio acquired in connection with the AACC Merger. This low rate is a result of us acquiring the entire portfolio of AACC, which included accounts to which we ascribed little or no value and which we have no intention to collect.

***Collections by Channel***

We currently utilize various business channels for the collection of our receivables. The following table summarizes the total collections by collection channel and geographic area (*in thousands*):

|                                    | <b>Three Months Ended September 30,</b> |                   | <b>Nine Months Ended September 30,</b> |                   |
|------------------------------------|---|-------------------|--|-------------------|
|                                    | <b>2013</b>                             | <b>2012</b>       | <b>2013</b>                            | <b>2012</b>       |
| <b>United States:</b>              |   |                   |  |                   |
| Legal collections                  | \$ 153,556                              | \$ 111,334        | \$ 409,511                             | \$ 335,782        |
| Collection sites                   | 119,080                                 | 116,928           | 362,495                                | 338,439           |
| Collection agencies <sup>(1)</sup> | 39,607                                  | 17,715            | 88,795                                 | 43,344            |
| <b>Subtotal</b>                    | <b>312,243</b>                          | <b>245,977</b>    | <b>860,801</b>                         | <b>717,565</b>    |
| <b>United Kingdom:</b>             |   |                   |  |                   |
| Collection sites                   | 37,931                                  |                   | 37,931                                 |                   |
| Collection agencies                | 29,496                                  |                   | 29,496                                 |                   |
| <b>Subtotal</b>                    | <b>67,427</b>                           |                   | <b>67,427</b>                          |                   |
| <b>Total collections</b>           | <b>\$ 379,670</b>                       | <b>\$ 245,977</b> | <b>\$ 928,228</b>                      | <b>\$ 717,565</b> |

- <sup>(1)</sup> Collections through our collection agency channel in the United States include accounts subject to bankruptcy filings collected by others. Additionally, collection agency collections often include accounts purchased from a competitor where we maintain the collection agency servicing until the accounts can be recalled and placed in our collection channels.

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Gross collections increased \$133.7 million, or 54.4%, to \$379.7 million during the three months ended September 30, 2013, from \$246.0 million during the three months ended September 30, 2012. Gross collections increased \$210.6 million, or 29.4%, to \$928.2 million during the nine months ended September 30, 2013, from \$717.6 million during the nine months ended September 30, 2012.

**Results of Operations**

Results of operations in dollars and as a percentage of total revenue were as follows (*in thousands, except percentages*):

|  | <b>Three Months Ended September 30,</b> |                |                  |               |
|--|---|----------------|------------------|---------------|
|  | <b>2013</b>                             |                | <b>2012</b>      |               |
| <b>Revenues</b>  |   |                |                  |               |
| Revenue from receivable portfolios, net                      | \$ 225,387                              | 95.7%          | \$ 140,682       | 96.9%         |
| Other revenues   | 5,792                                   | 2.5%           | 426              | 0.3%          |
| Net interest income tax lien business                        | 4,379                                   | 1.8%           | 4,110            | 2.8%          |
| <b>Total revenues</b>  | <b>235,558</b>                          | <b>100.0%</b>  | <b>145,218</b>   | <b>100.0%</b> |
| <b>Operating expenses</b>                                    |   |                |                  |               |
| Salaries and employee benefits                               | 52,253                                  | 22.2%          | 25,397           | 17.5%         |
| Cost of legal collections                                    | 50,953                                  | 21.6%          | 43,544           | 30.0%         |
| Other operating expenses                                     | 19,056                                  | 8.1%           | 14,829           | 10.2%         |
| Collection agency commissions                                | 14,158                                  | 6.0%           | 4,227            | 2.9%          |
| General and administrative expenses                          | 33,486                                  | 14.2%          | 14,091           | 9.7%          |
| Depreciation and amortization                                | 4,523                                   | 1.9%           | 1,533            | 1.1%          |
| <b>Total operating expenses</b>                              | <b>174,429</b>                          | <b>74.0%</b>   | <b>103,621</b>   | <b>71.4%</b>  |
| Income from operations                                       | 61,129                                  | 26.0%          | 41,597           | 28.6%         |
| <b>Other (expense) income</b>                                |   |                |                  |               |
| Interest expense   | (29,186)                                | (12.4)%        | (7,012)          | (4.8)%        |
| Other (expense) income                                       | (299)                                   | (0.1)%         | 610              | 0.4%          |
| <b>Total other expense</b>                                   | <b>(29,485)</b>                         | <b>(12.5)%</b> | <b>(6,402)</b>   | <b>(4.4)%</b> |
| <b>Income from continuing operations before income taxes</b> |   |                |                  |               |
|  | 31,644                                  | 13.5%          | 35,195           | 24.2%         |
| Provision for income taxes                                   | (10,272)                                | (4.4)%         | (13,887)         | (9.6)%        |
| <b>Income from continuing operations</b>                     | <b>21,372</b>                           | <b>9.1%</b>    | <b>21,308</b>    | <b>14.6%</b>  |
| Loss from discontinued operations, net of tax                | (308)                                   | (0.1)%         |                  | 0.0%          |
| <b>Net income</b>  | <b>\$ 21,064</b>                        | <b>9.0%</b>    | <b>\$ 21,308</b> | <b>14.6%</b>  |





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|   | Nine Months Ended September 30, |        |           |        |
|---|---------------------------------|--------|-----------|--------|
|   | 2013                            |        | 2012      |        |
| Income from operations                                | 129,726                         | 24.2%  | 115,050   | 27.9%  |
| Other (expense) income                                |                                 |        |           |        |
| Interest expense                                      | (43,522)                        | (8.1)% | (19,024)  | (4.6)% |
| Other (expense) income                                | (4,262)                         | (0.8)% | 771       | 0.2%   |
| Total other expense                                   | (47,784)                        | (8.9)% | (18,253)  | (4.4)% |
| Income from continuing operations before income taxes | 81,942                          | 15.3%  | 96,797    | 23.5%  |
| Provision for income taxes                            | (30,110)                        | (5.6)% | (38,393)  | (9.3)% |
| Income from continuing operations                     | 51,832                          | 9.7%   | 58,404    | 14.2%  |
| Loss from discontinued operations, net of tax         | (308)                           | (0.1)% | (9,094)   | (2.2)% |
| Net income  | \$ 51,524                       | 9.6%   | \$ 49,310 | 12.0%  |
| Net loss attributable to noncontrolling interest      | 822                             | 0.2%   |           | 0.0%   |
| Net income attributable to Encore shareholders        | \$ 52,346                       | 9.8%   | \$ 49,310 | 12.0%  |

**Non-GAAP Disclosure**

In addition to the financial information prepared in conformity with Generally Accepted Accounting Principles ( GAAP ), we provide certain historical non-GAAP financial information. Management believes that the presentation of such non-GAAP financial information is meaningful and useful in understanding the activities and business metrics of our operations. Management believes that these non-GAAP financial measures reflect an additional way of viewing aspects of our business that, when viewed with our GAAP results, provide a more complete understanding of factors and trends affecting our business.

Management believes that the presentation of these measures provides investors with greater transparency and facilitates comparison of operating results across a broad spectrum of companies with varying capital structures, compensation strategies, derivative instruments, and amortization methods, which provide a more complete understanding of our financial performance, competitive position, and prospects for the future. Readers should consider the information in addition to, but not instead of, our financial statements prepared in accordance with GAAP. This non-GAAP financial information may be determined or calculated differently by other companies, limiting the usefulness of these measures for comparative purposes.

**Adjusted Income from Continuing Operations Per Share.** Management believes that investors regularly rely on non-GAAP adjusted income and adjusted income per share, to assess operating performance, in order to highlight trends in our business that may not otherwise be apparent when relying on financial measures calculated in accordance with GAAP. Adjusted income from continuing operations attributable to Encore excludes non-cash interest and issuance cost amortization relating to our convertible notes, one-time charges, acquisition and integration related expenses, all net of tax, and the effect of tax credits applicable to prior periods. The following table provides a reconciliation between income from continuing operations and diluted income from continuing operations per share attributable to Encore calculated in accordance with GAAP to adjusted income from continuing operations and

adjusted income from continuing operations per share attributable to Encore, respectively. In addition, as described in Note 4, *Earnings Per Share* to the notes to our consolidated financial statements, GAAP diluted earnings per share includes the dilutive effect of approximately 805,000 and 298,000 common shares issuable upon the conversion of our convertible senior notes due 2017 for the three and nine months ended September 30, 2013, respectively, reflecting a conversion price of \$31.56 for those notes. However, as described in Note 11, *Debt Convertible Senior Notes 2017 Convertible Senior Notes* to the notes to our consolidated financial statements, the convertible note hedge transactions and warrant transactions entered into in connection with those notes have the effect of increasing the effective conversion price of those notes to \$44.19. Accordingly, while these common shares are included in our diluted earnings per share, the convertible note hedge and warrant transactions will offset the impact of this dilution and no shares will not be issued unless our stock price exceeds \$44.19 at the time of conversion, thereby creating a discrepancy between the accounting effect of those notes under GAAP and their economic impact. We have presented the following metrics both including and excluding the dilutive effect of the convertible notes due 2017 to better illustrate the economic impact of those notes to shareholders (*in thousands, except per share data*):

|  | Three Months Ended September 30, |             |         |             |             |         |
|--|----------------------------------|-------------|---------|-------------|-------------|---------|
|  | 2013                             |             |         | 2012        |             |         |
|  | Per Diluted                      | Per Diluted |         | Per Diluted | Per Diluted |         |
|  | Share -                          | Share -     |         | Share -     | Share -     |         |
|  | Accounting                       | Economic    |         | Accounting  | Economic    |         |
|  | \$                               |             | \$      | \$          |             | \$      |
| GAAP net income from continuing operations attributable to Encore, as reported | \$ 22,194                        | \$ 0.82     | \$ 0.84 | \$ 21,308   | \$ 0.82     | \$ 0.82 |
| Adjustments:   |                                  |             |         |             |             |         |
| Convertible notes non-cash interest and issuance cost amortization, net of tax | 1,103                            | 0.04        | 0.05    |             |             |         |

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|   | Three Months Ended September 30, |             |         |             |             |         |
|---|----------------------------------|-------------|---------|-------------|-------------|---------|
|   | 2013                             |             |         | 2012        |             |         |
|   | Per Diluted                      | Per Diluted |         | Per Diluted | Per Diluted |         |
|   | Share -                          | Share -     |         | Share -     | Share -     |         |
|   | Accounting                       | Economic    |         | Accounting  | Economic    |         |
|   | \$                               |             | \$      | \$          |             | \$      |
| Acquisition related legal and advisory fees, net of tax           | 4,775                            | 0.18        | 0.18    |             |             |         |
| Effect of tax credits applicable to prior periods                 | (1,236)                          | (0.05)      | (0.05)  |             |             |         |
| Adjusted income from continuing operations attributable to Encore | \$ 26,836                        | \$ 0.99     | \$ 1.02 | \$ 21,308   | \$ 0.82     | \$ 0.82 |

|  | Nine Months Ended September 30, |             |         |             |             |         |
|--|---------------------------------|-------------|---------|-------------|-------------|---------|
|  | 2013                            |             |         | 2012        |             |         |
|  | Per Diluted                     | Per Diluted |         | Per Diluted | Per Diluted |         |
|  | Share -                         | Share -     |         | Share -     | Share -     |         |
|  | Accounting                      | Economic    |         | Accounting  | Economic    |         |
|  | \$                              |             | \$      | \$          |             | \$      |
| GAAP net income from continuing operations attributable to Encore, as reported       | \$ 52,654                       | \$ 2.06     | \$ 2.08 | \$ 58,404   | \$ 2.25     | \$ 2.25 |
| Adjustments:   |                                 |             |         |             |             |         |
| Convertible notes non-cash interest and issuance cost amortization, net of tax       | 2,103                           | 0.08        | 0.08    |             |             |         |
| Acquisition related legal and advisory fees, net of tax                              | 9,756                           | 0.38        | 0.39    | 2,567       | 0.10        | 0.10    |
| Acquisition related integration and severance costs, and consulting fees, net of tax | 3,304                           | 0.13        | 0.13    |             |             |         |
| Acquisition related other expenses, net of tax                                       | 2,198                           | 0.09        | 0.09    |             |             |         |
| Effect of tax credits applicable to prior periods                                    | (712)                           | (0.03)      | (0.03)  |             |             |         |
| Adjusted income from continuing operations attributable to Encore                    | \$ 69,303                       | \$ 2.71     | \$ 2.74 | \$ 60,971   | \$ 2.35     | \$ 2.35 |

**Adjusted EBITDA.** Management utilizes adjusted EBITDA (defined as net income before interest, taxes, depreciation and amortization, stock-based compensation expenses, portfolio amortization, one-time charges, and acquisition and integration related expenses), which is materially similar to a financial measure contained in covenants used in the Encore revolving credit and term loan facility, in the evaluation of our operations and believes that this measure is a useful indicator of our ability to generate cash collections in excess of operating expenses through the liquidation of our receivable portfolios (*in thousands*):

**Three Months Ended September 30, Nine Months Ended September 30,**

|  | <b>2013</b> | <b>2012</b> | <b>2013</b> | <b>2012</b> |
|--|-------------|-------------|-------------|-------------|
| GAAP net income, as reported   | \$ 21,064   | \$ 21,308   | \$ 51,524   | \$ 49,310   |
| Adjustments:   |             |             |             |             |
| Loss from discontinued operations, net of tax                            | 308         |             | 308         | 9,094       |
| Interest expense   | 29,186      | 7,012       | 43,522      | 19,024      |
| Provision for income taxes   | 10,272      | 13,887      | 30,110      | 38,393      |
| Depreciation and amortization  | 4,523       | 1,533       | 8,527       | 4,193       |
| Amount applied to principal on receivable portfolios                     | 157,262     | 105,283     | 417,793     | 311,699     |
| Stock-based compensation expense   | 3,983       | 1,905       | 9,163       | 6,710       |
| Acquisition related legal and advisory fees                              | 7,752       |             | 15,976      | 4,263       |
| Acquisition related integration and severance costs, and consulting fees |             |             | 5,455       |             |
| Acquisition related other expenses                                       |             |             | 3,630       |             |
| Adjusted EBITDA  | \$ 234,350  | \$ 150,928  | \$ 586,008  | \$ 442,686  |

**Adjusted Operating Expenses.** We have included information concerning adjusted operating expenses, excluding stock-based compensation expense, operating expenses related to non-portfolio purchasing and recovery business, one-time charges, and acquisition

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and integration related operating expenses, in order to facilitate a comparison of approximate cash costs to cash collections for the portfolio purchasing and recovery business in the periods presented (*in thousands*):

|  | Three Months Ended September 30, |            | Nine Months Ended September 30, |            |
|--|----------------------------------|------------|---------------------------------|------------|
|  | 2013                             | 2012       | 2013                            | 2012       |
| GAAP total operating expenses, as reported                                   | \$ 174,429                       | \$ 103,621 | \$ 406,539                      | \$ 297,824 |
| Adjustments:   |                                  |            |                                 |            |
| Stock-based compensation expense   | (3,983)                          | (1,905)    | (9,163)                         | (6,710)    |
| Operating expenses related to non-portfolio purchasing and recovery business | (8,008)                          | (2,055)    | (14,534)                        | (3,568)    |
| Acquisition related legal and advisory fees                                  | (7,752)                          |            | (15,976)                        | (4,263)    |
| Acquisition related integration and severance costs, and consulting fees     |                                  |            | (5,455)                         |            |
| Adjusted operating expenses  | \$ 154,686                       | \$ 99,661  | \$ 361,411                      | \$ 283,283 |

**Comparison of Results of Operations****Revenues**

Our revenues consist primarily of portfolio revenue, contingent fee income and net interest income from our tax lien business.

Portfolio revenue consists of accretion revenue and zero basis revenue. Accretion revenue represents revenue derived from pools (quarterly groupings of purchased receivable portfolios) with a cost basis that has not been fully amortized. Revenue from pools with a remaining unamortized cost basis is accrued based on each pool's effective interest rate applied to each pool's remaining unamortized cost basis. The cost basis of each pool is increased by revenue earned and decreased by gross collections and portfolio allowances. The effective interest rate is the Internal Rate of Return (IRR) derived from the timing and amounts of actual cash received and anticipated future cash flow projections for each pool. All collections realized after the net book value of a portfolio has been fully recovered, or Zero Basis Portfolios, are recorded as revenue, or Zero Basis Revenue. We account for our investment in receivable portfolios utilizing the interest method in accordance with the authoritative guidance for loans and debt securities acquired with deteriorated credit quality. Interest income, net of related interest expense represents net interest income on receivables secured by property tax liens.

The following tables summarize collections, revenue, end of period receivable balance and other related supplemental data, by year of purchase from our portfolio purchasing and recovery segment (*in thousands, except percentages*):

|                                  | Three Months Ended September 30, 2013 | As of<br>September 30, 2013 |
|----------------------------------|---------------------------------------|-----------------------------|
| <b>Collections<sup>(1)</sup></b> |                                       |                             |

|                        | <b>Gross Revenue<sup>(2)</sup></b> | <b>Revenue Recognition Rate<sup>(3)</sup></b> | <b>Net Reversal (Portfolio Allowance)</b> | <b>Revenue % of Total Revenue</b> | <b>Unamortized Balances</b> | <b>Monthly IRR</b> |       |
|------------------------|------------------------------------|---|---|-----------------------------------|-----------------------------|--------------------|-------|
| <b>United States:</b>  |                                    |   |   |                                   |                             |                    |       |
| ZBA <sup>(4)</sup>     | \$ 7,205                           | \$ 4,227                                      | 58.7%                                     | \$ 2,978                          | 1.9%                        | \$                 |       |
| 2006                   | 2,112                              | 665   | 31.5%                                     |                                   | 0.3%                        | 3,420              | 5.1%  |
| 2007                   | 3,002                              | 1,102   | 36.7%                                     |                                   | 0.5%                        | 5,433              | 5.5%  |
| 2008                   | 9,581                              | 5,445   | 56.8%                                     |                                   | 2.4%                        | 20,428             | 7.7%  |
| 2009                   | 18,828                             | 13,104  | 69.6%                                     |                                   | 5.9%                        | 24,920             | 15.1% |
| 2010                   | 36,888                             | 24,895  | 67.5%                                     |                                   | 11.2%                       | 59,430             | 12.3% |
| 2011                   | 52,408                             | 32,613  | 62.2%                                     |                                   | 14.7%                       | 118,627            | 8.2%  |
| 2012                   | 82,056                             | 39,458  | 48.1%                                     |                                   | 17.7%                       | 314,483            | 3.8%  |
| 2013                   | 100,163                            | 59,708  | 59.6%                                     |                                   | 26.9%                       | 452,741            | 4.3%  |
| Subtotal               | 312,243                            | 181,217                                       | 58.0%                                     | 2,978                             | 81.5%                       | 999,482            | 5.4%  |
| <b>United Kingdom:</b> |                                    |   |   |                                   |                             |                    |       |
| 2013                   | 67,427                             | 41,192  | 61.1%                                     |                                   | 18.5%                       | 596,160            | 2.4%  |
| Total                  | \$ 379,670                         | \$ 222,409                                    | 58.6%                                     | \$ 2,978                          | 100.0%                      | \$ 1,595,642       | 4.3%  |

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|                       | Three Months Ended September 30, 2012 |                                 |   |                                      |                                  | As of<br>September 30, 2012 |                |
|-----------------------|---------------------------------------|---------------------------------|---|--------------------------------------|----------------------------------|-----------------------------|----------------|
|                       |                                       |                                 |   | Net                                  |                                  |                             |                |
|                       | Collections <sup>(1)</sup>            | Gross<br>Revenue <sup>(2)</sup> | Revenue<br>Recognition<br>Rate <sup>(3)</sup> | Reversal<br>(Portfolio<br>Allowance) | Revenue<br>% of Total<br>Revenue | Unamortized<br>Balances     | Monthly<br>IRR |
| <b>United States:</b> |                                       |                                 |   |                                      |                                  |                             |                |
| ZBA <sup>(4)</sup>    | \$ 6,388                              | \$ 5,469                        | 85.6%   | \$ 919                               | 3.9%                             | \$                          |                |
| 2005                  | 2,767                                 | 760                             | 27.5%   | 135                                  | 0.5%                             | 3,127                       | 5.8%           |
| 2006                  | 2,884                                 | 1,811                           | 62.8%   | (998)                                | 1.3%                             | 10,798                      | 5.1%           |
| 2007                  | 3,873                                 | 2,045                           | 52.8%   | (247)                                | 1.5%                             | 11,974                      | 5.1%           |
| 2008                  | 13,881                                | 7,478                           | 53.9%   | 908                                  | 5.3%                             | 36,946                      | 6.1%           |
| 2009                  | 25,881                                | 16,506                          | 63.8%   |                                      | 11.8%                            | 54,724                      | 9.0%           |
| 2010                  | 52,328                                | 32,612                          | 62.3%   |                                      | 23.3%                            | 120,327                     | 8.1%           |
| 2011                  | 71,657                                | 40,800                          | 56.9%   |                                      | 29.2%                            | 221,790                     | 5.6%           |
| 2012                  | 66,306                                | 32,484                          | 49.0%   |                                      | 23.2%                            | 351,934                     | 3.1%           |
| Total                 | \$ 245,965                            | \$ 139,965                      | 56.9%   | \$ 717                               | 100.0%                           | \$ 811,620                  | 5.1%           |

|                        | Nine Months Ended September 30, 2013 |                                 |   |                                      |                                  | As of<br>September 30, 2013 |                |
|------------------------|--------------------------------------|---------------------------------|---|--------------------------------------|----------------------------------|-----------------------------|----------------|
|                        |                                      |                                 |   | Net                                  |                                  |                             |                |
|                        | Collections <sup>(1)</sup>           | Gross<br>Revenue <sup>(2)</sup> | Revenue<br>Recognition<br>Rate <sup>(3)</sup> | Reversal<br>(Portfolio<br>Allowance) | Revenue<br>% of Total<br>Revenue | Unamortized<br>Balances     | Monthly<br>IRR |
| <b>United States:</b>  |                                      |                                 |   |                                      |                                  |                             |                |
| ZBA <sup>(4)</sup>     | \$ 20,654                            | \$ 13,632                       | 66.0%   | \$ 7,022                             | 2.7%                             | \$                          |                |
| 2005                   | 2,364                                | 239                             | 10.1%   | 10                                   | 0.0%                             |                             |                |
| 2006                   | 7,133                                | 2,707                           | 38.0%   | (402)                                | 0.5%                             | 3,420                       | 5.1%           |
| 2007                   | 9,650                                | 4,056                           | 42.0%   | 580                                  | 0.8%                             | 5,433                       | 5.5%           |
| 2008                   | 33,220                               | 18,891                          | 56.9%   | 448                                  | 3.7%                             | 20,428                      | 7.7%           |
| 2009                   | 63,758                               | 41,483                          | 65.1%   |                                      | 8.1%                             | 24,920                      | 15.1%          |
| 2010                   | 124,486                              | 79,492                          | 63.9%   |                                      | 15.6%                            | 59,430                      | 12.3%          |
| 2011                   | 180,155                              | 103,496                         | 57.4%   |                                      | 20.3%                            | 118,627                     | 8.2%           |
| 2012                   | 279,321                              | 124,895                         | 44.7%   |                                      | 24.5%                            | 314,483                     | 3.8%           |
| 2013                   | 140,060                              | 80,353                          | 57.4%   |                                      | 15.7%                            | 452,741                     | 4.3%           |
| Subtotal               | 860,801                              | 469,244                         | 54.5%   | 7,658                                | 91.9%                            | 999,482                     | 5.4%           |
| <b>United Kingdom:</b> |                                      |                                 |   |                                      |                                  |                             |                |
| 2013                   | 67,427                               | 41,192                          | 61.1%   |                                      | 8.1%                             | 596,160                     | 2.4%           |
| Total                  | \$ 928,228                           | \$ 510,436                      | 55.0%   | \$ 7,658                             | 100.0%                           | \$ 1,595,642                | 4.3%           |



|                       | Nine Months Ended September 30, 2012 |                              |   |                                | As of<br>September 30, 2012 |                      |             |
|-----------------------|--------------------------------------|------------------------------|---|--------------------------------|-----------------------------|----------------------|-------------|
|                       |                                      |                              | Net                                     |                                |                             |                      |             |
|                       | Collections <sup>(1)</sup>           | Gross Revenue <sup>(2)</sup> | Revenue Recognition Rate <sup>(3)</sup> | Reversal (Portfolio Allowance) | Revenue % of Total Revenue  | Unamortized Balances | Monthly IRR |
| <b>United States:</b> |                                      |                              |   |                                |                             |                      |             |
| ZBA <sup>(4)</sup>    | \$ 20,560                            | \$ 17,627                    | 85.7%                                   | \$ 2,933                       | 4.4%                        | \$                   |             |
| 2005                  | 9,403                                | 3,116                        | 33.1%                                   | 1,110                          | 0.7%                        | 3,127                | 5.8%        |
| 2006                  | 10,059                               | 6,457                        | 64.2%                                   | (2,993)                        | 1.6%                        | 10,798               | 5.1%        |
| 2007                  | 13,498                               | 7,143                        | 52.9%                                   | (123)                          | 1.7%                        | 11,974               | 5.1%        |
| 2008                  | 46,761                               | 24,955                       | 53.4%                                   | 579                            | 6.2%                        | 36,946               | 6.1%        |
| 2009                  | 88,278                               | 54,592                       | 61.8%                                   |                                | 13.5%                       | 54,724               | 9.0%        |
| 2010                  | 175,093                              | 104,705                      | 59.8%                                   |                                | 25.9%                       | 120,327              | 8.1%        |
| 2011                  | 237,268                              | 125,248                      | 52.8%                                   |                                | 31.0%                       | 221,790              | 5.6%        |
| 2012                  | 116,597                              | 60,469                       | 51.9%                                   |                                | 15.0%                       | 351,934              | 3.1%        |
| <b>Total</b>          | <b>\$ 717,517</b>                    | <b>\$ 404,312</b>            | <b>56.3%</b>                            | <b>\$ 1,506</b>                | <b>100.0%</b>               | <b>\$ 811,620</b>    | <b>5.1%</b> |

(1) Does not include amounts collected on behalf of others.

(2) Gross revenue excludes the effects of net portfolio allowances or net portfolio allowance reversals.

(3) Revenue recognition rate excludes the effects of net portfolio allowances or net portfolio allowance reversals.

(4) ZBA revenue typically has a 100% revenue recognition rate. However, collections on ZBA pool groups where a valuation allowance remains must first be recorded as an allowance reversal until the allowance for that pool group is zero. Once the entire valuation allowance is reversed, the revenue recognition rate will become 100%.

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Total revenues were \$235.6 million during the three months ended September 30, 2013, an increase of \$90.3 million, or 62.2%, compared to total revenues of \$145.2 million during the three months ended September 30, 2012. Total revenues were \$536.3 million during the nine months ended September 30, 2013, an increase of \$123.4 million, or 29.9%, compared to total revenues of \$412.9 million during the nine months ended September 30, 2012.

Accretion revenue from our portfolio purchasing and recovery segment was \$225.4 million during the three months ended September 30, 2013, an increase of \$84.7 million, or 60.2%, compared to revenue of \$140.7 million during the three months ended September 30, 2012. Portfolio revenue was \$518.1 million during the nine months ended September 30, 2013, an increase of \$112.3 million, or 27.7%, compared to portfolio revenue of \$405.8 million during the nine months ended September 30, 2012. The increase in portfolio revenue during the three and nine months ended September 30, 2013, compared to the same periods of the prior year, was due to additional accretion revenue associated with a higher portfolio balance, primarily associated with the Cabot Acquisition and the AACC Merger and increases in yields on certain pool groups due to over-performance. During the three months ended September 30, 2013, we recorded a portfolio allowance reversal of \$3.0 million, compared to a net portfolio allowance reversal of \$0.7 million during the three months ended September 30, 2012. During the nine months ended September 30, 2013, we recorded a net portfolio allowance reversal of \$7.7 million, compared to a net portfolio allowance reversal of \$1.5 million during the nine months ended September 30, 2012.

Other revenues primarily represent contingent fee income at our Cabot subsidiary earned on accounts collected on behalf of others, primarily debt issuers. The contingent fee based income was \$5.2 million for the three and nine months ended September 30, 2013.

Net interest income from our tax lien business segment was \$4.4 million and \$11.7 million for the three and nine months ended September 30, 2013. Net interest income from our tax lien business segment was \$4.1 million for the three months ended September 30, 2012 and \$6.4 million for the period from acquisition (May 8, 2012) through September 30, 2012.

## **Operating Expenses**

Total operating expenses were \$174.4 million during the three months ended September 30, 2013, an increase of \$70.8 million, or 68.3%, compared to total operating expenses of \$103.6 million during the three months ended September 30, 2012.

Total operating expenses were \$406.5 million during the nine months ended September 30, 2013, an increase of \$108.7 million, or 36.5%, compared to total operating expenses of \$297.8 million during the nine months ended September 30, 2012.

Operating expenses are explained in more detail as follows:

### ***Salaries and Employee Benefits***

Salaries and employee benefits increased \$26.9 million, or 105.7%, to \$52.3 million during the three months ended September 30, 2013, from \$25.4 million during the three months ended September 30, 2012. The increase was primarily the result of increases in headcount as a result of the Cabot Acquisition, the AACC Merger, and increases in headcount and related compensation expense to support our growth. Salaries and employee benefits related to our internal legal channel in the United States were approximately \$5.7 million and \$1.8 million for the three months ended September 30, 2013 and 2012, respectively.

Salaries and employee benefits increased \$41.2 million, or 56.5%, to \$114.1 million during the nine months ended September 30, 2013, from \$72.9 million during the nine months ended September 30, 2012. The increase was primarily the result of increases in headcount as a result of the Cabot Acquisition, the AACC Merger and the acquisition of Propel, and increases in headcount and related compensation expense to support our growth. Salaries and employee benefits related to our internal legal channel in the United States were approximately \$11.7 million and \$4.7 million for the nine months ended September 30, 2013 and 2012, respectively.

Salaries and employee benefits broken down between the reportable segments are as follows (*in thousands*):

|                                   | Three Months Ended September 30, |           | Nine Months Ended September 30, |           |
|-----------------------------------|----------------------------------|-----------|---------------------------------|-----------|
|                                   | 2013                             | 2012      | 2013                            | 2012      |
| Salaries and employee benefits:   |                                  |           |                                 |           |
| Portfolio purchasing and recovery | \$ 50,774                        | \$ 24,304 | \$ 109,721                      | \$ 71,110 |
| Tax lien business                 | 1,479                            | 1,093     | 4,333                           | 1,781     |
|                                   | \$ 52,253                        | \$ 25,397 | \$ 114,054                      | \$ 72,891 |

#### ***Cost of Legal Collections – Portfolio Purchasing and Recovery***

The cost of legal collections increased \$7.5 million, or 17.0%, to \$51.0 million during the three months ended September 30, 2013, compared to \$43.5 million during the three months ended September 30, 2012. These costs represent contingent fees paid to our nationwide network of attorneys and costs of litigation in the United States. The increase in the cost of legal collections was primarily the result of an

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increase of \$42.3 million, or 38.0%, in gross collections through our legal channels. Gross legal collections were \$153.6 million during the three months ended September 30, 2013, up from \$111.3 million collected during the three months ended September 30, 2012. The cost of legal collections decreased as a percentage of gross collections through this channel to 33.2% during the three months ended September 30, 2013 from 39.1% during the same period in the prior year. This decrease was primarily due to increased collections in our internal legal channel for which we do not pay a commission.

The cost of legal collections increased \$14.5 million, or 11.8%, to \$137.7 million during the nine months ended September 30, 2013, compared to \$123.2 million during the nine months ended September 30, 2012. The increase in the cost of legal collections was primarily the result of an increase of \$73.7 million, or 22.0%, in gross collections through our legal channels. Gross legal collections were \$409.5 million during the nine months ended September 30, 2013, up from \$335.8 million collected during the nine months ended September 30, 2012. The cost of legal collections decreased as a percentage of gross collections through this channel to 33.6% during the nine months ended September 30, 2013 from 36.7% during the same period in the prior year. This decrease was primarily due to increased collections in our internal legal channel for which we do not pay a commission.

The following table summarizes our legal collection channel performance and related direct costs (*in thousands, except percentages*):

|                            | Three Months Ended September 30, |        |            |        | Nine Months Ended September 30, |        |            |        |
|----------------------------|----------------------------------|--------|------------|--------|---------------------------------|--------|------------|--------|
|                            | 2013                             |        | 2012       |        | 2013                            |        | 2012       |        |
| <b>Collections:</b>        |                                  |        |            |        |                                 |        |            |        |
| Collections                |                                  |        |            |        |                                 |        |            |        |
| legal                      |                                  |        |            |        |                                 |        |            |        |
| outsourcing                | \$ 120,800                       | 78.7%  | \$ 106,254 | 95.4%  | \$ 350,379                      | 85.6%  | \$ 323,508 | 96.3%  |
| Collections                |                                  |        |            |        |                                 |        |            |        |
| internal legal             | 32,756                           | 21.3%  | 5,080      | 4.6%   | 59,132                          | 14.4%  | 12,274     | 3.7%   |
| Total collections          |                                  |        |            |        |                                 |        |            |        |
| legal networks             | \$ 153,556                       | 100.0% | \$ 111,334 | 100.0% | \$ 409,511                      | 100.0% | \$ 335,782 | 100.0% |
| <b>Costs:</b>              |                                  |        |            |        |                                 |        |            |        |
| Commissions                |                                  |        |            |        |                                 |        |            |        |
| legal                      |                                  |        |            |        |                                 |        |            |        |
| outsourcing                | 32,789                           | 27.1%  | 27,215     | 25.6%  | 91,938                          | 26.2%  | 83,055     | 25.7%  |
| Court cost                 |                                  |        |            |        |                                 |        |            |        |
| expense legal              |                                  |        |            |        |                                 |        |            |        |
| outsourcing <sup>(1)</sup> | 8,916                            |        | 13,928     |        | 28,275                          |        | 33,869     |        |
| Court cost                 |                                  |        |            |        |                                 |        |            |        |
| expense internal           |                                  |        |            |        |                                 |        |            |        |
| legal <sup>(1)</sup>       | 7,675                            |        | 1,715      |        | 14,105                          |        | 4,422      |        |
| Other <sup>(2)</sup>       | 1,573                            |        | 686        |        | 3,376                           |        | 1,857      |        |
| Total direct               |                                  |        |            |        |                                 |        |            |        |
| costs legal                |                                  |        |            |        |                                 |        |            |        |
| networks <sup>(3)</sup>    | \$ 50,953                        | 33.2%  | \$ 43,544  | 39.1%  | \$ 137,694                      | 33.6%  | \$ 123,203 | 36.7%  |

- (1) We advance certain out-of-pocket court costs and capitalize these costs in our consolidated financial statements and provide a reserve and corresponding court cost expense for the costs that we believe will be ultimately uncollectible. This amount includes changes in our anticipated recovery rate of court costs expensed.
- (2) Other costs consist of costs related to counter claims and legal network subscription fees.
- (3) Total direct costs – legal networks do not include internal legal channel employee salaries and benefits, and other related direct operating expenses. These expenses were \$9.8 million and \$2.7 million for the three months ended September 30, 2013 and 2012, respectively, and \$18.8 million and \$6.8 million for the nine months ended September 30, 2013 and 2012, respectively.

***Other Operating Expenses***

Other operating expenses increased \$4.3 million, or 28.5%, to \$19.1 million during the three months ended September 30, 2013, from \$14.8 million during the three months ended September 30, 2012. The increase was primarily the result of the Cabot Acquisition and the AACC Merger. The increase was partially offset by a reduction in mailing costs and various other operating expenses.

Other operating expenses increased \$7.2 million, or 18.7%, to \$46.1 million during the nine months ended September 30, 2013, from \$38.9 million during the nine months ended September 30, 2012. The increase was primarily the result of the Cabot Acquisition and the AACC Merger and an increase in Propel other operating expenses due to the inclusion of a full nine months of their expenses compared to a partial period in 2012 (from the acquisition date of May 8, 2012 through September 30, 2012) . The increase was partially offset by a reduction in mailing costs and various other operating expenses.

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Other operating expenses broken down between the reportable segments are as follows (*in thousands*):

|                                   | Three Months Ended September 30, 2013 |           | Nine Months Ended September 30, 2012 |           |
|-----------------------------------|---------------------------------------|-----------|--------------------------------------|-----------|
|                                   | 2013                                  | 2012      | 2013                                 | 2012      |
| Other operating expenses:         |                                       |           |                                      |           |
| Portfolio purchasing and recovery | \$ 18,233                             | \$ 14,339 | \$ 43,224                            | \$ 37,794 |
| Tax lien business                 | 823                                   | 490       | 2,894                                | 1,060     |
|                                   | \$ 19,056                             | \$ 14,829 | \$ 46,118                            | \$ 38,854 |

**Collection Agency Commissions Portfolio Purchasing and Recovery**

During the three months ended September 30, 2013, we incurred \$14.2 million in commissions to third party collection agencies, or 20.5% of the related gross collections of \$69.1 million. During the period, the commission rate as a percentage of related gross collections was 22.6% and 17.6% for our collection outsourcing channels in the United States and in the United Kingdom, respectively. During the three months ended September 30, 2012, we incurred \$4.2 million in commissions, or 23.9%, of the related gross collections of \$17.7 million. The lower commission rate during the three months ended September 30, 2013 was primarily driven by lower commission rates for collection agency outsourcing in the United Kingdom as compared to the commission rates in the United States.

During the nine months ended September 30, 2013, we incurred \$22.7 million in commissions to third party collection agencies, or 19.2% of the related gross collections of \$118.3 million. During the same period, the commission rate as a percentage of related gross collections was 19.7% and 17.6% for our collection outsourcing channel in the United States and in the United Kingdom, respectively. During the nine months ended September 30, 2012, we incurred 12.4 million in commissions, or 28.5%, of the related gross collections of \$43.3 million. The decrease in the net commission rate as a percentage of the related gross collections was primarily due to the lower commission rates on purchased bankruptcy receivable portfolios in the United States as a result of our increased purchase of bankruptcy receivable portfolios in recent periods and, as discussed above, the lower commission rates for collection agencies in the United Kingdom as compared to the rates in the United States.

**General and Administrative Expenses**

General and administrative expenses increased \$19.4 million, or 137.6%, to \$33.5 million during the three months ended September 30, 2013, from \$14.1 million during the three months ended September 30, 2012. The increase was primarily the result of the Cabot Acquisition, the AACC Merger, and general increases in expenses in order to support our growth, including acquisition and integration related costs of \$7.8 million, an increase in IT consulting and other IT expenses of \$3.0 million, an increase in legal costs of \$2.0 million, and an increase in building rent of \$1.6 million.

General and administrative expenses increased \$31.1 million, or 67.1%, to \$ 77.4 million during the nine months ended September 30, 2013, from \$46.3 million during the nine months ended September 30, 2012. The increase was primarily the result of the Cabot Acquisition, the AACC Merger, the acquisition of Propel and general increases in expense in order to support our growth including acquisition and integration related costs of \$18.2 million, an increase in IT consulting and other IT expenses of \$5.9 million, and an increase in building rent of \$2.4 million.

General and administrative expenses broken down between the reportable segments are as follows (*in thousands*):

|                                      | Three Months Ended September 30, 2013 |           | Nine Months Ended September 30, 2012 |           |
|--------------------------------------|---------------------------------------|-----------|--------------------------------------|-----------|
|                                      | 2013                                  | 2012      | 2013                                 | 2012      |
| General and administrative expenses: |                                       |           |                                      |           |
| Portfolio purchasing and recovery    | \$ 32,949                             | \$ 13,619 | \$ 75,505                            | \$ 45,604 |
| Tax lien business                    | 537                                   | 472       | 1,924                                | 727       |
|                                      | \$ 33,486                             | \$ 14,091 | \$ 77,429                            | \$ 46,331 |

### *Depreciation and Amortization*

Depreciation and amortization expense increased \$3.0 million, or 195.0%, to \$4.5 million during the three months ended September 30, 2013, from \$1.5 million during the three months ended September 30, 2012. Depreciation and amortization expense increased \$4.3 million, or 103.4%, to \$8.5 million during the nine months ended September 30, 2013, from \$4.2 million during the nine months ended September 30, 2012. The increases during the three and nine months ended September 30, 2013 were primarily related to increased depreciation expenses resulting from our Cabot Acquisition and AACC Merger.

**Table of Contents****Cost per Dollar Collected Portfolio Purchasing and Recovery**

The following tables summarize our cost per dollar collected (*in thousands, except percentages*):

|                                     | Three Months Ended September 30, |                           |                                   |                                 |             |                          |                                   |                                 |
|-------------------------------------|----------------------------------|---------------------------|-----------------------------------|---------------------------------|-------------|--------------------------|-----------------------------------|---------------------------------|
|                                     | 2013                             |                           |                                   |                                 | 2012        |                          |                                   |                                 |
|                                     | Collections                      | Cost                      | Cost Per Channel Dollar Collected | Cost Per Total Dollar Collected | Collections | Cost                     | Cost Per Channel Dollar Collected | Cost Per Total Dollar Collected |
| United States:                      |                                  |                           |                                   |                                 |             |                          |                                   |                                 |
| Collection sites <sup>(1)</sup>     | \$119,080                        | \$ 10,056                 | 8.4%                              | 3.2%                            | \$ 116,928  | \$ 6,944                 | 5.9%                              | 2.8%                            |
| Legal outsourcing                   | 120,800                          | 44,379                    | 36.7%                             | 14.2%                           | 106,254     | 41,829                   | 39.4%                             | 17.0%                           |
| Internal legal <sup>(2)</sup>       | 32,756                           | 16,395                    | 50.1%                             | 5.3%                            | 5,080       | 4,421                    | 87.0%                             | 1.8%                            |
| Collection agency outsourcing       | 39,607                           | 8,956                     | 22.6%                             | 2.9%                            | 17,715      | 4,227                    | 23.9%                             | 1.7%                            |
| Other indirect costs <sup>(3)</sup> |                                  | 56,540                    |                                   | 18.1%                           |             | 42,240                   |                                   | 17.2%                           |
| Subtotal                            | 312,243                          | \$ 136,326                |                                   | 43.7%                           | \$ 245,977  | \$ 99,661                |                                   | 40.5%                           |
| United Kingdom:                     |                                  |                           |                                   |                                 |             |                          |                                   |                                 |
| Collection sites <sup>(1)</sup>     | 37,931                           | 2,174                     | 5.7%                              | 3.2%                            |             |                          |                                   |                                 |
| Collection agency outsourcing       | 29,496                           | 5,202                     | 17.6%                             | 7.7%                            |             |                          |                                   |                                 |
| Other indirect costs <sup>(3)</sup> |                                  | 10,984                    |                                   | 16.3%                           |             |                          |                                   |                                 |
| Subtotal                            | 67,427                           | 18,360                    |                                   | 27.2%                           |             |                          |                                   |                                 |
| Total                               | \$379,670                        | \$ 154,686 <sup>(4)</sup> |                                   | 40.7%                           | \$ 245,977  | \$ 99,661 <sup>(4)</sup> |                                   | 40.5%                           |

|                                 | Nine Months Ended September 30, |           |                                   |                                 |             |           |                                   |                                 |
|---------------------------------|---------------------------------|-----------|-----------------------------------|---------------------------------|-------------|-----------|-----------------------------------|---------------------------------|
|                                 | 2013                            |           |                                   |                                 | 2012        |           |                                   |                                 |
|                                 | Collections                     | Cost      | Cost Per Channel Dollar Collected | Cost Per Total Dollar Collected | Collections | Cost      | Cost Per Channel Dollar Collected | Cost Per Total Dollar Collected |
| United States:                  |                                 |           |                                   |                                 |             |           |                                   |                                 |
| Collection sites <sup>(1)</sup> | \$ 362,495                      | \$ 24,472 | 6.8%                              | 2.8%                            | \$ 338,439  | \$ 20,096 | 5.9%                              | 2.8%                            |
| Legal outsourcing               | 350,379                         | 124,431   | 35.5%                             | 14.5%                           | 323,508     | 118,781   | 36.7%                             | 16.6%                           |
| Internal legal <sup>(2)</sup>   | 59,132                          | 32,093    | 54.3%                             | 3.7%                            | 12,274      | 11,196    | 91.2%                             | 1.6%                            |
| Collection agency outsourcing   | 88,795                          | 17,515    | 19.7%                             | 2.0%                            | 43,344      | 12,352    | 28.5%                             | 1.7%                            |



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|                                     |                   |                                 |  |              |                   |                                 |  |              |
|-------------------------------------|-------------------|---------------------------------|--|--------------|-------------------|---------------------------------|--|--------------|
| Other indirect costs <sup>(3)</sup> |                   | 144,540                         |  | 16.8%        |                   | 120,858                         |  | 16.8%        |
| <b>Subtotal</b>                     | <b>860,801</b>    | <b>343,051</b>                  |  | <b>39.9%</b> | <b>717,565</b>    | <b>283,283</b>                  |  | <b>39.5%</b> |
| United Kingdom:                     |                   |                                 |  |              |                   |                                 |  |              |
| Collection sites <sup>(1)</sup>     | 37,971            | 2,174                           |  | 5.7%         |                   |                                 |  | 3.2%         |
| Collection agency outsourcing       | 29,496            | 5,202                           |  | 17.6%        |                   |                                 |  | 7.7%         |
| Other indirect costs <sup>(3)</sup> |                   | 10,984                          |  |              |                   |                                 |  | 16.3%        |
| <b>Subtotal</b>                     | <b>67,427</b>     | <b>18,360</b>                   |  | <b>27.2%</b> |                   |                                 |  |              |
| <b>Total</b>                        | <b>\$ 928,228</b> | <b>\$ 361,411<sup>(4)</sup></b> |  | <b>38.9%</b> | <b>\$ 717,565</b> | <b>\$ 283,283<sup>(4)</sup></b> |  | <b>39.5%</b> |

(1) Cost in collection sites represents only account managers and their supervisors' salaries, variable compensation, and employee benefits.

(2) Cost in internal legal channel represents court costs expensed, internal legal channel employee salaries and benefits, and other related direct operating expenses.

(3) Other indirect costs represent non-collection site salaries and employee benefits, general and administrative expenses, other operating expenses and depreciation and amortization.

(4) Represents all operating expenses, excluding stock-based compensation expense, operating expenses related to non-portfolio purchasing and recovery business, one-time charges, and acquisition and integration related operating expenses. We include this information in order to facilitate a comparison of approximate cash costs to cash collections for the debt purchasing business in the periods presented. Refer to the Non-GAAP Disclosure section for further details.

During the three months ended September 30, 2013, overall cost per dollar collected increased slightly by 20 basis points to 40.7% of gross collections from 40.5% of gross collections during the three months ended September 30, 2012. During the same periods, total cost to collect in the United States increased to 43.7% from 40.5%. The increase was partially offset by a lower cost to collect in our

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Cabot subsidiary in the United Kingdom. Over time, we expect our cost to collect to improve, but also expect that it will fluctuate from quarter to quarter based on seasonality, the cost of investments in new operating initiatives, and the ongoing management of the changing regulatory and legislative environment.

The increase of total cost to collect in the United States was due to several factors, including:

The cost from our collection sites, which includes account manager salaries, variable compensation, and employee benefits, as a percentage of total collections in the United States, increased to 3.2% during the three months ended September 30, 2013, from 2.8% during the three months ended September 30, 2012 and, as a percentage of our site collections, increased to 8.4% during the three months ended September 30, 2013, from 5.9% during the three months ended September 30, 2012. The increase in cost as a percentage of total collections, through our collection sites in the United States, was primarily due to the higher cost to collect attributable to AACC. We expect our combined organization to be operated at our lower cost-to-collect within the next two to three quarters.

The cost of legal collections through our internal legal channel, as a percentage of total collections in the United States, increased to 5.3% during the three months ended September 30, 2013, from 1.8% during the three months ended September 30, 2012 and, as a percentage of channel collections, decreased to 50.1% during the three months ended September 30, 2013, from 87.0% during the three months ended September 30, 2012. The increase in cost as a percentage of total collections through our internal legal channel was primarily due to increased collections as a result of our continued expansion of this channel. The decrease in cost as a percentage of channel collections was primarily due to increased productivity in our internal legal platform, which we expect to continue over time.

Collection agency commissions, as a percentage of total collections in the United States, increased to 2.9% during the three months ended September 30, 2013, from 1.7% during the same period in the prior year. Our collection agency commission rate decreased to 22.6% during the three months ended September 30, 2013, from 23.9% during the same period in the prior year. The increase in commission as a percentage of total collections was primarily due to increased collections from this channel as a percentage of total collections. The decrease in commission rate during the quarter ended September 30, 2013 when compared to the period ended September 30, 2012, was due to an increase in bankruptcy receivable portfolio collections through this channel, which have a lower commission rate than non-bankruptcy accounts.

Other costs not directly attributable to specific channel collections (other indirect costs), as a percentage of total collections in the United States, increased 90 basis points, to 18.1% for the three months ended September 30, 2013, from 17.2% for the three months ended September 30, 2012. These costs include non-collection site salaries and employee benefits, general and administrative expenses, other operating expenses, and depreciation and amortization. The dollar increase and the increase in cost per dollar collected were due to several factors, including increases in corporate legal expenses, increases in headcount and increases in other general and

administrative expenses, to support our growth.

The increase in cost per dollar collected in the United States was partially offset by:

The cost of legal collections through our legal outsourcing channel, as a percentage of total collections in the United States, decreased to 14.2% during the three months ended September 30, 2013, from 17.0% during the three months ended September 30, 2012 and, as a percentage of channel collections, decreased to 36.7% from 39.4% compared to the same period of 2012. These decreases were primarily related to improvements in our ability to more accurately and consistently identify those consumers with the financial means to repay their obligations. These improvements resulted in an increase in our court cost recovery rate and an offsetting decrease in court cost expense.

As discussed above, the increase in total cost to collect in the United States was partially offset by a lower overall cost to collect in our Cabot subsidiary in the United Kingdom. During the three months ended September 30, 2013, the total cost to collect in the United Kingdom was 27.2%.

During the nine months ended September 30, 2013, overall cost per dollar collected decreased by 60 basis points to 38.9% of gross collections from 39.5% of gross collections during the nine months ended September 30, 2012. During the same periods, total cost to collect in the United States increased to 39.9% from 39.5%. The decrease in overall cost per dollar collected was attributable to lower cost to collect in our Cabot subsidiary in the United Kingdom.

The increase of total cost to collect in the United States was due to several factors, including:

The cost from our collection sites, which includes account manager salaries, variable compensation, and employee benefits, as a percentage of total collections in the United States, remained consistent at 2.8% during the nine months ended September 30, 2013 and 2012, but as a percentage of our site collections, increased to 6.8% during the nine months ended September 30, 2013, from 5.9% during the nine months ended September 30, 2012. The increase in cost as a percentage of site collections, through our collection sites in the United States, was primarily due to the higher cost to collect attributable to AACC. We expect that our combined organization to be operated at our lower cost-to-collect within the next two to three quarters.

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The cost of legal collections through our internal legal channel, as a percentage of total collections in the United States, increased to 3.7% during the nine months ended September 30, 2013, from 1.6% during the nine months ended September 30, 2012 and, as a percentage of channel collections, decreased to 54.3% during the nine months ended September 30, 2013, from 91.2% during the nine months ended September 30, 2012. The increase in cost as a percentage of total collections through our internal legal channel was primarily due to increased collections as a result of our continued expansion of this channel. The decrease in cost as a percentage of channel collections was primarily due to increased productivity in our internal legal platform, which we expect to continue over time.

Collection agency commissions, as a percentage of total collections in the United States, increased to 2.0% during the nine months ended September 30, 2013, from 1.7% during the same period in the prior year. Our collection agency commission rate decreased to 19.7% during the nine months ended September 30, 2013, from 28.5% during the same period in the prior year. The increase in commissions as a percentage of total collections was primarily due to increased collections from this channel as a percentage of total collections. The decrease in commission rate as a percentage of the related gross collections was primarily due to lower commission rates on purchased bankruptcy receivable portfolios as a result of our increased purchase of bankruptcy receivable portfolios in recent periods.

The increase in cost per dollar collected in the United States was partially offset by:

The cost of legal collections through our legal outsourcing channel, as a percentage of total collections in the United States, decreased to 14.5% during the nine months ended September 30, 2013, from 16.6% during the nine months ended September 30, 2012 and, as a percentage of channel collections, decreased to 35.5% from 36.7% compared to the same period of 2012. These decreases were primarily related to improvements in our ability to more accurately and consistently identify those consumers with the financial means to repay their obligations. These improvements resulted in an increase in our court cost recovery rate and an offsetting decrease in court cost expense.

**Interest Expense Portfolio Purchasing and Recovery**

Interest expense increased \$22.2 million to \$29.2 million during the three months ended September 30, 2013, from \$7.0 million during the three months ended September 30, 2012. Interest expense increased \$24.5 million, to \$43.5 million during the nine months ended September 30, 2013, from \$19.0 million during the nine months ended September 30, 2012.

The following table summarizes our interest expense (*in thousands, except percentages*):

|   | <b>Three Months Ended September 30,</b> |             |                  |                 |
|---|---|-------------|------------------|-----------------|
|   | <b>2013</b>                             | <b>2012</b> | <b>\$ Change</b> | <b>% Change</b> |
| Stated interest on debt obligations               | \$ 21,893                               | \$ 6,397    | \$ 15,496        | 242.2%          |
| Interest expense on preferred equity certificates | 5,877                                   |             | 5,877            |                 |

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|  |                  |                 |                  |               |
|--|------------------|-----------------|------------------|---------------|
| Amortization of loan fees and other loan costs                     | 1,249            | 615             | 634              | 103.1%        |
| Amortization of debt discount, net of appreciation of debt premium | 167              |                 | 167              |               |
| <b>Total interest expense</b>                                      | <b>\$ 29,186</b> | <b>\$ 7,012</b> | <b>\$ 22,174</b> | <b>316.2%</b> |

|  | <b>Nine Months Ended September 30,</b> |                  |                  |                 |
|--|--|------------------|------------------|-----------------|
|  | <b>2013</b>                            | <b>2012</b>      | <b>\$ Change</b> | <b>% Change</b> |
| Stated interest on debt obligations                                | \$ 33,130                              | \$ 17,379        | \$ 15,751        | 90.6%           |
| Interest expense on preferred equity certificates                  | 5,877                                  |                  | 5,877            |                 |
| Amortization of loan fees and other loan costs                     | 3,031                                  | 1,645            | 1,386            | 84.3%           |
| Amortization of debt discount, net of appreciation of debt premium | 1,484                                  |                  | 1,484            |                 |
| <b>Total interest expense</b>                                      | <b>\$ 43,522</b>                       | <b>\$ 19,024</b> | <b>\$ 24,498</b> | <b>128.8%</b>   |

The interest expense on the preferred equity certificates is payable in kind, not in cash. The ultimate payment of the accumulated interest would be satisfied only in connection with the disposition of the noncontrolling interests of J.C. Flowers and management.

The increase in interest expense during the three and nine months ended September 30, 2013 was primarily attributable to interest expense of \$18.2 million incurred at Cabot. The increase was also a result of increased interest expense related to additional borrowings resulting from our Cabot Acquisition and AACC Merger.

**Table of Contents****Provision for Income Taxes**

During the three months ended September 30, 2013 and 2012, we recorded an income tax provision of \$10.3 million and \$13.9 million, respectively. During the nine months ended September 30, 2013 and 2012, we recorded an income tax provision of \$30.1 million and \$38.4 million, respectively.

The effective tax rates for the respective periods are shown below:

|   | Three Months Ended September 30, |        | Nine Months Ended September 30, |        |
|---|----------------------------------|--------|---------------------------------|--------|
|   | 2013                             | 2012   | 2013                            | 2012   |
| Federal provision                             | 35.0%                            | 35.0%  | 35.0%                           | 35.0%  |
| State provision                               | 5.2%                             | 6.5%   | 5.2%                            | 6.5%   |
| State benefit                                 | (1.8%)                           | (2.3%) | (1.8%)                          | (2.3%) |
| Changes in state apportionment <sup>(1)</sup> | (4.0%)                           | (0.5%) | (1.7%)                          | 0.7%   |
| Tax reserves <sup>(2)</sup>                   | 1.8%                             | 0.0%   | 0.7%                            | 0.0%   |
| International provision <sup>(3)</sup>        | (4.8%)                           | (0.5%) | (2.0%)                          | (0.6%) |
| Permanent items <sup>(4)</sup>                | 1.1%                             | 1.3%   | 1.3%                            | 0.4%   |
| Effective rate                                | 32.5%                            | 39.5%  | 36.7%                           | 39.7%  |

(1) Represents changes in state apportionment methodologies.

(2) Represents reserves taken for certain tax position adopted by Encore.

(3) Relates primarily to the lower tax rate on the income attributable to Cabot.

(4) Represents a provision for nondeductible items.

Our subsidiary in Costa Rica is operating under a 100% tax holiday through December 31, 2018 and a 50% tax holiday for the subsequent four years. The impact of the tax holiday in Costa Rica for the three and nine months ended September 30, 2013 and 2012 was immaterial.

As of September 30, 2013, we had a gross unrecognized tax benefit of \$17.6 million that, if recognized, would result in a net tax benefit of approximately \$15.3 million and would have a positive effect on our effective tax rate. During the three and nine months ended September 30, 2013, there was an increase in the gross unrecognized tax benefit of \$2.2 million primarily as a result of the Cabot Acquisition.

During the three and nine months ended September 30, 2013, we did not provide for United States income taxes or foreign withholding taxes on the quarterly undistributed earnings from continuing operations of our subsidiaries operating outside of the United States. Undistributed earnings of these subsidiaries during the three and nine months ended September 30, 2013, were approximately \$1.5 million and \$4.7 million, respectively. Such undistributed earnings are considered permanently reinvested.

**Table of Contents****Supplemental Performance Data Portfolio purchasing and recovery*****Cumulative Collections to Purchase Price Multiple***

The following table summarizes our purchases and related gross collections by year of purchase (in thousands, except multiples):

**Cumulative Collections through September 30, 2013**

|     | 2004       | 2005       | 2006       | 2007       | 2008       | 2009       | 2010       | 2011       | 2012       |
|-----|------------|------------|------------|------------|------------|------------|------------|------------|------------|
| 727 | \$ 4,202   | \$ 2,042   | \$ 1,513   | \$ 989     | \$ 501     | \$ 406     | \$ 296     | \$ 207     | \$ 128     |
| 104 | 8,654      | 5,157      | 3,513      | 1,954      | 1,149      | 885        | 590        | 487        | 345        |
| 580 | 2,293      | 1,323      | 1,007      | 566        | 324        | 239        | 181        | 115        | 103        |
| 453 | 28,551     | 20,622     | 14,521     | 5,644      | 2,984      | 2,005      | 1,411      | 1,139      | 991        |
| 549 | 62,282     | 45,699     | 33,694     | 14,902     | 7,922      | 4,778      | 3,575      | 2,795      | 1,983      |
| 038 | 86,958     | 69,932     | 55,131     | 26,653     | 13,897     | 8,032      | 5,871      | 4,577      | 3,582      |
|     | 39,400     | 79,845     | 54,832     | 34,625     | 19,116     | 11,363     | 8,062      | 5,860      | 4,329      |
|     |            | 66,491     | 129,809    | 109,078    | 67,346     | 42,387     | 27,210     | 18,651     | 12,669     |
|     |            |            | 42,354     | 92,265     | 70,743     | 44,553     | 26,201     | 18,306     | 12,825     |
|     |            |            |            | 68,048     | 145,272    | 111,117    | 70,572     | 44,035     | 29,619     |
|     |            |            |            |            | 69,049     | 165,164    | 127,799    | 87,850     | 59,507     |
|     |            |            |            |            |            | 96,529     | 206,773    | 164,605    | 111,569    |
|     |            |            |            |            |            |            | 125,465    | 284,541    | 215,088    |
|     |            |            |            |            |            |            |            | 122,224    | 300,536    |
|     |            |            |            |            |            |            |            |            | 186,472    |
| 451 | \$ 232,340 | \$ 291,111 | \$ 336,374 | \$ 354,724 | \$ 398,303 | \$ 487,458 | \$ 604,006 | \$ 755,392 | \$ 939,746 |
|     | \$         | \$         | \$         | \$         | \$         | \$         | \$         | \$         | \$         |
|     | \$         | \$         | \$         | \$         | \$         | \$         | \$ 388     | \$ 4,247   | \$ 5,598   |
|     |            |            |            |            |            |            |            | 1,372      | 1,413      |
|     |            |            |            |            |            |            |            |            | 1,249      |
|     | \$         | \$         | \$         | \$         | \$         | \$         | \$ 388     | \$ 5,619   | \$ 8,260   |
| 451 | \$ 232,340 | \$ 291,111 | \$ 336,374 | \$ 354,724 | \$ 398,303 | \$ 487,458 | \$ 604,394 | \$ 761,011 | \$ 948,006 |

- (1) Adjusted for put-backs and account recalls. Put-backs represent accounts that are returned to the seller in accordance with the respective purchase agreement ( Put-Backs ). Recalls represent accounts that are recalled by the seller in accordance with the respective purchase agreement ( Recalls ).
- (2) Cumulative collections from inception through September 30, 2013, excluding collections on behalf of others.
- (3) Cumulative Collections Multiple ( CCM ) through September 30, 2013 refers to collections as a multiple of purchase price.



**Table of Contents****Total Estimated Collections to Purchase Price Multiple**

The following table summarizes our purchases, resulting historical gross collections, and estimated remaining gross collections by year of purchase (*in thousands, except multiples*):

|  | <b>Purchase Price<sup>(1)</sup></b> | <b>Historical Collections<sup>(2)</sup></b> | <b>Estimated Remaining Collections<sup>(3),(4)</sup></b> | <b>Total Estimated Gross Collections</b> | <b>Total Estimated Gross Collections to Purchase Price</b> |
|--|-------------------------------------|---|--|--|--|
| <b>Charged-off consumer receivables:</b> |                                     |   |  |  |  |
| <i>United States:</i>                    |                                     |   |  |  |  |
| <2006                                    | \$ 578,054                          | \$ 1,832,569                                | \$ 5,902   | \$ 1,838,471                             | 3.2  |
| 2006                                     | 141,026                             | 314,643                                     | 7,786  | 322,429                                  | 2.3  |
| 2007                                     | 204,065                             | 485,190                                     | 19,630   | 504,820                                  | 2.5  |
| 2008                                     | 227,780                             | 542,794                                     | 50,917   | 593,711                                  | 2.6  |
| 2009                                     | 253,295                             | 643,335                                     | 105,954  | 749,289                                  | 3.0  |
| 2010                                     | 346,073                             | 744,868                                     | 223,325  | 968,193                                  | 2.8  |
| 2011                                     | 382,801                             | 602,848                                     | 355,212  | 958,060                                  | 2.5  |
| 2012                                     | 476,350                             | 441,812                                     | 545,961  | 987,773                                  | 2.1  |
| 2013                                     | 473,274                             | 133,163                                     | 1,074,624  | 1,207,787                                | 2.6  |
| Subtotal                                 | \$ 3,082,718                        | \$ 5,741,222                                | \$ 2,389,311   | \$ 8,130,533                             | 2.6  |
| <i>United Kingdom:</i>                   |                                     |   |  |  |  |
| 2013                                     | \$ 585,930                          | \$ 67,427                                   | \$ 1,503,459   | \$ 1,570,886                             | 2.7  |
| <b>Purchased bankruptcy receivables:</b> |                                     |   |  |  |  |
| 2010                                     | \$ 11,975                           | \$ 14,969                                   | \$ 7,591   | \$ 22,560                                | 1.9  |
| 2011                                     | 1,642                               | 3,642                                       | 509  | 4,151                                    | 2.5  |
| 2012                                     | 83,445                              | 25,230                                      | 72,470   | 97,700                                   | 1.2  |
| 2013                                     | 39,978                              | 6,910                                       | 48,657   | 55,567                                   | 1.4  |
| Subtotal                                 | \$ 137,040                          | \$ 50,751                                   | \$ 129,227   | \$ 179,978                               | 1.3  |
| <b>Total</b>                             | <b>\$ 3,805,688</b>                 | <b>\$ 5,859,400</b>                         | <b>\$ 4,021,997</b>                                      | <b>\$ 9,881,397</b>                      | <b>2.6</b>   |

(1) Adjusted for Put-Backs and Recalls.

(2) Cumulative collections from inception through September 30, 2013, excluding collections on behalf of others.

(3) Estimated remaining collections for charged off consumer receivables includes \$102.0 million related to accounts that converted to bankruptcy after purchase.

(4)

The collection forecast of each pool is generally estimated to be between 84 to 96 months based on the expected collection period of each pool in the United States and up to 120 months in the United Kingdom.

**Estimated Remaining Gross Collections by Year of Purchase**

The following table summarizes our estimated remaining gross collections by year of purchase (*in thousands*):

|                                | Estimated Remaining Gross Collections by Year of Purchase <sup>(1), (2), (3)</sup> |            |            |            |            |            |            |            |            |    |
|--------------------------------|--|------------|------------|------------|------------|------------|------------|------------|------------|----|
|                                | 2014   | 2015       | 2016       | 2017       | 2018       | 2019       | 2020       | 2021       | >2022      |    |
| <b>Consumer receivables:</b>   |  |            |            |            |            |            |            |            |            |    |
| 1,257                          | \$ 3,517   | \$ 1,123   | \$ 5       | \$         | \$         | \$         | \$         | \$         | \$         | \$ |
| 1,691                          | 3,892  | 1,578      | 625        |            |            |            |            |            |            |    |
| 3,862                          | 8,784  | 3,913      | 2,088      | 983        |            |            |            |            |            |    |
| 7,972                          | 19,928   | 12,357     | 6,097      | 3,236      | 1,327      |            |            |            |            |    |
| 3,194                          | 41,989   | 22,768     | 13,828     | 7,641      | 4,698      | 1,836      |            |            |            |    |
| 5,371                          | 81,479   | 50,289     | 30,061     | 18,268     | 8,541      | 6,565      | 2,751      |            |            |    |
| 3,404                          | 128,377  | 79,191     | 48,591     | 27,842     | 15,490     | 8,791      | 6,012      | 2,514      |            |    |
| 5,081                          | 188,608  | 122,455    | 74,039     | 43,988     | 25,250     | 15,930     | 10,067     | 7,209      | 2,334      |    |
| 3,393                          | 300,379  | 248,140    | 160,999    | 108,473    | 73,006     | 51,363     | 32,297     | 17,790     | 13,784     |    |
| 5,225                          | \$ 776,953   | \$ 541,814 | \$ 336,333 | \$ 210,431 | \$ 128,312 | \$ 84,485  | \$ 51,127  | \$ 27,513  | \$ 16,118  |    |
| <b>Commercial:</b>             |  |            |            |            |            |            |            |            |            |    |
| 3,279                          | \$ 209,101   | \$ 221,069 | \$ 191,412 | \$ 165,107 | \$ 146,554 | \$ 133,372 | \$ 121,427 | \$ 112,084 | \$ 150,054 |    |
| <b>Bankruptcy receivables:</b> |  |            |            |            |            |            |            |            |            |    |
| 1,233                          | \$ 3,548   | \$ 2,192   | \$ 618     | \$         | \$         | \$         | \$         | \$         | \$         |    |
| 181                            | 229  | 59         | 37         | 3          |            |            |            |            |            |    |
| 5,563                          | 24,244   | 19,748     | 12,855     | 6,885      | 2,175      |            |            |            |            |    |
| 4,171                          | 17,851   | 15,116     | 8,755      | 2,652      | 112        |            |            |            |            |    |
| 2,148                          | \$ 45,872  | \$ 37,115  | \$ 22,265  | \$ 9,540   | \$ 2,287   | \$         | \$         | \$         | \$         |    |
| 1,652                          | \$ 1,031,926   | \$ 799,998 | \$ 550,010 | \$ 385,078 | \$ 277,153 | \$ 217,857 | \$ 172,554 | \$ 139,597 | \$ 166,172 |    |

- (1) Estimated remaining collections for Zero Basis Portfolios can extend beyond our collection forecasts.
- (2) Estimated remaining collections for charged off consumer receivables includes \$102.0 million related to accounts that converted to bankruptcy after purchase.
- (3) The collection forecast of each pool is generally estimated to be between 84 to 96 months based on the expected collection period of each pool in the United States and up to 120 months in the United Kingdom.

**Table of Contents****Unamortized Balances of Portfolios**

The following table summarizes the remaining unamortized balances of our purchased receivable portfolios by year of purchase (*in thousands, except percentages*):

|  | Unamortized<br>Balance as of<br>September 30, 2013 | Purchase<br>Price <sup>(1)</sup> | Unamortized<br>Balance as<br>a<br>Percentage<br>of<br>Purchase Price | Unamortized<br>Balance as a<br>Percentage<br>of Total |
|--|--|----------------------------------|--|---|
| <b>Charged-off consumer receivables:</b> |  |                                  |  |   |
| <i>United States:</i>                    |  |                                  |  |   |
| 2006                                     | \$ 3,420   | \$ 141,026                       | 2.4%   | 0.4%  |
| 2007                                     | 5,433  | 204,065                          | 2.7%   | 0.6%  |
| 2008                                     | 20,428   | 227,780                          | 9.0%   | 2.3%  |
| 2009                                     | 24,920   | 253,295                          | 9.8%   | 2.8%  |
| 2010                                     | 54,816   | 346,073                          | 15.8%  | 6.1%  |
| 2011                                     | 118,520  | 382,801                          | 31.0%  | 13.2%   |
| 2012                                     | 251,296  | 476,350                          | 52.8%  | 28.1%   |
| 2013                                     | 416,984  | 473,274                          | 88.1%  | 46.5%   |
| Subtotal                                 | \$ 895,817   | \$ 2,504,664                     | 35.8%  | 100.0%  |
| <i>United Kingdom:</i>                   |  |                                  |  |   |
| 2013                                     | \$ 596,160   | \$ 585,930                       | 101.7%   | 100.0%  |
| <b>Purchased bankruptcy receivables:</b> |  |                                  |  |   |
| 2010                                     | \$ 4,614   | \$ 11,975                        | 38.5%  | 4.5%  |
| 2011                                     | 107  | 1,642                            | 6.5%   | 0.1%  |
| 2012                                     | 63,187   | 83,445                           | 75.7%  | 61.0%   |
| 2013                                     | 35,757   | 39,978                           | 89.4%  | 34.4%   |
| Subtotal                                 | \$ 103,665   | \$ 137,040                       | 75.6%  | 100.0%  |
| Total                                    | \$ 1,595,642                                       | \$ 3,227,634                     | 49.4%  | 100.0%  |

- (1) Purchase price refers to the cash paid to a seller to acquire a portfolio less Put-Backs, plus an allocation of our forward flow asset (if applicable), and less the purchase price for accounts that were sold at the time of purchase to another debt purchaser.

**Changes in the Investment in Receivable Portfolios**

Revenue related to our investment in receivable portfolios comprises two groups. First, revenue from those portfolios that have a remaining book value and are accounted for on the accrual basis ( Accrual Basis Portfolios ), and second,

revenue from those portfolios that have fully recovered their book value ( Zero Basis Portfolios ) and, therefore, every dollar of gross collections is recorded entirely as Zero Basis Revenue. If the amount and timing of future cash collections on a pool of receivables are not reasonably estimable, we account for such portfolios on the cost recovery method ( Cost Recovery Portfolios ). No revenue is recognized on Cost Recovery Portfolios until the cost basis has been fully recovered, at which time they become Zero Basis Portfolios.

The following tables summarize the changes in the balance of the investment in receivable portfolios and the proportion of revenue recognized as a percentage of collections (*in thousands, except percentages*):

|   | <b>Three Months Ended September 30, 2013</b> |                                     |                                  |              |
|---|--|-------------------------------------|----------------------------------|--------------|
|   | <b>Accrual Basis<br/>Portfolios</b>          | <b>Cost Recovery<br/>Portfolios</b> | <b>Zero Basis<br/>Portfolios</b> | <b>Total</b> |
| Balance, beginning of period                          | \$ 1,090,922                                 | \$ 5,776                            | \$                               | \$ 1,096,698 |
| Purchases of receivable portfolios <sup>(1)</sup>     | 616,779                                      | 1,073                               |                                  | 617,852      |
| Gross collections <sup>(2)</sup>                      | (371,482)                                    | (983)                               | (7,205)                          | (379,670)    |
| Put-backs and recalls                                 | (755)  | (242)                               |                                  | (997)        |
| Foreign currency adjustments                          | 36,372                                       |                                     |                                  | 36,372       |
| Revenue recognized                                    | 218,182                                      |                                     | 4,227                            | 222,409      |
| Portfolio allowances reversals, net                   |  |                                     | 2,978                            | 2,978        |
| Balance, end of period                                | \$ 1,590,018                                 | \$ 5,624                            | \$                               | \$ 1,595,642 |
| Revenue as a percentage of collections <sup>(3)</sup> | 58.7%  | 0.0%                                | 58.7%                            | 58.6%        |

**Table of Contents****Three Months Ended September 30, 2012**

|   | <b>Accrual Basis<br/>Portfolios</b> | <b>Cost Recovery<br/>Portfolios</b> | <b>Zero Basis<br/>Portfolios</b> | <b>Total</b> |
|---|-------------------------------------|-------------------------------------|----------------------------------|--------------|
| Balance, beginning of period                              | \$ 869,859                          | \$                                  | \$                               | \$ 869,859   |
| Purchases of receivable portfolios                        | 47,311                              |                                     |                                  | 47,311       |
| Gross collections <sup>(2)</sup>                          | (239,577)                           |                                     | (6,388)                          | (245,965)    |
| Put-backs and recalls                                     | (267)                               |                                     |                                  | (267)        |
| Revenue recognized  | 134,496                             |                                     | 5,469                            | 139,965      |
| (Portfolio allowances) portfolio allowance reversals, net | (202)                               |                                     | 919                              | 717          |
| Balance, end of period                                    | \$ 811,620                          | \$                                  | \$                               | \$ 811,620   |
| Revenue as a percentage of collections <sup>(3)</sup>     | 56.1%                               | 0.0%                                | 85.6%                            | 56.9%        |

**Nine Months Ended September 30, 2013**

|   | <b>Accrual Basis<br/>Portfolios</b> | <b>Cost Recovery<br/>Portfolios</b> | <b>Zero Basis<br/>Portfolios</b> | <b>Total</b> |
|---|-------------------------------------|-------------------------------------|----------------------------------|--------------|
| Balance, beginning of period                          | \$ 873,119                          | \$                                  | \$                               | \$ 873,119   |
| Purchases of receivable portfolios <sup>(1)</sup>     | 1,098,663                           | 1,073                               |                                  | 1,099,736    |
| Transfer of portfolios                                | (6,649)                             | 6,649                               |                                  |              |
| Gross collections <sup>(2)</sup>                      | (905,751)                           | (1,825)                             | (20,652)                         | (928,228)    |
| Put-backs and recalls                                 | (2,512)                             | (273)                               | (2)                              | (2,787)      |
| Foreign currency adjustments                          | 35,708                              |                                     |                                  | 35,708       |
| Revenue recognized                                    | 496,804                             |                                     | 13,632                           | 510,436      |
| Portfolio allowances reversals, net                   | 636                                 |                                     | 7,022                            | 7,658        |
| Balance, end of period                                | \$ 1,590,018                        | \$ 5,624                            | \$                               | \$ 1,595,642 |
| Revenue as a percentage of collections <sup>(3)</sup> | 54.8%                               | 0.0%                                | 66.0%                            | 55.0%        |

**Nine Months Ended September 30, 2012**

|   | <b>Accrual Basis<br/>Portfolios</b> | <b>Cost Recovery<br/>Portfolios</b> | <b>Zero Basis<br/>Portfolios</b> | <b>Total</b> |
|---|-------------------------------------|-------------------------------------|----------------------------------|--------------|
| Balance, beginning of period                              | \$ 716,454                          | \$                                  | \$                               | \$ 716,454   |
| Purchases of receivable portfolios                        | 408,757                             |                                     |                                  | 408,757      |
| Gross collections <sup>(2)</sup>                          | (696,957)                           |                                     | (20,560)                         | (717,517)    |
| Put-backs and recalls                                     | (1,892)                             |                                     |                                  | (1,892)      |
| Revenue recognized  | 386,685                             |                                     | 17,627                           | 404,312      |
| (Portfolio allowances) portfolio allowance reversals, net | (1,427)                             |                                     | 2,933                            | 1,506        |
| Balance, end of period                                    | \$ 811,620                          | \$                                  | \$                               | \$ 811,620   |

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|   |       |      |       |       |
|---|-------|------|-------|-------|
| Revenue as a percentage of collections <sup>(3)</sup> | 55.5% | 0.0% | 85.7% | 56.3% |
|---|-------|------|-------|-------|

- (1) Purchases of portfolio receivables include \$381.2 million acquired in connection with the AACC Merger in June 2013 and \$559.0 million acquired in connection with the Cabot Acquisition in July 2013 discussed in Note 3, Business Combinations to the notes to our consolidated financial statements.
- (2) Does not include amounts collected on behalf of others.
- (3) Revenue as a percentage of collections excludes the effects of net portfolio allowances or net portfolio allowance reversals.

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As of September 30, 2013, we had \$1.6 billion in investment in receivable portfolios. This balance will be amortized based upon current projections of cash collections in excess of revenue applied to the principal balance. The estimated amortization of the investment in receivable portfolios balance is as follows (*in thousands*):

| Year Ending December 31, | Charged-off       |                   | Charged-off       |  | Total               |
|--------------------------|-------------------|-------------------|-------------------|--|---------------------|
|                          | Consumer          | Consumer          | Purchased         |  |                     |
|                          | Receivables       | Receivables       | Bankruptcy        |  |                     |
|                          | United States     | United Kingdom    | Receivables       |  | Amortization        |
| 2013 <sup>(1)</sup>      | \$ 58,391         | \$ 10,224         | \$ 8,238          |  | \$ 76,853           |
| 2014                     | 269,460           | 43,512            | 34,076            |  | 347,048             |
| 2015                     | 218,926           | 73,425            | 30,556            |  | 322,907             |
| 2016                     | 137,954           | 63,911            | 19,690            |  | 221,555             |
| 2017                     | 96,435            | 54,812            | 8,863             |  | 160,110             |
| 2018                     | 60,426            | 51,640            | 2,240             |  | 114,306             |
| 2019                     | 39,741            | 53,671            |                   |  | 93,412              |
| 2020                     | 14,486            | 57,787            |                   |  | 72,273              |
| 2021                     |                   | 66,263            |                   |  | 66,263              |
| 2022                     |                   | 76,470            |                   |  | 76,470              |
| 2023                     |                   | 44,445            |                   |  | 44,445              |
| <b>Total</b>             | <b>\$ 895,819</b> | <b>\$ 596,160</b> | <b>\$ 103,663</b> |  | <b>\$ 1,595,642</b> |

<sup>(1)</sup> 2013 amount consists of three months data from October 1, 2013 to December 31, 2013.

**Headcount by Function by Geographical Location**

The following table summarizes our headcount by function by geographical location:

|                                | Headcount as of September 30, |               |          |               |
|--------------------------------|-------------------------------|---------------|----------|---------------|
|                                | 2013                          |               | 2012     |               |
|                                | Domestic                      | International | Domestic | International |
| General & Administrative       | 1,035                         | 1,008         | 529      | 518           |
| Internal Legal Account Manager | 73                            | 32            | 20       | 10            |
| Account Manager                | 370                           | 1,743         | 201      | 1,410         |
| Bankruptcy Specialist          |                               |               |          | 72            |
|                                | 1,478                         | 2,783         | 750      | 2,010         |

**Gross Collections by Account Manager**

The following table summarizes our collection performance by account manager (*in thousands, except headcount*):

|   | Three Months Ended    |                       | Nine Months Ended     |                       |
|---|-----------------------|-----------------------|-----------------------|-----------------------|
|   | September 30,<br>2013 | September 30,<br>2012 | September 30,<br>2013 | September 30,<br>2012 |
| <b>United States<sup>(1)</sup>:</b>                           |                       |                       |                       |                       |
| Gross collections collection sites                            | \$ 119,080            | \$ 116,928            | \$ 362,495            | \$ 338,439            |
| Average active Account Manager                                | 1,705                 | 1,599                 | 1,634                 | 1,422                 |
| Collections per average active Account Manager <sup>(2)</sup> | \$ 69.8               | \$ 73.1               | \$ 221.8              | \$ 238.0              |
| <b>United Kingdom:</b>  |                       |                       |                       |                       |
| Gross collections collection sites                            | \$ 37,931             | \$                    | \$ 37,931             | \$                    |
| Average active Account Manager                                | 384                   |                       | 384                   |                       |
| Collections per average active Account Manager                | \$ 98.8               | \$                    | \$ 98.8               | \$                    |
| <b>Overall:</b>   |                       |                       |                       |                       |
| Collections per average active Account Manager                | \$ 75.2               | \$ 73.1               | \$ 198.4              | \$ 238.0              |

(1) United States represents account manager statistics for United States portfolios and includes collection statistics for our India and Costa Rica call centers.

(2) The decrease in collections per average active account manager is primarily driven by short-term ramp up in headcount as part of our long-term strategy in developing lower cost-to-collect international call centers, including our near-shore call center in Costa Rica. As we ramped up headcount in our international call centers, our overall collector productivity, as expected, has declined. Once we are fully ramped up and the new account managers become experienced, we expect productivity to move back towards previous levels. Additionally, the decrease in collections per headcount is attributable to a lower productivity in our AACC subsidiary, we expect our combined organization will be operating at our historical productivity levels within the next two to three quarters.



**Table of Contents****Gross Collections per Hour Paid**

The following table summarizes our gross collections per hour paid to account managers (*in thousands, except gross collections per hour paid*):

|  | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|--|-------------------------------------|------------|------------------------------------|------------|
|  | 2013                                | 2012       | 2013                               | 2012       |
| <b>United States<sup>(1)</sup>:</b>      |                                     |            |                                    |            |
| Gross collections collection sites       | \$ 119,080                          | \$ 116,928 | \$ 362,495                         | \$ 338,439 |
| Total hours paid                         | 769                                 | 730        | 2,216                              | 1,873      |
| Collections per hour paid <sup>(2)</sup> | \$ 154.9                            | \$ 160.2   | \$ 163.6                           | \$ 180.7   |
| <b>United Kingdom:</b>                   |                                     |            |                                    |            |
| Gross collections collection sites       | \$ 37,931                           | \$         | \$ 37,931                          | \$         |
| Total hours paid                         | 103                                 |            | 103                                |            |
| Collections per hour paid                | \$ 368.3                            | \$         | \$ 368.3                           | \$         |
| <b>Overall:</b>                          |                                     |            |                                    |            |
| Collections per hour paid                | \$ 180.1                            | \$ 160.2   | \$ 172.7                           | \$ 180.7   |

(1) United States represents account manager statistics for United States portfolios and includes collection statistics for our India and Costa Rica call centers.

(2) The decrease in gross collections per hour paid is primarily driven by short-term ramp up in headcount as part of our long-term strategy in developing lower cost-to-collect international call centers, including our near-shore call center in Costa Rica. As we ramped up headcount in our international call centers, our overall collector productivity, as expected, has declined. Once we are fully ramped up and the new account managers become experienced, we expect productivity to move back towards previous levels. Additionally, the decrease in gross collections per hour paid is attributable to a lower productivity in our AACC subsidiary, we expect our combined organization will be operating at our historical productivity levels within the next two to three quarters.

**Collection Sites Direct Cost per Dollar Collected**

The following table summarizes our gross collections in collection sites and the related direct cost (*in thousands, except percentages*):

|  | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|--|-------------------------------------|------------|------------------------------------|------------|
|  | 2013                                | 2012       | 2013                               | 2012       |
| <b>United States<sup>(1)</sup>:</b>      |                                     |            |                                    |            |
| Gross collections collection sites       | \$ 119,080                          | \$ 116,928 | \$ 362,495                         | \$ 338,439 |
| Direct cost <sup>(2)</sup>               | \$ 10,056                           | \$ 6,944   | \$ 24,472                          | \$ 20,096  |
| Cost per dollar collected <sup>(3)</sup> | 8.4%                                | 5.9%       | 6.8%                               | 5.9%       |
| <b>United Kingdom:</b>                   |                                     |            |                                    |            |
| Gross collections collection sites       | \$ 37,931                           | \$         | \$ 37,931                          | \$         |

|                            |          |      |          |      |
|----------------------------|----------|------|----------|------|
| Direct cost <sup>(2)</sup> | \$ 2,174 | \$   | \$ 2,174 | \$   |
| Cost per dollar collected  | 5.7%     |      | 5.7%     |      |
| <b>Overall:</b>            |          |      |          |      |
| Cost per dollar collected  | 7.8%     | 5.9% | 6.7%     | 5.9% |

- (1) United States statistics include gross collections and direct costs for our India and Costa Rica call centers.
- (2) Represent account managers and their supervisors' salaries, variable compensation, and employee benefits.
- (3) The increase in cost as a percentage of total collections, through our collection sites in the United States, was primarily due to the higher cost to collect attributable to our AACC subsidiary. We expect that our combined organization will be operating at our lower historical cost-to-collect within the next two to three quarters.

***Salaries and Employee Benefits by Function***

The following table summarizes our salaries and employee benefits by function (excluding stock-based compensation) (*in thousands*):

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|   | Three Months Ended September 30, |           | Nine Months Ended September 30, |           |
|---|----------------------------------|-----------|---------------------------------|-----------|
|   | 2013                             | 2012      | 2013                            | 2012      |
| Portfolio purchasing and recovery activities                      |                                  |           |                                 |           |
| Collection site salaries and employee benefits <sup>(1)</sup>     | \$ 10,056                        | \$ 6,944  | \$ 24,472                       | \$ 20,096 |
| Non-collection site salaries and employee benefits <sup>(2)</sup> | 36,735                           | 15,455    | 76,086                          | 44,304    |
| Subtotal  | 46,791                           | 22,399    | 100,558                         | 64,400    |
| Tax lien business   | 1,479                            | 1,093     | 4,333                           | 1,781     |
|   | \$ 48,270                        | \$ 23,492 | \$ 104,891                      | \$ 66,181 |

(1) Represent account managers and their supervisors' salaries, variable compensation, and employee benefits.

(2) Includes internal legal channel salaries and employee benefits of \$5.7 million and \$1.8 million for the three months ended September 30, 2013 and 2012, respectively, and internal legal channel salaries and employee benefits of \$11.7 million and \$4.7 million for the nine months ended September 30, 2013 and 2012, respectively.

**Purchases by Quarter**

The following table summarizes the purchases we made by quarter, and the respective purchase prices (in thousands):

| Quarter                | # of Accounts | Face Value | Purchase Price |
|------------------------|---------------|------------|----------------|
| Q1 2011                | 1,243         | 2,895,805  | 90,675         |
| Q2 2011                | 1,477         | 2,998,564  | 93,701         |
| Q3 2011                | 1,633         | 2,025,024  | 65,731         |
| Q4 2011                | 2,776         | 3,782,595  | 136,743        |
| Q1 2012                | 2,132         | 2,902,409  | 130,463        |
| Q2 2012                | 3,679         | 6,034,499  | 230,983        |
| Q3 2012                | 1,037         | 1,052,191  | 47,311         |
| Q4 2012                | 3,125         | 8,467,400  | 153,578        |
| Q1 2013                | 1,678         | 1,615,214  | 58,771         |
| Q2 2013 <sup>(1)</sup> | 23,887        | 68,906,743 | 423,113        |
| Q3 2013 <sup>(2)</sup> | 4,232         | 13,437,807 | 617,852        |

(1) Includes \$381.2 million of portfolios acquired with a face value of approximately \$68.2 billion in connection with the AACC Merger.

(2) Includes \$559.0 million of portfolios acquired with a face value of approximately \$12.8 billion in connection with the Cabot Acquisition.

**Liquidity and Capital Resources**

Historically, we have met our cash requirements by utilizing our cash flows from operations, bank borrowings, convertible debt offerings, and equity offerings. Our primary cash requirements have included the purchase of receivable portfolios, operating expenses, and the payment of interest and principal on bank borrowings and tax payments.

The following table summarizes our cash flows by category for the periods presented (*in thousands*):

|   | <b>Nine Months Ended September 30,</b> |             |
|---|--|-------------|
|   | <b>2013</b>                            | <b>2012</b> |
| Net cash provided by operating activities | \$ 39,866                              | \$ 66,153   |
| Net cash used in investing activities     | (214,394)                              | (282,001)   |
| Net cash provided by financing activities | 264,660                                | 227,064     |

As of September 30, 2013, under the Encore Amended and Restated Credit Agreement (the Restated Credit Agreement ) we have a credit facility (the Credit Facility ) consisting of a term loan facility tranche of \$150.0 million, six month term loan facility tranche of \$48.6 million, a revolving credit facility tranche of \$613.9 million and an accordion feature that allows us to increase the revolving credit facility by an additional \$162.5 million. Including the accordion feature, the maximum amount that can be borrowed under the Restated Credit Agreement is \$975.0 million. The term loan facility and the revolving credit facility have five-year maturities expiring in November 2017, except with respect to a \$50.0 million subtranche of the term loan facility, which has a three-year maturity, expiring in November 2015. The \$48.6 million six month term loan facility tranche has a six-month maturity, expiring November 2013. As of September 30, 2013, we had \$509.8 million outstanding and \$104.1 million of availability under the Encore revolving credit facility.

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On June 24, 2013, Encore sold \$150.0 million in aggregate principal amount of 3.0% convertible senior notes due July 1, 2020 in a private placement transaction. On July 18, 2013, the initial purchasers exercised, in full, their option to purchase an additional \$22.5 million of the convertible senior notes, which resulted in an aggregate principal amount of \$172.5 million of the convertible senior notes outstanding (collectively, the 2020 Convertible Notes ). The net proceeds from the sale of the 2020 Convertible Notes were approximately \$167.4 million, after deducting the initial purchasers' discounts and commissions and the estimated offering expenses paid by us. We used approximately \$18.1 million of the net proceeds from this offering to pay the cost of the capped call transactions entered into in connection with the 2020 Convertible Notes and used the remainder of the net proceeds to pay a portion of the purchase price for the Cabot Acquisition and for general corporate purposes.

Through Cabot Financial (UK) Limited ( Cabot Financial UK ), an indirect subsidiary, we have a revolving credit facility of £85.0 million (the Cabot Credit Facility ). As of September 30, 2013, there were no amounts outstanding and we had £85.0 million available for borrowing under the Cabot Credit Facility.

On August 2, 2013, Cabot Financial UK issued £100 million in aggregate principal amount of 8.375% Senior Secured Notes due 2020 (the Cabot 2020 Notes ). Of the proceeds from the issuance of the Cabot 2020 Notes, approximately £75 million was used to repay all amounts then outstanding under the senior credit facilities of Cabot Financial UK and £25 million was used to partially repay a portion of the J Bridge preferred equity certificates to J.C. Flowers.

We, through Propel, have a \$160.0 million syndicated loan facility (the Propel TLT Facility ). The Propel TLT Facility is used to fund growth in the tax lien transfer business at Propel. As of September 30, 2013, we had \$131.3 million outstanding and \$28.7 million of availability under our Propel TLT Facility.

We, through subsidiaries of Propel, have a \$100.0 million revolving credit facility (the Propel TLC Facility ). The Propel TLC Facility is used to purchase tax lien certificates from taxing authorities. As of September 30, 2013, we had \$27.0 million outstanding and \$73.0 million of availability under our Propel TLC Facility.

Currently, all of our portfolio purchases are funded with cash from operations and borrowings under our Restated Credit Agreement and our Cabot Credit Facility. All of our tax lien transfers are funded with cash from Propel operations and borrowings under the Propel TLT Facility. All of our tax lien certificate purchases are funded with cash from Propel operations and borrowings under the Propel TLC Facility.

See Note 11, Debt to our unaudited condensed consolidated financial statements for a further discussion of our debt.

***Operating Cash Flows***

Net cash provided by operating activities was \$39.9 million and \$66.2 million during the nine months ended September 30, 2013 and 2012, respectively.

Cash provided by operating activities during the nine months ended September 30, 2013 was primarily related to net income of \$51.5 million and various non-cash add backs in operating activities and changes in operating assets and liabilities, net of an income tax payment of \$54.5 million. Cash provided by operating activities during the nine months ended September 30, 2012, was primarily related to net income of \$49.3 million and a \$10.4 million non-cash add back related to impairment charges for goodwill and identifiable intangible assets related to Ascension Capital Group, Inc., which is included in our discontinued operations.

***Investing Cash Flows***

Net cash used in investing activities was \$214.4 million and \$282.0 million during the nine months ended September 30, 2013 and 2012, respectively.

Cash flows used in investing activities during the nine months ended September 30, 2013 were primarily related to cash paid for the AACC Merger and the Cabot Acquisition, net of cash acquired of \$413.1 million, receivable portfolio purchases (excluding the portfolios acquired from the AACC Merger of \$381.2 million and from the Cabot Acquisition of \$559.0 million) of \$156.4 million, and originations of receivables secured by tax liens of \$100.3 million, offset by gross collection proceeds applied to the principal of our receivable portfolios in the amount of \$418.0 million and collections applied to our receivables secured by tax liens of \$51.1 million. The cash flows used in investing activities during the nine months ended September 30, 2012, were primarily related to receivable portfolio purchases of \$406.9 million, cash paid for the Propel acquisition, net of cash acquired, of \$186.7 million, offset by gross collection proceeds applied to the principal of our receivable portfolios in the amount of \$313.2 million.

Capital expenditures for fixed assets acquired with internal cash flow were \$8.2 million and \$3.7 million for nine months ended September 30, 2013 and 2012, respectively.

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### ***Financing Cash Flows***

Net cash provided by financing activities was \$264.7 million and \$227.1 million during the nine months ended September 30, 2013 and 2012, respectively.

The cash provided by financing activities during the nine months ended September 30, 2013, reflects \$522.1 million in borrowings under our Credit Facility, the Propel TLT and TLC Facilities, the \$151.7 million issuance of senior secured notes at our Cabot subsidiary, and the \$172.5 million issuance of our 2020 Convertible Senior Notes, offset by \$491.5 million in repayments of amounts outstanding under our Credit Facility and the Propel TLT and TLC Facilities. The cash provided by financing activities during the nine months ended September 30, 2012, reflects \$390.4 million in borrowings under our Credit Facility and the Propel TLT Facility, including approximately \$187.2 million borrowed for our acquisition of the Propel entities, offset by \$163.0 million in repayments of amounts outstanding under our Credit Facility.

We are in compliance with all covenants under our financing arrangements. We believe that we have sufficient liquidity to fund our operations for at least the next twelve months, given our expectation of continued positive cash flows from operations, our cash and cash equivalents of \$110.2 million as of September 30, 2013 (approximately \$54.6 million of the cash and cash equivalents were held at our Cabot subsidiary), our access to capital markets, and availability under our credit facilities.

Our future cash needs will depend on our acquisitions of portfolios and businesses. We used cash and borrowings under our Restated Credit Agreement and our 2020 Convertible Notes to fund the Cabot Acquisition on July 1, 2013.

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

*Foreign Currency.* At September 30, 2013, there had not been a material change in any of the foreign currency risk information disclosed in Item 7A, Quantitative and Qualitative Disclosures About Market Risk, of our Annual Report on Form 10-K for the fiscal year ended December 31, 2012.

*Interest Rate.* At September 30, 2013, there had not been a material change in the interest rate risk information disclosed in Item 7A, Quantitative and Qualitative Disclosures About Market Risk, of our Annual Report on Form 10-K for the fiscal year ended December 31, 2012.

### **Item 4 Controls and Procedures**

#### ***Evaluation of Disclosure Controls and Procedures***

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our periodic reports filed or submitted under the Securities Exchange Act of 1934, as amended (the Exchange Act), is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission (the SEC) and that such information is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, our management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives and accordingly, management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Based on their most recent evaluation, as of the end of the period covered by this Quarterly Report on Form 10-Q, our Chief Executive Officer and Chief Financial Officer have concluded our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act are effective.

***Changes in Internal Control over Financial Reporting***

Except as disclosed in the following paragraph, there was no change in our internal control over financial reporting during the most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

As set forth above, we completed the Cabot Acquisition during the third quarter of 2013. Cabot will continue to be operated independently and we will not be integrating Cabot's systems with our systems, including our financial reporting systems. We will monitor and test Cabot's systems as part of management's annual evaluation of internal control over financial reporting beginning in 2014.



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**Table of Contents****PART II OTHER INFORMATION****Item 1 Legal Proceedings**

We are involved in disputes and legal actions from time to time in the ordinary course of business. We, along with others in our industry, are routinely subject to legal actions in the United States based on the FDCPA, comparable state statutes, the TCPA, state and federal unfair competition statutes, and common law causes of action. The violations of law alleged in these actions often include claims that we lack specified licenses to conduct our business, attempt to collect debts on which the statute of limitations has run, have made inaccurate assertions of fact in support of our collection actions and/or have acted improperly in connection with our efforts to contact consumers. These cases are frequently styled as supposed class actions.

On March 8, 2013, March 19, 2013 and March 20, 2013, three actions entitled *Shell v. Asset Acceptance Capital Corp., et. al.*, *Neumann v. Asset Acceptance Capital Corp., et. al.*, and *Jaluka v. Asset Acceptance Capital Corp. et. al.*, respectively, were filed in the Macomb County Circuit Court of the State of Michigan. On April 19, 2013, a fourth action entitled *Dix v. Asset Acceptance Capital Corp. et al* was filed in the Court of Chancery of the State of Delaware. These actions were brought by purported stockholders of Asset Acceptance Capital Corporation ( AACC ) against us, AACC, and certain other named entities and individuals, and allege, among other things, that we have aided and abetted AACC s directors in breaching their fiduciary duties of care, loyalty and candor or disclosure owed to AACC stockholders. Plaintiffs in the actions sought, among other things, injunctive relief prohibiting consummation of the proposed acquisition, or rescission of the proposed acquisition (in the event the transaction has already been consummated), as well as costs and disbursements, including reasonable attorneys and experts fees, and other equitable or injunctive relief as the court may deem just and proper. The plaintiffs did not specify the dollar amount of damages sought in each action. On June 2, 2013, AACC entered into a Memorandum of Understanding (the MOU ) with the plaintiffs in the Michigan actions and Delaware action that sets forth the parties agreement in principle for settlement. As explained in the MOU, without admitting any wrongdoing, AACC agreed to make certain additional disclosures related to the proposed merger, and to enter into a stipulation of settlement providing for the certification of a class, for settlement purposes only, that includes certain persons or entities who held shares of AACC common stock and the release of all asserted claims. On September 16, 2013, AACC entered into a stipulation of settlement which sets forth the terms of the MOU. On October 7, 2013, the Michigan court preliminarily approved the stipulation of settlement. Upon final approval by the Michigan court, which has yet to and may not occur, the attorneys for the class members intend to seek an award of attorneys fees and costs incurred in a total amount not to exceed \$550,000, which the defendants have agreed to not oppose.

Except as set forth above and as disclosed in our Quarterly Reports on Form 10-Q for the quarters ended March 31, 2013 and June 30, 2013, there has been no material development in any of the legal proceedings disclosed in our Annual Report on Form 10-K for the year ended December 31, 2012.

In certain legal proceedings, we may have recourse to insurance or third party contractual indemnities to cover all or portions of our litigation expenses, judgments, or settlements. In accordance with authoritative guidance, we record loss contingencies in our financial statements only for matters in which losses are probable and can be reasonably estimated. Where a range of loss can be reasonably estimated with no best estimate in the range, we record the minimum estimated liability. We continuously assess the potential liability related to our pending litigation and revise our estimates when additional information becomes available. As of September 30, 2013, we have no material reserves for litigation. Additionally, based on the current status of litigation matters, either the estimate of exposure is immaterial to our financial statements or an estimate cannot yet be determined. Our legal costs are recorded to expense as incurred.

**Item 1A Risk Factors**

There is no material change in the information reported under Part I Item 1A Risk Factors contained in our Annual Report on Form 10-K for the fiscal year ended December 31, 2012 and Part II, Item 1A Risk Factors in our subsequent quarterly reports on Form 10-Q with the exception of the following:

***If our goodwill or amortizable intangible assets become impaired we may be required to record a significant charge to earnings.***

We carry approximately \$489.5 million in goodwill and approximately \$10.5 million in amortizable intangible assets as of September 30, 2013. Under authoritative guidance, we review our goodwill for potential impairment at least annually, and review our amortizable intangible assets for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors that may indicate that the carrying value of our goodwill or amortizable intangible assets may not be recoverable include adverse changes in estimated future cash flows, growth rates and discount rates. We may be required to record a significant

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charge in our financial statements during the period in which any impairment of our goodwill or amortizable intangible assets is determined, which could negatively affect our results of operations.

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**Item 6 Exhibits**

- 4.1 Indenture, dated September 20, 2012, between Cabot Financial (Luxembourg) S.A., Cabot Credit Management Limited, Cabot Financial Limited and all material subsidiaries of Cabot Financial Limited, as guarantors, J.P. Morgan Europe Limited, as security agent, and Citibank, N.A., London Branch as trustee (filed herewith)
- 4.2 First Supplemental Indenture, dated June 13, 2013, between Cabot Financial (Luxembourg) S.A. and Citibank, N.A., London Branch as trustee (filed herewith)
- 10.1 Amended and Restated Senior Facilities Agreement, dated June 28, 2013, by and among Cabot Financial Limited, the several guarantors, banks and other financial institutions and lenders from time to time party thereto and J.P. Morgan Europe Limited as Agent and Security Agent (filed herewith)
- 10.2 Second Amendment to Securities Purchase Agreement, dated September 25, 2013, by and between Encore Europe Holdings S.À R.L. and JCF III Europe S.À R.L. (filed herewith)
- 31.1 Certification of the Principal Executive Officer pursuant to Rules 13a-14(a) and 15d-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith)
- 31.2 Certification of the Principal Financial Officer pursuant to Rules 13a-14(a) and 15d-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith)
- 32.1 Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith)
- 101 The following financial information from the Encore Capital Group, Inc. Quarterly Report on Form 10-Q for the quarter ended September 30, 2013 formatted in eXtensible Business Reporting Language (XBRL):  
(i) Condensed Consolidated Statements of Financial Condition; (ii) Condensed Consolidated Statements of Comprehensive Income; (iii) Condensed Consolidated Statements of Stockholders Equity; (iv) Condensed Consolidated Statements of Cash Flows; and (v) the Notes to Condensed Consolidated Financial Statements

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**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.

**ENCORE CAPITAL GROUP, INC.**

By: /s/ Paul Grinberg  
Paul Grinberg  
Executive Vice President,  
Chief Financial Officer and Treasurer

Date: November 7, 2013