Encore Capital Group, Inc.
Third Quarter Conference Call Prepared Remarks
October 26, 2011

Adam Sragovicz, Director of Finance & Treasury

Thank you, Ally. Good afternoon and thank you for joining Encore Capital Group's third quarter 2011 earnings call. The call will be led by Brandon Black, our President and Chief Executive Officer, and Paul Grinberg, our Chief Financial Officer. We will begin with prepared remarks, and then follow with a question and answer period.

Before we begin, let me take a moment to reference the Safe Harbor provisions. Throughout this conference call, we will use forward-looking statements, including predictions, expectations, estimates, or other information that might be considered forward-looking. While these forward looking statements represent our current judgment, these statements are also subject to risks and uncertainties that may cause actual results to differ materially from statements being made today. As a result, we caution you against placing undue reliance on these forward-looking statements, which speak only as of the date that they are made.

We will also be referencing both GAAP and non-GAAP financial results. We believe non-GAAP financial measures provide useful information about our business. However, the presentation of this additional information should not be considered an alternative to, or more meaningful than, our results prepared in accordance with GAAP. Management utilizes Adjusted EBITDA, which is similar to a financial measure contained in covenants used in our credit agreement, 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. We included information concerning adjusted operating expenses excluding stock-based compensation expense and bankruptcy servicing expenses in order to facilitate a comparison of approximate cash costs to cash collections for the debt purchasing business in the periods presented. Please be sure to see our 10-K, 10-Q, and other SEC filings, including a press release issued as an exhibit to our Periodic Report on Form 8-K filed today, for a more complete discussion of these factors and other risks.

As a reminder, this conference call will also be available for replay on the Investor Relations section of our website, and we also plan to post the prepared remarks following the conclusion of this call.

Now, it is my pleasure to turn the time over to Brandon Black, our Chief Executive Officer.

Brandon Black – President and CEO:

Thank you, Adam, and good afternoon, everyone. I appreciate your joining us for Encore's third quarter conference call.

We are pleased to be able to share results today that reflect contributions from all of our channels. We have continued to invest in areas that will provide long-term strategic advantages and build upon our industry-leading debt purchasing and recovery platform. Our deliberate and disciplined approach to portfolio underwriting and management led to strong earnings, collections, and operating cash flow in the third quarter.

Cash collections in the quarter were $189 million, which was a 20% increase from the third quarter of 2010. The strong collections were the result of our ability to identify and engage with those consumers with the greatest likelihood of recovery, as well as our continued emphasis on increasing the percentage of accounts that we can work profitably.

Our overall cost-to-collect decreased 10 basis points to 43.8% from 43.9% in the third quarter of 2010. This decrease reflects savings from various operational strategies which were offset by investments in our Internal Legal initiative, and additional spending required to manage the changing regulatory and legislative environment. In addition, we continue to expand our operations in India and are making significant investments in our analytics and consumer intelligence platforms.

Looking at consumer behavior, we saw payer rates and payment sizes remain consistent as compared to prior periods. We attribute the robust payer rates, in part, to enhancements in our operational capabilities, such as the increasing tenure of our collector workforce, and, in part, to continual improvements in our analytic abilities.

The success of our business has allowed us to increase both our domestic and international headcount. Our operations center in India continues to expand and produce an increasing percentage of total call center collections. At the end of the third quarter, the total number of employees in India was 1,471, up 23% from the same period in 2010. Our U.S. operations employed 795 people at the end of the third quarter, up 22% from the same period last year. Our improving cost structure has allowed us to expand our hiring here in the U.S., allowing Encore to continue recruit talented employees during a time of economic uncertainty for many in the domestic labor force.

During the quarter, we deployed $65.7 million to purchase more than $2 billion in face value of portfolios. The majority, or $52 million, went toward the purchase of credit card portfolios. Additionally, we spent $13 million on telecommunication receivables, which is an increase of

$8.4 million as compared to the prior year. As we mentioned previously, we continue to deploy capital in those asset classes, which we believe will yield the strongest return. Telecommunications is one such asset class, where the efficiency of our collection platform enables us to apply effort to small balance accounts at a lower overall cost than our competitors. During the quarter, we completed 46 individual purchase transactions from 13 unique sellers. While absolute purchase levels were lower than the run rate established in the first two quarters, it does not signal a trend. In fact, we've already secured $90 million in purchases for the fourth quarter, and are maintaining a very robust pipeline. As such, we remain committed to the purchase expectations we established in June of $380 million for 2011.

Our outlook regarding portfolio purchases is based largely on the strength of our operating platform, which is driven by an underwriting philosophy at the individual consumer level that is focused on willingness- and ability-to-pay, rather than asset type or age of receivable. We've refined our purchasing strategy to accommodate a broad range of delinquency characteristics and maximize internal rates of return. As mentioned at our investor day, portfolio prices are increasing moderately and this continues to be most apparent for newly charged-off, or "fresh," portfolios. Despite those increases, we have been able to find mismatches between portfolio returns and market clearing prices, and we will continue to capitalize upon these.

Following up on the strategic initiatives announced during our Investor Day, our Internal Legal and our near-shore call center projects are progressing nicely. Within our Internal Legal channel, we are operational in four states and are on track to add a fifth state by the beginning of 2012. We also expect to expand into five additional states by the end of next year. Our Internal Legal collections are tracking to plan and we are continuing to customize the information technology platform, which should give us substantial leverage in the future.

We are also pleased to report that we have selected Costa Rica for our near-shore operations site, to better serve our Spanish-speaking consumers. San Jose was selected because of its well-developed infrastructure, educated workforce, tax incentives and its proximity to the U.S. The market was also attractive to us because of the extensive number of existing call center and collections operations, and the availability of bi-lingual, qualified talent. We have established a local entity, executed a lease, and are currently on track to begin operations during the first quarter of 2012.

Of note, during the third quarter, Encore was named "San Diego's Healthiest Large Company" for 2011, a recognition awarded by the San Diego Business Journal. This award reflects our 5-year vision of building cutting-edge health and wellness programs. As a result of the advancements we have made with our health and wellness initiatives, we had no health care premium increases for employees in 2011, contrary to average increases of over 15% in health care costs nationally. We are expecting to have another year of minimal increases in 2012, in sharp contrast to what is happening more broadly. We are committed to healthy living and actively promoting personal and professional satisfaction. When competing for top talent, as well as the retention of our employees and the management of healthcare-related expenses, we believe that this kind of recognition is one of a kind.

Before turning the call over to Paul, I wanted to update you on the most recent developments in the affidavit related matters. As most of you are aware, in August, a Federal Judge confirmed the settlement of the Brent case on the terms we had previously agreed to and announced. With the Brent case behind us, we moved quickly to focus our attention on addressing related concerns raised by certain attorneys general, and have reached a settlement in principle with the Texas Attorney General. We continue to work on finalizing the agreement, and hope to have it completed in the next 30 days. Pursuant to the terms of the proposed settlement, the Company will pay a financial penalty and provide meaningful credits to certain consumers. We have also had discussions with the Minnesota Attorney General, but have not yet finalized an agreement. It is our hope, and intent, that we will be able to finalize an agreement with the Texas attorney general, and reach a resolution with Minnesota, but we are prepared to defend our positions if necessary.

We also anticipate engaging in discussions with other states' Attorneys General with a view towards putting the remainder of our affidavit related issues behind us.

With that, I will turn it over to Paul who will discuss our financial results in more detail.

Paul …

Paul Grinberg – EVP and CFO

Thank you, Brandon.

As Brandon discussed, we had a very strong third quarter. Collections were at an all-time high for a third quarter and the continued investments in our operating platform give us confidence in our ability to expand upon the operating leverage created over the past few years. We generated earnings of 60 cents per share during the quarter, which included a 2 cent per share charge in connection with the financial penalty component of the proposed settlement of the Texas matter.

Adjusted EBITDA, which represents the cash we generate that is available for future purchases, capital expenditures, debt service and taxes, was $107.2 million in the third quarter, an increase of 20% compared to the third quarter of 2010. This improvement allowed us to fund all portfolio acquisitions during the quarter, while reducing quarter-over-quarter net debt levels. Our leverage ratio declined, from 1.1 times trailing twelve months Adjusted EBITDA at the end of 2010, to 0.81 times at the end of the third quarter of 2011. We now have more than $100 million of available borrowing base to deploy for future purchases and potential acquisitions.

Our overall cost-to-collect decreased 10 basis points to 43.8% from 43.9% in the third quarter of 2010. Sequentially, our cost-to-collect increased from 40.9% in the second quarter due to the shifting of our collection mix, the increased spending on our Internal Legal team, and additional legal costs related to our defense of the Brent litigation and related matters. In addition, this quarter we saw a greater percentage of our collections come from the legal channel, which has a higher average cost-to-collect than our other channels. Our goal is to maximize dollars collected less dollars spent and, where we can generate incremental collections, we will do so even when it may entail a slightly higher average cost-to-collect.

Overall, we expect our cost-to-collect to continue to improve incrementally over time, but it *will* fluctuate from quarter to quarter based on seasonality, the level of our investment in initiatives like our internal legal platform and our near-shore site, as well as ongoing legal costs related to governmental discussions and other open legal matters. For 2012, we expect to invest 20 and 7 cents per share in our internal legal channel and near-shore initiatives, respectively. We are confident that these important investments will improve long-term profitability. For example, once we have achieved scale in our internal legal platform, we expect to be able to collect at a lower cost than our outside law firms. Each 100 basis point improvement in our cost-to-collect, should result in an increase of 6 cents in earnings per share, as compared to the commission rates we currently pay.

Due primarily to high volume and the strong performance of portfolio purchased over the last couple of years, our Estimated Remaining Collections, or ERC, at September 30th, increased by $173 million over the prior year, to approximately $1.5 billion. As we've discussed previously, we believe that ERC, which reflects the estimated remaining value of our existing portfolio, is conservatively stated because of our cautious approach to setting initial curves and our practice of only increasing future expectations after a sustained period of over-performance.

Moving on to other financial results, this quarter's collections were very strong, at $189 million, up 20% from $157.4 million during the same quarter last year. Our call centers contributed 44.1% of total collections, or $83 million for the quarter, as compared to $67.1 million in the third quarter of 2010. Direct cost per dollar collected in our call centers declined to 8.2% for the third quarter of 2011, from 9.3% in the third quarter of 2010.

This improvement is largely the result of collections growth from our operations center in India, which increased 29.8%, from $32.2 million in the third quarter of 2010 to $41.8 million in the third quarter of 2011. India represented 50.2% of total call center collections during the quarter. We now have 1,065 account managers at our New Delhi site. We expect that our call center performance will continue to improve, and that our cost-to-collect will decline, as more and more recently hired account managers reach the period of peak productivity, which is generally 12 months from hire. As the growth and mix of our employee base has important implications for our overall costs, we have included a table in our form 10-Q, which shows employee headcount by geography.

Legal channel collections grew to $94.9 million in the quarter, compared to $71.8 million in the third quarter of 2010, and accounted for 50.2% of total collections. Cost-to-collect in the legal channel was 42.3%, down meaningfully from 47.2% in the third quarter of 2010. The decline was primarily attributable to the continued refinement of our analytic capabilities and increased ability to predict consumer behavior, which has allowed us to become more precise about when to pursue litigation. We also incurred approximately $1.1 million in costs this quarter associated with the build-out of our internal legal platform.

I'd like to reiterate that our long-stated preference is to work with our consumers to negotiate a mutually acceptable payment plan which works within their personal financial situation. These plans almost always involve substantial discounts from what is owed to us. We not only believe that this is the right thing to do for our consumers, but that it is right thing to do for our business.

The remaining 5.7% of collections came primarily from third-party collection agencies. Third quarter agency collections decreased to $10.8 million from $18.1 million in the prior year, reflecting changes in our operating strategy that has seen us shift more of our work to our internal call centers at a lower overall cost-to-collect, especially as capacity continues to come on-line in India.

Consistent with our stated practice and in keeping with our Consumer Bill of Rights, we had no portfolio sales in the third quarter.

Moving on, revenue from receivable portfolios was $115.8 million, an increase of 23.5% over the $93.8 million in the third quarter of 2010. As a percentage of collections, and excluding the effects of allowances, the revenue recognition rate decreased to 62.1% in the third quarter of 2011 from 63.5% in the third quarter of 2010.

Our revenue recognition rate is attributable to our cautious approach to setting initial IRRs and our policy of increasing them gradually, after periods of over-performance. For example, our 2009 and 2010 vintages were initially booked at average multiples of 2.4 and 2.1 times, respectively. As a result of sustained over-performance, we have slowly increased the multiples on these vintages, to 2.7 and 2.4 times, respectively.

During the quarter, we expensed $1.6 million in net allowance charges, compared to $6.1 million in the third quarter of 2010. Looking at the breakdown by pool, we had $1.6 million of allowances in the 2006 vintage, $1.7 million in the 2007 vintage and $1.1 million in the 2008 vintage.

These allowances were offset by $2.8 million in reversals. We had no allowance charges for the 2009, 2010 or 2011 vintages in the quarter, as has been the case since we acquired these portfolios. This quarter, we over-performed our forecasted collection curves by 14%.

As most of you know, we account for the business on a quarterly pool basis, not at an overall level. When pools under-perform, we take allowance charges, which are reflected as an immediate reduction in revenue. We measure under-performance against the current yield that is assigned to a pool, not its original expectation. This pool-by-pool level accounting treatment leads inevitably to non-cash allowance charges in certain periods, even when we are overperforming a pool's initial expectations.

In contrast, when pools over-perform, that over-performance is not reflected immediately. Once we have evidence of sustained over-performance in a pool, we will increase that pool's yield. Unlike allowance charges, which are realized immediately, this increased yield will be reflected as increased revenue in the current and in future quarters. Consistent with this practice, as a result of continued over performance in certain pool groups, primarily in the 2009 and 2010 vintages, we increased yields in those pool groups this quarter.

Turning to Ascension, our fee-based bankruptcy-servicing business, revenue rose by 15% from the prior year, to $4.7 million.

As we discussed last quarter, performance from servicing one large new client was below our expectations, and we have parted ways with them. This departure will have a negative impact on the next few quarters at Ascension, but was the right decision for the long-term.

Despite these challenges at Ascension, we are confident that we will achieve Encore's overall growth targets.

Turning to expenses, our total operating expenses were $89.8 million, up from $74.3 million in the third quarter of 2010. Included in operating expenses for the third quarter of 2011 were stock-based compensation expenses of approximately $2.4 million and Ascension operating expenses of $4.6 million.

The income tax provision was nearly $9.9 million, reflecting an overall tax rate of 39.1%, as compared to 35% in the third quarter of 2010. The prior year's rate was lower largely due to state and federal tax refunds, true-ups of state and federal tax accounts, and the availability of the tax holiday in India, which expired on March 31, 2011.

Finally, our fully diluted earnings per share during the third quarter were 60 cents, a 22% increase compared to quarterly earnings per share of 49 cents in the same period last year. In connection with our agreement in principle with Texas, we have established a reserve for a cash penalty and other costs and fees of 2 cents per share that the Company anticipates paying as part of that settlement. In addition, our collection curves reflect the remainder of the anticipated impact of the proposed settlement. The final settlement terms are subject to continuing discussions with the Texas Attorney General; however, based upon the agreement in principle that we have reached in this matter, we believe that the anticipated settlement will serve both the best interests of Texas consumers and the Company's shareholders.

I'd like to end my remarks with some key points: First, our cautious approach to revenue recognition results in our setting lower initial yields and increasing them slowly over time as we outperform our initial expectations. Second, the continued improvement in productivity resulting from our growing workforce in India should result in continued improvements in cost-to-collect and operating margins. This will allow us to increase our purchasing levels in the future, while maintaining our financial discipline. Finally, our strong cash flow will enable us to maintain our conservative approach to financial leverage.

With that, I will turn it over briefly to Brandon before opening the call up for questions.
Brandon…

Brandon Black – President and CEO:

Thank you, Paul.

Encore's Third quarter performance was highlighted by record-setting cash collections and our continued deployment of capital at strong returns. Our proactive approach of engaging with regulators and investing in our Internal Legal platform are paving the way for stable growth in an uncertain and changing macroeconomic environment. Encore's key differentiators were at work in the third quarter and we expect they will continue to be key drivers in the growth of cash flows and year-over-year earnings that we anticipate in 2011.

With that, we would be happy to answer any questions you may have.

Operator, please open up the line for questions.