ENCORE CAPITAL GROUP

Moderator: Adam Sragovicz
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5:00 p.m. EST

Operator: Good day, ladies and gentlemen, and welcome to the Encore Capital Group third quarter 2013 earnings conference call.

At this time, all participants are in a listen-only mode. Later when we conduct the question and answer session and the instructions will follow at that time. If anyone should require operator assistance during the conference call, please the star, the zero key on your touchtone telephone.

As a reminder, this conference is being recorded.

I would now like to introduce your host for today's call, the Director of Finance, Mr. Adam Sragovicz. Sir, you may now begin the conference.

Adam Sragovicz: Thank you, Operator. Good afternoon, and welcome to Encore Capital Group's third quarter 2013 earnings call. With me on the call today are Ken Vecchione, our President and Chief Executive Officer, and Paul Grinberg, our Executive Vice President and Chief Financial Officer. Ken and Paul will make prepared remarks, and then we will be happy to take your questions.

Before we begin, we have a few housekeeping items. Unless otherwise noted, all comparisons made on this conference call will be between the third quarter of 2013 and the third quarter of 2012.

Today's discussion will include forward-looking statements subject to risks and uncertainties. Actual results could differ materially from these forward-looking statements. Please refer to our SEC filings for a detailed discussion of potential risks.

During this call, we will use rounding and abbreviations for the sake of brevity. We will be discussing non-GAAP financial measures. Reconciliations to the most directly comparable GAAP financial measures are included in our earnings release, which was filed on Form 8-K earlier today.

As a reminder, this conference call will also be made available for replay on the Investor section of our Web site, where we will also post our prepared remarks following the conclusion of this call.

With that, let me turn the call over to Ken Vecchione, our President and Chief Executive Officer.

Ken Vecchione: Thank you, Adam, and good afternoon, everyone. I appreciate you joining us for a discussion of Encore's third quarter results.

Earlier today we announced record financial results. This quarter we delivered strong performance across all key financial metrics, reflecting outstanding performance from our core business and our two recent acquisitions.

Our GAAP EPS was $0.82 per share, excluding onetime expenses and convertible noncash interest our adjusted EPS for the quarter was $1.02 per share. Paul will review the financial results in more detail during his presentation.

Cash collections increased 54 percent to $380 million. This significant increase is driven by our acquisitions of Asset Acceptance and Cabot Credit Management, both of which we will address in more detail as we move through the presentation.

Adjusted EBITDA was $234 million in the third quarter, an increase of 55 percent. Our overall cost to collect increased slightly by 20 basis points to 40.7 percent. This increase reflects the additional costs associated with the Asset Acceptance acquisition.

As we said previously, we expect a higher level of cost during the integration period. With the acquisitions of Cabot and Asset Acceptance our estimated remaining collections, or ERC, at September 30th increased by $2.1 billion to approximately $4 billion.

Our year-to-date results are equally impressive. Our GAAP EPS was $2.06 and after adjusting for onetime and certain noncash items our adjusted EPS was $2.74. We are approaching nearly $1 billion in collections. Our adjusted EBITDA was $586 million, and our cost to collect was 38.9 percent.

These results reflect a disciplined and delivered approach we've taken to deploying capital and building a very efficient operating platform, as well as the exceptional work of Encore's more than 4,200 people.

To continue to deliver these strong results it's important that we remain focused on solid execution, particularly on our acquisitions. At Asset Acceptance we continue to migrate accounts to our operating platform. To date we have moved more than 1.2 million accounts to Encore, including more than 800,000 accounts during the quarter, with more to follow. At the same time the Asset Acceptance operation continues to collect on the remaining accounts. Collections are running ahead of plan and expenses have been under our forecast.

At Cabot we are focused on expanding into new market segments and leveraging our operating site in India. More than two dozen account managers from our India center have been onsite at Cabot for the last few weeks, undergoing intensive education and learning about the U.K. collections environment and culture. We expect this team to return to India at the end of the year, and we are on track to begin making calls to the U.K. from India in the first quarter of 2014.

Propel is now operating in nine states and has recently funded its first tax lien transfer in the State of Nevada. As in our core business, we foresee industry consolidation in the tax lien transfer business in Texas, and Propel is in an excellent position to gain increased market share.

Turning to capital deployment, we had an extraordinary quarter, driven primarily by the $559 million allocated to the Cabot portfolio. We also deployed $13 million in capital for Propel, and as we stated earlier in the year we expect that the Asset Acceptance and Cabot will make up a significant portion of our purchasing volume for the year. That said, there are many other industry opportunities that we continue to track.

We're expecting Encore to continue to be a leader in the consolidation of our industry. In particular, as the OCC implements best practice guidelines for the issuers that it regulates we expect that larger, more sophisticated market leaders, like Encore, will benefit, while other competitors may be driven out of the marketplace.

As mentioned earlier, our strong capital deployment in this quarter and late last quarter, particularly the acquisitions of Asset and Cabot, sets a significant growth in our estimated remaining collections, bringing it to $4 billion. And, as we said before, the Asset Acceptance integration is complex, and we have a number of key people dedicated to ensuring that the integration proceeds smoothly.

Some of the complexities include the consolidation of two public companies, moving accounts from Asset to Encore's collection platform, consolidating two internal legal operations, and consolidating both companies' external legal and collection agency networks. I'm happy to report that we're meeting our expectations on all fronts.

Turning to Propel, two of our goals we set for ourselves when we acquired Propel were to introduce the tax lien transfer model to other states and to deploy capital acquiring tax lien certificates. We continue to make progress in both these areas. By funding our first tax lien transfer in the State of Nevada we are proving the applicability of the business model outside of Texas, and we have now deployed capital in nine states and are actively exploring additional expansion opportunities.

The acquisition of Cabot Credit Management contributed meaningfully to our record-breaking quarter. Cabot added $0.17 of EPS, over $50 million in adjusted EBITDA, and $1.5 billion in estimated remaining collections. We cannot be more pleased with the way that Encore and the Cabot teams are working together and the way that Cabot's leadership has embraced collaboration activities with Encore to grow market share in the U.K..

Our plan to expand Cabot's capital deployment into other market segments and to leverage Encore's efficient operations is proceeding as planned. As mentioned earlier, we have a program placed to begin servicing Cabot's accounts from India in 2014. We are also collaboratively looking to further improve Cabot's ability to deploy capital in other market segments.

On the regulatory front, there continues to be developments affecting the industry, specifically at the OCC and the CFPB. The OCC issued a memo emphasizing the need for issuers' strong vendor management to ensure that the industry participants have programs in place to monitor processes and manage risk responsibly. This has prompted issuers to order debt buyers' policies and procedures, which we believe will contribute to a reduction in the supply of receivable portfolios. Encore has been through several of these issuer audits and the feedback has been very positive, and we continue to improve by integrating feedback from issuers and regulators.

Among other things, the OCC inquired of the issuers about the levels of vendor offshoring and outsourcing. Understandably, the OCC wants to ensure consumer protection and, again, wants the insurers to have strong vendor management. In response to the OCC one issuer has requested that their portfolios be handled domestically, another most likely will follow suit when they come back into the market later this year. No other issuers have indicated that they will restrict offshoring collections.

The Encore business model is constructed around flexibility and agility across all of our collection operations regardless of location. In fact, around half of our call center collections come from our domestic sites, and about 20 percent of our overall collections are generated from India. As a result, we are well positioned to service these two portfolios and others, if need be, with our existing U.S. capacity. At the same time our India operations will continue to service our Asset Acceptance defaulted receivables, Cabot's existing volume, and its future for growth.

In addition, we've spent a lot of time exploring the India marketplace for purchasing and collecting charged off consumer and commercial debt. We expect to enter this market by the end of 2014. This business opportunity will be discussed in more detail at our Investor Day in June.

Finally, India's importance to our business is beyond being just a call center. Today India includes portions of our Technology Group, HR, Finance functions, and Analytics. Our India operation is and will continue to be a vibrant part of our Company and a key contributor to our financial success by enabling us to respond nimbly to the changing regulatory environment.

Speaking of the changing regulatory environment, yesterday the CFPB announced its advanced notice of proposed rulemaking on debt collection. This begins a series of steps in the rulemaking process that we expect to last through 2014.

Encore has been an industry leader with a consumer centric focus, and we share the overall vision of the CFPB to raise the standards for the collection industry. We continually demonstrate our commitment to the consumer through initiatives, including our Consumer Credit Research Institute, our industry leading Consumer Bill of Rights, and our constant focus on enterprise risk management and compliance.

As I've said on previous calls, these higher industry standards will create industry consolidation, as some companies will not be able to meet the higher compliance expectations. Ultimately we believe the evolving regulatory environment and Encore's efforts to position ourselves to a proactive and consumer centric approach will result in a collections industry that is stronger overall.

Before handing it over to Paul, I'd like to take a moment to revisit our value creation model that we originally talked about at our Investor Day in June. This is our view, we create top quartile shareholder returns. The foundation is our people, our organizational agility and our integrity. These elements underpin everything we do.

On top of that foundation are four pillars – analytics, operational scale and cost leadership, strong capital stewardship, and our extendable business model. Together these are the keys to delivering the financial results and shareholder returns that meet all of our expectations. Of course, our Corporate strategy needs to be in harmony with our value creation model, and we will continue to look at acquisitions, initiatives, and projects through this lens.

Finally, I would like to recognize and thank Encore's more than 4,200 people, including nearly 750 at Cabot, for a fantastic quarter. The foundation of our value creation model rests on the shoulders of the people of Encore. Our results are a direct reflection of their collective effort, and I appreciate their dedication and hard work.

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

Paul Grinberg: Thank you, Ken.

As Ken discussed, we had a very strong third quarter, reflecting strong performance from our core business and our recent acquisitions. Before I go into our financial results in detail, I would like to let you know that as required by U.S. GAAP we are showing 100 percent of Cabot's results in our financial statements. Where indicated, we will adjust the numbers to account for the non-controlling interest.

We collected a record $380 million, up 54 percent. Our call centers contributed 41 percent of total collections or $157 million, compared to $117 million. Legal channel collections grew to $154 million in the quarter, compared to $111 million, and accounted for 40 percent of total collections. Finally, 18 percent of collections came from third-party collection agencies.

As a result of the Asset Acceptance acquisition we expect to see an increase in third-party collections as many of those assets had already been placed with third-party agencies at the time of acquisition.

Because of our lower cost to collect and because we are better able to ensure a consistently positive consumer experience we plan to shift much of this work to our internal channels over time. Also, for some of Cabot's purchases we are contractually required to keep accounts with certain agencies for a period of time. Consistent with our stated practice and in keeping with our Consumer Bill of Rights, we had no portfolio sales in the quarter.

Revenue from receivable portfolios was $225 million, an increase of 60 percent over the $141 million in the third quarter of 2012. As a percentage of collections and excluding the affects of allowances our revenue recognition rate was 58.6 percent compared to 56.9 percent in 2012.

For the quarter we had $3 million in allowance reversals, all from ZBA, compared to $1 million of reversals in 2012. We had no allowance charges during the quarter.

As many of you know we account for the business on a quarterly pool basis rather than overall. When pools underperform we take allowance charges, which are reflected as an immediate reduction in revenue.

We measure underperformance against the current yield that is assigned to a pool, not its original expectation. This pool-by-pool accounting treatment may lead to noncash allowance charges in certain periods, even when we are over performing 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. Consistent with this practice and as a result of continued over performance, primarily in the 2009, 2010, 2011 and 2012 vintages we increased yields in those pool groups this quarter.

Turning to cost to collect, it's important to note that this is the first quarter that is fully loaded with Asset Acceptance costs. As a reminder, Asset Acceptance's cost to collect was 52.2 percent in 2012.

Excluding acquisition related and other onetime costs our overall cost to collect increased 20 basis points to 40.7 percent. Breaking the overall cost to collect into its components, Cabot's cost to collect is comparatively low, in the mid to high 20s, due to the fact that Cabot's portfolio primarily consists of consumers who are already in payment plans and involves very little litigation.

For our U.S. business direct costs per dollar collected in our call centers rose to 8.4 percent in the third quarter versus 5.9 percent in 2012. This was the result of the increased costs associated with the Asset Acceptance business. As mentioned earlier, until we complete the integration of Asset Acceptance we expect our cost to collect to remain higher than it has been in recent quarters and in some periods could be higher than we experienced this quarter depending on the level of headcount and collections coming from the Asset Acceptance portfolio.

Direct costs per dollar collected in the legal channel was 39.6 percent, down from 41.5 percent in 2012. While cost to collect is an important metric we don't focus on it in isolation. Overall success in our business is driven by generating the greatest net return per dollar invested. We accomplished that by generating more gross dollars collected per investment dollar at what we believe to be the lowest cost per dollar collected in the industry.

Over time we expect to build further efficiencies into our operations, which we believe will result in our cost to collect continuing to improve, but also expect it to fluctuate from quarter to quarter based on seasonality, the cost of investments and new operating initiatives and technology, and the ongoing management of the changing regulatory and legislative environment.

Our legal channel, which includes both legal outsourcing and our internal legal operation in the United States, continues to be a strong contributor to the business, both in terms of dollars collected and cost to collect.

Total dollars collected in our legal outsourcing channel was $121 million at a cost to collect of 36.7 percent, down from 39.4 percent. This decrease was primarily related to improvements in our ability to more accurately and consistently identify those consumers with the financial means to repay their obligations.

Total dollars collected in our internal legal channel were $33 million at a cost to collect of 50.1 percent. In 2011 our cost to collect in internal legal was over 200 percent, as we were investing in our technology platform, hiring staff, and opening new sites. As our volume in the channel increased our cost to collect came down. Last year our cost to collect was over 80 percent and this year we expect it to drop even further.

In our 10-Q, which we filed earlier today, we've broken out our legal cost to collect between our external and internal legal channels. This will provide investors with more visibility to our progress in reducing cost to collect in our internal legal channel.

I'd like to reiterate that our long-stated preference is to work with our consumers to negotiate a mutually acceptable payment plan, tailored to 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 the right thing to do for our business.

As mentioned earlier, collections reached an all-time high for a quarter and continued investments in our operating platform expanded the operating leverage in the quarter. This growth in collections and cost improvement led to improved cash flows with adjusted EBITDA increasing 55 percent over last year to $234 million.

There was a significant reduction in our effective tax rate this quarter, primarily as a result of two factors.

The first was the reduction in our effective state rate due to some changes we've made in apportionment factors. While the majority of the benefit this quarter related to the prior period catch-up we expect to see an ongoing quarterly benefit of just under 1 percent. The second is due to the lower overall tax rate in the U.K., which is currently at 23 percent and is expected to decline to 21 percent in the middle of 2014. We expect our long-term tax rate to be somewhere in the 36 percent to 37 percent range.

There were certain onetime and noncash item which affected our results this quarter. We had $0.04 related to the noncash interest costs associated with our convertible notes, $0.18 of onetime acquisition related and advisory fees, primarily associated with the Cabot acquisition, and finally we had the benefit associated with changes to our state apportionment factors that I just mentioned, which amounted to $0.05 per share.

After adjusting for these we end up with $0.99 per share on an accounting basis and $1.02 on an economic basis.

As you recall, late last year we issued $115 million in convertible notes at 3 percent with a conversion price of $31.56. At the time of this issuance we entered into a call spread transaction, which increased that conversion premium to $44.19.

For GAAP purposes if our share price exceeds $31.56 we are required to include the shares that would be issued pursuant to the convert in our diluted share count, but since we entered into the call spread we will only issue shares when our stock price exceeds $44.19 at the time of conversion.

Our average stock price during the quarter was $40.52, which resulted in 805,000 additional shares used to calculate fully diluted EPS. These shares will never be issued because of the call spread. As such, in calculating adjusting EPS we have not included these shares in our calculation, which increases adjusted EPS by $0.03 to $1.02 per share for the quarter.

We paid $11.6 million for the call spread, which protected us from economic dilution from $31.56 to $44.19. This represents more than a million shares, which we would have had to issue had we not entered into the call spread. As stewards of your capital and with our strong views about the strength of our business and our future share price we thought it prudent to protect from the dilution of the convert, so we entered into the call spread, which increased the conversion premium to 75 percent, resulting in savings significantly greater than the cost of the call spread.

I want to remind you that with our 2013 convert of $172.5 million we entered into a capped call transaction, which increased the economic conversion price from $45.72 to $61.55 per share.

We closed the Cabot acquisition at the beginning of the quarter. Through a new European subsidiary we acquired a 50.1 percent interest in Janus Holdings for $177 million. J.C. Flowers owns the remaining 49.9 percent.

Janus, in turn, owns 86 percent of Cabot Holdings and Cabot's management owns the other 14 percent. Encore's effective ownership interest in Cabot ends up being 42.9 percent after reflecting the ownership of the noncontrolling interests and the redemption or conversion of certain preferred equity certificates.

$12 million of Encore's ownership is reflected as equity in Janus, and $165 million consists of preferred equity certificates or PECs. The PECs accrue interest at 12 percent, and while the PECs are classified as debt in our financial statements, no interest or principal is paid on the PECs until the ultimate sale of the noncontrolling interest of J.C. Flowers and management. J.C. Flowers' 49.9 percent ownership consists of a similar equity PEC split as Encore's. Management has $9 million of PECs in equity, which represents the amount of their rollover into the transaction, the balance of their ownership represents the equivalent of an option pool, which only has value after the PECs and any accrued interest is redeemed.

As a result of the ownership structure and our rights as majority shareholders in Janus we consolidate 100 percent of Cabot's results in our financial statements and then adjust for the noncontrolling interest.

We recognize that the consolidation accounting may be complicated, but at the end of the day Cabot has exceeded our expectations. This quarter Cabot contributed $46 million in revenue, more than $50 million in adjusted EBITDA, and after adjusting for the noncontrolling interest and non-core share of the PEC interest expense, which eliminates in consolidation, $4.4 million or $0.17 in earnings per share.

Looking ahead, we believe our long-term prospects are favorable. We foster an operations culture of continuous improvement, which drives stronger performance as is demonstrated by our operating results and capital deployment.

We continue to enhance our ability to take advantage of new opportunities as a result of our strong liquidity and access to capital. As this quarter's results show our acquisition activities continue to drive ERC and collections upward, resulting in solid cash flows.

Finally, we are now a global Company with investments in several asset classes, which positions us for strong earnings growth in the future.

With that, we would be happy to answer any questions you may have. Operator, please open up the lines for questions.

Operator: Ladies and gentlemen, if you have a question at this time, please press the pound, the star, the one key on your touchtone telephone. If your question has been answered and you wish to remove yourself, please press the pound key. Once again, if you have a question at this time, please press the star, the one key on your touch tone telephone. If you question has been answered or you wish to remove yourself please press the pound key.

The first question comes from the line of David Scharf from JMP. Your line is open, please proceed with your question.

David Scharf: Good afternoon. Thanks for taking my questions. I'll just start off with two and then get back in line. The first has to do with just the yields that you wrote up this quarter. I mean, obviously, you've been presumably booking your collection curves pretty conservatively the last couple of years and inching up the yields a little bit over the last six, eight quarters, but it was a very pronounced increase on really all recent vintages. What happened in the third quarter that led you to write them up as much as you did versus what you saw the last year?

Paul Grinberg: Actually, David, we did increase them this quarter, as we have for the last couple. The one slide that we showed was a multiple and shows the cumulative increase in the multiples since the beginning of time, not just the amount for this quarter. So, in fact, the yields this quarter were not – the increases were not materially different than they have been the last couple of quarters.

David Scharf: OK, yes, I was just reflecting on the collection multiples in the Q relative to where you were a quarter ago.

Paul Grinberg: Yes, those multiples are the cumulative increases in multiples since we purchased those pool groups, so the increases this quarter were actually relatively moderate, probably actually even a little bit lower than the last quarter, so that slide represents cumulative, not just this quarter.

David Scharf: Got it, got it. Second question, obviously, it's the topic of the day or it has been the last week, offshoring. Can you give a little more color about the two issuers, one that specifically requested, the other that you expect to? Have they specifically just referenced sort of a blanket comment about the OCC guidelines, saying they just don't want to have to deal with any issues down the road or were there more specific issues regarding offshoring that they had? And for those that did not request that all servicing be done domestically did they put any limits on the percentage of the placements that would be offshore? Thank you.

Ken Vecchione: OK, this is Ken. So, first, the one issuer that requested us not to do any offshoring and the other that we think will make that same request, they're both out of the top five, OK? One of them just has more of a U.S. centric focus as a business philosophy, and the other has said that they want to be more conservative at the outset of this, and then indications are to us that over time they will loosen that conservative posture.

And regarding the other folks, no, there hasn't been any other restrictions on the other issuers that we're dealing with.

David Scharf: OK, that's helpful. Thank you.

Operator: The next question comes from Bob Napoli from William Blair. Your line is open, please proceed with your question.

Bob Napoli: Thank you. Good afternoon.

Ken Vecchione: Hi, Bob.

Bob Napoli: I guess maybe if you could give some updates on you had talked about a new market, I guess, I was wondering if you could give any color on the new market? And then the Cabot, the U.K. buying, I was wondering if you could give some thoughts on the level of purchases you expect to make out of the U.K. through the balance of this year?

Ken Vecchione: OK, that's a little bit of – the India debt buying market is a little bit of a tease for you in the sense of that we have a great opportunity to do domestic collections in India.

The India market is large and getting larger, so it's about $10 billion today, and we project it to grow to about $19 billion in 2017. It's very much a fragmented market, and we believe by starting slowly, and we plan to start towards the end of 2014, we'll be able to bring the same discipline and customer and consumer centric approach that we have here in the U.S..

Absent that, I don't feel comfortable enough yet to give you the full details. It's, we're rolling it out, we're working on it now, and I think it'll make for an interesting conversation come the middle of June when we have our Investor Day. But it's just to show you that the India center has a lot more flexibility to it than thinking of it just as a call center.

I'm sorry, oh, the second question is about Cabot – regarding Cabot's purchases and going forward, I would say they're good for north of 100 million Pounds of purchases per year, all right? And, like the U.S., there'll be some seasonality to it, a little bit quieter in Q3 and should be heavier as we move throughout Q4.

As with the U.S., it also depends on the timing of when issuers want to sell, but we bought Cabot for many reasons, and one of the reasons and I'll cite an investor note that came out, is probably the 12 percent growth rate that exists in the debt purchase market there, as well as what we believe will be consolidation activities.

So if you think about all our platforms for a moment, whether it be Encore, Propel or Cabot, they both grow two ways, they grow organically and they have the ability to be scalable and to make acquisitions, and we like all three of those platforms for that reason.

And in the U.K. you can go back a couple years and there were about 17 direct competitors there. Today that group of 17 has been whittled down closer to six or seven, and having some new entrants into the market but the bigger guys are now controlling that market, much like you see in the U.S..

Bob Napoli: Great. Thank you. Just on the collections, the use of agencies, outside agencies in the U.S., with the changing regulations it seems – has it become more restrictive, has the requirements of the banks when you do use outside agencies, even in the U.S., I know you talked about the India piece, but are they adding additional audit restrictions or that make it more prohibitive that would lead you to use that market less?

And I know a couple of your big competitors are almost exclusive I think in collecting through nonemployees and agencies. Has there been a big change in that piece of the market, and do you see – what are you doing about it?

Ken Vecchione: Yes, so I think I'll just broaden that a little bit and just say all issuers are concerned with the vendor management guidelines that the OCC has produced, that's one. Number two, this has been an ongoing and evolving process.

There have been some issuers that have come in three times because as they continue to do their audits and they like what they see here, they go back, and their risk management committees continue to push on them to think about other things and other concerns they may have that may be coming from their interactions with the OCC.

So, yes, we have more auditing to do of our outside legal collection firms and we're doing that, and we're doing it at a more accelerated pace than what we currently have. And really the only thing that so far we've seen only one issuer has put in a cap as to the amount of accounts that we could litigate, and that account relative to what we litigate there's such a bid ask spread that you could drive a truck through that it really doesn't really impact us, at all. So that's what we're seeing from that point of view.

Bob Napoli: Great. Thanks, Ken. Thanks, Paul.

Operator: Our next question comes from the line of (Ben O'Shea) from Raymond James. Your line is open.

Ben O'Shea: Hey, guys, good afternoon. A lot of my stuff was answered here. Could you talk a bit about the competitive landscape in the U.K.?

Ken Vecchione: Yes, OK, so let me just take a half a step back and talk to you a little bit about why we entered into the U.K., why we like Cabot, and that will also give you a sense of some of the market dynamics of that, I think that'll give you a good perspective.

So we like Cabot because we obviously purchased the leader in the U.K. debt buying market. What we like about Cabot, also, they grew methodically over the last 14 years, and Encore was fortunate enough to buy their platform, their intellectual property, their brand, a billion dollars of ERC, and a seasoned management team rather than entering the market on a smaller basis with denovo and spending an enormous amount of resources to cultivate a growth strategy there.

We saw when we looked at the U.K. that we thought consolidation would happen at a faster pace, it would resemble much like the U.S. market. As a matter of fact, it may even go a little bit faster than the U.S. market from this point on, and it was important for us to get the right platform. So we felt good about that. We even feel better these days that based upon the recent (Arrow) IPO our equity in Cabot is now valued at about two times the price we paid only four-and-a-half months ago.

With that as a backdrop, the market dynamics are such that, again I'm going to quote numbers from analysts' reports, that there's a 12 percent annual growth rate in portfolio purchases from new sales and the sales of older portfolios.

Banks still have to be concerned about their capital levels. They will look to sell these defaulted receivables in order to improve their capital positioning. And also as I tried to allude to before that the market, itself, is beginning to change, and you're beginning to see the beginning of issuers tightening on their own audit processes in response to the Lending Standards Board.

So you're beginning to see the early phases of what you see here, which is if you have the right scale and you attack this problem with the right amount of risk management and compliance and the appropriate attitude towards dealing with the consumer on a customer centric basis and others do not, and if those others get there late the guys that get there first will have an opportunity to really build their platform and to take advantage of the consolidation.

So that's sort of a little bit of the market. It's looking a little bit more like the U.S. market, in the early stages of the U.S. market.

And, as I said, in 2007, 2008 there were about 17 key players, those 17 key players have been reduced down to six players of size, and some of those players are now up for sale, as well. So you can see the market is beginning to consolidate, and we think we're in a good position and we hope to participate in that consolidation as it moves forward.

Ben O'Shea: OK. Thank you, guys.

Operator: Our next question comes from the line of Hugh Miller for Sidoti. Your line is open, please go ahead.

Hugh Miller: Hi, thank you for taking my questions.

Ken Vecchione: My pleasure.

Hugh Miller: I wanted to start off with I guess on the purchasing side, it seems like when you exclude the Cabot deployment of capital that you guys were still buying close to $60 million in the third quarter, was that all forward flow or from you and from Asset Acceptance or was there any kind of opportunistic buying that you guys were doing during the quarter?

Ken Vecchione: Most of it are traditional buying that we do, there was no portfolio, big portfolio purchase in there. A couple of the issuers may have had some cleanup portfolios, but they were nothing of any size compared to what we've been seeing and what we've done over the last couple of years.

Paul Grinberg: And, Hugh, I mean about half of the purchasing came from Encore, half of it came from Propel, so you have to now include, factor in Propel's purchasing, capital deployment into the totals that we have.

Hugh Miller: OK, sure, sure. And I guess from the commentary that you guys had talked about with regards to issuers and some may be likely to require onshore collections, I think you guys had mentioned when they return to the market later this year, is that your expectation that one of the two companies that has yet to kind of return to the selling market should probably return before yearend?

Ken Vecchione: That is what they're telling us.

Hugh Miller: OK, and have you seen any portfolios come to market so far in the fourth quarter or is it still yet to come?

Ken Vecchione: Are you talking from that particular issuer or just in general?

Hugh Miller: Correct, correct, from that issuer?

Ken Vecchione: No, that issuer has not started selling yet. That issuer has – we understand is just finishing up its audits and presenting the audit findings to its steering committee, and also presenting any remediation activities that have to occur to the particular debt purchasers.

Hugh Miller: OK, and looking at the Propel business, you guys had commented that you're now you know you've been deploying capital in nine states, can you talk about obviously one of the reasons why you like the Texas market was kind of the opt-in strategy with consumers having to kind of select you guys and trying to kind of export that model. Of those nine states that you're buying in, how many have that opt-in model?

Ken Vecchione: Well, Texas is the TLT business, and most of the other states, with the exception of just Nevada now, are our TLC model.

Hugh Miller: OK, and so is there a reason why you guys are kind of you know given how underpenetrated the Texas market is, is it just kind of R&D that you're buying in those other states or is there a reason why you're looking at that market, where it's kind of a free for all on people bidding?

Ken Vecchione: Well, it's just another way to deploy our capital, and we are trying to when we deploy our capital we're trying to achieve our internal rates of returns that we want, our hurdle rates, and we have an opportunity to do it in Texas or to do it in some other states.

In addition, we're working on as we start, as we end this year and enter into next year we'll be working with several other states to hopefully open up their TLT business, like we opened up Nevada's.

So we have a big legislative, regulatory effort here that will begin pretty soon to see if we can get some other states to start doing TLTs, as well, but we're still holding to about a 40 percent market share in Texas as it relates to TLTs.

And similar to the U.S. with Encore, similar to Cabot, we're now beginning to see, early stages here now, we're now beginning to see some acquisition opportunities that are occurring in Texas in the TLT business.

Paul Grinberg: And, Hugh, as we had mentioned before, we have a separate credit facility that focuses on tax lien certificates outside of our Texas tax lien transfer facility, so deploying capital in those other states doesn't take away from our growth opportunities in Texas because it is a separate pool of capital.

Hugh Miller: Sure, sure, and I certainly understand that, but I think you guys had kind of indicated that there was kind of a benefit to looking at an opt-in TLT model as opposed to just kind of bidding against other people for consumers that won't be opting in, but what are you guys hearing as maybe the reasons why some other states might be reluctant to move to a TLT model?

Ken Vecchione: I think some of it is education, they just don't understand yet what the TLT model does and how it helps consumers and it protects them and it gives them the opportunity to have affordable payment plans at interest rates that are far less than what the states are charging.

So as we go in and we start making that pitch, that education begins to resonate with these folks, rather than thinking it's a company looking to get in there, buy tax liens, and to take over property, so that's not our goal and that's not the business we want to be in.

So as we educate the states, the treasurers, the state legislatures, that's what we need to get them to understand, and then we've just got to go in and continue to prove ourselves, that we enter this business with high integrity, principle intent, and pretty much the same focus that we have in Encore we have in Propel, again being consumer centric and consumer focused.

Hugh Miller: OK, and then just two more general questions. One, any update that you can give us on kind of where things stand with the class action settlement and the issues outstanding with the state attorney generals?

Ken Vecchione: Conversations are ongoing, and that's probably all I will say.

Hugh Miller: OK, and then the last question, just about obviously given the strength of the quarter here and you guys had kind of issued updated guidance as of the last quarter, is there any update that you're going to be giving us on a guidance level for 2013 earnings?

Ken Vecchione: No, we've ran out of words, like comfortable, to give direction on EPS, so I think you guys can look at sort of where we ended this quarter and kind of extrapolate on run rates and I think you can get there for 2014.

Hugh Miller: Sure. Thank you very much.

Ken Vecchione: Thank you.

Operator: Our next question comes from the line of Sameer Gokhale from Janney Capital. Your line is open. Please go ahead.

Sameer Gokhale: Thank you, thanks for taking my questions. I just had three questions. I guess the first one is I think, Paul, one of you made a comment about if you had to (inaudible) what the collections were to be done onshore exclusively you know if you see more people sign up for that you could try to maybe reallocate some of your collectors and who works the account and then you can do that without too much difficulty.

From an operational standpoint, I mean is there like some transition time that it would take for you to move those accounts around?

I'm just trying to get a sense here for how much, and you mentioned you had enough capacity here for collectors to do their work, so is it going to be, would it be seamless in that instance or would you envision there being some transitional issues if you were to move some of those accounts around in terms of the collections? How should we think about that?

Ken Vecchione: Right now I would say it should be more or less seamless. We do run with an excess capacity in our call centers, and we do that because sometimes we never know when large portfolios are available and we want to have the ability to have people that are experienced work on these portfolios.

So this should be relatively seamless, and for us it's really just shifting around workflow from the U.S. into India. And, as I said, we've got that capability, we've got that modeling capability, and we've already planned for that and we know what to do.
So when the other large issuer comes back to market and if we can win our fair share of market share then we'll be able to handle that, and it'll be handled seamlessly.

Paul Grinberg: And, Sameer, I think if you go back a few years we had discussed with all of you one other seller who had limited our ability to collect only to domestic, they've now shifted and they're allowing us to collect everywhere, after they spent some time doing their diligence and understanding that we do the same type of collections in the U.S. and in India and in Costa Rica, but we've built the capacity to be able to shift volumes between sites.

So if it happened a week from now we'd be ready a week from now to do it.

Sameer Gokhale: OK, that's very helpful. The other question I had was unrelated, but it is about payment size, as one of your peers I think said that payment size isn't what they collected, the rest of you have grown it seems like 3 percent or something year-over-year.

Are you seeing a similar increase in payment size?

And would you agree with the characterization of the paper that's been purchased, say post 2009, after the Card Act was passed, as being in a certain sense higher quality than the pre 2009 paper because maybe if you look post 2009 after the Card Act there are limitations placed on who cards could be issued to and the terms and the like.

Is it better credit profile or better asset profile of those borrowers, so just some perspective on that would be helpful? Have you seen the payment size increase and then, also, is it fair to say that the kind of profile of the average debtor has improved compared to the pre 2009 levels, given the passage of the Card Act?

Paul Grinberg: Sameer, we've never historically talked about payment sizes and whether they're going up or down from any period to the other.

In terms of the second part of your question, I think they're at origination, the credit quality of consumers post the recession were certainly better than those pre recession. After they've charged off, the question is what does their profile look like, and what we've always focused on is at the account level whether a consumer can pay and how much can that consumer pay.

So I think we are seeing different types of consumers, when they charge off they're equally distressed pre and post 2009, but I think generally they were probably better consumers going into it and we're generating strong collections from them today.

Sameer Gokhale: Yes, understood. I mean clearly they're charged off (inaudible) I thought maybe it has something to do with their asset profile or ability to find jobs relative to the average profile of the consumer pre Card Act, and so (inaudible) but you're absolutely right, I mean at the end of the day they're all charged off.

So it's really asking from the other angles, and it doesn't sound like there's been that much of a change from what you're seeing.

I guess the last question I had was really on balance sheet leverage, and obviously you had these two large acquisitions that you made, generating a lot of cash for you guys, but is it safe to say that for the foreseeable future we're looking at any cash that's generated to be deployed more for portfolio acquisitions than for paying down your existing debt levels, so we shouldn't think of share buybacks within the foreseeable future as really being something that's on the table, is that fair to say at this point?

Ken Vecchione: Yes, I think that's fair to say that share buybacks are not in front of us at this point, and we see we have a lot of opportunities to deploy capital.

Paul Grinberg: I would, just to give you some perspective, to give everyone some perspective, I mean you all saw that we had close to $100 million of cash on our balance sheet at the end of this quarter, in our core business without our accordion we have $270 million of capital available, and with the accordion it goes up to in excess of $100 million.

We've got close to a couple $100 million available at Propel to deploy capital and well in excess of $100 million in Cabot, and so and we're generating a lot of cash.

So the business generates a lot of cash, has a lot of access to capital, so even though we have a lot more leverage now because of these two deals we've got plenty of availability to deploy at making investments that create value for our shareholders.

And the only other thing I'd like to point out is that a significant amount of the debt that is on our balance sheet today are these PECs, so there are a couple hundred million dollars that's classified as debt that ultimately is only going to be settled once, as we plan to buy up the noncontrolling interest in Cabot.

So while that is debt on the balance sheet, it's debt that's really not, that doesn't have any interest that's paid or with no fixed maturity date and it'll ultimately be settled through the final outcome of the Cabot purchase.

Sameer Gokhale: That's helpful. And then I guess the other thing in relation to your capacity on the (inaudible) and the like and your cash on hand is your adjusted EBITDA, which if you analyze it is about I think $940 million or something like that. So that should be adequate.

But that's helpful color to at least know how you're thinking about it in terms of use of cash. So that's all I had. Thank you very much.

Ken Vecchione: Thank you.

Paul Grinberg: Thanks, Sameer.

Operator: Our next question comes from the line of (Doug Newerder) from SunTrust. Your line is open, please go ahead with your question.

Doug Newerder: Hi, good afternoon. Doug Newerder here for Mark Hughes. Most of my questions have been answered. Two more general questions. First with regards to business mix, now that Cabot is on the books I guess how would we see some of the different line items shift a little bit, so is Cabot more legal heavy or less legal heavy or more third-party or less third-party? I'm sure you've already previously disclosed this, if you could just remind me how that might shift a little bit going forward?

Paul Grinberg: So right now Cabot is relatively light in legal. It does very little litigation, and it's largely because Cabot has historically been buying semi-performing portfolio where consumers, many of those consumers have already been in payment plans. Going forward we plan to expand into other segments into older portfolio and lower balance portfolio, and as Ken mentioned utilize our site in India to collect and to call into the U.K.. So we'll see a shift in mix related to the type of portfolio that's being acquired.

In the near term we don't expect to see that much shift into litigation. Over time it's something that we'll certainly explore, but nothing immediate there. Our plan is to look at the mix between agency and internal and over time shift work that we can where we're not contractually obligated to have it with an agency to internal resources.

Doug Newerder: OK, thanks for that. And my second question, just on the overall supply/demand picture for paper, I mean as you can see the industry charge offs have gone down considerably since the end of the recession, and so how is pricing looking or available supply?

I realize that you pretty much were all pretty much tapped out this quarter for obvious reasons, but looking ahead how do you see the supply/demand shaping up over the next couple quarters for just the regular organic type purchases in the U.S.?

Ken Vecchione: Yes, I mean I think you actually cemented or reaffirmed why we purchased Asset, which was to take care of some of the ups and downs in the supply.

What we're seeing here is the supply is a little bit uneven at this point, and mostly that's because issuers are getting their shops in order in order to sell. So I think it contracted a little bit in Q3, it wasn't as much clearly as it was last year at this time. Pricing is still at the same level, maybe a touch elevated.

Offsetting those two points are conversations that we've had with a lot of the issuers that say at the end of the day they're only selling to just a few players.

One to maybe three players, and we seem to be one of those players. And so while the supply is a little uneven today the purchase of Asset, Propel, Cabot gives us different channels with different pools of capital to deploy in order to support our earnings growth.

Doug Newerder: OK, thanks, that's all my questions.

Ken Vecchione: Thanks.

Operator: Our next question comes from the line of David Scharf from JMP. Your line is open, please go ahead with your question.

David Scharf: Actually, just a quick follow-up on the tax changes, should we be looking at that 36 percent, 37 percent rate as soon as early next year?

Paul Grinberg: As soon as the fourth quarter.

David Scharf: Fourth quarter, got it. Thank you.

Paul Grinberg: Sure, David.

Operator: Sir, I'm showing no further questions in the queue. I'd now like to turn the call over to ken Vecchione for further remarks.

Ken Vecchione: Yes, thank you, all, for joining us. We're very pleased with the quarter. We're very excited. We've got a lot of momentum here. And we look forward to coming back and talking to you about the results of the Company at the conclusion of Q4. So thank you, all, for participating today.

Operator: Thank you for calling, ladies and gentlemen. This does conclude your teleconference. You may all now disconnect. Everyone, have a wonderful day.

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