

# ECPG 10-Q 6/30/2010

## Section 1: 10-Q (FORM 10-Q)

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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 June 30, 2010

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)

48-1090909  
(IRS Employer  
Identification No.)

8875 Aero Drive, Suite 200  
San Diego, California  
(Address of principal executive offices)

92123  
(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 July 27, 2010
Common Stock, \$0.01 par value	23,805,717 shares

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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)

	June 30, 2010	December 31, 2009
<b>Assets</b>		
Cash and cash equivalents	\$ 10,402	\$ 8,388
Accounts receivable, net	2,478	3,134
Investment in receivable portfolios, net	566,815	526,877
Deferred court costs	25,954	25,957
Property and equipment, net	11,234	9,427
Prepaid income tax	2,039	—
Other assets	9,793	4,252
Goodwill	15,985	15,985
Identifiable intangible assets, net	943	1,139
<b>Total assets</b>	<b>\$645,643</b>	<b>\$ 595,159</b>
<b>Liabilities and stockholders' equity</b>		
<b>Liabilities:</b>		
Accounts payable and accrued liabilities	\$ 22,028	\$ 21,815
Income taxes payable	—	2,681
Deferred tax liabilities, net	16,958	16,980
Deferred revenue	4,808	5,481
Debt	328,656	303,075
Other liabilities	1,066	2,036
<b>Total liabilities</b>	<b>373,516</b>	<b>352,068</b>
<b>Commitments and contingencies and subsequent events</b>		
<b>Stockholders' equity:</b>		
Convertible preferred stock, \$.01 par value, 5,000 shares authorized, no shares issued and outstanding	—	—
Common stock, \$.01 par value, 50,000 shares authorized, 23,785 shares and 23,359 shares issued and outstanding as of June 30, 2010 and December 31, 2009, respectively	238	234
Additional paid-in capital	110,117	104,261
Accumulated earnings	162,433	139,842
Accumulated other comprehensive loss	(661)	(1,246)
<b>Total stockholders' equity</b>	<b>272,127</b>	<b>243,091</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$645,643</b>	<b>\$ 595,159</b>

See accompanying notes to condensed consolidated financial statements

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**ENCORE CAPITAL GROUP, INC.**  
**Condensed Consolidated Statements of Income**  
(In Thousands, Except Per Share Amounts)  
(Unaudited)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2010	2009	2010	2009
<b>Revenue</b>				
Revenue from receivable portfolios, net	\$91,845	\$73,965	\$174,752	\$146,240
Servicing fees and other related revenue	4,386	4,070	8,817	8,241
<b>Total revenue</b>	<u>96,231</u>	<u>78,035</u>	<u>183,569</u>	<u>154,481</u>
<b>Operating expenses</b>				
Salaries and employee benefits (excluding stock-based compensation expense)	16,484	14,762	31,969	28,719
Stock-based compensation expense	1,446	994	3,207	2,074
Cost of legal collections	31,235	28,626	57,668	58,573
Other operating expenses	9,027	6,598	18,141	12,578
Collection agency commissions	6,413	4,797	11,709	7,688
General and administrative expenses	7,425	7,097	14,304	12,794
Depreciation and amortization	752	620	1,425	1,243
<b>Total operating expenses</b>	<u>72,782</u>	<u>63,494</u>	<u>138,423</u>	<u>123,669</u>
<b>Income before other (expense) income and income taxes</b>	<u>23,449</u>	<u>14,541</u>	<u>45,146</u>	<u>30,812</u>
<b>Other (expense) income</b>				
Interest expense	(4,880)	(3,958)	(9,418)	(8,231)
Gain on repurchase of convertible notes, net	—	215	—	3,268
Other (expense) income	(90)	9	102	(72)
<b>Total other expense</b>	<u>(4,970)</u>	<u>(3,734)</u>	<u>(9,316)</u>	<u>(5,035)</u>
<b>Income before income taxes</b>	18,479	10,807	35,830	25,777
Provision for income taxes	(6,749)	(4,166)	(13,239)	(10,139)
<b>Net income</b>	<u>\$11,730</u>	<u>\$ 6,641</u>	<u>\$ 22,591</u>	<u>\$ 15,638</u>
<b>Weighted average shares outstanding:</b>				
Basic	23,713	23,168	23,673	23,145
Diluted	24,958	23,971	24,897	23,811
<b>Earnings per share:</b>				
Basic	\$ 0.49	\$ 0.29	\$ 0.95	\$ 0.68
Diluted	\$ 0.47	\$ 0.28	\$ 0.91	\$ 0.66

*See accompanying notes to condensed consolidated financial statements*

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**ENCORE CAPITAL GROUP, INC.**  
**Condensed Consolidated Statements of Stockholders' Equity and Comprehensive Income**  
(Unaudited, In Thousands)

	<u>Common Stock</u>		<u>Additional Paid-In Capital</u>	<u>Accumulated Earnings</u>	<u>Accumulated Other Comprehensive Income (loss)</u>	<u>Total Equity</u>	<u>Comprehensive Income</u>
	<u>Shares</u>	<u>Par</u>					
<b>Balance at December 31, 2009</b>	23,359	\$ 234	\$ 104,261	\$ 139,842	\$ (1,246)	\$243,091	\$ —
Net income	—	—	—	22,591	—	22,591	22,591
Other comprehensive gain:							
Unrealized gain on cash flow hedge, net of tax	—	—	—	—	585	585	585
Exercise of stock options and issuance of share-based awards, net of shares withheld for employee taxes	426	4	432	—	—	436	—
Stock-based compensation	—	—	3,207	—	—	3,207	—
Settlement of call options and warrants associated with convertible notes, net	—	—	524	—	—	524	—
Tax benefit related to stock-based compensation	—	—	1,693	—	—	1,693	—
<b>Balance at June 30, 2010</b>	<u>23,785</u>	<u>\$ 238</u>	<u>\$ 110,117</u>	<u>\$ 162,433</u>	<u>\$ (661)</u>	<u>\$272,127</u>	<u>\$ 23,176</u>

*See accompanying notes to condensed consolidated financial statements*

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**ENCORE CAPITAL GROUP, INC.**  
**Condensed Consolidated Statements of Cash Flows**  
(Unaudited, In Thousands)

	Six Months Ended	
	June 30,	
	2010	2009
<b>Operating activities:</b>		
Net income	\$ 22,591	\$ 15,638
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,425	1,243
Amortization of loan costs and debt discount	2,194	2,160
Stock-based compensation expense	3,207	2,074
Gain on repurchase of convertible notes, net	—	(3,268)
Deferred income tax expense	(22)	360
Excess tax benefit from stock-based payment arrangements	(1,813)	(28)
Provision for allowances on receivable portfolios, net	10,720	9,991
Changes in operating assets and liabilities		
Other assets	39	(2,456)
Deferred court costs	3	(1,425)
Prepaid income tax and income taxes payable	(3,027)	8,577
Deferred revenue	(673)	197
Accounts payable, accrued liabilities and other liabilities	(1,072)	611
Net cash provided by operating activities	<u>33,572</u>	<u>33,674</u>
<b>Investing activities:</b>		
Purchases of receivable portfolios	(164,968)	(137,946)
Collections applied to investment in receivable portfolios, net	112,446	81,163
Proceeds from put-backs of receivable portfolios	1,864	1,430
Purchases of property and equipment	(1,647)	(1,400)
Net cash used in investing activities	<u>(52,305)</u>	<u>(56,753)</u>
<b>Financing activities:</b>		
Payment of loan costs	(4,660)	—
Proceeds from revolving credit facility	53,000	62,500
Repayment of revolving credit facility	(31,000)	(21,500)
Repurchase of convertible notes	—	(22,262)
Proceeds from net settlement of certain call options	524	—
Proceeds from exercise of stock options	1,688	29
Excess tax benefit from stock-based payment arrangements	1,813	28
Repayment of capital lease obligations	(618)	(122)
Net cash provided by financing activities	<u>20,747</u>	<u>18,673</u>
<b>Net increase (decrease) in cash and cash equivalents</b>	<u>2,014</u>	<u>(4,406)</u>
<b>Cash and cash equivalents, beginning of period</b>	<u>8,388</u>	<u>10,341</u>
<b>Cash and cash equivalents, end of period</b>	<u>\$ 10,402</u>	<u>\$ 5,935</u>
<b>Supplemental disclosures of cash flow information:</b>		
Cash paid for interest	\$ 6,994	\$ 6,435
Cash paid for income taxes	\$ 16,544	\$ 1,626
<b>Supplemental schedule of non-cash investing and financing activities:</b>		
Fixed assets acquired through capital lease	\$ 1,389	\$ —

*See accompanying notes to condensed consolidated financial statements*

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### 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 systems-driven purchaser and manager of charged-off consumer receivable portfolios and, through its wholly owned subsidiary Ascension Capital Group, Inc. (“Ascension”), a provider of bankruptcy services to the finance industry. The Company purchases portfolios of defaulted consumer receivables and manages them by partnering 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, auto finance companies and telecommunication companies which the Company purchases at deep discounts. The Company’s success hinges on its understanding, measuring, and predicting the distressed consumer’s behavior. The Company has invested heavily to build one of the industry’s strongest analytic platforms. The Company purchases receivables based on account-level valuation methods, and employs a suite of proprietary statistical models across the full extent of its operations. Moreover, the Company has one of the industry’s largest distressed consumer databases, comprised of approximately 20 million consumer accounts. As a result, the Company has been able to historically realize significant returns from the receivables it acquires. The Company’s performance derives from its sophisticated and widespread use of analytics, its investments in data and consumer intelligence, its cost leadership position (based on the Company’s enterprise-wide, account-level cost database as well as its India facility), and its commitment to see principled intent drive every consumer interaction. The Company maintains strong relationships with many of the largest credit providers in the United States, and possesses one of the industry’s best collection staff retention rates.

In addition, the Company provides bankruptcy support services to some of the largest companies in the financial services industry through its Ascension subsidiary. Leveraging a proprietary software platform dedicated to bankruptcy servicing, Ascension’s operational platform integrates lenders, trustees, and consumers across the bankruptcy lifecycle.

Acquisitions of receivable portfolios are financed by operations and by borrowings from third parties. See Note 9 for further discussion of the Company’s debt.

#### ***Financial Statement Preparation***

The accompanying interim condensed consolidated financial statements have been prepared by Encore, without audit, in accordance with the instructions to Form 10-Q, and Rule 10-01 of Regulation S-X promulgated by the Securities and Exchange Commission 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.

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 results of operations, financial position 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, 2009. 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.

#### ***Principles of Consolidation***

The Company’s condensed consolidated financial statements include the assets, liabilities and operating results of its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated.

#### ***New Accounting Pronouncements***

In October 2009, the Financial Accounting Standards Board issued Accounting Standards Update No. 2009-13, “*Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements—a consensus of the FASB Emerging Issues Task Force*,” which establishes a selling price hierarchy for determining the selling price of a deliverable, and eliminates the residual method of allocation. This update requires the arrangement consideration be allocated at the inception of the arrangement to all deliverables using the relative selling price method. This update is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. The Company is currently analyzing the impact of this update, if any, to its consolidated financial statements.



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### Note 2: Earnings per Share

Basic earnings per share is calculated by dividing net earnings available to common stockholders 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 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 and restricted stock units.

The components of basic and diluted earnings per share are as follows (*in thousands, except earnings per share*):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Net income available for common shareholders	\$ 11,730	\$ 6,641	\$ 22,591	\$ 15,638
Weighted average outstanding shares of common stock	23,713	23,168	23,673	23,145
Dilutive effect of stock-based awards	1,245	803	1,224	666
Common stock and common stock equivalents	<u>24,958</u>	<u>23,971</u>	<u>24,897</u>	<u>23,811</u>
<b>Earnings per share:</b>				
Basic <sup>(1)</sup>	\$ 0.49	\$ 0.29	\$ 0.95	\$ 0.68
Diluted <sup>(2)</sup>	\$ 0.47	\$ 0.28	\$ 0.91	\$ 0.66

(1) Represents net income available for common shareholders divided by weighted average outstanding shares of common stock.

(2) Represents net income available for common shareholders divided by common stock and common stock equivalents.

Employee stock options to purchase approximately 259,000 and 264,000 shares of common stock during the three and six months ended June 30, 2010, respectively, and employee stock options to purchase approximately 1,346,000 shares of common stock during the three and six months ended June 30, 2009, 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.

### Note 3: 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 that reflect the reporting entity’s own assumptions.

Liabilities measured at fair value on a recurring basis at June 30, 2010 are summarized below (*in thousands*):

	Level 1	Level 2	Level 3	Total
<b>Liabilities</b>				
Foreign exchange contracts	\$ —	\$ 120	\$ —	\$120
Interest rate swap agreements	\$ —	\$ 946	\$ —	\$946

Fair values of derivative instruments included in Level 2 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 exchange rates, and forward and spot prices for currencies. As of June 30, 2010, the Company did not have any financial instruments carried at fair value that required Level 3 measurement.

#### *Financial instruments not required to be carried at fair value*

Borrowings under the Company’s revolving credit facility are carried at historical cost, adjusted for additional borrowings less principal repayments, which approximates fair value. The Company’s Convertible Notes are carried at historical cost, adjusted for repurchases and debt discount. The fair value estimate for these notes incorporates quoted market prices at the balance sheet date, which was determined to be approximately equal to book value as of June 30, 2010 and December 31, 2009. For investment in receivable portfolios, there is no active market or observable inputs for the fair value estimation. The Company considers it not practical to attempt to estimate the fair value of such financial instruments due to the excessive costs that would be incurred in doing so.

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### **Note 4: 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 exchange contracts qualify for hedge accounting treatment under the authoritative guidance for derivatives and hedging.

#### ***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 June 30, 2010, the Company has one interest rate swap agreement outstanding with a notional amount of \$25.0 million and an expiration date of April 2011. Under the swap agreement, the Company receives floating interest rate payments and makes interest payments based on a fixed interest rate of 5.01%. 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 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. 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.

#### ***Foreign Exchange Contracts***

The Company conducts business in a currency other than the U.S. dollar, associated with its international subsidiary in India. As a result, India's forecasted expenditures expose the Company to foreign currency risk. 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 24 months. The Company adjusts the level and use of derivatives as soon as practicable after learning that an exposure has changed and the Company reviews all exposures and derivative positions on an ongoing basis.

Gains and losses on cash flow hedges are recorded in accumulated other comprehensive income (loss) 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 accumulated gain or loss on the derivative into earnings. If all or a portion of the forecasted transaction was 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 June 30, 2010, the total notional amount of the forward contracts to buy Indian rupees in exchange for U.S. dollars was \$13.3 million. All outstanding contracts qualified for hedge accounting treatment as of June 30, 2010. The Company estimates that approximately \$0.1 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 six months ended June 30, 2010.

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 consolidated statements of financial position (*in thousands*):

	June 30, 2010		December 31, 2009	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives designated as hedging instruments:				
Interest rate swaps	Other liabilities	\$ 946	Other liabilities	\$ 1,791
Foreign exchange contracts	Other liabilities	\$ 120	Other liabilities	\$ 245

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The following tables summarize the effects of derivatives in cash flow hedging relationships on the Company's statements of income for the three and six months ended June 30, 2010 and 2009 (*in thousands*):

	Gain or (Loss) Recognized in OCI- Effective Portion		Location of Gain or (Loss) Reclassified from OCI into Income - Effective Portion	Gain or (Loss) Reclassified from OCI into Income - Effective Portion		Location of Gain or (Loss) Recognized - Ineffective Portion and Amount Excluded from Effectiveness Testing	Amount of Gain or (Loss) Recognized - Ineffective Portion and Amount Excluded from Effectiveness Testing	
	Three Months Ended June 30,			Three Months Ended June 30,			Three Months Ended June 30,	
	2010	2009		2010	2009		2010	2009
Interest rate swaps	\$ 374	\$ 528	Interest expense	\$ —	\$ —	Other (expense) income	\$ —	\$ —
Foreign exchange contracts	\$ (381)	\$ —	Salaries and employee benefits	\$ 9	\$ —	Other (expense) income	\$ —	\$ —
Foreign exchange contracts	\$ (78)	\$ —	General and administrative expenses	\$ 3	\$ —	Other (expense) income	\$ —	\$ —
	Gain or (Loss) Recognized in OCI- Effective Portion		Location of Gain or (Loss) Reclassified from OCI into Income - Effective Portion	Gain or (Loss) Reclassified from OCI into Income - Effective Portion		Location of Gain or (Loss) Recognized - Ineffective Portion and Amount Excluded from Effectiveness Testing	Amount of Gain or (Loss) Recognized - Ineffective Portion and Amount Excluded from Effectiveness Testing	
	Six Months Ended June 30,			Six Months Ended June 30,			Six Months Ended June 30,	
	2010	2009		2010	2009		2010	2009
Interest rate swaps	\$ 845	\$ 835	Interest expense	\$ —	\$ —	Other (expense) income	\$ —	\$ —
Foreign exchange contracts	\$ 113	\$ —	Salaries and employee benefits	\$ 12	\$ —	Other (expense) income	\$ —	\$ —
Foreign exchange contracts	\$ 26	\$ —	General and administrative expenses	\$ 2	\$ —	Other (expense) income	\$ —	\$ —

### Note 5: Stock-Based Compensation

On March 9, 2009, the Board of Directors approved an amendment and restatement of the 2005 Stock Incentive Plan ("2005 Plan"), which was originally adopted on March 30, 2005, for Board members, employees, officers, and executives of, and consultants and advisors to, the Company. The amendment and restatement of the 2005 Plan increased by 2,000,000 shares the maximum number of shares of the Company's common stock that may be issued or be subject to awards under the plan, established a new 10-year term for the plan and made certain other amendments. The 2005 Plan amendment was approved by the Company's stockholders on June 9, 2009. The 2005 Plan provides for the granting of incentive stock options, nonqualified stock options, stock appreciation rights, restricted stock, restricted stock units, and performance-based awards to eligible individuals. As amended, the 2005 Plan allows the granting of an aggregate of 3,500,000 shares of the Company's common stock for awards, plus the number of shares of stock that were available for future awards under the prior 1999 Equity Participation Plan ("1999 Plan"). In addition, shares subject to options granted under either the 1999 Plan or the 2005 Plan that terminate or expire without being exercised will become available for grant under the 2005 Plan. The benefits provided under these plans are compensation subject to authoritative guidance for stock-based compensation.

In accordance with authoritative guidance for stock-based compensation, compensation expense is recognized only for those shares expected to vest, based on the Company's historical experience and future expectations. Total compensation expense during the six months ended June 30, 2010 and 2009 was \$3.2 million and \$2.1 million, respectively.

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The Company's stock-based compensation arrangements are described below:

### **Stock Options**

The 2005 Plan permits the granting of stock options to employees, officers and executives, and directors of, and consultants and advisors to, the Company. The Company uses the Black-Scholes option-pricing model to determine the fair-value of stock-based awards. All options are amortized ratably over the requisite service periods of the awards, which are generally the vesting periods.

The fair value for options granted was estimated at the date of grant using a Black-Scholes option-pricing model with the following weighted-average assumptions:

	Six Months Ended June 30,	
	2010	2009
Weighted average fair value of options granted	\$ 9.70	\$ 1.36
Risk free interest rate	2.3%	1.9%
Dividend yield	0.0%	0.0%
Volatility factor of the expected market price of the Company's common stock	62.0%	52.8%
Weighted-average expected life of options	5 Years	5 Years

Unrecognized compensation cost related to stock options as of June 30, 2010 was \$4.3 million. The weighted-average remaining expense period, based on the unamortized value of these outstanding stock options was approximately 2.3 years.

A summary of the Company's stock option activity as of June 30, 2010, and changes during the six months then ended, is presented below:

	Number of Shares	Option Price Per Share	Weighted Average Exercise Price	Aggregate Intrinsic Value <i>(in thousands)</i>
Outstanding at December 31, 2009	2,667,137	\$0.35 – \$20.09	\$ 9.28	
Granted	215,000	17.90	17.90	
Cancelled/forfeited	(39,333)	2.89 – 17.90	11.13	
Exercised	(242,038)	0.35 – 16.19	6.97	
Outstanding at June 30, 2010	<u>2,600,766</u>	<u>\$0.35 – \$20.09</u>	<u>\$ 10.18</u>	\$ 27,129
Exercisable at June 30, 2010	<u>1,518,487</u>	<u>\$0.35 – \$20.09</u>	<u>\$ 8.95</u>	\$ 17,708

The total intrinsic value of options exercised during the six months ended June 30, 2010 and 2009 was \$3.2 million and \$0.1 million, respectively. As of June 30, 2010, the weighted-average remaining contractual life of options outstanding and options exercisable was 6.3 years and 4.5 years, respectively.

### **Non-Vested Shares**

Under the Company's 2005 Plan, employees, officers and executives and directors of, and consultants and advisors to, the Company are eligible to receive restricted stock units and restricted stock awards. In accordance with the authoritative guidance, the fair value of these non-vested shares is equal to the closing sale price of the Company's common stock on the date of issuance. The total number of these awards expected to vest is adjusted by estimated forfeiture rates. As of June 30, 2010, 88,825 of the non-vested shares are expected to vest over approximately one to two years based on certain performance goals ("Performance-Based Awards"). The fair value of the Performance-Based Awards is expensed over the expected vesting period, net of estimated forfeitures. If performance goals are not expected to be met, the compensation expense previously recognized would be reversed. No reversals of compensation expense related to the Performance-Based Awards have been made as of June 30, 2010. The remaining 718,482 non-vested shares are not performance-based, and will vest over approximately one to five years of continuous service.

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A summary of the status of the Company's non-vested shares as of June 30, 2010, and changes during the six months then ended, is presented below:

<u>Non-Vested Shares</u>	<u>Non-Vested Shares</u>	<u>Weighted Average Grant Date Fair Value</u>
Non-vested at December 31, 2009	675,790	\$ 9.27
Awarded	335,169	\$ 17.81
Vested	(184,987)	\$ 9.85
Cancelled/forfeited	(18,665)	\$ 11.33
Non-vested at June 30, 2010	<u>807,307</u>	<u>\$ 12.63</u>

Unrecognized compensation expense related to non-vested shares as of June 30, 2010, was \$5.9 million. The weighted-average remaining expense period, based on the unamortized value of these outstanding non-vested shares was approximately 2.5 years. The fair value of vested shares during the six months ended June 30, 2010 and 2009 was \$3.5 million and \$1.0 million, respectively.

### **Note 6: 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 consumer receivable portfolios using either the interest method or the cost recovery method. The interest method applies an effective interest rate, or 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 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 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.

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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 current period (*in thousands*):

	Accretable Yield	Estimate of Zero Basis Cash Flows	Total
Balance at December 31, 2009	\$628,439	\$ 4,695	\$633,134
Revenue recognized, net	(80,851)	(2,056)	(82,907)
Net additions to existing portfolios	45,179	1,702	46,881
Additions for current purchases	93,430	—	93,430
Balance at March 31, 2010	<u>\$686,197</u>	<u>\$ 4,341</u>	<u>\$690,538</u>
Revenue recognized, net	(89,490)	(2,355)	(91,845)
Additions to existing portfolios	16,481	1,960	18,441
Additions for current purchases	95,862	—	95,862
Balance at June 30, 2010	<u>\$709,050</u>	<u>\$ 3,946</u>	<u>\$712,996</u>
	Accretable Yield	Estimate of Zero Basis Cash Flows	Total
Balance at December 31, 2008	\$592,825	\$ 8,337	\$601,162
Revenue recognized, net	(69,775)	(2,500)	(72,275)
Net additions to existing portfolios	5,715	1,032	6,747
Additions for current purchases	81,917	—	81,917
Balance at March 31, 2009	<u>610,682</u>	<u>6,869</u>	<u>617,551</u>
Revenue recognized, net	(71,576)	(2,389)	(73,965)
(Reductions) additions to existing portfolios	(15,399)	2,614	(12,785)
Additions for current purchases	106,771	—	106,771
Balance at June 30, 2009	<u>\$630,478</u>	<u>\$ 7,094</u>	<u>\$637,572</u>

During the three months ended June 30, 2010, the Company purchased receivable portfolios with a face value of \$2.2 billion for \$83.3 million, or a purchase cost of 3.7% of face value. The estimated future collections at acquisition for these portfolios amounted to \$174.5 million. During the six months ended June 30, 2010, the Company purchased receivable portfolios with a face value of \$4.4 billion for \$165.0 million, or a purchase cost of 3.8% of face value. The estimated future collections at acquisition for these portfolios amounted to \$347.8 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"). Zero Basis Revenue remained consistent at \$2.4 million during the three months ended June 30, 2010 and 2009. During the six months ended June 30, 2010 and 2009, approximately \$4.4 million and \$4.9 million were recognized as Zero Basis Revenue, respectively.

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

	Three Months Ended June 30, 2010			
	Accrual Basis Portfolios	Cost Recovery Portfolios	Zero Basis Portfolios	Total
Balance, beginning of period	\$ 549,180	\$ 480	\$ —	\$ 549,660
Purchases of receivable portfolios	83,336	—	—	83,336
Gross collections <sup>(1)</sup>	(154,367)	(24)	(2,355)	(156,746)
Put-backs and recalls <sup>(2)</sup>	(1,280)	—	—	(1,280)
Revenue recognized <sup>(3)</sup>	92,329	—	2,355	94,684
Portfolio allowances, net	(2,383)	(456)	—	(2,839)
Balance, end of period	<u>\$ 566,815</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 566,815</u>
Revenue as a percentage of collections <sup>(4)</sup>	<u>59.8%</u>	<u>0.0%</u>	<u>100.0%</u>	<u>60.4%</u>

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	Three Months Ended June 30, 2009			
	Accrual Basis Portfolios	Cost Recovery Portfolios	Zero Basis Portfolios	Total
Balance, beginning of period	\$ 472,875	\$ 609	\$ —	\$ 473,484
Purchases of receivable portfolios	82,033	—	—	82,033
Gross collections <sup>(1)</sup>	(119,823)	(56)	(2,389)	(122,268)
Put-backs and recalls <sup>(2)</sup>	(506)	—	—	(506)
Revenue recognized <sup>(3)</sup>	76,172	—	2,357	78,529
(Portfolio allowances) portfolio allowance reversals, net	(4,596)	—	32	(4,564)
Balance, end of period	\$ 506,155	\$ 553	\$ —	\$ 506,708
Revenue as a percentage of collections <sup>(4)</sup>	63.6%	0.0%	98.7%	64.2%

	Six Months Ended June 30, 2010			
	Accrual Basis Portfolios	Cost Recovery Portfolios	Zero Basis Portfolios	Total
Balance, beginning of period	\$ 526,366	\$ 511	\$ —	\$ 526,877
Purchases of receivable portfolios	164,968	—	—	164,968
Gross collections <sup>(1)</sup>	(293,451)	(55)	(4,412)	(297,918)
Put-backs and recalls <sup>(2)</sup>	(1,864)	—	—	(1,864)
Revenue recognized <sup>(3)</sup>	181,061	—	4,411	185,472
(Portfolio allowances) portfolio allowance reversals, net	(10,265)	(456)	1	(10,720)
Balance, end of period	\$ 566,815	\$ —	\$ —	\$ 566,815
Revenue as a percentage of collections <sup>(4)</sup>	61.7%	0.0%	100.0%	62.3%

	Six Months Ended June 30, 2009			
	Accrual Basis Portfolios	Cost Recovery Portfolios	Zero Basis Portfolios	Total
Balance, beginning of period	\$ 460,598	\$ 748	\$ —	\$ 461,346
Purchases of receivable portfolios	137,946	—	—	137,946
Gross collections <sup>(1)</sup>	(232,314)	(195)	(4,885)	(237,394)
Put-backs and recalls <sup>(2)</sup>	(1,426)	—	(4)	(1,430)
Revenue recognized <sup>(3)</sup>	151,374	—	4,857	156,231
(Portfolio allowances) portfolio allowance reversals, net	(10,023)	—	32	(9,991)
Balance, end of period	\$ 506,155	\$ 553	\$ —	\$ 506,708
Revenue as a percentage of collections <sup>(4)</sup>	65.2%	0.0%	99.4%	65.8%

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

(2) 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").

(3) Includes retained interest.

(4) 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*):

	Valuation Allowance			
	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Balance at beginning of period	\$84,343	\$62,579	\$76,462	\$57,152
Provision for portfolio allowances	4,659	4,722	14,389	10,302
Reversal of prior allowance	(1,820)	(158)	(3,669)	(311)
Balance at end of period	\$87,182	\$67,143	\$87,182	\$67,143

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

	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	<u>2010</u>	<u>2009</u>	<u>2010</u>	<u>2009</u>
Collection sites	\$ 66,619	\$ 44,680	\$ 132,424	\$ 95,022
Legal collections	68,049	61,460	125,222	117,867
Collection agencies	21,960	15,506	39,712	23,173
Sales and other	161	727	698	1,544
	<u>\$ 156,789</u>	<u>\$ 122,373</u>	<u>\$ 298,056</u>	<u>\$ 237,606</u>

### **Note 7: Deferred Court Costs**

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 debtor 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. Deferred Court Costs not recovered within three years of placement are fully written off. Collections received from these debtors are first applied against related court costs with the balance applied to the debtors' account.

Deferred Court Costs for the three-year deferral period consist of the following as of the dates presented (*in thousands*):

	<u>June 30,</u> <u>2010</u>	<u>December 31,</u> <u>2009</u>
Court costs advanced	\$ 178,882	\$ 172,488
Court costs recovered	(46,164)	(44,980)
Court costs reserve	<u>(106,764)</u>	<u>(101,551)</u>
	<u>\$ 25,954</u>	<u>\$ 25,957</u>

### **Note 8: Other Assets**

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

	<u>June 30,</u> <u>2010</u>	<u>December 31,</u> <u>2009</u>
Debt issuance costs, net of amortization	\$ 4,422	\$ 553
Prepaid expenses	3,198	1,728
Security deposit – India building lease	1,018	1,013
Deferred compensation assets	707	758
Other	448	200
	<u>\$ 9,793</u>	<u>\$ 4,252</u>

Deferred compensation assets represent monies held in a trust associated with the Company's deferred compensation plan.

### **Note 9: Debt**

The Company is obligated under borrowings, as follows (*in thousands*):

	<u>June 30,</u> <u>2010</u>	<u>December 31,</u> <u>2009</u>
Convertible notes	\$ 42,920	\$ 42,920
Less: Debt discount	(629)	(2,013)
Revolving credit facility	282,000	260,000
Capital lease obligations	4,365	2,168
	<u>\$328,656</u>	<u>\$ 303,075</u>



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### *Convertible Senior Notes*

In 2005, the Company issued \$100.0 million of 3.375% Convertible Notes due September 19, 2010. Interest on the Convertible Notes is payable semi-annually, in arrears, on March 19 and September 19 of each year. The Convertible Notes rank equally with the Company's existing and future senior indebtedness and are senior to the Company's potential future subordinated indebtedness. Prior to the implementation of the net-share settlement feature discussed below, the Convertible Notes were convertible, prior to maturity, subject to certain conditions described below, into shares of the Company's common stock at an initial conversion rate of 44.7678 per \$1,000 principal amount of notes, which represented an initial conversion price of approximately \$22.34 per share, subject to adjustment.

In October 2005, the Company obtained stockholder approval of a net-share settlement feature that allows the Company to settle conversion of the Convertible Notes through a combination of cash and stock. The net-settlement feature is accounted for as convertible debt and is not subject to derivative accounting treatment. As a result of the net-settlement feature, the Company will be able to substantially reduce the number of shares issuable in the event of conversion of the Convertible Notes by repaying principal in cash instead of issuing shares of common stock for that amount. Additionally, the Company will not be required to include the underlying shares of common stock in the calculation of its diluted weighted average shares outstanding for earnings per share until the Company's common stock price exceeds \$22.34.

Effective January 1, 2009, the Company retrospectively adopted the authoritative guidance for debt with conversion and other options. The authoritative guidance requires that issuers of convertible debt instruments that, upon conversion, may be settled fully or partially in cash, 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.

In accordance with the authoritative guidance, the Company determined that the fair value of the Convertible Notes at issuance in 2005 was approximately \$73.2 million, and designated the residual value of approximately \$26.8 million as the equity component. Additionally, the Company allocated approximately \$2.5 million of the \$3.4 million original Convertible Notes issuance cost as debt issuance cost and the remaining \$0.9 million as equity issuance cost.

The balances of the liability and equity components as of each period presented are as follows (*in thousands*):

	<u>June 30, 2010</u>	<u>December 31, 2009</u>
Liability component – principal amount	\$42,920	\$ 42,920
Unamortized debt discount	(629)	(2,013)
Liability component – net carrying amount	42,291	40,907
Equity component	25,878	25,878

The remaining debt discount is being amortized into interest expense over the remaining life of the Convertible Notes using the effective interest rate. The Convertible Notes are due on September 19, 2010. The effective interest rate on the liability component was 10.38%.

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

	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	<u>2010</u>	<u>2009</u>	<u>2010</u>	<u>2009</u>
Interest expense – stated coupon rate	\$ 362	\$ 369	\$ 724	\$ 908
Interest expense – amortization of debt discount	706	650	1,385	1,560
Total interest expense – convertible notes	<u>\$ 1,068</u>	<u>\$ 1,019</u>	<u>\$ 2,109</u>	<u>\$ 2,468</u>

As of June 30, 2010, the Company is making the required interest payments on the Convertible Notes and no other changes in the balance or structure of the Convertible Notes has occurred.

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The Convertible Notes also contain a restricted convertibility feature that does not affect the conversion price of the Convertible Notes but, instead, places restrictions on a holder's ability to convert their Convertible Notes into shares of the Company's common stock. Prior to March 19, 2010, a holder of the Convertible Notes, under certain criteria defined in the agreement, had the ability to convert the Convertible Notes into shares of the Company's common stock. None of the criteria were met and therefore no such conversions took place.

Holders may surrender their Convertible Notes for conversion anytime on or after March 19, 2010, until the close of business on the trading day immediately preceding September 19, 2010.

*Convertible Notes Hedge Strategy.* Concurrent with the sale of the Convertible Notes, the Company purchased call options to purchase from the counterparties an aggregate of 4,476,780 shares of the Company's common stock at a price of \$22.34 per share. The cost of the call options totaled \$27.4 million. The Company also sold warrants to the same counterparties to purchase from the Company an aggregate of 3,984,334 shares of the Company's common stock at a price of \$29.04 per share and received net proceeds from the sale of these warrants of \$11.6 million. Taken together, the call option and warrant agreements have the effect of increasing the effective conversion price of the Convertible Notes to \$29.04 per share. The call options and warrants must be settled in net shares, except in connection with certain termination events, in which case they would be settled in cash based on the fair market value of the instruments. On the date of settlement, if the market price per share of the Company's common stock is above \$29.04 per share, the Company will be required to deliver shares of its common stock representing the value of the call options and warrants in excess of \$29.04 per share.

The warrants have a strike price of \$29.04 and are generally exercisable at any time. The Company issued and sold the warrants in a transaction exempt from the registration requirements of the Securities Act of 1933, as amended, because the offer and sale did not involve a public offering. There were no underwriting commissions or discounts in connection with the sale of the warrants. In accordance with the authoritative guidance for equity securities, the Company recorded the net call options and warrants as a reduction in additional paid in capital as of December 31, 2005, and will not recognize subsequent changes in the fair value of the call options and warrants in its consolidated financial statements.

As of June 30, 2010, the Company had outstanding call options to purchase from the counterparties an aggregate of 3,133,746 shares of the Company's common stock at a price of \$22.34 per share and outstanding warrants to the same counterparties to purchase from the Company an aggregate of 2,789,035 shares of the Company's common stock at a price of \$29.04 per share.

### ***Revolving Credit Facility***

On February 8, 2010, the Company entered into a new \$327.5 million revolving credit facility ("2010 Revolving Credit Facility") to be used for the purpose of purchasing receivable portfolios and for general working capital needs. The 2010 Revolving Credit Facility expires in May 2013. The 2010 Revolving Credit Facility replaced the Company's previous revolving credit facility which was due to expire in May 2010.

The 2010 Revolving Credit Facility contains an accordion feature which allows the Company, on or subsequent to closing, at its option, and subject to customary conditions, to request an increase in the facility of up to \$100.0 million, (not to exceed a total facility of \$427.5 million) by obtaining one or more commitments from one or more lenders or other entities with the consent of the administrative agent, but without the consent of any other lenders. On July 15, 2010, the Company obtained an additional \$33.0 million in commitments from lenders and exercised a portion of its \$100.0 million accordion feature. The Company thereby increased its revolving credit facility to \$360.5 million from \$327.5 million, leaving \$67.0 million available under the accordion feather. Upon exercise of the accordion, there was \$78.5 million in available capacity under the facility, subject to borrowing base and applicable debt covenants.

Provisions of the 2010 Revolving Credit Facility include:

- Interest at a floating rate equal to, at the Company's option, either: (1) reserve adjusted LIBOR plus a spread that ranges from 350 to 400 basis points, depending on the Company's leverage; or (2) Alternate Base Rate ("ABR") plus a spread that ranges from 250 to 300 basis points, depending on the Company's leverage. ABR, as defined in the agreement, means the highest of (i) the rate of interest publicly announced by JP Morgan Chase Bank as its prime rate in effect at its principal office in New York City, (ii) the federal funds effective rate from time to time plus 0.5% and (iii) reserved adjusted LIBOR for a one month interest period on the applicable date plus 1%;
- \$10.0 million sub-limits for swingline loans and letters of credit;
- A borrowing base equal to the lesser of (1) 30% of eligible estimated remaining collections minus, to the extent the borrowing base is being calculated on or after June 19, 2010, and so long as the Convertible Notes are outstanding, the aggregate outstanding principal amount of the Convertible Notes plus the aggregate amount of the Company's unrestricted and unencumbered cash and cash equivalent investments (not to exceed the aggregate outstanding principal amount of the Convertible Notes) and (2) the product of the net book value of all receivable portfolios acquired on or after January 1, 2005 multiplied by 95%;

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- Restrictions and covenants, which limit, among other things, the payment of dividends and the incurrence of additional indebtedness and liens;
- Repurchases of up to \$50.0 million in any combination of the Company's common stock and Convertible Notes, subject to compliance with certain covenants and available borrowing capacity;
- A change of control definition which excludes acquisitions of stock by Red Mountain, JCF FPK and their respective affiliates;
- Events of default which, upon occurrence, may permit the lenders to terminate the 2010 Revolving Credit Facility and declare all amounts outstanding to be immediately due and payable;
- An annual capital expenditure maximum of \$12.5 million;
- An annual rental expense maximum of \$12.5 million;
- An outstanding capital lease maximum of \$12.5 million;
- An acquisition limit of \$100.0 million; and
- Collateralization by all assets of the Company.

In conjunction with the 2010 Revolving Credit Facility, the Company incurred loan fees and other loan costs of approximately \$4.7 million. These costs will be amortized over the term of the agreement.

As of June 30, 2010, the outstanding balance on the 2010 Revolving Credit Facility was \$282.0 million, which bore a weighted average interest rate of 4.70% and 4.63% for the three and six months ended June 30, 2010, respectively. The aggregate borrowing base was \$327.5 million, of which \$45.5 million was available for future borrowings. As discussed above, effective July 15, 2010, the 2010 Revolving Credit Facility was increased to \$360.5 million. Accordingly, the amount available for future borrowings increased by \$33.0 million. The Company is in compliance with all covenants under its financing arrangements.

### ***Capital Lease Obligations***

The Company has capital lease obligations for certain computer equipment. As of June 30, 2010, the Company's combined obligation was approximately \$3.4 million. These lease obligations require monthly payments that range from approximately \$1,000 to \$20,000 through June 2013 and have implicit interest rates that range from approximately 5.9% to 7.7%.

The Company has financed certain leasehold improvement projects with its lessors in its Phoenix and St. Cloud facilities. As of June 30, 2010, the Company's combined obligation was approximately \$1.0 million. These financing agreements require monthly principal and interest payments, accrue interest at 8% to 9% per annum and will mature in June and September 2013.

### **Note 10: Income Taxes**

The Company recorded an income tax provision of \$6.7 million, reflecting an effective rate of 36.5% of pretax income during the three months ended June 30, 2010. The effective tax rate for the three months ended June 30, 2010, consists primarily of a provision for federal income taxes of 32.4% (which is net of a benefit for state taxes of 2.6%), a provision for state taxes of 7.3%, a benefit of permanent book versus tax differences of 1.5%, and a benefit of an Internal Revenue Service ("IRS") refund of 1.7%. The Company recorded an income tax provision of \$4.2 million, reflecting an effective rate of 38.5% of pretax income during the three months ended June 30, 2009. The effective tax rate for the three months ended June 30, 2009, consists primarily of a provision for federal income taxes of 32.3% (which is net of a benefit for state taxes of 2.7%), a provision for state taxes of 7.8%, the benefit of permanent book versus tax differences and a state refund 1.6%.

The Company recorded an income tax provision of \$13.2 million, reflecting an effective rate of 36.9% of pretax income during the six months ended June 30, 2010. The effective tax rate for the six months ended June 30, 2010, consists primarily of a provision for federal income taxes of 32.4% (which is net of a benefit for state taxes of 2.6%), a provision for state taxes of 7.3%, a benefit of permanent book versus tax differences of 1.9%, and a benefit of an IRS refund of 0.9%. The Company recorded an income tax provision of \$10.1 million, reflecting an effective rate of 39.3% of pretax income during the six months ended June 30, 2009. The effective tax rate for the six months ended June 30, 2009, consists primarily of a provision for federal income taxes of 32.3% (which is net of a benefit for state taxes of 2.7%), a provision for state taxes of 7.8%, the benefit of permanent book versus tax differences and a state refund of 0.8%.

As of June 30, 2010, the Company had a gross unrecognized tax benefit of \$0.6 million that, if recognized, would result in a net tax benefit of approximately \$0.4 million and would reduce the Company's effective tax rate. During the three months ended June 30, 2010, the Company recognized a \$0.3 million tax benefit which was a result of an IRS refund.

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For the three and six months ended June 30, 2010, the Company has not provided for the United States income taxes or foreign withholding taxes on the quarterly undistributed earnings from continuing operations of its subsidiary operating outside of the United States. Undistributed earnings of the subsidiary for the three and six months ended June 30, 2010, were approximately \$1.8 million and \$2.5 million, respectively. Such undistributed earnings are considered permanently reinvested.

The Company's subsidiary operating outside of the United States is currently operating under a tax holiday in India. The tax holiday is due to expire on March 31, 2011. The impact of the tax holiday on the Company's consolidated financial statements is not material.

### **Note 11: Purchase Concentrations**

The following table summarizes the concentration of initial purchase cost by seller sorted by total aggregate costs (*in thousands, except percentages*):

	Six Months Ended June 30, 2010	
	Cost	%
Seller 1	\$ 39,531	23.9%
Seller 2	29,360	17.8%
Seller 3	26,881	16.3%
Seller 4	24,606	14.9%
Seller 5	15,136	9.2%
Other sellers	29,454	17.9%
	<u>\$164,968</u>	<u>100.0%</u>
Adjustments <sup>(1)</sup>	(95)	
Purchases, net	<u>\$164,873</u>	

<sup>(1)</sup> Adjusted for Put-backs and Recalls.

### **Note 12: Commitments and Contingencies**

#### *Litigation*

The Company, along with others in its industry, is subject to legal actions based on the Fair Debt Collection Practices Act, or FDCPA, and comparable state statutes, which could have a material adverse effect on it due to the remedies available under these statutes, including punitive damages. 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, and has made inaccurate assertions of fact in support of its collection actions. A number of these cases are styled as class actions and a class has been certified in several of these cases. Many of these cases present novel issues on which there is no clear legal precedent. As a result, the Company is unable to predict the range of possible outcomes.

In one such action, captioned *Brent v. Midland Credit Management, Inc et. al.*, filed on May 19, 2008, in the United States District Court for the Northern District of Ohio [Western Division], the plaintiff has filed a class action counter-claim against Midland Credit Management, Inc. and Midland Funding LLC (the "Midland Defendants"). The complaint alleges that the Midland Defendants' business practices violated consumers' rights under the FDCPA and the Ohio Consumer Sales Practices Act. The plaintiff is seeking actual and statutory damages for the class of Ohio residents, plus attorney's fees and costs of class notice and class administration. On August 11, 2009, the court issued an order partially granting plaintiff's motion for summary judgment and entering findings adverse to the Midland Defendants on certain of plaintiff's claims. The Midland Defendants subsequently moved the court to reconsider the order and were partially successful. However, because the court did not completely reverse the August 11 order, certain portions of the order remain subject to reversal only on appeal. On February 22, 2010, the District Court denied Plaintiff's attempts to enlarge the case to include a national class of consumers, and ordered the parties to brief issues relating to whether a statewide class should be certified. No class has been certified to date.

There are a number of other lawsuits, claims and counterclaims pending or threatened against the Company. In general, these lawsuits, claims or counterclaims have arisen in the ordinary course of business and involve claims for damages arising from a variety of alleged misconduct or improper reporting of credit information by the Company or its employees or agents. In addition, from time to time, the Company is subject to various regulatory investigations, inquiries and other actions, relating to its collection activities.

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The Company has established loss provisions only for matters in which losses are probable and can be reasonably estimated. Some of the matters pending against the Company involve potential compensatory, punitive damage claims, fines or sanctions that, if granted, could require it to pay damages or make other expenditures in amounts that could have a material adverse effect on its financial position or results of operations. Although litigation is inherently uncertain, at this time, based on past experience, the information currently available and the possible availability of insurance and/or indemnification in some cases, the Company does not believe that the resolution of these matters will have a material adverse effect on its consolidated financial position or its results of operations.

### *Purchase Commitments*

In the normal course of business, the Company enters into forward flow purchase agreements and other purchase commitment agreements. As of June 30, 2010, the Company has entered into agreements to purchase receivable portfolios with a face value of approximately \$2.3 billion for a purchase price of approximately \$89.9 million. Certain of these agreements allow the Company to terminate the commitment with 60 days notice or by paying a one-time cancellation fee. The Company does not anticipate cancelling any of these commitments at this time. The Company has no purchase commitments extending past one year.

### **Note 13: Subsequent Event**

The Company's 2010 Revolving Credit Facility contains an accordion feature which allows the Company, on or subsequent to closing, at its option, and subject to customary conditions, to request an increase in the facility of up to \$100.0 million, (not to exceed a total facility of \$427.5 million) by obtaining one or more commitments from one or more lenders or other entities with the consent of the administrative agent, but without the consent of any other lenders. On July 15, 2010, the Company obtained an additional \$33.0 million in commitments from lenders increasing its revolving credit facility to \$360.5 million from \$327.5 million.

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### **Item 2—Management’s Discussion and Analysis of Financial Condition and Results of Operations**

#### **Special Note on Forward-Looking Statements**

The following discussion contains, in addition to historical information, forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Statements that are other than historical information are forward-looking statements. For example, statements relating to our beliefs, expectations and plans are forward-looking statements, as are statements that certain actions, conditions or circumstances will continue. Forward-looking statements involve risks and uncertainties, which are difficult to predict and many of which are beyond our control. Therefore, actual results could differ materially and adversely from those expressed in any forward-looking statements. For additional information regarding factors that may affect our actual financial condition and results of operations, see the information under the caption “Risk Factors” in Item 1A in our Annual Report on Form 10-K for the year ended December 31, 2009 and herein. We undertake no obligation to revise or update any forward-looking statements for any reason.

#### **Introduction**

We purchase portfolios of defaulted consumer receivables and manage them by partnering 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, auto finance companies and telecommunication companies which we purchase at deep discounts. Success in our business hinges on understanding, measuring, and predicting distressed consumer behavior, and we have invested heavily to build one of the industry’s strongest analytic platforms. We purchase receivables based on account-level valuation methods, and employ a suite of proprietary statistical models across the full extent of our operations. Moreover, we have one of the industry’s largest distressed consumer databases, comprised of approximately 20 million accounts. As a result, we have been able to historically realize significant returns from receivables we acquire. Our performance derives from our sophisticated and widespread use of analytics, our investments in data and consumer intelligence, our cost leadership position (based on our enterprise-wide, account-level cost database as well as our India facility), and our commitment to see principled intent drive every consumer interaction. We maintain strong relationships with many of the largest credit providers in the United States, and possess one of the industry’s best collection staff retention rates.

In addition, we provide bankruptcy support services to some of the largest companies in the financial services business through our wholly-owned subsidiary Ascension Capital Group, Inc. (“Ascension”). Leveraging a proprietary software platform dedicated to bankruptcy servicing, Ascension’s operational platform integrates lenders, trustees, and consumers across the bankruptcy lifecycle.

#### **Market Overview**

While there has been some improvement in macroeconomic indicators during the first half of 2010, a broad economic recovery has yet to take hold. Minimal new jobs growth and limited credit availability continue to challenge U.S. consumers as demonstrated by weak consumer spending and volatile consumer confidence levels. Within the credit card space, we find mixed signals. Although charge-off rates remain at historic highs, delinquency levels have improved at a rate that may indicate a fundamental improvement in consumer financial strength. However, related measures, like personal bankruptcies and home foreclosure filings, remain elevated and indicate continued near-term pressure on the average consumer.

Despite this macroeconomic volatility, during the first half of 2010, most of our internal collection metrics were consistent with, or better than, what we observed in 2008 and 2009. To illustrate, payer rates and average payment size, adjusted for changes in settlement-in-full vs. payment plan mix, remained constant. However, more of our consumers are opting to settle their debt obligations through payment plans as opposed to one-time settlements. Settlements made through payment plans impact our recoveries in two ways. First, the delay in cash flows from payments received over extended time periods may result in a provision for portfolio allowance. When a long-term payment stream (as compared to a one-time payment of the same amount) is discounted using a pool group’s internal rate of return, or IRR, the net present value is lower. In other words, despite the absolute value of total cash received being identical in both scenarios, accounting for the timing of cash flows in a payment plan yields a lower net present value which, in turn, can result in a provision for portfolio allowance. Second, payment plans inherently contain the possibility of consumers failing to complete all scheduled payments, which we term a “broken payer.”

Despite the generally negative broad macroeconomic environment, the rate at which consumers are honoring their obligations and completing their payment plans has increased in 2010 when compared to 2009. We believe this is the result of two factors. The first is our commitment to partner effectively with consumers during their recovery process. The second is the strength of our analytic platform, which allows us to make accurate and timely decisions about how best to maximize our portfolio returns. Nevertheless, payment plans may still produce broken payers that fail to fulfill all scheduled payments. When this happens, we are often successful in getting the consumer back on plan, but this is not always the case and in those instances where we are unable to do so, we experience a shortfall in recoveries as compared to our initial forecasts. Please refer to “Management’s Discussion and Analysis—Revenue” below for a more detailed explanation of the provision for portfolio allowances for the three and six months ended June 30, 2010.

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Throughout the credit crisis, we strategically invested in receivable portfolio as credit card charge-offs increased to historic levels and we believe that some of our competitors were (i) caught owning receivables with low yields as a result of purchasing certain portfolios at elevated pricing levels between 2005 and 2008 and (ii) faced with a constrained access to capital to fund portfolio purchases due to depressed capital markets. These dynamics resulted in a recent supply-demand gap that dramatically reduced pricing of available portfolios, beginning in early 2009. For example, prices for freshly charged-off assets (i.e., receivables sold within thirty days of charge-off by the credit issuers) declined from a range of 8% – 13% in 2008 to a range of 5% – 9% over the last eighteen months. Similar price reductions were apparent across a broad range of defaulted consumer receivable asset classes (including credit cards and other consumer loans), balance ranges, and ages. After such a dramatic decline, pricing in 2010 has started to increase incrementally, but remains favorable when compared to 2005 through 2008 levels. In response to the price declines in 2009 and 2010, some issuers have opted not to sell all of their receivable portfolio unless pricing recovers more fully. These issuers are currently pursuing internal liquidation strategies or partnering with third party agencies.

In light of the uncertainties presented by current market conditions, we believe we are employing a conservative approach to portfolio valuation as well as to forecasting recoveries. Furthermore, while we believe that consumers who have recently defaulted on their credit card debt (i.e., during bad economic conditions) are more likely to recover faster than consumers who have defaulted during earlier, stronger economic times, we have not factored this perspective into our forecasts.

When evaluating the long-term returns of our business, we believe that the benefits arising from the abovementioned conditions will outweigh the potential negative impact to recoveries stemming from additional consumer distress. However, if the pricing environment re-attracts significant capital to our industry and increases demand and, therefore, price, or if the ability of consumers to repay their debt deteriorates further, our returns may be negatively impacted.

### **Purchases and Collections**

#### ***Purchases***

During the three months ended June 30, 2010, we invested \$83.3 million in receivable portfolios, primarily for charged-off credit card portfolios with face values aggregating \$2.2 billion, for an average purchase price of 3.7% of the face value of the purchased receivables. This is a \$1.3 million increase, or 1.6%, in the amount invested, compared with the \$82.0 million invested during the three months ended June 30, 2009, to acquire receivable portfolios, primarily consisting of charged-off credit card portfolios, with a face value aggregating \$1.9 billion for an average purchase price of 4.2% of the face value of the purchased receivables.

During the six months ended June 30, 2010, we invested \$165.0 million in receivable portfolios, primarily for charged-off credit card portfolios with face values aggregating \$4.4 billion, for an average purchase price of 3.8% of the face value of the purchased receivables. This is a \$27.1 million increase, or 19.6%, in the amount invested, compared with the \$137.9 million invested during the six months ended June 30, 2009, to acquire receivable portfolios, primarily consisting of charged-off credit card portfolios, with a face value aggregating \$3.3 billion for an average purchase price of 4.2% of the face value of the purchased receivables.

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.

#### ***Collections by Channel***

We utilize numerous business channels for the collection of charged-off credit card receivables and other charged-off receivables. The following table summarizes gross collections by collection channel in the respective periods (*in thousands*):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Collection sites	\$ 66,619	\$ 44,680	\$ 132,424	\$ 95,022
Legal collections	68,049	61,460	125,222	117,867
Collection agencies	21,960	15,506	39,712	23,173
Sales and other	161	727	698	1,544
	<u>\$ 156,789</u>	<u>\$ 122,373</u>	<u>\$ 298,056</u>	<u>\$ 237,606</u>

Gross collections increased \$34.4 million, or 28.1%, to \$156.8 million during the three months ended June 30, 2010, from \$122.4 million during the three months ended June 30, 2009. Gross collections increased \$60.5 million, or 25.4%, to \$298.1 million during the six months ended June 30, 2010, from \$237.6 million during the six months ended June 30, 2009.

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A portion of our collections comes from the weekly remittances we receive from our law firm and agency partners. Typically there are 13 remittances in each quarter, however, there were only 12 remittances during the three months ended March 31, 2010. As our average weekly remittances have grown to approximately \$8.0 million, our collections for the six months ended June 30, 2010 were negatively affected by the one fewer weekly remittance. There were 13 remittances in each quarter during the three and six months ended March 31, 2009 and June 30, 2009. The third quarter of 2010 will have 14 remittances and the fourth quarter will have a typical 13 remittances.

### 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 June 30,</b>			
	<b>2010</b>		<b>2009</b>	
<b>Revenue</b>				
Revenue from receivable portfolios, net	\$ 91,845	95.4%	\$ 73,965	94.8%
Servicing fees and related revenue	4,386	4.6%	4,070	5.2%
<b>Total revenue</b>	<b>96,231</b>	<b>100.0%</b>	<b>78,035</b>	<b>100.0%</b>
<b>Operating expenses</b>				
Salaries and employee benefits	16,484	17.1%	14,762	18.9%
Stock-based compensation expense	1,446	1.5%	994	1.3%
Cost of legal collections	31,235	32.4%	28,626	36.7%
Other operating expenses	9,027	9.4%	6,598	8.5%
Collection agency commissions	6,413	6.7%	4,797	6.1%
General and administrative expenses	7,425	7.7%	7,097	9.1%
Depreciation and amortization	752	0.8%	620	0.8%
<b>Total operating expenses</b>	<b>72,782</b>	<b>75.6%</b>	<b>63,494</b>	<b>81.4%</b>
<b>Income before other (expense) income and income taxes</b>	<b>23,449</b>	<b>24.4%</b>	<b>14,541</b>	<b>18.6%</b>
<b>Other (expense) income</b>				
Interest expense	(4,880)	(5.1)%	(3,958)	(5.1)%
Gain on repurchase of convertible notes, net	—	0.0%	215	0.3%
Other (expense) income	(90)	(0.1)%	9	0.0%
<b>Total other expense</b>	<b>(4,970)</b>	<b>(5.2)%</b>	<b>(3,734)</b>	<b>(4.8)%</b>
<b>Income before income taxes</b>	<b>18,479</b>	<b>19.2%</b>	<b>10,807</b>	<b>13.8%</b>
Provision for income taxes	(6,749)	(7.0)%	(4,166)	(5.3)%
<b>Net income</b>	<b>\$ 11,730</b>	<b>12.2%</b>	<b>\$ 6,641</b>	<b>8.5%</b>

	<b>Six Months Ended June 30,</b>			
	<b>2010</b>		<b>2009</b>	
<b>Revenue</b>				
Revenue from receivable portfolios, net	\$174,752	95.2%	\$146,240	94.7%
Servicing fees and related revenue	8,817	4.8%	8,241	5.3%
<b>Total revenue</b>	<b>183,569</b>	<b>100.0%</b>	<b>154,481</b>	<b>100.0%</b>
<b>Operating expenses</b>				
Salaries and employee benefits	31,969	17.4%	28,719	18.6%
Stock-based compensation expense	3,207	1.7%	2,074	1.3%
Cost of legal collections	57,668	31.4%	58,573	37.9%
Other operating expenses	18,141	9.9%	12,578	8.1%
Collection agency commissions	11,709	6.4%	7,688	5.0%
General and administrative expenses	14,304	7.8%	12,794	8.3%
Depreciation and amortization	1,425	0.8%	1,243	0.8%
<b>Total operating expenses</b>	<b>138,423</b>	<b>75.4%</b>	<b>123,669</b>	<b>80.0%</b>
<b>Income before other (expense) income and income taxes</b>	<b>45,146</b>	<b>24.6%</b>	<b>30,812</b>	<b>20.0%</b>



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	Six Months Ended June 30,			
	2010		2009	
<b>Other (expense) income</b>				
Interest expense	(9,418)	(5.2)%	(8,231)	(5.4)%
Gain on repurchase of convertible notes, net	—	0.0%	3,268	2.1%
Other income (expense)	102	0.1%	(72)	0.0%
Total other expense	<u>(9,316)</u>	<u>(5.1)%</u>	<u>(5,035)</u>	<u>(3.3)%</u>
<b>Income before income taxes</b>	35,830	19.5%	25,777	16.7%
Provision for income taxes	<u>(13,239)</u>	<u>(7.2)%</u>	<u>(10,139)</u>	<u>(6.7)%</u>
<b>Net income</b>	<u>\$ 22,591</u>	<u>12.3%</u>	<u>\$ 15,638</u>	<u>10.0%</u>

## Comparison of Results of Operations

### Revenue

Our revenue consists primarily of portfolio revenue and bankruptcy servicing revenue. 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 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. Servicing fee revenue is revenue primarily associated with bankruptcy servicing fees earned from our Ascension subsidiary, a provider of bankruptcy services to the finance industry.

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

	Three Months Ended June 30, 2010					As of June 30, 2010	
	Collections <sup>(1)</sup>	Gross Revenue <sup>(2)</sup>	Revenue Recognition Rate <sup>(3)</sup>	Net Reversal (Portfolio Allowance)	Revenue % of Total Revenue	Unamortized Balances	Monthly IRR
ZBA	\$ 2,355	\$ 2,355	100.0%	\$ —	2.5%	\$ —	—
2002	164	—	0.0%	164	0.0%	—	—
2003	1,247	218	17.5%	668	0.2%	26	30.3%
2004	2,209	826	37.4%	469	0.9%	2,787	7.5%
2005	7,364	4,324	58.7%	(411)	4.6%	23,863	5.6%
2006	7,122	5,691	79.9%	(942)	6.0%	35,243	5.1%
2007	19,390	11,617	59.9%	(977)	12.3%	50,741	6.8%
2008	34,324	20,770	60.5%	(1,810)	21.9%	127,313	5.1%
2009	53,321	33,887	63.6%	—	35.8%	181,270	5.8%
2010	29,250	14,996	51.3%	—	15.8%	145,572	4.3%
<b>Total</b>	<u>\$ 156,746</u>	<u>\$ 94,684</u>	<u>60.4%</u>	<u>\$ (2,839)</u>	<u>100.0%</u>	<u>\$ 566,815</u>	<u>6.0%</u>

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	Three Months Ended June 30, 2009					As of June 30, 2009	
	Collections <sup>(1)</sup>	Gross Revenue <sup>(2)</sup>	Revenue Recognition Rate <sup>(3)</sup>	Net Reversal (Portfolio Allowance)	Revenue % of Total Revenue	Unamortized Balances	Monthly IRR
ZBA	\$ 2,357	\$ 2,357	100.0%	\$ —	3.0%	\$ —	—
2002	802	302	37.7%	100	0.4%	90	—
2003	2,247	1,744	77.6%	—	2.2%	1,585	34.8%
2004	2,941	1,844	62.7%	(60)	2.3%	6,914	30.8%
2005	11,129	6,896	62.0%	(156)	8.8%	38,714	8.1%
2006	11,348	8,202	72.3%	(1,904)	10.5%	51,585	5.6%
2007	30,210	16,892	55.9%	(1,133)	21.5%	92,755	5.1%
2008	43,389	29,121	67.1%	(1,411)	37.1%	184,676	5.5%
2009	17,845	11,171	62.6%	—	14.2%	130,389	5.0%
Total	<u>\$ 122,268</u>	<u>\$ 78,529</u>	<u>64.2%</u>	<u>\$ (4,564)</u>	<u>100.0%</u>	<u>\$ 506,708</u>	<u>5.1%</u>

  

	Six Months Ended June 30, 2010					As of June 30, 2010	
	Collections <sup>(1)</sup>	Gross Revenue <sup>(2)</sup>	Revenue Recognition Rate <sup>(3)</sup>	Net Reversal (Portfolio Allowance)	Revenue % of Total Revenue	Unamortized Balances	Monthly IRR
ZBA	\$ 4,412	\$ 4,411	100.0%	\$ 1	2.4%	\$ —	—
2002	417	—	0.0%	418	0.0%	—	—
2003	2,724	751	27.6%	1,371	0.5%	26	30.3%
2004	4,349	1,905	43.8%	636	1.0%	2,787	7.5%
2005	15,027	9,268	61.7%	(1,182)	5.0%	23,863	5.6%
2006	14,547	11,954	82.2%	(5,264)	6.4%	35,243	5.1%
2007	40,278	24,160	60.0%	(1,869)	13.0%	50,741	6.8%
2008	69,465	43,841	63.1%	(4,831)	23.6%	127,313	5.1%
2009	109,108	70,888	65.0%	—	38.2%	181,270	5.8%
2010	37,591	18,294	48.7%	—	9.9%	145,572	4.3%
Total	<u>\$ 297,918</u>	<u>\$185,472</u>	<u>62.3%</u>	<u>\$ (10,720)</u>	<u>100.0%</u>	<u>\$ 566,815</u>	<u>6.0%</u>

  

	Six Months Ended June 30, 2009					As of June 30, 2009	
	Collections <sup>(1)</sup>	Gross Revenue <sup>(2)</sup>	Revenue Recognition Rate <sup>(3)</sup>	Net Reversal (Portfolio Allowance)	Revenue % of Total Revenue	Unamortized Balances	Monthly IRR
ZBA	\$ 4,857	\$ 4,857	100.0%	\$ —	3.1%	\$ —	—
2002	1,711	872	51.0%	253	0.6%	90	34.8%
2003	4,596	3,929	85.5%	(409)	2.5%	1,585	30.8%
2004	6,316	4,055	64.2%	(497)	2.6%	6,914	8.1%
2005	23,163	14,678	63.4%	(1,413)	9.4%	38,714	5.6%
2006	24,132	17,251	71.5%	(2,894)	11.0%	51,585	5.1%
2007	63,431	35,977	56.7%	(1,981)	23.0%	92,755	5.5%
2008	88,333	60,928	69.0%	(3,050)	39.0%	184,676	5.0%
2009	20,855	13,684	65.6%	—	8.8%	130,389	4.3%
Total	<u>\$ 237,394</u>	<u>\$156,231</u>	<u>65.8%</u>	<u>\$ (9,991)</u>	<u>100.0%</u>	<u>\$ 506,708</u>	<u>5.1%</u>

(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.

Total revenue was \$96.2 million for the three months ended June 30, 2010, an increase of \$18.2 million, or 23.3%, compared to total revenue of \$78.0 million for the three months ended June 30, 2009. Portfolio revenue was \$91.8 million for the three months ended June 30, 2010, an increase of \$17.8 million, or 24.2%, compared to portfolio revenue of \$74.0 million for the three months ended June 30, 2009.

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Total revenue was \$183.6 million for the six months ended June 30, 2010, an increase of \$29.1 million, or 18.8%, compared to total revenue of \$154.5 million for the six months ended June 30, 2009. Portfolio revenue was \$174.7 million for the six months ended June 30, 2010, an increase of \$28.5 million, or 19.5%, compared to portfolio revenue of \$146.2 million for the three months ended June 30, 2009.

The increase in portfolio revenue for the three and six months ended June 30, 2010, was primarily the result of additional accretion revenue associated with a higher portfolio balance during the three and six months ended June 30, 2010 compared to the three and six months ended June 30, 2009, respectively. During the three months ended June 30, 2010, we recorded a net portfolio allowance provision of \$2.8 million, compared to a net portfolio allowance provision of \$4.6 million in the same period of the prior year. During the six months ended June 30, 2010, we recorded a net portfolio allowance provision of \$10.7 million, compared to a net portfolio allowance provision of \$10.0 million in the same period of the prior year. The net provision for portfolio allowances for the three and six months ended June 30, 2010 and 2009 was largely due to a shortfall in collections in certain pool groups against our forecast. While our total collections exceeded our forecast, there is often variability at the pool group level between our actual collections and our forecasts, primarily our 2005 through 2008 vintage portfolios. This is the result of several factors, including pressure on the consumer due to a weakened economy, changes in internal operating strategy, shifts in consumer payment patterns and the inherent challenge of forecasting collections at the pool group level.

Revenue associated with bankruptcy servicing fees earned from Ascension was \$4.4 million for the three months ended June 30, 2010, an increase of \$0.3 million, or 8.1%, compared to revenue of \$4.1 million for the three months ended June 30, 2009. Revenue associated with bankruptcy servicing fees earned from Ascension was \$8.8 million for the six months ended June 30, 2010, an increase of \$0.6 million, or 7.2%, compared to revenue of \$8.2 million for the three months ended June 30, 2009. The increase in Ascension revenue was due to a higher volume of bankruptcy placements in 2010.

### **Operating Expenses**

Total operating expenses were \$72.8 million for the three months ended June 30, 2010, an increase of \$9.3 million, or 14.6%, compared to total operating expenses of \$63.5 million for the three months ended June 30, 2009.

Total operating expenses were \$138.4 million for the six months ended June 30, 2010, an increase of \$14.7 million, or 11.9%, compared to total operating expenses of \$123.7 million for the six months ended June 30, 2009.

Operating expenses are explained in more detail as follows:

#### ***Salaries and employee benefits***

Total salaries and employee benefits increased \$1.7 million, or 11.7%, to \$16.5 million during the three months ended June 30, 2010, from \$14.8 million during the three months ended June 30, 2009. Total salaries and employee benefits increased \$3.3 million, or 11.3%, to \$32.0 million during the six months ended June 30, 2010, from \$28.7 million during the six months ended June 30, 2009. The increase was primarily the result of increases in headcount and related compensation expenses to support our growth.

#### ***Stock-based compensation expenses***

Stock-based compensation increased \$0.4 million, or 45.5%, to \$1.4 million during the three months ended June 30, 2010, from \$1.0 million during the three months ended June 30, 2009. This increase was primarily attributable to higher fair value of equity awards granted in recent periods due to an increase in our stock price.

Stock-based compensation increased \$1.1 million, or 54.6%, to \$3.2 million during the six months ended June 30, 2010, from \$2.1 million during the six months ended June 30, 2009. This increase was primarily attributable to awards granted to our senior management team in the three months ended March 31, 2010 and higher fair value of equity awards granted in recent periods due to an increase in our stock price and higher fair value of equity awards granted in recent periods due to an increase in our stock price.

#### ***Cost of legal collections***

The cost of legal collections increased \$2.6 million, or 9.1%, to \$31.2 million during the three months ended June 30, 2010, compared to \$28.6 million during the three months ended June 30, 2009. These costs represent contingent fees paid to our nationwide network of attorneys and costs of litigation. The increase in the cost of legal collections was primarily the result of an increase of \$6.5 million, or 10.7%, in gross collections through our legal channel and upfront litigation costs. Gross legal collections amounted to \$68.0 million during the three months ended June 30, 2010, up from \$61.5 million collected during the three months ended June 30, 2009. The cost of legal collections decreased as a percent of gross collections through this channel to 45.9% during the three months ended June 30, 2010, from 46.6% during the three months ended June 30, 2009, primarily due to a more targeted placement volume as part of an initiative to primarily sue higher quality accounts.

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The cost of legal collections decreased \$0.9 million, or 1.6%, to \$57.7 million during the six months ended June 30, 2010, compared to \$58.6 million during the six months ended June 30, 2009. These costs represent contingent fees paid to our nationwide network of attorneys and costs of litigation. The decrease in the cost of legal collections was primarily the result of a decrease in upfront court cost expenses due to more targeted placement volumes as part of an initiative to primarily sue higher quality accounts. Court costs advanced for the six months ended June 30, 2010 decreased to \$31.8 million, compared to \$35.8 million for the six months ended June 30, 2009. As a result, court cost expense decreased to \$20.0 million, or 15.9% as a percent of collections, for the six months ended June 30, 2010, compared to \$23.9 million, or 20.2% of collections, for the six months ended June 30, 2009. This decrease was partially offset by an increase in commissions paid on increased collections through our legal channel. For the six months ended June 30, 2010, we paid commissions of \$36.5 million, or 29.1%, on legal collections of \$125.2 million, compared to commissions of \$33.7 million, or 28.6%, on legal collections of \$117.9 million for the six months ended June 30, 2009. In addition to a fixed-rate commission, we incentivize certain third-party law firms by paying bonus commissions when a law firm exceeds specific targets. During the six months ended June 30, 2010, certain firms exceeded their targets due to a one-time change in placement volume. Accordingly, the increased bonus commissions resulted in a higher over-all commission rate as compared to the same period in the prior year. As a result of the factors discussed above, the cost of legal collections, as a percent of gross collections through this channel, decreased to 46.1% for the six months ended June 30, 2010 from 49.7% for the six months ended June 30, 2009.

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

	Three Months Ended June 30,				Six Months Ended June 30,			
	2010		2009		2010		2009	
Collections	\$68,049	100.0%	\$61,460	100.0%	\$125,222	100.0%	\$117,867	100.0%
Court costs advanced	18,479	27.2%	15,576	25.3%	31,800	25.4%	35,839	30.4%
Court costs deferred	(7,054)	(10.4)%	(5,023)	(8.1)%	(11,843)	(9.5)%	(11,983)	(10.2)%
Court cost expense <sup>(1)</sup>	11,425	16.8%	10,553	17.2%	19,957	15.9%	23,856	20.2%
Other <sup>(2)</sup>	593	0.9%	484	0.8%	1,214	1.0%	1,028	0.9%
Commissions	19,217	28.2%	17,589	28.6%	36,497	29.2%	33,689	28.6%
Total Costs	\$31,235	45.9%	\$28,626	46.6%	\$ 57,668	46.1%	\$ 58,573	49.7%

<sup>(1)</sup> In connection with our agreement with contracted attorneys, we advance certain out-of-pocket court costs. We 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.

<sup>(2)</sup> Other costs consist of costs related to counter claims and legal network subscription fees.

### Other operating expenses

Other operating expenses increased \$2.4 million, or 36.8%, to \$9.0 million during the three months ended June 30, 2010, from \$6.6 million during the three months ended June 30, 2009. The increase was primarily the result of an increase of \$0.7 million in telephone expenses, an increase of \$0.6 million in direct mail campaign expenses, an increase of \$0.4 million in media-related expenses and a net increase in various other operating expenses of \$0.7 million to support our growth.

Other operating expenses increased \$5.5 million, or 44.2%, to \$18.1 million during the six months ended June 30, 2010, from \$12.6 million during the six months ended June 30, 2009. The increase was primarily the result of an increase of \$1.4 million in telephone expenses, an increase of \$0.6 million in skip tracing expenses, an increase of \$1.4 million in direct mail campaign expenses, an increase of \$1.1 million in media-related expenses and a net increase in various other operating expenses of \$1.0 million to support our growth.

### Collection agency commissions

During the three months ended June 30, 2010, we incurred \$6.4 million in commissions to third party collection agencies, or 29.2%, of the related gross collections of \$22.0 million, compared to \$4.8 million in commissions, or 30.9%, of the related gross collections of \$15.5 million during the three months ended June 30, 2009. The increase in commissions was due to the increase in collections through this channel, offset by a lower net commission rate. The decrease in the net commission rate as a percentage of the related gross collections was primarily due to the mix of accounts placed with the agencies. Commissions, as a percentage of collections through this channel, vary from period to period depending on, among other things, the time from charge-off of the accounts placed with an agency. Generally, freshly charged-off accounts have a lower commission rate than accounts that have been charged off for a longer period of time. During the three months ended June 30, 2010, we placed more freshly charged-off accounts with the agencies as compared to the same period in the prior year.

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During the six months ended June 30, 2010, we incurred \$11.7 million in commissions to third party collection agencies, or 29.5%, of the related gross collections of \$39.7 million, compared to \$7.7 million in commissions, or 33.2%, of the related gross collections of \$23.2 million during the six months ended June 30, 2009. The increase in commissions was due to the increase in collections through this channel, offset by a lower net commission rate. The decrease in the net commission rate as a percentage of the related gross collections was primarily due to the mix of accounts placed with the agencies. Commissions, as a percentage of collections through this channel, vary from period to period depending on, among other things, the time from charge-off of the accounts placed with an agency. Generally, freshly charged-off accounts have a lower commission rate than accounts that have been charged off for a longer period of time. During the six months ended June 30, 2010, we placed more freshly charged-off accounts with the agencies as compared to the same period in the prior year.

### *General and administrative expenses*

General and administrative expenses increased \$0.3 million, or 4.6%, to \$7.4 million during the three months ended June 30, 2010, from \$7.1 million during the three months ended June 30, 2009. The increase was primarily the result of an increase of \$0.9 million in corporate settlements, an increase of \$0.3 million in system maintenance costs, and a net increase in other general and administrative expenses of \$0.7 million. The increase was offset by a decrease of \$1.6 million in corporate legal expenses.

General and administrative expenses increased \$1.5 million, or 11.8%, to \$14.3 million during the six months ended June 30, 2010, from \$12.8 million during the six months ended June 30, 2009. The increase was primarily the result of an increase of \$0.3 million in building rent related to our India expansion, an increase of \$0.3 million in consulting fees, an increase of \$1.2 million in corporate settlements, an increase of \$0.7 million in system maintenance costs, and a net increase in other general and administrative expenses of \$1.3 million. The increase was offset by a decrease of \$2.3 million in corporate legal expenses.

### *Cost per Dollar Collected*

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

	Three Months Ended June 30,							
	2010				2009			
	Collections	Cost	Cost Per Channel Dollar Collected	Cost Per Total Dollar Collected	Collections	Cost	Cost Per Channel Dollar Collected	Cost Per Total Dollar Collected
Collection sites	\$ 66,619	\$ 6,346 <sup>(1)</sup>	9.5%	4.0%	\$ 44,680	\$ 5,675 <sup>(1)</sup>	12.7%	4.7%
Legal networks	68,049	31,235	45.9%	19.9%	61,460	28,626	46.6%	23.4%
Collection agency outsourcing	21,960	6,413	29.2%	4.1%	15,506	4,797	30.9%	3.9%
Sales and other	161	—	—	—	727	—	—	—
Other indirect costs <sup>(2)</sup>	—	24,042	—	15.4%	—	19,948	—	16.3%
Total	<u>\$ 156,789</u>	<u>\$68,036<sup>(3)</sup></u>		<u>43.4%</u>	<u>\$ 122,373</u>	<u>\$59,046<sup>(3)</sup></u>		<u>48.3%</u>

  

	Six Months Ended June 30,							
	2010				2009			
	Collections	Cost	Cost Per Channel Dollar Collected	Cost Per Total Dollar Collected	Collections	Cost	Cost Per Channel Dollar Collected	Cost Per Total Dollar Collected
Collection sites	\$ 132,424	\$ 12,368 <sup>(1)</sup>	9.3%	4.2%	\$ 95,022	\$ 11,480 <sup>(1)</sup>	12.1%	4.8%
Legal networks	125,222	57,668	46.1%	19.3%	117,867	58,573	49.7%	24.7%
Collection agency outsourcing	39,712	11,709	29.5%	3.9%	23,173	7,688	33.2%	3.2%
Sales and other	698	—	—	—	1,544	—	—	—
Other indirect costs <sup>(2)</sup>	—	46,860	—	15.7%	—	37,014	—	15.6%
Total	<u>\$ 298,056</u>	<u>\$128,605<sup>(3)</sup></u>		<u>43.1%</u>	<u>\$ 237,606</u>	<u>\$114,755<sup>(3)</sup></u>		<u>48.3%</u>

<sup>(1)</sup> Represents only account manager salaries, variable compensation and employee benefits.

<sup>(2)</sup> Other indirect costs represent non collection salaries and employee benefits, general and administrative expenses, other operating expenses, and depreciation and amortization.

<sup>(3)</sup> Represents all operating expenses excluding stock-based compensation expense and bankruptcy servicing 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 reconciliation of operating expenses, excluding stock-based compensation expense and bankruptcy servicing operating expenses to GAAP total operating expenses in the table below.

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The following table provides a reconciliation of operating expenses, excluding stock-based compensation expense and bankruptcy servicing operating expenses to GAAP total operating expenses, (*in thousands*):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
GAAP total operating expenses, as reported	\$ 72,782	\$ 63,494	\$ 138,423	\$ 123,669
Stock-based compensation expense	(1,446)	(994)	(3,207)	(2,074)
Bankruptcy servicing operating expenses	(3,300)	(3,454)	(6,611)	(6,840)
Operating expenses, excluding stock-based compensation expense and bankruptcy servicing operating expenses	<u>\$ 68,036</u>	<u>\$ 59,046</u>	<u>\$ 128,605</u>	<u>\$ 114,755</u>

During the three months ended June 30, 2010, cost per dollar collected decreased by 490 basis points to 43.4% of gross collections from 48.3% of gross collections during the three months ended June 30, 2009. This decrease was due to several factors, including:

- The cost of legal collections, as a percent of total collections, decreased to 19.9% in three months ended June 30, 2010 from 23.4% in the three months ended June 30, 2009 and, as a percentage of legal collections, decreased to 45.9% in three months ended June 30, 2010 from 46.6% in the three months ended June 30, 2009. The decrease was primarily a result of our strategy to sue better quality accounts in this channel, see “cost of legal collections” section above for details.
- The cost from our collection sites, account manager salaries, variable compensation and employee benefits, as a percentage of total collections, decreased to 4.0% in three months ended June 30, 2010 from 4.7% in the three months ended June 30, 2009 and, as a percentage of our site collections, decreased to 9.5% in three months ended June 30, 2010 from 12.7% in the three months ended June 30, 2009. The decrease was primarily due to a shift in our collection workforce from the United States to India and a change in our compensation plan structure in the United States.
- Other costs not directly attributable to specific channel collections, including non collection salaries and employee benefits, general and administrative expenses, other operating expenses, and depreciation and amortization, decreased as a percentage of total collection to 15.4% in three months ended June 30, 2010 from 16.3% in the three months ended June 30, 2009 as we continue to leverage our costs across our higher collections. These costs increased in order to support the growth of our business. However, our collections grew at a rate greater than that of the indirect costs resulting in a reduction in other indirect costs as a percent of total collections.

The decrease was offset by:

- An increase in collection agency commissions, as a percentage of total collections, to 4.1% in three months ended June 30, 2010 from 3.9% in the three months ended June 30, 2009. The increase in the percentage of commissions to total collections is due to collection agency commissions growing at a rate faster than total collections, offset by a decline in our commission rate, resulting in a decline in cost per dollar collected in this channel from 30.9% in the three months ended June 30, 2009 to 29.2% in three months ended June 30, 2010. This was the result of a change in the mix of accounts placed into this channel, primarily freshly charged off accounts. Freshly charged-off accounts have a lower commission rate than accounts that have been charged off for a longer period of time.

During the six months ended June 30, 2010, cost per dollar collected decreased by 520 basis points to 43.1% of gross collections from 48.3% of gross collections during the six months ended June 30, 2009. This decrease was due to several factors, including:

- The cost of legal collections as a percent of total collections decreased to 19.3% in six months ended June 30, 2010 from 24.7% in the six months ended June 30, 2009 and, as a percentage of legal collections, decreased to 46.1% in six months ended June 30, 2010 from 49.7% in the six months ended June 30, 2009. The decrease was primarily due to our initiative to primarily sue higher quality accounts resulting in more targeted placement volumes, resulting in less upfront court costs expensed in this channel, as further discussed in the “cost of legal collections” section above.
- The cost from our collection sites’, account manager salaries, variable compensation and employee benefits, as a percentage of total collections, decreased to 4.1% in six months ended June 30, 2010 from 4.8% in the six months ended June 30, 2009 and, as a percentage of our site collections, decreased to 9.3% in six months ended June 30, 2010 from 12.1% in the six months ended June 30, 2009. The decrease was primarily due to a shift in our collection workforce from the United States to India and a change in our compensation plan structure in the United States.

The decrease was offset by:

- An increase in collection agency commissions, as a percentage of total collections, to 3.9% in six months ended June 30, 2010 from 3.2% in the six months ended June 30, 2009. The increase in the percentage of commissions to total collections is due to collection agency commissions growing at a rate faster than total collections, offset by a decline in our commission rate, resulting in a decline in cost per dollar collected in this channel from 33.2% in the six months ended June 30, 2009 to 29.5% in six months ended June 30, 2010. This was the result of a change in the mix of accounts placed into this channel, primarily freshly charged off accounts. Freshly charged-off accounts have a lower commission rate than accounts that have been charged off for a longer period of time.

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### Interest Expense

Interest expense increased \$0.9 million, or 23.3%, to \$4.9 million during the three months ended June 30, 2010, from \$4.0 million during the three months ended June 30, 2009. Interest expense increased \$1.2 million, or 14.4%, to \$9.4 million during the six months ended June 30, 2010, from \$8.2 million during the six months ended June 30, 2009.

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

	Three Months Ended June 30,			
	2010	2009	\$ Change	% Change
Stated interest on debt obligations	\$3,749	\$3,019	\$ 730	24.2%
Amortization of loan fees and other loan costs	425	289	136	47.1%
Amortization of debt discount – convertible notes	706	650	56	8.6%
Total interest expense	<u>\$4,880</u>	<u>\$3,958</u>	<u>\$ 922</u>	23.3%

	Six Months Ended June 30,			
	2010	2009	\$ Change	% Change
Stated interest on debt obligations	\$7,224	\$6,071	\$ 1,153	19.0%
Amortization of loan fees and other loan costs	809	600	209	34.8%
Amortization of debt discount – convertible notes	1,385	1,560	(175)	(11.2)%
Total interest expense	<u>\$9,418</u>	<u>\$8,231</u>	<u>\$ 1,187</u>	14.4%

Stated interest on debt obligations increased \$0.7 million during the three months ended June 30, 2010, compared to the same period of the prior year. Stated interest on debt obligations increased \$1.2 million during the six months ended June 30, 2010, compared to the same period of the prior year. The increases in stated interest on debt obligations for the three and six months ended June 30, 2010, were primarily due to an increase in our outstanding loan balances and an increase in the credit spread required under our new 2010 Revolving Credit Facility.

### Provision for Income Taxes

During the three months ended June 30, 2010, we recorded an income tax provision of \$6.7 million, reflecting an effective rate of 36.5% of pretax income. The effective tax rate for the three months ended June 30, 2010 consists primarily of a provision for federal income taxes of 32.4% (which is net of a benefit for state taxes of 2.6%), a blended provision for state taxes of 7.3%, a benefit of permanent book versus tax differences of 1.5%, and a benefit of an Internal Revenue Service (“IRS”) refund of 1.7%. During the three months ended June 30, 2009, we recorded an income tax provision of \$4.2 million, reflecting an effective rate of 38.5% of pretax income. Our effective tax rate for the three months ended June 30, 2009, differed from the federal statutory rate, primarily due to the net effect of state taxes, the effect of permanent book versus tax differences and a state tax refund.

During the six months ended June 30, 2010, we recorded an income tax provision of \$13.2 million, reflecting an effective rate of 36.9% of pretax income. The effective tax rate for the six months ended June 30, 2010 consists primarily of a provision for federal income taxes of 32.4% (which is net of a benefit for state taxes of 2.6%), a blended provision for state taxes of 7.3%, a benefit for the effect of permanent book versus tax differences of 1.9%, and a benefit of an IRS refund of 0.9%. During the six months ended June 30, 2009, we recorded an income tax provision of \$10.1 million, reflecting an effective rate of 39.3% of pretax income. Our effective tax rate for the six months ended June 30, 2009 differed from the federal statutory rate, primarily due to the net effect of state taxes, the effect of permanent book versus tax differences and a state tax refund.

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### Supplemental Performance Data

#### *Cumulative Collections to Purchase Price Multiple*

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

Year of Purchase	Purchase Price <sup>(1)</sup>	Cumulative Collections through June 30, 2010									
		<2004	2004	2005	2006	2007	2008	2009	2010	Total <sup>(2)</sup>	CCM <sup>(3)</sup>
<2004	\$ 284,161 <sup>(4)</sup>	\$517,451	\$192,940	\$144,775	\$109,379	\$ 50,708	\$ 26,777	\$ 16,345	\$ 6,379	\$1,064,754	3.7
2004	101,325	—	39,400	79,845	54,832	34,625	19,116	11,363	4,348	243,529	2.4
2005	192,591	—	—	66,491	129,809	109,078	67,346	42,387	15,140	430,251	2.2
2006	141,043	—	—	—	42,354	92,265	70,743	44,553	14,547	264,462	1.9
2007	204,295	—	—	—	—	68,048	145,272	111,117	40,278	364,715	1.8
2008	227,922	—	—	—	—	—	69,049	165,164	70,229	304,442	1.3
2009	253,880	—	—	—	—	—	—	96,529	109,366	205,895	0.8
2010	164,873	—	—	—	—	—	—	—	37,631	37,631	0.2
<b>Total</b>	<b>\$1,570,090</b>	<b>\$517,451</b>	<b>\$232,340</b>	<b>\$291,111</b>	<b>\$336,374</b>	<b>\$354,724</b>	<b>\$398,303</b>	<b>\$487,458</b>	<b>\$297,918</b>	<b>\$2,915,679</b>	<b>1.9</b>

(1) Adjusted for put-backs, account recalls, purchase price rescissions, and the impact of an acquisition in 2000. Put-backs represent accounts that are returned to the seller in accordance with the respective purchase agreement ("Put-Backs"). Recalls represents accounts that are recalled by the seller in accordance with the respective purchase agreement ("Recalls").

(2) Cumulative collections from inception through June 30, 2010, excluding collections on behalf of others.

(3) Cumulative Collections Multiple ("CCM") through June 30, 2010 – collections as a multiple of purchase price.

(4) From inception through December 31, 2003.

#### *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):

	Purchase Price <sup>(1)</sup>	Historical Collections <sup>(2)</sup>	Estimated Remaining Collections	Total Estimated Gross Collections	Total Estimated Gross Collections to Purchase Price
<2004	\$ 284,161 <sup>(3)</sup>	\$1,064,754	\$ 148	\$ 1,064,902	3.7
2004	101,325	243,529	4,253	247,782	2.4
2005	192,591	430,251	40,827	471,078	2.4
2006	141,043	264,462	70,725	335,187	2.4
2007	204,295	364,715	111,778	476,493	2.3
2008	227,922	304,442	268,947	573,389	2.5
2009	253,880	205,895	453,388	659,283	2.6
2010	164,873	37,631	329,745	367,376	2.2
<b>Total</b>	<b>\$ 1,570,090</b>	<b>\$2,915,679</b>	<b>\$1,279,811</b>	<b>\$ 4,195,490</b>	<b>2.7</b>

(1) Adjusted for Put-Backs, Recalls, purchase price rescissions, and the impact of an acquisition in 2000.

(2) Cumulative collections from inception through June 30, 2010, excluding collections on behalf of others.

(3) From inception through December 31, 2003.



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### *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								
	2010 <sup>(2)</sup>	2011	2012	2013	2014	2015	2016	2017	Total
<2004 <sup>(1)</sup>	\$ 148	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 148
2004	2,345	1,908	—	—	—	—	—	—	4,253
2005	13,484	20,312	7,014	17	—	—	—	—	40,827
2006	15,137	27,005	19,283	9,300	—	—	—	—	70,725
2007	29,610	39,379	24,997	14,033	3,759	—	—	—	111,778
2008	62,725	88,953	55,537	35,053	19,739	6,940	—	—	268,947
2009	89,758	150,207	101,627	58,581	32,131	15,551	5,533	—	453,388
2010	51,141	106,521	77,346	44,544	26,037	13,929	8,313	1,914	329,745
<b>Total</b>	<b>\$264,348</b>	<b>\$434,285</b>	<b>\$285,804</b>	<b>\$161,528</b>	<b>\$81,666</b>	<b>\$36,420</b>	<b>\$13,846</b>	<b>\$1,914</b>	<b>\$1,279,811</b>

<sup>(1)</sup> Estimated remaining collections for Zero Basis Portfolios can extend beyond the 84-month accrual basis collection forecast.

<sup>(2)</sup> 2010 amount consists of six months data from July 1, 2010 to December 31, 2010.

### *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 Balance as of June 30, 2010	Purchase Price <sup>(1)</sup>	Unamortized Balance as a Percentage of Purchase Price	Unamortized Balance as a Percentage of Total
2003	\$ 26	\$ 88,501	0.0%	0.0%
2004	2,787	101,325	2.8%	0.5%
2005	23,863	192,591	12.4%	4.2%
2006	35,243	141,043	25.0%	6.2%
2007	50,741	204,295	24.8%	8.9%
2008	127,313	227,922	55.9%	22.5%
2009	181,270	253,880	71.4%	32.0%
2010	145,572	164,873	88.3%	25.7%
<b>Total</b>	<b>\$ 566,815</b>	<b>\$ 1,374,430</b>	<b>41.2%</b>	<b>100.0%</b>

<sup>(1)</sup> 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.

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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*):

	Three Months Ended June 30, 2010			
	Accrual Basis Portfolios	Cost Recovery Portfolios	Zero Basis Portfolios	Total
Balance, beginning of period	\$ 549,180	\$ 480	\$ —	\$ 549,660
Purchases of receivable portfolios	83,336	—	—	83,336
Gross collections <sup>(1)</sup>	(154,367)	(24)	(2,355)	(156,746)
Put-backs and recalls	(1,280)	—	—	(1,280)
Revenue recognized <sup>(2)</sup>	92,329	—	2,355	94,684
Portfolio allowances, net	(2,383)	(456)	—	(2,839)
Balance, end of period	\$ 566,815	\$ —	\$ —	\$ 566,815
Revenue as a percentage of collections <sup>(3)</sup>	59.8%	0.0%	100.0%	60.4%

	Three Months Ended June 30, 2009			
	Accrual Basis Portfolios	Cost Recovery Portfolios	Zero Basis Portfolios	Total
Balance, beginning of period	\$ 472,875	\$ 609	\$ —	\$ 473,484
Purchases of receivable portfolios	82,033	—	—	82,033
Gross collections <sup>(1)</sup>	(119,823)	(56)	(2,389)	(122,268)
Put-backs and recalls	(506)	—	—	(506)
Revenue recognized <sup>(2)</sup>	76,172	—	2,357	78,529
(Portfolio allowances) portfolio allowance reversals, net	(4,596)	—	32	(4,564)
Balance, end of period	\$ 506,155	\$ 553	\$ —	\$ 506,708
Revenue as a percentage of collections <sup>(3)</sup>	63.6%	0.0%	98.7%	64.2%

	Six Months Ended June 30, 2010			
	Accrual Basis Portfolios	Cost Recovery Portfolios	Zero Basis Portfolios	Total
Balance, beginning of period	\$ 526,366	\$ 511	\$ —	\$ 526,877
Purchases of receivable portfolios	164,968	—	—	164,968
Gross collections <sup>(1)</sup>	(293,451)	(55)	(4,412)	(297,918)
Put-backs and recalls	(1,864)	—	—	(1,864)
Revenue recognized <sup>(2)</sup>	181,061	—	4,411	185,472
(Portfolio allowances) portfolio allowance reversals, net	(10,265)	(456)	1	(10,720)
Balance, end of period	\$ 566,815	\$ —	\$ —	\$ 566,815
Revenue as a percentage of collections <sup>(3)</sup>	61.7%	0.0%	100.0%	62.3%

	Six Months Ended June 30, 2009			
	Accrual Basis Portfolios	Cost Recovery Portfolios	Zero Basis Portfolios	Total
Balance, beginning of period	\$ 460,598	\$ 748	\$ —	\$ 461,346
Purchases of receivable portfolios	137,946	—	—	137,946
Gross collections <sup>(1)</sup>	(232,314)	(195)	(4,885)	(237,394)
Put-backs and recalls	(1,426)	—	(4)	(1,430)
Revenue recognized <sup>(2)</sup>	151,374	—	4,857	156,231
(Portfolio allowances) portfolio allowance reversals, net	(10,023)	—	32	(9,991)
Balance, end of period	\$ 506,155	\$ 553	\$ —	\$ 506,708
Revenue as a percentage of collections <sup>(3)</sup>	65.2%	0.0%	99.4%	65.8%

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

(2) Includes retained interest.

(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 June 30, 2010, we had \$566.8 million 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 portfolio balance is as follows (*in thousands*):

<u>Year Ended December 31,</u>	<u>Amortization</u>
2010 <sup>(1)</sup>	\$ 81,215
2011	169,069
2012	143,923
2013	87,533
2014	48,540
2015	23,709
2016	10,989
2017	1,837
<b>Total</b>	<b>\$ 566,815</b>

<sup>(1)</sup> 2010 amount consists of six months data from July 1, 2010 to December 31, 2010.

## Analysis of Changes in Revenue

The following table analyzes the components of the change in revenue from our receivable portfolios (*in thousands, except percentages*):

<u>Variance Component</u>	<u>Three Months Ended June 30,</u>			<u>Revenue Variance</u>
	<u>2010</u>	<u>2009</u>	<u>Change</u>	
Average portfolio balance	\$534,768	\$468,442	\$66,326	\$10,785
Weighted average monthly effective interest rate <sup>(1)</sup>	5.8%	5.4%	0.4%	\$ 5,371
Zero basis revenue	\$ 2,355	\$ 2,357		\$ (2)
Net portfolio allowances	\$ (2,838)	\$ (4,564)		\$ 1,726
<b>Total variance</b>				<b>\$17,880</b>

<u>Variance Component</u>	<u>Six Months Ended June 30,</u>			<u>Revenue Variance</u>
	<u>2010</u>	<u>2009</u>	<u>Change</u>	
Average portfolio balance	\$529,737	\$459,396	\$70,341	\$23,178
Weighted average monthly effective interest rate <sup>(1)</sup>	5.7%	5.5%	0.2%	\$ 6,509
Zero basis revenue	\$ 4,411	\$ 4,857		\$ (446)
Net portfolio allowances	\$ (10,720)	\$ (9,991)		\$ (729)
<b>Total variance</b>				<b>\$28,512</b>

<sup>(1)</sup> For accrual basis portfolios, the weighted average monthly effective interest rate is the accrual rate utilized in recognizing revenue on our accrual basis portfolios. This rate represents the monthly internal rate of return. The monthly internal rate of return is determined based on the timing and amounts of actual cash received to date and the anticipated future cash flow projections for each pool. These effective interest rates represent gross rates before the impact of collection and other costs.

## Collections by Channel

We utilize numerous business channels for the collection of charged-off credit cards and other receivables. The following table summarizes the gross collections by collection channel (*in thousands*):

	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	<u>2010</u>	<u>2009</u>	<u>2010</u>	<u>2009</u>
Collection sites	\$ 66,619	\$ 44,680	\$ 132,424	\$ 95,022
Legal collections	68,049	61,460	125,222	117,867
Collection agencies	21,960	15,506	39,712	23,173
Sales and other	161	727	698	1,544
	<b>\$ 156,789</b>	<b>\$ 122,373</b>	<b>\$ 298,056</b>	<b>\$ 237,606</b>

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### External Collection Channels and Related Direct Costs

The following tables summarize our external collection channel performance and related direct costs (*in thousands, except percentages*):

	Legal Collections				Collection Agencies			
	Three Months Ended June 30,				Three Months Ended June 30,			
	2010		2009		2010		2009	
Collections	\$68,049	100.0%	\$61,460	100.0%	\$21,960	100.0%	\$15,506	100.0%
Commissions	\$19,217	28.2%	\$17,589	28.6%	\$ 6,413	29.2%	\$ 4,797	30.9%
Court cost expense <sup>(1)</sup>	11,425	16.8%	10,553	17.2%	—	—	—	—
Other <sup>(2)</sup>	593	0.9%	484	0.8%	—	—	—	—
<b>Total Costs</b>	<b>\$31,235</b>	<b>45.9%</b>	<b>\$28,626</b>	<b>46.6%</b>	<b>\$ 6,413</b>	<b>29.2%</b>	<b>\$ 4,797</b>	<b>30.9%</b>

	Legal Collections				Collection Agencies			
	Six Months Ended June 30,				Six Months Ended June 30,			
	2010		2009		2010		2009	
Collections	\$125,222	100.0%	\$117,867	100.0%	\$39,712	100.0%	\$23,173	100.0%
Commissions	\$ 36,497	29.2%	\$ 33,689	28.6%	\$11,709	29.5%	\$ 7,688	33.2%
Court cost expense <sup>(1)</sup>	19,957	15.9%	23,856	20.2%	—	—	—	—
Other <sup>(2)</sup>	1,214	1.0%	1,028	0.9%	—	—	—	—
<b>Total Costs</b>	<b>\$ 57,668</b>	<b>46.1%</b>	<b>\$ 58,573</b>	<b>49.7%</b>	<b>\$11,709</b>	<b>29.5%</b>	<b>\$ 7,688</b>	<b>33.2%</b>

<sup>(1)</sup> In connection with our agreement with contracted attorneys, we advance certain out-of-pocket court costs. We 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.

<sup>(2)</sup> Other costs consist primarily of costs related to counter claims and legal network subscription fees.

### Legal Outsourcing Collections and Related Costs

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

Placement Year	Gross Collections by Year of Collection <sup>(1)</sup>								Total Collections
	2003	2004	2005	2006	2007	2008	2009	2010	
2003	\$10,750	\$27,192	\$17,212	\$ 9,566	\$ 5,561	\$ 3,050	\$ 2,014	\$ 839	\$ 76,184
2004	—	\$23,455	\$37,674	\$21,676	\$12,029	\$ 5,840	\$ 3,665	\$ 1,498	\$105,837
2005	—	—	\$21,694	\$40,762	\$22,152	\$10,582	\$ 6,226	\$ 2,401	\$103,817
2006	—	—	—	\$39,395	\$82,740	\$43,303	\$ 22,527	\$ 7,589	\$195,554
2007	—	—	—	—	\$41,958	\$80,211	\$ 44,321	\$13,186	\$179,676
2008	—	—	—	—	—	\$47,320	\$110,868	\$36,612	\$194,800
2009	—	—	—	—	—	—	\$ 40,856	\$49,358	\$ 90,214
2010 YTD	—	—	—	—	—	—	—	\$12,758	\$ 12,758

<sup>(1)</sup> Includes collections for accounts placed in our legal channel beginning January 1, 2003. We continue to collect on accounts placed in this channel prior to that date.

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Placement Year	Court Costs by Year of Collection <sup>(1)</sup>								
	2003	2004	2005	2006	2007	2008	2009	2010	Total Court Costs
2003	\$908	\$2,046	\$ 571	\$ 300	\$ 147	\$ 103	\$ 86	\$ 29	\$ 4,190
2004	—	\$2,509	\$2,937	\$ 1,087	\$ 406	\$ 223	\$ 153	\$ 63	\$ 7,378
2005	—	—	\$3,271	\$ 4,426	\$ 859	\$ 356	\$ 218	\$ 97	\$ 9,227
2006	—	—	—	\$10,158	\$10,291	\$ 1,829	\$ 407	\$ 301	\$ 22,986
2007	—	—	—	—	\$15,357	\$11,952	\$ 1,178	\$ 309	\$ 28,796
2008	—	—	—	—	—	\$19,322	\$15,842	\$1,433	\$ 36,597
2009	—	—	—	—	—	—	\$17,009	\$8,965	\$ 25,974
2010 YTD	—	—	—	—	—	—	—	\$7,764	\$ 7,764

<sup>(1)</sup> Includes court cost expense for accounts placed in our legal channel beginning January 1, 2003. We continue to incur court cost expense on accounts placed in this channel prior to that date. Court cost expense in this table is calculated based on our blended court cost expense rate.

Placement Year	Commissions by Year of Collection <sup>(1)</sup>								
	2003	2004	2005	2006	2007	2008	2009	2010	Total Commissions
2003	\$3,574	\$8,606	\$ 5,496	\$ 2,898	\$ 1,574	\$ 872	\$ 577	\$ 247	\$ 23,844
2004	—	\$7,273	\$12,060	\$ 6,653	\$ 3,498	\$ 1,690	\$ 1,063	\$ 449	\$ 32,686
2005	—	—	\$ 6,725	\$12,108	\$ 6,364	\$ 3,036	\$ 1,792	\$ 714	\$ 30,739
2006	—	—	—	\$11,451	\$23,659	\$12,370	\$ 6,464	\$ 2,240	\$ 56,184
2007	—	—	—	—	\$11,845	\$22,927	\$12,697	\$ 3,913	\$ 51,382
2008	—	—	—	—	—	\$13,678	\$31,794	\$10,836	\$ 56,308
2009	—	—	—	—	—	—	\$11,476	\$14,271	\$ 25,747
2010 YTD	—	—	—	—	—	—	—	\$ 3,560	\$ 3,560

<sup>(1)</sup> Includes commissions for accounts placed in our legal channel beginning January 1, 2003. We continue to incur commissions on collections for accounts placed in this channel prior to that date.

Placement Year	Court Cost Expense and Commissions as a % of Gross Collections by Year of Collection								
	2003	2004	2005	2006	2007	2008	2009	2010	Cumulative Average
2003	41.7%	39.2%	35.2%	33.4%	31.0%	32.0%	32.9%	32.9%	36.8%
2004	—	41.7%	39.8%	35.7%	32.4%	32.8%	33.2%	34.1%	37.9%
2005	—	—	46.1%	40.6%	32.6%	32.1%	32.3%	33.8%	38.5%
2006	—	—	—	54.9%	41.0%	32.8%	30.5%	33.5%	40.5%
2007	—	—	—	—	64.8%	43.5%	31.3%	32.0%	44.6%
2008	—	—	—	—	—	69.7%	43.0%	33.5%	47.7%
2009	—	—	—	—	—	—	69.7%	47.1%	57.3%
2010 YTD	—	—	—	—	—	—	—	88.8%	88.8%

Placement Year <sup>(2)</sup>	Lawsuits Filed by Year <sup>(1)</sup>								
	2003	2004	2005	2006	2007	2008	2009	2010	Total
2003	23	29	5	2	—	—	—	—	59
2004	—	59	39	11	2	—	—	—	111
2005	—	—	76	46	3	—	—	—	125
2006	—	—	—	205	105	4	—	—	314
2007	—	—	—	—	269	106	4	—	379
2008	—	—	—	—	—	338	136	2	476
2009	—	—	—	—	—	—	245	79	324
2010 YTD	—	—	—	—	—	—	—	144	144

<sup>(1)</sup> Represents the year the account was placed into litigation.

<sup>(2)</sup> Represents the year the account was placed into our legal channel.

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### ***Headcount by Function by Site***

The following table summarizes our headcount by function by site:

	<b>Headcount as of June 30,</b>			
	<b>2010</b>		<b>2009</b>	
	<b>U.S.</b>	<b>India</b>	<b>U.S.</b>	<b>India</b>
General & Administrative	351	212	324	106
Account Manager	230	822	249	382
Bankruptcy Specialist	59	73	77	52
	<u>640</u>	<u>1,107</u>	<u>650</u>	<u>540</u>

### ***Gross Collections by Account Manager***

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

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>
Gross collections – collection sites	\$66,619	\$44,680	\$132,424	\$95,022
Average active account managers	1,019	624	979	603
Collections per average active account manager	\$ 65.4	\$ 71.6	\$ 135.3	\$ 157.6

The decrease in collections per average active account manager is a result of our India expansion. Our India workforce continues to grow as part of our long-term strategy to maintain headcount at current levels in our domestic collection sites and focus our future growth in India. As we ramped up headcount in our new, larger India site and as we migrate more of our collections there, 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.

### ***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*):

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>
Gross collections – collection sites	\$66,619	\$44,680	\$132,424	\$95,022
Total hours paid	499	293	938	558
Collections per hour paid	\$ 133.5	\$ 152.5	\$ 141.2	\$ 170.3

### ***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*):

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>
Gross collections – collection sites	\$66,619	\$44,680	\$132,424	\$95,022
Direct cost <sup>(1)</sup>	\$ 6,346	\$ 5,675	\$ 12,368	\$11,480
Cost per dollar collected	9.5%	12.7%	9.3%	12.1%

<sup>(1)</sup> Represents salaries, variable compensation and employee benefits.

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### *Salaries and Employee Benefits by Function*

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

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2010	2009	2010	2009
Portfolio Purchasing and Collecting Activities				
Collections related	\$ 6,346	\$ 5,675	\$12,368	\$11,480
General & administrative	8,289	7,007	15,875	13,113
Subtotal	14,635	12,682	28,243	24,593
Bankruptcy Services	1,848	2,080	3,726	4,126
	<u>\$16,483</u>	<u>\$14,762</u>	<u>\$31,969</u>	<u>\$28,719</u>

### *Purchases by Quarter*

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

Quarter	# of		Purchase Price	Forward Flow Allocation <sup>(1)</sup>
	Accounts	Face Value		
Q1 2007	1,434	2,510,347	45,386	3,539
Q2 2007	1,042	1,341,148	41,137	2,949
Q3 2007	659	1,281,468	47,869	2,680
Q4 2007	1,204	1,768,111	74,561	2,536
Q1 2008	647	1,199,703	47,902	2,926
Q2 2008	676	1,801,902	52,492	2,635
Q3 2008	795	1,830,292	66,107	—
Q4 2008	1,084	1,729,568	63,777	—
Q1 2009	505	1,341,660	55,913	—
Q2 2009	719	1,944,158	82,033	—
Q3 2009	1,515	2,173,562	77,734	10,302
Q4 2009	519	1,017,998	40,952	—
Q1 2010	839	2,112,332	81,632	—
Q2 2010	1,002	2,245,713	83,336	—

<sup>(1)</sup> Allocation of the forward flow asset to the cost basis of receivable portfolio purchases. In July 2008, we ceased forward flow purchases from Jefferson Capital due to an alleged breach by Jefferson Capital and its parent, CompuCredit Corporation, of certain agreements. In September 2009, we settled our dispute with Jefferson Capital. As part of the settlement, we purchased a receivable portfolio and applied the remaining forward flow asset to that purchase.

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### Liquidity and Capital Resources

#### Overview

Historically, we have met our cash requirements by utilizing our cash flows from operations, bank borrowings and equity offerings. Our primary cash requirements have included the purchase of receivable portfolios, operational 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*):

	Six Months Ended June 30,	
	2010	2009
Net cash provided by operating activities	\$ 33,572	\$ 33,674
Net cash used in investing activities	\$(52,305)	\$(56,753)
Net cash provided by financing activities	\$ 20,747	\$ 18,673

On February 8, 2010, we entered into a new \$327.5 million, revolving credit facility, or 2010 Revolving Credit Facility. This new facility replaced the previous revolving credit facility and is due to expire in May 2013. As discussed in Note 9 to our consolidated financial statements, subject to certain conditions, this facility contains an accordion feature which allows us to request an increase in the facility of up to \$100.0 million, (not to exceed a total facility of \$427.5 million). On July 15, 2010, we obtained an additional \$33.0 million in commitments increasing our revolving credit facility to \$360.5 million from \$327.5 million.

At June 30, 2010, we had approximately \$42.9 million principal amount of outstanding 3.375% Convertible Notes due September 19, 2010, and a balance on our revolving credit facility of \$282.0 million.

Currently, all of our portfolio purchases are funded with cash from operations and borrowings from third parties under our 2010 Revolving Credit Facility. See Note 9 to our consolidated financial statements for a further discussion on our debt and our 2010 Revolving Credit Facility.

On February 8, 2010, our board of directors approved a new \$50.0 million securities repurchase program to replace the remaining available repurchase authority allowed under our prior program. Under the 2010 Revolving Credit Facility, we have the renewed ability to repurchase up to \$50.0 million in any combination of our common stock and Convertible Notes, subject to compliance with certain covenants and available borrowing capacity. The board's approval authorizes us to repurchase an aggregate of up to \$50.0 million of any combination of our common stock and Convertible Notes. See Note 9 to our consolidated financial statements for a further discussion of our Convertible Notes. We have not repurchased any common stock or Convertible Notes under this program during the six months ended June 30, 2010.

#### Operating Cash Flows

Net cash provided by operating activities was \$33.6 million for the six months ended June 30, 2010 as compared to \$33.7 million for the six months ended June 30, 2009.

Cash provided by operating activities for the six months ended June 30, 2010, is primarily related to net income of \$22.6 million and \$10.7 million in a non-cash add back related to the net provision for allowance on our receivable portfolios. Cash provided by operating activities for the six months ended June 30, 2009, was primarily attributable to net income of \$15.6 million, \$10.0 million in a non-cash add back related to the net provision for allowance on our receivable portfolios and a net increase of \$2.5 million due to changes in other operating assets and liabilities, offset by a change in a non-cash gain of \$3.3 million related to a repurchase of our Convertible Notes.

#### Investing Cash Flows

Net cash used in investing activities was \$52.3 million for the six months ended June 30, 2010 and \$56.8 million for the six months ended June 30, 2009.

The cash flows used in investing activities for the six months ended June 30, 2010, are primarily related to receivable portfolio purchases of \$165.0 million, offset by gross collection proceeds applied to the principal of our receivable portfolios in the amount of \$112.4 million. The cash flows used in investing activities for the six months ended June 30, 2009, are primarily related to receivable portfolio purchases of \$137.9 million, offset by gross collection proceeds applied to the principal of our receivable portfolios in the amount of \$81.2 million.

Capital expenditures for fixed assets acquired with internal cash flow were \$1.6 million for six months ended June 30, 2010 and \$1.4 million for six months ended June 30, 2009.



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

Net cash provided by financing activities was \$20.7 million for the six months ended June 30, 2010 and \$18.7 million for the six months ended June 30, 2009.

The cash provided by financing activities during the six months ended June 30, 2010, reflects \$31.0 million in repayments of amounts outstanding under our line of credit, offset by \$53.0 million in borrowings under our line of credit agreement. The cash provided by financing activities during the six months ended June 30, 2009, reflects \$22.3 million used to repurchase \$28.5 million in principal amount of our outstanding Convertible Notes and \$62.5 million in borrowings under our line of credit agreement.

We are in compliance with all covenants under our financing arrangements and, excluding the effects of the one-time payment of \$16.9 million to eliminate all future Contingent Interest payments in the second quarter of 2007 (this payment, less amounts accrued on our balance sheet, resulted in a charge in our statement of operations of \$6.9 million after the effect of income taxes) and the effects of the adoption of a new accounting principal related to our Convertible Notes, we have achieved 34 consecutive quarters of positive net income. 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 \$10.4 million as of June 30, 2010, our access to the capital markets and availability under our 2010 Revolving Credit Facility which expires in May 2013.

### ***Off Balance Sheet Arrangements***

We do not have any off balance sheet arrangements as defined by Item 303(a)(4) of Regulation S-K.

### **Item 3. Quantitative and Qualitative Disclosures about Market Risk**

For quantitative and qualitative disclosures about market risk affecting Encore, see Item 7A, “Quantitative and Qualitative Disclosures About Market Risk,” of our Annual Report on Form 10-K for the fiscal year ended December 31, 2009, which is incorporated herein by reference. Our exposure to market risk has not changed materially since December 31, 2009.

### **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 with the Securities and Exchange Commission (“SEC”) is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief 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 management accordingly is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As of the end of the period covered by this report, we conducted an evaluation, with the participation of management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the disclosure controls and procedures pursuant to the Exchange Act Rule 13a-15(b). Based upon this evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of June 30, 2010. The conclusions of the Chief Executive Officer and Chief Financial Officer from this evaluation were communicated to the Audit Committee. We intend to continue to review and document our disclosure controls and procedures, including our internal controls and procedures for financial reporting, and may from time to time make changes aimed at enhancing their effectiveness and to ensure that our systems evolve with our business.

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

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.

## 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 our business. There have been no material developments in legal proceedings during the quarter ended June 30, 2010. For a description of previously reported legal proceedings refer to Part I, Item 3, “Legal Proceedings,” of our 2009 Form 10-K for the year ended December 31, 2009, and Part II, Item 1 of our Form 10-Q for the quarter ended March 31, 2010.

### Item 1A—Risk Factors

This section highlights some specific risks affecting our business, operating results and financial condition. The list of risks is not intended to be exhaustive and the order in which the risks appear is not intended as an indication of their relative weight or importance.

#### Risk Factors

*Recent instability in the financial markets and global economy may affect our access to capital, our ability to purchase accounts, and the success of our collection efforts.*

The residential real estate market in the U.S. has experienced a significant downturn due to declining real estate values, substantially reducing mortgage loan originations and securitizations and precipitating more generalized credit market dislocations and a significant contraction in available liquidity globally. Financial markets in the United States, Europe and Asia have experienced extreme disruption, including, among other things, volatility in security prices, rating downgrades of certain investments and declining valuations of others. These factors, combined with fluctuating oil prices, declining business and consumer confidence and increased unemployment, have led to an economic recession. Individual consumers are experiencing higher delinquency rates on various consumer loans and defaults on indebtedness of all kinds have increased. These developments, as well as further declines in real estate values in the U.S. or elsewhere and continuing credit and liquidity concerns, could reduce our ability to collect on our purchased consumer receivable portfolios further and would adversely affect their value. In addition, continued or further credit market dislocations or sustained market downturns may reduce the ability of lenders to originate new credit, limiting our ability to purchase consumer receivable portfolios in the future. Further, increased financial pressure on the distressed consumer may result in additional regulatory restrictions on our operations and increased litigation filed against us. We are unable to predict the likely duration or severity of the current disruption in financial markets and adverse economic conditions and the effects they may have on our business, financial condition and results of operations.

*Our quarterly operating results may fluctuate due to a variety of factors.*

Our quarterly operating results will likely vary in the future due to a variety of factors that could affect our revenues and operating expenses in any particular quarter. We expect that our operating expenses as a percentage of collections will fluctuate in the future as we expand into new markets, increase our new business development efforts, hire additional personnel and incur increased insurance and regulatory compliance costs. In addition, our operating results have fluctuated and may continue to fluctuate as the result of the factors described below and elsewhere in this Quarterly Report on Form 10-Q:

- the timing and amount of collections on our receivable portfolios, including the effects of seasonality and economic recession;
- any change to earnings resulting from an impairment in the carrying value of our receivable portfolios;
- increases in operating expenses associated with the growth or change of our operations;
- the cost of credit to finance our purchases of receivable portfolios; and
- the timing and terms of our purchases of receivable portfolios.

Due to fluctuating prices for consumer receivable portfolios, there has been considerable variation in our purchasing volume from quarter to quarter and we expect that to continue. The volume of our portfolio purchases will be limited while prices are high, and may or may not increase when portfolio pricing is more favorable to us. We believe our ability to collect on consumer receivable portfolios may be negatively impacted because of current economic conditions, and this may require us to increase our projected return hurdles in calculating prices we are willing to pay for individual portfolios. An increase in portfolio return hurdles may decrease the volume of portfolios we are successful in purchasing. Because we recognize revenue on the basis of projected collections on purchased portfolios, we may experience variations in quarterly revenue and earnings due to the timing of portfolio purchases.

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Accordingly, results for any one quarter are not necessarily indicative of results to be expected for any other quarter or for any year, and revenues and earnings for any particular future period may decrease.

### ***Fluctuations in our operating results may lead to decreases in the trading prices of our common stock and convertible notes.***

In the future, if operating results fall below the expectations of securities analysts and investors, the price of our common stock and convertible notes likely would decrease. In addition, uncertainty about current global economic conditions have impacted and could continue to increase the volatility of our stock price.

### ***We may not be able to purchase receivables at sufficiently favorable prices or terms, or at all.***

Our ability to continue to operate profitably depends upon the continued availability of receivable portfolios that meet our purchasing standards and are cost-effective based upon projected collections exceeding our costs. Our profitability is also affected by our actual collections on accounts meeting or exceeding our projected collections. The market for acquiring receivable portfolios is competitive. Our industry has historically attracted a large amount of investment capital. With this inflow of capital, we saw an increase in the pricing of receivable portfolios to levels that we believed may generate reduced returns on investment. While more recently, the downturn in the economy and contraction of available capital have somewhat lessened competition for these receivable portfolios and reduced prices, there is no assurance as to how long these current economic conditions and competitive climate will continue or that portfolios will be available for purchase on terms acceptable to us or that we will collect a sufficient amount to make the portfolio collections cost-effective.

In addition to the competitive factors discussed above, the availability of consumer receivable portfolios at favorable prices and on favorable terms depends on a number of factors, within and outside of our control, including:

- the continuation of the current growth and charge-off trends in consumer debt;
- the continued sale of receivable portfolios by originating institutions at prevailing price levels;
- our ability to develop and maintain long-term relationships with key major credit originators;
- our ability to obtain adequate data from credit originators or portfolio resellers to appropriately evaluate the collectability of, and estimate the value of, portfolios;
- changes in laws and regulations governing consumer lending, bankruptcy and collections; and
- the potential availability of government funding to competing purchasers for the acquisition of account portfolios under various programs intended to serve as an economic stimulus.

In addition, because of the length of time involved in collecting charged-off consumer receivables on acquired portfolios and the volatility in the timing of our collections, we may not be able to identify trends and make changes in our purchasing strategies in a timely manner. Ultimately, if we are unable to continually purchase and collect on a sufficient volume of receivables to generate cash collections that exceed our costs, our business will be materially and adversely affected.

### ***We may not be successful in acquiring and collecting on portfolios consisting of new types of receivables.***

We may pursue the acquisition of portfolios consisting of assets with which we have little collection experience. We may not be successful in completing any of these acquisitions. If we do purchase such assets, our lack of experience with new types of receivables may cause us to pay too much for these receivable portfolios, which may substantially hinder our ability to generate profits from such portfolios. Even if we successfully acquire such new types of receivables, our existing methods of collections may prove ineffective for such new receivables and our inexperience may have a material and adverse affect on our results of operations.

### ***We may purchase receivable portfolios that contain unprofitable accounts and we may not be able to collect sufficient amounts to recover our costs and to fund our operations.***

We acquire and service receivables that the obligors have failed to pay and the sellers have deemed uncollectible and written off. The originating institutions generally make numerous attempts to recover on their nonperforming receivables, often using a combination of their in-house collection and legal departments as well as third-party collection agencies. In order to operate profitably over the long term, we must continually purchase and collect on a sufficient volume of receivables to generate revenue that exceeds our costs. These receivables are difficult to collect, and we may not be successful in collecting amounts sufficient to cover the costs associated with purchasing the receivables and funding our operations. If we are not able to collect on these receivables or collect sufficient amounts to cover our costs, this may materially and adversely affect our results of operations.

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### ***We may purchase portfolios that contain accounts which do not meet our account collection criteria.***

In the normal course of our portfolio acquisitions, some receivables may be included in the portfolios that fail to conform to the terms of the purchase agreements and we may seek to return these receivables to the seller for payment or replacement. However, we cannot guarantee that such sellers will be able to meet their obligations to us. Accounts that we are unable to return to sellers may yield no return. If we purchase portfolios containing too many accounts that do not conform to the terms of the purchase contracts or contain accounts that are otherwise uncollectible, we may be unable to collect a sufficient amount and the portfolio purchase could be unprofitable, which would have an adverse effect on our cash flows. If cash flows from operations are less than anticipated, our ability to satisfy our debt obligations, purchase new portfolios and our future growth and profitability may be materially and adversely affected.

### ***We may not be able to use our sales channel to sell unprofitable accounts.***

Due to current economic conditions, portfolio pricing in the resale market is currently lower than historical levels. While we have in the past periodically sold certain accounts in a portfolio when we believed the current market price exceeded our estimate of the net present value of the estimated remaining collections or determined that additional recovery efforts are not warranted, we may not be able to do so if resale pricing is unfavorable or if the number of resale transactions is limited. The inability to resell unprofitable accounts may reduce our portfolio returns.

### ***The statistical models we use to project remaining cash flows from our receivable portfolios may prove to be inaccurate, which could result in reduced revenues or the recording of an impairment charge if we do not achieve the collections forecasted by our models.***

We use our internally developed Unified Collection Score, or UCS model, and Behavioral Liquidation Score, or BLS model, to project the remaining cash flows from our receivable portfolios. Our UCS and BLS models consider known data about our consumers' accounts, including, among other things, our collection experience and changes in external consumer factors, in addition to all data known when we acquired the accounts. There can be no assurance, however, that we will be able to achieve the collections forecasted by our UCS and BLS models. If we are not able to achieve these levels of forecasted collection, our revenues will be reduced or we may be required to record an impairment charge, which may materially and adversely impact our results of operations.

### ***We may not be successful in recovering the level of court costs we anticipate recovering.***

We contract with a nationwide network of attorneys that specialize in collection matters. We generally refer charged-off accounts to our contracted attorneys when we believe the related debtor has sufficient assets to repay the indebtedness but has, to date, been unwilling to pay. In connection with our agreements with our contracted attorneys, we advance certain out-of-pocket court costs, or Deferred Court Costs. Deferred Court Costs represent amounts we believe we will recover from our consumers. Deferred Court Costs are in addition to the amounts owed on our consumers' accounts that we expect to collect. These court costs may be difficult or impossible to collect, and we may not be successful in collecting amounts sufficient to cover the amounts deferred in our financial statements. Further, our network of attorneys may not utilize all, or a portion, of the amounts we advanced for the payment of court costs in the manner for which they were intended. If we are not able to recover these court costs, this may materially and adversely affect our results of operations.

### ***Our industry is highly competitive, and we may be unable to continue to compete successfully with businesses that may have greater resources than we have.***

We face competition from a wide range of collection and financial services companies that may have substantially greater financial, personnel and other resources, greater adaptability to changing market needs and more established relationships in our industry than we currently have. We also compete with traditional contingency collection agencies and in-house recovery departments. Competitive pressures adversely affect the availability and pricing of charged-off receivable portfolios, as well as the availability and cost of qualified recovery personnel. Because there are few significant barriers to entry for new purchasers of charged-off receivable portfolios, there is a risk that additional competitors with greater resources than ours, including competitors that have historically focused on the acquisition of different asset types, will enter our market. If we are unable to develop and expand our business or adapt to changing market needs as well as our current or future competitors, we may experience reduced access to charged-off receivable portfolios at acceptable prices, which could reduce our profitability.

Moreover, we may not be able to offer competitive bids for charged-off receivable portfolios. We face bidding competition in our acquisition of charged-off receivable portfolios. In our industry, successful bids generally are awarded on a combination of price, service and relationships with the debt sellers. Some of our current and future competitors may have more effective pricing and collection models, greater adaptability to changing market needs and more established relationships in our industry. They also may pay prices for portfolios that we determine are not reasonable. We may not be able to offer competitive bids for charged-off consumer receivable portfolios. In addition, there continues to be consolidation of issuers of credit cards, which have been a principal source of receivable purchases. This consolidation has limited the number of sellers in the market and has correspondingly given the remaining sellers increasing market strength in the price and terms of the sale of credit card accounts.

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In addition, we believe that issuers of credit cards are increasingly using outsourced, off-shore alternatives in connection with their collection of delinquent accounts in an effort to reduce costs. If these off-shore efforts are successful, these issuers may decrease the number of portfolios they offer for sale and increase the purchase price for portfolios they offer for sale.

***Our failure to purchase sufficient quantities of receivable portfolios may necessitate workforce reductions, which may harm our business.***

Because fixed costs, such as certain personnel costs and lease or other facilities costs, constitute a significant portion of our overhead, we may be required to reduce the number of employees in our collection operations if we do not continually augment the receivable portfolios we service with additional receivable portfolios or collect sufficient amounts on receivables we own. Reducing the number of employees can affect our business adversely and lead to:

- lower employee morale, higher employee attrition rates, fewer experienced employees and higher recruiting and training costs;
- disruptions in our operations and loss of efficiency in collection functions; and
- excess costs associated with unused space in collection facilities.

***A significant portion of our portfolio purchases during any period may be concentrated with a small number of sellers.***

We expect that a significant percentage of our portfolio purchases for any given fiscal year may be concentrated with a few large sellers, some of which also may involve forward flow arrangements. We cannot be certain that any of our significant sellers will continue to sell charged-off receivables to us on terms or in quantities acceptable to us, or that we would be able to replace such purchases with purchases from other sellers.

A significant decrease in the volume of purchases from any of our principal sellers would force us to seek alternative sources of charged-off receivables. We may be unable to find alternative sources from which to purchase charged-off receivables, and even if we could successfully replace such purchases, the search could take time, the receivables could be of lower quality, cost more, or both, any of which could materially adversely affect our financial performance.

***We may be unable to meet our future short- or long-term liquidity requirements.***

We depend on both internal and external sources of financing to fund our purchases of receivable portfolios and our operations. Our need for additional financing and capital resources increases dramatically as our business grows. Our inability to obtain financing and capital as needed or on terms acceptable to us would limit our ability to acquire additional receivable portfolios and to operate our business.

***Volatility in U.S. credit markets could affect our ability to refinance and/or retire existing debt, obtain financing to fund acquisitions, investments, or other significant operating or capital expenditures.***

At the end of June 30, 2010, we had approximately \$42.9 million principal amount of outstanding 3.375% Convertible Subordinated Notes due September 19, 2010, and a balance on our revolving credit facility of \$282.0 million. On July 15, 2010, we obtained an additional \$33.0 million in commitments from lenders increasing our revolving credit facility to \$360.5 million from \$327.5 million. A tightening of credit availability could restrict our ability to refinance the principal amount of the Convertible Notes other than through the use of our revolving credit facility, and could restrict our ability to further exercise the remaining accordion feature of our revolving credit facility.

***We may not be able to continue to satisfy the restrictive covenants in our debt agreements.***

All of our receivable portfolios are pledged to secure amounts owed to our lenders. Our debt agreements impose a number of restrictive covenants on how we operate our business. Failure to satisfy any one of these covenants could result in all or any of the following consequences, each of which could have a materially adverse effect on our ability to conduct business:

- acceleration of outstanding indebtedness;
- our inability to continue to purchase receivables needed to operate our business; or
- our inability to secure alternative financing on favorable terms, if at all.

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### ***We use estimates in our revenue recognition and our earnings will be reduced if actual results are less than estimated.***

We utilize the interest method to determine revenue recognized on substantially all of our receivable portfolios. Under this method, each pool of receivables is modeled based upon its projected cash flows. A yield is then established which, when applied to the outstanding balance of the pool of receivables, results in the recognition of revenue at a constant yield relative to the remaining balance in the pool. The actual amount recovered by us may substantially differ from our projections and may be lower than initially projected. If the differences are material, we may be required to take an impairment charge on a portion of our investment, which would negatively affect our earnings.

### ***We may incur impairment charges based on the provisions of Financial Accounting Standards Board Accounting Standards Codification Subtopic 310-30.***

We account for our portfolio revenue in accordance with the Financial Accounting Standards Board's Accounting Standards Codification Subtopic 310-30 "Loans and Debt Securities Acquired with Deteriorated Credit Quality," or ASC 310-30. ASC 310-30 limits the revenue that may be accrued to the excess of the estimate of expected future cash flows over a portfolio's initial cost of accounts receivable acquired, requires that the excess of the contractual cash flows over expected cash flows not be recognized as an adjustment of revenue, expense, or on the balance sheet, and freezes the internal rate of return, or IRR originally estimated when the accounts receivable are purchased for subsequent impairment testing. Rather than lower the estimated IRR if the expected future cash flow estimates are decreased, the carrying value of our receivable portfolios would be written down to maintain the then-current IRR. Increases in expected future cash flows would be recognized prospectively through an upward adjustment of the IRR over a portfolio's remaining life. Any increased yield then becomes the new benchmark for impairment testing. Since ASC 310-30 does not permit yields to be lowered, there is an increased probability of our having to incur impairment charges in the future, which would negatively impact our profitability.

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

We carry approximately \$16.0 million in goodwill and approximately \$1.0 million in amortizable intangible assets on our balance sheet. Under generally accepted accounting principles, 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 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 charge in our financial statements during the period in which any impairment of our goodwill or amortizable intangible assets is determined, negatively impacting our results of operations.

### ***Negative news regarding the debt collection industry and individual debt collectors may have a negative impact on a debtor's willingness to pay the debt we acquire.***

Consumers are exposed to information from a number of sources that may cause them to be more reluctant to pay their debts or to pursue legal actions against us. Print and other media publish stories about the debt collection industry which cite specific examples of abusive collection practices. These stories are also published on websites, which can lead to the rapid dissemination of the story, adding to the level of exposure to negative publicity about our industry. Various internet sites are maintained where consumers can list their concerns about the activities of debt collectors and seek guidance from other website posters on how to handle the situation. Advertisements by debt relief attorneys and credit counseling centers are becoming more common, adding to the negative attention given to our industry. As a result of this negative publicity, debtors may be more reluctant to pay their debts or could pursue legal action against us regardless of whether those actions are warranted. These actions could impact our ability to collect on the receivables we acquire and affect our revenues and profitability.

### ***Our business of enforcing the collection of purchased receivables is subject to extensive statutory and regulatory oversight.***

Some laws and regulations applicable to credit card issuers or other debt originators may preclude us from collecting on receivables we purchase where the card issuer or originator failed to comply with applicable federal or state laws in generating or servicing the receivables that we have acquired. Because our receivables generally are originated and serviced nationwide, we cannot be certain that the originating lenders have complied with applicable laws and regulations. While our receivable acquisition contracts typically contain provisions indemnifying us for losses owing to the originating institution's failure to comply with applicable laws and other events, we cannot be certain that any indemnities received from originating institutions will be adequate to protect us from losses on the receivables or liabilities to consumers.

We sometimes purchase accounts in asset classes that are subject to industry-specific restrictions that limit the collections methods that we can use on those accounts. Our inability to collect sufficient amounts from these accounts through available collections methods could materially and adversely affect our results of operations.

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### ***Present and future government regulation, legislation or enforcement actions may limit our ability to recover and enforce the collection of receivables.***

Federal and state laws and regulations may limit our ability to recover and enforce the collection of receivables regardless of any act or omission on our part. Laws relating to debt collections also directly apply to our business. Our failure or the failure of third party agencies and attorneys or the originators of our receivables to comply with existing or new laws, rules or regulations could limit our ability to recover on receivables or cause us to pay damages to the original debtors, which could reduce our revenues and harm our business.

Additional consumer protection or privacy laws and regulations may be enacted that impose additional restrictions on the collection of receivables. Such new laws may materially adversely affect our ability to collect on our receivables, which could materially and adversely affect our earnings.

### ***Failure to comply with government regulation could result in the suspension or termination of our ability to conduct business, may require the payment of significant fines and penalties, or require other significant expenditures.***

The collections industry is regulated under various federal and state laws and regulations. Many states and several cities require that we be licensed as a debt collection company. The Federal Trade Commission, state Attorneys General and other regulatory bodies have the authority to investigate consumer complaints against debt collection companies and to recommend enforcement actions and seek monetary penalties. If we or our third party collection agencies or law firms fail to comply with applicable laws and regulations, it could result in the suspension or termination of our ability to conduct collection operations, which would materially adversely affect us. In addition, new federal, state or local laws or regulations, or changes in the ways these rules or laws are interpreted or enforced, could limit our activities in the future or significantly increase the cost of regulatory compliance.

### ***We are dependent upon third parties to service a substantial portion of our consumer receivable portfolios.***

Although we utilize our in-house collection staff to collect a substantial portion of our receivables, we also use outside collection services. Further, we are increasing our collection activity through the legal channel, whereby third-party law firms initiate legal actions on our behalf to collect accounts. As a result, we are dependent upon the efforts of those third-party collection agencies and attorneys to service and collect our consumer receivables. Any failure by our third-party collection agencies and attorneys to perform collection services for us adequately or remit such collections to us could materially reduce our revenue and our profitability. In addition, if one or more of those third-party collection agencies or attorneys were to cease operations abruptly, or to become insolvent, such cessation or insolvency could materially reduce our revenue and profitability. Our revenue and profitability could also be materially adversely affected if we are not able to secure replacement third party collection agencies or attorneys and transfer account information to our new third party collection agencies or attorneys promptly in the event our agreements with our third-party collection agencies and attorneys are terminated, our third-party collection agencies or attorneys fail to perform their obligations adequately, or if our relationships with such third-party collection agencies and attorneys otherwise change adversely.

### ***A significant portion of our collections relies upon our success in individual lawsuits brought against consumers and our ability to collect on judgments in our favor.***

We generate a significant portion of our revenue by collecting on judgments that are granted by courts in lawsuits filed against debtors. A decrease in the willingness of courts to grant such judgments, a change in the requirements for filing such cases or obtaining such judgments, or a decrease in our ability to collect on such judgments could have a material and adverse effect on our results of operations. As we increase our use of the legal channel for collections, our short-term margins may decrease as a result of an increase in upfront court costs and costs related to counter claims. We may not be able to collect on certain aged accounts because of applicable statutes of limitations and we may be subject to adverse effects of regulatory changes that we cannot predict. Further, courts in certain jurisdictions require that a copy of the account statements or applications be attached to the pleadings in order to obtain a judgment against the account debtors. If we are unable to produce account documents, these courts will deny our claims. Additionally, our ability to collect non-judicially may be impacted by state laws which require that certain types of account documentation be in our possession prior to the institution of any collection activities.

### ***Increases in costs associated with our collections through a network of attorneys can materially raise our costs associated with our collection strategies and the individual lawsuits brought against consumers to collect on judgments in our favor.***

We generally outsource those accounts where it appears the consumer is able, but unwilling to pay. We utilize lawyers that specialize in collection matters, paying them a contingency fee on amounts collected. In connection with our agreement with the contracted attorneys, we advance certain out-of-pocket court costs and capitalize those costs in our consolidated financial statements. We are increasing the portion of our collection activity through the legal channel, and as a consequence, due to an increase in upfront court costs associated with our pursuit of legal collections, and an increase in costs related to counterclaims, our costs in collecting on these accounts can increase, which can have a material and adverse affect on our results of operations. We also rely on our network of attorneys to interact with consumers in accordance with state and federal law, to appropriately handle funds advanced by us in connection with collections activities, and to appropriately apply and account for funds remitted by consumers. In the event that one or more of our attorneys fails to apply funds as intended, fails to observe applicable laws, or otherwise fails in their duties, this may also materially and adversely affect our results of operations.

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***We are subject to ongoing risks of litigation, including individual and class actions under consumer credit, collections, employment, securities and other laws, and may be subject to awards of substantial damages.***

We operate in an extremely litigious climate and currently are, and may in the future, be named as defendants in litigation, including individual and class actions under consumer credit, collections, employment, securities and other laws.

In the past, securities class-action litigation has often been filed against a company after a period of volatility in the market price of its stock. Our industry experiences a high volume of litigation, and legal precedents have not been clearly established in many areas applicable to our business. Additionally, employment-related litigation is increasing throughout the country. Defending a lawsuit, regardless of its merit, could be costly and divert management's attention from the operation of our business. Damage awards or settlements could be significant. The use of certain collection strategies could be restricted if class-action plaintiffs were to prevail in their claims. All of these factors could have an adverse effect on our business and financial condition.

***We may make acquisitions that prove unsuccessful or strain or divert our resources.***

From time to time, we consider acquisitions of other companies that could complement our business, including the acquisition of entities in diverse geographic regions and entities offering greater access to businesses and markets that we do not currently serve. For instance, during 2005 we acquired Ascension Capital Group and certain assets of Jefferson Capital. We may not be able to successfully acquire other businesses or, if we do, the acquisition may be unprofitable. In addition, we may not successfully operate the businesses acquired, or may not successfully integrate such businesses with our own, which may result in our inability to maintain our goals, objectives, standards, controls, policies or culture. In addition, through acquisitions, we may enter markets in which we have limited or no experience. The occurrence of one or more of these events may place additional constraints on our resources such as diverting the attention of our management from other business concerns, which can materially adversely affect our operations and financial condition. Moreover, any acquisition may result in a potentially dilutive issuance of equity securities, incurrence of additional debt and amortization of identifiable intangible assets, all of which could reduce our profitability.

***We are dependent on our management team for the adoption and implementation of our strategies and the loss of their services could have a material adverse effect on our business.***

Our management team has considerable experience in finance, banking, consumer collections and other industries. We believe that the expertise of our executives obtained by managing businesses across numerous other industries has been critical to the enhancement of our operations. Our management team has created a culture of new ideas and progressive thinking, coupled with increased use of technology and statistical analysis. The loss of the services of one or more of our key executive officers could disrupt our operations and seriously impair our ability to continue to acquire or collect on portfolios of charged-off consumer receivables and to manage and expand our business. Our success depends on the continued service and performance of our management team, and we cannot guarantee that we will be able to retain such individuals.

***We may not be able to hire and retain enough sufficiently trained employees to support our operations, and/or we may experience high rates of personnel turnover.***

Our industry is very labor-intensive, and companies in our industry typically experience a high rate of employee turnover. We generally compete for qualified collections personnel with companies in our business and in the collection agency, teleservices and telemarketing industries and we compete for qualified non-collections personnel with companies in many industries. We will not be able to service our receivables effectively, continue our growth or operate profitably if we cannot hire and retain qualified collection personnel. Further, high turnover rates among our employees increases our recruiting and training costs and may limit the number of experienced collection personnel available to service our receivables. Our newer employees tend to be less productive and generally produce the greatest rate of personnel turnover. If the turnover rate among our employees increases, we will have fewer experienced employees available to service our receivables, which could reduce collections and therefore materially and adversely impact our results of operations.

***Exposure to regulatory, political and economic conditions in India exposes us to risks or loss of business.***

A significant element of our business strategy is to continue to develop and expand offshore operations in India. While wage costs in India are significantly lower than in the U.S. and other industrialized countries for comparably skilled workers, wages in India are increasing at a faster rate than in the U.S., and we experience higher employee turnover in our India site than is typical in our U.S. locations. The continuation of these trends could result in the loss of the cost savings we sought to achieve by moving a portion of our collection operations to India. In the past, India has experienced significant inflation and shortages of readily available foreign currency exchange, and has been subject to civil unrest. We may be adversely affected by changes in inflation, exchange rate fluctuations, interest rates, tax provisions, social stability or other political, economic or diplomatic developments in or affecting India in the future. In addition, the infrastructure of the Indian economy is relatively poor. Further, the Indian government is significantly involved in and exerts considerable influence over its economy through its complicated tax code and pervasive bureaucracy. In the recent past, the Indian government has provided significant tax incentives and relaxed certain regulatory restrictions in order to encourage foreign investment in certain sectors of the economy, including the technology industry. Changes in the business or regulatory climate of India could have a material and adverse effect on our business, results of operations and financial condition.



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India has also experienced persistent though declining mass poverty, civil unrest and terrorism and has been involved in conflicts with neighboring countries. In recent years, there have been military confrontations between India and Pakistan that have occurred in the region of Kashmir and along the Indian-Pakistan border. The potential for hostilities between the two countries has been high in light of tensions related to recent terrorist incidents in India and the unsettled nature of the regional geopolitical environment, including events in and related to Afghanistan and Iraq. Additionally, India's recent nuclear activity could expose it to increased political scrutiny, exclusion, or sanctions. Changes in the political stability of India could have a material adverse effect on our business, results of operations and financial condition.

***We may not be able to manage our growth effectively, including the expansion of our operations in India.***

We have expanded significantly in recent years. However, future growth will place additional demands on our resources, and we cannot be sure that we will be able to manage our growth effectively. Continued growth could place a strain on our management, operations and financial resources. We cannot be certain that our infrastructure, facilities and personnel will be adequate to support our future operations or to effectively adapt to future growth. If we cannot manage our growth effectively, our results of operations may be materially and adversely affected.

***The failure of our technology and telecommunications systems could have an adverse effect on our operations.***

Our success depends in large part on sophisticated computer and telecommunications systems. The temporary or permanent loss of our computer and telecommunications equipment and software systems, through casualty, operating malfunction, software virus, or service provider failure, could disrupt our operations. In the normal course of our business, we must record and process significant amounts of data quickly and accurately to properly bid on prospective acquisitions of receivable portfolios and to access, maintain and expand the databases we use for our collection activities. Any simultaneous failure of our information systems and their backup systems would interrupt our business operations.

Our business depends heavily on services provided by various local and long-distance telephone companies. A significant increase in telephone service costs or any significant interruption in telephone services could negatively affect our operating results or disrupt our operations.

***We may not be able successfully to anticipate, invest in or adopt technological advances within our industry.***

Our business relies on computer and telecommunications technologies, and our ability to integrate new technologies into our business is essential to our competitive position and our success. We may not be successful in anticipating, managing, or adopting technological changes in a timely basis. Computer and telecommunications technologies are evolving rapidly and are characterized by short product life cycles.

We are making significant modifications to our information systems to ensure that they continue to meet our current and foreseeable demands and continued expansion, and our future growth may require additional investment in these systems. These system modifications may exceed our cost or time estimates for completion or may be unsuccessful. If we cannot update our information systems effectively, our results of operations may be materially and adversely affected.

We depend on having the capital resources necessary to invest in new technologies to acquire and service receivables. We cannot be certain that adequate capital resources will be available to us.

***We may not be able adequately to protect the intellectual property rights upon which we rely.***

We rely on proprietary software programs and valuation and collection processes and techniques, and we believe that these assets provide us with a competitive advantage. We consider our proprietary software, processes and techniques to be trade secrets, but they are not protected by patent or registered copyright. We may not be able to protect our technology and data resources adequately, which may materially diminish our competitive advantage.

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*Our results of operations may be materially adversely affected if bankruptcy filings increase or if bankruptcy or other debt collection laws change.*

Our business model may be uniquely vulnerable to an economic recession, which typically results in an increase in the amount of defaulted consumer receivables, thereby contributing to an increase in the amount of personal bankruptcy filings. Under certain bankruptcy filings, a debtor's assets are sold to repay credit originators, with priority given to holders of secured debt. Since the defaulted consumer receivables we typically purchase are generally unsecured, we often would not be able to collect on those receivables. In addition, since we purchase receivables that are seriously delinquent, this is often an indication that many of the consumer debtors from whom we collect would be unable to service their debts going forward and are more likely to file for bankruptcy in an economic recession. We cannot be certain that our collection experience would not decline with an increase in bankruptcy filings. If our actual collection experience with respect to a defaulted consumer receivable portfolio is significantly lower than we projected when we purchased the portfolio, our results of operations could be materially and adversely affected.

In 2005, the Bankruptcy Abuse Prevention and Consumer Protection Act, or the Protection Act, was enacted which made significant changes in the treatment of consumer filers for bankruptcy protection. Since the Protection Act was enacted, the number of bankruptcy filings has decreased, and the volume of business at Ascension has decreased as a result. We cannot determine the impact of the Protection Act on the number of bankruptcy filings, on a prospective basis, and its impact on the collectability of consumer debt.

Current federal legislative and executive branch proposals made in response to current economic conditions may have an effect on the rights of creditors in a consumer bankruptcy. We cannot predict whether these or other proposals will be enacted or the extent to which they may affect our business.

*We are subject to examinations and challenges by tax authorities.*

We are subject to periodic examination from federal, state and international taxing authorities. In calculating any taxes due as a result of our operations, we undertake a diligent review of key data, and make decisions with respect to the appropriate application of relevant tax laws. In areas where the appropriate application of tax laws is subject to competing views or interpretation, we make determinations based on our view of the probable outcome, document the reasoning behind those determinations, and seek the concurrence of outside tax consultants. Positions we take with respect to the application of tax laws, may, from time to time, be challenged by tax authorities. If such challenges are made, and not resolved in our favor, they could have an adverse effect on our financial condition and results of operations.

### **Item 2. Unregistered Sales Of Equity Securities And Use Of Proceeds**

None.

### **Item 3. Defaults Upon Senior Securities**

None.

### **Item 4. Removed and Reserved**

### **Item 5. Other Information**

None.

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### **Item 6. Exhibits**

- 10.1 Form of Restricted Stock Agreement by and between George Lund and Encore Capital Group, Inc. (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on June 17, 2010).
- 31.1 Certification of the Principal Executive Officer pursuant to rule 13-14(a) under the Securities Exchange Act of 1934 (filed herewith).
- 31.2 Certification of the Principal Financial Officer pursuant to rule 13-14(a) under the Securities Exchange Act of 1934 (filed herewith).
- 32.1 Certification 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 (filed herewith).

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**ENCORE CAPITAL GROUP, INC.**

**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: August 2, 2010

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**EXHIBIT INDEX**

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## **Section 2: EX-31.1 (CERTIFICATION)**

**Exhibit 31.1**

### **CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER**

I, J. Brandon Black, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Encore Capital Group, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 2, 2010

By: /s/ J. Brandon Black  
J. Brandon Black  
President and Chief Executive Officer

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## **Section 3: EX-31.2 (CERTIFICATION)**

**Exhibit 31.2**

## CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER

I, Paul Grinberg, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Encore Capital Group, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 2, 2010

By: /s/ Paul Grinberg

Paul Grinberg  
Executive Vice President, Chief Financial  
Officer and Treasurer

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## Section 4: EX-32.1 (CERTIFICATION)

Exhibit 32.1

### ENCORE CAPITAL GROUP, INC.

#### CERTIFICATION 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

In connection with the Quarterly Report of Encore Capital Group, Inc. (the "Company") on Form 10-Q for the period ended June 30, 2010 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), each of the undersigned certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to the best of his knowledge:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the consolidated financial condition and results of operations of the Company.

/s/ J. Brandon Black

J. Brandon Black  
President and Chief Executive Officer

August 2, 2010

/s/ Paul Grinberg

Paul Grinberg  
*Executive Vice President, Chief  
Financial Officer and Treasurer*

August 2, 2010

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