

ENCORE CAPITAL GROUP INC  
Form 10-Q  
April 29, 2009  
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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 March 31, 2009

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

**48-1090909**  
(IRS Employer  
Identification No.)  
  
**92123**  
(Zip code)  
  
**(877) 445 - 4581**

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(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 April 21, 2009 |
|--------------------------------|-------------------------------|
| Common Stock, \$0.01 par value | 23,060,871 shares             |

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

(In Thousands, Except Par Value Amounts)

(Unaudited)

|   | March 31,<br>2009 | December 31,<br>2008<br>Adjusted |
|---|-------------------|----------------------------------|
| <b>Assets</b>   |                   |                                  |
| Cash and cash equivalents   | \$ 4,261          | \$ 10,341                        |
| Accounts receivable, net  | 1,775             | 1,757                            |
| Investment in receivable portfolios, net  | 473,484           | 461,346                          |
| Deferred court costs  | 30,645            | 28,335                           |
| Property and equipment, net   | 6,279             | 6,272                            |
| Prepaid income tax  | 2,515             | 7,935                            |
| Forward flow asset  | 10,302            | 10,302                           |
| Other assets  | 4,703             | 5,067                            |
| Goodwill  | 15,985            | 15,985                           |
| Identifiable intangible assets, net   | 1,578             | 1,739                            |
| <b>Total assets</b>   | <b>\$ 551,527</b> | <b>\$ 549,079</b>                |
| <b>Liabilities and stockholders equity</b>  |                   |                                  |
| Liabilities:  |                   |                                  |
| Accounts payable and accrued liabilities  | \$ 17,805         | \$ 18,204                        |
| Deferred tax liabilities, net   | 15,253            | 15,108                           |
| Deferred revenue and purchased servicing obligation   | 5,229             | 5,203                            |
| Debt  | 296,356           | 303,655                          |
| Other liabilities   | 3,176             | 3,483                            |
| Total liabilities   | 337,819           | 345,653                          |
| Commitments and contingencies   |                   |                                  |
| Stockholders equity:  |                   |                                  |
| Convertible preferred stock, \$.01 par value, 5,000 shares authorized, no shares issued and outstanding   |                   |                                  |
| Common stock, \$.01 par value, 50,000 shares authorized, 23,061 shares and 23,053 shares issued and outstanding as of March 31, 2009, and December 31, 2008, respectively | 231               | 231                              |
| Additional paid-in capital  | 99,622            | 98,521                           |
| Accumulated earnings  | 115,792           | 106,795                          |
| Accumulated other comprehensive loss  | (1,937)           | (2,121)                          |
| Total stockholders equity   | 213,708           | 203,426                          |
| <b>Total liabilities and stockholders equity</b>  | <b>\$ 551,527</b> | <b>\$ 549,079</b>                |



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

(In Thousands, Except Per Share Amounts)

(Unaudited)

|   | <b>Three Months Ended<br/>March 31,</b> |                          |
|---|---|--------------------------|
|   | <b>2009</b>                             | <b>2008<br/>Adjusted</b> |
| <b>Revenue</b>  |   |                          |
| Revenue from receivable portfolios, net                                     | \$ 72,275                               | \$ 64,068                |
| Servicing fees and other related revenue                                    | 4,171                                   | 3,486                    |
| <b>Total revenue</b>  | <b>76,446</b>                           | <b>67,554</b>            |
| <b>Operating expenses</b>   |   |                          |
| Salaries and employee benefits (excluding stock-based compensation expense) | 13,957                                  | 14,851                   |
| Stock-based compensation expense  | 1,080                                   | 1,094                    |
| Cost of legal collections   | 29,947                                  | 20,306                   |
| Other operating expenses  | 5,980                                   | 5,651                    |
| Collection agency commissions   | 2,891                                   | 4,031                    |
| General and administrative expenses   | 5,697                                   | 4,460                    |
| Depreciation and amortization   | 623                                     | 722                      |
| <b>Total operating expenses</b>   | <b>60,175</b>                           | <b>51,115</b>            |
| <b>Income before other (expense) income and income taxes</b>                | <b>16,271</b>                           | <b>16,439</b>            |
| <b>Other (expense) income</b>   |   |                          |
| Interest expense  | (4,273)                                 | (5,200)                  |
| Gain on repurchase of convertible notes                                     | 3,053                                   |                          |
| Other (expense) income  | (81)                                    | 21                       |
| <b>Total other expense</b>  | <b>(1,301)</b>                          | <b>(5,179)</b>           |
| <b>Income before income taxes</b>   | <b>14,970</b>                           | <b>11,260</b>            |
| Provision for income taxes  | (5,973)                                 | (4,509)                  |
| <b>Net income</b>   | <b>\$ 8,997</b>                         | <b>\$ 6,751</b>          |
| <b>Weighted average shares outstanding:</b>                                 |   |                          |
| Basic   | 23,122                                  | 22,992                   |
| Diluted   | 23,631                                  | 23,431                   |
| <b>Earnings per share:</b>  |   |                          |
| Basic   | \$ 0.39                                 | \$ 0.29                  |
| Diluted   | \$ 0.38                                 | \$ 0.29                  |

*See accompanying notes to unaudited condensed consolidated financial statements*



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## ENCORE CAPITAL GROUP, INC.

## Condensed Consolidated Statements of Stockholders Equity

(Unaudited, In Thousands)

|  | Common Stock |        | Additional<br>Paid-In<br>Capital | Accumulated<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>(Loss)<br>Income | Total<br>Equity | Comprehensive<br>Income |
|--|--------------|--------|----------------------------------|-------------------------|---|-----------------|-------------------------|
|  | Shares       | Par    |                                  |                         |   |                 |                         |
| <b>Balance at December 31, 2008, Adjusted</b>  | 23,053       | \$ 231 | \$ 98,521                        | \$ 106,795              | \$ (2,121)  | \$ 203,426      |                         |
| Net income                                     |              |        |                                  | 8,997                   |   | 8,997           | 8,997                   |
| Other comprehensive income:                    |              |        |                                  |                         |   |                 |                         |
| Unrealized gain on cash flow hedge, net of tax |              |        |                                  |                         | 184   | 184             | 184                     |
| Issuance of share-based awards                 | 8            |        |                                  |                         |   |                 |                         |
| Stock-based compensation                       |              |        | 1,080                            |                         |   | 1,080           |                         |
| Tax benefit related to stock option exercises  |              |        | 21                               |                         |   | 21              |                         |
| <b>Balance at March 31, 2009</b>               | 23,061       | \$ 231 | \$ 99,622                        | \$ 115,792              | \$ (1,937)  | \$ 213,708      | \$ 9,181                |

*See accompanying notes to unaudited condensed consolidated financial statements*



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

(Unaudited, In Thousands)

|   | <b>Three Months Ended<br/>March 31,</b> |                          |
|---|---|--------------------------|
|   | <b>2009</b>                             | <b>2008<br/>Adjusted</b> |
| <b>Operating activities:</b>  |   |                          |
| Net Income  | \$ 8,997                                | \$ 6,751                 |
| Adjustments to reconcile net income to net cash provided by operating activities: |   |                          |
| Depreciation and amortization   | 623                                     | 722                      |
| Amortization of loan costs and debt discount                                      | 1,221                                   | 1,567                    |
| Stock-based compensation expense  | 1,080                                   | 1,094                    |
| Gain on repurchase of convertible notes, net                                      | (3,053)                                 |                          |
| Deferred income tax expense (benefit)   | 145                                     | (559)                    |
| Tax benefit from stock-based payment arrangements                                 | (21)                                    | (5)                      |
| Provision for impairment on receivable portfolios, net                            | 5,427                                   | 5,335                    |
| Changes in operating assets and liabilities                                       |   |                          |
| Other assets  | (165)                                   | 1,386                    |
| Deferred court costs  | (2,310)                                 | (2,906)                  |
| Prepaid income tax  | 5,441                                   | 4,819                    |
| Deferred revenue and purchased service obligation                                 | 26                                      | 185                      |
| Accounts payable and accrued liabilities  | (523)                                   | (2,559)                  |
| Net cash provided by operating activities   | 16,888                                  | 15,830                   |
| <b>Investing activities:</b>  |   |                          |
| Purchases of receivable portfolios, net of forward flow allocation                | (55,913)                                | (44,976)                 |
| Collections applied to investment in receivable portfolios, net                   | 37,424                                  | 34,877                   |
| Proceeds from put-backs of receivable portfolios                                  | 924                                     | 1,692                    |
| Purchases of property and equipment   | (469)                                   | (1,117)                  |
| Net cash used in investing activities   | (18,034)                                | (9,524)                  |
| <b>Financing activities:</b>  |   |                          |
| Proceeds from revolving credit facility   | 32,000                                  | 9,000                    |
| Repayment of revolving credit facility  | (17,000)                                | (11,169)                 |
| Repurchase of convertible notes   | (19,834)                                |                          |
| Proceeds from exercise of stock options   |   | 2                        |
| Tax benefit from stock-based payment arrangements                                 | 21                                      | 5                        |
| Repayment of capital lease obligations  | (121)                                   | (83)                     |
| Net cash used in financing activities   | (4,934)                                 | (2,245)                  |
| <b>Net (decrease) increase in cash</b>  | <b>(6,080)</b>                          | <b>4,061</b>             |
| <b>Cash and cash equivalents, beginning of period</b>                             | <b>10,341</b>                           | <b>8,676</b>             |
| <b>Cash and cash equivalents, end of period</b>                                   | <b>\$ 4,261</b>                         | <b>\$ 12,737</b>         |
| <b>Supplemental disclosures of cash flow information:</b>                         |   |                          |
| Cash paid for interest  | \$ 3,699                                | \$ 4,172                 |

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|  |        |          |
|--|--------|----------|
| Income tax payment (refund)  | \$ 499 | \$ (407) |
| <b>Supplemental schedule of non-cash investing and financing activities:</b>           |        |          |
| Allocation of forward flow asset to acquired receivable portfolios                     | \$     | \$ 2,926 |
| <i>See accompanying notes to unaudited condensed consolidated financial statements</i> |        |          |

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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 acquires its receivable portfolios at deep discounts from their face values using its proprietary valuation process that is based on the consumer attributes of the underlying accounts. Based upon the Company's ongoing analysis of these accounts, it employs a dynamic mix of collection strategies to maximize its return on investment. The receivable portfolios the Company purchases consist primarily of unsecured, charged-off domestic consumer credit card, auto deficiency and telecom receivables purchased from national financial institutions, major retail credit corporations, telecom companies and resellers of such portfolios. Acquisitions of receivable portfolios are financed by operations and by borrowings from third parties. See Note 7 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, 2008. 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.

***Change in Accounting Principle***

Effective January 1, 2009, the Company retrospectively applied Financial Accounting Standard Board ( *FASB* ) Staff Position APB 14-1 ( *FSP APB 14-1* ) *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)* to account for its outstanding convertible senior notes. As a result, prior years' consolidated financial statements have been retrospectively adjusted. See Note 12 for additional information on the application of this accounting principle.

***Reclassification***

The prior year's consolidated statement of cash flows has been changed to the indirect method, to conform to the current year's presentation. Additionally, certain reclassifications have been made to the consolidated financial statements to conform to the current year's presentation.

***Earnings per Share***

Basic earnings per share ( *EPS* ) is calculated by dividing net earnings available to common stockholders by the weighted average number of shares of common stock outstanding. Common stock outstanding includes shares of common stock and restricted stock units for which no future

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service is required as a condition to the delivery of the underlying common stock. Diluted EPS includes the determinants of basic EPS and, in addition, reflects the dilutive effect of the common stock

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deliverable pursuant to stock options and to restricted stock units for which future service is required as a condition to the delivery of the underlying common stock. Employee stock options to purchase approximately 1,393,000 and 1,303,000 shares of common stock were outstanding during the three months ended March 31, 2009 and 2008, respectively, but not included in the computation of diluted earnings per share because the effect on diluted earnings per share would be anti-dilutive.

**New Accounting Pronouncements**

In December 2008, the FASB released FSP FAS 132(R)-1, *Employers' Disclosures about Postretirement Benefit Plan Assets*, which amends Statement of Financial Accounting Standard No. 132R to provide guidance on an employer's disclosures about plan assets of a defined benefit pension or other postretirement plan. This FASB Staff Position is effective for financial statements issued for fiscal years ending after December 15, 2009. The Company expects to adopt this new standard and its required disclosures in its consolidated financial statements for the fiscal year ending December 31, 2009.

In April 2009, the FASB issued FSP FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments*. This FASB Staff Position amends FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments*, to require disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. This FASB Staff Position also amends APB Opinion No. 28, *Interim Financial Reporting*, to require certain disclosures in summarized financial information at interim reporting periods. This standard will be effective for the Company's second quarter ended June 30, 2009. The Company is in the process of determining the effects of the adoption of this standard on its consolidated financial statement disclosures.

In April 2009, the FASB issued FSP FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*. This FASB Staff Position provides additional guidance for estimating fair value in accordance with FASB Statement No. 157, *Fair Value Measurements*, when the volume and level of activity for the asset or liability have significantly decreased. It also includes guidance on identifying circumstances that indicate a transaction is not orderly. This standard will be effective for the Company for its second quarter ended June 30, 2009. The Company does not expect that the adoption of this standard will have a material impact on its consolidated financial statements.

**Note 2: Fair Value Measurements**

On January 1, 2008, the Company adopted Statement of Financial Accounting Standard No. 157, *Fair Value Measurements* (FAS 157), for financial assets and liabilities. On January 1, 2009, the Company adopted the provisions of FAS 157 for non-financial assets and non-financial liabilities that are recognized and disclosed at fair value on a nonrecurring basis. FAS 157 defines fair value, provides guidance for measuring fair value and requires certain disclosures. It does not require any new fair value measurements, but rather applies to all other accounting pronouncements that require or permit fair value measurements.

FAS 157 utilizes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The following is a brief description of those three levels:

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.

The Company's financial instruments measured at fair value on a recurring basis are summarized below (*in thousands*):

| Financial Instruments | Fair<br>Value | Fair<br>Value at | Fair Value<br>at |
|-----------------------|---------------|------------------|------------------|
|-----------------------|---------------|------------------|------------------|

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|                               | Hierarchy | March 31,<br>2009 | December 31,<br>2008 |
|-------------------------------|-----------|-------------------|----------------------|
| Cash and cash equivalents     | Level 1   | \$ 4,261          | \$ 10,341            |
| Cash flow hedging instruments | Level 2   | (3,176)           | (3,483)              |

The Company does not have any non-financial assets or liabilities that are measured at fair value on a nonrecurring basis.

**Table of Contents****Note 3: Stock-Based Compensation**

On March 30, 2005, the Board of Directors of the Company adopted the 2005 Stock Incentive Plan ( 2005 Plan ) for Board members, employees, officers, and executives of, and consultants and advisors to, the Company. 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. Upon adoption, an aggregate of 1,500,000 shares of the Company's common stock were available for awards under the 2005 Plan, plus ungranted shares of stock that were available for future awards under the 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 are available for grant under the 2005 Plan. The benefits provided under these plans are share-based compensation subject to the provisions of FAS 123R.

In accordance with FAS 123R, compensation expense is recognized only for those shares expected to vest, net of estimated forfeitures based on the Company's historical experience and future expectations. For the three months ended March 31, 2009, approximately \$1.1 million was recognized as stock-based compensation expense.

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

**Stock Options**

The 2005 Plan permits the granting of stock options to certain employees and directors of the Company. Option awards are generally granted with an exercise price equal to the market price of the Company's stock at the date of issuance. Options generally vest based on three to five years of continuous service and have ten-year contractual terms.

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 of options granted is estimated at the date of grant using a Black-Scholes option-pricing model with the following weighted-average assumptions (there were no options granted during the three months ended March 31, 2008):

|  | Three Months Ended<br>March 31, 2009 | Three Months Ended<br>March 31, 2008 |
|--|--------------------------------------|--------------------------------------|
| Weighted average fair value of options granted                               | \$ 1.36                              |                                      |
| Risk free interest rate  | 1.9%                                 |                                      |
| Dividend yield   | 0.0%                                 |                                      |
| Volatility factor of the expected market price of the Company's common stock | 52.8%                                |                                      |
| Weighted-average expected life of options                                    | 5 Years                              |                                      |

Unrecognized estimated compensation cost related to stock options as of March 31, 2009, was \$1.9 million, which is expected to be recognized over a weighted-average period of approximately 2.3 years.

A summary of the Company's stock option activity and related information is as follows for the three months ended March 31, 2009:

|                                  | Number of<br>Shares | Option Price<br>Per Share | Weighted<br>Average<br>Exercise<br>Price | Aggregate<br>Intrinsic<br>Value<br>(in thousands) |
|----------------------------------|---------------------|---------------------------|--|---|
| Outstanding at December 31, 2008 | 2,139,503           | \$ 0.35 - \$20.09         | \$ 9.14                                  |   |
| Granted                          | 262,500             | 2.89                      | 2.89                                     |   |
| Cancelled/forfeited              | (24,200)            | 10.92 - 16.19             | 13.33                                    |   |
| Exercised                        |                     |                           |  |   |
| Outstanding at March 31, 2009    | 2,377,803           | \$ 0.35 - \$20.09         | \$ 8.38                                  | \$ 3,101  |

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|                               |           |                   |         |          |
|-------------------------------|-----------|-------------------|---------|----------|
| Exercisable at March 31, 2009 | 1,622,106 | \$ 0.35 - \$20.09 | \$ 8.26 | \$ 2,671 |
|-------------------------------|-----------|-------------------|---------|----------|

There were no stock options exercised during the three months ended March 31, 2009. The total intrinsic value of options exercised during the three months ended March 31, 2008 was less than \$0.1 million. As of March 31, 2009, the weighted-average remaining contractual life of options outstanding and options exercisable was 6.11 years and 4.70 years, respectively.



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Under the Company's 2005 Plan, certain employees and directors are eligible to receive restricted stock units. In accordance with FAS 123R, the fair value of restricted stock units is equal to the closing price of the Company's common stock on the date of issuance. The total number of restricted stock unit awards expected to vest is adjusted by estimated forfeiture rates. As of March 31, 2009, 113,100 of the non-vested shares are expected to vest over approximately three to five years based on certain performance goals ( Performance-Based Awards ). The fair value of the Performance-Based Awards is expensed over the expected vesting period based on our forfeiture assumptions. 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 March 31, 2009. The remaining 696,202 non-vested shares are not performance-based, and will vest and are being expensed over approximately two to five years of continuous service.

For the three months ended March 31, 2009, restricted stock unit activity and related information is as follows:

| Restricted Stock Units          | Non-Vested<br>Shares | Weighted Average<br>Grant Date<br>Fair Value |
|---------------------------------|----------------------|--|
| Non-vested at December 31, 2008 | 628,752              | \$ 11.18                                     |
| Awarded                         | 203,114              | \$ 3.33                                      |
| Vested                          | (22,364)             | \$ 6.93                                      |
| Cancelled/forfeited             | (200)                | \$ 10.25                                     |
| Non-vested at March 31, 2009    | 809,302              | \$ 9.33                                      |

Unrecognized estimated compensation cost related to restricted stock units as of March 31, 2009, was \$3.6 million, which is expected to be recognized over a weighted-average period of approximately 2.4 years. The fair value of restricted stock units vested for the three months ended March 31, 2009 and 2008 was \$0.2 million and \$0.1 million, respectively.

**Note 4: Investment in Receivable Portfolios, Net**

In accordance with the provisions of SOP 03-3, 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. All portfolios with common risk characteristics purchased prior to the adoption of SOP 03-3 in the first quarter of 2005 were aggregated by quarter of purchase.

In compliance with SOP 03-3, 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 impairment of 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 impairment. 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 impairments.

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. As of March 31, 2009, there were five portfolios accounted for using the

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cost recovery method, consisting of \$0.6 million in net book value of investment in receivable portfolios, representing all of the healthcare portfolios that the Company had acquired. In September 2007, the Company decided to exit its healthcare purchasing and collection activities. At that time the Company anticipated either selling these healthcare portfolios or placing the underlying accounts with external agencies for collections. The Company no longer anticipates a sale of these receivable

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portfolios and has placed them with external collection agencies. Since the Company is no longer actively collecting on these accounts internally, it has classified them as Cost Recovery Portfolios. The \$0.6 million net book value reflects the value the Company expects to realize through the collection activities of the external agencies.

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

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

|  | Three Months Ended March 31, 2009 |                                   |            |
|--|-----------------------------------|-----------------------------------|------------|
|  | Accretable Yield                  | Estimate of Zero Basis Cash Flows | Total      |
| Beginning balance at December 31, 2008 | \$ 592,825                        | \$ 8,337                          | \$ 601,162 |
| Revenue recognized, net                | (69,775)                          | (2,500)                           | (72,275)   |
| Additions on existing portfolios       | 5,715                             | 1,032                             | 6,747      |
| Additions for current purchases        | 81,917                            |                                   | 81,917     |
| Balance at March 31, 2009              | \$ 610,682                        | \$ 6,869                          | \$ 617,551 |

|   | Three Months Ended March 31, 2008 |                                   |            |
|---|-----------------------------------|-----------------------------------|------------|
|   | Accretable Yield                  | Estimate of Zero Basis Cash Flows | Total      |
| Beginning balance at December 31, 2007  | \$ 486,652                        | \$ 13,002                         | \$ 499,654 |
| Revenue recognized, net                 | (61,510)                          | (2,558)                           | (64,068)   |
| Reductions on existing portfolios       | (50,898)                          | (1,015)                           | (51,913)   |
| Additions for 12 months curve extension | 67,287                            |                                   | 67,287     |
| Additions for current purchases         | 112,780                           |                                   | 112,780    |
| Balance at March 31, 2008               | \$ 554,311                        | \$ 9,429                          | \$ 563,740 |

During the three months ended March 31, 2009, the Company purchased receivable portfolios with a face value of \$1.3 billion for \$55.9 million, or a purchase cost of 4.2% of face value. The estimated future collections at acquisition for these portfolios amounted to \$138.4 million.

All collections realized after the net book value of a portfolio has been fully recovered ( Zero Basis Portfolios ) are recorded as revenue ( Zero Basis Revenue ). During the three months ended March 31, 2009 and 2008, approximately \$2.5 million and \$2.6 million were recognized as Zero Basis Revenue, respectively.

During the quarter ended March 31, 2008, the Company revised the forecasting methodology it used to value a portfolio by extending the collection forecast from 72 months to 84 months. This change was made as a result of the Company's increased confidence in its ability to forecast future cash collections to 84 months. Extending the collection forecast from 72 months to 84 months resulted in an increase in the aggregate total estimated remaining collections for the receivable portfolios, as of March 31, 2008, by \$67.3 million, or 7.5%. The impact of the change in estimate resulted in an increase in net income of \$1.9 million, and an increase in fully diluted earnings per share of \$0.08, for the quarter ended March 31, 2008.

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

|   | For the Three Months Ended March 31, 2009 |                          |                       |                   |
|---|---|--------------------------|-----------------------|-------------------|
|   | Accrual Basis Portfolios                  | Cost Recovery Portfolios | Zero Basis Portfolios | Total             |
| Balance, beginning of period                          | \$ 460,598                                | \$ 748                   | \$                    | \$ 461,346        |
| Purchases of receivable portfolios                    | 55,913                                    |                          |                       | 55,913            |
| Gross collections <sup>(1)</sup>                      | (112,491)                                 | (139)                    | (2,496)               | (115,126)         |
| Put-backs and recalls <sup>(2)</sup>                  | (920)                                     |                          | (4)                   | (924)             |
| Revenue recognized                                    | 75,202                                    |                          | 2,500                 | 77,702            |
| Impairment, net                                       | (5,427)                                   |                          |                       | (5,427)           |
| <b>Balance, end of period</b>                         | <b>\$ 472,875</b>                         | <b>\$ 609</b>            | <b>\$</b>             | <b>\$ 473,484</b> |
| Revenue as a percentage of collections <sup>(3)</sup> | 66.9%                                     | 0.0%                     | 100.0%                | 67.5%             |

|   | For the Three Months Ended March 31, 2008 |                          |                       |                   |
|---|---|--------------------------|-----------------------|-------------------|
|   | Accrual Basis Portfolios                  | Cost Recovery Portfolios | Zero Basis Portfolios | Total             |
| Balance, beginning of period                          | \$ 390,564                                | \$ 1,645                 | \$                    | \$ 392,209        |
| Purchases of receivable portfolios                    | 47,902                                    |                          |                       | 47,902            |
| Gross collections <sup>(1)</sup>                      | (101,523)                                 | (199)                    | (2,558)               | (104,280)         |
| Put-backs and recalls <sup>(2)</sup>                  | (1,678)                                   | (14)                     |                       | (1,692)           |
| Revenue recognized <sup>(4)</sup>                     | 66,845                                    |                          | 2,558                 | 69,403            |
| Impairment, net <sup>(4)</sup>                        | (5,335)                                   |                          |                       | (5,335)           |
| <b>Balance, end of period</b>                         | <b>\$ 396,775</b>                         | <b>\$ 1,432</b>          | <b>\$</b>             | <b>\$ 398,207</b> |
| Revenue as a percentage of collections <sup>(3)</sup> | 65.8%                                     | 0.0%                     | 100.0%                | 66.6%             |

(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 represents accounts that are recalled by the seller in accordance with the respective purchase agreement ( Recalls ).

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

(4) Reflects additional revenue of \$0.1 million and a lower net impairment of \$3.1 million, as a result of extending the collection curves from 72 to 84 months. The following table summarizes the change in the valuation allowance for investment in receivable portfolios during the three months ended March 31, 2009 (*in thousands*):

**Valuation  
Allowance**

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|                                 |           |
|---------------------------------|-----------|
| Balance at December 31, 2008    | \$ 57,152 |
| Provision for impairment losses | 5,580     |
| Reversal of prior allowance     | (153)     |
| Balance at March 31, 2009       | \$ 62,579 |

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

|                                  | <b>Three Months Ended March 31,</b> |             |
|----------------------------------|-------------------------------------|-------------|
|                                  | <b>2009</b>                         | <b>2008</b> |
| Collection sites                 | \$ 50,342                           | \$ 43,289   |
| Legal collections                | 56,407                              | 45,292      |
| Collection agencies              | 7,667                               | 10,961      |
| Sales                            | 817                                 | 4,214       |
| Other                            |                                     | 599         |
| Gross collections for the period | \$ 115,233                          | \$ 104,355  |

**Note 5: 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*):

|                       | <b>March 31,</b> | <b>December 31,</b> |
|-----------------------|------------------|---------------------|
|                       | <b>2009</b>      | <b>2008</b>         |
| Court costs advanced  | \$ 160,077       | \$ 145,579          |
| Court costs recovered | (39,649)         | (36,929)            |
| Court costs reserve   | (89,783)         | (80,315)            |
|                       | \$ 30,645        | \$ 28,335           |

**Note 6: Other Assets**

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

|                              | <b>March 31,</b> | <b>December 31,</b> |
|------------------------------|------------------|---------------------|
|                              | <b>2009</b>      | <b>2008</b>         |
|                              |                  | <b>Adjusted</b>     |
| Debt issuance costs          | \$ 1,441         | \$ 1,953            |
| Deferred compensation assets | 681              | 1,206               |
| Prepaid expenses             | 1,292            | 973                 |
| Other                        | 1,289            | 935                 |
|                              | \$ 4,703         | \$ 5,067            |



**Table of Contents****Note 7: Debt**

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

|                           | March 31,<br>2009 | December 31,<br>2008<br>Adjusted |
|---------------------------|-------------------|----------------------------------|
| Convertible Senior Notes  | \$ 45,845         | \$ 71,422                        |
| Less: Debt discount       | (4,264)           | (7,664)                          |
| Revolving Credit Facility | 253,000           | 238,000                          |
| Capital Lease Obligations | 1,775             | 1,897                            |
|                           | \$ 296,356        | \$ 303,655                       |

**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. Based on the provisions of Emerging Issues Task Force No. 90-19, *Convertible Bonds with Issuer Option to Settle for Cash upon Conversion* (EITF 90-19), and Emerging Issues Task Force No. 00-19, *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled In, a Company's Own Stock* (EITF 00-19), the net-settlement feature is accounted for as convertible debt and is not subject to the provisions of Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities* (FAS 133). 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 the Company's 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 FSP APB 14-1 to account for its Convertible Notes. This FSP 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. This FSP requires retrospective application and, accordingly, the prior periods' financial statements included herein have been adjusted. See Note 12 for additional information and the effect of the change in accounting principle on the Company's condensed consolidated financial statements.

During the three months ended March 31, 2009, the Company, under three separate transactions, repurchased \$25.6 million principal amount of its outstanding Convertible Notes for a total price of \$19.8 million plus accrued interest. These transactions left \$45.8 million principal amount of the Company's Convertible Notes outstanding and resulted in a net gain of \$3.1 million. The Company has written-off approximately \$0.2 million in debt issuance costs and \$2.5 million in debt discount in connection with the repurchase of its Convertible Notes during the three months ended March 31, 2009.

As of March 31, 2009, 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.

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. A holder may convert the Convertible Notes prior to March 19, 2010, only if one or more of the following conditions are satisfied:



the average of the trading prices of the Convertible Notes for any five consecutive trading day period is less than 103% of the average of the conversion values of the Convertible Notes during that period;

the Company makes certain significant distributions to holders of the Company's common stock;

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the Company enters into specified corporate transactions; or

the Company's common stock ceases to be approved for listing on the NASDAQ Global Market and is not listed for trading on a U.S. national securities exchange or any similar U.S. system of automated securities price dissemination.

Holder may also 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, regardless of whether any of the foregoing conditions have been satisfied. Upon the satisfaction of any of the foregoing conditions, on the last day of a reporting period, or during the twelve months prior to September 19, 2010, the Company would write off to expense all remaining unamortized debt issuance costs in that period.

If the Convertible Notes are converted in connection with certain fundamental changes that occur prior to March 19, 2010, the Company may be obligated to pay an additional make-whole premium with respect to the Convertible Notes.

*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 EITF No. 00-19 and Statement of Financial Accounting Standards No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*, 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 fair value of the call options and warrants in its consolidated financial statements.

***Revolving Credit Facility***

During 2005, the Company entered into a three-year Revolving Credit Facility, to be used for the purposes of purchasing receivable portfolios and for general working capital needs. This Revolving Credit Facility has been amended several times to meet the needs of the Company, and is due to expire in May 2010.

Effective February 27, 2007, the Company amended the Revolving Credit Facility to allow for the Company to repurchase up to \$50.0 million of its common stock and Convertible Notes, with no more than \$25.0 million to repurchase Convertible Notes. Effective May 9, 2008, the Company amended the Revolving Credit Facility to remove the \$25.0 million cap on Convertible Note repurchases and allow for the Company to repurchase up to \$50.0 million in any combination of its common stock and Convertible Notes, subject to compliance with certain covenants and available borrowing capacity.

Effective May 7, 2007, the Company amended the Revolving Credit Facility in connection with an agreement reached with the lender under the Company's prior Secured Financing Facility. This amendment allows the Company to exclude the expense associated with a one-time payment of \$16.9 million in connection with its termination of all future obligations under its Secured Financing Facility as further discussed below.

Effective October 19, 2007, the Company amended the Revolving Credit Facility to change the definition of "change of control" to exclude from that definition acquisitions of stock by Red Mountain Capital Partners LLC ( "Red Mountain" ), JCF FPK I LP ( "JCF FPK" ) and their respective affiliates.

Effective July 3, 2008, the Company amended the Revolving Credit Facility to expand the capacity from \$230.0 million to \$335.0 million. This amendment added three additional lenders to the syndicate of lenders in the Revolving Credit Facility and increased the applicable margin under certain circumstances between 25 and 75 basis points.

Other provisions of the amended Revolving Credit Facility include:

Interest at a floating rate equal to, at the Company's option, either: (a) reserve adjusted LIBOR plus a spread that ranges from 225 to 275 basis points, depending on the Company's leverage; or (b) the higher of the federal funds

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rate then in effect plus a spread of 50 basis points or the prime rate plus a spread that ranges from 25 to 75 basis points.

\$5.0 million sub-limits for swingline loans and letters of credit.

A borrowing base that provides for an 85.0% initial advance rate for the purchase of qualified receivable portfolios. The borrowing base reduces for each qualifying portfolio by 3% per month beginning after the third complete month subsequent to the initial purchase. The aggregate borrowing base is equal to the lesser of (a) the sum of all of the borrowing bases of all qualified receivable portfolios under this facility, as defined above, or (b) 95% of the net book value of all receivable portfolios acquired on or after January 1, 2005.

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

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

Collateralization by all assets of the Company.

At March 31, 2009, the outstanding balance on the Revolving Credit Facility was \$253.0 million, which bore a weighted average interest rate of 4.01%. The aggregate borrowing base was \$278.6 million, of which \$25.6 million was available for future borrowings.

**Derivative Instruments**

On April 11, 2007, the Company entered into two separate interest rate swap agreements intended to more effectively manage interest rates by establishing a set level of fixed rates associated with a portion of the borrowings under its Revolving Credit Facility. The first agreement is for a notional amount of \$25.0 million, a term of three years and a fixed interest rate of 4.99%. The second agreement is for a notional amount of \$25.0 million, a term of four years and a fixed interest rate of 5.01%. Giving effect to these hedges, the interest rate the Company will pay on \$50.0 million of the outstanding balance under the Revolving Credit Facility will be the fixed interest rates mentioned above plus the required credit spread. In accordance with FAS 133, the Company designates its interest rate swap instruments as cash flow hedges.

FAS 133 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 is recorded in other comprehensive income. The ineffective portion of the change in fair value of the derivative, 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. Accordingly, no gain or loss has been recognized in earnings for the three months ended March 31, 2009 and 2008. The change in fair value recognized in accumulated other comprehensive loss represented a gain of \$0.3 million and a loss of \$1.4 million for the three months ended March 31, 2009 and 2008, respectively. As of March 31, 2009, the fair value of the hedges represented a liability of \$3.2 million.

|   | Fair Values of Derivative Instruments (in thousands) |            |                         |            |
|---|--|------------|-------------------------|------------|
|   | Liability Derivatives                                |            |                         |            |
|   | As of March 31, 2009                                 |            | As of December 31, 2008 |            |
|   | Balance Sheet Location                               | Fair Value | Balance Sheet Location  | Fair Value |
| Derivatives designated as hedging instruments under FAS 133 |  |            |                         |            |
| Interest rate swaps   | Other liabilities                                    | \$ 3,176   | Other liabilities       | \$ 3,483   |

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The Effect of Derivative Instruments on the Statements of Income for the Three Months Ended March 31, 2009 and 2008 (in thousands)

| Derivatives in FAS  | Amount of Gain or (Loss)<br>Recognized in OCI on<br>Derivative (Effective<br>Portion) |            | Location of Gain<br>or (Loss)<br>Reclassified from<br>Accumulated OCI<br>into Income<br>(Effective Portion) | Amount of Gain or (Loss)<br>Reclassified from<br>Accumulated OCI into<br>Income (Effective Portion) |      | Location of Gain<br>or (Loss)<br>Recognized in<br>Income<br>(Ineffective<br>Portion and<br>Amount Excluded<br>from Effectiveness<br>Testing) | Amount of Gain or (Loss)<br>Recognized in Income<br>(Ineffective Portion and<br>Amount Excluded from<br>Effectiveness Testing) |      |
|---------------------|---|------------|---|---|------|--|--|------|
|                     | 2009  | 2008       |   | 2009  | 2008 |  | 2009   | 2008 |
| 133 Cash Flow       |   |            |   |   |      |  |  |      |
| Hedging             |   |            |   |   |      |  |  |      |
| Relationships       |   |            |   |   |      |  |  |      |
| Interest rate swaps | \$ 307  | \$ (1,430) | Interest  | \$  | \$   | Other income   | \$   | \$   |

**Table of Contents****Capital Lease Obligations**

The Company has capital lease obligations for certain computer equipment. These lease obligations require monthly payments aggregating approximately \$20,000 through November 2011 and have an implicit interest rate of approximately 6.9%.

The Company finances certain leasehold improvement projects with its lessors in its Phoenix and St. Cloud facilities. As of March 31, 2009, the Company's combined obligation was approximately \$1.2 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 8: Income Taxes**

The Company recorded an income tax provision of \$6.0 million, reflecting an effective rate of 39.9% of pretax income during the three months ended March 31, 2009. The effective tax rate for the three months ended March 31, 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% and the benefit of permanent book versus tax differences of 0.2%. Effective January 1, 2009, the Company retrospectively adjusted its prior years' income tax provisions for the change in accounting principle related to its accounting for Convertible Notes. See Note 12 for additional information on the change in accounting principle. The adjusted income tax provision for the three months ended March 31, 2008, was \$4.5 million, reflecting an effective rate of 40.0% of pretax income. The effective tax rate for the three months ended March 31, 2008, consists primarily of a provision for Federal income taxes of 32.1% (which is net of a benefit for state taxes of 2.9%), a provision for state taxes of 8.2%, and the benefit of permanent book versus tax differences of 0.3%.

Effective January 1, 2007, the Company adopted the provisions of Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48). As of March 31, 2009, the Company had a gross unrecognized tax benefit of \$1.2 million that, if recognized, would result in a net tax benefit of approximately \$0.9 million and would have a positive effect on the Company's effective tax rate. During the three months ended March 31, 2009, there were no material changes to the unrecognized tax benefit.

For the three months ended March 31, 2009, 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 months ended March 31, 2009, were approximately \$0.2 million. 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, 2010. The impact of the tax holiday on the Company's condensed consolidated financial statements is not material.

**Note 9: Purchase Concentrations**

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

|                            | Concentration of Initial Purchase<br>Cost by Seller for the Three<br>Months Ended March 31, 2009 |        |
|----------------------------|--|--------|
|                            | Cost   | %      |
| Seller 1                   | \$ 19,343  | 34.6%  |
| Seller 2                   | 12,274   | 22.0%  |
| Seller 3                   | 10,987   | 19.7%  |
| Seller 4                   | 5,440  | 9.7%   |
| Seller 5                   | 3,299  | 5.9%   |
| Other                      | 4,570  | 8.1%   |
|                            | \$ 55,913  | 100.0% |
| Adjustments <sup>(1)</sup> | (371)  |        |
| Purchases, net             | \$ 55,542  |        |

(1) Adjusted for Put-backs and Recalls.

**Table of Contents****Note 10: Commitments and Contingencies*****Litigation***

On October 18, 2004, Timothy W. Moser, one of the Company's former officers, filed an action in the United States District Court for the Southern District of California against the Company, and certain individuals, including several of the Company's officers and directors. On February 14, 2005, the Company was served with an amended complaint in this action alleging defamation, intentional interference with contractual relations, breach of contract, breach of the covenant of good faith and fair dealing, intentional and negligent infliction of emotional distress and civil conspiracy arising out of certain statements in the Company's Registration Statement on Form S-1, originally filed in September 2003, and alleged to be included in the Company's Registration Statement on Form S-3 originally filed in May 2004. The amended complaint seeks injunctive relief, economic and punitive damages in an unspecified amount plus an award of profits allegedly earned by the defendants and alleged co-conspirators as a result of the alleged conduct, in addition to attorney's fees and costs. On May 2, 2006, the court denied the Company's special motion to strike pursuant to California's anti-SLAPP statute, denied in part and granted in part the Company's motion to dismiss, denied a variety of *ex parte* motions and applications filed by the plaintiff and denied the plaintiff's motion for leave to conduct discovery or file supplemental briefing. The court granted the plaintiff 30 days in which to further amend his complaint, and on June 1, 2006, the plaintiff filed a second amended complaint in which he amended his claim for negligent infliction of emotional distress. On May 25, 2006, the Company filed a notice of appeal of the court's order denying the anti-SLAPP motion and on June 16, 2006, the Company filed a motion to stay the case pending the outcome of the appeal, which was granted. Oral argument on the appeal was heard on July 17, 2008, and on July 28, 2008, the appellate court affirmed the trial court's denial of the Company's anti-SLAPP motion. The appellate court denied the Company's request for a rehearing and the case has been returned to the district court where it is proceeding from the point at which it was stayed. Discovery is continuing and management believes the claims are without merit and intends to defend the action vigorously. Although the outcome of this matter cannot be predicted with certainty, management does not currently believe that this matter will have a material adverse effect on the Company's consolidated financial position or results of operations.

On September 7, 2005, Mr. Moser filed a related action in the United States District Court for the Southern District of California against Triarc Companies, Inc. (Triarc), which at the time was a significant stockholder of the Company, alleging intentional interference with contractual relations and intentional infliction of emotional distress. The case arises out of the same statements made or alleged to have been made in the Company's Registration Statements mentioned above. On January 7, 2006, Triarc was served with an amended complaint seeking injunctive relief, an order directing Triarc to issue a statement of retraction or correction of the allegedly false statements, economic and punitive damages in an unspecified amount and attorney's fees and costs. Triarc tendered the defense of this action to the Company, and the Company accepted the defense and will indemnify Triarc, pursuant to the indemnification provisions of the Registration Rights Agreements dated as of October 31, 2000 and February 21, 2002, and the Underwriting Agreements dated September 25, 2004 and January 20, 2005 to which Triarc is a party. Although the outcome of this matter cannot be predicted with certainty, management does not currently believe that this matter will have a material adverse effect on the Company's consolidated financial position or results of operations.

Claims based on the Fair Debt Collection Practices Act (FDCPA) and comparable state statutes may result in class action lawsuits, which can be material to the Company due to the remedies available under these statutes, including punitive damages. A number of cases styled as class actions have been filed against the Company. A class has been certified in several of these cases. Several of these cases present novel issues on which there is no legal precedent. As a result, the Company is unable to predict the range of possible outcomes. 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 actual damages arising from alleged misconduct or improper reporting of credit information by the Company or its employees or agents. Although litigation is inherently uncertain, based on past experience, the information currently available and the possible availability of insurance and/or indemnification in some cases, management of the Company does not believe that the currently pending and threatened litigation or claims will have a material adverse effect on the Company's consolidated financial position or results of operations. However, future events or circumstances, currently unknown to management, will determine whether the resolution of pending or threatened litigation or claims will ultimately have a material effect on the Company's consolidated financial position, liquidity or results of operations in any future reporting periods.

***Purchase Commitments***

In the normal course of business, the Company enters into forward flow purchase agreements and other purchase commitment agreements. As of March 31, 2009, the Company has entered into agreements to purchase receivable portfolios with a face value of approximately \$1.1 billion for a purchase price of approximately \$46.1 million. Certain of these



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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, except as discussed below.

In connection with the Company's acquisition of certain assets of Jefferson Capital in June 2005, the Company entered into a forward flow agreement to purchase a minimum of \$3.0 billion in face value of credit card charge-offs over a five-year period at a fixed price.

On June 10, 2008, the Federal Trade Commission (the "FTC") announced that it had sued Jefferson Capital and its parent company, CompuCredit Corporation, alleging, among other allegations, that Jefferson Capital and CompuCredit had violated the FTC Act with deceptive marketing practices when issuing credit cards. The FTC announced on December 19, 2008, that it had agreed to a settlement of the litigation with Jefferson Capital and CompuCredit, whereby those companies will credit approximately \$114.0 million to certain customer accounts. Jefferson Capital and CompuCredit have advised the Company that a substantial number of the accounts affected by the settlement had been sold to the Company.

On July 15, 2008, the Company gave Jefferson Capital and CompuCredit Corporation, notice of breach by Jefferson Capital and CompuCredit of the Asset Purchase and Forward Flow Agreement dated June 2, 2005, as amended, as well as a related Balance Transfer Agreement dated the same date, based upon the actions noted in the FTC complaint. On July 16, 2008, the Company initiated arbitration as a result of the breach, pursuant to the arbitration provisions of the Agreements. The Company asserts that the litigation initiated by the FTC violates the Asset Purchase and Forward Flow Agreement and Balance Transfer Agreement in several respects. The Company seeks an arbitral award that (i) Jefferson Capital and CompuCredit are in material breach of the Agreements, (ii) declares the Company's obligations to purchase forward flow accounts under the Agreements is thereby excused or discharged, (iii) confirms the Company's rights to cause Jefferson Capital to repurchase certain accounts previously sold to the Company under the Agreements, and other appropriate relief, including return of prepaid amounts relating to forward flow purchases, (iv) confirms the Company's rights to indemnity by Jefferson Capital and CompuCredit and (v) awards compensatory damages, attorney fees, interest, arbitration costs and other appropriate relief.

Arbitrators have been identified and the proceeding is in the discovery stage. The Company has ceased forward flow purchases of accounts from Jefferson Capital, the sale of bankrupt accounts to Jefferson Capital and participation in a balance transfer program with CompuCredit. The Company's remaining purchase commitment at the time of the breach by Jefferson Capital was approximately \$51.3 million. In response to the Notice of Breach from the Company, Jefferson Capital and CompuCredit delivered its own Notice of Default to the Company alleging the breach by the Company of the Company's forward flow purchase, bankruptcy sale and balance transfer obligations and initiated a separate arbitration of the Company's alleged breach of its bankruptcy sale obligations.

This matter is in the early stages of development and any impact on the recoverability of the Company's forward flow asset, currently stated at \$10.3 million, is uncertain. The condensed consolidated financial statements do not include any adjustment that might result from the outcome of this uncertainty.

**Note 11: Securities Repurchase Program**

On February 27, 2007, the Company's board of directors authorized a securities repurchase program under which the Company may buy back up to \$50 million (at cost) of a combination of its common stock and Convertible Notes. The purchases may be made from time to time in the open market or through privately negotiated transactions and will be dependent upon various business and financial considerations. Securities repurchases are subject to compliance with applicable legal requirements and other factors. During the three months ended March 31, 2009, the Company repurchased \$25.6 million principal amount of its outstanding Convertible Notes, for a total price of \$19.8 million, plus accrued interest. From the inception of the securities repurchase program, the Company has repurchased \$54.2 million principal amount of its Convertible Notes, for a total cash payment of \$39.9 million. The Company has not repurchased any common stock under this program.

**Table of Contents****Note 12: Change in Accounting Principle**

Effective January 1, 2009, the Company adopted the provisions of FASB Staff Position No. APB 14-1 ( FSP APB 14-1 ), *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)*. FSP APB 14-1 applies to convertible debt instruments that may be settled in cash upon conversion, including partial cash settlement, when the conversion option does not need to be bifurcated and accounted for separately as a derivative instrument in accordance with FAS 133.

FSP APB 14-1 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. FSP APB 14-1 requires retrospective application and, accordingly, the prior periods' financial statements included herein have been adjusted.

In accordance with the provisions of FSP APB 14-1, 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*):

|   | March 31,<br>2009 | December 31,<br>2008<br>Adjusted |
|---|-------------------|----------------------------------|
| Liability component - principal amount    | \$ 45,845         | \$ 71,422                        |
| Unamortized debt discount                 | (4,264)           | (7,664)                          |
| Liability component - net carrying amount | 41,581            | 63,758                           |
| 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% for the three months ended March 31, 2009 and 2008.

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

|  | For the Three Months Ended<br>March 31,<br>2009 | March 31,<br>2008<br>Adjusted |
|--|---|-------------------------------|
| Interest expense - stated coupon rate            | \$ 540  | \$ 844                        |
| Interest expense - amortization of debt discount | 910   | 1,299                         |
| Total interest expense - convertible notes       | \$ 1,450  | \$ 2,143                      |

**Table of Contents****Effect of Change in Accounting Principle to Consolidated Statements of Financial Condition**

The following table summarizes the effect of the change in accounting principle related to the Company's Convertible Notes on the consolidated statements of financial condition as of March 31, 2009 and December 31, 2008 (*in thousands*):

|   | March 31, 2009                                     |   | As of            |                        | December 31, 2008 |                  |
|---|--|---|------------------|------------------------|-------------------|------------------|
|   | As computed without change in accounting principle | As reported with change in accounting principle | Effect of Change | As Previously Reported | As Adjusted       | Effect of Change |
| <b>Assets:</b>                                      |  |   |                  |                        |                   |                  |
| Cash and cash equivalents                           | \$ 4,261   | \$ 4,261  | \$               | \$ 10,341              | \$ 10,341         | \$               |
| Accounts receivable, net                            | 1,775  | 1,775   |                  | 1,757                  | 1,757             |                  |
| Investment in receivable portfolios, net            | 473,484  | 473,484   |                  | 461,346                | 461,346           |                  |
| Deferred court costs                                | 30,645   | 30,645  |                  | 28,335                 | 28,335            |                  |
| Property and equipment, net                         | 6,279  | 6,279   |                  | 6,272                  | 6,272             |                  |
| Prepaid income tax                                  | 2,590  | 2,515   | (75)             | 7,935                  | 7,935             |                  |
| Forward flow asset                                  | 10,302   | 10,302  |                  | 10,302                 | 10,302            |                  |
| Other assets  | 4,823  | 4,703   | (120)            | 5,286                  | 5,067             | (219)            |
| Goodwill  | 15,985   | 15,985  |                  | 15,985                 | 15,985            |                  |
| Identifiable intangible assets, net                 | 1,578  | 1,578   |                  | 1,739                  | 1,739             |                  |
| <b>Total Assets</b>                                 | <b>\$ 551,722</b>                                  | <b>\$ 551,527</b>                               | <b>\$ (195)</b>  | <b>\$ 549,298</b>      | <b>\$ 549,079</b> | <b>\$ (219)</b>  |
| <b>Liabilities:</b>                                 |  |   |                  |                        |                   |                  |
| Accounts payable and accrued liabilities            | \$ 17,805  | \$ 17,805                                       | \$               | \$ 18,204              | \$ 18,204         | \$               |
| Deferred tax liabilities, net                       | 15,344   | 15,253  | (91)             | 15,199                 | 15,108            | (91)             |
| Deferred revenue and purchased servicing obligation | 5,229  | 5,229   |                  | 5,203                  | 5,203             |                  |
| Debt  | 300,620  | 296,356   | (4,264)          | 311,319                | 303,655           | (7,664)          |
| Other liabilities                                   | 3,176  | 3,176   |                  | 3,483                  | 3,483             |                  |
| <b>Total liabilities</b>                            | <b>342,174</b>                                     | <b>337,819</b>                                  | <b>(4,355)</b>   | <b>353,408</b>         | <b>345,653</b>    | <b>(7,755)</b>   |
| <b>Stockholders' equity:</b>                        |  |   |                  |                        |                   |                  |
| Common Stock  | 231  | 231   |                  | 231                    | 231               |                  |
| Additional paid-in capital                          | 82,470   | 99,622  | 17,152           | 79,971                 | 98,521            | 18,550           |
| Accumulated earnings                                | 128,784  | 115,792   | (12,992)         | 117,809                | 106,795           | (11,014)         |
| Accumulated other comprehensive loss                | (1,937)  | (1,937)   |                  | (2,121)                | (2,121)           |                  |
| <b>Total stockholders' equity</b>                   | <b>209,548</b>                                     | <b>213,708</b>                                  | <b>4,160</b>     | <b>195,890</b>         | <b>203,426</b>    | <b>7,536</b>     |
| <b>Total liabilities and stockholders' equity</b>   | <b>\$ 551,722</b>                                  | <b>\$ 551,527</b>                               | <b>\$ (195)</b>  | <b>\$ 549,298</b>      | <b>\$ 549,079</b> | <b>\$ (219)</b>  |

**Table of Contents****Effect of Change in Accounting Principle to Consolidated Statements of Income**

The following table summarizes the effect of change in accounting principle related to the Company's Convertible Notes on the consolidated statements of income for the three months ended March 31, 2009 and 2008 (*in thousands*):

|   | Three Months Ended March 31,                                      |  |                     |                           |             |                     |
|---|---|--|---------------------|---------------------------|-------------|---------------------|
|   | 2009  |  |                     | 2008                      |             |                     |
|   | As computed<br>without<br>change<br>in<br>accounting<br>principle | As reported<br>with change<br>in accounting<br>principle | Effect of<br>Change | As Previously<br>Reported | As Adjusted | Effect of<br>Change |
| Total revenue   | \$ 76,446   | \$ 76,446  | \$                  | \$ 67,554                 | \$ 67,554   | \$                  |
| Total operating expenses                              | 60,175  | 60,175   |                     | 51,115                    | 51,115      |                     |
| Income before other (expense) income and income taxes | 16,271  | 16,271   |                     | 16,439                    | 16,439      |                     |
| Other (expense) income                                |   |  |                     |                           |             |                     |
| Interest expense                                      | (3,389)   | (4,273)  | (884)               | (3,946)                   | (5,200)     | (1,254)             |
| Gain on repurchase of convertible notes, net          | 5,470   | 3,053  | (2,417)             |                           |             |                     |
| Other income  | (81)  | (81)   |                     | 21                        | 21          |                     |
| Total other expense                                   | 2,000   | (1,301)  | (3,301)             | (3,925)                   | (5,179)     | (1,254)             |
| Income before income taxes                            | 18,271  | 14,970   | (3,301)             | 12,514                    | 11,260      | (1,254)             |
| Provision for income taxes                            | (7,296)   | (5,973)  | 1,323               | (5,014)                   | (4,509)     | 505                 |
| Net income  | \$ 10,975   | \$ 8,997   | \$ (1,978)          | \$ 7,500                  | \$ 6,751    | \$ (749)            |
| Earnings Per Share:                                   |   |  |                     |                           |             |                     |
| Basic   | \$ 0.47   | \$ 0.39  | \$ (0.08)           | \$ 0.33                   | \$ 0.29     | \$ (0.04)           |
| Diluted   | \$ 0.46   | \$ 0.38  | \$ (0.08)           | \$ 0.32                   | \$ 0.29     | \$ (0.03)           |

**Effect of Change in Accounting Principle to Consolidated Statements of Stockholders' Equity**

The following table summarizes the effect of change in accounting principle related to the Company's Convertible Notes on the consolidated statements of stockholders' equity for the three months ended March 31, 2009 and 2008 (*in thousands*):

|   | Three Months Ended March 31,                                   |  |                     |                           |             |                     |
|---|--|--|---------------------|---------------------------|-------------|---------------------|
|   | 2009   |  |                     | 2008                      |             |                     |
|   | As computed<br>without<br>change in<br>accounting<br>principle | As reported<br>with change<br>in accounting<br>principle | Effect of<br>Change | As Previously<br>Reported | As Adjusted | Effect of<br>Change |
| <b>Balance, beginning of the period</b>               | \$ 195,890   | \$ 203,426   | \$ 7,536            | \$ 171,520                | \$ 187,435  | \$ 15,915           |
| Net income  | 10,975   | 8,997  | (1,978)             | 7,500                     | 6,751       | (749)               |
| Other comprehensive gain (loss):                      |  |  |                     |                           |             |                     |
| Unrealized gain (loss) on cash flow hedge, net of tax | 184  | 184  |                     | (853)                     | (853)       |                     |
| Exercise of stock options                             |  |  |                     | 2                         | 2           |                     |
| Stock-based compensation                              | 1,080  | 1,080  |                     | 1,094                     | 1,094       |                     |
| Tax benefit related to stock option exercises         | 21   | 21   |                     | 5                         | 5           |                     |
| Tax benefit from convertible note interest expense    | 375  |  | (375)               | 536                       | 12          | (524)               |

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|  |            |            |          |            |            |           |
|--|------------|------------|----------|------------|------------|-----------|
| Tax benefit from repurchase of convertible notes | 1,023      | (1,023)    |          |            |            |           |
| <b>Balance, end of the period</b>                | \$ 209,548 | \$ 213,708 | \$ 4,160 | \$ 179,804 | \$ 194,446 | \$ 14,642 |

**Table of Contents****Effect of Change in Accounting Principle to Consolidated Statements of Cash Flows**

The following table summarizes the effect of change in accounting principle related to the Company's Convertible Notes on the consolidated statements of cash flows for the three months ended March 31, 2009 and 2008 (*in thousands*):

|   | Three Months Ended March 31,                                   |   |                     |   |             |                     |
|---|--|---|---------------------|---|-------------|---------------------|
|   | 2009   |   | 2008                |   |             |                     |
|   | As computed<br>without<br>change in<br>accounting<br>principle | As reported<br>with change<br>in<br>accounting<br>principle | Effect of<br>Change | As<br>Previously<br>Reported <sup>(1)</sup> | As Adjusted | Effect of<br>Change |
| <b>Operating activities:</b>  |  |   |                     |   |             |                     |
| Net Income  | \$ 10,975  | \$ 8,997  | \$ (1,978)          | \$ 7,500                                    | \$ 6,751    | \$ (749)            |
| Adjustments to reconcile net income to net cash provided by operating activities: |  |   |                     |   |             |                     |
| Depreciation and amortization   | 623  | 623   |                     | 722   | 722         |                     |
| Amortization of loan costs and debt discount                                      | 311  | 1,221   | 910                 | 313   | 1,567       | 1,254               |
| Stock-based compensation expense  | 1,080  | 1,080   |                     | 1,094                                       | 1,094       |                     |
| Gain on repurchase of convertible notes, net                                      | (5,470)  | (3,053)   | 2,417               |   |             |                     |
| Deferred income tax expense (benefit)   | 145  | 145   |                     | (578)                                       | (559)       | 19                  |
| Tax benefit from stock-based payment arrangements                                 | (21)   | (21)  |                     | (5)   | (5)         |                     |
| Provision for impairment on receivable portfolios, net                            | 5,427  | 5,427   |                     | 5,335                                       | 5,335       |                     |
| Changes in operating assets and liabilities                                       |  |   |                     |   |             |                     |
| Other assets  | (139)  | (165)   | (26)                | 1,386                                       | 1,386       |                     |
| Deferred court costs  | (2,310)  | (2,310)   |                     | (2,906)                                     | (2,906)     |                     |
| Prepaid income tax  | 6,764  | 5,441   | (1,323)             | 5,343                                       | 4,819       | (524)               |
| Deferred revenue and purchased service obligation                                 | 26   | 26  |                     | 185   | 185         |                     |
| Accounts payable and accrued liabilities  | (523)  | (523)   |                     | (2,559)                                     | (2,559)     |                     |
| Net cash provided by operating activities   | 16,888   | 16,888  |                     | 15,830                                      | 15,830      |                     |
| <b>Investing activities:</b>  |  |   |                     |   |             |                     |
| Net cash used in investing activities   | (18,034)   | (18,034)  |                     | (9,524)                                     | (9,524)     |                     |
| <b>Financing activities:</b>  |  |   |                     |   |             |                     |
| Net cash used in financing activities   | (4,934)  | (4,934)   |                     | (2,245)                                     | (2,245)     |                     |
| Net (decrease) increase in cash   | (6,080)  | (6,080)   |                     | 4,061                                       | 4,061       |                     |
| Cash and cash equivalents, beginning of period                                    | 10,341   | 10,341  |                     | 8,676                                       | 8,676       |                     |
| Cash and cash equivalents, end of period  | \$ 4,261   | \$ 4,261  | \$                  | \$ 12,737                                   | \$ 12,737   | \$                  |

<sup>(1)</sup> Certain reclassifications have been made to conform to the current year's presentation. The Company reclassified \$3.7 million of restricted cash as of March 31, 2008 from restricted cash to cash and cash equivalents in order to conform to the current year's presentation.

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

This information should be read in conjunction with the condensed consolidated financial statements and the notes thereto included in Item 1 of Part I of this Quarterly Report on Form 10-Q and the audited consolidated financial statements and notes thereto and Management's Discussion and Analysis of Financial Condition and Results of Operations for the year ended December 31, 2008 contained in our 2008 Annual Report on Form 10-K. The Form 10-K contains a general description of our industry and a discussion of recent trends affecting the industry. Certain statements herein may constitute forward-looking statements under the Private Securities Litigation Reform Act of 1995 (the Reform Act), for which we claim the protection of the safe harbor of the Reform Act. See Part II, Item 1A Risk Factors for more discussion on our forward-looking statements.

#### **Introduction**

We are a systems-driven purchaser and manager of charged-off consumer receivable portfolios and a provider of bankruptcy services to the finance industry. We acquire receivable portfolios at deep discounts from their face values using our proprietary valuation process that is based on the consumer attributes of the underlying accounts. Based upon the ongoing analysis of these accounts, we employ a dynamic mix of collection strategies to maximize our return on investment.

#### **Market Overview**

The United States and global economies are currently in a recession. In the U.S., the availability of credit is limited, unemployment rates are at 25-year highs, credit card charge-offs and delinquencies have reached a 20-year high increasing nearly 50% from first quarter 2008 levels, home foreclosures have dramatically increased and the housing market is experiencing a significant downturn. These conditions present both opportunities and challenges for Encore.

On the opportunities side, the increase in credit card charge-offs and delinquencies (which contribute to an increase in supply), combined with the challenges some of our competitors are facing in (i) generating sufficient returns on receivables they purchased in 2005 - 2007, when prices were high and (ii) obtaining sufficient capital to fund future purchases (which contributes to a decrease in demand) have resulted in a significant reduction in the market price for portfolios of charged-off receivables. For example, prices for fresh charge-offs (receivables that are sold immediately after charge-off) have declined from 8% - 13% of face value in early 2008 to 5% - 8% of face value in early 2009. We have seen similar pricing declines across all ages of charge-offs and the decline is more pronounced in the resale market. While this is generally positive for our business, as a result of the significant price decline, some sellers of portfolio have chosen not to sell and, as an alternative to selling their charge-offs, have collected on accounts internally or placed accounts with third-party collection agencies. As such, the full impact the price reduction will have on our purchasing volumes is presently unclear.

On the challenges side, increases in unemployment, high foreclosure rates and the difficulties consumers are experiencing in obtaining credit may, for a period of time, negatively impact collections on receivables that we currently own or that we purchase during these challenging economic times. Despite these market conditions, during 2008, most of the collection metrics we track have remained relatively consistent, as compared to 2007. For example, payer rates and average payment size, adjusted for the change in single payment/payment plan mix, have remained relatively constant. One change we have noted is that more consumers are settling their debts through payment plans rather than in one-time settlements. While settlement rates remain consistent, payments made over longer periods of time impact our business in two ways. First, when payments are extended over longer periods of time rather than received up front, this delay in cash flows could result in a provision for impairment. This is because discounting a long-term payment stream using our pool group IRRs rather than discounting a one-time settlement payment using the same IRR will result in a lower net present value. As a result, even if the cash received through long-term payment plans is the same as the cash received through one-time settlements, accounting for the stream of payments under SOP 03-3 may result in a provision for impairment. Second, when debts are settled through payment plans, there is a possibility that consumers will not make all of the payments required by those plans. We refer to consumers who do not make all of their payments as broken payers. 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 get the consumer back on plan, we experience a shortfall in collections. We believe that this shift from single payment settlements to payment streams is one reason for the provision for impairment experienced in the first quarter of 2009. Despite the current economic environment, we have not experienced an increase in the broken payer rate in the first quarter of 2009 as compared to the same period in 2008. Please refer to Management's Discussion and Analysis - Revenue below for a more detailed explanation of the provision for impairment for the three months ended March 31, 2009.

As a result of the uncertainties presented by the current economic environment, we believe we are applying conservative assumptions when valuing portfolios for purchase and when establishing our forecasted collections. Additionally, while we





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believe that consumers who are currently charging off their debt (when economic conditions are bad) are more likely to recover faster than consumers who charged off their debt historically (when economic times were good), we have not factored any such recovery into our forecasts.

When evaluating the overall, long-term returns of our business, we believe that the benefits resulting from the current lower portfolio pricing will outweigh the negative impacts from the collection shortfalls we may experience from a more distressed consumer. However, if the lower pricing environment re-attracts significant capital to our industry and prices are bid up, or if the ability of the consumer to repay their debt deteriorates further, our returns would be negatively impacted.

**Purchases and Collections*****Purchases by Paper Type***

The following tables summarize the types of charged-off consumer receivable portfolios we purchased for the three months ended March 31, 2009 and 2008 (*in thousands*):

|             | <b>Three Months Ended<br/>March 31,</b> |                  |
|-------------|---|------------------|
|             | <b>2009</b>                             | <b>2008</b>      |
| Credit card | \$ 55,913                               | \$ 45,280        |
| Other       |   | 2,622            |
|             | <b>\$ 55,913</b>                        | <b>\$ 47,902</b> |

During the three months ended March 31, 2009, we invested \$55.9 million for portfolios with face values aggregating \$1.3 billion for an average purchase price of 4.2% of face value. This is an \$8.0 million increase, or 16.7%, in the amount invested, compared with the \$47.9 million invested during the three months ended March 31, 2008, to acquire portfolios with a face value aggregating \$1.2 billion for an average purchase price of 4.0% of face value. 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***

During the three months ended March 31, 2009 and 2008, we utilized several 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 thousands*):

|                                  | <b>Three Months Ended March 31,</b> |                   |
|----------------------------------|-------------------------------------|-------------------|
|                                  | <b>2009</b>                         | <b>2008</b>       |
| Collection sites                 | \$ 50,342                           | \$ 43,289         |
| Legal collections                | 56,407                              | 45,292            |
| Collection agencies              | 7,667                               | 10,961            |
| Sales                            | 817                                 | 4,214             |
| Other                            |                                     | 599               |
| Gross collections for the period | <b>\$ 115,233</b>                   | <b>\$ 104,355</b> |

Gross collections increased \$10.8 million, or 10.4%, to \$115.2 million during the three months ended March 31, 2009, from \$104.4 million during the three months ended March 31, 2008.

**Table of Contents****Results of Operations**

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

|  | <b>Three Months Ended March 31,</b> |               |                               |               |
|--|-------------------------------------|---------------|-------------------------------|---------------|
|  | <b>2009</b>                         |               | <b>2008</b>                   |               |
|  |                                     |               | <b>Adjusted<sup>(1)</sup></b> |               |
| <b>Revenue</b>   |                                     |               |                               |               |
| Revenue from receivable portfolios, net                      | \$ 72,275                           | 94.5%         | \$ 64,068                     | 94.8%         |
| Servicing fees and other related revenue                     | 4,171                               | 5.5%          | 3,486                         | 5.2%          |
| <b>Total revenue</b>   | <b>76,446</b>                       | <b>100.0%</b> | <b>67,554</b>                 | <b>100.0%</b> |
| <b>Operating expenses</b>                                    |                                     |               |                               |               |
| Salaries and employee benefits                               | 13,957                              | 18.3%         | 14,851                        | 22.0%         |
| Stock-based compensation expense                             | 1,080                               | 1.4%          | 1,094                         | 1.6%          |
| Cost of legal collections                                    | 29,947                              | 39.2%         | 20,306                        | 30.1%         |
| Other operating expenses                                     | 5,980                               | 7.8%          | 5,651                         | 8.4%          |
| Collection agency commissions                                | 2,891                               | 3.8%          | 4,031                         | 6.0%          |
| General and administrative expenses                          | 5,697                               | 7.4%          | 4,460                         | 6.6%          |
| Depreciation and amortization                                | 623                                 | 0.8%          | 722                           | 1.0%          |
| <b>Total operating expenses</b>                              | <b>60,175</b>                       | <b>78.7%</b>  | <b>51,115</b>                 | <b>75.7%</b>  |
| <b>Income before other (expense) income and income taxes</b> | <b>16,271</b>                       | <b>21.3%</b>  | <b>16,439</b>                 | <b>24.3%</b>  |
| <b>Other (expense) income</b>                                |                                     |               |                               |               |
| Interest expense   | (4,273)                             | (5.6)%        | (5,200)                       | (7.7)%        |
| Gain on repurchase of convertible notes                      | 3,053                               | 4.0%          |                               | 0.0%          |
| Other (expense) income                                       | (81)                                | (0.1)%        | 21                            | 0.0%          |
| <b>Total other expense</b>                                   | <b>(1,301)</b>                      | <b>(1.7)%</b> | <b>(5,179)</b>                | <b>(7.7)%</b> |
| <b>Income before income taxes</b>                            | <b>14,970</b>                       | <b>19.6%</b>  | <b>11,260</b>                 | <b>16.6%</b>  |
| Provision for income taxes                                   | (5,973)                             | (7.8)%        | (4,509)                       | (6.6)%        |
| <b>Net income</b>  | <b>\$ 8,997</b>                     | <b>11.8%</b>  | <b>\$ 6,751</b>               | <b>10.0%</b>  |

<sup>(1)</sup> Adjusted for change in accounting principle related to our convertible senior notes. See Note 12 to our unaudited condensed consolidated financial statements for additional information and the effect of the change in accounting principle to our financial statements.

**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 impairments. 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 ( Zero Basis Portfolios ) are recorded as revenue ( Zero Basis Revenue ). We account for our investment in receivable portfolios utilizing

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the interest method in accordance with the provisions of the AICPA's Statement of Position 03-3, *Accounting for Certain Debt Securities Acquired in a Transfer* ( SOP 03-3 ). Servicing fee revenue is revenue primarily associated with bankruptcy servicing fees earned from our subsidiary, Ascension Capital Group, Inc. ( Ascension ), a provider of bankruptcy services to the finance industry.

Effective January 1, 2008, we revised our Unified Collection Score ( UCS ) and Behavioral Liquidation Score ( BLS ) methodologies by extending our collection forecast from 72 months to 84 months. UCS is a proprietary forecasting tool that generates portfolio level expectations of liquidation for portfolios that we have owned and serviced for more than six months. BLS forecasts portfolio level expectations based on credit characteristics for portfolios owned and serviced less than six

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months. We have observed that receivable portfolios purchased in 2001 and prior have consistently experienced cash collections beyond 72 months from the date of purchase. When we first developed our cash forecasting models in 2001, limited historical collection data was available with which to accurately model projected cash flows beyond 60 months. During the quarter ended June 30, 2006, we determined there was enough additional collection data accumulated over the previous several years, in addition to improvements in our forecasting tools, allowing us to extend the collection forecast to 72 months. During the quarter ended March 31, 2008, we determined that there was enough additional collection data to accurately extend the collection forecast in both our UCS and BLS models to 84 months. The increase in the collection forecast from 72 to 84 months was applied, effective January 1, 2008, to each portfolio for which we could accurately forecast through such term and resulted in an increase in the aggregate total estimated remaining collections for the receivable portfolios by \$67.3 million, or 7.5%, as of March 31, 2008. We did not extend the forecast on telecom portfolios as we do not anticipate significant collections past 72 months on these portfolios. The extension of the collection forecast is treated as a change in estimate and, in accordance with Statement of Financial Accounting Standard No. 154, *Accounting Changes and Error Corrections – a replacement of APB Opinion No. 20 and FASB Statement No. 3*, is being recognized prospectively in our consolidated financial statements. This prospective treatment resulted in a reduction in our net impairment provision of \$3.1 million and an increase in revenue of \$0.1 million for the quarter ended March 31, 2008. The impact of the change in estimate resulted in an increase in net income of \$1.9 million and an increase in fully diluted earnings per share of \$0.08 for the quarter ended March 31, 2008.

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

|       | For the Three Months Ended<br>March 31, 2009 |                                 |   |                                 | As of<br>March 31, 2009             |                         |                               |
|-------|--|---------------------------------|---|---------------------------------|-------------------------------------|-------------------------|-------------------------------|
|       | Collections <sup>(1)</sup>                   | Gross<br>Revenue <sup>(2)</sup> | Revenue<br>Recognition<br>Rate <sup>(3)</sup> | Net<br>(Impairment)<br>Reversal | Revenue<br>% of<br>Total<br>Revenue | Unamortized<br>Balances | Monthly<br>IRR <sup>(4)</sup> |
| ZBA   | \$ 2,500                                     | \$ 2,500                        | 100.0%  | \$                              | 3.2%                                | \$                      |                               |
| 2002  | 909  | 570                             | 62.7%   | 153                             | 0.7%                                | 491                     | 29.8%                         |
| 2003  | 2,349  | 2,185                           | 93.0%   | (409)                           | 2.8%                                | 2,090                   | 30.7%                         |
| 2004  | 3,375  | 2,211                           | 65.5%   | (437)                           | 2.9%                                | 8,073                   | 8.1%                          |
| 2005  | 12,034                                       | 7,782                           | 64.7%   | (1,257)                         | 10.0%                               | 43,103                  | 5.6%                          |
| 2006  | 12,784                                       | 9,049                           | 70.8%   | (990)                           | 11.7%                               | 56,642                  | 5.1%                          |
| 2007  | 33,221                                       | 19,085                          | 57.4%   | (848)                           | 24.6%                               | 107,220                 | 5.4%                          |
| 2008  | 44,944                                       | 31,807                          | 70.8%   | (1,639)                         | 40.9%                               | 200,820                 | 5.0%                          |
| 2009  | 3,010  | 2,513                           | 83.5%   |                                 | 3.2%                                | 55,045                  | 4.2%                          |
| Total | \$ 115,126                                   | \$ 77,702                       | 67.5%   | \$ (5,427)                      | 100.0%                              | \$ 473,484              | 5.3%                          |

|       | For the Three Months Ended<br>March 31, 2008 |                                 |   |                                 | As of<br>March 31, 2008             |                         |                               |
|-------|--|---------------------------------|---|---------------------------------|-------------------------------------|-------------------------|-------------------------------|
|       | Collections <sup>(1)</sup>                   | Gross<br>Revenue <sup>(2)</sup> | Revenue<br>Recognition<br>Rate <sup>(3)</sup> | Net<br>(Impairment)<br>Reversal | Revenue<br>% of<br>Total<br>Revenue | Unamortized<br>Balances | Monthly<br>IRR <sup>(4)</sup> |
| ZBA   | \$ 2,558                                     | \$ 2,558                        | 100.0%  | \$                              | 3.7%                                | \$                      |                               |
| 2002  | 1,665  | 1,351                           | 81.1%   | (69)                            | 1.9%                                | 1,437                   | 27.1%                         |
| 2003  | 4,189  | 3,781                           | 90.3%   | (289)                           | 5.4%                                | 3,714                   | 30.7%                         |
| 2004  | 6,037  | 4,665                           | 77.3%   | (856)                           | 6.7%                                | 18,489                  | 7.8%                          |
| 2005  | 20,936                                       | 13,976                          | 66.8%   | (2,303)                         | 20.2%                               | 78,085                  | 5.6%                          |
| 2006  | 21,575                                       | 13,940                          | 64.6%   | (1,818)                         | 20.1%                               | 86,227                  | 5.1%                          |
| 2007  | 40,032                                       | 25,617                          | 64.0%   |                                 | 36.9%                               | 166,169                 | 4.8%                          |
| 2008  | 7,288  | 3,515                           | 48.2%   |                                 | 5.1%                                | 44,086                  | 4.8%                          |
| Total | \$ 104,280                                   | \$ 69,403                       | 66.6%   | \$ (5,335)                      | 100.0%                              | \$ 398,207              | 5.5%                          |

- (1) Does not include amounts collected on behalf of others.
- (2) Gross revenue excludes the effects of net impairment or net impairment reversals.
- (3) Revenue recognition rate excludes the effects of net impairment or net impairment reversals.
- (4) Our monthly IRR is calculated based on the weighted average of each pool's IRR relative to each pool's percentage of the unamortized balance for each year of purchase. Therefore, it is possible for the monthly IRR to be lower than that reported in the prior quarter due to this weighted average calculation.

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Total revenue was \$76.4 million for the three months ended March 31, 2009, an increase of \$8.8 million, or 13.2%, compared to total revenue of \$67.6 million for the three months ended March 31, 2008. Portfolio revenue increased \$8.2 million, or 12.8%, to \$72.3 million. The increase of portfolio revenue was primarily the result of additional accretion revenue associated with a higher portfolio balance during the three months ending March 31, 2009 compared to the three months ending March 31, 2008. During the three months ended March 31, 2009, we recorded a net impairment provision of \$5.4 million, compared to a net impairment provision of \$5.3 million (net of a reduction in our net impairment provision of \$3.1 million as a result of the extension of our collection forecast discussed above) during the same period in the prior year. The impairments for the three months ended March 31, 2009 and 2008, were primarily due to a shortfall in collections in certain pool groups against our forecast. We believe the shortfall against our forecast was the result of the broadening pressure on our consumers due to a weakening economy as well as to particular challenges we experienced in working certain portfolios. As a result of the deteriorating economic conditions, as mentioned in the Market Overview section above, we have seen a shift in payments from consumers from single payment settlements to payment plans. Payments made over longer periods of time impact our business in two ways. First, when payments are extended over longer periods of time rather than received up front, this delay in cash flows could result in a provision for impairment. This is because discounting a long-term payment stream using our pool group IRRs rather than discounting a one-time settlement payment using the same IRR will result in a lower net present value. As a result, even if the cash received through long-term payment plans is the same as the cash received through one-time settlements, accounting for the stream of payments under SOP 03-3 may result in a provision for impairment. Second, when debts are settled through payment plans, there is a possibility that consumers will not make all of the payments required by those plans. The impact of the broken payers will reduce our overall expected collections, which results in a provision for impairment. This shift from single payment settlements to payment plans has resulted in a decrease in our actual collections, as compared to our forecasts, in certain pool groups.

Until economic conditions improve, we may continue to experience a shortfall in collections against our UCS forecast which, depending on the magnitude of the shortfall and the pool groups that experience such shortfall, may result in future provisions for impairment. In accordance with SOP 03-3, an impairment provision to reduce the book value and therefore, maintain a level yield on a pool group's internal rate of return, is only recorded when current information and events indicate that it is probable that an entity will be unable to collect all of its expected future cash flows, or when the timing of such cash flows is delayed. Since we cannot presently determine the future impact of the current economic conditions on our collections, we cannot conclude that further reductions in cash flows are probable or that the timing of cash flows has changed in a manner that would significantly impact any pool groups' internal rate of return and, therefore, have not recorded a related additional impairment.

Revenue associated with bankruptcy servicing fees earned from Ascension, was \$4.1 million for the three months ended March 31, 2009, an increase of \$0.7 million, or 20.5%, compared to revenue of \$3.4 million for the three months ended March 31, 2008. The increase in Ascension revenue for the three months ended March 31, 2009, is due to a higher volume of bankruptcy placements.

**Operating Expenses**

Total operating expenses were \$60.2 million for the three months ended March 31, 2009, an increase of \$9.1 million, or 17.7%, compared to total operating expenses of \$51.1 million for the three months ended March 31, 2008.

Operating expenses are explained in more detail as follows:

***Salaries and Employee Benefits***

Total salaries and employee benefits decreased by \$0.9 million, or 6.0%, to \$14.0 million during the three months ended March 31, 2009, from \$14.9 million during the three months ended March 31, 2008. The decrease was primarily the result of a decrease of \$1.4 million in salaries and related payroll taxes and benefits, due to a shift in our collection workforce from the United States to India. This decrease was offset by an increase of \$0.5 million in health related expenses.

***Stock-Based Compensation Expenses***

Stock-based compensation expense remained consistent at \$1.1 million during the three months ended March 31, 2009 and 2008.

**Table of Contents****Cost of Legal Collections**

The cost of legal collections increased \$9.6 million, or 47.5%, to \$29.9 million during the three months ended March 31, 2009, compared to \$20.3 million during the three months ended March 31, 2008. 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 \$11.1 million, or 24.5%, in gross collections through our legal channel and upfront litigation costs. Gross legal collections amounted to \$56.4 million during the three months ended March 31, 2009, up from \$45.3 million collected during the three months ended March 31, 2008. The cost of legal collections increased as a percent of gross collections through this channel to 53.1% during the three months ended March 31, 2009, from 44.8% during the three months ended March 31, 2008, primarily due to an increase in upfront court costs expensed associated with our pursuit of legal collections.

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

|                                   | Legal Collections and related costs<br>Three Months Ended March 31, |         |           |         |
|-----------------------------------|---|---------|-----------|---------|
|                                   | 2009  |         | 2008      |         |
| Collections                       | \$ 56,407   | 100.0%  | \$ 45,292 | 100.0%  |
| Court costs advanced              | \$ 20,544   | 36.4%   | \$ 13,894 | 30.7%   |
| Court costs deferred              | (7,241)   | (12.8)% | (7,093)   | (15.7)% |
| Court cost expense <sup>(1)</sup> | 13,303  | 23.6%   | 6,801     | 15.0%   |
| Other <sup>(2)</sup>              | 544   | 1.0%    | 688       | 1.5%    |
| Commissions                       | 16,100  | 28.5%   | 12,817    | 28.3%   |
| Total Costs                       | \$ 29,947   | 53.1%   | \$ 20,306 | 44.8%   |

(1) 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.

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

**Other Operating Expenses**

Other operating expenses increased \$0.3 million, or 5.8%, to \$6.0 million during the three months ended March 31, 2009, compared to \$5.7 million during the three months ended March 31, 2008. The increase was primarily attributable to a \$0.3 million increase in Ascension legal expenses resulting from the higher volume of bankruptcy placements discussed above.

**Collection Agency Commissions**

During the three months ended March 31, 2009, we incurred \$2.9 million in commissions to third party collection agencies, or 37.7% of the related gross collections of \$7.7 million, compared to \$4.0 million in commissions, or 36.8% of the related gross collections of \$11.0 million during the three months ended March 31, 2008. The decrease in commissions was consistent with the decrease in collections through this channel. The increase in the commission rate as a percentage of the related gross collections is primarily due to the mix of accounts placed with the agencies. Commissions as a percentage of collections in 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.

**General and Administrative Expenses**

General and administrative expenses increased \$1.2 million, or 27.7%, to \$5.7 million during the three months ended March 31, 2009, from \$4.5 million during the three months ended March 31, 2008. The increase was primarily the result of an increase of \$1.1 million in corporate legal expenses. Other expenses associated with general corporate matters remained consistent as compared with the prior period.

*Depreciation and Amortization*

Depreciation and amortization expense decreased \$0.1 million, to \$0.6 million during the three months ended March 31, 2009, from \$0.7 million during the three months ended March 31, 2008. Depreciation expense was \$0.4 million for the three



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months ended March 31, 2009, compared to \$0.5 million for the three months ended March 31, 2008. Amortization expense relating to intangible assets acquired in conjunction with the acquisition of Ascension remained consistent at \$0.2 million during the three months ended March 31, 2009 and 2008.

**Cost per Dollar Collected**

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

|                                   | <b>Three Months<br/>Ended March 31,</b> |             |
|-----------------------------------|---|-------------|
|                                   | <b>2009</b>                             | <b>2008</b> |
| Gross collections                 | \$ 115,233                              | \$ 104,355  |
| Operating expenses <sup>(1)</sup> | \$ 55,709                               | \$ 47,283   |
| Cost per dollar collected         | 48.3%                                   | 45.3%       |

<sup>(1)</sup> Represent all operating expenses excluding stock-based compensation expense of \$1.1 million for three months ended March 31, 2009 and 2008 and costs related to Ascension of \$3.4 million and \$2.7 million for the three months ended March 31, 2009 and 2008, respectively.

During the three months ended March 31, 2009, cost per dollar collected increased to 48.3% of gross collections from 45.3% of gross collections during the three months ended March 31, 2008. This increase was primarily due to several factors, as follows:

an increase in upfront litigation costs of \$6.5 million as discussed in costs of legal collections above

a decrease in site salaries and employee benefits of \$0.9 million, primarily due to a shift in our collection workforce from the United States to India

a decrease of \$3.4 million of collections coming from the sales channel (these collections have minimal costs associated with them)

approximately \$1.0 million of incremental corporate legal expenses

**India Expansion**

Due to the strong performance of our team in India and our ability to reduce our overall site cost to collect through the expansion of our offshore collection efforts, on April 22, 2009, we signed a lease for a new, larger site. This site, which is close to our existing site in Gurgaon, India, will allow us to expand our collector headcount from approximately 350 (capacity at our current site) to 1,100. Over the next several months we will be building out this new site and expect to occupy it in October 2009. During this period, we will incur lease costs at our existing and new sites, which will result in incremental lease expense totaling approximately \$1.0 million for the period April 2009 through October 2009. Additionally, there will be costs associated with expanding our workforce in India.

Our plan is to continue to maintain headcount at current levels in our domestic collection sites and leverage India for future growth. As we ramp up headcount in our new, larger India site and migrate more of our collections there, we expect that our overall variable cost to collect will increase and our overall collector productivity will decline. Once we are fully ramped up, we expect that this expansion will have a positive long-term impact on both our overall cost to collect and our productivity.

**Interest Expense**

Total interest expense decreased \$0.9 million, or 17.8%, to \$4.3 million during the three months ended March 31, 2009, from \$5.2 million during the three months ended March 31, 2008.

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

|   | For the Three Months Ended March 31, |                  |           |          |
|---|--------------------------------------|------------------|-----------|----------|
|   | 2009                                 | 2008<br>Adjusted | \$ Change | % Change |
| Stated interest on debt obligations             | \$ 3,053                             | \$ 3,632         | \$ (579)  | (15.9)%  |
| Amortization of loan fees and other loan costs  | 310                                  | 269              | 41        | 15.2%    |
| Amortization of debt discount convertible notes | 910                                  | 1,299            | (389)     | (29.9)%  |
| Total interest expense                          | \$ 4,273                             | \$ 5,200         | \$ (927)  | (17.8)%  |

Interest expense during the three months ended March 31, 2008 was retrospectively adjusted as a result of a change in accounting principle. Effective January 1, 2009, we adopted FASB Staff Position APB 14-1, ( FSP APB 14-1 ) *Accounting*

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for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement). In accordance with the provisions of FSP APB 14-1, we adjusted our prior years financial statements to separately account for the liability and equity components of our convertible senior notes in a manner that reflects our nonconvertible debt borrowing rate at the time of the issuance. As a result, we created a debt discount for our convertible senior notes and incurred additional interest expense due to the amortization of debt discount. See Note 12 to our unaudited condensed consolidated financial statements for a further discussion of this change in accounting principle.

The following table summarizes the impact of adopting FSP APB 14-1 on our interest expense and net debt balance related to our Convertible Notes during the previous reporting periods (*in thousands*):

|                    | Interest Expense For<br>the<br>Three Months Ended |             | Net Convertible Note<br>Balance As of |             |
|--------------------|---|-------------|---------------------------------------|-------------|
|                    | As Previously                                     |             | As Previously                         |             |
|                    | Reported  | As Adjusted | Reported                              | As Adjusted |
| September 30, 2005 | \$ 101  | \$ 230      | \$ 100,000                            | \$ 73,347   |
| December 31, 2005  | 841   | 1,914       | 100,000                               | 74,419      |
| March 31, 2006     | 858   | 1,912       | 100,000                               | 75,474      |
| June 30, 2006      | 844   | 1,942       | 100,000                               | 76,572      |
| September 30, 2006 | 844   | 1,963       | 100,000                               | 77,691      |
| December 31, 2006  | 844   | 2,031       | 100,000                               | 78,878      |
| March 31, 2007     | 844   | 2,010       | 100,000                               | 80,045      |
| June 30, 2007      | 844   | 2,059       | 100,000                               | 81,260      |
| September 30, 2007 | 844   | 2,081       | 100,000                               | 82,497      |
| December 31, 2007  | 844   | 2,150       | 100,000                               | 83,803      |
| March 31, 2008     | 844   | 2,143       | 100,000                               | 85,102      |
| June 30, 2008      | 810   | 2,099       | 95,000                                | 82,124      |
| September 30, 2008 | 802   | 2,103       | 95,000                                | 83,426      |
| December 31, 2008  | 704   | 1,920       | 71,422                                | 63,758      |

Stated interest on debt obligations decreased \$0.6 million during the three months ended March 31, 2009, as compared to the same period in the prior year, due to a decrease in our variable interest rate on our Revolving Credit Facility and decreased stated interest expense on our convertible senior notes due to a reduced principal balance as a result of buybacks of a portion of our convertible senior notes, offset by an increase in amounts borrowed under our Revolving Credit Facility to fund our purchases of receivable portfolios and general working capital needs.

**Other Income and Expense**

During the three months ended March 31, 2009, total other expense was \$0.1 million, compared to other income of less than \$0.1 million during the three months ended March 31, 2008. The \$0.1 million other expense during the three months ended March 31, 2009, was primarily attributable to the net loss in our non-qualified employee plan assets and liabilities.

**Provision for Income Taxes**

During the three months ended March 31, 2009, we recorded an income tax provision of \$6.0 million, reflecting an effective rate of 39.9% of pretax income. Our effective tax rate for the three months ended March 31, 2009, differed from the Federal statutory rate, primarily due to the net effect of state taxes and the effect of permanent book versus tax differences.

Effective January 1, 2009, we retrospectively adjusted our prior years income tax provisions upon adoption of FSP APB 14-1. See interest expense above and Note 12 to our unaudited condensed consolidated financial statements for a further discussion of the change in accounting principle related to the adoption of FSP APB 14-1. The adjusted income tax provision for the three months ended March 31, 2008, was \$4.5 million, which reflected an effective rate of 40.0% of pretax income. Our effective tax rate for the three months ended March 31, 2008, differed from the Federal statutory rate primarily due to the net effect of state taxes and the effect of permanent book versus tax differences.

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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 March 31, 2009 |                   |                   |                   |                   |                   |                   |                   |                   |                      | CCM <sup>(3)</sup> |
|------------------|-------------------------------|---|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|----------------------|--------------------|
|                  |                               | <2002   | 2002              | 2003              | 2004              | 2005              | 2006              | 2007              | 2008              | 2009              | Total <sup>(2)</sup> |                    |
| <1999            | \$ 41,117 <sup>(4)</sup>      | \$ 111,174                                    | \$ 15,007         | \$ 7,546          | \$ 4,202          | \$ 2,042          | \$ 1,513          | \$ 989            | \$ 501            | \$ 131            | \$ 143,105           | 3.5                |
| 1999             | 48,712                        | 48,337  | 16,259            | 11,508            | 8,654             | 5,157             | 3,513             | 1,954             | 1,149             | 298               | 96,829               | 2.0                |
| 2000             | 6,153                         | 12,661  | 4,542             | 4,377             | 2,293             | 1,323             | 1,007             | 566               | 324               | 76                | 27,169               | 4.4                |
| 2001             | 38,186                        | 21,197  | 54,184            | 33,072            | 28,551            | 20,622            | 14,521            | 5,644             | 2,984             | 562               | 181,337              | 4.7                |
| 2002             | 61,494                        |   | 48,322            | 70,227            | 62,282            | 45,699            | 33,694            | 14,902            | 7,922             | 1,406             | 284,454              | 4.6                |
| 2003             | 88,509                        |   |                   | 59,038            | 86,958            | 69,932            | 55,131            | 26,653            | 13,897            | 2,353             | 313,962              | 3.5                |
| 2004             | 101,333                       |   |                   |                   | 39,400            | 79,845            | 54,832            | 34,625            | 19,116            | 3,375             | 231,193              | 2.3                |
| 2005             | 192,593                       |   |                   |                   |                   | 66,491            | 129,809           | 109,078           | 67,346            | 12,144            | 384,868              | 2.0                |
| 2006             | 141,999                       |   |                   |                   |                   |                   | 42,354            | 92,265            | 70,743            | 12,784            | 218,146              | 1.5                |
| 2007             | 204,345                       |   |                   |                   |                   |                   |                   | 68,048            | 145,272           | 33,223            | 246,543              | 1.2                |
| 2008             | 228,736                       |   |                   |                   |                   |                   |                   |                   | 69,049            | 45,703            | 114,752              | 0.5                |
| 2009             | 55,542                        |   |                   |                   |                   |                   |                   |                   |                   | 3,071             | 3,071                | 0.1                |
| <b>Total</b>     | <b>\$ 1,208,719</b>           | <b>\$ 193,369</b>                             | <b>\$ 138,314</b> | <b>\$ 185,768</b> | <b>\$ 232,340</b> | <b>\$ 291,111</b> | <b>\$ 336,374</b> | <b>\$ 354,724</b> | <b>\$ 398,303</b> | <b>\$ 115,126</b> | <b>\$ 2,245,429</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 March 31, 2009.

(3) Cumulative Collections Multiple ( CCM ) through March 31, 2009 collections as a multiple of purchase price.

(4) From inception through December 31, 1998.

**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 Gross Collections <sup>(2)</sup> | Estimated Remaining Collections <sup>(3)</sup> | Total Estimated Gross Collections | Total Estimated Gross Collections to Purchase Price |
|-------|-------------------------------|---|--|-----------------------------------|---|
| <1999 | \$ 41,117 <sup>(4)</sup>      | \$ 143,105                                  | \$ 91  | \$ 143,196                        | 3.5   |
| 1999  | 48,712                        | 96,829                                      | 32   | 96,861                            | 2.0   |
| 2000  | 6,153                         | 27,169                                      | 92   | 27,261                            | 4.4   |
| 2001  | 38,186                        | 181,337                                     | 867  | 182,204                           | 4.8   |
| 2002  | 61,494                        | 284,454                                     | 2,394  | 286,848                           | 4.7   |

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|              |                     |                     |                     |                     |            |
|--------------|---------------------|---------------------|---------------------|---------------------|------------|
| 2003         | 88,509              | 313,962             | 8,113               | 322,075             | 3.6        |
| 2004         | 101,333             | 231,193             | 16,589              | 247,782             | 2.4        |
| 2005         | 192,593             | 384,868             | 89,105              | 473,973             | 2.5        |
| 2006         | 141,999             | 218,146             | 130,623             | 348,769             | 2.5        |
| 2007         | 204,345             | 246,543             | 232,507             | 479,050             | 2.3        |
| 2008         | 228,736             | 114,752             | 475,863             | 590,615             | 2.6        |
| 2009         | 55,542              | 3,071               | 134,759             | 137,830             | 2.5        |
| <b>Total</b> | <b>\$ 1,208,719</b> | <b>\$ 2,245,429</b> | <b>\$ 1,091,035</b> | <b>\$ 3,336,464</b> | <b>2.8</b> |

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

(2) Cumulative collections from inception through March 31, 2009.

(3) Includes \$0.6 million in expected collections for the healthcare portfolios on cost recovery.

(5) From inception through December 31, 1998.

**Table of Contents****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 |                   |                   |                   |                  |                  |                  |               |                     |
|----------------------|---|-------------------|-------------------|-------------------|------------------|------------------|------------------|---------------|---------------------|
|                      | 2009 <sup>(2)</sup>                                       | 2010              | 2011              | 2012              | 2013             | 2014             | 2015             | 2016          | Total               |
| <1999 <sup>(1)</sup> | \$ 91   | \$                | \$                | \$                | \$               | \$               | \$               | \$            | \$ 91               |
| 1999 <sup>(1)</sup>  | 32  |                   |                   |                   |                  |                  |                  |               | 32                  |
| 2000 <sup>(1)</sup>  | 92  |                   |                   |                   |                  |                  |                  |               | 92                  |
| 2001 <sup>(1)</sup>  | 767   | 100               |                   |                   |                  |                  |                  |               | 867                 |
| 2002 <sup>(1)</sup>  | 2,153   | 189               | 52                |                   |                  |                  |                  |               | 2,394               |
| 2003 <sup>(1)</sup>  | 5,568   | 2,545             |                   |                   |                  |                  |                  |               | 8,113               |
| 2004                 | 8,000   | 6,455             | 2,134             |                   |                  |                  |                  |               | 16,589              |
| 2005                 | 30,512  | 31,176            | 20,258            | 7,159             |                  |                  |                  |               | 89,105              |
| 2006                 | 34,276  | 38,125            | 28,022            | 20,317            | 9,883            |                  |                  |               | 130,623             |
| 2007                 | 76,979  | 67,065            | 41,612            | 27,215            | 15,448           | 4,188            |                  |               | 232,507             |
| 2008                 | 128,929   | 138,148           | 88,334            | 56,543            | 36,188           | 20,520           | 7,201            |               | 475,863             |
| 2009                 | 32,876  | 32,506            | 24,972            | 16,952            | 12,518           | 8,265            | 5,865            | 805           | 134,759             |
| <b>Total</b>         | <b>\$ 320,275</b>   | <b>\$ 316,309</b> | <b>\$ 205,384</b> | <b>\$ 128,186</b> | <b>\$ 74,037</b> | <b>\$ 32,973</b> | <b>\$ 13,066</b> | <b>\$ 805</b> | <b>\$ 1,091,035</b> |

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

<sup>(2)</sup> 2009 amount consists of nine months data, from April 1, 2009 to December 31, 2009.

**Unamortized Balances of Portfolios**

The following table summarizes the remaining unamortized balances of our purchased receivable portfolios by year of purchase, as of March 31, 2009 (*in thousands, except percentages*):

|              | Unamortized Balance                    |                               | Unamortized Balance<br>as a Percentage of<br>Purchase Price | Unamortized Balance<br>as a Percentage of<br>Total |
|--------------|--|-------------------------------|---|--|
|              | as of<br>March 31, 2009 <sup>(1)</sup> | Purchase Price <sup>(2)</sup> |   |  |
| 2002         | \$ 491                                 | \$ 61,494                     | 0.8%  | 0.1%   |
| 2003         | 2,090                                  | 88,509                        | 2.4%  | 0.4%   |
| 2004         | 8,073                                  | 101,333                       | 8.0%  | 1.8%   |
| 2005         | 43,103                                 | 192,593                       | 22.4%   | 9.1%   |
| 2006         | 56,642                                 | 141,999                       | 39.9%   | 12.0%  |
| 2007         | 107,220                                | 204,345                       | 52.5%   | 22.6%  |
| 2008         | 200,820                                | 228,736                       | 87.8%   | 42.4%  |
| 2009         | 55,045                                 | 55,542                        | 99.1%   | 11.6%  |
| <b>Total</b> | <b>\$ 473,484</b>                      | <b>\$ 1,074,551</b>           | <b>44.1%</b>  | <b>100.0%</b>                                      |

<sup>(1)</sup> Includes \$0.6 million for healthcare portfolios being accounted for on the cost recovery method.

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- (2) 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 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*):

|   | For the Three Months Ended March 31, 2009 |                          |                       |                   |
|---|---|--------------------------|-----------------------|-------------------|
|   | Accrual Basis Portfolios                  | Cost Recovery Portfolios | Zero Basis Portfolios | Total             |
| Balance, beginning of period                          | \$ 460,598                                | \$ 748                   | \$                    | \$ 461,346        |
| Purchases of receivable portfolios                    | 55,913                                    |                          |                       | 55,913            |
| Gross collections <sup>(1)</sup>                      | (112,491)                                 | (139)                    | (2,496)               | (115,126)         |
| Put-backs and recalls                                 | (920)                                     |                          | (4)                   | (924)             |
| Revenue recognized                                    | 75,202                                    |                          | 2,500                 | 77,702            |
| Impairment, net                                       | (5,427)                                   |                          |                       | (5,427)           |
| <b>Balance, end of period</b>                         | <b>\$ 472,875</b>                         | <b>\$ 609</b>            | <b>\$</b>             | <b>\$ 473,484</b> |
| Revenue as a percentage of collections <sup>(2)</sup> | 66.9%                                     | 0.0%                     | 100.0%                | 67.5%             |

|   | For the Three Months Ended March 31, 2008 |                          |                       |                   |
|---|---|--------------------------|-----------------------|-------------------|
|   | Accrual Basis Portfolios                  | Cost Recovery Portfolios | Zero Basis Portfolios | Total             |
| Balance, beginning of period                          | \$ 390,564                                | \$ 1,645                 | \$                    | \$ 392,209        |
| Purchases of receivable portfolios                    | 47,902                                    |                          |                       | 47,902            |
| Gross collections <sup>(1)</sup>                      | (101,523)                                 | (199)                    | (2,558)               | (104,280)         |
| Put-backs and recalls                                 | (1,678)                                   | (14)                     |                       | (1,692)           |
| Revenue recognized <sup>(3)</sup>                     | 66,845                                    |                          | 2,558                 | 69,403            |
| Impairment, net <sup>(3)</sup>                        | (5,335)                                   |                          |                       | (5,335)           |
| <b>Balance, end of period</b>                         | <b>\$ 396,775</b>                         | <b>\$ 1,432</b>          | <b>\$</b>             | <b>\$ 398,207</b> |
| Revenue as a percentage of collections <sup>(2)</sup> | 65.8%                                     | 0.0%                     | 100.0%                | 66.6%             |

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

(2) Revenue as a percentage of collections excludes the effects of net impairment or net impairment reversals.

(3) Reflects additional revenue of \$0.1 million and a lower net impairment of \$3.1 million, as a result of extending the collection curves from 72 to 84 months. As of March 31, 2009, we had \$473.5 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*):

| For the Years Ended December 31, | Amortization |
|----------------------------------|--------------|
| 2009 <sup>(1)</sup>              | 107,363      |
| 2010                             | 130,113      |
| 2011                             | 94,273       |
| 2012                             | 65,413       |



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|       |            |
|-------|------------|
| 2013  | 43,526     |
| 2014  | 21,465     |
| 2015  | 10,537     |
| 2016  | 794        |
| Total | \$ 473,484 |

<sup>(1)</sup> 2009 amount consists of nine months data from April 1, 2009 to December 31, 2009.

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**Analysis of Changes in Revenue**

The following table analyzes the components of the increase in revenue from our receivable portfolios for the three months ended March 31, 2009, compared to the three months ended March 31, 2008 (*in thousands, except percentages*):

| Variance Component                                      | For The Three Months Ended March 31, |            |           | Revenue Variance |
|---|--------------------------------------|------------|-----------|------------------|
|   | 2009                                 | 2008       | Change    |                  |
| Average portfolio balance                               | \$ 449,569                           | \$ 395,278 | \$ 54,291 | \$ 9,181         |
| Weighted average effective interest rate <sup>(1)</sup> | 66.9%                                | 62.2%      | 4.7%      | (824)            |
| Zero basis revenue                                      | \$ 2,500                             | \$ 2,558   |           | (58)             |
| Net impairment  | \$ (5,427)                           | \$ (5,335) |           | (92)             |
| <b>Total variance</b>                                   |                                      |            |           | <b>\$ 8,207</b>  |

<sup>(1)</sup> For accrual basis portfolios, the weighted average annualized 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, which has been annualized utilizing the simple interest method. 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.

**Collections by Channel**

We utilized 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*):

|   | Three Months Ended March 31, |                   |
|---|------------------------------|-------------------|
|   | 2009                         | 2008              |
| Collection sites                        | \$ 50,342                    | \$ 43,289         |
| Legal collections                       | 56,407                       | 45,292            |
| Collection agencies                     | 7,667                        | 10,961            |
| Sales                                   | 817                          | 4,214             |
| Other                                   |                              | 599               |
| <b>Gross collections for the period</b> | <b>\$ 115,233</b>            | <b>\$ 104,355</b> |

**External Collection Channels and Related Direct Costs**

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

|                                   | Legal Collections<br>Three Months Ended March 31, |        |           |        | Collection Agencies<br>Three Months Ended March 31, |        |           |        |
|-----------------------------------|---|--------|-----------|--------|---|--------|-----------|--------|
|                                   | 2009  |        | 2008      |        | 2009  |        | 2008      |        |
| Collections                       | \$ 56,407   | 100.0% | \$ 45,292 | 100.0% | \$ 7,667  | 100.0% | \$ 10,961 | 100.0% |
| Commissions                       | \$ 16,100   | 28.5%  | \$ 12,817 | 28.3%  | \$ 2,891  | 37.7%  | \$ 4,031  | 36.8%  |
| Court cost expense <sup>(1)</sup> | 13,303  | 23.6%  | 6,801     | 15.0%  |   |        |           |        |
| Other <sup>(2)</sup>              | 544   | 1.0%   | 688       | 1.5%   |   |        |           |        |

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|             |           |       |           |       |          |       |          |       |
|-------------|-----------|-------|-----------|-------|----------|-------|----------|-------|
| Total Costs | \$ 29,947 | 53.1% | \$ 20,306 | 44.8% | \$ 2,891 | 37.7% | \$ 4,031 | 36.8% |
|-------------|-----------|-------|-----------|-------|----------|-------|----------|-------|

(1) 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.

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

**Table of Contents****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   |                   |
| 2003           | \$ 10,750  | \$ 27,192 | \$ 17,212 | \$ 9,566 | \$ 5,561 | \$ 3,050 | \$ 554 | \$ 73,885         |
| 2004           |  | 23,455    | 37,674    | 21,676   | 12,029   | 5,840    | 987    | \$ 101,661        |
| 2005           |  |           | 21,694    | 40,762   | 22,152   | 10,582   | 1,705  | \$ 96,895         |
| 2006           |  |           |           | 39,395   | 82,740   | 43,303   | 6,675  | \$ 172,113        |
| 2007           |  |           |           |          | 41,958   | 80,211   | 13,718 | \$ 135,887        |
| 2008           |  |           |           |          |          | 47,320   | 30,666 | \$ 77,986         |
| 2009           |  |           |           |          |          |          | 1,395  | \$ 1,395          |

<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.

| Placement Year | Court Costs by Year of Collection <sup>(1)</sup> |          |        |        |        |        |       | Total Court Costs |
|----------------|--|----------|--------|--------|--------|--------|-------|-------------------|
|                | 2003   | 2004     | 2005   | 2006   | 2007   | 2008   | 2009  |                   |
| 2003           | \$ 908   | \$ 2,046 | \$ 571 | \$ 300 | \$ 147 | \$ 103 | \$ 18 | \$ 4,093          |
| 2004           |  | 2,509    | 2,937  | 1,087  | 406    | 223    | 30    | \$ 7,192          |
| 2005           |  |          | 3,271  | 4,426  | 859    | 356    | 46    | \$ 8,958          |
| 2006           |  |          |        | 10,158 | 10,291 | 1,829  | 216   | \$ 22,494         |
| 2007           |  |          |        |        | 15,357 | 11,952 | 912   | \$ 28,221         |
| 2008           |  |          |        |        |        | 19,322 | 8,704 | \$ 28,026         |
| 2009           |  |          |        |        |        |        | 1,406 | \$ 1,406          |

<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> |          |          |          |          |        |        | Total Commissions |
|----------------|--|----------|----------|----------|----------|--------|--------|-------------------|
|                | 2003   | 2004     | 2005     | 2006     | 2007     | 2008   | 2009   |                   |
| 2003           | \$ 3,574   | \$ 8,606 | \$ 5,496 | \$ 2,898 | \$ 1,574 | \$ 872 | \$ 155 | \$ 23,175         |
| 2004           |  | 7,273    | 12,060   | 6,653    | 3,498    | 1,690  | 280    | \$ 31,454         |
| 2005           |  |          | 6,725    | 12,108   | 6,364    | 3,036  | 480    | \$ 28,713         |
| 2006           |  |          |          | 11,451   | 23,659   | 12,370 | 1,882  | \$ 49,362         |
| 2007           |  |          |          |          | 11,845   | 22,927 | 3,865  | \$ 38,637         |
| 2008           |  |          |          |          |          | 13,678 | 8,719  | \$ 22,397         |
| 2009           |  |          |          |          |          |        | 384    | \$ 384            |

<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.

**Court Cost Expense and Commissions as a % of Gross Collections  
by Year of Collection**

| <b>Placement Year</b> | <b>2003</b> | <b>2004</b> | <b>2005</b> | <b>2006</b> | <b>2007</b> | <b>2008</b> | <b>2009</b> | <b>Cumulative<br/>Average</b> |
|-----------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------------------------|
| 2003                  | 41.7%       | 39.2%       | 35.2%       | 33.4%       | 31.0%       | 32.0%       | 31.2%       | 36.9%                         |
| 2004                  |             | 41.7%       | 39.8%       | 35.7%       | 32.4%       | 32.8%       | 31.4%       | 38.0%                         |
| 2005                  |             |             | 46.1%       | 40.6%       | 32.6%       | 32.1%       | 30.9%       | 38.9%                         |
| 2006                  |             |             |             | 54.9%       | 41.0%       | 32.8%       | 31.4%       | 41.7%                         |
| 2007                  |             |             |             |             | 64.8%       | 43.5%       | 34.8%       | 49.2%                         |
| 2008                  |             |             |             |             |             | 69.7%       | 56.8%       | 64.7%                         |
| 2009                  |             |             |             |             |             |             | 128.3%      | 128.3%                        |

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| Placement Year <sup>(2)</sup> | Lawsuits Filed by Year <sup>(1)</sup> |      |      |      |      |      |      | Total |
|-------------------------------|---------------------------------------|------|------|------|------|------|------|-------|
|                               | 2003                                  | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 |       |
| 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  | 2    | 377   |
| 2008                          |                                       |      |      |      |      | 338  | 108  | 446   |
| 2009                          |                                       |      |      |      |      |      | 38   | 38    |

(1) Represents the year the account was placed into litigation.

(2) Represents the year the account was placed into our legal channel.

**Headcount by Function by Site**

The following table summarizes our headcount by function by site as of March 31, 2009 and 2008:

|                          | Head Count As of March 31, |       |      |       |
|--------------------------|----------------------------|-------|------|-------|
|                          | 2009                       |       | 2008 |       |
|                          | U.S.                       | India | U.S. | India |
| General & Administrative | 317                        | 98    | 317  | 63    |
| Account Manager          | 270                        | 350   | 310  | 264   |
| BK Specialist            | 62                         | 37    | 66   | 24    |
|                          | 649                        | 485   | 693  | 351   |

**Gross Collections by Account Manager**

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

|  | Three Months Ended March 31, |           |
|--|------------------------------|-----------|
|  | 2009                         | 2008      |
| Gross collections - collection sites           | \$ 50,342                    | \$ 43,289 |
| Average active account managers                | 587                          | 560       |
| Collections per average active account manager | \$ 85.8                      | \$ 77.3   |

**Gross Collections per Hour Paid**

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

|                                      | Three Months Ended March 31, |           |
|--------------------------------------|------------------------------|-----------|
|                                      | 2009                         | 2008      |
| Gross collections - collection sites | \$ 50,342                    | \$ 43,289 |
| Total hours paid                     | 265                          | 243       |
| Gross collections per hour paid      | \$ 190.0                     | \$ 178.1  |

**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*):

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|                                      | <b>Three Months Ended March 31,</b> |             |
|--------------------------------------|-------------------------------------|-------------|
|                                      | <b>2009</b>                         | <b>2008</b> |
| Gross collections - collection sites | \$ 50,342                           | \$ 43,289   |
| Direct cost <sup>(1)</sup>           | \$ 5,805                            | \$ 6,710    |
| Cost per dollar collected            | 11.5%                               | 15.5%       |

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

**Table of Contents****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 March 31, |           |
|--|------------------------------|-----------|
|  | 2009                         | 2008      |
| Portfolio Purchasing and Collecting Activities |                              |           |
| Collections related                            | \$ 5,805                     | \$ 6,710  |
| General & administrative                       | 6,106                        | 6,543     |
| Subtotal                                       | 11,911                       | 13,253    |
| Bankruptcy Services                            | 2,046                        | 1,598     |
|  | \$ 13,957                    | \$ 14,851 |

**Purchases by Quarter**

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

| Quarter | # of<br>Accounts | Face Value | Purchase<br>Price | Forward Flow<br>Allocation <sup>(1)</sup> |
|---------|------------------|------------|-------------------|---|
| Q1 2006 | 673              | \$ 558,574 | \$ 27,091         | \$ 2,403                                  |
| Q2 2006 | 837              | 594,190    | 21,262            | 2,118                                     |
| Q3 2006 | 1,469            | 1,081,892  | 32,334            | 2,939                                     |
| Q4 2006 | 814              | 1,439,826  | 63,600            | 3,184                                     |
| 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            |   |

<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 a breach by Jefferson Capital and its parent, CompuCredit Corporation, of certain agreements. See Note 10 to our unaudited condensed consolidated financial statements for further information about our dispute with Jefferson Capital and CompuCredit.

**Purchases by Paper Type**

The following table summarizes the types of charged-off consumer receivable portfolios we purchased for the three months ended March 31, 2009 and 2008 (*in thousands*):

|             | Three Months Ended<br>March 31, |           |
|-------------|---------------------------------|-----------|
|             | 2009                            | 2008      |
| Credit card | \$ 55,913                       | \$ 45,280 |
| Other       |                                 | 2,622     |





**Table of Contents****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, the payment of interest and principal on bank borrowings and tax payments.

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

|   | <b>Three Months Ended</b> |                 |
|---|---------------------------|-----------------|
|   | <b>March 31,</b>          |                 |
|   | <b>2009</b>               | <b>2008</b>     |
|   |                           | <b>Adjusted</b> |
| Net cash provided by operating activities | \$ 16,888                 | \$ 15,830       |
| Net cash used in investing activities     | (18,034)                  | (9,524)         |
| Net cash used in financing activities     | (4,934)                   | (2,245)         |

***Repurchase of Convertible Notes***

On February 27, 2007, our board of directors authorized a securities repurchase program under which we may buy back up to \$50.0 million (at cost) of a combination of our common stock and Convertible Notes. The purchases may be made from time to time in the open market or through privately negotiated transactions and will be dependent upon various business and financial considerations. Securities repurchases are subject to compliance with applicable legal requirements and other factors. During the three months ended March 31, 2009, we repurchased \$25.6 million principal amount of our outstanding Convertible Notes, for a total price of \$19.8 million, plus accrued interest. From the inception of the securities repurchase program, we have repurchased \$54.2 million principal amount of our Convertible Notes, for a total cash payment of \$39.9 million. We have not repurchased any common stock under this program.

As of March 31, 2009, we had approximately \$45.8 million principal amount of outstanding Convertible Notes due September 19, 2010. A tightening of credit availability could restrict our ability to refinance and/or retire our existing debt. If we are unable to retire or obtain suitable replacement financing for our long-term debt when and as it becomes due, this may have a material and adverse impact on our business and financial condition.

***Operating Cash Flows***

Net cash provided by operating activities was \$16.9 million and \$15.8 million for the three months ended March 31, 2009 and 2008, respectively. The increase in cash provided by operating activities was primarily attributable to an increase of \$2.2 million in net income, and a net increase of \$1.9 million due to changes in other operating assets and liabilities, offset by a non-cash gain of \$3.0 million related to repurchase of our Convertible Notes.

***Investing Cash Flows***

Net cash used in investing activities was \$18.0 million for the three months ended March 31, 2009 and \$9.5 million for the three months ended March 31, 2008.

The cash flows used in investing activities for the three months ended March 31, 2009, are primarily related to receivable portfolio purchases of \$55.9 million, offset by gross collection proceeds applied to the principal of our receivable portfolios in the amount of \$37.4 million. The cash flows used in investing activities for the three months ended March 31, 2008, primarily related to receivable portfolio purchases of \$45.0 million offset by gross collection proceeds applied to the principal of our receivable portfolios in the amount of \$34.9 million.

Capital expenditures for fixed assets acquired with internal cash flow were \$0.5 million and \$1.1 million for the three months ended March 31, 2009 and 2008, respectively.

***Financing Cash Flows***

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Net cash used in financing activities was \$4.9 million and \$2.2 million for the three months ended March 31, 2009 and 2008, respectively.

The cash used in financing activities during the three months ended March 31, 2009, reflects \$19.8 million used to repurchase \$25.6 million in principal amount of our outstanding Convertible Notes and \$32.0 million in borrowings under our Revolving Credit Facility, offset by \$17.0 million in repayments of principal under our Revolving Credit Facility. The cash used in financing activities during the three months ended March 31, 2008, reflects \$9.0 million in borrowings, offset by \$11.2 million in repayments under our Revolving Credit Facility.

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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 an expense of \$6.9 million after the effect of income taxes), we have achieved 29 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, and \$82.0 million in borrowing capacity and \$25.6 million in borrowing base availability under our Revolving Credit Facility as of March 31, 2009.

***Off Balance Sheet Arrangements***

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

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**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, 2008, which is incorporated herein by reference. Our exposure to market risk has not changed materially since December 31, 2008.

**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 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.

Based on their most recent evaluation, as of the end of the period covered by this Quarterly Report on Form 10-Q, our Chief Executive Officer and Chief Financial Officer have concluded our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934 ( Exchange Act ), as amended, are effective.

***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.

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

On October 18, 2004, Timothy W. Moser, one of our former officers, filed an action in the United States District Court for the Southern District of California against us, and certain individuals, including several of our officers and directors. On February 14, 2005, we were served with an amended complaint in this action alleging defamation, intentional interference with contractual relations, breach of contract, breach of the covenant of good faith and fair dealing, intentional and negligent infliction of emotional distress and civil conspiracy arising out of certain statements in our Registration Statement on Form S-1, originally filed in September 2003, and alleged to be included in our Registration Statement on Form S-3, originally filed in May 2004. The amended complaint seeks injunctive relief, economic and punitive damages in an unspecified amount plus an award of profits allegedly earned by the defendants and alleged co-conspirators as a result of the alleged conduct, in addition to attorney's fees and costs. On May 2, 2006, the court denied our special motion to strike pursuant to California's anti-SLAPP statute, denied in part and granted in part our motion to dismiss, denied a variety of *ex parte* motions and applications filed by the plaintiff and denied the plaintiff's motion for leave to conduct discovery or file supplemental briefing. The court granted the plaintiff 30 days in which to further amend his complaint, and on June 1, 2006, the plaintiff filed a second amended complaint in which he amended his claim for negligent infliction of emotional distress. On May 25, 2006, we filed a notice of appeal of the court's order denying the anti-SLAPP motion and on June 16, 2006, we filed a motion to stay the case pending the outcome of the appeal, which was granted. Oral argument on the appeal was heard on July 17, 2008, and on July 28, 2008, the appellate court affirmed the trial court's denial of our anti-SLAPP motion. The appellate court denied our request for a rehearing and the case has been returned to the district court where it is proceeding from the point at which it was stayed. Discovery is continuing and management believes the claims are without merit and intends to defend the action vigorously. Although the outcome of this matter cannot be predicted with certainty, we do not currently believe that this matter will have a material adverse effect on our consolidated financial position or results of operations.

On September 7, 2005, Mr. Moser filed a related action in the United States District Court for the Southern District of California against Triarc Companies, Inc. (Triarc), which at the time, was a significant stockholder of ours, alleging intentional interference with contractual relations and intentional infliction of emotional distress. The case arises out of the same statements made or alleged to have been made in our Registration Statements mentioned above. On January 7, 2006, Triarc was served with an amended complaint seeking injunctive relief, an order directing Triarc to issue a statement of retraction or correction of the allegedly false statements, economic and punitive damages in an unspecified amount and attorney's fees and costs. Triarc tendered the defense of this action to us, and we accepted the defense and will indemnify Triarc, pursuant to the indemnification provisions of the Registration Rights Agreements dated as of October 31, 2000 and February 21, 2002, and the Underwriting Agreements dated September 25, 2004 and January 20, 2005 to which Triarc is a party. Although the outcome of this matter cannot be predicted with certainty, we do not currently believe that this matter will have a material adverse effect on our consolidated financial position or results of operations.

Claims based on the Fair Debt Collection Practices Act (FDCPA) and comparable state statutes may result in class action lawsuits, which can be material to us due to the remedies available under these statutes, including punitive damages. A number of cases styled as class actions have been filed against us. A class has been certified in several of these cases. Several of these cases present novel issues on which there is no legal precedent. As a result, we are unable to predict the range of possible outcomes. There are a number of other lawsuits, claims and counterclaims pending or threatened against us. In general, these lawsuits, claims or counterclaims have arisen in the ordinary course of business and involve claims for actual damages arising from alleged misconduct or improper reporting of credit information by us or our employees or agents. Although litigation is inherently uncertain, based on past experience, the information currently available and the possible availability of insurance and/or indemnification in some cases, we do not believe that the currently pending and threatened litigation or claims will have a material adverse effect on our consolidated financial position or results of operations. However, future events or circumstances, currently unknown to management, will determine whether the resolution of pending or threatened litigation or claims will ultimately have a material effect on our consolidated financial position, liquidity or results of operations in any future reporting periods.

On June 10, 2008, the Federal Trade Commission (the FTC) announced that it had sued Jefferson Capital and its parent company, CompuCredit Corporation, alleging that Jefferson Capital and CompuCredit had violated the FTC Act with deceptive marketing practices when issuing credit cards, among other allegations. The FTC announced on December 19, 2008, that it had agreed to a settlement of the litigation with Jefferson Capital and CompuCredit whereby those companies will credit approximately \$114.0 million to certain customer accounts. Jefferson Capital and CompuCredit have advised us that a substantial number of the accounts affected by the settlement had been sold to us.

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On July 15, 2008, we gave Jefferson Capital and CompuCredit notice of breach by Jefferson Capital and CompuCredit of the Asset Purchase and Forward Flow Agreement dated June 2, 2005, as amended, as well as a related Balance Transfer Agreement dated the same date based upon the actions noted in the FTC complaint. On July 16, 2008, we initiated arbitration as a result of the breach, pursuant to the arbitration provisions of the Agreements. We assert that the litigation initiated by the FTC violates the Asset Purchase and Forward Flow Agreement and Balance Transfer Agreement in several respects. We seek an arbitral award that (i) Jefferson Capital and CompuCredit are in material breach of the Agreements, (ii) declares our obligations to purchase forward flow accounts under the Agreements is thereby excused or discharged, (iii) confirms our rights to cause Jefferson Capital to repurchase certain accounts previously sold to us under the Agreements, and other appropriate relief, including return of prepaid amounts relating to forward flow purchases, (iv) confirms our rights to indemnity by Jefferson Capital and CompuCredit and (v) awards compensatory damages, attorney fees, interest, arbitration costs and other appropriate relief.

Arbitrators have been identified and the proceeding is in the discovery stage. We have ceased forward flow purchases of accounts from Jefferson Capital, the sale of bankrupt accounts to Jefferson Capital and participation in a balance transfer program with CompuCredit. In response to our Notice of Breach, Jefferson Capital and CompuCredit delivered its own Notice of Default to us alleging our breach of forward flow purchase, bankruptcy sale and balance transfer obligations and initiated a separate arbitration of our alleged breach of our bankruptcy sale obligations.

This matter is in the early stages of development and any impact on the recoverability of our forward flow asset, currently stated at \$10.3 million, is uncertain. Our consolidated financial statements do not include any adjustment that might result from the outcome of this uncertainty.

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### **Item 1A. Risk Factors**

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act), which we believe are subject to certain safe harbors. Many statements, other than statements of historical facts, included or incorporated into this Quarterly Report on Form 10-Q are forward-looking statements. The words believe, expect, anticipate, estimate, project, intend, plan, will, may, and other similar expressions often characterize forward-looking statements. These statements may include, but are not limited to, projections of collections, revenues, income or loss, estimates of capital expenditures, plans for future operations, products or services, and financing needs or plans, as well as assumptions relating to these matters. In particular, these statements may be found, among other places, under the Management's Discussion and Analysis of Financial Condition and Results of Operations and Risk Factors sections.

Although we believe that the expectations reflected in these forward-looking statements are reasonable, we caution you that these expectations or predictions may not prove to be correct or we may not achieve the financial results, savings or other benefits anticipated in the forward-looking statements. These forward-looking statements are necessarily estimates reflecting the best judgment of our senior management and involve a number of risks and uncertainties, some of which may be beyond our control or cannot be predicted or quantified, that could cause actual results to differ materially from those suggested by the forward-looking statements. Many factors, including but not limited to those set forth below, could cause our actual results, performance, achievements, or industry results to be very different from the results, performance or achievements expressed or implied by these forward-looking statements. Our business, financial condition or results of operations could also be materially and adversely affected by other factors besides those listed. These factors include, but are not limited to, the following:

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;

Our quarterly operating results may fluctuate and cause the prices of our common stock and convertible notes to decrease;

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

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

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;

Collections on our receivable portfolios purchased from Jefferson Capital may be adversely affected by litigation brought against Jefferson Capital and its parent, CompuCredit Corporation, by the Federal Trade Commission and Federal Deposit Insurance Corporation and the subsequent settlement of such litigation;

We may purchase portfolios that contain accounts which do not meet our account collection criteria;

We may not be able to use our sales channel to sell unprofitable accounts;

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;



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We may not be successful in recovering the level of court costs we anticipate recovering;

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;

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

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

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

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

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

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

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We may incur impairment charges based on the provisions of American Institute of Certified Public Accountants Statement of Position 03-3;

Present and future government regulation may limit our ability to recover and enforce the collection of receivables;

Failure to comply with government regulation could result in the suspension or termination of our ability to conduct business;

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 are subject to ongoing risks of litigation, including individual and class actions under consumer credit, collections, employment, securities and other laws, as well as our dispute with Jefferson Capital and CompuCredit Corporation;

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

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;

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;

Exposure to regulatory and economic conditions in India exposes us to risks or loss of business;

We may not be able to manage our growth effectively;

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

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

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

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

For more information about these risks, see the discussion under Part I, Item 1A Risk Factors of our Annual Report on Form 10-K for the fiscal year ended December 31, 2008, filed with the Securities and Exchange Commission, which is incorporated herein by reference.

Forward-looking statements speak only as of the date the statements were made. We do not undertake any obligation to update or revise any forward-looking statements to reflect new information or future events, or for any other reason even if experience or future events make it clear that any expected results expressed or implied by these forward-looking statements will not be realized.

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In addition, it is our policy generally not to make any specific projections as to future earnings and we do not endorse projections regarding future performance that may be made by third parties.

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**Item 6. Exhibits**

- 10.1 Severance protection letter agreement dated as of March 11, 2009 between the Company and J. Brandon Black (incorporated by reference to Exhibit 10.1 to Form 8-K filed March 13, 2009).
- 10.2 Severance protection letter agreement dated as of March 11, 2009 between the Company and Paul Grinberg (incorporated by reference to Exhibit 10.2 to Form 8-K filed March 13, 2009).
- 10.3 Lease Agreement dated as of March 24, 2009 between Midland Credit Management India Private Limited, Dinesh Kumar and Manmohan Gaiind, for real property located in Gurgaon, India (filed herewith).
- 10.4 Lease Deed, dated as of April 22, 2009, between Midland Credit Management India Private Limited and R.S. Technologies Private Limited, for real property located in Gurgaon, India (filed herewith).
- 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: April 29, 2009

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**EXHIBIT INDEX**

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