ENCORE CAPITAL GROUP INC
Form 10-Q
July 30, 2009
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended June 30, 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)**	**48-1090909** **(IRS Employer** **Identification No.)**
8875 Aero Drive, Suite 200 **San Diego, California** **(Address of principal executive offices)**	**92123** **(Zip code)**

(877) 445-4581

(Registrant s telephone number, including area code)

(Not Applicable)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the last 90 days. Yes x 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 x 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 x

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

Class	**Outstanding at July 21, 2009**
Common Stock, $0.01 par value	23,139,790 shares

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PART I. FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements (Unaudited)

ENCORE CAPITAL GROUP, INC.

Condensed Consolidated Statements of Financial Condition

(In Thousands, Except Par Value Amounts)

(Unaudited)

	June 30, 2009	December 31, 2008 Adjusted
Assets		
Cash and cash equivalents	$ 5,935	$ 10,341
Accounts receivable, net	3,385	1,757
Investment in receivable portfolios, net	506,708	461,346
Deferred court costs	29,760	28,335
Property and equipment, net	6,750	6,290
Prepaid income tax		7,935
Forward flow asset	10,302	10,302
Other assets	5,073	5,049
Goodwill	15,985	15,985
Identifiable intangible assets, net	1,418	1,739
Total assets	$ 585,316	$ 549,079
Liabilities and stockholders equity		
Liabilities:		
Accounts payable and accrued liabilities	$ 19,410	$ 18,204
Income tax payable	686	
Deferred tax liabilities, net	15,468	15,108
Deferred revenue and purchased servicing obligation	5,400	5,203
Debt	320,340	303,655
Other liabilities	2,648	3,483
Total liabilities	363,952	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, 23,138 shares and 23,053 shares issued and outstanding as of June 30, 2009, and December 31, 2008, respectively	231	231
Additional paid-in capital	100,321	98,521
Accumulated earnings	122,433	106,795
Accumulated other comprehensive loss	(1,621)	(2,121)
Total stockholders equity	221,364	203,426
Total liabilities and stockholders equity	$ 585,316	$ 549,079

See accompanying notes to unaudited condensed consolidated financial statements

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ENCORE CAPITAL GROUP, INC.

Condensed Consolidated Statements of Income

(In Thousands, Except Per Share Amounts)

(Unaudited)

	Three Months Ended June 30, 2009	Three Months Ended June 30, 2008 Adjusted	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008 Adjusted
Revenue				
Revenue from receivable portfolios, net	$ 73,965	$ 66,275	$ 146,240	$ 130,343
Servicing fees and other related revenue	4,070	3,745	8,241	7,231
Total revenue	78,035	70,020	154,481	137,574
Operating expenses				
Salaries and employee benefits (excluding stock-based compensation expense)	14,762	15,689	28,719	30,540
Stock-based compensation expense	994	1,228	2,074	2,322
Cost of legal collections	28,626	23,829	58,573	44,135
Other operating expenses	6,598	5,987	12,578	11,638
Collection agency commissions	4,797	3,781	7,688	7,812
General and administrative expenses	7,097	4,581	12,794	9,041
Depreciation and amortization	620	766	1,243	1,488
Total operating expenses	63,494	55,861	123,669	106,976
Income before other (expense) income and income taxes	14,541	14,159	30,812	30,598
Other (expense) income				
Interest expense	(3,958)	(4,831)	(8,231)	(10,031)
Gain on repurchase of convertible notes, net	215	707	3,268	707
Other income (expense)	9	352	(72)	373
Total other expense	(3,734)	(3,772)	(5,035)	(8,951)
Income before income taxes	10,807	10,387	25,777	21,647
Provision for income taxes	(4,166)	(4,225)	(10,139)	(8,734)
Net income	$ 6,641	$ 6,162	$ 15,638	$ 12,913
Weighted average shares outstanding:				
Basic	23,168	23,007	23,145	23,000
Diluted	23,971	23,512	23,811	23,468
Earnings per share:				
Basic	$ 0.29	$ 0.27	$ 0.68	$ 0.56
Diluted	$ 0.28	$ 0.26	$ 0.66	$ 0.55

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 Shares	Common Stock Par	Additional Paid-In Capital	Accumulated Earnings	Accumulated Other Comprehensive (Loss) Income	Total Equity	Comprehensive Income
Balance at December 31, 2008, Adjusted	23,053	$ 231	$ 98,521	$ 106,795	$ (2,121)	$ 203,426	
Net income				15,638		15,638	15,638
Other comprehensive income:							
Unrealized gain on cash flow hedge, net of tax					500	500	500
Issuance of share-based awards	85		(231)			(231)	
Stock-based compensation			2,074			2,074	
Tax provision related to stock option exercises			(43)			(43)	
Balance at June 30, 2009	23,138	$ 231	$ 100,321	$ 122,433	$ (1,621)	$ 221,364	$ 16,138

See accompanying notes to unaudited condensed consolidated financial statements

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ENCORE CAPITAL GROUP, INC.

Condensed Consolidated Statements of Cash Flows

(Unaudited, In Thousands)

	Six Months Ended June 30, 2009	2008 Adjusted
Operating activities:		
Net Income	$ 15,638	$ 12,913
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,243	1,488
Amortization of loan costs and debt discount	2,160	3,110
Stock-based compensation expense	2,074	2,322
Gain on repurchase of converitible notes, net	(3,268)	(707)
Deferred income tax expense	360	36
Tax provision from stock-based payment arrangements	43	12
Provision for impairment on receivable portfolios, net	9,991	8,725
Changes in operating assets and liabilities		
Other assets	(2,456)	1,008
Deferred court costs	(1,425)	(4,622)
Prepaid income tax and income tax payable	8,577	8,846
Deferred revenue and purchased service obligation	197	472
Accounts payable, accrued liabilities and other liabilities	611	(217)
Net cash provided by operating activities	33,745	33,386
Investing activities:		
Purchases of receivable portfolios, net of forward flow allocation	(137,946)	(94,833)
Collections applied to investment in receivable portfolios, net	81,163	67,272
Proceeds from put-backs of receivable portfolios	1,430	2,047
Purchases of property and equipment	(1,400)	(2,034)
Net cash used in investing activities	(56,753)	(27,548)
Financing activities:		
Proceeds from revolving credit facility	62,500	15,000
Repayment of revolving credit facility	(21,500)	(17,169)
Repurchase of convertible notes	(22,262)	(3,500)
Proceeds from exercise of stock options	29	8
Tax provision from stock-based payment arrangements	(43)	(12)
Repayment of capital lease obligations	(122)	(145)
Net cash provided by (used in) financing activities	18,602	(5,818)
Net (decrease) increase in cash	(4,406)	20
Cash and cash equivalents, beginning of period	10,341	8,676
Cash and cash equivalents, end of period	$ 5,935	$ 8,696
Supplemental disclosures of cash flow information:		
Cash paid for interest	$ 6,435	$ 6,792

Income tax payment (refund)	$	1,626	$	(236)
Supplemental schedule of non-cash investing and financing activities:				
Allocation of forward flow asset to acquired receivable portfolios	$		$	2,926

See accompanying notes to unaudited condensed consolidated financial statements

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ENCORE CAPITAL GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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

Encore Capital Group, Inc. (Encore), through its subsidiaries (collectively, the Company), is a systems-driven purchaser and manager of charged-off consumer receivable portfolios and, through its wholly owned subsidiary Ascension Capital Group, Inc. (Ascension), a provider of bankruptcy services to the finance industry. The Company 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 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 deliverable pursuant to stock options and

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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 1,346,000 shares of common stock during the three and six months ended June 30, 2009, and employee stock options to purchase approximately 1,298,000 shares of common stock during the three and six months ended June 30, 2008, were outstanding but not included in the computation of diluted earnings per share because the effect on diluted earnings per share would be anti-dilutive.

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 June 2009, the FASB issued FAS No. 166, a revision to FAS No. 140, *Accounting for Transfers of Financial Assets,* and will require more information about transferred financial assets and where companies have continuing exposure to the risks related to transferred financial assets. This standard is effective at the start of a company s first fiscal year beginning after November 15, 2009, or January 1, 2010 for companies reporting earnings on a calendar-year basis. The Company is currently analyzing the impact of this statement, if any, to its consolidated financial statements.

In June 2009, the FASB issued FAS No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting.* This standard represents the last numbered standard issued by FASB under the old (pre-Codification) numbering system, and amends the GAAP hierarchy. On July 1, FASB launched FASB s new Codification (*i.e.* the FASB Accounting Standards Codification). The Codification supersedes existing GAAP for nongovernmental entities. The Company will revise its financial statement disclosure in compliance with the new codification system effective in its third quarter ended September 30, 2009.

Note 2: Fair Value Measurement

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 consist of the following:

Financial instruments recognized at fair value in the statement of financial position

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

Financial instruments measured at fair value	Fair Value Hierarchy	As of June 30, 2009 Carrying Value	As of June 30, 2009 Fair Value	As of December 31, 2008 Carrying Value	As of December 31, 2008 Fair Value
Cash and cash equivalents	Level 1	$ 5,935	$ 5,935	$ 10,341	$ 10,341
Cash flow hedging instruments	Level 2	(2,648)	(2,648)	(3,483)	(3,483)

The fair value of cash and cash equivalents approximates their respective carrying value. Cash flow hedging instruments, which are considered over-the-counter derivatives, are also carried at their fair values. The Company s fair value estimate for such derivative instruments incorporates quoted market prices at the balance sheet date from the counter party using significant observable inputs and is considered a level 2 fair value measurement.

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Financial instruments not required to be carried at fair value

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. The Company is required to estimate the fair value of financial instruments when it is practical to do so.

Borrowings under the Company s Revolving Credit Facility are carried at historical cost, adjusted for additional borrowings less principal repayments, which approximates fair value. The Company s Convertible Notes are carried at historical cost, adjusted for repurchases and debt discount. The fair value estimate incorporates quoted market prices at the balance sheet date, which was determined to be approximately $34.9 million and $51.4 million as of June 30, 2009 and December 31, 2008, respectively. For investment in receivable portfolios, there is no active market or observable inputs for the fair value estimation. The Company considers it not practical to attempt to estimate the fair value of such financial instruments due to the excessive costs that would be incurred in doing so.

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

Note 3: Stock-Based Compensation

On March 9, 2009, the Board of Directors approved an amendment and restatement of the 2005 Stock Incentive Plan (2005 Plan) which was originally adopted on March 30, 2005 for Board members, employees, officers, and executives of, and consultants and advisors to, the Company. The amendment and restatement of the 2005 Plan increased by 2,000,000 shares the maximum number of shares of the Company s common stock that may be issued or subject to awards under the plan, established a new 10-year term for the plan and made certain other amendments. The 2005 Plan was approved by the Company s stockholders on June 9, 2009. The 2005 Plan provides for the granting of incentive stock options, nonqualified stock options, stock appreciation rights, restricted stock, restricted stock units, and performance-based awards to eligible individuals. The 2005 Plan originally authorized an aggregate of 1,500,000 shares of the Company s common stock for awards under the 2005 Plan, plus ungranted shares of stock that were available for future awards under the prior 1999 Equity Participation Plan (1999 Plan). In addition, shares subject to options granted under either the 1999 Plan or the 2005 Plan that terminate or expire without being exercised are available for grant under the 2005 Plan. The benefits provided under these plans are share-based compensation subject to the provisions of Statement of Financial Accounting Standard No. 123R, *Share-Based Payment* (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 six months ended June 30, 2009, approximately $2.1 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.

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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 six months ended June 30, 2008):

	Six Months Ended June 30, 2009	Six Months Ended June 30, 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 June 30, 2009, was $1.5 million, which is expected to be recognized over a weighted-average period of approximately 2.0 years.

A summary of the Company s stock option activity and related information is as follows for the six months ended June 30, 2009:

	Number of Shares	Option Price Per Share	Weighted Average Exercise Price	Aggregate Intrinsic Value *(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	(72,000)	10.92 -16.19	12.28	
Exercised	(10,000)	2.95	2.95	
Outstanding at June 30, 2009	2,320,003	$ 0.35 - $20.09	$ 8.33	$ 13,012
Exercisable at June 30, 2009	1,620,506	$ 0.35 - $20.09	$ 8.31	$ 9,598

The total intrinsic value of options exercised during the six months ended June 30, 2009 and 2008 remained consistent at $0.1 million. As of June 30, 2009, the weighted-average remaining contractual life of options outstanding and options exercisable was 5.75 years and 4.35 years, respectively.

Restricted Stock Units

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 June 30, 2009, 106,500 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 June 30, 2009. The remaining 617,540 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 six months ended June 30, 2009, restricted stock unit activity and related information are as follows:

Restricted Stock Units	Non-Vested Shares	Weighted Average Grant Date Fair Value
Non-vested at December 31, 2008	628,752	$ 11.18

Awarded	224,714	$	4.20
Vested	(115,846)	$	10.92
Cancelled/forfeited	(13,580)	$	10.96
Non-vested at June 30, 2009	724,040	$	9.06

Unrecognized estimated compensation cost related to restricted stock units as of June 30, 2009, was $3.3 million, which is expected to be recognized over a weighted-average period of approximately 2.3 years. The fair value of restricted stock units vested for the six months ended June 30, 2009 and 2008 was $1.0 million and $0.2 million, respectively.

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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 June 30, 2009, there were five portfolios accounted for using the 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 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)*:

	Six Months Ended June 30, 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
Revenue recognized, net	(71,576)	(2,389)	(73,965)

(Reductions) additions on existing portfolios	(15,399)	2,614	(12,785)
Additions for current purchases	106,771		106,771
Balance at June 30, 2009	$ 630,478	$ 7,094	$ 637,572

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	Six Months Ended June 30, 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
Revenue recognized, net	(63,652)	(2,623)	(66,275)
(Reductions) additions on existing portfolios	(3,206)	1,598	(1,608)
Additions for current purchases	79,159		79,159
Balance at June 30, 2008	$ 566,612	$ 8,404	$ 575,016

During the three months ended June 30, 2009, the Company purchased receivable portfolios with a face value of $1.9 billion for $82.0 million, or a purchase cost of 4.2% of face value. The estimated future collections at acquisition for these portfolios amounted to $203.3 million. During the six months ended June 30, 2009, the Company purchased receivable portfolios with a face value of $3.3 billion for $137.9 million, or a purchase cost of 4.2% of face value. The estimated future collections at acquisition for these portfolios amounted to $341.6 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 June 30, 2009 and 2008, approximately $2.4 million and $2.6 million were recognized as Zero Basis Revenue, respectively. During the six months ended June 30, 2009 and 2008, approximately $4.9 million and $5.1 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.

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

For the Three Months Ended June 30, 2008

	Accrual Basis Portfolios	Cost Recovery Portfolios	Zero Basis Portfolios	Total
Balance, beginning of period	$ 396,775	$ 1,432	$	$ 398,207
Purchases of receivable portfolios	52,492			52,492
Gross collections[1]	(99,306)	(131)	(2,623)	(102,060)
Put-backs and recalls[2]	(357)	2		(355)
Revenue recognized[4]	67,042		2,623	69,665
Impairment, net [4]	(3,390)			(3,390)
Balance, end of period	$ 413,256	$ 1,303	$	$ 414,559
Revenue as a percentage of collections[3]	67.5%	0.0%	100.0%	68.3%

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

	For the Six Months Ended June 30, 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	100,394			100,394
Gross collections[1]	(200,829)	(330)	(5,181)	(206,340)
Put-backs and recalls[2]	(2,035)	(12)		(2,047)
Revenue recognized[4]	133,887		5,181	139,068
Impairment, net [4]	(8,725)			(8,725)
Balance, end of period	$ 413,256	$ 1,303	$	$ 414,559
Revenue as a percentage of collections[3]	66.7%	0.0%	100.0%	67.4%

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

(2) Put-backs represent accounts that are returned to the seller in accordance with the respective purchase agreement (Put-Backs). Recalls represent accounts that are recalled by the seller in accordance with the respective purchase agreement (Recalls).

(3) 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 six months ended June 30, 2009 (*in thousands*):

	Valuation Allowance
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
Provision for impairment losses	4,722
Reversal of prior allowance	(158)
Balance at June 30, 2009	$ 67,143

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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)*:

	Three Months Ended June 30, 2009	Three Months Ended June 30, 2008	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
Collection sites	$ 44,680	$ 38,929	$ 95,022	$ 82,218
Legal collections	61,460	49,184	117,867	94,476
Collection agencies	15,506	10,009	23,173	20,970
Sales	727	3,633	1,544	7,847
Other		375		974
Gross collections for the period	$ 122,373	$ 102,130	$ 237,606	$ 206,485

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*):

	June 30, 2009	December 31, 2008
Court costs advanced	$ 167,721	$ 145,579
Court costs recovered	(42,282)	(36,929)
Court costs reserve	(95,679)	(80,315)
	$ 29,760	$ 28,335

Note 6: Other Assets

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

	June 30, 2009	December 31, 2008 Adjusted
Debt issuance costs	$ 1,132	$ 1,953
Deferred compensation assets	638	1,206
Prepaid expenses	1,448	973
Security deposit India building lease	782	
Other	1,073	917
	$ 5,073	$ 5,049

Note 7: Debt

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

	June 30, 2009	December 31, 2008 Adjusted
Convertible Senior Notes	$ 42,920	$ 71,422
Less: Debt discount	(3,354)	(7,664)
Revolving Credit Facility	279,000	238,000
Capital Lease Obligations	1,774	1,897
	$ 320,340	$ 303,655

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Convertible Senior Notes

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

In October 2005, the Company obtained stockholder approval of a net-share settlement feature that allows the Company to settle conversion of the Convertible Notes through a combination of cash and stock. 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 June 30, 2009, the Company repurchased $2.9 million principal amount of its outstanding Convertible Notes for a total price of $2.4 million plus accrued interest. During the six months ended June 30, 2009, the Company repurchased $28.5 million principal amount of its outstanding Convertible Notes for a total price of $22.3 million plus accrued interest. These repurchases left $42.9 million principal amount of the Company s Convertible Notes outstanding as of June 30, 2009, and resulted in a net gain of $0.2 million and $3.3 million for the three and six months ended June 30, 2009, respectively. The Company has written-off less than $0.1 million and approximately $0.2 million in debt issuance costs and approximately $0.3 million and $2.7 million in debt discount in connection with the repurchase of its Convertible Notes during the three and six months ended June 30, 2009, respectively.

During the three and six months ended June 30, 2008, the Company repurchased $5.0 million principal amount of its outstanding Convertible Notes for a total price of $3.5 million plus accrued interest. The repurchase resulted in a net gain of $0.7 million. The Company wrote-off approximately $0.1 million in debt issuance costs and approximately $0.7 million in debt discount in connection with the repurchase of its Convertible Notes during the three and six months ended June 30, 2008.

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.

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

	June 30, 2009	December 31, 2008 Adjusted
Liability component principal amount	$ 42,920	$ 71,422
Unamortized debt discount	(3,354)	(7,664)
Liability component net carrying amount	39,566	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 six months ended June 30, 2009 and 2008.

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

	Three Months Ended June 30, 2009	Three Months Ended June 30, 2008 Adjusted	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008 Adjusted
Interest expense stated coupon rate	$ 369	$ 810	$ 908	$ 1,653
Interest expense amortization of debt discount	650	1,290	1,560	2,589
Total interest expense convertible notes	$ 1,019	$ 2,100	$ 2,468	$ 4,242

As of June 30, 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;
- 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.

Holders 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.

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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 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 June 30, 2009, the outstanding balance on the Revolving Credit Facility was $279.0 million, which bore a weighted average interest rate of 3.84% and 3.92% for the three and six months ended June 30, 2009, respectively. The aggregate borrowing base as of June 30, 2009, was $303.8 million, of which $24.8 million was available for future borrowings.

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Derivative Instruments

The Company entered into two separate interest rate swap agreements intended to manage interest rates more effectively by establishing a set level of fixed rates associated with a portion of the borrowings under its Revolving Credit Facility. Under the swap agreements, the Company receives floating interest rate payments and makes interest payments based on fixed interest rates. 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%. No credit spread was hedged. The Company intends to continue electing the one-month reserve-adjusted LIBOR as the benchmark interest rate on the debt being hedged through its term. The Company does not intend to repay the Revolving Credit Facility below the notional amounts of the interest rate swaps before the maturity of these swaps. 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 instrument is recorded in other comprehensive income. The ineffective portion of the change in fair value of the derivative instrument, if any, is recognized in interest expense in the period of change. From the inception of the hedging program, the Company has determined that the hedging instruments are highly effective.

The following tables summarize the fair value and the effect of the interest rate swaps on the Company s statements of income *(in thousands):*

Fair Values of Derivative Instruments

	Liability Derivatives			
	As of June 30, 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	$ 2,648	Other liabilities	$ 3,483

The Effect of Derivative Instruments on the Statements of Income for the Three and Six Months Ended June 30, 2009 and 2008

	Amount of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion)		Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)		Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)	Amount of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)	
Periods Reported	**2009**	**2008**		**2009**	**2008**		**2009**	**2008**
Three months ended June 30	$ 528	$ 1,404	Interest expense	$	$	Other income (expense)	$	$
Six months ended June 30	$ 835	$ (26)	Interest expense	$	$	Other income (expense)	$	$

Capital Lease Obligations

The Company has capital lease obligations for certain computer equipment. These lease obligations require monthly payments that range from approximately $1,000 to $20,000 through June 2013 and have implicit interest rates that range from approximately 5.9% to 6.9%.

The Company finances certain leasehold improvement projects with its lessors in its Phoenix and St. Cloud facilities. As of June 30, 2009, the Company s combined obligation was approximately $1.1 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 $4.2 million, reflecting an effective rate of 38.5% of pretax income during the three months ended June 30, 2009. The effective tax rate for the three months ended June 30, 2009, consists primarily of a provision for federal income taxes of 32.3% (which is net of a benefit for state taxes of 2.7%), a provision for state taxes of 7.8%, the benefit of permanent book versus tax differences and a state refund of 1.6%. 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 June 30, 2008, was $4.2 million, reflecting an effective rate of 40.7% of pretax income. The effective tax rate for the three months ended June 30, 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 a provision for the effect of permanent book verses tax differences of 0.4%.

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The Company recorded an income tax provision of $10.1 million, reflecting an effective rate of 39.3% of pretax income during the six months ended June 30, 2009. The effective tax rate for the six months ended June 30, 2009, consists primarily of a provision for federal income taxes of 32.3% (which is net of a benefit for state taxes of 2.7%), a provision for state taxes of 7.8%, the benefit of permanent book versus tax differences and a state refund of 0.8%. 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 six months ended June 30, 2008, was $8.7 million, reflecting an effective rate of 40.3% of pretax income. The effective tax rate for the six months ended June 30, 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%), and a provision for state taxes of 8.2%.

Effective January 1, 2007, the Company adopted the provisions of Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48). As of June 30, 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 and six months ended June 30, 2009, there were no material changes to the unrecognized tax benefit.

For the three and six months ended June 30, 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 and six months ended June 30, 2009, were approximately $0.2 million and $0.4 million, respectively. Such undistributed earnings are considered permanently reinvested.

The Company s subsidiary operating outside of the United States is currently operating under a tax holiday in India. The tax holiday is due to expire on March 31, 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 Cost by Seller for the Six Months Ended June 30, 2009	
	Cost	%
Seller 1	$ 42,379	30.7%
Seller 2	32,488	23.6%
Seller 3	28,063	20.3%
Seller 4	18,174	13.2%
Seller 5	5,585	4.0%
Other	11,257	8.2%
	$ 137,946	100.0%
Adjustments[1]	(1)	
Purchases, net	$ 137,945	

(1) Adjusted for Put-backs and Recalls.

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*

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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 in the final stages and the parties have filed various motions. 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 June 30, 2009, the Company has entered into agreements to purchase receivable portfolios with a face value of approximately $1.8 billion for a purchase price of approximately $70.8 million. Certain of these agreements allow the Company to terminate the commitment with 60 days notice or by paying a one-time cancellation fee. The Company does not anticipate cancelling any of these commitments at this time. The Company has no purchase commitments extending past one year, 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.

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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 and other claims. 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 and related conduct 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 continues 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 continues to develop 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. In accordance with the provisions of Statement of Financial Accounting Standard No. 144 *Accounting for the Impairment or Disposal of Long-Lived Assets,* the Company does not believe that the forward flow asset is impaired as a result of the arbitration.

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 $50.0 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 six months ended June 30, 2009, the Company repurchased $28.5 million principal amount of its outstanding Convertible Notes, for a total price of $22.6 million, plus accrued interest. From the inception of the securities repurchase program, the Company has repurchased $57.1 million principal amount of its Convertible Notes, for a total cash payment of $42.4 million. The Company has not repurchased any common stock under this program.

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.

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Effect of Change in Accounting Principle to Consolidated Financial Statements

The 2008 condensed consolidated financial statements presented in this quarterly report have been retroactively adjusted to reflect the change in accounting principle related to the Company s Convertible Notes. The following table provides the impact of FSP APB 14-1 on the 2008 condensed consolidated financial statements *(in thousands, except per share amounts):*

	As Previously Reported	As Adjusted by FSP APB 14-1	Effect of Change
Condensed Consolidated Statements of Financial Condition			
(As of December 31, 2008)			
Assets:			
Other assets[1]	$ 5,268	$ 5,049	$ (219)
Total assets	549,298	549,079	(219)
Liabilities:			
Deferred tax liabilities, net	$ 15,199	$ 15,108	$ (91)
Debt	311,319	303,655	(7,664)
Total liabilities	353,408	345,653	(7,755)
Stockholders equity:			
Additional paid-in capital	$ 79,971	$ 98,521	$ 18,550
Accumulated earnings	117,809	106,795	(11,014)
Total stockholders equity	195,890	203,426	7,536
Total liabilities and stockholders equity	549,298	549,079	(219)
Condensed Consolidated Statements of Income			
(Three months ended June 30, 2008)			
Interest expense	$ (3,583)	$ (4,831)	$ (1,248)
Gain on repurchase of convertible notes, net	1,417	707	(710)
Income before income taxes	12,345	10,387	(1,958)
Provision for income taxes	(5,015)	(4,225)	790
Net Income	7,330	6,162	(1,168)
Earnings Per Share:			
Basic	$ 0.32	$ 0.27	$ (0.05)
Diluted	0.31	0.26	(0.05)
(Six months ended June 30, 2008)			
Interest expense	$ (7,529)	$ (10,031)	$ (2,502)
Gain on repurchase of convertible notes, net	1,417	707	(710)
Income before income taxes	24,859	21,647	(3,212)
Provision for income taxes	(10,029)	(8,734)	1,295
Net Income	14,830	12,913	(1,917)
Earnings Per Share:			
Basic	$ 0.64	$ 0.56	$ (0.08)
Diluted	0.63	0.55	(0.08)
Condensed Consolidated Statements of Cash Flows			
(Six months ended June 30, 2008)			
Net Income	$ 14,830	$ 12,913	$ (1,917)
Amortization of loan costs and debt discount	608	3,110	2,502
Deferred income tax expense (benefit)	(10)	36	46
Change in prepaid income tax[1]	10,187	8,846	(1,341)
Gain on repurchase of convertible notes, net	(1,417)	(707)	710
Net cash provided by operating activities[1]	33,386	33,386	

(1) Certain reclassifications other than the impact of FSP APB 14-1 have been made 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 approximately 60% from second 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 portfolios 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 2009, most of the collection metrics we track have remained relatively consistent, as compared to 2008. 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. Despite the current economic environment, we have not experienced an increase in the broken payer rate in the first half 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 and six months ended June 30, 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 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.

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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 table summarizes the types of charged-off consumer receivable portfolios we purchased for the three and six months ended June 30, 2009 and 2008 *(in thousands):*

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Credit card	$ 82,033	$ 40,165	$ 137,946	$ 85,445
Other		12,327		14,949
	$ 82,033	$ 52,492	$ 137,946	$ 100,394

During the three months ended June 30, 2009, we invested $82.0 million for portfolios with face values aggregating $1.9 billion for an average purchase price of 4.2% of face value. This is a $29.5 million increase, or 56.3%, in the amount invested, compared with the $52.5 million invested during the three months ended June 30, 2008, to acquire portfolios with a face value aggregating $1.8 billion for an average purchase price of 2.9% of face value. During the six months ended June 30, 2009, we invested $137.9 million for portfolios with face values aggregating $3.3 billion for an average purchase price of 4.2% of face value. This is a $37.5 million increase, or 37.4%, in the amount invested compared with the $100.4 million invested during the six months ended June 30, 2008, to acquire portfolios with a face value aggregating $3.0 billion for an average purchase price of 3.3% 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 and six months ended June 30, 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)*:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Collection sites	$ 44,680	$ 38,929	$ 95,022	$ 82,218
Legal collections	61,460	49,184	117,867	94,476
Collection agencies	15,506	10,009	23,173	20,970
Sales	727	3,633	1,544	7,847
Other		375		974
Gross collections for the period	$ 122,373	$ 102,130	$ 237,606	$ 206,485

Gross collections increased $20.3 million, or 19.8%, to $122.4 million during the three months ended June 30, 2009, from $102.1 million during the three months ended June 30, 2008.

Gross collections increased $31.1 million, or 15.1%, to $237.6 million during the six months ended June 30, 2009, from $206.5 million during the six months ended June 30, 2008.

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Results of Operations

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

	Three Months Ended June 30, 2009		2008 Adjusted[(1)]	
Revenue				
Revenue from receivable portfolios, net	$ 73,965	94.8%	$ 66,275	94.7%
Servicing fees and other related revenue	4,070	5.2%	3,745	5.3%
Total revenue	78,035	100.0%	70,020	100.0%
Operating expenses				
Salaries and employee benefits	14,762	18.9%	15,689	22.4%
Stock-based compensation expense	994	1.3%	1,228	1.8%
Cost of legal collections	28,626	36.7%	23,829	34.0%
Other operating expenses	6,598	8.5%	5,987	8.6%
Collection agency commissions	4,797	6.1%	3,781	5.4%
General and administrative expenses	7,097	9.1%	4,581	6.5%
Depreciation and amortization	620	0.8%	766	1.1%
Total operating expenses	63,494	81.4%	55,861	79.8%
Income before other (expense) income and income taxes	14,541	18.6%	14,159	20.2%
Other (expense) income				
Interest expense	(3,958)	(5.1)%	(4,831)	(6.9)%
Gain on repurchase of convertible notes	215	0.3%	707	1.0%
Other (expense) income	9	0.0%	352	0.5%
Total other expense	(3,734)	(4.8)%	(3,772)	(5.4)%
Income before income taxes	10,807	13.8%	10,387	14.8%
Provision for income taxes	(4,166)	(5.3)%	(4,225)	(6.0)%
Net income	$ 6,641	8.5%	$ 6,162	8.8%

	Six Months Ended June 30, 2009		2008 Adjusted[(1)]	
Revenue				
Revenue from receivable portfolios, net	$ 146,240	94.7%	$ 130,343	94.7%
Servicing fees and other related revenue	8,241	5.3%	7,231	5.3%
Total revenue	154,481	100.0%	137,574	100.0%
Operating expenses				

Salaries and employee benefits	28,719	18.6%	30,540	22.2%
Stock-based compensation expense	2,074	1.3%	2,322	1.7%
Cost of legal collections	58,573	37.9%	44,135	32.1%
Other operating expenses	12,578	8.1%	11,638	8.4%
Collection agency commissions	7,688	5.0%	7,812	5.7%
General and administrative expenses	12,794	8.3%	9,041	6.6%
Depreciation and amortization	1,243	0.8%	1,488	1.1%
Total operating expenses	123,669	80.0%	106,976	77.8%
Income before other (expense) income and income taxes	30,812	20.0%	30,598	22.2%
Other (expense) income				
Interest expense	(8,231)	(5.4)%	(10,031)	(7.3)%
Gain on repurchase of convertible notes	3,268	2.1%	707	0.5%

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	Six Months Ended June 30, 2009		2008 Adjusted[1]	
Other (expense) income	(72)	(0.0)%	373	0.3%
Total other expense	(5,035)	(3.3)%	(8,951)	(6.5)%
Income before income taxes	25,777	16.7%	21,647	15.7%
Provision for income taxes	(10,139)	(6.7)%	(8,734)	(6.3)%
Net income	$ 15,638	10.0%	$ 12,913	9.4%

(1) 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 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 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.

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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 June 30, 2009					As of June 30, 2009	
	Collections(1)	Gross Revenue(2)	Revenue Recognition Rate(3)	Net (Impairment) Reversal	Revenue % of Total Revenue	Unamortized Balances	Monthly IRR(4)
ZBA	$ 2,357	$ 2,357	100.0%	$	3.0%	$	
2002	802	302	37.7%	100	0.4%	90	34.8%
2003	2,247	1,744	77.6%		2.2%	1,585	30.8%
2004	2,941	1,844	62.7%	(60)	2.3%	6,914	8.1%
2005	11,129	6,896	62.0%	(156)	8.8%	38,714	5.6%
2006	11,348	8,202	72.3%	(1,904)	10.5%	51,585	5.1%
2007	30,210	16,892	55.9%	(1,133)	21.5%	92,755	5.5%
2008	43,389	29,121	67.1%	(1,411)	37.1%	184,676	5.0%
2009	17,845	11,171	62.6%		14.2%	130,389	4.3%
Total	$ 122,268	$ 78,529	64.2%	$ (4,564)	100.0%	$ 506,708	5.1%

	For the Three Months Ended June 30, 2008					As of June 30, 2008	
	Collections(1)	Gross Revenue(2)	Revenue Recognition Rate(3)	Net (Impairment) Reversal	Revenue % of Total Revenue	Unamortized Balances	Monthly IRR(4)
ZBA	$ 2,623	$ 2,623	100.0%	$	3.8%	$	
2002	1,603	1,108	69.1%	140	1.6%	1,080	28.9%
2003	3,880	3,170	81.7%	(24)	4.5%	2,976	30.7%
2004	5,316	4,127	77.6%	(721)	5.9%	16,575	7.9%
2005	18,576	12,383	66.7%	(2,342)	17.8%	69,527	5.6%
2006	19,497	12,608	64.7%	(336)	18.1%	79,001	5.1%
2007	37,059	23,977	64.7%	(107)	34.4%	152,669	5.0%
2008	13,506	9,669	71.6%		13.9%	92,731	4.6%
Total	$ 102,060	$ 69,665	68.3%	$ (3,390)	100.0%	$ 414,559	5.4%

	For the Six Months Ended June 30, 2009					As of June 30, 2009	
	Collections(1)	Gross Revenue(2)	Revenue Recognition Rate(3)	Net (Impairment) Reversal	Revenue % of Total Revenue	Unamortized Balances	Monthly IRR(4)
ZBA	$ 4,857	$ 4,857	100.0%	$	3.1%	$	
2002	1,711	872	51.0%	253	0.6%	90	34.8%
2003	4,596	3,929	85.5%	(409)	2.5%	1,585	30.8%
2004	6,316	4,055	64.2%	(497)	2.6%	6,914	8.1%
2005	23,163	14,678	63.4%	(1,413)	9.4%	38,714	5.6%
2006	24,132	17,251	71.5%	(2,894)	11.0%	51,585	5.1%
2007	63,431	35,977	56.7%	(1,981)	23.0%	92,755	5.5%

2008	88,333	60,928	69.0%	(3,050)	39.0%	184,676	5.0%
2009	20,855	13,684	65.6%		8.8%	130,389	4.3%
Total	$ 237,394	$ 156,231	65.8%	$ (9,991)	100.0%	$ 506,708	5.1%

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	For the Six Months Ended June 30, 2008					As of June 30, 2008	
	Collections(1)	Gross Revenue(2)	Revenue Recognition Rate(3)	Net (Impairment) Reversal	Revenue % of Total Revenue	Unamortized Balances	Monthly IRR(4)
ZBA	$ 5,181	$ 5,181	100.0%	$	3.7%	$	
2002	3,268	2,459	75.2%	71	1.8%	1,080	28.9%
2003	8,069	6,951	86.1%	(313)	4.9%	2,976	30.8%
2004	11,353	8,792	77.4%	(1,577)	6.3%	16,575	7.9%
2005	&nbs						