ENCORE CAPITAL GROUP INC
Form 10-Q
April 29, 2009
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended March 31, 2009

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from _________ to _________.

COMMISSION FILE NUMBER: 000-26489

ENCORE CAPITAL GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware **(State or other jurisdiction of** **incorporation or organization)**	**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 April 21, 2009**
Common Stock, $0.01 par value	23,060,871 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)

	March 31, 2009	December 31, 2008 Adjusted
Assets		
Cash and cash equivalents	$ 4,261	$ 10,341
Accounts receivable, net	1,775	1,757
Investment in receivable portfolios, net	473,484	461,346
Deferred court costs	30,645	28,335
Property and equipment, net	6,279	6,272
Prepaid income tax	2,515	7,935
Forward flow asset	10,302	10,302
Other assets	4,703	5,067
Goodwill	15,985	15,985
Identifiable intangible assets, net	1,578	1,739
Total assets	$ 551,527	$ 549,079
Liabilities and stockholders equity		
Liabilities:		
Accounts payable and accrued liabilities	$ 17,805	$ 18,204
Deferred tax liabilities, net	15,253	15,108
Deferred revenue and purchased servicing obligation	5,229	5,203
Debt	296,356	303,655
Other liabilities	3,176	3,483
Total liabilities	337,819	345,653
Commitments and contingencies		
Stockholders equity:		
Convertible preferred stock, $.01 par value, 5,000 shares authorized, no shares issued and outstanding		
Common stock, $.01 par value, 50,000 shares authorized, 23,061 shares and 23,053 shares issued and outstanding as of March 31, 2009, and December 31, 2008, respectively	231	231
Additional paid-in capital	99,622	98,521
Accumulated earnings	115,792	106,795
Accumulated other comprehensive loss	(1,937)	(2,121)
Total stockholders equity	213,708	203,426
Total liabilities and stockholders equity	$ 551,527	$ 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 March 31,	
	2009	**2008 Adjusted**
Revenue		
Revenue from receivable portfolios, net	$ 72,275	$ 64,068
Servicing fees and other related revenue	4,171	3,486
Total revenue	76,446	67,554
Operating expenses		
Salaries and employee benefits (excluding stock-based compensation expense)	13,957	14,851
Stock-based compensation expense	1,080	1,094
Cost of legal collections	29,947	20,306
Other operating expenses	5,980	5,651
Collection agency commissions	2,891	4,031
General and administrative expenses	5,697	4,460
Depreciation and amortization	623	722
Total operating expenses	60,175	51,115
Income before other (expense) income and income taxes	16,271	16,439
Other (expense) income		
Interest expense	(4,273)	(5,200)
Gain on repurchase of convertible notes	3,053	
Other (expense) income	(81)	21
Total other expense	(1,301)	(5,179)
Income before income taxes	14,970	11,260
Provision for income taxes	(5,973)	(4,509)
Net income	$ 8,997	$ 6,751
Weighted average shares outstanding:		
Basic	23,122	22,992
Diluted	23,631	23,431
Earnings per share:		
Basic	$ 0.39	$ 0.29
Diluted	$ 0.38	$ 0.29

See accompanying notes to unaudited condensed consolidated financial statements

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ENCORE CAPITAL GROUP, INC.

Condensed Consolidated Statements of Stockholders Equity

(Unaudited, In Thousands)

	Common Stock		Additional		Accumulated Other Comprehensive		
	Shares	Par	Paid-In Capital	Accumulated Earnings	(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				8,997		8,997	8,997
Other comprehensive income:							
Unrealized gain on cash flow hedge, net of tax					184	184	184
Issuance of share-based awards	8						
Stock-based compensation			1,080			1,080	
Tax benefit related to stock option exercises			21			21	
Balance at March 31, 2009	23,061	$ 231	$ 99,622	$ 115,792	$ (1,937)	$ 213,708	$ 9,181

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)

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

Income tax payment (refund)	$	499	$	(407)
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

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

New Accounting Pronouncements

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

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

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

Note 2: Fair Value Measurements

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

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

Level 1: Observable inputs such as quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2: Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly. These include quoted prices for similar assets or liabilities in active markets and quoted prices for identical or similar assets or liabilities in markets that are not active.

Level 3: Unobservable inputs that reflect the reporting entity s own assumptions.

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

Financial Instruments	**Fair Value**	**Fair Value at**	**Fair Value at**

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

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

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Note 3: Stock-Based Compensation

On March 30, 2005, the Board of Directors of the Company adopted the 2005 Stock Incentive Plan (2005 Plan) for Board members, employees, officers, and executives of, and consultants and advisors to, the Company. The 2005 Plan provides for the granting of incentive stock options, nonqualified stock options, stock appreciation rights, restricted stock, restricted stock units, and performance-based awards to eligible individuals. Upon adoption, an aggregate of 1,500,000 shares of the Company s common stock were available for awards under the 2005 Plan, plus ungranted shares of stock that were available for future awards under the 1999 Equity Participation Plan (1999 Plan). In addition, shares subject to options granted under either the 1999 Plan or the 2005 Plan that terminate or expire without being exercised are available for grant under the 2005 Plan. The benefits provided under these plans are share-based compensation subject to the provisions of FAS 123R.

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

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

Stock Options

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

The Company uses the Black-Scholes option-pricing model to determine the fair-value of stock-based awards. All options are amortized ratably over the requisite service periods of the awards, which are generally the vesting periods.

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

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

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

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

	Number of 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	(24,200)	10.92 - 16.19	13.33	
Exercised				
Outstanding at March 31, 2009	2,377,803	$ 0.35 - $20.09	$ 8.38	$ 3,101

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

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

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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 March 31, 2009, 113,100 of the non-vested shares are expected to vest over approximately three to five years based on certain performance goals (Performance-Based Awards). The fair value of the Performance-Based Awards is expensed over the expected vesting period based on our forfeiture assumptions. If performance goals are not expected to be met, the compensation expense previously recognized would be reversed. No reversals of compensation expense related to the Performance-Based Awards have been made as of March 31, 2009. The remaining 696,202 non-vested shares are not performance-based, and will vest and are being expensed over approximately two to five years of continuous service.

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

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

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

Note 4: Investment in Receivable Portfolios, Net

In accordance with the provisions of SOP 03-3, discrete receivable portfolio purchases during a quarter are aggregated into pools based on common risk characteristics. Once a static pool is established, the portfolios are permanently assigned to the pool. The discount (*i.e.*, the difference between the cost of each static pool and the related aggregate contractual receivable balance) is not recorded because the Company expects to collect a relatively small percentage of each static pool s contractual receivable balance. As a result, receivable portfolios are recorded at cost at the time of acquisition. All portfolios with common risk characteristics purchased prior to the adoption of SOP 03-3 in the first quarter of 2005 were aggregated by quarter of purchase.

In compliance with SOP 03-3, the Company accounts for its investments in consumer receivable portfolios using either the interest method or the cost recovery method. The interest method applies an effective interest rate, or IRR, to the cost basis of the pool, which remains unchanged throughout the life of the pool, unless there is an increase in subsequent, expected cash flows. Subsequent increases in expected cash flows are generally recognized prospectively through an upward adjustment of the pool s IRR over its remaining life. Subsequent decreases in expected cash flows do not change the IRR, but are recognized as an impairment of the cost basis of the pool, and are reflected in the consolidated statements of income as a reduction in revenue, with a corresponding valuation allowance, offsetting the investment in receivable portfolios in the consolidated statements of financial condition.

The Company accounts for each static pool as a unit for the economic life of the pool (similar to one loan) for recognition of revenue from receivable portfolios, for collections applied to the cost basis of receivable portfolios and for provision for loss or impairment. Revenue from receivable portfolios is accrued based on each pool s IRR applied to each pool s adjusted cost basis. The cost basis of each pool is increased by revenue earned and decreased by gross collections and impairments.

If the amount and timing of future cash collections on a pool of receivables are not reasonably estimable, the Company accounts for such portfolios on the cost recovery method as Cost Recovery Portfolios. The accounts in these portfolios have different risk characteristics than those included in other portfolios acquired during the same quarter, or the necessary information was not available to estimate future cash flows and, accordingly, they were not aggregated with other portfolios. Under the cost recovery method of accounting, no income is recognized until the purchase price of a Cost Recovery Portfolio has been fully recovered. As of March 31, 2009, there were five portfolios accounted for using the cost recovery method, consisting of $0.6 million in net book value of investment in receivable portfolios, representing all of the healthcare portfolios that the Company had acquired. In September 2007, the Company decided to exit its healthcare purchasing and collection activities. At that time the Company anticipated either selling these healthcare portfolios or placing the underlying accounts with external agencies for collections. The Company no longer anticipates a sale of these receivable

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(4) Reflects additional revenue of $0.1 million and a lower net impairment of $3.1 million, as a result of extending the collection curves from 72 to 84 months.

The following table summarizes the change in the valuation allowance for investment in receivable portfolios during the three months ended March 31, 2009 (*in thousands*):

	Valuation Allowance

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

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

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

Note 5: Deferred Court Costs

The Company contracts with a nationwide network of attorneys that specialize in collection matters. The Company generally refers charged-off accounts to its contracted attorneys when it believes the related debtor has sufficient assets to repay the indebtedness and has, to date, been unwilling to pay. In connection with the Company s agreement with the contracted attorneys, it advances certain out-of-pocket court costs (Deferred Court Costs). The Company capitalizes Deferred Court Costs in its consolidated financial statements and provides a reserve for those costs that it believes will ultimately be uncollectible. The Company determines the reserve based on its analysis of court costs that have been advanced and those that have been recovered. Deferred Court Costs not recovered within three years of placement are fully written off. Collections received from these debtors are first applied against related court costs with the balance applied to the debtors account.

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

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

Note 6: Other Assets

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

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

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Note 7: Debt

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

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

Convertible Senior Notes

In 2005, the Company issued $100.0 million of 3.375% Convertible Notes due September 19, 2010. Interest on the Convertible Notes is payable semi-annually, in arrears, on March 19 and September 19 of each year. The Convertible Notes rank equally with the Company s existtyle="DISPLAY: block; MARGIN-LEFT: 0pt; TEXT-INDENT: 0pt; MARGIN-RIGHT: 0pt" align="left">By:

/s/ Darren Levine

Darren Levine, Attorney-In-Fact

DEERFIELD SPECIAL SITUATIONS FUND INTERNATIONAL LIMITED

By: /s/ Darren Levine
Darren Levine, Attorney-In-Fact

JAMES E. FLYNN

/s/ Darren Levine
Darren Levine, Attorney-In-Fact

Exhibit B

Due to the relationships between them, the reporting persons hereunder may be deemed to constitute a "group" with one another for purposes of Section 13(d)(3) of the Securities Exchange Act of 1934.